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Appendix 1  ABOUT THE AUTHORS ...............................................................................................381

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This seventh edition of *The Insolvency Review* once again offers an in-depth review of market conditions and insolvency case developments in key countries. A debt of gratitude is owed to the outstanding professionals around the world who have dedicated their time and talents to this book. As always, their contributions reflect diverse viewpoints and approaches, which in turn reflect the diversity of their respective national commercial cultures and laws.

In a prior edition of this book, we examined the challenges faced by multinational enterprise groups attempting to restructure under diverse and potentially conflicting insolvency regimes. At that time, the European Parliament and Counsel had recently published the Recast Insolvency Regulation, which included provisions relating to cooperation and communication across group restructuring proceedings in multiple jurisdictions, and UNCITRAL’s Working Group V was in the process of developing its Enterprise Group Insolvency: Draft Model Law (the EGI Model Law). This year’s edition provides an occasion to revisit this topic in light of the Working Group’s EGI Model Law and the EGI Model Law’s Guide to Enactment (the Guide to Enactment).

The EGI Model Law is designed to provide states with a legislative framework to address the cross-border insolvency of enterprise groups, complementing the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law) and part three of the UNCITRAL Legislative Guide on Insolvency Law (the Legislative Guide, part three). What distinguishes the EGI Model Law from the Model Law, which concerns itself with multiple proceedings of a single debtor, is the focus on multiple insolvency proceedings relating to multiple related debtors.

The EGI Model Law defines ‘enterprise group’ as two or more entities, regardless of legal form, that are engaged in economic activities and may be governed by insolvency law, that are interconnected by control or significant ownership. When members of an enterprise group are located in different jurisdictions, the EGI Model Law is intended to support cross-border cooperation and coordination with respect to their insolvency proceedings and establish new mechanisms that can be used to develop and implement a solution for the group.

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4 ibid., at I.A.3.
5 EGI Model Law, at Article 2.
group insolvency solution) through one (or potentially more) insolvency proceedings (each a planning proceeding) taking place in a state where a group member has its centre of main interests (COMI). A planning proceeding is a main proceeding commenced in respect of an enterprise group member provided (1) one or more other enterprise group members are participating in that main proceeding for the purpose of developing and implementing a group insolvency solution, (2) the enterprise group member subject to the main proceeding is likely to be a necessary and integral participant in that group insolvency solution, and (3) a group representative has been appointed. The group representative will be able to seek a wide range of relief in any group member’s insolvency proceeding. Ultimately, a group insolvency solution can be a reorganisation, sale or liquidation of some or all of the assets and operations of one or more enterprise group members, with the goal of protecting, preserving, realising or enhancing the overall combined value of those enterprise group members. The EGI Model Law does not address the procedure for seeking approval of the group insolvency solution, leaving that to the law of the approving jurisdiction.

The court overseeing the planning proceeding may grant certain types of relief if necessary to preserve the possibility of developing or implementing a group insolvency solution. These forms of relief include, among other things, staying execution against the assets of an enterprise group member, suspending the right to transfer, encumber, or otherwise dispose of any assets of an enterprise group member, staying the commencement or continuation of individual actions or individual proceedings concerning the assets, rights, obligations or liabilities of an enterprise group member, and approving arrangements concerning the funding of an enterprise group member and authorising the provision of finance under those funding arrangements. With respect to approval of post-filing funding arrangements, the Guide to Enactment notes that the court might take into consideration various criteria, including whether the funding arrangement is necessary for the continued operation or survival of the business of that enterprise group member or for the preservation or enhancement of the value of its estate, whether any harm to creditors of that enterprise group member will be offset by the benefit to be derived from continuing that funding arrangement, whether the funding arrangement safeguards the development of a group insolvency solution, and whether the interests of local creditors are protected.

Moreover, the EGI Model Law also seeks to minimise the need for commencement of non-main proceedings in a second state in which an enterprise group member has an establishment and facilitates the centralised treatment of claims in an enterprise group insolvency by including a mechanism under which such claims can be addressed.

It remains to be seen how swiftly and extensively the EGI Model Law will be incorporated into national laws. There is reason to believe, however, that some of the 45 jurisdictions

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7 ibid., at Article 2(f).
8 ibid., at Article 26.
9 ibid., at Article 19.
10 ibid., at Article 20.
12 ibid.
that have adopted the existing Model Law may act relatively quickly, given the need for an enterprise group solution and the public nature of Working Group V’s work.

Recent experiences in high-profile enterprise group restructurings further underscore the benefits promised by this new regime. The United States Bankruptcy Court for the Southern District of New York quoted from a working draft of the EGI Model Law in its opinion denying recognition of the Dutch insolvency proceeding of Oi Brasil Holdings Coöperatief UA (Coop).13 There, the Dutch trustee of Coop sought such recognition notwithstanding that:

a. the Oi Group was a Brazilian enterprise that maintained nearly all its operations, management, principal executive offices, customers, assets and employees in Brazil;
b. many of the Oi debtors, including Coop, were already subject to restructuring proceedings in Brazil (recuperação judicial (RJ));
c. an RJ had previously been recognised by the US Bankruptcy Court as foreign main proceedings;
d. Coop was merely a special purpose vehicle (SPV) used to finance the Oi Group as a whole; and
e. Brazil was the preferred venue of the Oi Group.

The Coop dispute was highly contentious and costly, but had the EGI Model Law existed, the effects of the dispute might have been mitigated. The group representative of a hypothetical Brazilian planning proceeding for the Oi Group could have, among other things, petitioned the Dutch court for (1) recognition of the planning proceeding and (2) relief to support the development and implementation of an insolvency solution for the Oi Group as a whole. The existence and recognition of a planning proceeding might have reduced the likelihood of the contested recognition hearing in the United States. The same may be true for the case of OAS SA and its debtor affiliates, which also involved a COMI determination regarding a European SPV that served as a financing vehicle for a Brazilian enterprise.14

As I do each year, I want to thank each of the contributors to this book for their efforts to make The Insolvency Review a valuable resource. As each of our authors knows, this book is a significant undertaking because of the current coverage of developments we seek to provide. As in previous years, my hope is that this year’s volume will help all of us, authors and readers alike, to reflect on the larger picture, keeping our eye on likely, as well as necessary, developments, on both the near and distant horizons.

Donald S Bernstein
Davis Polk & Wardwell LLP
New York
September 2019

13 In re Oi Brasil Holdings Coöperatief U.A., 578 B.R. 169, 243 (Bankr. S.D.N.Y. 2017) (noting that ‘the promotion of cooperation between courts and other competent authorities among States involved in cases of cross-border insolvency affecting members of an enterprise group’ is a key objective of both the Enterprise Group Insolvency Model Law and reflects current trends in international insolvency law).
I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

The Corporations Act 2001 (Cth) (the Corporations Act) is the primary legislative reference for, among other things, the registration, insolvency and reorganisation of companies incorporated in Australia. In the context of insolvency, the Corporations Act prescribes the manner in which an Australian company can enter into a formal insolvency process and how its assets are ultimately distributed to creditors.

The legislative framework for personal insolvency is set out in the Bankruptcy Act 1966 (Cth) (the Bankruptcy Act), which prescribes the manner in which an individual may enter into a personal insolvency agreement or a formal bankruptcy process. Unlike some other jurisdictions, bankruptcy in the Australian context refers to the insolvency of an individual only.

Despite the regulation and rules governing corporate and personal insolvency being contained in two separate and distinct pieces of legislation, the Australian government has introduced legislative reform by way of the Insolvency Law Reform Act 2016 (Cth), intended to align, to the extent possible, the Bankruptcy Act and the Corporations Act and create common rules for both corporate and personal insolvency processes (where possible).

For the purpose of this chapter, however, we have focused on the statutory framework and substantive law for corporate insolvency processes only.

The broad aim of insolvency law is to balance the interests of the primary stakeholders in an insolvent estate, these being debtors and creditors. A number of formal procedures are available under the Corporations Act in the event of insolvency. These include receivership (private and court-ordered), voluntary administration, deeds of company arrangement, provisional liquidation, liquidation (voluntary and involuntary, and solvent and insolvent), and schemes of arrangement (court-sanctioned).

The Australian test for solvency is set out in Section 95A of the Corporations Act, which provides that: 'A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable. A person who is not solvent is insolvent.'

The courts have not applied Section 95A as a rigid rule but rather as a factual question to be determined as a matter of commercial reality and in light of all the surrounding circumstances. The Section has been applied in a wide and varied manner. Despite its broad reading, courts have highlighted certain key issues that must be considered when faced with the question of assessing a company's solvency at a particular point in time. These key issues relate to the cash flow test and prospective considerations.
The position in Australia is that the key test of solvency is the ‘cash flow’ test, rather than the ‘balance sheet’ test (and this is clear from the wording of the legislation). That is to say, a company must have sufficient cash flow available to it to meet its debts as and when they fall due. The balance sheet analysis is not immaterial, however, as courts have held that it is often relevant in providing background and context for the proper application of the cash flow test.²

### ii  Policy

**Safe harbour and ipso facto reforms**

There has been a historical view, propounded by some, that Australia’s insolvency regime is focused more on punitive measures than on the rehabilitation of debtor companies. This is in contrast to other jurisdictions³ whose insolvency laws, many consider, better promote restructuring, innovative reorganizations and value preservation. To seek to address some of these perceived issues, on 18 September 2017, the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill (the TLA Act) received royal assent. The TLA Act brought into operation two fundamental changes to Australia’s insolvency laws:

- **a** a new safe harbour from civil liability for insolvent trading for directors seeking to restructure financially distressed or insolvent companies (i.e., a safe harbour); and
- **b** a legislative stay on the enforcement of certain *ipso facto* rights (i.e., an automatic stay on the enforcement of *ipso facto* rights).

The safe harbour provisions introduced Section 588GA into the Corporations Act. Under this Section, a director will not be liable for debts incurred by a company while it is insolvent if ‘at a particular time after the director starts to suspect the company may become or be insolvent, the director starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company’ than the ‘immediate appointment of an administrator or liquidator to the company’.⁴ The relevant director bears the evidential burden if he or she seeks to rely on this defence.

Importantly, the safe harbour provisions are not intended to protect directors against more general breach of duty claims. A director cannot rely on the new safe harbour provisions if, at the time the debt is incurred, the company has failed to pay employee entitlements or comply with certain reporting or taxation requirements.

The second recent development, the introduction into the Corporations Act of an automatic stay on the enforcement of *ipso facto* provisions, came into effect from 1 July 2018. Broadly, the automatic stay operates to preclude a party from enforcing certain rights (including terminating a contract or accelerating a debt) simply because the company has entered into certain formal insolvency processes.

However, the automatic stay will not apply to:

- **a** receiver or controller appointments that are not over the whole or substantially the whole of the company’s assets;
- **b** entry by a company into a deed of company arrangement (DOCA);

---

² For further consideration of the cash flow test, see *Bell Group Limited (in liq) v. Westpac Banking Corporation [No. 9] [2008] WASC 239*.

³ The best example of a liberal insolvency regime is found in Chapter 11 of the US Bankruptcy Code. The United Kingdom, Singapore, Germany and Canada have also reformed their insolvency regimes in an effort to promote financial recovery.

⁴ See Section 588GA of the Corporations Act 2001 (Cth) [Corporations Act].
c liquidations, other than those immediately following a voluntary administration or where the company is fully wound up in connection with a scheme of arrangement; 
d rights or self-executing provisions arising under contracts entered into prior to 1 July 2018; and  
e certain contract types and rights prescribed in the Regulations and Ministerial Declaration as being exempt from the automatic stay.

Pursuant to the new Sections 415E, 434K and 451F of the Corporations Act, a court may lift the automatic stay if the court is satisfied that it is in the interests of justice to do so or where a relevant scheme of arrangement is found not to be for the purpose of avoiding being wound up in insolvency.

**Strengthening protections for employee entitlements**

On 5 April 2019, the Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018 (Cth) (the SPE Act) received royal assent. The SPE Act introduced, among other things, three significant changes to the Corporations Act:

a an extension of the existing criminal offence provision to capture a person recklessly entering into transactions to avoid the recovery of employee entitlements;

b enhanced personal liability consequences by introducing a new civil penalty for such action with an objective reasonable person test; and  
c the ability for a liquidator, in certain circumstances, to seek compensation for loss or damage suffered because of a contravention of the civil penalty provision, among other things.

The SPE Act introduced a new Section 596AB into the Corporations Act that sets a lower bar for contraventions; a person will contravene the offence provision if they enter into a relevant agreement or a transaction with the intention of preventing the recovery, or significantly reducing the amount, of employee entitlements and they are reckless as to whether such an agreement or transaction will avoid or prevent the recovery of the entitlements of employees, or significantly reduce the amount of the entitlements of employees that can be recovered.

Under the new Section 596AC of the Corporations Act, the SPE Act also introduced civil liability for persons who enter into a relevant agreement or a transaction and the person knows, or ‘a reasonable person in the position of the person would know, that the relevant agreement or the transaction is likely to’ avoid or prevent the recovery of employee entitlements or significantly reduce the amount of the entitlements of employees of a company that can be recovered. Section 596ACA provides that a person is liable to pay compensation for any loss or damage suffered by employees resulting from a contravention of Section 596AC while the company is in liquidation, and that a liquidator may recover from the person, as a debt to the company, the amount of loss or damage.

The SPE Act further introduced a Division 8 to Part 5.7B of the Corporations Act dealing with contribution orders for employee entitlements. Section 588ZA(1) provides that a court may make an employee entitlements contribution order in relation to an entity when it is satisfied that a company is being wound up; an amount of the entitlements of one or more employees of the insolvent company that are protected under Part 5.8A has not been paid; the contributing entity is a member of the same group; the contributing entity has benefited directly or indirectly from work done by those employees; that benefit exceeds the benefit that would be reasonable if the insolvent company and contributing entity were
dealing at arm’s length; and it is just and equitable to make the order. Section 588ZA(2) of 
the Corporations Act provides that the court may make an order for a contributing entity 
to pay the liquidator an amount equal to the benefit received by the contributing entity that 
exceeds the ‘reasonable benefit’ that might be expected if the contributing entity and the 
insolvent company were dealing at arm’s length.

Given the already limited judicial interpretation of the former Section 596AC, it may 
take some time before the reforms are properly considered by the courts. Despite this, it will 
be interesting to see if liquidators pursue debts from persons engaging in employee-creditor 
defeating behaviour going forward under the new Section 596ACA.

**Combating illegal phoenixing**

As part of the 2018–2019 Federal Budget, the Australian government announced a series of 
reforms to combat illegal phoenix activity (i.e., transactions taking place at a time when a 
company is nearing insolvency that are intended to defeat creditors).

The Insolvency Practice Rules (Corporations) Amendment (Restricting Related Creditor 
Voting Rights) Rules 2018 (Cth) (the Rules) took effect on 7 December 2018 and amended 
the Insolvency Practice Rules (Corporations) 2016 (Cth) by, in effect, preventing phoenix 
operators from ‘stacking’ votes at creditors’ meetings by assigning debts without consideration 
to related creditors who then vote to appoint, and keep in place, a ‘friendly’ liquidator or 
voluntary administrator (who will in turn fail to properly investigate the phoenix activity that 
has occurred). The Rules provide, in respect of debt assigned to a related creditor, that:

a. the related creditor will only be allowed to vote up to the value it paid for the debt; and

b. an external administrator must ask all related creditors who have been assigned a debt 
for written evidence of the assignment and the consideration paid for the assignment 
for voting purposes.

In addition, the Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019 (the 
Bill) proposes a power for liquidators to recover property that is the subject of creditor-defeating 
dispositions (in line with their existing legislated ability to claw back voidable transactions).

Following the 2019 federal election, the Bill is currently on hold; however, if passed, 
the Bill will result in the introduction of a new Section 588FE(6B) of the Corporations Act, 
which will provide that creditor-defeating dispositions of company property are voidable 
if they are made while a company is insolvent or if they cause the company to become 
insolvent or enter external administration within 12 months of the disposition. The proposed 
new Section 588FDB of the Corporations Act defines a creditor-defeating disposition as ‘a 
disposition of company property for less than its market value (or the best price reasonably 
obtainable) that has the effect of preventing, hindering or significantly delaying the property 
becoming available to meet the demands of the company’s creditors in winding up’.

The Bill also proposes enhancing the personal liability consequences for illegal 
phoenix transactions by introducing both a civil penalty regime and criminal liability (with 
recklessness being the fault element) for creditor-defeating behaviour conducted by directors 
or facilitators (e.g., pre-insolvency advisers).

The Bill also seeks to introduce a new Section 203AA of the Corporations Act to prevent 
the backdating of director resignations when such resignations are reported to the Australian 
Securities and Investments Commission (ASIC) more than 28 days after their purported 
ocurrence. It also provides that if a resignation would result in the company having no other 
directors, it will have no effect unless the company is being wound up.
These proposed laws seek to address illegal phoenix practices relating to backdating the effective date of director resignations to escape liability for a company’s actions following the effective date.

### Insolvency procedures

#### Formal procedures

The formal insolvency procedures available under Australian law are:

- a. receivership (both private and court-appointed);
- b. voluntary administration;
- c. a DOCA;
- d. provisional liquidation;
- e. liquidation (both solvent (members’ voluntary liquidation) and insolvent); and
- f. a court-sanctioned scheme of arrangement between creditors and the company.

For all insolvency processes, other than for a members’ voluntary liquidation, the individual appointed must be a registered liquidator.

#### Receivership

The main role of a receiver is to take control of the assets of a company (subject to the security pursuant to which the receiver is appointed) and realise those assets for the benefit of the secured creditor. One or more individuals may be appointed as a receiver or a receiver and manager of the assets. Despite some historical differences, in practice, it is difficult to distinguish between a receiver and a receiver and manager. Receivers are not under an active obligation to unsecured creditors on appointment, although they do have a range of duties under statute and common law.

A receiver can be appointed to a debtor company pursuant to either (1) the relevant security document granted in favour of the secured creditor when a company has defaulted and the security has become enforceable, or (2) an application made to the court. The latter is far less common and, as such, this chapter focuses on privately appointed receivers.

The security document itself will set out the secured party’s rights to appoint a receiver (usually effected by way of a deed of appointment, and the secured creditor will ordinarily indemnify the receiver by way of a deed of indemnity). Once appointed, the receiver will ordinarily (by way of contract) be the agent of the debtor company (not the appointee) and will have wide-ranging powers, including the ability to operate the business, sell assets or borrow against the secured assets. Those powers are set out in the underlying security document and are supplemented by the receiver’s statutory powers set out in Section 420 of the Corporations Act.

On appointment, a receiver will immediately take possession of the assets subject to the security. Once in control of the assets, the receiver may elect to run the business (if relevant) if he or she is appointed to oversee the whole or substantially the whole of the assets of a company. Alternatively, and depending on the financial circumstances, a receiver

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5 Most security interests will allow for the appointment of either. We use these terms interchangeably in this chapter.

6 Court appointments normally take place to preserve the assets of the company in circumstances where it may not be possible to otherwise trigger a formal insolvency process.
may immediately engage in a sale process. When engaging in a sale process, a receiver has a statutory obligation under Section 420A of the Corporations Act to obtain market value or, in the absence of a market, the best price reasonably obtainable in the circumstances. It is this duty that has presented the most significant stumbling block to the adoption of pre-packaged restructuring processes through external administration that have been seen in, for example, the UK market (colloquially referred to as pre-packs). This is because of the inherent concern that a pre-pack involving a sale of any asset without testing the market could be seen as a breach of the duty under Section 420A.

Having said that, pre-packs are becoming more common in circumstances where time and funding is short or the value of what is being sold is clearly below the value of the secured debt, or a sale process with integrity has been conducted prior to the receiver's appointment.

Once a receiver has realised the secured assets and distributed any net proceeds to the secured creditor (returning any surplus to the company or later-ranking security holders), he or she will retire in the ordinary course.

Voluntary administration

The concept of voluntary administration was introduced into Australian law in 1993. Voluntary administration, unlike receivership for example, is entirely a creature of statute. The purpose and practice is outlined in Part 5.3A of the Corporations Act. While voluntary administration has often been compared to the Chapter 11 process in the United States, it is not a debtor-friendly process like Chapter 11. In a voluntary administration, the administrator and creditors control the final outcome to the exclusion of management and members.

The object of Part 5.3A is to:

a maximise the chances of the company, or as much as possible of its business, to remain in existence; or

b if the first option is not possible, achieve a better return for the company’s creditors and members than would result from an immediate winding up of the company.

There are three ways an administrator may be appointed under the Corporations Act:

a by resolution of the board of directors that, in their opinion, the company is, or is likely to become, insolvent;

b a liquidator or provisional liquidator of a company may, in writing, appoint an administrator of the company if he or she is of the opinion that the company is, or is likely to become, insolvent; and

c a secured creditor that is entitled to enforce security over the whole or substantially the whole of a company’s property may, in writing, appoint an administrator if the security interest is enforceable.

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7 A pre-pack is where a restructure is developed by the secured lenders prior to the appointment of a receiver, and is implemented immediately, or very shortly after, the appointment is made.
8 The regulation of pre-packs in Australia was flagged in the Productivity Commission’s Report on Business Set-up, Transfer and Closure that was released to the public on 7 December 2015, although no further steps have been taken to date.
9 Corporations Act, Section 435A.
10 ibid., Section 436A.
11 ibid., Section 436B.
12 ibid., Section 436C.
An administrator (often called a voluntary administrator) has wide powers to manage the company to the exclusion of the existing board of directors. Once an administrator is appointed, a statutory moratorium is activated, which restricts the exercise of rights by third parties under leases and security interests\(^\text{13}\) and in respect of litigation claims. This moratorium is designed to give the administrator the opportunity to investigate the affairs of the company, and either implement change or be in a position to realise value, with protection from certain claims against the company.

There are two meetings during the course of an administration that are critical to its outcome. Once appointed, an administrator must convene the first meeting of creditors within eight business days. At this first meeting, the identity of the voluntary administrator is confirmed, the initial remuneration of the administrator is approved and a committee of creditors may be established. The second creditors’ meeting is normally convened 20 business days after the commencement of the administration (this may be extended by application to the court). At the second creditors’ meeting, the administrator must provide a report on the affairs of the company to the creditors and outline their view on the best option available to maximise returns to creditors. There are three possible outcomes that can be put to the meeting: entry into a DOCA with creditors (discussed further below), winding up the company, or terminating the administration\(^\text{14}\) (this is rare as it would only occur when the company is actually solvent).

The administration will terminate following the outcome of the second meeting (i.e., either by progressing to liquidation, entry into a DOCA or returning the business to the directors to operate as a going concern). When the administration terminates, a secured creditor that was previously estopped from enforcing a security interest because of the statutory moratorium becomes entitled to take steps to enforce that security interest unless the reason for the termination is the implementation of a DOCA approved by that secured creditor. The automatic stay on \textit{ipso facto} provisions (see Section I.ii, above) will not apply when the company enters into a DOCA. If the creditors of the company resolve at the second meeting that the company should be wound up, the automatic stay will apply.

\textit{DOCA}

A DOCA is effectively a contract or compromise between a company and its creditors. Although closely related to voluntary administration, it should, in fact, be viewed as a distinct regime, as the rights and obligations of the creditors and company will differ from those under administration.

DOCAs are flexible. The terms of a DOCA may provide for, inter alia, a moratorium of debt repayments, a reduction in outstanding debt and the forgiveness of all or a portion of the outstanding debt. They may also involve the issuance of shares (subject to certain conditions), and can be used as a way to achieve a debt-for-equity swap through the transfer of shares either by consent or with leave of the court.\(^\text{15}\)

\(^\text{13}\) However, there is an exception to the moratorium on the exercise of rights under security interests in the case of a secured creditor that has security over the whole or substantially the whole of the assets of the company and such rights are exercised within the ‘decision period’ (being 13 business days after the appointment of the administrator).

\(^\text{14}\) Corporations Act, Section 439C.

\(^\text{15}\) ibid., Section 444GA. The mechanism under Section 444GA was to effect various ‘high-profile’ debt for equity restructurings, such as Mirabela, Nexus Energy, Ten Network and Paladin.
For a debtor company to enter into a DOCA, a bare majority of creditors, both by value and number, voting at the second creditors’ meeting must vote in favour of the company executing a DOCA. If there is a voting deadlock, for example when there is a majority in number but not in value or vice versa, pursuant to Rule 75-115(3) of the Insolvency Practice Rules (Corporations) 2016 (Cth), the chairperson of the meeting (usually the administrator) may exercise a casting vote to pass, or not to pass, a resolution. The right to exercise a casting vote is not mandatory and cannot be used if the resolution relates to an administrator’s remuneration.

Once executed, a DOCA will bind the company, its shareholders, directors and unsecured creditors. Secured creditors can, but do not need to, vote at the second creditors’ meeting, and typically only those who voted in favour of the DOCA at the second creditors’ meeting are bound by its terms. Unlike a scheme of arrangement, court approval is not required for a DOCA to be implemented, provided it is approved by the requisite majority of creditors.

Upon execution of a DOCA, the voluntary administration terminates. The outcome of a DOCA is generally dictated by the terms of the DOCA itself. Typically, once a DOCA has achieved its stated aims, it will terminate. If a DOCA does not achieve its objectives, or is challenged by creditors, it may be terminated by the court or in accordance with its terms.

**Provisional liquidation**

A provisional liquidator may be appointed by the court at any time after the filing of a winding-up application and before the making of a winding-up order in a number of circumstances. The most commonly used grounds include:

- **a** insolvency;
- **b** when an irreconcilable dispute at a board or shareholder level has arisen that affects the management of the company; or
- **c** if the court is of the opinion that it is ‘just and equitable’ to do so.

There must be a reasonable prospect of the company being wound up.

A creditor, a shareholder or the company itself has standing to apply for the appointment of a provisional liquidator, although in most cases a creditor will be the applicant.

The effect of the appointment is to give interim control of the company to a liquidator to the exclusion of the directors. A provisional liquidator will normally only be appointed by the court if there is a risk to the assets and affairs of a company prior to a company formally

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16 There have been two cases in the past few years challenging the validity of the widely held view that secured creditors are not ‘bound’ by a deed of company arrangement [DOCA] unless they vote in favour of it. In *Australian Gypsum Industries Pty Ltd v. Dalesun Holdings Pty Ltd* [2015] WASCA 95 and *Re Bluenergy Group Limited* [2015] NSWSC 977, it was held that a DOCA can (if so expressed) have the effect of extinguishing the debt of a secured creditor that did not vote in favour of the DOCA pursuant to Section 444D(1) of the Corporations Act. However, this extinguishment is subject to the preservation of the secured creditor’s ability (by virtue of Section 444D(2)) to realise or deal with its security in respect of its proprietary interest in the secured property and to the extent that its debt was provable, and secured assets were available at the date that debt would otherwise be released under the DOCA, without requiring that the debt be preserved into the future or for other purposes.

17 Corporations Act, Section 472(2).
entering liquidation. As such, a provisional liquidator is normally only given very limited powers (i.e., to take possession of the assets), and the main role of the provisional liquidator is to preserve the status quo.

A court determines the outcome of a provisional liquidation, and may order either that the company move to a winding up (with the appointment of a liquidator) or that the appointment of the provisional liquidator is terminated.

The automatic stay on *ipso facto* provisions (see Section I.ii, above) does not apply to provisional liquidation and therefore provisional liquidation is likely to result in some form of damage to the business of the company.

**Liquidation**

Liquidation is the process whereby the affairs of a company are wound up and its business and assets are realised. A company may be wound up voluntarily by its members if solvent or, if it is insolvent, by its creditors or compulsorily by order of the court.

*Voluntary liquidation (members and creditors)*

The members of a solvent company may resolve that a company be wound up if the board of directors is able to give a 12-month forecast of solvency (i.e., an ability to meet all the company’s debts in the following 12 months). If not, or if the company is later found to be insolvent, the creditors take control of the process and it converts to a creditor’s voluntary liquidation.

Creditors may also resolve at a meeting of creditors to wind up the company and appoint a liquidator (this may take place at the second meeting of creditors during an administration). If the requisite approvals are obtained in either a members’ voluntary winding up or a creditors’ voluntary winding up, a liquidator is appointed.

*Compulsory liquidation*

The most common ground for a winding-up application being made to the court is insolvency. This is usually indicated by the company’s failure to comply with a statutory demand issued by a creditor for payment of a debt. Following a successful application by a creditor, a court will order the appointment of a liquidator.

In both a voluntary and a compulsory winding up, the liquidator will have wide-ranging powers, including the ability to challenge voidable transactions and take control of the assets of the company. Most likely, a liquidator will not run the business as a going concern, unless that will ultimately result in a greater return to stakeholders. During the course of the winding up, the liquidator will realise the assets of the company for the benefit of its creditors and, to the extent of any surplus, its members. At the end of a winding up, the company will be deregistered and cease to exist as a corporate entity.

**Scheme of arrangement**

A scheme of arrangement is a restructuring tool that sits outside a formal insolvency process; that is, the company may become subject to a scheme of arrangement whether it is solvent or insolvent. A scheme of arrangement is a proposal put forward (with input from management, the company or its creditors) to restructure the company in a manner that includes a compromise of rights by any or all stakeholders. The process is overseen by the courts and requires approval by all classes of creditors. In recent times, schemes of arrangement have
become more common, in particular for complex restructurings involving debt-for-equity swaps, in circumstances where the number of creditors within creditor stakeholder groups may make a contractual and consensual restructure difficult.

A scheme of arrangement must be approved by at least 50 per cent in number and 75 per cent in value of creditors in each class of creditors. It must also be approved by the court to become effective (it requires court approval at two stages). The test for identifying classes of creditors for the purposes of a scheme is that a class should include those persons whose rights are not so dissimilar as to make it impossible for them to consult one another with a view to a ‘common interest’. Despite this long-standing proposition, recent case law has suggested that courts may be willing to stretch the boundaries of what would ordinarily be considered the composition of a class and, in doing so, may agree to put creditors in classes even where such creditors within the class appear to have objectively distinct interests.18 Thus, the basis upon which parties have previously grouped creditors into classes is now a less certain benchmark for class composition moving forward.

The outcome of a scheme of arrangement is dependent on the terms of the arrangement or compromise agreed with the creditors but, most commonly, a company is returned to its normal state upon implementation as a going concern with the relevant compromises having taken effect.

The scheme of arrangement process does have a number of limiting factors associated with it, however, including cost, complexity of arrangements, uncertainty of implementation, timing issues (because it must be approved by the court, it is subject to the court timetable and cannot be expedited) and the overriding issue of court approval (a court may exercise its discretion to not approve a scheme of arrangement, despite a successful vote, if the court is of the view that the scheme of arrangement is not equitable). These factors explain why schemes of arrangement tend to be undertaken only in large corporate restructures and in situations where timing is not fatal to a restructure.

### iv Starting proceedings

The Federal Court of Australia and the Supreme Courts of each Australian state and territory have jurisdiction to hear matters relating to the insolvency of a corporation (both civil and criminal offences arising from insolvency proceedings).

Matters pertaining to debt recovery and monetary compensation can also be dealt with by other courts, such as district courts, county courts and magistrates’ courts, within their jurisdictional limits. The judicial institutions have discretion to transfer matters between them if considered appropriate.

It is generally only the Federal Court and the Supreme Courts that have jurisdiction to wind up a company.

Interestingly, two of the more common forms of insolvency process – voluntary administration and receivership – often have no court involvement.

### v Control of insolvency proceedings

For administrations and liquidations, the relevant insolvency practitioner has control of the company itself to the exclusion of the directors.

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In an insolvent winding up, the members lose any right to management of the company. The liquidator is vested with wide powers of investigation and inquiry as well as the power to recover and gather in and secure the company’s property. Liquidation does not interfere with the rights of a secured creditor who is able to retain and enforce the security and recover the full amount for the debt owed.

In a voluntary administration, the creditors control the final outcome to the exclusion of management and members, and ultimately decide on the outcome of the company.

Upon execution of a DOCA, the voluntary administration will terminate and the company will no longer enjoy the benefit of any automatic statutory stay or moratorium prescribed in the Corporations Act. Once the DOCA has been executed, a director’s powers are no longer suspended, but they can only exercise their powers consistently with the provisions of the DOCA.

When the powers granted to a receiver are expressed broadly, as they usually are, the receiver will control the management of the company and its business to the exclusion of the directors.

Following the implementation of a scheme, often an administrator will be appointed (a scheme administrator) to implement the terms of the scheme, which role ceases once the scheme is implemented. This is not a requirement under the Corporations Act but is often used in large and complex creditors’ schemes.

vi Special regimes

As noted in Section I.i, the Corporations Act is the primary legislative instrument for insolvency and restructuring in Australia and governs the insolvency proceedings of all companies incorporated in Australia and companies incorporated or possessing separate legal personality in foreign jurisdictions that carry on business in Australia, as well as building societies, credit unions and managed investment schemes.

The provisions of the Corporations Act do not govern the potential insolvency proceedings for:

- government agencies;
- state or federal corporate bodies; or
- entities created by statute that are not companies.

The individual statutes creating these bodies will normally provide for their dissolution or winding up.

As a general comment, there is no precedent in Australia for a government-owned enterprise becoming insolvent.

The Personal Property Securities Act 2009 (Cth) is the primary legislation that governs personal property security and is therefore an integral part of restructuring and insolvency law in Australia.

vii Cross-border issues

Australian courts cooperate with foreign courts and insolvency practitioners, and will recognise the jurisdiction of the relevant court in which the centre of main interest (often referred to as the COMI) is located. This approach follows the UNCITRAL Model Law on Cross-border Insolvency (the Model Law), which was codified into Australian law through the Cross-Border Insolvency Act 2008 (Cth) (the Cross-Border Act). The aim of the
The UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments of 2018 (MLREIJ) is to complement and to clarify uncertainties arising from the Model Law. The MLREIJ has not yet been adopted in Australia.

Both the Corporations Act and the Cross-Border Act contain mechanisms to address cross-border insolvency matters.

Under Section 581 of the Corporations Act, Australian courts have a duty to render assistance when so requested by a foreign insolvency court. While in most cases Australian courts have provided assistance when requested to do so under Section 581, there have been exceptions. For example, in *Yu v. STX Pan Ocean Co Ltd (South Korea)*, the Federal Court of Australia was reluctant to grant additional relief on the basis that it would adversely affect any rights that other Australian creditors may have otherwise had, whether under the Corporations Act or otherwise.

The Cross-Border Act (incorporating the Model Law) also allows for the recognition of foreign proceedings. The court's power to grant relief appears to extend also to the enforcement of foreign judgments. Notably, receivers do not have the benefit of taking action in foreign jurisdictions that other insolvency administrators have under the Cross-Border Act. This is because receiverships relate only to a debt owed to the appointer and, as such, cannot be said to be ‘collective proceedings’ in terms of the application of the Model Law.

Furthermore, the Foreign Judgments Act 1991 (Cth) creates a general system of registration of judgments obtained in foreign countries but will only apply to judgments pronounced by courts in countries where, in the opinion of the governor general, substantial reciprocity of treatment will be accorded by that country in respect of the enforcement in that country of judgments of Australian courts.

The determination of whether a foreign proceeding should be recognised in Australia as a ‘foreign main proceeding’ or a ‘foreign non-main proceeding’ depends on the location of the debtor’s COMI. This distinction is important because recognition of a foreign proceeding as a foreign main proceeding will automatically stay actions of individual creditors against the debtor and of enforcement proceedings concerning the assets of the debtor in all non-main jurisdictions, suspend the debtor’s right to dispose of its assets and allow clawback proceedings in respect of antecedent transactions to be commenced by the foreign representative (this is not necessarily the case for a foreign non-main proceeding). Under the Cross-Border Act, there is a rebuttable presumption that a debtor’s COMI is its registered office, or in the case of a natural person, his or her habitual residence.

The Model Law provides no guidance on the standard required for COMI determination. It is noted in the explanatory memorandum for the Model Law that this silence was deliberate as the concept of a COMI has been developed through case law. To that end, Australian courts have applied the general test from *Re Eurofood IFSC Ltd* when...
considering whether this presumption has been rebutted, as follows: ‘The “centre of main interests” should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.’

In addition, the Australian courts will aim to adopt similar reasoning when considering a COMI as comparable jurisdictions (such as the bankruptcy courts in the United States) and have, accordingly, equated the concept of COMI with the principal place of business. In considering where the COMI of a debtor or group of companies exists, the courts will consider a number of factors, including:

\[\begin{align*}
  a & \text{ the location of the debtor’s headquarters;} \\
  b & \text{ the location of those who actually manage the debtor;} \\
  c & \text{ the location of the debtor’s primary assets;} \\
  d & \text{ the location of the majority of the debtor’s creditors or a majority of creditors who would be affected by the case; and} \\
  e & \text{ the jurisdiction whose law applies to most disputes.}
\end{align*}\]

II INSOLVENCY METRICS

With the handing down of the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) in February 2019 (the Final Report), the Australian corporate and banking market has changed, perhaps indefinitely. A key driver of this transformation has been the effect of increased media attention (especially social media) on the behaviour of banks, which has resulted in reputational risk becoming a primary concern for management and general counsel. A key outcome of the Royal Commission was a renewed focus on regulation, with the Final Report recommending greater collaboration between ASIC and the Australian Prudential Regulatory Authority. Importantly, the Royal Commission has introduced a shift towards a ‘why not litigate?’ stance regarding ASIC’s enforcement approach and has placed greater scrutiny on regulator performance. This is likely to embolden regulators and increase the level of public oversight.

Sectors that have suffered particular distress in recent times include retail, mining and mining services, property and construction. Increased restructuring activity is expected in each of these sectors in the foreseeable future.

A significant proportion of external administration appointments have continued to result from borrowers breaching financial covenants, not meeting amortisation payments or an inability to refinance at the end of facility terms. In these circumstances, when there are no other options available, directors will invariably opt to appoint a voluntary administrator. Often this will result in concurrent appointments, with the secured creditor appointing a receiver ‘over the top’ of a voluntary administrator. Even though receivership appointments have decreased in light of banks’ revised approaches to distressed situations, these dual appointments still occur and are a feature of the Australian restructuring landscape.

Each quarter, ASIC publishes insolvency statistics outlining the total number of companies that entered into external administration (that is administration, liquidation or receivership) during that quarter and a comparative analysis of the previous quarter and a 12-month comparison.

For the quarter ending March 2019, ASIC reported a notional 10 per cent decrease in external administration appointments against the December 2018 quarter, with a total of 1,817 companies entering into external administration. The March 2019 quarterly total of 1,813 companies was similar to that of March 2018.
III PLENARY INSOLVENCY PROCEEDINGS

Significant proceedings in the Australian market include the following restructures:

a Toys R Us Australia (Toys), by way of a voluntary administration and subsequent liquidation of the Australian business. The winding up of Toys followed the collapse of its US parent (which filed for bankruptcy protection under Chapter 11 of the US Bankruptcy Code in 2017) and reflects the particular challenges faced by the retail industry;

b Slater and Gordon Limited (S&G) (arguably the highest-profile restructure for a publicly listed company in the Australian market in recent times) was achieved by way of two inter-conditional schemes of arrangement resulting in S&G’s senior lenders taking control of the S&G Group via a debt-for-equity swap involving the exchange of 95 per cent of S&G’s equity for a reduction of A$636.6 million in senior secured debt owed by S&G. Significantly, this transaction involved the resolution of shareholder class actions (both brought and threatened) against S&G and, unusually, using a scheme to achieve this outcome in a manner that ensured that there are no future adverse financial consequences for S&G or its directors;

c Paladin Energy Limited (Paladin) by way of a voluntary administration followed by a DOCA (approved by Paladin’s creditors) involving an extinguishment of certain claims in exchange for the transfer of 98 per cent of the equity from existing shareholders by way of a court application under Section 444GA of the Corporations Act (and without the need for existing shareholder approval – note our comments regarding Section 444GA in footnote 15, above). The successful outcome demonstrates the flexibility of DOCAs to effect restructures and recapitalisations and should encourage creditors of listed companies to pursue value-preserving debt-for-equity transactions without the need for shareholder approval, or the need for the threshold of 75 per cent in value to be met for each class of creditors as required under a creditors’ scheme; and

d Ten Network Holdings Limited (Ten Network) by way of a voluntary administration resulting in a contested bidding process with competing DOCA proposals put forward. A DOCA proposal involving the use of a creditors’ trust mechanism (whereby the DOCA completes and converts into a creditors’ trust enabling the company to come out of insolvency quickly and the creditors release their claims against the company in exchange for a claim as a beneficiary against the trust) and a court application for orders under Section 444GA of the Corporations Act were accepted by creditors.

The Paladin and Ten Network restructures demonstrate the flexibility of DOCAs and the ability of a deed administrator, under Section 444GA of the Corporations Act, to transfer shares in a company with leave of the court when this is opposed by the shareholders. The court will only grant orders under this Section if ‘it is satisfied that the transfer would not unfairly prejudice the interests of members of the company’. These shareholders would not be prejudiced, based on the existing case law, if their shares have no ‘economic value’. This provision ensures that existing shareholders are afforded a level of protection and consideration, through the court process, while allowing creditors, or others, to acquire the equity interests through a DOCA when it is fair to do so.
IV ANCILLARY INSOLVENCY PROCEEDINGS

There have been no significant ancillary insolvency proceedings in the past 12 months.

However, recent case law has foreshadowed the prospect that foreign representatives administering international formal processes in Australia (as part of applying for recognition under the Model Law) might be required to make a security payment into court as to ensure that local courts are kept better informed of any changes in the status of foreign processes.23

V TRENDS

The Australian economy has experienced only limited growth during the past few years despite record low interest rates. It feels as if the country is still recovering from the aftermath of the global financial crisis.

Further, tightening capital adequacy requirements (through the Basel Accords) and prudential standards, and more conservative approaches to risk (particularly following the Royal Commission), have resulted in banks limiting their exposures to certain industries and allowing ‘non-traditional’ lenders (such as hedge funds, investment banks and alternative capital providers) to enter certain sectors.

The changing risk appetite of the banks and the general lending climate has limited opportunities in Australia’s relatively new secondary debt market. Although there are proactive buyers present in the Australian secondary debt market, there are fewer opportunities to purchase debt. Despite this, in recent years, large and complex restructures (i.e., S&G and BIS Industries) saw lenders trading their debt to facilitate the transaction; the driver to sell the debt, in those cases, was the banks’ general unwillingness to hold equity in the distressed entities. Considering the relative stability of the Australian banking sector and the robust regulatory framework governing it, secondary debt traders can look forward to greater participation in the Australian market that should become more active if economic conditions continue to decline. With the culmination of the Royal Commission and a very low interest rate environment prevailing (as noted above), the past 12 months have been a subdued period for Australian restructures. We expect this to continue for the remainder of this calendar year.

However, with more and increasingly diverse parties entering the lending market, new legislation having just come into effect and borrowers still vulnerable to interest rate rises and other shocks (such as decreases in commodity prices), the ensuing years could be very interesting in the restructuring and insolvency market in Australia.

Chapter 2

AUSTRIA

Gottfried Gassner and Georg Wabl

I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

The relevant primary legislation is the Austrian Insolvency Code, which provides general rules and thereby builds the framework for the following types of judicial insolvency proceedings for enterprises:

a bankruptcy proceedings;

b restructuring proceedings with self-administration; and

c restructuring proceedings without self-administration.

Other than those that apply in other countries (such as Germany), there are no practically relevant preliminary insolvency proceedings in Austria. The general rules of the Insolvency Code, such as priority of creditors’ claims, a statutory moratorium, termination rights or avoidance, apply to all the aforementioned proceedings. The main difference between them is that bankruptcy proceedings primarily aim to liquidate the debtor's assets whereas restructuring proceedings primarily aim to restructure a debtor's business with the support of the majority of creditors. Restructuring proceedings with self-administration are debtor-in-possession (DIP) proceedings (i.e., the debtor keeps control of day-to-day operations).

Special provisions relevant to insolvency are also provided by Austrian company law, tax law and employment law, as well as Regulation (EU) 2015/848 (the Insolvency Regulation (EIR)). In practice, the Austrian Equity Substitution Act, which potentially qualifies loans granted by shareholders as equity (and therefore statutorily subordinated) is also very relevant. The Austrian Business Reorganisation Act provides rules for corporate reorganisation proceedings (which are not insolvency proceedings) in relation to a solvent debtor’s business that affect creditors’ rights to a lesser degree. In practice, these types of proceedings are rarely applied.

Priority of creditors’ claims

The Insolvency Code does not expressly provide for formal rules on classes or priority of creditors’ claims. Structurally, creditors are prioritised as follows:

a preferential creditors such as those with a right to property regarding the assets of a debtor’s estate or secured creditors;

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1 Gottfried Gassner is attorney at law and partner, and Georg Wabl is attorney at law, at Binder Grösswang Rechtsanwälte GmbH.
estate creditors that can demand full payment from the debtor's estate because their claims arise after the insolvency proceedings have opened (e.g., trade creditors contracting with the administrator or banks granting financing during proceedings); unsecured creditors receiving an insolvency quota; and statutorily or contractually subordinated creditors.

Statutory moratorium

Individual enforcement actions against a debtor are prohibited in all types of insolvency proceedings (i.e., there is a collective statutory moratorium). Creditors must instead file their claims in the insolvency proceedings and the insolvency administrator has to scrutinise and approve or reject each claim. If a claim is rejected, the creditor may sue the administrator for approval. In principle, this does not apply to preferential creditors whose claims are, as a general rule, not affected by the opening of insolvency proceedings.

Termination rights

The opening of insolvency proceedings does not automatically terminate or amend contracts. However, special provisions of the Insolvency Code allow, under certain circumstances, an eased termination by the debtor (in restructuring proceedings with self-administration) or the insolvency administrator (in restructuring proceedings without self-administration and in bankruptcy proceedings). However, contract partners may be prevented from termination to protect the debtor's estate from losing contracts that are essential for continuing the business. *Ipso facto* clauses (i.e., clauses allowing the termination of a contract simply because of the opening of insolvency proceedings over the assets of the other party) are not enforceable.

Avoidance

Austrian avoidance rules allow the challenge of legal actions and transactions that have taken place within certain clawback periods before the opening of insolvency proceedings. Avoidance actions are exclusively on the insolvency administrator. A successful challenge forces the other party to return received payments or transferred assets to the debtor's estate. The challenged legal action or transaction must:

a. have taken place within a certain clawback period before the opening of insolvency proceedings (from six months up to 10 years, depending on the specific avoidance rule);
b. have been directly or indirectly detrimental to the insolvency estate; and
c. meet the criteria set by one of the avoidance rules provided in the Insolvency Code (avoidance owing to an intent to discriminate, avoidance owing to squandering of assets, avoidance of transactions with no consideration and analogous transactions, avoidance owing to preferential treatment, or avoidance owing to knowledge of insolvency).

Avoidance owing to preferential treatment or knowledge of insolvency (respectively, a one-year and six-month clawback period) are most commonly argued by the insolvency administrator. These two provisions require the debtor's material insolvency at the time of the challenged action or transaction and shall protect the principle of equal treatment of creditors (*par conditio creditorum*).
ii Policy

A major insolvency law reform in 2010 resulted in debtor-friendly restructuring tools being strengthened. The reform aimed to facilitate the restructuring of viable businesses and to prevent liquidation. Nevertheless, as private workouts (silent out-of-court restructurings) are well established and tested in Austrian restructuring practice, large restructuring cases are often handled without court involvement. The main challenge in a private workout is that there are certain rules regarding the protection and equal treatment (i.e., *pari passu* and *par conditio creditorum*) of creditors (in particular, directors’ duty to file for insolvency).

Currently, there are no material reforms envisaged, but existing legislation is regularly evaluated. In response to the EIR, the Austrian legislature has amended the provisions of the Insolvency Code regarding cross-border constellations in both an EU and an international (i.e., non-EU) context.

Further changes in Austrian insolvency law may be required owing to harmonisation efforts being discussed at an EU level (including the recently adopted EU Directive on restructuring and insolvency, which will have to be implemented into Austrian law by 2021).

iii Insolvency procedures

As stated in Section I.i, the corporate insolvency proceedings under the Insolvency Code are divided into bankruptcy proceedings, restructuring proceedings with self-administration and restructuring proceedings without self-administration.

Bankruptcy proceedings

Bankruptcy proceedings require a debtor’s material insolvency (illiquidity or over-indebtedness) and are initiated after application by the debtor or a creditor.

As soon as proceedings are formally opened, an insolvency administrator is appointed by the court. The administrator is called a *Masseverwalter* and acts as a liquidator who is in charge of administering and selling the debtor’s assets. Bankruptcy proceedings cannot be DIP proceedings (other than restructuring proceedings). Although these proceedings aim to sell a debtor’s estate, the main focus is on continuing the business and to sell it as a going concern, provided that this does not jeopardise the interests of creditors.

If continuation of the business is not in the interests of the creditors, the insolvency administrator must shut down and liquidate the business.

The duration of proceedings may vary from several months to several years, depending on the case. The proceedings end by court order after a final distribution of the insolvency quota.

If a debtor wants to prevent his or her assets from being sold, he or she can still file a restructuring plan at any stage of the proceedings and thereby try to restructure the business as well as the insolvent entity itself.

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2 Because of the confidentiality of such restructurings, no detailed statistics are available.
**Restructuring proceedings**

The aim of both restructuring proceedings with self-administration (i.e., DIP proceedings) and restructuring proceedings without self-administration is the restructuring of an insolvent entity as a going concern.

At the beginning of the proceedings, an administrator is appointed by the court, who either merely supervises the debtor (proceedings with self-administration, for which the administrator is called a *Sanierungsverwalter*) or manages and represents the entirety of the business (proceedings without self-administration, for which the administrator is called a *Masseverwalter*, as in bankruptcy proceedings).

The proceedings are only called restructuring proceedings if the debtor presents a restructuring plan with the initial application to open insolvency proceedings. The plan must provide for a minimum restructuring quota of 30 per cent for proceedings with self-administration and 20 per cent for proceedings without self-administration (payable in each case within no more than two years).

The restructuring plan must be approved by:

- a creditors’ meeting (there is a double-majority requirement, i.e., simple majority of the creditors present at the sanctioning hearing and of the represented capital of claims); and
- the insolvency court. Note that the court can only approve the plan if it:
  - treats unsecured creditors equally (with rare exceptions);
  - does not affect the rights of preferential and estate creditors; and
  - is feasible and appropriate in comparison to alternative circumstances (liquidation of the business).

Timely quota payment leads to a debt discharge in the amount exceeding the restructuring quota; hence, the discharge can be up to 80 per cent of the unsecured debt.

Restructuring proceedings are debtor-driven. Creditors can neither force the debtor to present a restructuring plan nor present a restructuring plan (or a counterproposal) themselves. Creditors can therefore ‘only’ vote on and challenge the plan.

At best, restructuring proceedings can be completed within roughly three months (especially for self-administration as DIP must be revoked by the court if the restructuring plan is not approved by the creditors within 90 days of the opening of proceedings).

**Ancillary insolvency proceedings**

Ancillary insolvency proceedings are mainly relevant within the scope of the EIR. If the centre of main interest (COMI)\(^4\) of the debtor is in another EU Member State but the debtor has a branch and assets\(^5\) in Austria, a secondary insolvency proceeding can be opened in Austria, which is limited to the ‘Austrian assets’. There are few examples of such proceedings, but the *NIKI Luftfahrt GmbH* case\(^6\) has shown the various challenges in connection with ancillary proceedings. The duration of ancillary proceedings opened in Austria mainly depends on

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\(^4\) Within the meaning of Article 3(1) of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (the EU Insolvency Regulation) [EIR].

\(^5\) Both within the meaning of Article 3(2) and Article 2 Nos. 9 and 10 EIR.

\(^6\) [2018] EIRCR(A) 679. Both Austrian and German courts considered themselves competent for main insolvency proceedings. Finally, the main insolvency proceedings were opened in Austria and secondary proceedings were opened in Germany (see further details in Section III.i).
the complexity of the main proceedings, the cooperation between the competent courts and the appointed administrators, among other things. Generally, proceedings in a cross-border context tend to take longer than purely national proceedings.

Outside the scope of the EIR, international jurisdiction is not harmonised and depends on the existence of bilateral treaties. Ancillary proceedings in this context have rarely been relevant to date.

iv Starting proceedings

Bankruptcy proceedings can be commenced by the debtor or creditors (including in ancillary insolvency proceedings). Restructuring proceedings can only be commenced by the debtor.

The main requirement for the opening of insolvency proceedings is the debtor’s insolvency (i.e., illiquidity or over-indebtedness). Illiquidity within the meaning of the Insolvency Code means that the debtor cannot pay all debt as it falls due and is not able to acquire the necessary funds to satisfy all due debt within a reasonable amount of time (as a general rule, liquidity can be assumed if 95 per cent of due debt can be paid). Liabilities becoming due in future or not yet payable (e.g., deferred or statutorily subordinated liabilities) do not have to be considered; only matured liabilities are relevant. Over-indebtedness within the meaning of the Insolvency Code means that the debtor’s liabilities exceed its assets based on liquidation values and the debtor has a negative forecast on its continued existence. The duty to file for insolvency for directors is linked to illiquidity and over-indebtedness (see also Section 1.v ‘Debtor and directors’).

Restructuring proceedings may be commenced by the debtor in a case of impending illiquidity, although there is no duty to do so.

Upon commencement by a debtor, proceedings are usually opened very quickly (i.e., within a few days). If creditors commence proceedings, the court must first assess whether the creditor is formally entitled and whether the debtor is indeed insolvent; this process may take weeks or even months.

Debtors may mainly oppose commencements by a creditor by arguing that the debtor, in fact, is not insolvent or that the creditor is not formally entitled.

v Control of insolvency proceedings

Insolvency proceedings are mainly controlled by the insolvency court and an appointed administrator, who must primarily seek to protect the creditors’ interests. In restructuring proceedings with self-administration, the debtor can significantly influence proceedings.

Insolvency court

The insolvency court has a strong role in all insolvency proceedings from the beginning and is involved in, and competent for, all main decisions. The court, among other things, decides on the opening of proceedings, appointment of the administrator and a possible creditors’ committee, the sale of the business or relevant assets, and the end of the proceedings.

In addition, the court supervises the proceedings and the actions of the administrator and debtor.

Administrator

The administrator is selected by the court from a list of potential candidates. In bankruptcy proceedings and restructuring proceedings without self-administration, he or she is called a
Masseverwalter; in restructuring proceedings with self-administration, he or she is called a Sanierungsverwalter. Administrators are usually lawyers; in most cases, an individual lawyer is appointed, rather than a law firm.

Neither the debtor nor creditors can formally influence the court’s selection but they may try to put forward proposals.

The Masseverwalter must, in particular, manage the debtor’s estate and inventory, and administer and sell the debtor’s assets. He or she must meet the objective standards of a professional expert. A breach of the described duties may lead to personal liability. In restructuring proceedings with self-administration, these tasks are divided between the debtor and the supervising Sanierungsverwalter.

Debtor and directors
Before the opening of insolvency proceedings, directors are subject to a strict duty to file. As soon as it becomes objectively apparent that a debtor is illiquid or over-indebted, directors must file for insolvency proceedings without undue delay and not later than 60 days. This is considered a maximum period. If there are no directors, the duty to file falls to the controlling shareholders.

Directors keep their formal position also within insolvency proceedings. Their roles depend on the type of proceedings.

In bankruptcy proceedings and restructuring proceedings without self-administration, the debtor and its directors are automatically deprived of power from day one. However, directors remain formally appointed and must cooperate with the administrator. Further, the debtor is a party to the proceedings and can thereby challenge court decisions or try to influence the proceedings by presenting a restructuring plan.

In restructuring proceedings with self-administration, the debtor remains in the driving seat and the directors can continue running the day-to-day business, under the supervision of the court-appointed administrator.7

Shareholders
Commencement of insolvency proceedings does not affect the corporate structure, which is why shareholders keep their formal ownership rights. Still, they can as a general rule neither instruct the administrator nor participate in court hearings (unless they are also creditors). In restructuring proceedings with self-administration, shareholders may try to instruct the self-administrating directors.

There is no statutory debt-to-equity swap in Austria; thus, shareholders cannot be forced to sell or transfer their shares.

Creditors
Creditors cannot actively ‘run’ the proceedings but have certain rights of control. The creditors’ committee is appointed by the insolvency court and must approve certain actions, as well as supervise and support the administrator.8 In certain instances, appointment of a committee is mandatory (e.g., in the case of the sale of a business or in complex proceedings).

7 A current topic under discussion is whether directors in self-administration may be subject to the same liability rules as insolvency administrators.
8 Individual creditors do not have a formal right to become part of the committee.
Further, creditors have access to the court files, and can participate and vote in creditors’ meetings and in court hearings. They can, for example, challenge court decisions or contest claims filed by other creditors. Most importantly, they have the right to vote on and approve or reject a proposed restructuring plan.

vi Special regimes

Besides the Insolvency Code, special regimes apply for banks (Act on the Recovery and Resolution of Banks), insurance companies (Act on the Supervision of Insurance Companies) and pension funds (Pension Fund Act). These types of institutions can still go into bankruptcy proceedings if the tools provided in the special regimes do not work out. The rules on restructuring proceedings generally do not apply to these institutions.

There is no concept of a group insolvency in Austria; each entity must be assessed individually and – if necessary – insolvency proceedings must be opened over the assets of each respective entity. In most cases, different administrators are appointed for each entity. In line with the EIR, rules on cooperation within group insolvencies have also been included in the Insolvency Code.

vii Cross-border issues

The implications of the EIR have already been addressed. Foreign insolvency proceedings are automatically recognised in Austria if they are mentioned in Annex A of the EIR. Outside the scope of the EIR, foreign insolvency proceedings tend to be recognised if the COMI is in the respective foreign country and the basic principles of the foreign proceedings are comparable to Austrian insolvency law.

Challenges in relation to cross-border insolvency often result from the varying interpretations of COMI in different Member States (as shown in the NIKI Luftfahrt GmbH case). Besides, matters of cross-border cooperation between courts and insolvency administrators have not yet been tested extensively.

Forum shopping of companies happens occasionally but is not a frequent problem in Austria as there is a well-functioning private workout practice.

II INSOLVENCY METRICS

Compared to the strong growth during 2017 and 2018, economic development in Austria slowed down in the first half of 2019. The decline in unemployment is also no longer as strong as it was in 2018.9 Gross domestic product grew in 2018 by 2.7 per cent as compared with 2017. Economic growth was thus the strongest since 2011.10 Accordingly, the number of company insolvencies fell again in 2018, as compared with 2017, which means that insolvencies are again at an all-time low. The decline in the number of insolvencies is not so much due to the robustness of the economy, but rather the extremely low interest rates,

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9 See the latest statistics compiled by the Austrian Public Employment Service (Arbeitsmarktservice Österreich) at https://www.ams.at/content/dam/download/arbeitsmarktdata/%C3%B6sterreich/berichte-auswertungen/001_uebersicht_aktuell_0519.pdf (accessed on 3 July 2019).
10 See the latest statistics compiled by the Austrian Economic Chambers (Wirtschaftskammer Österreich) at http://wko.at/statistik/prognose/prognose.pdf (accessed on 3 July 2019).
which keep even weak and highly indebted companies alive. However, in 2018, the numbers of both affected employees and company liabilities have risen noticeably as a result of some major insolvencies.11

Around 5,000 companies filed for insolvency during 2018.12 In the first six months of 2019, there were about 2,600 filings13 (almost as many as in the first half of 2018).14 Most insolvencies were opened in Vienna. Insolvencies with total liabilities of more than €100 million are rather rare (the most recent insolvencies of this size are Waagner Biro, NIKI Luftfahrt GmbH and MFC Corporate Services GmbH). The vast majority of company insolvencies relate to small companies with liabilities of less than €2 million (around 95 per cent in 2018). Almost 60 per cent of insolvencies affect relatively young businesses (established in 2010 or later). Most insolvencies affect Austrian limited liability companies (around 45 per cent) or individual businesses (around 40 per cent). Insolvencies of stock corporations or private foundations are very rare.

The industry sectors that are most affected are construction (about 20 per cent of all company insolvencies in 2018), corporate services (about 18 per cent), hospitality (about 14 per cent) and traffic (around 8 per cent, mostly because of the insolvency of NIKI Luftfahrt GmbH).

In 2018, around 87 per cent of insolvencies were bankruptcy proceedings (primarily seeking the winding up of the company) and only about 13 per cent were restructuring proceedings (with the aim of a restructuring of the insolvent entity). However, statistics show neither how many businesses were restructured in private workouts nor in how many of the bankruptcy proceedings was the business sold as a going concern or if a restructuring plan was presented at a later stage.

III PLENARY INSOLVENCY PROCEEDINGS

During 2018 and the first six months of 2019, several large plenary insolvency proceedings determined the press landscape. The following are the most interesting examples.15

i NIKI Luftfahrt GmbH

This has been one of the most widely followed and discussed insolvency cases.16 NIKI Luftfahrt GmbH was an Austria-based airline limited liability company with more than 1,000 employees and more than €150 million of liabilities, which formed part of the German Air Berlin group. Following the opening of insolvency proceedings over the assets of Air Berlin in Germany and after the sale of NIKI to Lufthansa failed, NIKI also filed for insolvency in Germany in

11 See the detailed statistics for 2018 compiled by Kreditschutzverband 1870 (the largest Austrian association for the protection of creditors) at https://www.ksv.at/media/940/download (accessed on 3 July 2019). There was also a record rate of private insolvency proceedings in 2018 because of a recent change in legislation.
12 Around 2,000 of them were not opened because of a lack of cost-covering assets.
13 Around 1,000 of them were not opened because of a lack of cost-covering assets.
14 See the detailed statistics for the first six months of 2019 compiled by Kreditschutzverband 1870 at https://www.ksv.at/KSV1870_PA_Insolvenzstatistik_Unternehmen_HJ2019_HR (accessed on 3 July 2019).
15 The examples chosen do not address out-of-court restructurings that were also partly discussed in the media.
December 2017. NIKI was registered in the Austrian companies’ register and its corporate seat was in Austria. However, NIKI argued that its COMI was in fact in Germany because, among other things, its airline operations were handled by Air Berlin to a large extent.

Preliminary insolvency proceedings were opened in Germany and the preliminary German insolvency administrator sold most of NIKI’s assets (particularly slots) to IAG/Vueling after an exciting bidding process during the Christmas holidays. IAG/Vueling also granted post-commencement financing. Before the closing of this sale, an Austrian creditor challenged the decision of the German insolvency court to open preliminary proceedings in Germany and filed for the opening of main insolvency proceedings in Austria. The creditor argued that the COMI of NIKI was in fact in Austria.

In January 2018, the German court of appeal confirmed the creditor’s argumentation and, a few days later, main insolvency proceedings were opened in Austria. This was particularly controversial as there was still the possibility of an appeal being filed against the decision of the court of appeal in Germany. However, the Austrian competent judge argued that there was no German proceeding any more and therefore considered himself competent to open main insolvency proceedings in Austria. So as not to jeopardise a possible sale of NIKI’s business, the parties refrained from starting a complex court dispute but found a practical solution instead. The main insolvency proceedings in Austria therefore continued and the German insolvency proceedings were modified into secondary insolvency proceedings.

The Austrian main insolvency administrator and the German secondary insolvency administrator then started a second bidding process and finally sold most of NIKI’s assets to Laudamotion (a new airline established by the Austrian entrepreneur Niki Lauda, the initial founder of NIKI). The insolvency proceedings in Austria and Germany are still pending.

This insolvency showed in particular the challenges connected with cross-border insolvencies. Proceedings are still running as the administrator has to work through several issues and assess possible claims to several stakeholders.

**ii Waagner Biro**

The insolvency of the Waagner Biro group was the largest in 2018, with liabilities amounting to €194.1 million. Founded in 1854, Waagner Biro is one of the most traditional Austrian businesses and is best known for its involvement in spectacular projects such as the Louvre Abu Dhabi, the Reichstag dome in Berlin, the Sydney Opera House and the Elbphilharmonie in Hamburg. The group, which employed around 1,500 people, fell into difficulties mainly because of two major projects: in particular, the steel construction at the Louvre Abu Dhabi caused problems because of withheld payments; and the construction of the new Gazprom headquarters in St Petersburg also resulted in losses.17

In total, four members of the Waagner Biro group (Waagner-Biro AG, Waagner Biro Stahlbau AG, Waagner Biro Bridge Systems AG and WBB Stahl- und Maschinen Bau GmbH) filed for insolvency in October and November 2018 (two bankruptcy proceedings and two restructuring proceedings without self-administration).

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The initial restructuring proceedings of Waagner-Biro AG were converted into bankruptcy proceedings and subsequently the main subsidiaries held by Waagner-Biro AG were sold. The restructuring plan of Waagner-Biro Bridge Systems AG also failed at first and the subsidiary was to go bankrupt. However, investors were found and another restructuring plan was submitted. The improved restructuring plan was accepted by the creditors, thus ensuring the continued existence of Waagner-Biro Bridge Systems AG.

The bankruptcy proceedings against Waagner-Biro AG, Waagner Biro Stahlbau AG and WBB Stahl- und Maschinen Bau GmbH are still pending.

This insolvency shows how fragile and vulnerable even traditional and arguably successful businesses can be when it comes to unexpected difficulties in ongoing projects.

### Wienwert

In March 2018, the Wienwert group, a large real estate group with investments in several renowned real estate projects, had to file for insolvency (in fact, a total of 13 separate bankruptcy proceedings). The group was mainly financed by bonds issued to more than 900 bondholders (many of them retail) in the amount of around €35 million. These bondholders may lose all their investment as the issuance was structured in a way that the bondholders did not receive security on the real estate itself.

The public prosecutor’s office investigated the role of the (former) founders and management of the group (among others, regarding accounting fraud) especially in relation to the bond issuances. In April 2019, the insolvency administrator filed lawsuits against the auditors, tax consultants and management consultants of Wienwert in the total amount of around €14 million at the Vienna Commercial Court. The administrator argued that the real estate group became insolvent largely because of breaches of duty and culpable conduct by all the defendants; this led to a delayed insolvency and caused a quota damage to the creditors. The defendants deny the administrator’s argumentation.

To allow a bundled representation of interests of bondholders, the insolvency court appointed trustees who are also part of the appointed creditors’ committee.

These proceedings show the immense importance of the acting persons and advisers in pre-insolvency situations as well as the risks they face.

### Alufix

Alufix is an Austrian company that produces foils, baking paper and refuse sacks for households, restaurants and businesses. The company experienced payment difficulties after a cost-intensive expansion in eastern Europe, which was followed by increasing price pressure and declining sales.
On 7 March 2019, Alufix applied for restructuring proceedings without self-administration. Around 250 creditors and 170 employees filed claims amounting to €53.6 million, which were approved by the administrator in the amount of €41 million. In terms of liabilities, this was the largest insolvency in Austria in the first quarter of 2019.

At the sanctioning hearing on 13 June 2019, the creditors accepted the restructuring plan, which provides for a quota of 20 per cent in four instalments within two years. A predominantly Upper Austrian consortium finally took over the insolvent company, saving the jobs of around 170 Alufix employees.

This insolvency shows how Austrian insolvency law in the best case allows the debtor to return to normal business within three months. Within this time, the business found new investors, was financially restructured by achieving a 80 per cent debt haircut, and operationally restructured by taking advantage of eased termination rights, shutting down unprofitable business parts, among other things.

Charles Vögele

The insolvency of the fashion chain Charles Vögele is particularly remarkable because the company had to file for insolvency twice within one year.21

In autumn 2018, the creditors had agreed to a restructuring plan offering a 20 per cent cash quota, which was distributed to the creditors by the insolvency administrator. At that time, Vögele was discharged from all its unsecured liabilities arising from the period before the opening of its first proceedings. Soon afterwards, however, as a result of a failed partnership with the strategic investor, the supply of goods for the remaining 57 stores could no longer be ensured to the extent required. Therefore, bankruptcy proceedings were opened on 3 May 2019 with the aim of winding up the company. The bankruptcy proceedings affect 394 employees, about 250 creditors and around €21.1 million of liabilities.

This shows that even the financial restructuring of a business may not guarantee its long-term success if the operational prerequisites are not secure.

IV ANCILLARY INSOLVENCY PROCEEDINGS

Ancillary insolvency proceedings do not have a major role in Austria. The best-known example of a cross-border insolvency in which the main and the ancillary proceedings opened in different Member States is the NIKI Luftfahrt GmbH case.

V TRENDS

As the Austrian economy is predicted to remain stable or continue to grow, it is not expected that the insolvency landscape will change substantially within the next year.

Existing legislation is regularly evaluated but, for now, no changes are envisaged. The harmonisation efforts discussed at an EU level (the recently adopted Directive on restructuring and insolvency) have led to a further dynamic in the respective working groups as it will have to be assessed how to implement the Directive into Austrian law. A first ministerial draft of the law is expected in 2020 with – from a current perspective – a very open outcome.

Chapter 3

BERMUDA

John Wasty, John Riihiluoma, Lalita Vaswani and Sam Riihiluoma

I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

Bermuda is an overseas territory of the United Kingdom and its legal system is based on English common law, which comprises statute and case law. Decisions of the English courts are not binding on a Bermuda court, but they are highly persuasive. However, in general, the decisions of the Privy Council are binding on the Bermuda courts unless they are based on a reference from a jurisdiction with significantly different statutory provisions. The Privy Council is Bermuda’s highest appellate court and sits in London. Bermuda’s Commercial Court, a division of the Supreme Court of Bermuda, hears matters relating to insolvency.

The principal statutory provisions governing corporate insolvency and restructuring are contained in Part XIII of the Companies Act 1981 (the Companies Act) and are supported by the Companies (Winding-Up) Rules 1982. The former is based on the UK Companies Act 1948 and the latter are based on the UK Companies (Winding-Up) Rules 1949.

At the heart of Bermuda insolvency law is the *pari passu* treatment of unsecured creditors, that is to say, when a company does not have sufficient assets to satisfy its debts to unsecured creditors, each unsecured creditor would receive an equal distribution on a rateable basis according to the quantum of their claim.² Secured creditors are unaffected by insolvency proceedings in Bermuda and may enforce their security in accordance with the terms of the governing security instrument³ (although they have standing to present winding-up petitions).

The Companies Act provides for challenging certain transactions executed by insolvent companies through avoidance or clawback provisions, which includes the avoidance of preferential payments to creditors and transactions at an undervalue. The Companies Act also provides remedies for fraudulent trading and dispositions of company property after the commencement of the winding up.

ii Policy

Bermuda is a creditor-friendly jurisdiction. A key feature of the insolvency regime is the Supreme Court’s development of a rescue culture. When a company is insolvent, rather than making a winding-up order immediately upon hearing the petition, the Supreme Court often

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1 John Wasty is a partner, John Riihiluoma is a senior counsel, Lalita Vaswani is a senior associate and Sam Riihiluoma is an associate at Appleby.

2 Certain amounts due to employees have preferential status.

3 The stay of proceedings that occurs when a winding-up order is made does not prevent secured creditors from exercising their rights under validly created security.
appoints provisional liquidators on a soft or light-touch basis. A provisional liquidator is an officer (typically an insolvency practitioner) for a limited purpose with clearly defined powers (known as light-touch powers) that may be used when there is a prospect of ‘rescuing’ an insolvent company through restructuring without the displacement of all executive functions of the board of directors. Restructurings are often achieved through a scheme of arrangement. In a soft liquidation, a company may continue its business operations as usual, pending the implementation of a restructuring plan.

Through the appointment of provisional liquidators with light-touch powers and the court’s broad discretion to determine the allocation of powers and responsibilities between provisional liquidators and company directors, the Bermuda courts continue to create lifelines for the healthy recovery of distressed companies and for the protection of creditor interests.

Another distinguishing element of the Bermuda insolvency landscape is the willingness of the Bermuda courts to work in tandem with and to lend assistance to the foreign courts and companies having interests in other jurisdictions where there is a substantial international creditor or asset base.

iii Insolvency procedures

The insolvency and rescue procedures available under Bermuda law are:

a liquidation under the supervision of the Bermuda court (also known as compulsory liquidation);
b provisional liquidation for the purpose of restructuring; and
c schemes of arrangement.

Liquidation under the supervision of the court

Typically, a creditor seeking to place a debtor into insolvent winding up in Bermuda will present a petition to the Supreme Court seeking such relief on the grounds that the company is unable to pay its debts, or it is just and equitable for the company to be wound up. Once appointed, the liquidator must obtain the sanction of the Supreme Court or the committee of inspection before taking certain actions. Upon the final distribution of the assets to the creditors or the members, the liquidator must obtain an order from the Supreme Court for its release and for the dissolution of the company.

If there is a risk that the company’s assets may be dissipated prior to the hearing of the petition, a provisional liquidator may be appointed on an ex parte basis to take control of the assets. This form of provisional liquidation is contrasted with provisional liquidation on a soft or light-touch basis (discussed in the following subsection).

Provisional liquidation for the purpose of restructuring

When a company is insolvent, rather than making a winding-up order immediately upon hearing the petition, the Supreme Court often appoints provisional liquidators on a soft or light-touch basis. Authority for provisional liquidators with light-touch powers is not found in the Companies Act or any other legislation, but rather in the Bermuda common law. The Bermuda courts have used provisional liquidation as a tool to restructure the affairs of a company, preserve value in a business and to provide a platform for distressed companies to recover – which together promote the sustainability and success of cross-border business.

The provisional liquidators are subject to the supervision of the Bermuda court and they would typically provide periodic updates to the court on the status of a restructuring in the form of reports.
### Schemes of arrangement

A scheme of arrangement is the only court-supervised reorganisation procedure in Bermuda, provided for in Sections 99 and 100 of the Companies Act. A scheme of arrangement may be initiated by a company, any member or creditor of a company or, where applicable, a liquidator who has been appointed in relation to a company. A proposed scheme must represent a compromise or arrangement between a company and its creditors or members, or any classes thereof.

Proceedings are started by applying to the Supreme Court for directions to convene meetings with the various classes of creditors or shareholders (or both) who will be affected by the scheme's proposals. Once the meetings have been convened, a further application is made to the Supreme Court to approve the scheme.

Classes of creditors are determined by the requirement for a class to be confined to those persons whose rights (as affected by the proposed scheme) are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.

For a scheme to be presented to the Bermuda courts for sanction, a majority in number representing 5 per cent in value of the creditors or members present, and voting either in person or by proxy at each creditors' or members' class meeting, as the case may be, must approve the scheme.

Cram up or cram down (as those terms are generally understood in reorganisation proceedings) of a scheme of arrangement on to any dissenting class of creditors or members is not permitted in a Bermuda scheme of arrangement. To the extent that any single class of affected creditors or members fails to approve a scheme of arrangement by the requisite majority, the scheme will fail completely.

### iv Starting proceedings

Statutory winding-up proceedings can be commenced by any one or more of the following:

- the company itself;
- creditors, including any contingent or prospective creditors. However, the court will not give a hearing to a winding-up petition presented by a contingent or prospective creditor until (1) security for costs has been given and (2) a *prima facie* case for winding up has been established;
- contributories, subject to certain restrictions; and
- the regulator (if applicable).

A winding-up proceeding is started by filing a winding-up petition with the Supreme Court of Bermuda supported by a standard form affidavit verifying the contents of the petition. Once the Supreme Court fixes a date for the hearing of the petition, the petition must be served on the company at its registered office. Before the hearing, the petitioner must obtain a certificate of compliance from the Registrar of the Supreme Court certifying that the petition is ready for hearing because it has been properly filed, served and advertised in an appointed newspaper.

Those intending to appear at the hearing of the petition, including those who wish to oppose the petition, are required to provide advance written notice to the petitioner within a prescribed time limit, failing which they require special leave of the Supreme Court to appear at the hearing.
On hearing a winding-up petition, the Supreme Court may grant, dismiss or adjourn the petition, or make any other order it thinks fit. It is unlikely that the Supreme Court would grant a stay of winding-up proceedings, save in exceptional circumstances. However, the Supreme Court regularly adjourns winding-up petitions.

It is now well established that adjournments can be granted to facilitate a proposed restructuring by provisional liquidators who may be appointed under Section 170 of the Companies Act 1981. This is where the court is satisfied that a restructuring will produce a better result for creditors than a winding up. As stated by the Hon. Mr Justice Kawaley in Z-Obee Holdings Ltd: ‘This provision has for almost 20 years been construed as empowering this Court to appoint a provisional liquidator with powers limited to implementing a restructuring rather than displacing the management altogether pending a winding-up of the respondent company.’ Benefits of this approach include the stay of proceedings against the company triggered by the appointment of provisional liquidators and independent oversight of the restructuring by court officers focused on protecting creditor interests.

Case law contains guidance in relation to how a court exercises its discretion to grant an adjournment: the views of the majority of unsecured creditors ordinarily hold considerable weight and the court will consider whether the proposed restructuring has a reasonable prospect of success.

### v Control of insolvency proceedings

The Supreme Court orders the winding up of a company by one or more liquidators when it grants a winding-up petition. Liquidators are officers of the Supreme Court and, accordingly, under the supervision of the Supreme Court. They are commonly appointed from accountancy firms. If nobody else is appointed, the Official Receiver, a public officer, acts as liquidator. Following the making of a winding-up order, the Supreme Court’s role is primarily supervisory. Liquidators can return to the Supreme Court for directions regarding any particular matter arising in the winding up and they require approval of either the court or committee of inspection before exercising certain of their statutory powers, such as deciding to bring or defend legal proceedings on behalf of the company.

In directing insolvency proceedings, the Supreme Court will be guided by the main purpose of its winding-up jurisdiction, namely, protecting the best interests of the general body of unsecured creditors.

When the Supreme Court winds up a company and appoints liquidators, the board of directors becomes functus officio. This should be distinguished from the situation when the court adjourns the winding-up petition and appoints provisional liquidators to facilitate a restructuring (as discussed above). In the latter case, the Supreme Court may, in appropriate circumstances, reserve powers of management to the existing board for the purpose of implementing a restructuring and give the provisional liquidators light-touch powers to monitor the board. For example, it is necessary to keep the directors in place when a company is subject to proceedings under Chapter 11 of the US Bankruptcy Code and parallel proceedings in Bermuda, because Chapter 11 requires a debtor in possession – meaning the directors.

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5 Up Energy Development Group Ltd [2018] SC (Bda) 76 Civ.
vi Special regimes

The Companies Act 1981 is applicable to the insolvencies or restructurings of all corporate entities in Bermuda, save to the extent that its provisions are amended by other legislation that applies to specific types of corporate entities, including the Insurance Act 1978 (for licensed insurance companies), the Segregated Accounts Companies Act 2000 (for licensed segregated accounts companies) and, once in force, the Banking (Special Resolution Regime) Act 2016 (for licensed banks).

Under the Insurance Act 1978, a liquidator is required to carry on the long-term business of an insurer with a view to it being transferred as a going concern to another insurer, unless the court orders otherwise.

The Segregated Accounts Companies Act 2000 allows for the appointment of a receiver over the assets and liabilities of an insolvent segregated account; the Bermuda courts will direct the receiver to manage the segregated account for the purposes of the management, sale, rehabilitation, run-off or termination of its business, or distribution of assets.

There are no special insolvency rules relating to corporate groups. To achieve practical efficiency, insolvencies of a group of companies may occur at the same time. If this occurs, each company within the group is treated separately and is subject to separate legal proceedings. Assets of the companies within the group are not pooled for distribution, unless a scheme of arrangement has been approved or another consensual arrangement has been put in place between the group and its creditors.

vii Cross-border issues

The Supreme Court does not have jurisdiction to wind up an overseas company, save for certain statutory exceptions. Accordingly, it is generally not possible to obtain an ancillary winding-up order from the Supreme Court in respect of a company domiciled outside Bermuda. Thus, forum shopping ‘in Bermuda’ is not relevant. However, if the main insolvency proceedings are in Bermuda, liquidators appointed by the Supreme Court may commence ancillary insolvency proceedings in other jurisdictions that permit ancillary proceedings, such as Hong Kong or England. The Bermuda courts are willing to assist foreign courts where it has the common law power to do so. However, that power cannot be used to grant relief to a foreign liquidator in circumstances where the court in the country where the liquidation is taking place could not have granted such relief.

II INSOLVENCY METRICS

There is no information publicly available about companies restructuring their debts or defaulting.

During the course of 2018, Bermuda witnessed 14 compulsory winding-up petitions, 10 of which converted into court orders. It looks likely that a similar level will be achieved in

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7 Singularis Holdings Limited v. PricewaterhouseCoopers [2014] UKPC 36. The Supreme Court of Bermuda could not order production of information to the liquidator appointed in Cayman when no equivalent order could have been made by the Cayman court.
2019 – there have been seven petitions to date, at the time of writing. Petitions in Bermuda that do convert generally do so in a swift and orderly fashion, with many being processed within a month, which is quicker than anywhere else in the offshore region.

There are cases currently pending in which a Bermuda company is subject to insolvency proceedings outside Bermuda and parallel proceedings in Bermuda but, as has been discussed, the Supreme Court does not have jurisdiction to wind up foreign companies and so Bermuda is not an ‘ancillary jurisdiction’ in a true sense. There are no reported cases in the past 12 months involving the Bermuda courts assisting, or being called upon to assist, foreign liquidators.

III PLENARY INSOLVENCY PROCEEDINGS

i Noble Group
Noble Group Ltd was registered and incorporated in Bermuda. Its shares were listed on the Singapore Stock Exchange. It was the holding company of a group that was a major global commodity trader, with hubs in London, Hong Kong and Singapore. It ran into financial difficulty because of a worldwide decline in commodity prices, resulting in a default on its main financial obligations. Its pre-restructuring debt exceeded US$3 billion (unsecured). The company’s directors originally sought to achieve a restructuring by entering parallel schemes of arrangement in England and Bermuda. Prior to presenting the English scheme, the company took steps to shift its centre of main interest from Hong Kong to England, including by moving its main office to London. The English and Bermuda schemes were approved by an overwhelming majority of scheme creditors in November 2018, following which the US Bankruptcy Court for the Southern District of New York granted recognition of the scheme in the United States via Chapter 15 of the US Bankruptcy Code. Shortly afterwards, however, the Singaporean authorities blocked the transfer of the company’s listing on the Singapore Stock Exchange to the restructured company (or new co) created under the scheme because of ongoing investigations of the company and one of its subsidiaries. Against this background, the company’s directors had to pursue the restructuring using Bermuda-appointed provisional liquidators with light-touch powers. The provisional liquidators were granted sufficient latitude to implement the transfer of the company’s assets to the new co provided that the scheme creditors were not prejudiced, even if that meant the new co would no longer have a listing on the Singapore Stock Exchange as previously envisaged. The new co is now fully operational.

Provisional liquidators with light-touch powers would normally be appointed, if at all, prior to the proposal of a scheme of arrangement. Thus, when the Supreme Court of Bermuda appointed provisional liquidators over the company after the approval of the scheme in a company-driven restructuring, this was an innovative and welcome development. In practical terms, this decision allows the company’s plans for restructuring its business operations to come to fruition, albeit with modified terms. Had the Bermuda court not appointed a provisional liquidator for the purpose of a restructuring, the company would have undergone a compulsory liquidation, meaning its business would have come to an end and its creditors would have received a significantly smaller dividend.

ii Up Energy Development Group Ltd
Up Energy Development Group Ltd is a Bermuda-registered company, publicly listed on the main board of the Hong Kong Stock Exchange. The company is an international energy
investment group based in China. It is principally engaged in mining, producing and selling coking coal. At the Supreme Court hearing, it was reported that the company held a large interest in a Canadian coal mining company, whose operations had been suspended, and interests in a coal coking facility operating at less than 50 per cent and three coal mines in the pre-production development stages.\(^8\)

Credit Suisse AG, Singapore Branch, petitioned the Court for the winding up of the company in May 2016. This was the culmination of a long-standing dispute between the petitioner and the chief executive officer of the company, who is also the ultimate beneficial owner of the company. The petitioner has an undisputed debt of HK$150 million under matured convertible notes. Also in 2016, HEC Securities Limited sought to wind up the company in the High Court of Hong Kong on the grounds of an unpaid debt in the form of a matured convertible note for HK$230 million. The petitioning creditors in Bermuda and Hong Kong, however, do not represent the majority of creditors, and stakeholders have disagreed regarding the direction of the insolvency proceedings.

In July 2016, Credit Suisse sought the appointment of provisional liquidators to oversee the restructuring. This was opposed by the company on the basis that, among other things, the company had already retained independent restructuring advisers and a provisional liquidation may be misunderstood in Asia. The Bermuda court felt that a case for the appointment of provisional liquidators had not been made because there was no evidence of any misconduct on the part of management and there seemed to be significant creditor support for there to be no appointment. The Bermuda court sought to fill the gap in independent monitoring by requiring the company to attempt to form an informal creditors’ committee. Credit Suisse subsequently renewed its application for the appointment of provisional liquidators to oversee the restructuring being pursued by the directors, complaining that the restructuring was moving too slowly and that appointing provisional liquidators was necessary given conflicting interests among creditors and ‘information black holes’ about the company’s financing. The Bermuda court granted Credit Suisse’s application, emphasising that it was preferable for the restructuring to be supervised by provisional liquidators having statutory powers and not an ad hoc out of court company-directed process – and that this practice was so entrenched in Bermuda that all stakeholders have a legitimate expectation of provisional liquidators being appointed to monitor an insolvent restructuring. A practical benefit of this approach was that provisional liquidators appointed by the Bermuda court, acting as officers of the Bermuda court and agents of the company, would be able to access all relevant information, review it and report to the court.

The Supreme Court has allowed the company to remain in provisional liquidation for more than three years to afford it the opportunity to present a scheme of arrangement to its creditors during the latter part of 2019.

### iii Seadrill

Seadrill Limited was registered and incorporated in Bermuda. It was one of the world’s largest offshore drilling companies but ran into financial difficulty as a result of the knock-on effects of the downturn in the oil market, a resulting decline in revenue forecast in the short to medium term and a series of debt maturities running from 2016 to 2020.

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\(^8\) In the Matter of Up Energy Development [2016] SC (Bda) 83 Com (20 September 2016).
Seadrill and two subsidiaries, Sevan Drilling Ltd and North Atlantic Drilling Ltd, filed for (voluntary) Chapter 11 Bankruptcy Protection in the Bankruptcy Court of Houston, Texas to serve as a platform for restructuring the Group as a response to the liquidity challenges. The following day, a parallel Bermuda winding-up proceeding was commenced and the appointment of provisional liquidators with light-touch powers was granted by the Bermuda court.

The order appointing the provisional liquidators empowered them, *inter alia*, to review the financial position of the company, to oversee the continuation of the business of the company under the control of the company’s board of directors and to oversee, in conjunction with the board of directors, the Chapter 11 proceedings and any such proceedings as deemed appropriate by the company after consultation with the provisional liquidators. One of the primary benefits of commencing parallel proceedings was to ensure that all proceedings against the company were stayed, pending the determination of a restructuring solution and to prevent issues being determined in the US court to be re-litigated in Bermuda.

The provisional liquidators worked with the company to develop a viable restructuring plan for the Seadrill Group, which was presented to the US bankruptcy court pursuant to a Chapter 15 application for approval. This plan contemplated the negotiation of settlements, the grant of new capital and reprofiling Seadrill’s capital structure. The US order approving the restructuring plan was subsequently presented to the Bermuda court for recognition, which was successfully obtained.

Seadrill is considered to be one of the most successful and complex cross-border restructurings. This case also demonstrates the willingness of the Bermuda’s Supreme Court to cooperate with foreign jurisdictions (and, where possible, align its insolvency processes to the extent possible) to provide a platform for failing businesses to recover and to support cross-border business.

**IV ANCILLARY INSOLVENCY PROCEEDINGS**

The Supreme Court does not have jurisdiction to wind up foreign companies and so Bermuda is not an ‘ancillary jurisdiction’ in a true sense. There are no reported cases in the past 12 months involving the Court assisting, or being called upon to assist, foreign liquidators.

**V TRENDS**

The Bermuda insolvency and restructuring practice is at an interesting juncture. With increased regulation across the financial services industries (particularly insurance), the organic development and evolving flexibility of provisional liquidation on a light-touch basis, and the absence of statutory provisions governing provisional liquidation, the Bermuda courts will be required to conduct an important balancing act when considering, in particular, the competing interests of creditor rights against the need to have deterrence-based regulation, as well as the costs of prolonged provisional liquidation against the prospects of a successful restructuring. While the courts have allowed provisional liquidation to evolve into a malleable tool that has a vital role in cross-border business, it is anticipated that the courts may in due course start defining the boundaries and scope of provisional liquidation in a clearer and more systematic manner.
I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

General

Several statutes regulate insolvency and bankruptcy proceedings in Brazil. The most prominent legislative instrument is the Bankruptcy and Reorganisation Act, which regulates bankruptcy, judicial reorganisation and extrajudicial reorganisation proceedings applicable to companies, whether they are limited liability companies, publicly traded stock corporations, private stock corporations or sole proprietorships – with the exclusion of companies controlled by the government.

The purpose of bankruptcy proceedings is to liquidate a company’s assets and distribute the proceeds to its creditors, used as a last resort in the case of severe financial hardship. In turn, judicial and extrajudicial reorganisation proceedings are intended to streamline a company’s debt structure, allowing it to preserve its business, retain its workforce and continue to pay taxes. Judicial reorganisation proceedings are entirely carried out under the control and supervision of the bankruptcy court and the judicial administrator, whereas extrajudicial reorganisation proceedings are the result of direct negotiations with each creditor, culminating in the submission of a prearranged reorganisation plan for court approval.

The Bankruptcy and Reorganisation Act was inspired by Chapter 11 of the US Bankruptcy Code, but with numerous adaptations. For instance, under Brazilian law, only the debtor may officially submit a reorganisation plan, and not its creditors. It is also important to note that Brazilian law provides for a system that is concerned primarily with the preservation of the company, which may at times be contrary to the creditors’ interests.

Other insolvency proceedings for specific persons are provided for by various other legislation:

a insolvency for natural persons is governed by certain provisions in the Brazilian Civil Code and the still effective provisions of the revoked Brazilian Code of Civil Procedure;
b bankruptcy proceedings for limited liability companies are provided by the Brazilian Civil Code; and

c stock corporations are liquidated in accordance with the Stock Corporations Act.⁵

The scope of this chapter is limited to addressing bankruptcy and reorganisation proceedings in a more comprehensive manner, rather than approaching several subjects without the necessary depth.

**Main effects of bankruptcy and reorganisation proceedings**

There are certain consequences to the commencement of bankruptcy or judicial reorganisation proceedings. The declaration of bankruptcy or the admittance of judicial reorganisation generate the following effects:

- **a** the appointment of a judicial administrator who undertakes the role of examiner and court assistant, supervising the debtor's activity and reviewing the creditors' accounts. In bankruptcy proceedings, the judicial administrator also takes possession of the company's administration and liquidates the assets;

- **b** the stay of legal actions and enforcement proceedings against the debtor for 180 days, except for tax claims, actions that demand an illiquid amount and judicial proceedings concerning claims that are not affected by the debtor's bankruptcy or judicial reorganisation; and

- **c** with respect to tax collection claims and claims that are not affected by a debtor's bankruptcy or judicial reorganisation, the seizure of the debtor's assets or any judicial proceedings that may interfere with the debtor's possession of assets that are essential to the continuity of the business activity are suspended and subject to the bankruptcy court's assessment.

In bankruptcy proceedings, the judicial administrator may choose to satisfy existing contracts if they are financially viable to the estate and may possibly benefit the company as a going concern, maximising its value. In judicial reorganisation proceedings, all existing contracts are normally fulfilled by the company's management, unless they are beyond its economic capacity. In both cases, there is controversy regarding the possibility of the other party terminating the contract based on an *ipso facto* provision, with scholars recognising that such a provision is void and case law analysing the singularities of each situation to determine whether to nullify this provision.

In judicial reorganisation proceedings, the sale of assets by the company's management is restricted. The sale of fixed assets after the filing requires either the authorisation of the bankruptcy court or a specific provision in the reorganisation plan, to be approved by the creditors.

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Creditors’ claims in insolvency proceedings

Brazilian bankruptcy law provides for particular treatment in respect of secured and unsecured claims. Secured claims may be divided into two categories:

a. claims held by creditors with property interests that are in the possession of the debtor, such as chattel mortgage and capital or operating leases. These claims are not affected by bankruptcy or judicial reorganisation proceedings; and

b. claims that are secured by certain assets of the debtor’s estate, such as pledges and mortgages. These claims are affected by bankruptcy and reorganisation proceedings:
   • in bankruptcy, the creditor is entitled to the satisfaction of his or her claim with the earnings from the sale of the secured asset; and
   • in judicial reorganisation, the creditor may be subject to a haircut, a deferral of payment or even the suppression of the security, if approved by the creditors.

Unsecured claims are classified as follows:

a. claims arising from the labour legislation or resulting from work-related accidents, with the highest priority in bankruptcy and judicial reorganisation;

b. tax claims, administrative fines and other penalties imposed by government entities. These claims are subject to bankruptcy, but not to judicial reorganisation proceedings;

c. claims with special and general privileges established by law;

d. claims that have no preference or privilege whatsoever. This class usually encompasses the vast majority of claims in bankruptcy or judicial reorganisation proceedings; and

e. subordinate claims, which arise from contractual agreements or legal provisions, or are held by creditors who are also shareholders, partners or executives without an employment relationship.

Unsecured claims are affected by bankruptcy and are discharged with the proceeds from the sale of the estate’s assets. In judicial reorganisation, too, all these claims are affected, except for tax claims. Certain other claims are unimpaired by bankruptcy or judicial reorganisation proceedings, such as administrative expenses, post-petition claims, advances on foreign exchange contracts and certain bank loans relating to export finance.

ii. Policy

The main purpose of judicial reorganisation proceedings is to protect the company and stimulate economic activity, providing the debtor with the tools needed to overcome its economic and financial crisis, to maintain the production source, the employment of workers and the interests of creditors. Usually, a company will only be admitted into judicial reorganisation if it demonstrates its economic viability. Once a company is considered viable, all efforts are made to preserve it and ensure its continuity.

Although it is recommended that companies resort to judicial reorganisation at the first sign of financial hardship, it is not uncommon for companies to use this instrument as a way to postpone bankruptcy, dragging creditors and stakeholders down a long and tortuous road paved with little economic activity, plummeting revenue and even more debt.

However, extrajudicial reorganisation is a measure used by companies that intend to limit the reputational troubles caused by the filing of a judicial reorganisation. By nature, it is an agreement achieved by direct negotiation with certain creditors – commonly the most important and relevant creditors. The result is an extrajudicial reorganisation plan that is submitted to the bankruptcy court for validation. For a long time since the enactment of
the Bankruptcy and Reorganisation Act, this instrument was seldom used by companies owing to the lack of legal discipline, legal studies and case law; only recently has extrajudicial reorganisation gathered interest from companies undergoing financial difficulty.

Finally, the main objectives of bankruptcy proceedings are to maximise the value of assets and liquidate the company, using the proceeds from the sale to pay the company’s creditors. Whenever possible, the judicial administrator will sell the company as a whole, transferring to the buyer all, or most of, the assets, the workforce and existing contracts. This allows the business to continue, without the responsibility of paying the estate’s creditors, which will receive the gains from the sale in the order of priority.

### iii Insolvency procedures

#### Extrajudicial reorganisation proceedings

Considering its transactional nature, extrajudicial reorganisation proceedings begin with the company submitting a reorganisation plan to the bankruptcy court for validation. Alongside the reorganisation plan, the company must present a commitment term for each creditor that approves the plan. If all creditors encompassed by the plan approve it, the bankruptcy court may validate the plan, as long as it fulfils the other legal requirements. However, the plan may be validated if at least three-fifths of the encompassed creditors approve it, in which case the plan will bind the remaining creditors that did not approve it.

Once the plan is presented to the court, the bankruptcy judge shall order the release of a public notice so that all creditors may submit their objection, if any, including those that are not affected by the extrajudicial reorganisation plan. With the resolution of any potential objection, the bankruptcy court must validate the plan, after which it will start taking effect.

It should be emphasised that not all claims may be impaired by the extrajudicial reorganisation plan, such as labour-related claims, tax claims, claims held by creditors with property interests that are in possession of the debtor, advances on foreign exchange contracts and certain bank loans relating to export finance.

#### Judicial reorganisation proceedings

In judicial reorganisation proceedings, the debtor remains in possession of its business, maintaining shareholders’ powers and prerogatives, barring a few occasions when the bankruptcy court, its creditors and even the debtor may replace the company’s management. When a company is under financial duress, it may file for judicial reorganisation hoping to stay any payments to its creditors and renegotiate its debts.

At the time of filing, there is no judicial reorganisation plan and there are usually very few ongoing negotiations with creditors. Once the petition is filed, all existing claims, except for those mentioned previously, are subject to the effects of judicial reorganisation and any payments regarding such debts are halted. These claims will be paid in accordance with the provisions of the judicial reorganisation plan and may suffer a haircut, have lower interest rates and longer payment schedules, for example.

The Bankruptcy and Reorganisation Act requires the following of a company that is filing for judicial reorganisation:

a  the petition must explain the causes of the company’s financial hardship and the grounds for restructuring;

b  the company must submit financial statements for the current year and the past three years, its cash flow report and projection, and its bank statements;

c  the petition must also be accompanied by a list of creditors and employees;
the controlling shareholders and management must provide a list of their private assets; and

c the company must present a list of any existing protests of titles and legal actions.

The request is reviewed by the bankruptcy court and, if all legal requirements are fulfilled, the company is admitted into judicial reorganisation. A judicial administrator is appointed, but it does not hold managing powers; it works as a court examiner, reviews the list of creditors, provides an independent evaluation of the debtor's accounts and is heard on almost every subject regarding the proceedings. At the same time, legal actions and enforcement proceedings against the debtor are stayed for 180 days, and there is a suspension of the statute of limitations.

Although much of the debtor's corporate information becomes public after the filing, the judicial reorganisation proceeding does not interfere with the company's day-to-day matters, considering that the debtor is still running the business and relatively free to make business-oriented decisions. It must ask the court's permission to sell fixed assets but does not need any previous authorisation to run the business as a whole.

After the company is admitted into judicial reorganisation, its management and executives negotiate the terms of the reorganisation plan with its main creditors and submit the plan for discussion and voting at the general creditors' meeting, if need be. The plan is filed by the debtor before the general creditors' meeting, and the creditors may present an objection to the plan before the vote. Although the Bankruptcy and Reorganisation Act provides that only the debtor may submit a reorganisation plan to the creditors, it is common for creditors to submit modifications to the plan at the general creditors' meeting, to be reviewed, discussed and voted by the creditors – however, any changes need to be approved by the debtor before they can replace the original plan's provisions.

The means of reorganisation that serve as a foundation for the company's recovery are listed by the Bankruptcy and Reorganisation Act, but not to the exclusion of other possible means of rehabilitation. The following are only examples of the methods used most often:

a modification of the contractual framework, which may include an extension in the payment schedule, an equalisation of financial charges and interest rates, and, most often, a haircut on the face value of the claims;

b the sale of assets, be it a partial sale of the company's assets, a lease or the sale of a complete isolated productive unit;

c a conversion of debt to equity in the company; and

d corporate restructuring, with a transfer of the company's control, a total or partial spin-off, a merger consolidation, or, simply, the replacement of its executives.

If none of the creditors opposes the reorganisation plan presented by the debtor, the court will grant the company's judicial reorganisation. However, if at least one creditor objects, a general creditors' meeting must be held to discuss and vote on the plan. There are two possible outcomes from this: if the plan is approved (by double majority – heads and volume of claims), the bankruptcy court simply confirms the plan; if the plan is rejected, the bankruptcy court may allow the debtor to submit an alternative plan, declare the debtor's bankruptcy or confirm the plan through cramdown.

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6 The debtor must ensure that the plan is economically viable, presenting an economic and financial evaluation based on the company's assets and projections.
There are specific requirements that need to be met for a Brazilian bankruptcy court to confirm a reorganisation plan via cramdown: (1) approval of the plan by creditors representing more than half the value of all claims present in the meeting, regardless of class; (2) approval of two classes of claims, or at least one class if there are only two classes; and (3) within the class that rejected the plan, the approval of at least one-third of its creditors.

The approval and confirmation of the reorganisation plan binds all creditors (whether they have approved the plan or not) and results in the novation of the impaired claims. The debtor must remain under supervision of the court and the judicial administrator for two years, after which it may request the court to terminate the judicial reorganisation proceeding, if all the plan’s obligations, within that period, are duly satisfied. If any obligations are defaulted, the bankruptcy court may declare the debtor’s bankruptcy, though recently courts have allowed for a debtor to submit an amendment to the plan for creditor approval, before declaring the company bankrupt.

**Bankruptcy proceedings**

With an order of bankruptcy, a judicial administrator is appointed to replace the company’s executives and management. The judicial administrator takes control of the company and seizes all its assets for liquidation at a later date. If the company still performs a business activity, the judicial administrator may choose to preserve it to generate more proceeds and maximise the value of the company’s assets when sold.

Following the seizure of the debtor’s assets, they are listed and evaluated by the judicial administrator. The evaluation may consider each asset individually (for instance, a piece of machinery inside a factory) or bundled together in an isolated productive unit (the factory and everything needed for it to operate), whichever generates more resources to pay the creditors.

Once the assets have been evaluated, the judicial administrator moves on to the judicial sale of the assets, under the bankruptcy court’s supervision. There are three different procedures that may be adopted: (1) a public auction of the assets; (2) a sale through sealed proposals, in which the bids are submitted to the bankruptcy court and are opened by the judge and judicial administrator on a designated day, time and place; and (3) a two-stage auction, with the submission of sealed proposals first, then an auction by oral bidding, in which only interested buyers who have submitted proposals of no less than 90 per cent of the highest bid may participate.

The winning bidder will acquire the property without any risk of succession of debts or other obligations originating from the asset or the debtor.

After the sale of assets, the judicial administrator shall distribute the proceeds to the creditors in accordance with the classification of their claims. If all creditors are paid in full (which is very unusual), the remaining balance is transferred to shareholders, pro rata. The judicial administrator then presents a report of its accounts to the bankruptcy court with all necessary documents, which the judge does or does not accept. If the accounts are not accepted, the judicial administrator is responsible for indemnifying the debtor against any damages caused. If the accounts are accepted, the judicial administrator submits a final report, and the court terminates the bankruptcy proceeding.

Notwithstanding, the debtor is only discharged of its obligations (1) if all claims are satisfied completely, (2) if at least half of the unsecured claims without preference or privilege have been paid, (3) five years after termination of the proceeding, if the debtor, its controlling
shareholder or its executives have not been convicted for committing a crime provided by the Bankruptcy and Reorganisation Act, and (4) 10 years after termination of the bankruptcy proceeding, in the case of conviction.

iv Starting proceedings

Judicial and extrajudicial reorganisation proceedings

Only a company may file for judicial or extrajudicial reorganisation (its creditors are not legally allowed to do so), and provided it:

a has been in activity for at least two years prior to the filing;
b has not been declared bankrupt or, if it has, was discharged by a final decision of the bankruptcy court;
c has not been granted judicial reorganisation in the previous five years;
d has not been granted special judicial reorganisation (for small business entities) in the previous eight years; and
e does not have an executive or manager who has been convicted of any crimes provided by the Bankruptcy and Reorganisation Act.

There are a few entities that are not encompassed by the Bankruptcy and Reorganisation Act and may not file for judicial or extrajudicial reorganisation, such as government entities, public or private financial institutions, credit unions, insurance companies, healthcare companies, supplementary pension companies, cooperatives, associations and natural persons.

A judicial or extrajudicial reorganisation proceeding may involve one company or a group of companies. As regards the latter, bankruptcy courts have allowed for a substantive consolidation (and not just a procedural consolidation) of the entire group, with all its assets responsible for satisfying all its debts, as if it were a single company. Thus, instead of an individual reorganisation plan for each company, separate lists of creditors and separate general creditors’ meetings, there is only one reorganisation plan, one list of creditors and one general creditors’ meeting.

Bankruptcy proceedings

The commencement of bankruptcy proceedings may be a result of a request from a debtor or one of its creditors. When a debtor files for bankruptcy, the petition must be accompanied by essential information and documents (much like a petition filed for judicial reorganisation):

a the company must submit a special financial statement (made exclusively for the bankruptcy petition), as well as financial statements for the past three years, a cash flow report and projection, and its bank statements;
b the company’s articles of incorporation, with the indication of its shareholders, their addresses and a list of their assets;
c a list of the company’s assets and properties, with estimated values and the necessary documents to prove ownership;
d a list of the company’s executives and management for the previous five years, their positions, their addresses and their equity interest in the company;
e an updated list of creditors; and
f the company’s books and accounts, as required by law.
A creditor has the burden of proof regarding a company’s insolvent state and the necessity for a declaration of bankruptcy by the court. A company’s insolvency may be proved by demonstrating that:

- without relevant reason, the company defaulted on an obligation corresponding to more than 40 minimum wages at the time of the request;
- in an enforcement procedure proposed by the creditor, the company did not pay its debt or did not offer any of its assets as attachment, within the legal time frame (what is commonly known as a frustrated enforcement procedure); and
- the company committed any of the following acts, among others, except in the case of judicial reorganisation:
  - a hasty liquidation of the company’s assets;
  - the fraudulent transfer of assets to third parties;
  - the transfer of the whole company without the consent of its creditors and without enough assets to satisfy its debts; and
  - a default on any obligation arising from the reorganisation plan.

However, the company may stay the bankruptcy proceeding if it deposits the amount owed, or if it files for judicial reorganisation, within the legal time frame for submitting its defence.

**v Control of insolvency proceedings**

Bankruptcy, judicial reorganisation and extrajudicial reorganisation proceedings are held before the bankruptcy court where the company’s main establishment is situated, or where the company conducts most of its business. In large cities, such as São Paulo and Rio de Janeiro, there are specialised bankruptcy courts, but in smaller cities, common civil courts hold jurisdiction.

The bankruptcy court has power to determine whether the company fulfils the requirements for its admittance into judicial or extrajudicial reorganisation; if the reorganisation plan meets the legal requirements and, with the approval of the majority of creditors, grants judicial reorganisation; analyses requests for bankruptcy and, if need be, declares a company bankrupt; and if the proceedings may be terminated.

It is also an attribution of the bankruptcy court to appoint a judicial administrator in the case of bankruptcy, or judicial reorganisation, and to oversee the proceedings. During the proceedings, the bankruptcy court holds hearings and decides on relevant matters involving the debtor’s assets and the creditors’ claims.

In turn, the judicial administrator appointed by the bankruptcy court performs different roles depending on the type of proceeding. In a judicial reorganisation, the judicial administrator supervises the debtor’s activities, draws up a list of claims based on the list submitted by the debtor and the declarations provided by the creditors, presents its opinion in matters relevant to the proceeding and prepares monthly reports. In a case of bankruptcy, the judicial administrator replaces the debtor’s management, initiates an inventory and evaluation of its assets, promotes the sale of the assets and pays the creditors, in accordance with their classification.
**vi  Special regimes**

Financial institutions and insurance companies are subject to extrajudicial intervention and bankruptcy proceedings undertaken by the Brazilian Central Bank and are regulated by Statute No. 6,024, dated 13 March 1974. However, the trustee appointed by the Brazilian Central Bank, with its authorisation, may commence a bankruptcy proceeding that is governed by the Bankruptcy and Reorganisation Act.

Electrical power companies, as public service providers, are governed by a special regime introduced most recently by Statute No. 12,767, dated 27 December 2012. The National Electrical Power Agency intervenes in the company in distress, and its shareholders propose a reorganisation plan for the Agency’s approval. However, this special regime is not applicable to the holding company, which is still subject to the Bankruptcy and Reorganisation Act.

**vii  Cross-border issues**

There is currently no legislation regarding transnational insolvency, ancillary proceedings and cross-border issues in Brazil. The Bankruptcy and Reorganisation Act adopts the principle of territorialism, which determines the jurisdiction of the country where the company’s assets are situated. In contrast, the principle of universalism (embraced by the UNCITRAL Model Law on Cross-Border Insolvency) asserts that insolvency proceedings should commence in the jurisdiction of the company’s centre of main interests and encourages cooperation between different countries.

Although Brazil has not yet passed an amendment to the Bankruptcy and Reorganisation Act based on the Model Law, case law has allowed for judicial reorganisation proceedings to encompass foreign companies, as long as they are part of a larger economic group with its centre of main interests in Brazil. Examples of this were the submission of foreign companies to the judicial reorganisation proceedings of Constellation Group,7 OGX Group,8 Sete Brasil Group,9 OAS Group10 and Oi Group,11 all carried out by bankruptcy courts in Brazil. Even without any provision in the Bankruptcy and Reorganisation Act regarding cross-border insolvency, Brazilian courts have cooperated with foreign courts and received their assistance when needed.

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8 OGX International GmbH and OGX Austria GmbH HSBC CTVM S/A incorporated in Austria.

9 Sete Holding GmbH, Sete International One GmbH and Sete International Two GmbH incorporated in Austria.

10 OAS Finance Ltd and OAS Investments Ltd incorporated in the British Virgin Islands and OAS Investments GmbH incorporated in Austria.

11 Oi Brasil Holdings Coöperatief UA and Portugal Telecom International Finance BV incorporated in the Netherlands.
II INSOLVENCY METRICS

Between 2004 and 2014, Brazil’s gross domestic product (GDP) has grown annually by an average of 3.72 per cent (with its peak reaching 7.5 per cent in 2010). However, after the beginning of Operation Car Wash in early 2014, Dilma Rousseff’s victory in the 2014 presidential election and the decline in market value of several commodities (particularly petroleum and iron ore), Brazil entered into a deep recession, with its GDP falling by 3.8 per cent in 2015 and by another 3.6 per cent in 2016.12

In roughly the same time frame, the economy’s base interest rate (SELIC) was raised by the Brazilian Central Bank from 7.25 per cent in 2013 to 14.25 per cent in 2015,13 in an attempt to slow down the rate of inflation (10.67 per cent in 2015).14 Unemployment rates skyrocketed from 4.8 per cent in 2014 to 13.7 per cent in early 2017.15

The economic crisis deepened with the revelation that several companies colluded with government officials in elaborate corruption schemes, involving state-controlled companies, to divert funds from government contracts. This worsened the political climate and culminated with President Dilma Rousseff’s impeachment in mid 2016. The presidency was handed over to Vice President Michel Temer, who took power with a discourse of financial austerity and plans to reinvigorate the economy, with the renewal of the economic cabinet. Markets responded well and the Brazilian Stock Exchange rose from 51,804 points on 13 May 2016 to 87,652 points on 26 February 2018, even though President Temer was implicated in the large corruption scheme unearthed by Operation Car Wash on 17 May 2017 (which caused the Brazilian Stock Exchange to plunge 8.8 per cent in a single day).16

In the 2018 election, Jair Bolsonaro was elected president with a liberal economic agenda led by Economy Minister Paulo Guedes. The first radical change that the government and Congress proposed was the Social Security Reform. Although it had its ups and downs, on 7 August 2019, after two rounds of voting, the House of Representatives approved the Proposed Amendment to the Constitution, which may reduce the social security deficit by 933.5 billion reais over the course of 10 years. The proposal still awaits a vote in the Senate, before the Constitution is amended. The Social Security Reform is expected to be the first of a series of reforms intended to usher in a new period of economic growth, create new jobs and attract a wave of investments in several areas of the Brazilian economy. In the days immediately before the first round of voting by the House of Representatives, the Brazilian Stock Exchange reached an historic high of 106,650 points (10 July 2019).

Brazil’s GDP grew by 1 per cent in 2017, 1.1 per cent in 2018 and is expected to grow by 0.83 per cent in 2019. The rate of inflation in 2017 was 2.95 per cent, 3.75 per cent in 2018 and projected to be 3.71 per cent in 2019. In light of this, the base interest rate was lowered to 6 per cent on 31 July 2019 and is expected to be lowered again later in the year.17

All this political and financial turbulence caused an increase in the number of bankruptcy and reorganisation proceedings in Brazil, according to the table that follows. A

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13 Source: www.bcb.gov.br.
14 Source: www.ibge.gov.br.
15 ibid.
16 Source: www.bmfbovespa.com.br.
17 Source: www.bcb.gov.br.

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record 1,863 companies filed for judicial reorganisation in 2016, more than twice the number verified two years previously. The information in this table takes account of proceedings commenced after the Bankruptcy and Reorganisation Act passed into law in 2005.

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<tr>
<th>Year</th>
<th>No. of bankruptcy proceedings</th>
<th>Variation</th>
<th>No. of judicial reorganisation proceedings</th>
<th>Variation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>2,876</td>
<td>–</td>
<td>110</td>
<td>–</td>
</tr>
<tr>
<td>2006</td>
<td>1,977</td>
<td>-31.25%</td>
<td>252</td>
<td>129.09%</td>
</tr>
<tr>
<td>2007</td>
<td>1,479</td>
<td>-25.19%</td>
<td>269</td>
<td>6.75%</td>
</tr>
<tr>
<td>2008</td>
<td>969</td>
<td>-34.48%</td>
<td>312</td>
<td>15.98%</td>
</tr>
<tr>
<td>2009</td>
<td>908</td>
<td>-6.30%</td>
<td>670</td>
<td>114.74%</td>
</tr>
<tr>
<td>2010</td>
<td>732</td>
<td>-19.38%</td>
<td>475</td>
<td>-29.09%</td>
</tr>
<tr>
<td>2011</td>
<td>641</td>
<td>-12.43%</td>
<td>515</td>
<td>8.42%</td>
</tr>
<tr>
<td>2012</td>
<td>688</td>
<td>7.33%</td>
<td>757</td>
<td>46.98%</td>
</tr>
<tr>
<td>2013</td>
<td>746</td>
<td>8.43%</td>
<td>874</td>
<td>15.45%</td>
</tr>
<tr>
<td>2014</td>
<td>740</td>
<td>-0.80%</td>
<td>828</td>
<td>-5.26%</td>
</tr>
<tr>
<td>2015</td>
<td>829</td>
<td>12.03%</td>
<td>1,287</td>
<td>55.43%</td>
</tr>
<tr>
<td>2016</td>
<td>721</td>
<td>-13.03%</td>
<td>1,863</td>
<td>44.76%</td>
</tr>
<tr>
<td>2017†</td>
<td>928</td>
<td>2.71%†</td>
<td>1,420</td>
<td>-23.775%†</td>
</tr>
<tr>
<td>2018</td>
<td>930</td>
<td>0.21%</td>
<td>1,408</td>
<td>-0.84%</td>
</tr>
<tr>
<td>2019</td>
<td>258</td>
<td>-17.30%</td>
<td>371</td>
<td>-28.37%</td>
</tr>
</tbody>
</table>

1 Total number of companies declared bankrupt.
2 Total number of judicial reorganisation requests.
3 The numbers account for bankruptcy and judicial reorganisation proceedings until April 2019.
4 Calculated considering the number of companies declared bankrupt until April 2019 (258) and the same time frame in 2018.
5 Calculated considering the number of judicial reorganisation proceedings until April 2019 (371) and the same time frame in 2018.
Source: www.serasaexperian.com.br

This table shows a great leap in judicial reorganisation proceedings after the sub-prime mortgage crisis in 2008–2009. In 2015 and 2016, another gradual increase is noticeable, because of the deep recession that Brazil went through. Since bankruptcy is considered the last resort for executives and management, the number of bankruptcy proceedings does not show a growth, but rather a decrease since the enactment of the Bankruptcy and Reorganisation Act in 2005, which offered companies the possibility of commencing reorganisation proceedings to ensure their recovery.

In the year from April 2018 to April 2019, 853 small businesses, 329 medium-sized companies and 212 large companies have filed for judicial reorganisation; and 657 small businesses, 223 medium-sized companies and 74 large companies have been declared bankrupt. Although this information shows the difficult situation being faced by Brazilian companies, there is hope for a new cycle of economic growth, with the government’s commitment to propose important reforms and the ability of Congress to pass them.

III PLENARY INSOLVENCY PROCEEDINGS

i Odebrecht Group

On 17 June 2019, Odebrecht Group, one of Brazil’s largest conglomerates with businesses in the fields of engineering, construction, chemicals and petrochemicals, among others, filed its petition for judicial reorganisation. It is considered the largest judicial reorganisation in Brazilian history, with a total debt of 83.6 billion reais, considering intercompany obligations.
According to the filing, Brazil’s tough economic recession and the consequences of the corruption scheme revealed by Operation Car Wash were the main reasons for the judicial reorganisation request.

The proceeding is still in its early stages, and the reorganisation plan has not yet been filed, but reports indicate that it may restructure part of its debt by issuing a perpetual domestic profit-sharing bond, which would entail the payment of dividends, and a portion of the proceeds from asset sales – most notably, Odebrecht Group’s ownership of a 38 per cent stake in Braskem, one of the largest petrochemical companies in the world. A challenge lies ahead: the Braskem shares were previously given as collateral to financial institutions, which would be entitled to sell the shares and pay themselves. However, an order was granted by the bankruptcy court staying any enforcement measures by the creditors; this order was later suspended by an injunctive relief issued by the São Paulo Court of Appeals. The discussion should continue and may become an important precedent for similar situations in the future.

ii Constellation Group

The Constellation Group, formerly known as Queiroz Galvão Óleo e Gás, is an oil and gas services company that operates drill ships, both onshore and offshore. On 6 December 2018, the Constellation Group filed for judicial reorganisation after pre-negotiating the support of several of its creditors via a plan support agreement (totalling 48.3 per cent of secured claims and 60.2 per cent of unsecured claims), to restructure its debt of 5.75 billion reais. Since the first signs of financial deterioration, Constellation Group has been working with external financial and legal advisers in Brazil and abroad; their assistance in negotiating with creditors and the evaluation of viable alternatives for recovery has been essential to the success of the reorganisation process.

Owing to the transnational services it provides, the Constellation Group encompasses 14 foreign companies as well as the four companies incorporated in Brazil. A judicial reorganisation of this complexity required a coordinated effort, with the judicial reorganisation filed in Brazil, alongside a Chapter 15 filing in the US Bankruptcy Court and a Joint Provisional Liquidation in the British Virgin Islands. On 9 May 2019, the US Bankruptcy Court recognised Brazil as the centre of main interests for seven of the nine foreign entities party to the Chapter 15 filing and granted recognition as a foreign main proceeding – the US Bankruptcy Court did not issue an order regarding the other three entities until the Brazilian court decides whether they should be included in the Brazilian judicial reorganisation proceeding.

On 1 July 2019, the Brazilian court confirmed the reorganisation plan approved by a general creditors’ meeting held on 28 June 2019.

iii Oi Group

Oi Group is Brazil’s largest telecommunications company. Several events paved the way to the group’s judicial reorganisation proceeding, including, but not limited to: changes in consumer habits over time; excessive regulation over the telecommunications sector, which has forced Oi to invest in less relevant markets; high interest rates; and substantial enforcement of regulatory fines by the Brazilian Telecommunications Agency.

In parallel with the judicial reorganisation proceeding in Brazil, the Dutch Court of Appeals has declared the bankruptcy of two Netherlands-based companies that are part of Oi’s conglomerate and subject to the Brazilian reorganisation proceeding.

The group’s total debt subject to the judicial reorganisation proceeding exceeds 65 billion reais, which makes it the second largest reorganisation proceeding in Brazilian
history. There is also a substantial number of creditors – more than 90,000. On 20 December 2017, a general creditors’ meeting approved the reorganisation plan, with the possibility of the creditors owning up to 75 per cent of the company, through a conversion of debt to equity. The plan was subsequently confirmed by the US Bankruptcy Court of the Southern District of New York and the Dutch court overseeing the bankruptcy proceeding of the foreign subsidiaries, namely Oi Brasil Holdings Còoperatief UA (FinCo) and Portugal Telecom International Finance BV.

Oi has been carrying out its reorganisation plan and, on 15 January 2019, issued new common shares in a capital increase equivalent to approximately 337 million reais, subscribed by investors and investment funds.

iv Eneva Group

Eneva, previously known as MPX Energia S/A, is an energy company that focuses on power generation, as well as oil and gas exploration and production. It is considered one of the sector’s main players.

The company has accumulated debts with financial institutions through project finance operations. Eneva has organised its expansion by using special purpose companies to concentrate its operational activity, but because of difficult economic conditions, the group was not able to fulfil its plans to build power plants. When these subsidiaries did not generate the estimated revenue, Eneva could not satisfy its obligations to financial institutions. Furthermore, a significant increase in the price of electric energy and economic instability were also deciding factors that contributed to the filing of the judicial reorganisation proceeding in December 2014 by the Eneva Group. The special purpose companies that are party to the government contracts for energy production were not involved in the proceeding.

After a very successful restructuring process, Eneva’s judicial reorganisation proceeding was terminated roughly 19 months after its filing and 11 months after the decision that confirmed the reorganisation plan. This time frame is well below the two-year minimum supervision period and is considered one of the most successful judicial reorganisation cases since the enactment of the Bankruptcy and Reorganisation Act.

On 21 June 2019, Eneva disclosed to its shareholders and the market in general that it has paid 100 per cent of the unsecured creditors ahead of the schedule set forth by the reorganisation plan.

v Triunfo Group

Triunfo Group is one of Brazil’s largest infrastructure conglomerates. The recent economic instability is one of the main reasons for the financial distress suffered by the group, which has had a substantial effect on the infrastructure sector and on credit costs. In addition, the Brazilian National Bank of Investment (BNDES) filed enforcement claims against the group’s companies to receive a payment of more than 980 million reais. These factors forced Triunfo Group to negotiate with its creditors and file for extrajudicial reorganisation, to restructure its debts with financial institutions. The group's debt covered by its extrajudicial reorganisation proceeding amounts to nearly 2.5 billion reais.

The group’s restructuring proceeding is one of the largest and most significant extrajudicial reorganisation cases, considering its total debt and the participation of important creditors, such as BNDES. On 9 February 2018, the São Paulo bankruptcy court confirmed the extrajudicial reorganisation plan.
Although the ruling is the object of pending appeals, they did not stay the implementation of the extrajudicial reorganisation plan. Thus, in compliance with the plan, the company has conducted a reverse Dutch auction in which the creditors had the opportunity to propose haircuts on their own claims. At the end of this auction, the debt restructuring process proved to be very successful, resulting in an average haircut of 55.2 per cent on the group’s debts.

Currently, Triunfo Group awaits the rejection of the pending appeals against the extrajudicial reorganisation plan by the São Paulo Court of Appeals.

IV  ANCILLARY INSOLVENCY PROCEEDINGS

Ancillary insolvency proceedings are not mentioned by the Bankruptcy and Reorganisation Act, but despite the lack of legal provisions, case law in recent years has allowed the dialogue between Brazilian bankruptcy courts and foreign courts, mostly in cases in which the foreign subsidiary is part of a larger economic group with its centre of main interests in Brazil. Examples of this were the submission of foreign companies to the judicial reorganisation proceedings of Constellation Group, OGX Group, Sete Brasil Group, OAS Group and Oi Group, as discussed in Section III.

A major discussion involves the Dutch subsidiaries part of the Oi Group, namely FinCo and PTIF: the Dutch court has declared these companies bankrupt, and the Brazilian bankruptcy court handling Oi’s judicial reorganisation proceeding has not acknowledged this ruling. Further, the Brazilian court imposed a fine in the event that the trustee in the Dutch proceedings fails to respect its decision. In light of this, the trustee requested the recognition of FinCo’s declaration of bankruptcy by the US Bankruptcy Court of the Southern District of New York, the same court that signed off on Oi’s Chapter 15 protection (recognising the judicial reorganisation before the Brazilian court as the foreign main proceeding). The US Bankruptcy Court later acknowledged that the Dutch court and the trustee should comply with the Brazilian bankruptcy court’s rulings.

Once the reorganisation plan was approved and confirmed by the Brazilian court at the end of 2017, the Dutch court and the US Bankruptcy Court also confirmed the plan, demonstrating a remarkable level of cooperation between different jurisdictions, with the same goal: the successful recovery of the ailing telecommunications conglomerate.

In Constellation Group’s judicial reorganisation, as previously mentioned, 14 entities incorporated abroad petitioned in Brazil alongside four Brazilian entities. The Brazilian court’s jurisdiction was questioned, and the Rio de Janeiro Court of Appeals ruled that any foreign entities with assets in national territory are subject to Brazilian jurisdiction. Notwithstanding, a special appeal is still pending before the Superior Court of Justice, which is expected to decide whether the notion of centre of main interests may be adopted in light of Brazilian law (or lack thereof).
V TRENDS

One of the many proposals to boost economic growth is an amendment to the Bankruptcy and Reorganisation Act – the Draft Bill No. 10,220 – introduced to the Brazilian House of Representatives on 10 May 2018. The first draft was the result of a working group put together with several respected scholars and tasked with the objective of updating the current legislation. Unfortunately, this first draft has been significantly modified by the Ministry of Economy, mainly to strengthen the tax authority's privileges in judicial reorganisation proceedings.

However, the Draft Bill proposes some relevant changes to the current legislation:

- Financing would be facilitated tremendously with several provisions allowing the encumbrance of assets after the filing for judicial reorganisation;
- The Bankruptcy and Reorganisation Act would no longer separate creditors into different classes in judicial reorganisation proceedings. The debtor would be able to do so in the reorganisation plan, dividing creditors in accordance with their interests and similarities;
- Secured claims held by creditors with property interests that are in possession of the debtor, such as chattel mortgage and capital or operating leases, would be affected by judicial or extrajudicial proceedings;
- The termination of contracts based on an ipso facto provision would not be allowed, and such a clause would be legally considered void; and
- The termination of the judicial reorganisation proceeding would occur at the same time it is granted.

One of the most important changes in the Bankruptcy and Reorganisation Act would be the adoption of the UNCITRAL Model Law on Cross-Border Insolvency, with its mechanisms for international cooperation, expressly permitting plenary insolvency proceedings at the centre of main interests and ancillary proceedings where the debtor has foreign affiliates. Nevertheless, this draft of the Bill still needs to be deliberated in both the House of Representatives and the Senate (where it could be subject to any number of changes) and then passed into law, with the President’s sanction.

Although the Draft Bill has almost been forgotten, the Special Treasury Secretary (part of the Ministry of Economy) has announced that the government will propose structural changes to the current bankruptcy and reorganisation regimes.

It is also relevant to mention that, because of Brazil’s economic instability, as has been discussed, as well as the increase in the number of judicial reorganisation proceedings, creditors seem more open to directly negotiating their claims with companies in debt. This creates the possibility of a greater number of extrajudicial reorganisation proceedings, which is seen by stakeholders as a way of avoiding the negative reputational effects of judicial reorganisation proceedings.
Chapter 5

CANADA

Michael Nowina, Alissa Scarcello and Brittany Shales

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

In 2018, Canada’s economy was growing and the unemployment rate fell to a 40-year low. The economy was operating close to potential, then slowed in the fourth quarter of 2018. While there was a small increase in insolvency filings (2.4 per cent), the number of business insolvency filings actually fell by 0.8 per cent and Canada continues to enjoy low levels of business insolvencies. Many economies experienced a slowdown in late 2018 against a background of high trade uncertainty, tighter financial conditions and political headwinds, but in Canada the deceleration was more severe than elsewhere, primarily because of continued low prices for Western Canadian oil. However, the number of consumer insolvency filings rose by 2.5 per cent, underscoring continuing concern about the level of household debt remaining very high.

The Bank of Canada has noted in its most recent monetary report that trade tensions and elevated uncertainty have been important factors weighing on the Canadian economy. Improvements in financial conditions since the beginning of 2019, continuing strong immigration and sustained global expansion are expected to support growth in the short term.

II RESTRUCTURING AND INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework

There are three federal statutes that govern insolvency law in Canada: the Bankruptcy and Insolvency Act (BIA), the Companies’ Creditors Arrangement Act (CCAA) and the Winding-Up and Restructuring Act (WURA).

The BIA, with its regulations, is a self-contained code that deals with the liquidation of assets and the restructuring of debts of individuals, partnerships, corporations (other than

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1 Michael Nowina is a partner and Alissa Scarcello and Brittany Shales are summer associates at Baker & McKenzie LLP.
3 ibid.
5 Bankruptcy and Insolvency Act, RSC 1985, c B-3.
6 Companies’ Creditors Arrangement Act, RSC 1985, c C-36.
7 Winding-Up and Restructuring Act, RSC 1985, c W-11.
certain excluded types of corporations) and other business entities that meet residency and minimal debt requirements. The BIA also provides for receiverships in which an insolvent entity's assets and rights are placed in the custody and care of a third party called a receiver. The receiver may continue operations but, more typically, the assets are liquidated.

The CCAA, with its regulations, deals only with the restructuring of the debts of corporations (other than certain excluded types of corporations) and income trusts that meet certain residency requirements and meet higher minimum debt requirements than those found under the BIA.

The WURA deals with the liquidation and restructurings of certain specified entities, such as banks and trust companies; in effect, all those entities and corporations specifically excluded from the BIA and CCAA.

Of the three insolvency statutes, the BIA represents the most complete code, providing substantive provisions dealing with, \textit{inter alia}, the scope and breadth of stays of proceedings, distributional priorities, fraudulent transfers, the sale of assets, the treatment of contracts, interim financings, cross-border proceedings, and penalties and sanctions against debtors and their directors for violations under the BIA. The BIA also contains provisions dealing with the appointment of receivers and the rules regarding their conduct. Restructurings under the BIA are by way of 'proposals' to creditors. These proposals bind all affected creditors, if approved by the requisite double majority (two-thirds of proved claims and more than 50 per cent of creditors per class) and subsequently by the court.

The CCAA is a more flexible statute than the BIA, allowing courts more discretion in assisting restructuring corporations. For example, under the BIA, a stay of proceedings is limited to a maximum of six months in a proposal, and the scope of that stay is set out and limited by statute. However, there is no limit to the maximum cumulative length of a stay of proceedings under the CCAA because the court has significant discretion on the scope of the stay of proceedings beyond what is available under the BIA. Like the BIA, the CCAA has substantive provisions dealing with distributional priorities, fraudulent transfers, the sale of assets, the treatment of contracts, interim financings and cross-border proceedings. Restructurings under the CCAA are done through a 'plan of compromise or arrangement'. Such a plan, if approved by the requisite double majority (the same as under the BIA) and subsequently by the court, binds all affected creditors.

The WURA is less structured than the BIA or the CCAA and applies primarily to financial institutions. The banking system in Canada is very stable and, therefore, there are few proceedings under WURA.

\textbf{ii} \hspace{1em} \textbf{Policy}

With respect to restructurings, whether it is the debts of an individual or a business entity, the objective is to provide a debtor in financial difficulty the time and opportunity to restructure and develop a fresh arrangement with creditors with a view to avoiding a bankruptcy liquidation. The goal is to keep debtors who are in financial difficulty operating and protected from creditors, to allow the debtor to stabilise operations and develop a restructuring plan that may then be put to its creditors for consideration. If the requisite majorities approve the plan, it binds all affected creditors and the debtor emerges from bankruptcy protection and continues its (restructured) operations.
iii Insolvency procedures

To reorganise under the BIA, an insolvent debtor must have liabilities of at least C$1,000, carry on business in Canada and be insolvent. A BIA reorganisation is commenced by a debtor either lodging a proposal to creditors with a proposal trustee or filing what is known as a notice of intention (NOI) to make a proposal under the BIA. If a NOI is filed, the debtor has 30 days to file a proposal, which may be extended by a court order for up to five additional months, in periods of no more than 45 days at a time. If the debtor fails to file a proposal by the end of the final period, or if the proposal is rejected, then the debtor is deemed to have made an assignment into bankruptcy. A stay of proceedings is automatically imposed by statute upon a proposal or NOI being filed.

A bankruptcy liquidation commences with either an assignment into bankruptcy by the insolvent debtor or an application for a bankruptcy order by one or more creditors who are owed at least C$1,000, where the debtor is insolvent and has committed an act of bankruptcy. Once a bankruptcy order or assignment is made, a trustee is appointed over the assets and is charged with collecting and liquidating the assets of the bankrupt with a view to distributing proceeds to creditors. A meeting of creditors takes place shortly after the bankruptcy, and inspectors may be elected by the creditors to oversee and provide instructions to the trustee on how the proceeding is conducted. Once the assets are liquidated, the trustee distributes the proceeds to creditors who have filed proofs of claim based on the priorities scheme set out in the BIA.

To reorganise under the CCAA, a company must carry on business in Canada, have total liabilities exceeding C$5 million and be insolvent. CCAA proceedings are commenced with a court application by the reorganising debtor for what is known as an initial order, which establishes the proceeding and sets out the general parameters, including stays of proceedings, provisions that prohibit creditors from enforcing claims against the debtor, provisions that prohibit contracting parties from terminating contracts with the debtor, interim operational matters for the debtor, the appointment of a monitor, and interim financing. Under the new CCAA amendments, after the 10-day stay of proceeding, the proceeding may be extended at the discretion of the court for any additional period of time. In the past, reorganisations have taken the form of the development of a plan of compromise or arrangement, consisting of a proposal to creditors to compromise claims. The time frame in which a debtor has to file a plan is at the discretion of the court. Creditors are grouped into classes based on commonality of interest for the purposes of voting and distribution under the plan. A majority in number, representing two-thirds in value of the claim of each creditor class, must approve the plan, as well as the court. If they do, then the plan will be binding on all creditors in the class. The CCAA is silent on the time frame for seeking court approval.

Under the WURA, depending on the circumstances, a debtor, a creditor, a shareholder or the Attorney General of Canada may commence a proceeding. A stay of proceedings may be sought from the court by the debtor, creditor, contributory, liquidator or the original applicant. The remedy is discretionary. Upon the making of a winding-up order, an automatic stay is imposed. The WURA provides no restrictions on the amount of time a debtor has to restructure or any restriction on the discretion of the court to grant or restrict the amount of time. There is also no time frame for seeking court approval.

In proceedings under the BIA, CCAA and WURA, any affected party may oppose or seek to lift the stay of proceedings. To do so, creditors must prove that they are likely to be materially prejudiced by the continuance of the stay, or it is equitable on other grounds that
the stay be lifted. Unless there are compelling reasons to lift the stay, courts are normally reluctant to do so, especially at the outset of the proceeding, so that the debtor has time to attempt to restructure.

Receiverships can be commenced either under the BIA or under provincial legislation. As an equitable remedy, receiverships take on many forms but typically a receiver is appointed either privately pursuant to a security agreement or by way of court order, and is given certain powers to either operate a business, seize and liquidate assets, or sell a business as a going concern, with a view to distributing the proceeds of sale to the creditors of the debtor. Receiverships are a very common remedy for dealing with insolvency in Canada and a useful tool for monetising the business or assets of an insolvent debtor.

III PLENARY INSOLVENCY PROCEEDINGS

i Orphan Well Association v. Grant Thornton Ltd 2019 SCC 5

The Supreme Court of Canada issued an important decision regarding the intersection between Alberta’s provincial oil and gas regulations and the federal BIA. At issue was whether the provincial regulatory regime operationally conflicted with the BIA or frustrated its purposes. In what is commonly referred to as the Redwater decision, the Supreme Court found that there was no conflict and effectively established a super-priority for environmental remediation claims. This means that the bankruptcy trustee of an insolvent company must satisfy the abandonment and reclamation obligations (up to the value of the estate’s remaining assets) that are owed to Alberta’s environmental regulator before paying the company’s creditors.

The practical consequence was that the bankruptcy trustee could not disclaim the spent oil and gas properties and only retain the profitable assets for distribution to Redwater’s creditors. Although the trustee remained fully protected from personal liability by the BIA, it could not walk away from the environmental liabilities of the bankrupt estate under the Alberta’s regulations. The majority at the Supreme Court looked at the Alberta regulatory regime and concluded that the regime is currently structured to make the costs of abandonment and reclamation part of the overall net value of the licensed assets. The implication is that these amounts were not a debt and the Alberta regulator was not a creditor, subject to the priority rules in the BIA.

Redwater has been seen as a strong affirmation of the ‘polluter pays’ approach to environmental remediation in Canadian law. However, as pointed out by the Supreme Court dissent, the true impact of this decision may well be to displace the ‘polluter pays’ principle with a ‘creditor pays’ reality. Creditors of companies in this industry now bear the risk of covering environmental remediation costs, which directly affects their recovery from insolvency. Going forward, lenders are likely to keep the Redwater decision in mind when developing or reviewing their loan portfolios. This may limit the availability of credit for Alberta oil and gas companies in the future.

ii Callidus Capital Corp v. Canada 2018 SCC 47

Canada’s Excise Tax Act (ETA) gives the Crown priority over other creditors by virtue of various provisions, including a deemed trust imposed by the statute. The issue in this appeal dealt with the effect of the deemed trust when a secured creditor receives proceeds before the bankruptcy. In this case, the debtor had collected amounts pursuant to the ETA, but failed to
remit those amounts to the Crown. When the debtor entered into bankruptcy, the Crown sued Callidus for the proceeds that the debtor failed to remit on the basis of the deemed trust in the ETA.

The Supreme Court of Canada adopted the dissenting opinion in the Federal Court of Appeal judgment, which ruled that a bankruptcy renders the ETA’s deemed trust ineffective. Therefore, it does not matter if a creditor has received proceeds from a tax debtor’s assets before bankruptcy. This decision means that the Crown cannot recoup from a lender the statutorily required remittances that a bankrupt debtor failed to make to the Crown.

iii Rose of Sharon

In *Rose of Sharon*, the Ontario Labour Relations Board (the Labour Board) examined whether a receivership precluded a union from negotiating a new collective agreement. Rose of Sharon Korean Long-Term Care Home (Rose of Sharon) operated as a long-term care facility. In the same year that the employees joined a union, there was also the court appointment of a receiver over Rose of Sharon. The union filed numerous requests to initiate bargaining for a collective agreement with the receiver, who failed to respond. This led the union to seek a declaration before the Labour Board.

Generally, the purchaser of a business becomes bound by any collective agreement to which the seller is a party, unless the Labour Board declares otherwise. Prior to this decision, it was unsettled in Ontario whether successor rights extended to the context of court-appointed receiverships. The issue in this case was whether the Labour Board was precluded from making a declaration that the receiver was a successor employer. Canadian law protects the receiver from undertaking liabilities that may be imposed under applicable labour legislation. However, the Labour Board determined that the union was not making any claim against the receiver ‘beyond recognition of bargaining rights and the negotiation of a collective agreement’. The Labour Board found that recognition of bargaining rights and negotiation of a collective agreement is ‘not necessarily inconsistent with the purposes of the BIA’. Moving forward, this means that a court-appointed receiver will be required to bargain with a union if it continues to operate a business—at least in Ontario.

iv Arrangement relatif à 9354-9186 Québec inc (Bluberi Gaming Technologies Inc), 2019 QCCA 171

Bluberi Gaming Technologies (Bluberi) was a company that sold games and casino machines. In August 2012, the company sought financing from Callidus Capital Corp (Callidus), which provided additional funding. In 2015, Bluberi filed for protection under the CCAA to develop a plan of arrangement to its creditors. While the CCAA proceedings were under way, the Quebec Court approved a litigation financing agreement (LFA) to allow Bluberi to pursue a claim against Callidus, which in response sponsored a plan of arrangement to be voted on by creditors. The proposed plan would have provided Callidus with a full release of the litigation claim.

At the heart of the dispute was an insolvent company that wanted to pursue litigation against a creditor and a creditor that wanted to put forward a plan of arrangement for a

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9 *Rose of Sharon*, at Paragraph 73.
10 ibid., at Paragraph 74.
vote. In Canada, it is settled law that a creditor can propose a plan of arrangement and every creditor is entitled to vote unless the law specifically precludes such a right. This provides creditors with two basic rights: ‘to participate in the distribution of the debtor’s assets and to participate in the decision-making process of the insolvency through the exercise of their voting rights’.11

The Quebec Court of Appeal determined that Callidus’s plan of arrangement should be submitted for a vote and that Callidus could vote on the plan. The Supreme Court of Canada will hear an appeal from Bluberi and the litigation funder.

IV ANCILLARY INSOLVENCY PROCEEDINGS

i Significant transactions

Shortly after its arrival in Canada in 2013, the Target retail chain decided to wind down its operations – less than two years later, it applied for CCAA protection to facilitate an orderly withdrawal from Canada.12 This failure was not an isolated incident in the retail environment. In 2017, Sears Canada closed almost 60 of their retail locations across Canada and liquidation sales were implemented at several of the remaining locations.13 The company filed for bankruptcy in 201714 and was followed by the bankruptcy of its parent in the United States approximately one year later.15 Carillion Canada Holdings Inc, a UK subsidiary of Carillion PLC, began proceedings under the CCAA in January 2018.16 After the UK parent company commenced proceedings, Carillion Canada faced an imminent crisis that resulted in the Canadian filing.17

ii Key developments

Emergence of litigation financing in Canada

LFAs are a relatively new element in Canadian insolvency and restructuring practice. Although widely used in Australia, the United States and the United Kingdom, LFAs are still relatively uncommon in Canada. Canadian courts will allow them, provided they do not overreach or interfere with the lawyer-client relationship or the administration of justice.

11 Arrangement relatif à 9354-9186 Québec inc. (Bluberi Gaming Technologies Inc), 2019 QCCA 17, at Paragraph 69.
16 Re Carillion Canada Holdings Inc, et al. [2018] (Ont SCJ [Commercial List]), Court File No. CV-18-590812-00C.
LFAs in a restructuring context originated from *Crystallex* and *Strateco*. In *Crystallex*, the court considered whether the CCAA allowed a judge to approve financing that would continue significantly outside the period of CCAA protection, without approval from the creditors. The case dealt with an interim financing through a specialised lender that was to be used to finance litigation in exchange for the lender receiving 35 per cent of the litigation proceeds. In *Strateco* the court evaluated another interim financing under the CCAA, which was intended to guarantee legal fees for the prosecution of a claim against the government that constituted the debtor’s principal asset. In both cases, the pending litigation was the best chance at recovering any value for the creditors from the insolvent assets and the courts relied on a liberal and purposive interpretation of the CCAA in finding that the financing agreements were in the interest of the creditors. These two cases laid the foundation for *Bluberi*, which is the latest in a string of LFA-type cases in the context of CCAA restructurings. Despite the developments in case law, the use of LFAs in Canada is still limited and the rules are relatively undefined. This is an area that will continue to develop since LFAs are an attractive option for insolvent parties lacking the resources to pursue and monetise litigation claims.

iii  **Most active and distressed industries**

The Canadian economy experienced activity and growth during 2018, with an overall decline in business insolvency filings as compared to 2017. The industries with fewer insolvency filings include manufacturing, mining, oil and gas, and wholesale trade. Two industries that were more distressed were construction and real estate.

iv  **International**

Plenary proceedings in Canada may only be commenced by debtors resident in, carrying on business in, or having assets in Canada. A debtor that has no presence in Canada may not commence a plenary proceeding. If a debtor carries on business in more than one location, the courts will look at factors such as the location of main operations, the location of management, the location of the majority of creditors and convenience for the majority of stakeholders. Canadian courts have generally expressed a willingness to assist foreign courts, provided that assistance would not contravene public policy concerns in Canada.

With the adoption of most of the UNCITRAL Model Law on Cross-Border Insolvencies in 2009, Canadian courts are now mandated to cooperate with foreign courts, subject to public policy concerns, once an ancillary proceeding is commenced. Pursuant to these regimes, proceedings ancillary to both foreign main and foreign non-main proceedings may be commenced in Canada. Neither the BIA nor the CCAA contains time frames or time restrictions for any such filings. Ancillary proceedings may be commenced by a foreign representative, which is a party appointed in the foreign proceeding. An automatic stay is granted if the proceeding is recognised as a foreign main proceeding, and a discretionary stay may be granted if the proceeding is recognised as a foreign non-main proceeding.

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19  Statistics Canada (see footnote 2, above).

20  ibid.
Reforms to the BIA and CCAA that were announced in Canada’s federal 2019 budget will come into force on 1 November 2019. Key changes to the insolvency regime include:

- Requiring participants in an insolvency proceeding to act in good faith;
- Providing for the possibility of court-ordered disclosure of a creditor’s real economic interest in an insolvent company;
- Explicitly permitting management to consider the interests of workers and pensioners in fulfilling their corporate duties;
- Imposing director liability in appropriate cases for executive compensation payments in the year leading up to an insolvency;
- Limiting the decisions that can be taken at the outset of a CCAA proceeding to measures necessary to avoid the immediate liquidation of an insolvent company (the length of initial stay is reduced from 30 to 10 days and relief is limited to what is reasonably necessary for the continued operations of the debtor company in the ordinary course of business); and
- Exempting assets held in registered disability savings plans from creditor claims in bankruptcy.

These reforms are aimed at improving transparency of the insolvency regime and enhancing protections for workers and pensioners. In addition, legislative changes intended to provide consistent protection of intellectual property (IP) licence rights in BIA and CCAA proceedings announced in Canada’s 2018 budget, will also come into force on 1 November 2019. Currently, in BIA and CCAA restructurings, IP licensees in good standing can continue to use the IP if an insolvent licensor disclaims the licence. The reforms extend this protection to other insolvency situations, such as bankruptcies, receiverships and asset sales, where there had been uncertainty in the law regarding protections for IP licences. With the coming into force of the new amendments, IP licensees may preserve rights under IP licence agreements, as long as they continue to perform their obligations even if the licensor goes through a receivership, bankruptcy or asset sale.
I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

The most important legislation in the bankruptcy system in mainland China is the Enterprise Bankruptcy Law of the People's Republic of China promulgated on 27 August 2006 (the 2006 Law), which entered into effect on 1 June 2007, replacing its predecessor, the Enterprise Bankruptcy Law of the People's Republic of China (Trial) passed in 1986 (the 1986 Law). The 2006 Law applies only to corporate entities. Organisations other than corporates may be liquidated by reference to the application of the 2006 Law, provided that other laws have provisions for their liquidation, and that the liquidation is bankruptcy liquidation. Individuals are still unable to seek relief in mainland China.

Compared with the 1986 Law, new provisions with the 2006 Law include, but are by no means limited to:

a enabling organisations other than corporate entities to be liquidated;
b setting up three distinct bankruptcy procedures – liquidation, reorganisation and conciliation – indicating that the 2006 Law also has the function of the rescue of distressed enterprises when necessary;
c establishing the central position of the bankruptcy administrator in bankruptcy proceedings;
d clarifying the functions of the creditors’ meeting and the creditors’ committee; and
e giving bankruptcy administrators the right to revoke any biased behaviour, such as repayments to individual creditors.

The power of judicial interpretation by the Supreme People’s Court comes from two sources. The first is the Organisation Law of the People’s Court of the People’s Republic of China. It states that ‘judicial interpretation’ is the interpretation of the principal application of law in judicial work by the Supreme People’s Court. The second is the Resolution of the Standing Committee of the National People’s Congress on Strengthening Legal Interpretation. It states that the issues concerning the specific application of laws and decrees in court trials are explained by the Supreme People’s Court. At present, the Supreme People’s Court has formulated a number of judicial interpretations for current insolvency law, covering topics

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1 Ren Yimin is a senior partner at Capital Equity Legal Group. The author would like to thank Zhu Yun, Wang Jianye and Dr He Huan for their contributions to this chapter.
2 Organisation Law of the People’s Court of the People’s Republic of China, Article 18.
3 Resolution of the Standing Committee of the National People’s Congress on Strengthening Legal Interpretation, Article 2.
such as designation of administrator, remuneration of administrator, issues relating to case acceptance, debtors’ property, and the rights that creditors can exercise. In addition, the trial work meetings held by the Supreme People’s Court and the minutes of those meetings also have relevance for bankruptcy trials and practice.

There have been three developments worthy of mention. First, a revision of the 2006 Law has been launched in accordance with the Legislative Planning of the Standing Committee of the Thirteenth National People’s Congress (announced in 2018). Second, there has been a strong call for legislation on individuals insolvency law, and the Supreme People’s Court and relevant government departments have expressed support for this. Third, the relevant authorities have been discussing the establishment of a separate financial institution insolvency law, and the relevant officials are open to this.

ii Policy

In general, society’s attitude towards the debt crisis experienced by enterprises has gradually become more rational. The public are open to distressed enterprises being regenerated through insolvency proceedings that can maximise the overall interests of a debtor and its creditors.

All aspects of insolvency law are developing rapidly, and the number of bankruptcy cases has been rising fast. For instance, in Zhejiang Province, in the southeast of China, the number of insolvency cases accepted by the courts has exceeded 1,000 for two consecutive years. At the same time, the number of bankruptcy administrators, bankruptcy practitioners and scholars engaged in bankruptcy law practice and research has increased significantly. The administrative departments associated with insolvency proceedings have become increasingly concerned about the bankruptcy field, such as the necessary cooperation with bankruptcy judicial activities.

The understanding of insolvency law has also changed, from a unilateral recognition of bankruptcy liquidation under the 1986 Law to its necessary function as a means of rescuing distressed enterprises, which is reflected in the order of Chapters in the 2006 Law – Reorganisation (Chapter VIII) and Conciliation (Chapter IX) are placed before Liquidation (Chapter X). The Supreme People’s Court and local courts have repeatedly stressed that the court shall be construed as a ‘hospital’ for distressed enterprises, and that reorganisation is preferable to liquidation. For example, Article 14 of the Minutes of the National Courts of Bankruptcy Trial Work Conference in 2018 emphasises that the People’s Court should review whether or not a debtor has a reorganisation value and consider the possibility of reorganisation based on a debtor’s assets, technical processes, production and sales, industry prospects and so on.

From the perspective of the debtor and local government, reorganisation proceedings are favoured by all parties above liquidation proceedings, because the operational value of the enterprise and the value of the intangible assets can be maintained. Up to now, all the bankruptcy cases of listed companies have preferred reorganisation without exception. Large non-listed companies often also choose reorganisation, such as Bohai Iron and Steel Group (a debt scale of nearly 200 billion yuan) and Liaoning Huishan Dairy Group (Shenyang) Co Ltd (a debt scale of nearly 50 billion yuan).

iii Insolvency procedures

Insolvency can be resolved by one of three procedures – liquidation, reorganisation or conciliation. The characteristics of each of these procedures can be summarised as follows.
Liquidation
This is a straightforward process in which the value of the debtor’s property is realised in a relatively short space of time and distributed in accordance with the order stipulated in the 2006 Law. The registration of the debtor shall be cancelled once the procedure has been concluded.

Reorganisation
This is a more complicated and complete regeneration procedure, with an emphasis on maintaining the debtor’s operating value. A variety of measures can be adopted, including but not limited to automatic freezing (especially the freezing of security interests), reorganisation financing, realising necessary assets, sustaining the debtor’s business operations, introducing investors, and even compulsory approval of the reorganisation plan.

Conciliation
A simpler and faster regeneration procedure, emphasising the negotiation between the unsecured creditors and the debtor. The measures that can be adopted are mainly the freezing of unsecured claims, while the security interest is not restricted by the procedure. Mandatory approval can not be applied.

To a certain extent, it is possible to convert from one procedure to another. If there is no reasonable probability of success in a reorganisation or conciliation procedure, it could be converted to liquidation. Equally, liquidation can be converted to reorganisation. Although there is no explicit provision in the legislation for conversion between conciliation and reorganisation procedures, or of a liquidation procedure to a conciliation procedure, in practice these measures are applied in many cases, subject to the approval of the creditors’ meeting and the recognition of the court.

It is not practical to start an auxiliary (non-main) bankruptcy procedure in mainland China under the 2006 Law, because a bankruptcy case shall be under the jurisdiction of the people’s court of the debtor’s domicile, that is to say the location of the principal office of the debtor. If the debtor has no office, the domicile will be taken to mean the place of registration. In other words, a debtor who has to file for bankruptcy in China must either have a principal office located in China, or be registered as having a residence in China. Although there are different definitions of the centre of main interest (COMI) theoretically, insolvency proceedings initiated in China may only be the main process, not the non-main process.

iv Starting proceedings
The commencement of insolvency proceedings is the date of the acceptance of insolvency applications by the court, rather than the filing of the applications. All remedies provided by insolvency law can only be triggered after the insolvency application has been accepted.

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4 2006 Law, Article 3.
5 Civil Code, Article 63.
6 Provisions on Several Issues Concerning the Trial of Enterprise Bankruptcy Cases, Article 1.
The creditor, the debtor and the company’s liquidation obligor of dissolution (in a specific case) all have the right to apply to initiate insolvency proceedings. However, according to Article 2 of the 2006 Law, the burden of proof for each is quite different.

A creditor that applies for insolvency only needs to prove that the debtor cannot pay the debt due. Once the creditor proves this, the burden of proof is transferred to the debtor. If the debtor is unable to provide evidence or otherwise prove that it is not the case that its ‘assets are insufficient to pay off all debts’ or that it ‘apparently lacks the ability to pay off his debts’, the court shall accept the insolvency application promptly.

A debtor that applies for insolvency is required to prove that he or she meets all the conditions set out in Article 2 of the 2006 Law.

The premise of a company’s liquidation obligor of dissolution for bank insolvency is where an enterprise legal person has been dissolved but has not started or completed liquidation and does not have enough assets to pay off his or her debts. The person responsible for liquidation according to law shall make an application to the people’s court for bankruptcy liquidation. In this situation, the bankruptcy application is an obligation for the company’s liquidation obligor rather than a right, and the obligor can only apply for bankruptcy liquidation.

When a creditor applies for insolvency, the debtor has the right to raise an objection. The rights of other creditors to challenge an application, or to file an objection when a debtor has filed for insolvency are not stipulated specifically in the legislation and judicial interpretations; however, these rights are protected in practice.

v Control of insolvency proceedings

In practice, the entire bankruptcy process is controlled by the administrator. The duties of the administrator include, but are not limited to:

- taking over the property, seals, account books, documents and other data of the debtor;
- investigating the financial position of the debtor and preparing a report on such position;
- deciding on matters of internal management of the debtor;
- deciding on the debtor’s daily expenses and other necessary expenditures;
- deciding whether to continue or suspend a debtor’s business (before the first creditors’ meeting, when the debtor has not filed an application for self-management, or the debtor’s application has not been approved by the court);
- managing and disposing of the debtor’s property;
- participating in litigation, arbitration or any other legal procedure on behalf of the debtor;
- proposing that a creditors’ meeting should be held;

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7 If an enterprise legal person cannot pay off the debts due and the assets are insufficient to pay off all the debts, or the person apparently lacks the ability to pay off his or her debts, the debt shall be liquidated in accordance with the provisions of the 2006 Law. If an enterprise legal person is under the circumstances as specified before or has apparently forfeited the ability to pay off his or her debts, he or she may undergo reorganisation.
8 2006 Law, Article 7.2.
9 ibid., at Article 2.1.
10 ibid., at Article 7.
11 ibid., at Article 25.
choosing whether or not to continue to perform a contract; 12
exercising the right of revocation so as to recover a debtor’s property; 13
examining the claims declared; 14
supervising a debtor while managing a property and business operations on his or her own (reorganisation); 15
formulating a reorganisation plan and organising the voting (except when managed by the debtor itself); 16 and
supervising the implementation of the reorganisation plan (reorganisation). 17

The duties of the court are mainly aligned to the supervision of the insolvency proceedings, including:
- the review of insolvency applications;
- designating administrators and determining their remuneration;
- hearing the trial for bankruptcy revocation;
- confirming the claims that have been declared;
- approval of debtor-in-possession;
- executing an automatic freeze (revocation of violations, approval of freeze release);
- approving a reorganisation plan (including mandatory approval); and
- ruling on the termination of the procedure.

The powers of boards of directors are largely taken over by an administrator during insolvency proceedings. This is less straightforward in a reorganisation procedure. If the debtor is managed by the administrator, the administrator may appoint the debtor’s management personnel to be responsible for business affairs. If the debtor applies for self-management, the obligations of the relevant personnel of the debtor (the people’s court can be interpreted as including the board of directors) include:
- properly preserving the property, seals, account books, documents, etc., that are in their possession and under their management;
- proceeding with the work as required by the people’s court and the administrator, and truthfully responding to their enquiries;
- attending the creditors’ meetings as non-voting participants and truthfully answering the creditors’ enquiries;
- remaining at their domiciles, unless otherwise permitted by the people’s court; and
- not taking up any post as director, supervisor or senior manager in any other enterprise. 18

12 ibid., at Article 18.
13 ibid., at Articles 31 to 39.
14 ibid., at Article 57.
15 ibid., at Article 73.
16 ibid., at Article 80.
17 ibid., at Article 90.
18 ibid., at Article 15.
vi Special regimes

The insolvency of commercial banks, securities companies, insurance companies and other financial institutions has special features. First, it can be applied to the takeover and custody procedures of the financial supervision and administration authority of the state council, as well as reorganisation or liquidation. Second, the proceedings applicable to those financial institutions are decided by the financial supervision and administration authority of the state council, rather than by the debtor.

There are also special rules for affiliates (which can be interpreted as including enterprise groups). One is substantive consolidation. When there is a high level of variation in the corporate personality of affiliated enterprises, which can have serious consequences for a fair settlement for creditors, and the cost to distinguish the members’ property of each affiliated enterprise is too high, the rule of substantive consolidation of affiliated companies could be applied.

The other special rule is the coordination of judicial practice. When a number of affiliated companies that are in different locations are at risk of bankruptcy and apply for insolvency, but do not meet the conditions for substantive mergers, the insolvency proceedings of those affiliated companies can be coordinated, including under the jurisdiction of one court.

vii Cross-border issues

As has already been stated, the main requirement for making an application for insolvency in China is that the debtor’s domicile is in China. Once the procedure for insolvency is initiated according to the 2006 Law, it shall come into effect in respect of the debtor’s property outside the territory of the People’s Republic of China, if applicable.

According to Article 5, Paragraph 2 of the 2006 Law, when a legally effective judgment or ruling made on a bankruptcy case by a court of another country involves a debtor’s property within the territory of the People’s Republic of China, and the said court applies with or requests the people’s court to recognise and enforce it, the people’s court shall – according to the relevant international treaties that China has concluded, or to which China has acceded, or on the basis of the principle of reciprocity – conduct an examination thereof and, on finding that the said judgment or ruling does not (1) violate the basic principles of the laws of the People’s Republic of China, (2) jeopardise the sovereignty and security of the state or public interests, or (3) undermine the legitimate rights and interests of the creditors within the territory of the People’s Republic of China, and decide to recognise and enforce the judgment or ruling.

According to Article 50 of the Minutes of Bankruptcy Trial Proceedings of National Courts in 2018, ‘when a legally effective judgment or ruling made on a bankruptcy case by a court of another country has been recognised by the people’s court, the remaining property of the debtor within the territory of the People’s Republic of China may be distributed in accordance with the provisions of the foreign court after the creditor’s right of security right, employee’s creditor’s right, the social insurance premiums and the taxes which the bankruptcy fails to pay have been paid in full’.

19 ibid., at Article 134.
20 ibid., at Articles 32 to 37.
21 ibid., at Articles 38 and 39.
22 2006 Law, Article 5.1.
As regards cooperation in cross-border insolvency cases, according to Article 49 of the Minutes of Bankruptcy Trial Proceedings of National Courts in 2018, the people’s courts should properly resolve legal conflicts and contradictions that have occurred, and determine the jurisdiction in reasonable terms. Under the principle of equal protection of the same kinds of creditors’ rights, a balance should be struck between the interests of foreign creditors and those of Chinese creditors, and protect the repayment interests of the priority of the creditors’ rights, including employees and tax claims in China. The country will actively participate in and promote the negotiation and signing of international treaties on cross-border insolvency, explore new ways to apply the principle of reciprocity, strengthen cooperation between Chinese courts and administrators in cross-border bankruptcy, and promote the healthy and orderly development of international investment.

II INSOLVENCY METRICS

In the light of the 2019 Government Work Report, China’s gross domestic product grew by 6.6 per cent in 2018 and total volume exceeded 90 trillion yuan. The economic growth rate matches the actual quantity indicators, such as electricity consumption and freight transportation. The consumer price index rose by 2.1 per cent. The balance of international payments is, essentially, balanced. As regards employment, 13.61 million new urban jobs were created and the surveyed unemployment rate remained at a low level of around 5 per cent (the lowest in five years). According to data from the National Bureau of Statistics, there were 3,584 listed companies in China in 2018, with a total market value of 43,492.4 billion yuan and a turnover of 90,173.9 billion yuan. The Chinese economy is on the right track, but the business environment is complex and uncertainties are increasing. By May 2019, there were 20 corporate bond defaults through public channels, involving more than 16 billion yuan and dozens of listed companies or major shareholders of listed companies.

During 2018, the number of cases accepted and concluded by the courts rose rapidly. The Chinese courts accepted 18,823 new cases of compulsory liquidation and insolvency (up 97.3 per cent year-on-year) and 11,669 cases were concluded (up 86.5 per cent year-on-year). The rise in the number of cases has been linked to the cleaning up of ‘zombie enterprises’ and the policy of ‘cutting overcapacity’, which refers to industries such as coal and steel. Some coal and steel enterprises have been closed down through insolvency proceedings. One of the common reasons that so many enterprises have been in crisis is the high cost of financing. Lending institutions have usually invested in state-owned enterprises and battalion enterprises with a very high profile in their locality, while a large number of small and medium-sized private enterprises still obtain loans though the use of material guarantee (especially real estate, listed companies and other collaterals, the value of which is relatively stable, and can be circulated rapidly). Another common reason is that a large number of enterprises are surrounded by a ‘guarantee circle’. When a certain enterprise encounters risks,
associated enterprises and cooperative enterprises are often faced with having to bear their guarantee responsibility. This can result in threats to the cash flow of those enterprises, or the generation of regional risks.

III  TRENDS

In all likelihood, the number of insolvency cases will continue to rise in the future. First of all, the economic environment still faces many challenges, such as overseas trade war and the transformation of industry within China. In some industries, such as coal and steel, consolidation and withdrawals will continue for a while. Second, the popularity of insolvency is increasing steadily. More and more debtors have begun to understand the relevant law and tried to find a way out of their debts by means of insolvency. Third, the insolvency process itself is expanding. For example, the introduction of pre-packaged resolutions would reduce the time and costs of formal insolvency process, therefore more and more debtors, especially corporate groups, prefer to implement it before applying for bankruptcy reorganisation. In addition, the mechanism of insolvency for individuals is also being explored, and might be incorporated into the law in the near future.

The following areas of industry and types of companies are likely to be affected by developments in the coming year.

i  Large private group company

One of the main characteristics of this type of company is family governance, rather than a professional management system. Another is its source of funds, a large proportion of which comes from private loans rather than financial loans with high rate interests. Large private group companies can occur in diverse industries. The high financial costs and scattered business operations make them relatively vulnerable to risks, and most of them are not well prepared for the risks they may face the future. In the event of a trade war or a reduction in capacity, they can be vulnerable to financial crisis.

ii  Holding company or parent company of a listed company

The shareholders of listed companies tend to maximise the use of listed companies as financing tools. The high stock pledge rate of listed companies has been of wide concern during 2018, having triggered the need for loan recovery via forced liquidation by financial institutions. To resolve this crisis, many local governments introduced funds for shareholders of listed companies through acquisition and restructuring from various channels. However, this policy was adopted for only a few high-profile enterprises and industrial support enterprises. It is also only a short-term solution, and there is therefore the potential for serious risks resulting from distrust and non-cooperation between the restructuring party and the original controllers.

iii  Real estate companies

The real estate market, especially in terms of commercial real estate companies, is showing a trend of uneven development. The market in mega cities and central cities has been buoyant for a long time; many places have even issued lottery policies to regulate it. In contrast, a large number of small and medium-sized cities, and even suburban areas of large cities, have developed blindly in the past few years. Some commercial real estate companies rely more on
the possibilities for follow-ups rather than the buildings themselves. However, if the level of investment fails to reach expected targets, it can be difficult for them to collect payments and pay their due debts (especially in the case of after-sales leaseback and buyback).

iv  New economy and new financial corporates

These types of companies are those promoted by high-profile enterprises and founded by entrepreneurs who are over-optimistic about the future and rely on sharing, platform and other similar concepts. Following the removal of the requirement for the paid-in contribution ratio under the Company Law, the threshold for setting up a company is greatly reduced, which has stimulated a wide range of entrepreneurial enthusiasm. However, these companies are often ‘chasing the wind gap’. They are significantly affected by market forces and other non-specific factors, and have almost no anti-risk capabilities. This year, the incidence of financial crisis experienced by online peer-to-peer companies indicates that these types of companies can potentially be at great risk.

v  Developments in insolvency

Integration with asset trading markets

More and more asset management companies and distressed asset investors are starting to invest in distressed debts and bankrupt companies. They have already gained considerable income based on their advantages of information, profession and funds. Some companies have even established funds specifically to invest in bankrupt companies. To a certain extent, the insolvency area is considered an opportunist’s paradise.

Regeneration of bankrupt enterprises

Credit repair, business recovery and debt exemption are all difficult for bankrupt enterprises to resolve solely under the regime of the insolvency law. Better coordination between insolvency law and numerous other laws and regulations is therefore necessary. There have been some attempts in this regard, and investigations have been carried out through various ‘coordination between government and court’ policies, but, in practice, there are still significant difficulties that need to be overcome.

vi  Expectations in legislation

a  Personal insolvency will be formally legislated for, either separately or incorporated into the existing insolvency law. We remain cautiously optimistic.

b  Special enterprises, such as banks, securities companies and insurance companies, may be governed by special laws.

c  Pre-packaged resolution may be incorporated into regulations, in preparation for being part of formal insolvency proceedings in the near future.

d  A procedure for summary bankruptcy may become a special system, similar to simple trial in litigation. With more and more bankruptcy cases occurring, the use of a summary bankruptcy procedure would improve efficiency greatly.

e  Enterprise group insolvency will be included in the field of law enforcement, and may be regulated by a specific provision in the insolvency law.

f  The cross-border insolvency system will be gradually improved. At present, the Supreme Court has initiated judicial interpretative work to draft and pilot the system, which may be regulated in a specific chapter in the forthcoming insolvency law.
I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law
The Cypriot Companies Law (Cap 113) is the primary legislation that governs corporate insolvency matters in Cyprus and is supplemented by the Companies (Winding-up) Rules and the Civil Procedure Rules. Certain provisions of the Bankruptcy Law (Cap 5) and the Bankruptcy Rules, which apply to individuals, are also applicable to companies in insolvency. The provisions of the Companies Law govern every company that is registered in the Republic of Cyprus, notwithstanding that there are special insolvency rules for sector-specific instances, such as banking institutions and insurance companies.

The Companies Law was amended in 2015, with the aim of modernising the legal framework and simplifying the procedure for compulsory winding up, and for the purpose of introducing an examinership scheme as a creditor-friendly alternative option to the winding up of a company.

With the latest amendments, the procedure for compulsory winding up has been expedited significantly with the implementation of various provisions to this effect, such as faster appointment of a liquidator of a company, even in circumstances where there are different classes of creditors, and the power of the court to order the premature liquidation of a company if its assets are insufficient to cover the liquidation expenses and its affairs do not require further investigation. Another significant amendment, which was introduced to facilitate the liquidation procedure, is the enhancement of the liquidator's overall powers, including the management of assets that have been subject to a charge in favour of a secured creditor. Still, the granting of this power is subject to the court's discretion, upon its satisfaction that such a disposal could lead to a more beneficial liquidation of the assets of the company.

The examiner scheme allows the creditors of a company to reach a formal settlement that will enable the company, which would have otherwise been wound up, to continue its operations for the purpose of repaying all its creditors. Aside from examinership and compulsory winding up, the insolvency of legal entities can also be dealt with through voluntary or court-supervised winding up, reorganisation and receivership.

ii Policy
The prevailing practice for companies in financial distress was to liquidate, owing to the absence of any material corporate rescue mechanisms. The provisions on examinership signify a shift in policy, made in an effort to avoid liquidation in circumstances where there are

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prospects that a company can become viable, provided that the creditors of the company can reach a compromise. In line with this policy, the requirements for the approval of a compromise or arrangement between a company’s creditors or its members, have also been simplified by lowering the relevant threshold.

At the same time, the necessity for reform of the company insolvency provisions was mandated by the need to resolve a great number of non-performing loans by companies, which had accumulated during the financial crisis in 2013 in Cyprus. The aim of this legislative reform was to render the liquidation procedure more efficient and cost-effective, as well as to ensure that, following the liquidation of a company, assets would be released and subsequently bolster the economy.²

### iii Insolvency procedures

#### Liquidation

In general, the purpose of winding-up proceedings under Cypriot law is to enable a liquidator to collect and realise a company’s assets for the settlement of its liabilities by way of distribution of the assets to the creditors. Under Cypriot law, a company may be wound up following a compulsory winding up, a voluntary winding up or through a court-supervised winding up.

**Voluntary winding up**

Voluntary winding up does not require any court involvement and it may be commenced either by the members of the company or its creditors, depending on whether the company is solvent or not, respectively.

The key aspect of a voluntary winding up by members is that the company must be in a position to be able to pay its debts within 12 months of commencement of the liquidation procedure, during which time its assets shall be distributed among its members. To this effect, a statutory declaration must be made by the directors of the company, stating the ability of the company to pay its debts within the above-mentioned time frame. In the event that the members’ liquidation procedure as a whole is not concluded within 12 months, the liquidation must then continue as a creditors’ voluntary liquidation.

Once the affairs of the company are completely wound up, certain procedural steps must be taken by the liquidator so that the company is deemed dissolved. These include the preparation of a report indicating how the winding up was conducted and the way the company assets were distributed, the presentation of said report to a general meeting of the company, and the filing of the same with the registrar of companies.

As to a creditors’ voluntary winding up, the procedure comprises members’ meetings and creditors’ meetings. The aim of the former is to adopt a resolution for the winding up of the company and for the appointment of a liquidator. At the creditors’ meeting, a statement of the company’s financial position must be presented, with a list of the creditors’ claims, and a liquidator must be nominated to act in the place of the liquidator chosen by the members of the company. Should the two nominees differ, the creditors’ choice shall prevail, and if there is a dispute, the matter may be resolved by the court. Finally, a committee of inspections must be appointed by the creditors, which may consist of up to five persons who will provide supervision and assistance to the liquidator, as well as fixing his or her remuneration.

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² Preamble of Amending Law No. 63(I)/2015, titled The Companies (Amending) (No. 3) Law of 2015.
In both types of voluntary liquidation, the liquidator is granted extensive powers to complete the process of winding up. In certain instances, the approval of the inspection committee or the court shall be required, for example if the liquidator decides to settle any claim or proceed with a compromise.

**Compulsory winding up**

A compulsory winding up may be commenced, *inter alia*, if:

- a company has resolved, by special resolution, to be wound up by the court;
- a company fails to deliver the statutory report to the registrar of companies or to hold the statutory meeting;
- a company does not commence its business within a year of its incorporation, or it suspends its business for a whole year;
- the number of members is reduced to below one in the case of a private company, or below seven in the case of any other company;
- a company is unable to pay its debts; or,
- the court is of the opinion that it is just and equitable that a company should be wound up.

Pursuant to the Companies Law, a company is considered unable to pay its debts if:

- it is indebted with a total sum exceeding €5,000, the concerned creditor has served the company with a written notice demanding payment of the incurred debt due, and the company has failed to pay the sum owed within three weeks of the date on which the written notice was served;
- following a judgment issued against a company’s property, the execution thereof fails to settle the debt;
- the court is satisfied that the company is unable to pay its debts when due, having taken into consideration, for the purpose of reaching this decision, the prospective and future liabilities of the company; or
- the court is satisfied that the value of the assets of a company is less than its liabilities, taking into account its prospective and future liabilities.

There is no additional test to be applied by the court to establish whether a company is insolvent. Thus, for instance, in case (a) above, the mere fact that the company failed to pay the amount of €5,000 will suffice for the issuance of a winding-up order of the company by the court. However, winding up is a discretionary remedy and the court, in exercising that discretion, may take into account various factors, such as the possibility that the company may secure funding or the fact that the winding-up petition is not supported by the majority of the creditors.

If a winding-up order is issued, the company can no longer trade, except with the approval of the court (or the committee of creditors, if there is one), for the realisation of the available assets. No pending action can be continued, or commenced against, the company except by leave of the court and subject to such terms as the court may impose. Any disposition of the company’s property that takes place after the commencement of winding up (i.e., after the filing of the winding-up petition), and any transfer of shares or alteration in the status of the members of the company after the commencement of winding up, shall be void unless the court orders otherwise.
Compulsory liquidation is the most formal insolvency process and the relevant proceedings generally require more than two years to complete, depending on a number of factors, such as the available assets of the company and the number of creditors. Once all the affairs of the company have been completely wound up, the court, following an application by the liquidator, shall order the dissolution of the company.

_Court-supervised winding up_

Court-supervised winding up constitutes a combination of the voluntary and compulsory winding up processes. Specifically, following the approval of a resolution for a voluntary winding up, the court may issue an order for the continuation of this procedure under its supervision. The time frame for the conclusion of these proceedings shall vary from case to case.

_Examinership_

Examinership is a debt restructuring and corporate rescue procedure for insolvent companies, or companies that are likely to be insolvent, the purpose of which is to give a company facing insolvency a period of protection from its creditors, to facilitate its survival as a going concern and to save viable businesses and jobs.

For an examinership order to be granted, the court must be convinced that the company has a ‘reasonable prospect of survival’. Whether such a prospect exists is determined by the court on the basis of a petition that is filed before it, accompanied by a report by an independent expert. Courts and insolvency practitioners are granted a margin of appreciation in determining whether a company has reasonable prospects of survival. The policy in instances of examinership is that creditors should not be put in a worse position than they would be in the event of liquidation.

Examinership orders are issued if the following requirements are collectively met:

- **a** the company in question must be unable to pay its debts or is likely to be unable to pay its debts;
- **b** no liquidation order has been issued by a court, nor has a voluntary liquidation resolution been adopted;
- **c** the company has reasonable prospects of survival of its business as a going concern either in whole or part; and
- **d** no receiver has been in office for more than 30 days.

Once an application for the appointment of an examiner is filed, the company is placed under the protection of the court for four months (which may be extended under specific circumstances for another two months by the examiner, if appointed). Within this period, no winding-up orders can be issued against the company, a receiver cannot be appointed, no execution measures can be taken against the company, and no action can be taken to materialise a mortgage of a company under examinership without the consent of the examiner, if an examiner has been appointed.

Once appointed, the examiner is vested with the rights and powers of an auditor, thus enabling the examiner to formulate proposals for saving the company. The court may also grant the examiner additional powers, including any or all of the directors’ powers (management and borrowing) or the liquidator’s powers, or both.
The examiner formulates proposals and presents them to the creditors and shareholders. He or she is primarily responsible for the formulation of an arrangement scheme that will allow the company to continue its operation as a going concern after the protection period has expired. Having formulated his or her proposals, the examiner must convene and preside over such meetings of the members and creditors of the company as he or she thinks proper, and report back to the court on those proposals within 60 days of being appointed.

The examinership procedure is still rather new and, so far, it has not been successful, because the law enables the respondent company to easily employ delaying tactics or simply to oppose the application for the appointment. Thus, in most cases, it will not be possible to have a hearing on the application for the appointment of an examiner and to obtain a court order for the appointment of one within the four months during which the company is under the protection of the court.

Reorganisation

The Companies Law allows for company restructurings to materialise in the form of compromises or arrangements, either between the company and its creditors or any class of them, or between the company and its members. This mechanism may be used for the financial restructuring of a company that is viable but subject to short-term liquidity problems, or to effect a wide range of mergers and reorganisations of companies. It may also be employed in the context of winding up.

Under this scheme, compromises between the majority of a company’s creditors can be made, which may then be imposed on all its creditors and enable class rights of company members to be varied. Such a scheme cannot be sanctioned by the court if it is ultra vires to the company’s memorandum and articles of association, or if it is contrary to the law.

To be precise, a company, creditor, member, or, in the case of a company being wound up, the liquidator, may apply to the court for an order for a meeting of the creditors or members of the company to be convened, in whatever way the court directs, to consider the proposal. If the majority, in value, of the creditors or members present and voting, either in person or by proxy, agree to the compromise or arrangement, an application is then made to the court for sanctioning. Once the court has sanctioned the compromise or arrangement, this becomes binding on all the creditors or members, as the case may be.

During the procedure for the reorganisation or compromise, the company has no protection from the creditors of the company. However, the procedure is flexible and fast. Therefore, with proper planning, reorganisations can be completed fairly quickly, especially if the majority of the creditors consent to such a restructuring.

Receivership

The appointment of a receiver may be available if a charge has been provided to a creditor. The receiver is responsible for realising the assets subject to the charge and for discharging the debt from the proceeds. The general practice in Cyprus is that a receiver is appointed on the basis of a floating charge covering all the assets of the company, up to the amount of the secured debt. The standard provisions of the debenture would enable the creditor, without having to obtain a court order to that effect, to appoint a receiver with extensive powers to manage the company.
The precise powers and capacity of the receiver will be determined by the provisions of the authorising instrument, pursuant to which the receiver was appointed. Not only does the receiver enjoy the express powers conferred by the authorising instrument, but he or she also has implied powers to take the necessary steps to liquidate the charged assets.

An appointed receiver acts as a fiduciary of the secured lender by which he or she was appointed, and is liable towards him or her, including civil liability as a result of a duty of care, or a contractual liability on the basis of the contract between the receiver and the secured lender. In addition, the receiver has a duty of care towards third persons, whose assets the receiver happens to hold under his or her capacity. Further, the receiver is under a duty to act diligently towards the rest of the creditors of the company. In view of the importance of the role, the receiver must exercise his or her duties with accuracy, honesty and diligence. Once a receiver has been appointed on the basis of the terms of the debenture, most of the directors’ powers are suspended and the directors are left only with limited residual powers.

The appointment of a receiver on the basis of a charge is preferred by creditors because it is more efficient and less time-consuming. In practice, the receiver will aim to liquidate the company’s charged assets, to recover and pay the debt to the secured creditors as effectively and quickly as the receiver’s rights and duties allow. A receiver may also be appointed as an interim measure in the context of ongoing legal proceedings, provided that the conditions of the law are met, pending the adjudication of such proceedings.

Ancillary insolvency proceedings

In instances where Regulation (EU) 2015/848 on insolvency proceedings (the Insolvency Regulation) is applicable, insolvency proceedings initiated in another EU Member State are instantly recognised in Cyprus. Secondary proceedings may be initiated in support of main proceedings in another Member State only when the company has an establishment in Cyprus. The Regulation applies only to companies whose core main interests are within the European Union.

In instances where the Insolvency Regulation is not applicable, and in the absence of any bilateral treaty stating otherwise, Cypriot courts will apply the general principles established under English common law in relation to insolvency. These principles dictate that the effect of a winding up or a dissolution of a foreign company will be recognised under the law of the state of the company’s incorporation. Additionally, Cypriot courts will recognise the status of a foreign liquidator and his or her right to be in control of company assets. This recognition stems from the principle of universalism, which is a long-established feature of common law.

iv Starting proceedings

Voluntary winding up

A members’ voluntary winding up can be effected on the basis of a special resolution by the members of a company, or with an ordinary resolution if the articles of association of a company envisage a fixed period for the company’s lifetime or indicate that the company may be wound up if a certain event should occur. The voluntary winding up of a company is deemed to be effective as of the date of the adoption of the resolution. Similarly, a creditors’ voluntary winding up is initiated with the adoption of the relevant resolution and the convening of the relevant meetings, as explained in Section I.iii.
Compulsory winding up

Compulsory winding up commences with the filing of a winding-up petition. This may be filed by, among others, the company, its creditors, its contributories, an examiner, or an insolvency practitioner of a different EU Member State in accordance with the provisions of the Insolvency Regulation.

Examinership

A petition for the appointment of an examiner may be filed by the company itself, its creditors, shareholders holding more than 10 per cent of the issued share capital of the company, or by any guarantor of the company’s obligations.

Reorganisation

An application to convene a meeting for the purpose of reaching a compromise or arrangement may be filed by the company itself, a creditor, a member or, in the case of a company being wound up, the liquidator.

Receivership

A receiver may be appointed once the conditions set out in the relevant underlying instrument are fulfilled, provided he or she also submits to the registrar of companies the relevant forms and documents required in relation to his or her appointment.

Control of insolvency proceedings

The court and the official receiver act as supervising authorities of the winding-up procedure, and of the liquidators in a compulsory winding up. As regards voluntary winding up, the liquidator, any contributory or a creditor may apply to the court to determine any question arising in the course of the winding up of a company, or to exercise all or any of the powers that the court could exercise if the company were to be wound up by the court.

In the context of receivership, the receiver may, if deemed necessary, apply to the court for directions in relation to any particular matter arising in connection with the performance of his or her functions. The court may give such directions, or may make such order declaring the rights of persons before the court or otherwise, as the court deems just.

Special regimes

The Business of Credit Institutions Law\(^3\) and the Resolution of Credit Institutions and Investment Companies Law\(^4\) have been enacted for the purpose of regulating the operations and compliance issues of banking institutions. The Insurance and Reinsurance Services and Other Related Business Law\(^5\) governs the same in relation to insurance companies. The provisions of these laws are supplementary to the insolvency provisions provided in the Companies Law.

\(^3\) Law No. 66(I)/1997.
\(^4\) Law No. 22(I)/2016.
\(^5\) Law No. 38(I)/2016.
vii  Cross-border issues
The jurisdiction of the Cypriot courts in cross-border insolvency cases derives primarily from the Insolvency Regulation and the principles developed under English common law. In general, Cypriot courts are willing to assist with and facilitate corporate insolvency proceedings or judgments with cross-border characteristics, provided that the proceedings or judgments are not against public policy in Cyprus, that they were taken in accordance with the law of the country of incorporation of the company, and that there is no domestic law that prevents the recognition or enforcement thereof.

II  INSOLVENCY METRICS
The growth rate of the Cypriot economy in the first quarter of 2019 was positive, and was estimated at 3.2 per cent compared to the first quarter of 2018. This can be explained by the growth in construction, information and communication, professional, scientific and technical, administrative and support, and arts and entertainment sectors. The financial and insurance sector recorded a negative growth rate. In the same period, there has been a steady decline in unemployment (roughly 34 per cent). The growth forecast for 2020 is currently 2.6 per cent.6

According to the available data, the number of winding-up orders issued in the context of compulsory winding up has decreased significantly compared to previous years, whereas there has been a steady increase in voluntary winding-up proceedings.7

III  PLENIARY INSOLVENCY PROCEEDINGS
One of the most significant insolvency proceedings in Cyprus is the liquidation proceedings of FBME Bank Ltd (the Bank). The Central Bank of Cyprus (CBC), having revoked the Bank’s licence to operate a branch in Cyprus on the basis of the Resolution of Banking and other Institutions Law,8 filed a petition with the court pursuant to the provisions of the Business of Credit Institutions Law, seeking the special liquidation of the Bank, the headquarters of which are located in Tanzania. Both the CBC’s application and the respective appeal were dismissed.

In the meantime, the Bank’s licence to operate as a banking institution in Tanzania was revoked by the Bank of Tanzania, which subsequently appointed a liquidator. The Tanzanian liquidator filed an application in Cyprus seeking formal recognition of its authority to act as the liquidator of the Bank in Cyprus as well. Pending the determination of this application, the CBC filed another application seeking the liquidation of the Bank’s branch in Cyprus. The second application was filed on the basis of the newly amended provisions of the Business of Credit Institutions Law, with which the definition of a licensed banking institution was amended to include a Cyprus branch of a foreign bank. Both applications are currently pending.

8 Law No. 17(I)/2013.
The cases involve complex and unprecedented legal and procedural issues, as follows:

- The relevant legal provisions for the special liquidation of banking institutions were only implemented in Cyprus in 2013. They are now being tested before the court and are subject to legislative review;
- This is the first case concerning the special liquidation of a bank in Cyprus;
- It is the first time that Cypriot courts had to decide whether they had jurisdiction to put a foreign banking institution under special liquidation, based on the fact that the institution’s licence to operate a branch in Cyprus had been revoked; and
- It is the first time Cypriot courts are having to adjudicate whether the CBC or a foreign regulator (non-EU) has the authority to liquidate the Cyprus branch of a foreign banking institution.

IV ANCILLARY INSOLVENCY PROCEEDINGS

There is no public information or publicly available cases regarding ancillary insolvency proceedings pending before Cypriot courts.

V TRENDS

Following the financial crisis in 2013, Cyprus’ economy has shown remarkable resilience and, following various reforms to correct fundamental weaknesses in its financial system, the economy has, for the most part, recovered and been stabilised. Proactive measures combined with insolvency legislation have led to the reduction of non-performing loans. In addition, the regulation and supervision of banking institutions has become stricter, which has also affected lending. These factors have resulted in a significant decline in the number of insolvent companies, and the general anticipation is that insolvency activity will generally decrease in the coming years.

Cyprus’ economy has also experienced, and is continuing to undergo, a period of consolidation, which has mostly affected the banking and insurance sectors. In total, four banking institutions have ceased operations, two of which were considered to be among the largest domestic banks. Consolidation in the insurance industry is also anticipated in the near future. These mergers and acquisitions are perceived to be necessary and positive as these sectors have long been understood to be non-viable.

I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

The cornerstones of UK insolvency law are the Insolvency Act 1986 (IA 1986) and the Insolvency Rules 2016 (IR 2016), which together form the legislative landscape that applies to both companies and individuals on their insolvency (or at the time when insolvency is a real possibility). A modified form also applies to certain forms of partnership, with special insolvency regimes applying to distinct categories of regulated entities (see Section I.vi).

Supplemental legislation, including the Companies Act 2006 (which formulates certain requirements for schemes of arrangement, often used to implement restructurings) (CA 2006), the Company Directors’ Disqualification Act 1986 and the Law of Property Act 1925 (which, in some cases, governs the ability of a secured creditor to enforce its security or pursue other self-help remedies outside the insolvency framework), also serve to support the IA 1986 and the IR 2016.

Although the laws of the European Union have only limited effect on the UK’s domestic insolvency framework, it regulates issues of jurisdiction and recognition in many EU cross-border cases. As discussed in more detail in Section V.i, there remains considerable uncertainty (and there is likely to be uncertainty for some time to come) as to the impact of the United Kingdom’s withdrawal from the European Union (as notified on 29 March 2017 in accordance with Article 50 of the Treaty on European Union) on these cross-border cases (both in the European Union and the United Kingdom), and on the continued applicability of EU law in the United Kingdom. Much depends on the form that Brexit takes, which is as yet unclear. The existing legal framework is expected to remain until the United Kingdom

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1 Peter Newman and Karen McMaster are partners and Isabel Drylie is an associate at Milbank LLP. The authors acknowledge the contributions of Ian Johnson of Slaughter and May to the England and Wales chapter published in the sixth edition of The Insolvency Review, upon which this chapter is based.

2 This chapter considers insolvency and related restructuring laws applicable in England and Wales, which are referred to as UK insolvency law. It does not address analogous, but different, laws that apply in Scotland and Northern Ireland.

3 These came into force on 6 April 2016, in most cases replacing the Insolvency Rules 1986 in their entirety.

4 With certain significant exceptions, such as the Financial Collateral Arrangements (No. 2) Regulations 2003 (implementing the EU Directive on Financial Collateral Arrangements, which aims to simplify the process of taking and enforcing financial collateral across the European Union). The regulations disapply a number of provisions of the Insolvency Act 1986 [IA 1986], including the moratorium on enforcement of security in insolvency processes, such as administration and company voluntary arrangements and the order of priority of claims in floating charge realisations.
withdraws, with the expectation that significant elements of the restructuring and insolvency framework will remain in place during any transitional period, and is therefore still addressed in detail in this chapter.

Regulation (EU) 2015/848 on insolvency proceedings (recast) (the Recast Insolvency Regulation) is currently the most significant piece of EU law in the restructuring and insolvency space – though the impact of the recently approved Directive (EU) 2019/1023 on Preventative Restructuring Frameworks (the Preventative Restructuring Directive) remains to be seen. The Directive provides for increased moratorium protection, prohibition of use of *ipso facto* termination clauses and the introduction of a restructuring plan that can be confirmed with cross-class cramdown. Proposed reforms to the UK legislative framework that incorporate these changes are discussed in Section V.iv.

The Recast Insolvency Regulation is directly applicable in all EU Member States except Denmark,\(^5\) in cases where the debtor's centre of main interests (COMI) is situated in an EU Member State. It imposes a framework of jurisdictional rules governing the opening of all proceedings that fall within its scope, overriding the national law of EU Member States where necessary, and thus limiting the jurisdiction of the English courts to open main insolvency proceedings in certain circumstances. Particular debtors fall outside the scope of the Recast Insolvency Regulation, the key examples being credit institutions and insurance undertakings, which are subject to separate regimes. The majority of the provisions in the Recast Insolvency Regulation came into force on 26 June 2017, following extensive review and revision of Council Regulation (EC) No. 1346/2000 (the original Insolvency Regulation). The original Insolvency Regulation continues to govern insolvency proceedings opened prior to that date. Throughout this chapter, we use the term ‘Insolvency Regulation’ where the position under the original Insolvency Regulation and the Recast Insolvency Regulation is the same.

Where the Insolvency Regulation applies, main proceedings\(^6\) may only be opened in the UK if the debtor company’s COMI (which is presumed, in the absence of proof to the contrary, to be where the debtor's registered office is located)\(^7\) is in the UK. If the company’s COMI is in another EU Member State, secondary proceedings\(^8\) may be opened in the UK if the company has an establishment\(^9\) in the UK. Insolvency proceedings opened in an EU Member State under the Insolvency Regulation will be automatically recognised without

\(^{5}\) References to ‘EU Member State’ in the remainder of this chapter should be taken to mean an EU Member State other than Denmark.

\(^{6}\) Main and secondary proceedings for the purposes of Regulation (EU) 2015/848 on insolvency proceedings (recast) [Recast Insolvency Regulation] must be ‘collective insolvency proceedings’ and are listed in Annex A to the Regulation. Those relevant to corporate insolvencies in the UK are: winding up by or subject to the supervision of the court; creditors’ voluntary liquidation (with confirmation by the court); administration (including out-of-court appointments) and voluntary arrangements.

\(^{7}\) Under the Recast Insolvency Regulation, the presumption does not arise if the registered office has been moved to another Member State in the three months before the request for the opening of insolvency proceedings.

\(^{8}\) Under the original Insolvency Regulation, such secondary proceedings had to be winding-up proceedings, and were listed in Annex B. The Recast Insolvency Regulation has removed this restriction.

\(^{9}\) The Insolvency Regulations diverge in their definition of ‘establishment’ – the Recast Insolvency Regulation introduces a three-month ‘look back’ period from the onset of main proceedings to determine whether a company has or had an establishment for the purposes of the Recast Insolvency Regulation, whereas the original Insolvency Regulation contained no such time limit.
any formality in all EU Member States, including the UK, from the time the judgment opening the proceedings becomes effective in the EU Member State in which the proceedings are opened.

In instances where a company's COMI is outside the European Union, the Insolvency Regulation will not apply and the UK, in common with other EU Member States, will be free to act in accordance with its existing laws and practice when exercising jurisdiction, opening proceedings and recognising and enforcing proceedings opened within and outside the European Union.

ii Policy

The Enterprise Act 2002 overhauled the corporate insolvency regime in the United Kingdom to better facilitate corporate rescues. The administration regime was simplified and the circumstances in which the holder of a qualifying floating charge\(^\text{10}\) (QFC holder) may appoint an administrative receiver were significantly curtailed. These changes were intended to make the UK appear more rescue-orientated and debtor-friendly as a jurisdiction, where entrepreneurial activity is encouraged and where, in the absence of wrongdoing by a company’s directors, business failure should not face the same stigma as previously. Although the government has been considering options for the reform of the corporate insolvency framework, including proposals intended to further facilitate restructurings and business rescue, it remains unclear at the time of writing whether the proposed reforms will be implemented. The proposed reforms are discussed in Section V.iiv.

When a business in the United Kingdom is in financial difficulties, the traditional approach to keep the business trading was to attempt to achieve a consensual solution. That said, the ever-increasing complexity of capital structures, diverse views of different stakeholders and the flexibility of implementation options (such as schemes of arrangement, company voluntary arrangements (CVAs) and pre-packaged administrations (discussed in Section I.iii)) have contributed to an increasing prevalence of solutions that are not fully consensual – either a ‘stick’ to encourage consensual negotiations and elicit compromises from creditor groups, or the implementation of a broadly consensual process with some dissenting creditors.

iii Insolvency and rescue procedures

Absent any jurisdictional limitations imposed by the Insolvency Regulation or any special insolvency regimes being relevant (see Section I.vi), the processes described below can be used either to rescue or to wind up a company in the UK. In brief, a company (including an overseas company if its COMI is in England or if the company is otherwise found to have sufficient connection with this jurisdiction)\(^\text{11}\) may be placed into voluntary or compulsory liquidation (unless it is subject to a special insolvency regime), or made the subject of any of three alternative statutory procedures: administration, CVA or receivership. In addition, a company may have its debts rescheduled or compromised by way of a creditors’ scheme of arrangement (hereafter, a scheme). Unlike liquidation, administration, CVAs and schemes may each form part of a restructuring plan, or may offer a means to rescue a company. The

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\(^{10}\) Broadly defined as a floating charge over the whole or substantially the whole of the company’s property.

\(^{11}\) See Sections 220 to 221 of the IA 1986, which allow for the winding up of foreign companies as unregistered companies.
IA 1986 also provides for receivership (including administrative receivership)\(^{12}\) – a self-help remedy allowing a secured creditor to realise charged assets to recover what it is owed, outside a formal insolvency process.

**Liquidation**

A company may be liquidated on a solvent basis by way of a members’ voluntary liquidation (MVL) or on an insolvent basis through a creditors’ voluntary liquidation (CVL). CVLs are also available for companies to exit administration. Creditors have greater power in a CVL than in an MVL, being able to appoint a liquidation committee to supervise certain aspects of the winding up. A company can also be wound up on an insolvent basis by the courts in a compulsory liquidation.

In both voluntary and compulsory liquidations, the liquidator’s duties include collecting in and realising the assets of the company over which he or she has been appointed for distribution to the creditors. There is no prescribed time limit within which to complete this process – once concluded, the company will be dissolved. If the liquidator believes that he or she could achieve a better result for the creditors were the company to be placed in administration, then he or she may make an application to the courts for himself or herself or another person to be appointed as administrator.

To the extent that main proceedings are pending in another EU Member State (in which the company’s COMI is located), a CVL can still be commenced in the UK where the company has an establishment in the UK. If, however, main proceedings have already been opened in another EU Member State, the English courts must stay the secondary proceedings in whole or in part if requested to do so by the officeholder in the main proceedings.\(^{13}\) The English courts also have the power to request the officeholder in the main proceedings to take any suitable measure to guarantee the interests of the creditors in the secondary proceedings and of individual classes of creditors.

If a company is incorporated outside the UK and the company’s COMI is not located in an EU Member State, it may still be wound up as an unregistered company under the IA 1986 in certain circumstances, including when it is unable to pay its debts or if a court is of the opinion that it is just and equitable to wind it up. Statute does not provide guidance as to the criteria that an English court would rely on to assume jurisdiction; however, case law has identified the following further requirements that must be met for the courts to exercise their discretion to make a winding-up order:

\(\text{a}\) there must be a sufficient connection with England;

\(\text{b}\) there must be a reasonable possibility, if a winding-up order is made, of benefit to those applying for the winding-up order; and

\(\text{c}\) one or more persons interested in the distribution of assets of the company must be persons over whom the courts can exercise jurisdiction.

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\(^{12}\) It is not possible to appoint an administrative receiver in respect of a company incorporated outside the UK.

\(^{13}\) As discussed in Section I.v, the court may refuse to open secondary proceedings if an undertaking to respect local priorities is in place.
The sufficient connection test may be satisfied by, for example, the presence of assets within the jurisdiction or finance documents that are governed by English law. The courts may also assume jurisdiction if the insolvency procedures in the relevant foreign jurisdiction are found to be unsuitable or outmoded.\textsuperscript{14}

\textit{Administration}

An administrator can be appointed in instances where (1) a company is, or is likely to become, unable to pay its debts and (2) the purpose of administration is likely to be achieved. The ‘purpose’ of administration is set out as a hierarchy of three objectives. The primary objective is to rescue the company as a going concern, failing which the administrator must seek a better result for the company’s creditors as a whole than would be likely in a winding up (this being the second objective). If the second objective is not achievable, the third objective is to realise the company’s property for distribution to secured or preferential creditors.

The second objective may be achieved by disposing of the company’s business or its assets by way of a pre-packaged sale (pre-pack), the terms of which are agreed before the appointment of an administrator. In the case of a pre-pack, the sale is effected immediately (or soon after) the administrator takes the appointment (neither notification to the unsecured creditors nor their prior consent is required). Although the pre-pack is the subject of some controversy, it has proven to be a useful restructuring tool that has, on occasion and subject to the approval of the courts, been used by foreign companies following a shift of their COMI to England (see Section I.vii). In the \textit{Hellas Telecommunications} case,\textsuperscript{15} the court held that the industry guidance on the use of pre-packs provided by Statement of Insolvency Practice\textsuperscript{16} had been complied with and expressly gave the administrators liberty to proceed with the pre-pack as, on the evidence, there was no realistic alternative to realising better value for creditors.\textsuperscript{17} In addition, since November 2015, an independent pre-pack pool of experienced business people has been available to scrutinise proposed deals involving connected parties, set up to address concerns about the fairness and transparency of pre-packs involving connected parties. This has not been extensively used to date, but its use is encouraged in these connected party cases.

An administrator cannot be appointed to a company whose COMI is located outside the European Union unless it is either registered under the Companies Act 2006 or incorporated in a European Economic Area state other than the UK.\textsuperscript{18} The English courts’ jurisdiction is, for this purpose, narrower than that for liquidations (as discussed earlier in this Section, an

\begin{itemize}
\item \textsuperscript{14} \textit{Re a company (No. 003102 of 1991) ex parte Nyckeln Finance Co Ltd} [1991] BCLC 539.
\item \textsuperscript{15} For example, \textit{Hellas Telecommunications (Luxembourg) II SCA} [2009] EWHC 3199 (Ch).
\item \textsuperscript{16} A Statement of Insolvency Practice (SIP 16 – Pre-packaged Sales in Administration) was introduced in November 2015 to ensure greater transparency of pre-packs. It sets out the required disclosures that an administrator must make to creditors of the details of any pre-pack agreement and sale.
\item \textsuperscript{17} A pre-pack administration can also be combined with a scheme, as seen in the IMO Carwash, McCarthy & Stone and, more recently, New Look restructurings.
\item \textsuperscript{18} But note the exception provided by Section 426 of the IA 1986 that permits the English courts to assist courts having insolvency jurisdiction in other ‘relevant countries’: in \textit{Re Dallhold Estates (UK) Pty Ltd} [1992] BCC 394 the court acceded to the request of a Western Australian court to grant an administration order in respect of an Australian company with assets in this jurisdiction.
\end{itemize}
overseas company can be wound up if it has sufficient connection with this jurisdiction). Annex A of the Recast Insolvency Regulation lists administration as a ‘collective insolvency proceeding’.

The administration will end automatically after one year, save when extended by court order or with the consent of the creditors. Complex administrations often necessitate extensions.

**Company voluntary arrangement**

A CVA constitutes a binding agreement between a company and its unsecured creditors to compromise the company’s debts, made with the aim of allowing companies in financial difficulties to avoid liquidation. If the proposal advanced by a CVA is (1) approved by 75 per cent or more (by value) of the company’s creditors and (2) not rejected by more than 50 per cent (by value) of the company’s creditors admitted for voting who are ‘unconnected creditors’, 20 it will bind all creditors who were entitled to vote in the decision-making process, regardless of whether they were notified about it. 21 Dissenting creditors and creditors whose votes are required to be left out of account are therefore bound by a resolution of the requisite majorities. Secured and preferential creditors will not be bound unless they have given their consent and, therefore, CVAs are less commonly used by companies to compromise large amounts of secured debt.

A CVA may be used alongside, or to obviate the need for, other insolvency procedures, such as administration or liquidation, where the moratorium against creditor action can be advantageous. An optional moratorium in a CVA is otherwise available for certain small companies. The advantage of a CVA is that it is quick to implement, 22 offering a flexible tool that requires minimal court involvement. CVAs have proven to be a fashionable tool for the retail sector, both at the height of the global financial crisis and more recently, as a way for a company to reach agreement with its landlords and other unsecured creditors. The most recent trends are discussed in Section III.i.

Annex A of the Recast Insolvency Regulation lists a CVA as a collective insolvency proceeding, and it can therefore be proposed by any company, wherever incorporated,
provided the company’s COMI is situated in the UK. If approved, the CVA will be binding throughout the European Union and will have the same effect in other EU Member States as it does under English law.23

**Creditors’ scheme of arrangement**

Although a scheme of arrangement is not an insolvency process *per se* (the court’s authority to approve a scheme of arrangement is contained in the Companies Act 2006),24 it offers a court-sanctioned compromise or arrangement between a company and its creditors, or any class of them, to reorganise or reschedule the company’s debts. It can be implemented with or without formal insolvency proceedings – a scheme alone does not benefit from a moratorium, so administration or liquidation would be required if this is necessary.25 A scheme may be used to vary a class of creditors’ rights and can bind dissenting creditors if the requisite majority or majorities of each class (being 50 per cent in number and at least 75 per cent by value) vote in favour of the scheme. Uses have included amendments and extensions to maturity of outstanding loans, or implementation of debt-for-equity swaps, where the underlying loan facility requires higher levels of consent that are not forthcoming. It may provide valuable breathing space ahead of a wider restructuring26 or as a threat to encourage consensus in restructuring negotiations.

The process of obtaining sanction for a scheme takes time but it may be possible to complete the procedure in approximately six weeks, subject to court availability, once the scheme document has been finalised and circulated. In contrast to a CVA (in which the creditors effectively vote as a single class), debates regarding the appropriate composition of creditors are common and will be considered at the convening hearing. However, the scheme does retain the critical advantage over a CVA in that it is binding on all members of the relevant class (or classes) of secured creditors once it has been approved by the requisite majorities, received court sanction and is filed with the Registrar of Companies – in contrast, a CVA can only bind secured creditors to the extent that the relevant creditor gives its consent to be so bound.

Schemes of arrangement have become popular with overseas companies as restructuring tools. They are available to companies capable of being wound up under the IA 1986,27

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23 A CVA is not specifically listed as a winding-up proceeding for the purposes of Annex B to the original Insolvency Regulation. Arguably though, if it is not effected within a liquidation or administration, it can be proposed as a means of terminating secondary proceedings for the purposes of the original Insolvency Regulation on the basis that it amounts to a ‘composition’ (see Article 34). The original Insolvency Regulation provides that closure in this way requires the consent of the liquidator in the main proceedings but, in the absence of such consent, it may become final if the financial interests of the creditors in the main proceedings are not affected by the measure proposed. The scope of secondary proceedings under the Recast Insolvency Regulation is no longer limited to winding-up proceedings.

24 The English courts’ jurisdiction to sanction a scheme hinges on their jurisdiction to wind up the scheme company in question (the criteria for which are discussed earlier in this Section).

25 The court has stayed proceedings for summary judgment, however, in a case where steps to implement a scheme were well advanced and it had a reasonable prospect of success: *Re Vietnam Shipbuilding Industry Group & Ors* [2013] EWHC (Comm) 1146.

26 For example, the scheme proposed by DTEK Finance Plc in April 2016, which provided the group with a moratorium in which to negotiate a restructuring.

27 Companies Act 2006, Section 895.
including an unregistered company that has ‘sufficient connection’ to the jurisdiction;\(^\text{28}\) English governing law and jurisdiction clauses in financing documents have been held to give sufficient connection to the jurisdiction,\(^\text{29}\) including where the relevant clauses have been amended to English law in anticipation of the scheme.\(^\text{30}\) Whether a procedure that is equivalent to a scheme is available in the relevant overseas jurisdiction will be a factor that the courts take into account: the courts will also want to be satisfied that recognition of the effects of the scheme will be given in other jurisdictions. This concern is often heightened when local creditors that are known to oppose the scheme may attempt to ignore its terms and bring claims against the debtor or its assets (if located outside the UK) on the basis of the original (pre-scheme) finance documents (see Section I.vii for further details).

Recognition of schemes by the courts of certain EU Member States has been made challenging owing to the fact that a scheme falls outside the scope of the Insolvency Regulation and is neither an informal out-of-court procedure nor a formal court-based procedure. Although Regulation (EU) No. 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (the Judgments Regulation) may provide for recognition, the courts have not conclusively determined whether schemes fall within its scope (see Section I.vii for further details). If an overseas court refuses to recognise a scheme under the Judgments Regulation (or recognition has been sought in jurisdictions where the Regulation does not apply), that court may be able, typically with the benefit of expert evidence, to recognise the scheme under private international law. Recognition of schemes remains a divisive topic and robust expert evidence on recognition is almost certain to be required if, for example, there are foreign borrowers or guarantors, or if some or all of the debt is foreign-law governed. In addition, depending on the terms upon which the UK withdraws from the European Union, the position regarding recognition of schemes involving companies incorporated within the European Union, or with assets located in the European Union, may be further complicated and uncertain.

Schemes may also be afforded recognition in countries outside the European Union that have implemented the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (the UNCITRAL Model Law) in a form allowing for recognition of such processes.\(^\text{31}\)

\(^{28}\) Including those whose centre of main interests [COMI] is located in another EU Member State. The English courts’ jurisdiction in relation to schemes of foreign companies has been found not to have been fettered by the Insolvency Regulation: see Re Drax Holdings; Re Inpower [2003] EWHC 2743 (convening hearing: 17 November 2003) and Re Dap Holding NV [2005] EWHC 2092 (sanction hearing: 26 September 2005).

\(^{29}\) See, for example, the decisions relating to Tele Columbus, Rodenstock, PrimaCom, Seat Pagine, Vivacom, Cortefiel and Zlomex.

\(^{30}\) e.g., Re Apcoa Parking Holdings GmbH & Ors [2014] EWHC 1867 and Re DTEK Finance BV [2015] EWHC 1164 (Ch), in which the governing law in an indenture relating to high-yield bonds was changed from New York law to English law before the scheme application was made.

\(^{31}\) e.g., Chapter 15 of the US Bankruptcy Code, which implements the UNCITRAL Model Law in the United States, amended the definition of ‘foreign proceedings’ to include ‘adjustment of debt’, which may include certain schemes of arrangement. US courts have recognised a significant number of schemes of arrangement, particularly in cases involving the restructuring of New York law-governed bonds or loans, including most recently the Nyrstar and Noble restructurings.
iv Starting proceedings

**Liquidation**

A voluntary liquidation (whether an MVL or a CVL) is initiated by members of the company passing a special resolution that must state either, in the case of an MVL, that they are in favour of a voluntary liquidation, or, in the case of a CVL, that the company cannot continue its business by reason of its liabilities and that it is advisable to wind it up. Prior notice must be given by the directors to any QFC holder of their intention to propose a resolution for voluntary liquidation. The liquidation commences on the date the resolution is passed. In an MVL, the liquidator is appointed by the members, while in a CVL they are appointed by the creditors. An MVL will be converted to a CVL if, during the MVL, the liquidator forms the opinion that the company will be unable to pay its debts (and any interest) in full.

A compulsory liquidation is typically initiated on presentation of a winding-up petition to the court, generally by the company, the directors or (more often) a creditor. A court can make a winding-up order on the grounds that the company is unable to pay its debts or if the court believes it is just and equitable that the company be wound up. The petition must be advertised, either through publication in the London Gazette, or in another manner deemed suitable by the court, at least seven days before the hearing. This provides notice to creditors and other interested parties who may then attend the hearing and bring the court’s attention to material relevant to whether a winding-up order should be made.

If the court is satisfied that the grounds for winding up are met, it will make a winding-up order. The role of liquidator will be automatically assumed by the official receiver (who is an officer of the court) until another liquidator is appointed. Receivers and administrators may also present petitions, and any QFC holder entitled to appoint an administrator may apply to the court to have the winding-up order discharged and an administrator appointed.

After the presentation of the winding-up petition but before a winding-up order is made, the court has the power to appoint a provisional liquidator to a company. This is similar in effect to compulsory liquidation, though the court can limit the powers of the provisional liquidator. Although relatively uncommon, provisional liquidation may be useful in certain circumstances, including when there are concerns that the directors will dissipate the company’s assets between the presentation of the winding-up petition and the making of the winding-up order.

**Administration**

A company is placed in administration through either the in-court route (filing an application to the court for the appointment of an administrator) or the out-of-court-route (filing documents with the court to document the appointment of an administrator). The company, its directors or a QFC holder have the power to appoint an administrator out of court; however, a QFC holder may prefer the directors to make an application for reputational reasons, while also being able to influence the selection of the administrator.

An application for a court-based appointment may be made by the company, its directors or any creditor. This form of application might be the only route available – if, for instance, a creditor has presented a winding-up petition against the company, or if there are other reasons why a court-based appointment is expedient. It may be preferable

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32 Notice would also be required to the appropriate regulator under the Financial Services and Markets Act 2000 if the company is an authorised deposit taker under the Banking Act 2009.
to seek a court-based appointment to give a proposed administrator comfort in instances where a pre-pack sale of the company or its assets is proposed which is otherwise at risk of being challenged, or when there is a cross-border element and there is a concern that an out-of-court appointment might not readily be recognised by a foreign court. A court-based application can also avoid the risk of a subsequent challenge as to the validity of an out-of-court appointment on the basis of a procedural irregularity.

The QFC holder may seek an in-court or out-of-court appointment if an event has occurred permitting it to enforce its security – typically a default under the relevant finance documents. Although this right of appointment can arise when a company is not insolvent, in all other circumstances it will be necessary to demonstrate that the company is, or is likely to become, unable to pay its debts, and to obtain an opinion from the proposed administrator that the purpose of the administration is capable of being achieved.

If an administrative receiver is in office, the appointment of an administrator can only be made by an application to the court. The court will only appoint an administrator with the consent of the appointor of the administrative receiver or when the court regards the security under which the administrative receiver was appointed as liable to be released or discharged (whether as a preference or a transaction at an undervalue) or that the floating charge is voidable for want of new consideration at the time of its creation.

If a secured creditor retains the right to appoint an administrative receiver, it may seek to block the appointment of an administrator by pre-emptively exercising its rights to appoint an administrative receiver, prior to the appointment of an administrator. If appointing an administrator, notice of his or her intention to appoint an administrator must be given to certain persons, including a QFC holder. During the notice period, a secured creditor who is entitled to appoint an administrative receiver may do so, or may substitute its choice of insolvency practitioner as administrator. A QFC holder who does not have the power to appoint an administrative receiver cannot block the appointment of an administrator, but may (provided the appointment is not being made by a prior ranking QFC holder) substitute its choice of insolvency practitioner as administrator.

If there is a delay between the applicant filing for administration and the order taking effect (when the in-court procedure is used) or if the applicant is required to give advance notice of its notice of intention to appoint an administrator (when the out-of-court procedure is used), an interim moratorium shields the company from creditor action, with the full moratorium taking effect on appointment.

Company voluntary arrangement

After the terms of a CVA have been proposed to a company’s shareholders and unsecured creditors, an insolvency specialist (generally an accountant) will be appointed as nominee by the directors (or, if the company is in administration or liquidation, the administrator or liquidator) to implement the CVA. The nominee reports to the court whether, in his or her opinion, the proposal should be put to members and creditors. If the nominee believes it should, he or she will seek the approval of the members at a meeting, and of the creditors by way of a qualifying decision procedure.

33 If the company is in administration or liquidation, the administrator or liquidator will usually act as the nominee.

34 Unless the liquidator or administrator is acting as nominee, in which case he or she does not need to report to the court, but proceeds straight to the decision-making stage.
A creditor or member can challenge the CVA in court only on the grounds of unfair prejudice or material irregularity (or both). Any challenge must be made within 28 days of filing of the notice of approval with the courts or, if the applicant did not receive notice, within 28 days of the day on which he or she became aware that the qualifying decision procedure had taken place. The CVA process is unlikely to be favoured if there is uncertainty regarding identification of the company’s creditors, because of the risk of a late challenge from ‘hidden creditors’.

**Creditors’ scheme of arrangement**

A scheme is typically initiated by the company (or, if the company is in administration or liquidation, the administrator or liquidator). The first step is generally the issuance of a creditors’ issues letter or ‘practice statement’ letter to outline the key terms of the scheme and set out the company’s views on class and other issues, following which the company will make an application to court for an order granting permission to convene a meeting (or meetings) of the affected creditors to vote on the scheme. The company can exclude from the scheme any creditors that are unaffected by it (e.g., those being paid in full or whose debts are not required to be compromised). Creditors whose rights are affected by the scheme vote as a class but if the requisite majority has been achieved, that class will be bound, the minority view can be disregarded and dissenting creditors’ claims will face the same treatment as creditors voting in favour of the scheme. If the voting majorities are obtained at the meeting, or meetings, the company will apply to the court for an order sanctioning the scheme. The scheme becomes effective and binding on all affected creditors when filed with the Registrar of Companies.

Affected creditors have the opportunity at the convening hearing to challenge class composition, and other creditor issues, including the fairness of the scheme. If the proposed scheme relates to an overseas company, although jurisdiction issues are considered more fully at the sanction hearing, the court may give some preliminary consideration regarding whether it will ultimately have jurisdiction to sanction the scheme.

Further objections may be raised by scheme creditors at the sanction hearing (although any objections regarding class composition should have been heard at the convening hearing so any issues to be raised should go to fairness); the court may reject them and refuse to grant leave to appeal. It is unusual for a scheme to be appealed; however, in the event that the court considers that an appeal has a reasonable prospect of success, a short-term stay may be granted prior to the sanction order being made (thus preventing an order being delivered to the Registrar of Companies for registration, and the scheme becoming effective), allowing that creditor time to seek permission to appeal. If the creditor wishes to appeal a scheme in instances where an order sanctioning the scheme has already been granted and given statutory effect through registration with the Registrar of Companies, that scheme cannot be altered or terminated other than as provided for by the scheme itself, or by an application to court for a further scheme.

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35 See Practice Statement (Scheme of Arrangements with Creditors) [2002] All ER (D) 57 (Apr), the purpose of which is to enable issues concerning the composition of classes of creditor and the summoning of meetings to be identified and, if appropriate, resolved early in the proceedings.

36 Practice Statement (Companies: Schemes of Arrangement) [2002] 1 WLR 1345.

v Control of insolvency proceedings

Insolvency proceedings are managed by the insolvency office holder appointed to the company in relation to the insolvency process. In general, and as required by the IA 1986, this will be a qualified insolvency practitioner who is required to act in accordance with the regulatory regime governing their professional conduct.\(^{38}\)

As regards the directors of a company in the UK, while the company is solvent, the directors owe their duties to the company for the benefit of present and future shareholders and are not under a duty to consider creditors’ interests. To the extent that there is doubt as to a company’s solvency, or as a company approaches a ‘zone of insolvency’, its directors become obliged to consider the interests of the company’s creditors, so as to minimise the potential loss to them. In instances where a director continues to trade a business after the time that he or she has realised, or ought to have concluded, that the company has no reasonable prospect of avoiding an insolvent liquidation or administration, and do not thereafter take every step to minimise loss to each creditor, he or she may be liable for the offence of wrongful trading. A director may be liable for fraudulent trading if he or she allows a company to incur debt in circumstances where there are no good reasons for believing that funds would be available to repay the amount owed at the time, or shortly after, it became due and payable.

The liquidator or administrator is empowered, under the IA 1986, to seek a court order against directors for contributions to the company’s assets if their investigations reveal instances of wrongful or fraudulent trading, and to set aside transactions at an undervalue, preferences and transactions defrauding creditors. They may also assign certain of these claims to third parties, including creditors. They are further required under the Company Directors’ Disqualification Act 1986 to submit a report to the relevant secretary of state on the conduct of the directors and former directors of the company. That report may lead to a director being disqualified from acting as a director, or being involved in the management of a company, for a defined period, in addition to a disqualified director being required to pay compensation.

The court has minimal involvement in the conduct of a voluntary liquidation, whereas in a compulsory liquidation the court hears the application for a winding-up order. In contrast, in an administration the court will have varying levels of involvement, depending on whether the process is commenced by way of an in-court or out-of-court application and whether the administrator is likely to need directions, owing to the complexity of the company’s affairs. The court’s involvement in an out-of-court and simple application may be limited to receipt and processing of the documents required to be filed at court.

Court involvement in a CVA (other than in instances where creditors challenge the CVA) is limited to receiving a report from the nominee as to whether, in his or her opinion, the CVA proposed has a reasonable prospect of being approved and implemented and whether it should be put to the creditors and shareholders. The approval (or rejection) of the proposal must then be notified to the court through a filing within four business days of the meeting of shareholders.

Creditors wishing to challenge a CVA have 28 days following filing with the court of the CVA (or, if the creditor did not receive notice of the CVA, within 28 days of the day on which the creditor became aware of the decision procedure having taken place)\(^{39}\) in which to raise their appeal. This can be brought on the grounds of unfair prejudice or material

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\(^{38}\) An official receiver (appointed in a compulsory liquidation) is not subject to such a regime. He or she is an officer of the court and responsible directly to it and to the relevant secretary of state.

\(^{39}\) IA 1986, Section 6.
irregularity. Whether there are grounds to challenge a CVA on the basis of unfair prejudice is ultimately a question of fact; for instance, a CVA that treats different unsecured creditors in different ways may be prejudicial to those creditors, but the question of fairness depends on the overall effect of the CVA. As to material irregularity, this is also a question of fact, but relates to how the decision procedure used to consider the CVA proposal was conducted. Issues that the courts have considered include valuation of creditor claims and whether creditors with claims likely to be settled by a third party can vote in favour of a CVA.

vi Special regimes

The nature of certain businesses means that entities operating in those areas are excluded from general insolvency regimes and subject instead to special insolvency regimes that, depending on the type of business, may be based on the administration procedure in the IA 1986.

It is beyond the remit of this chapter to set out in detail the scope of each special regime; however, it should be noted that particular rules apply to certain banks and analogous bodies (both from a national and broader European standpoint), insurance companies, postal services, water or sewerage companies, certain railway companies, air traffic control companies, London Underground public-private partnership companies, building societies and bodies licensed under the Energy Act 2004.

Under English law, each company is treated as a separate legal entity and there are no special regimes applicable to corporate groups. The original Insolvency Regulation did not address insolvency of corporate groups, but the Recast Insolvency Regulation formalises the historic practice under the original Regulation of streamlining insolvencies of corporate groups by opening main proceedings in one jurisdiction and effectively preventing the opening of secondary proceedings in other EU Member States by agreeing to respect local priorities (thereby achieving the same outcome for local creditors) or by postponing the opening of secondary proceedings until a global sale has been completed. The Recast Insolvency Regulation has expanded the framework for coordination of insolvency proceedings concerning corporate groups by obliging insolvency practitioners and courts involved in the

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40 Re Cancol Ltd [1996] 1 All ER 37.
41 Re Newlands (Seaford) Educational Trust [2007] BCC 195.
42 HMRC v. Portsmouth City Football Club Ltd and others [2010] EWHC 2013 (Ch).
45 Note, however, the existence of a number of statutes that provide for company groups to be considered as one entity in non-insolvency situations, for example, the Companies Act 2006 with the concept of group accounting; and taxation legislation with concepts such as ‘controlling interests’ and group taxation and tax relief.
different proceedings to cooperate and communicate, with insolvency practitioners afforded procedural tools to request a stay of other proceedings, facilitating the opening of group coordination proceedings.

Group coordination proceedings involve appointing an insolvency practitioner to act as group coordinator. This practitioner proposes a coordination plan setting out an integrated solution for insolvent group companies or those that are restructuring. That said, participation is not required, nor are participating insolvency practitioners obliged to follow the group coordinator’s recommendations or the group coordination plan. These provisions are not sufficiently embedded to assess the effectiveness of these provisions in practice and the frequency with which these tools will be used.

UNCITRAL has broadly endorsed the group coordination provisions, but has also produced a framework for legislation in relation to the insolvency of enterprise groups.48 UNCITRAL also encourages the use of cross-border protocols to facilitate cooperation between courts and practitioners.49 An early example of this approach is the Maxwell Communications Corporation case, in which the administrators appointed in the UK agreed a protocol with the examiners in the US Chapter 11 proceedings. More recently, attempts have been made to use cross-border protocols (which provide guidelines for cooperation rather than legal requirements) in certain insolvency situations, such as the Lehman and Madoff insolvencies, with mixed success.

vii Cross-border issues

This section considers the framework for cross-border cooperation and recognition as at the time of writing. The UK’s withdrawal from the European Union, which may have a significant effect on this framework, is discussed in Section V.i.

The English courts’ jurisdiction in cross-border insolvency cases derives from four sources: the Insolvency Regulation, the Cross-Border Insolvency Regulations 2006 (CBIR), Section 426 of the IA 1986 and the common law.50 As discussed in Section I.i, the English courts’ jurisdiction may be fettered by the Insolvency Regulation if a company’s COMI is situated in another EU Member State, in which case the court of that state will have jurisdiction to open main insolvency proceedings. Prior to the original Insolvency Regulation coming into effect, if a foreign company was found to have sufficient connection with England, an English court could exercise its discretion to wind up that company as an unregistered company under Section 221 of the IA 1986 (see Section I.iii). The Insolvency Regulation now prevents such steps being taken, although the test remains in place for companies that fall outside the Insolvency Regulation’s scope. An example of this is Re Arena Corporation Ltd,51 in which the English court found that a company incorporated in the Isle of Man but with

49 See the UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation (adopted 1 July 2009).
50 Note, too, the Foreign Judgments (Reciprocal Enforcement) Act 1933, which provides for enforcement in England of civil and commercial judgments made in designated jurisdictions, provided that the judgment has been registered under that statute.
51 Re Arena Corporation Ltd [2003] All ER (D) 277.
its COMI in Denmark had sufficient connection with England (in the form of location of assets) to enable the court to exercise its jurisdiction under Section 221 of the IA 1986 to wind up the company. Cases such as these, which fall outside the purview of the Insolvency Regulation, will be subject to the relevant national law, and recognised by EU Member States and non-Member States alike in accordance with the rules of private international law.

If the debtor’s COMI is outside the European Union, the Insolvency Regulation will not apply and the English courts, like those of other EU Member States, will be free to act in accordance with the UK’s existing laws and practice when exercising jurisdiction, opening proceedings and recognising and enforcing proceedings opened within and outside the European Union. However, the associated provisions under the Insolvency Regulation, including automatic recognition in all EU Member States, which are available when main proceedings are opened, will not be available. This could prove an impediment to group restructurings in which some of the debtor companies have substantial connections with one or more EU Member States but fall outside the scope of the Insolvency Regulation because their COMIs are not located in an EU Member State.

The CBIR offer another means whereby English courts may otherwise be required to recognise foreign main proceedings and foreign non-main proceedings (the equivalent of main and secondary proceedings under the Insolvency Regulation). The CBIR implement the UNCITRAL Model Law and apply it regardless of whether the relevant foreign country has enacted the Model Law. Relief by way of a moratorium on creditor action is automatically granted on recognition; other relief may be obtained at the court’s discretion. The English courts are required to cooperate ‘to the maximum extent possible’ when recognition is granted.

The English courts can also offer assistance and relief under Section 426 of the IA 1986, which provides for cooperation both between jurisdictions within the UK and between the UK and other designated (mainly Commonwealth) jurisdictions.

If the Insolvency Regulation, the CBIR and Section 426 of the IA 1986 do not apply, the English courts have inherent jurisdiction to cooperate with foreign insolvency representatives and recognise foreign proceedings, in instances where the relevant foreign office holder has satisfied the common law principles developed by the English courts. The Supreme Court considered the principles in detail in Rubin v. Eurofinance.

Some foreign companies have taken steps in recent years to shift their COMIs to the UK to take advantage of the UK’s established insolvency and restructuring processes. Forum shopping in this manner has received judicial support at EU level with clear delineation between ‘good forum shopping’, when a COMI is shifted to the best place to reorganise the

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52 Recital (33) of the original Insolvency Regulation and Recital (88) of the Recast Insolvency Regulation confirm that Denmark, which exercised its opt-out in relation to the Insolvency Regulation, is not to be regarded as a Member State for the purposes of the Insolvency Regulation.

53 The English courts may refuse to provide assistance under the Cross-Border Insolvency Regulations 2006 [CBIR] if it would be manifestly contrary to public policy.

54 In cases of conflict between the obligations of the UK under the Insolvency Regulation and the provisions of the CBIR, the Insolvency Regulation will prevail. In essence, the CBIR provide an alternative basis for judicial cooperation where the Insolvency Regulation does not apply, for example if the debtor’s COMI is not situated in an EU Member State or where the type of proceeding (or foreign representative) in question is not covered by the Insolvency Regulation, or to the extent that they do not conflict with the Insolvency Regulation.


company and its group for the benefit of creditors (and, possibly, other stakeholders), in contrast to ‘bad forum shopping’, when the company acts for selfish motives to benefit itself, or its shareholders or directors, at the expense of creditors.

Hellas Telecommunications and the more recent cases of Algeco Scotsman and Noble Group contain instructive judgments about the requirements for shifting a COMI and rebutting the presumption that a company’s COMI is in the state of registration. Factors that the courts considered relevant to the migration of COMI include: moving the company’s head office and principal operating address to England; notifying creditors of the change in address and that the company was shifting its activities to England; opening a bank account, from and to which payments were made; and registration of the company as a foreign company at Companies House. The courts in these three cases also considered it relevant that negotiations between the company and its creditors took place in England, with the court in Hellas noting that this factor was ‘one of the most important features of the evidence’ given that the ‘purpose of the COMI is to enable creditors in particular to know where the company is and where it may deal with the company’. However, it should also be noted that the court in Re Videology Ltd has cast doubt on the importance of this factor during a restructuring. While finding that the company’s dealings with customers, trade creditors and finance creditors generally was relevant to establishing the COMI, the court found that the location of restructuring meetings and negotiations ‘provide very little guidance as to where the company conducts the administration of its interests on a regular basis’.

Foreign companies may also seek to make use of an English law scheme of arrangement to compromise or amend the terms of their debt documents without first migrating their COMIs, giving rise to different cross-border issues to be determined by the English courts. They will need to determine matters such as whether the English courts have jurisdiction over the foreign company, and whether the scheme will be recognised in the foreign jurisdiction. In respect of jurisdiction, there remains some uncertainty as to the extent to which the Judgments Regulation may affect the English courts’ jurisdiction to sanction the scheme. Judges have generally avoided reaching a firm conclusion as to whether the Regulation applies to schemes, instead proceeding on the basis that even if it were to apply, one or more of the exceptions to the general rule that persons should be sued in the Member State in which they are domiciled would apply in each respective case, and so the English courts do have jurisdiction.

Finance documents, in most cases, do contain clauses conferring jurisdiction (typically one-way exclusive jurisdiction clauses) on the English courts. In the Van Gansewinkel case, Mr Justice Snowden took the view that if the jurisdiction provisions of the Judgments Regulation were to apply to schemes (a point that was not decided) then, in that particular case, it would not limit the court’s jurisdiction to sanction the scheme. If the provisions did apply, he was entitled to regard all scheme creditors as coming within the jurisdiction

57 An early example of ‘good’ forum shopping can be seen in the Schefenacker restructuring, where the holding company of a German automotive supplier moved ownership of its assets and liabilities to a new, English-registered holding company so that it could enter into a CVA.
58 Hellas Telecommunications (Luxembourg) II SCA [2009] EWHC 3199 (Ch); 2010 BCC 295.
59 Re Algeco Scotsman PIK SA [2017] EWHC 2236 (Ch); [2018] BCC 82.
61 Hellas Telecommunications (Luxembourg) II SCA [2009] EWHC 3199 (Ch); 2010 BCC 295 at [5].
62 Re Videology Ltd [2018] EWHC 2186 (Ch); [2019] BCC 195.
63 ibid., at [71].
64 Re Van Gansewinkel Groep BV & Ors [2015] EWHC 2151 (Ch) (22 July 2015).
of the English court under Article 8(1) of Chapter II, which provides that a party may be made a party to proceedings in another EU Member State in instances where one or more of the co-defendants are domiciled in that Member State and it is expedient to hear the claims against all the defendants in a single court.\textsuperscript{65} However, Snowden J noted that a one-sided exclusive jurisdiction clause for the benefit of the scheme creditors did not amount to submission by those creditors to the jurisdiction of the English court. As such, if the jurisdiction provisions of the Judgments Regulation apply to schemes, absent a migration of a COMI or other connecting factors, a one-way exclusive jurisdiction clause alone would not be sufficient to bring a company within the jurisdiction of the English court by virtue of Article 25(1) of Chapter II.

The meaning of the term ‘judgment’ in Article 32 of the Judgments Regulation also continues to be debated in relation to schemes. Some commentators have argued that, albeit that the term is given broad scope by Article 32, the procedure for implementing an English scheme is not adversarial in nature and so the sanction order cannot be considered a judgment and cannot not be granted recognition under that regulation. Further English and European case law on this topic is likely, particularly as the approach with regard to recognition following Brexit becomes clear, as schemes remain a popular and flexible implementation tool.

\section{II INSOLVENCY METRICS}

In the first quarter of 2019, the underlying number of companies entering insolvency proceedings increased, rising by 5.1 per cent compared with the same quarter in 2018 and 6.3 per cent higher than the previous quarter. The main increase was in CVLs and administrations, with the latter increasing by 21.8 per cent on the previous quarter. In the 12 months ending in the first quarter of 2018, the estimated liquidation rate was 0.42 per cent of all active registered companies (or one in 238 of all active companies), up slightly from 0.41 per cent in the 12 months ending in the fourth quarter of 2018. The highest number of insolvencies in the 12 months ending in the first quarter of 2019 was in the construction sector, and the second highest\textsuperscript{66} was in the ‘wholesale and retail trade; repair of vehicles’ industrial grouping, the grouping in which there was also the greatest increase in insolvencies for that period.\textsuperscript{67}

The common view among commentators is that the economy continues to be adversely affected by the continued uncertainty regarding Brexit. UK gross domestic product (GDP) was estimated to have increased by just 0.5 per cent in the first quarter of 2019, driven by strong growth in manufacturing output of 1.9 per cent. Production increased by 1.1 per cent, widely regarded to be consistent with increased activity ahead of the UK’s originally intended departure date from the European Union, as businesses seek to build stocks of raw materials and other inputs in anticipation of delays at border crossings; however, it is not possible to

\textsuperscript{65} Mr Justice Snowden found that the number of scheme creditors domiciled in England (15 of the 106 creditors, spread across the classes) and the size of their claims (€135 million in total) were sufficient to make it expedient for all scheme claims to be determined together.

\textsuperscript{66} Adjusting for an anomalous bulk insolvency filing.

discern the extent of the influence of these uncertainties. The July average of independent forecasts for GDP growth (compiled by HM Treasury) was 1.3 per cent for 2019, increasing to 1.4 per cent for 2020.68

The labour market remains robust, with data from April to June 2019 demonstrating an employment rate (the proportion of people aged between 16 and 64 in work) of 76.1 per cent, the joint highest level since comparable records began in 1971. The unemployment rate remained stable at 3.9 per cent, down from 4 per cent a year earlier.69

The 12-month inflation rate was 2 per cent in June 2019, unchanged from May 2019. The rate has fallen steadily from a high of 2.8 per cent in autumn 2017, and the Bank of England has said in its latest inflation report that it is projected to continue on a downward trajectory owing to projected falls in energy prices in the short term, but that it will gently increase as GDP increases and surpass the target rate of 2 per cent, reaching 2.4 per cent by the end of the three-year forecast period.70

In August 2018, the Monetary Policy Committee, whose remit is to set monetary policy to meet the 2 per cent target rate in a way that helps sustain growth and employment, voted to raise the bank rate to 0.75 per cent from 0.5 per cent (only the second rate increase in more than a decade). Along with other commentators, the Monetary Policy Committee has been clear in its view that the process of withdrawal of the UK from the European Union has noticeably affected the economic outlook, and that although monetary policy can support the economy, it is limited in its ability to shield the economy from the adjustments promulgated by Brexit. At its meeting in July 2019, the Monetary Policy Committee acknowledged that the levels of adjustment remain uncertain, and that its current decision-making is predicated on the basis of a smooth transition. Moreover, assuming a smooth Brexit and some recovery in global growth, the Committee expects a significant margin of excess demand to build in the medium term, which could necessitate increases in interest rates to return inflation sustainably to the 2 per cent target.71

III PLENIARY INSOLVENCY PROCEEDINGS

i CVA restructurings

In the past, a significant number of restaurants and bricks-and-mortar retailers turned to CVAs as part of their efforts to restructure their businesses. As the high street continues to be challenged by declining footfall, increasing business rates and the shift in preferences to online retail, businesses have used CVAs increasingly to restructure their lease portfolios and compromise their landlords. Commentators have noted that CVAs are not generally sufficient to save businesses (particularly retail) in isolation, and the four examples below illustrate this trend. This is particularly relevant for Jamie’s Italian, where the CVA did not ultimately prove sufficient to save the business.

71 Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 31 July 2019, 1 August 2019.
**Debenhams**

Debenhams is a department store in the United Kingdom and Ireland with franchise stores in other countries. The company, founded in the 18th century as a single store in London, now operates in 178 locations across the UK, in Ireland and in Denmark. As conditions have become more challenging on the high street, Debenhams' trading performance has weakened. In October 2018, the company announced the largest loss in its history – a pre-tax loss of £491 million – and plans to close up to 50 stores with the potential loss of 4,000 jobs.

Debenhams entered into negotiations with its lenders and other stakeholders, including Sports Direct, which owned close to 30 per cent of the shares in the retailer, regarding a restructuring of the group. A number of offers were made by Sports Direct International plc to inject new capital into the group, which were ultimately not considered deliverable. Debenhams plc entered administration on 9 April 2019 and the group was sold, via a pre-pack administration, to its lenders in a debt-for-equity swap.

On 26 April 2019, Debenhams announced that it was proposing a CVA with its landlords. The key elements of the CVA were that, although it was proposed that all Debenhams stores were to remain open during 2019, including through Christmas peak trading, up to 22 stores would be expected to close in 2020. The CVA also contemplated a business rate cut of between 48 per cent and 50 per cent on 58 of its stores. If approved, the CVA also provided for a fund of up to £25 million to be made available for those creditors compromised by the CVA to participate in future growth of the UK business.

The CVA was approved by the requisite majorities on 9 May 2019. Companies in the Sports Direct group and the Combined Property Control Group (the landlord of six Debenhams sites) sought to challenge the CVA. At the time of writing, the High Court had heard (but had not handed down judgment on) a challenge to the CVA brought by the Combined Property Control Group (the landlord of six Debenhams sites), which was funded by the Sports Direct group (though the group had withdrawn its challenge to the CVA). The hearing had been brought on an expedited basis as one of the challenges to the CVA was the grant of security to creditors that were previously unsecured, and the granting of that security would not be reviewable by an administrator absent an order on the challenge to the CVA during early September 2019.

**Arcadia Group**

The Arcadia group owns a number of high street brands, including Topshop, Dorothy Perkins, Miss Selfridge, Evans and Burton, with more than 570 stores in the UK.

Having lost credit insurance for suppliers, and with like-for-like sales at Topshop (its flagship brand) falling by 20 per cent in the year to December 2018, on 22 May 2019 Arcadia announced seven CVAs in respect of its group, which contemplated the closure of 23 stores, the wind-down of its US operations, a rent reduction of between 25 per cent and 50 per cent across the majority of its remaining stores (down from between 30 per cent and 70 per cent reductions originally), a reduction in the level of contributions to its pension scheme and a business rates holiday to 1 April 2020. In return the shareholder, Lady Tina Green, committed to contribute £100 million over three years to the pension fund, and landlords were offered a portion of the returns of any sale of Topshop.

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The CVA was narrowly approved by creditors, including the Pension Regulator and the Pension Protection Fund, on 12 June 2019. However, two of the CVAs now face a legal challenge in the United States from the landlords of two Topshop stores in the United States. At the time of writing, those challenges are still pending.

**Jamie's Italian**

Jamie's Italian was established in 2008, and priced towards the upper end of high street chains of Italian restaurant. A number of factors had affected the performance of the business, including a legacy of underinvestment in older restaurants, investment in unsuitable locations and sites with high occupancy costs. At the same time, conditions in the casual dining market have become increasingly challenging, with higher labour costs and business rates alongside lower consumer spending power and confidence. The sector is particularly competitive as brands have expanded rapidly, leaving businesses little scope to pass on increased costs to consumers, with other chains – including Carluccio’s, Prezzo and Byron Burger – turning to CVAs themselves.

Jamie’s Italian Limited proposed a CVA with its creditors, with a key aim of placing its lease portfolio on a more sustainable footing. Landlords were split into four bands, based on the profitability of their sites, and each band faced different treatment:

a. the business would continue to pay full rent at the top sites, though on a monthly rather than a quarterly basis;

b. in the second group, landlords would have their rent reduced by 30 per cent;

c. the third group of less profitable sites would have their rent reduced by 75 per cent until May 2018, whereafter the business intended them to close; and

d. the final group comprised landlords who did not receive any payments under the proposal as the sites were not being used for trading.

The proposal was approved by 97.44 per cent by value of all creditors on 9 February 2018.

Unfortunately, the steps taken were ultimately insufficient to save the business and, on 21 May 2019, KPMG were appointed as administrators to Jamie Oliver Restaurant Group Limited (which owned Jamie’s Italian and a number of other restaurant brands).

**New Look**

New Look is a fast-fashion brand with 593 stores in the UK and 302 stores across Europe, China and Asia. New Look has also suffered from a challenging trading performance in a difficult retail environment, which has again been affected by factors such as increased online competition, weaker consumer confidence and the changing tastes of its target customers.

To reduce its rental cost base and to restore long-term profitability, New Look launched a CVA on 7 March 2018 to deliver cost savings by compromising leases. Under the CVA proposal, 60 UK stores were identified for potential closure, along with six sites that were sublet to third parties, and 393 stores benefited from reduced rent (ranging between 15 per cent and 55 per cent) and revised lease terms. On 21 March 2018, 98 per cent of New Look’s creditors voted in favour of the CVA proposals.

New Look announced on 14 January 2019 that it had reached an agreement in principle with certain of its key financial stakeholders in relation to a transaction aimed at deleveraging and strengthening its balance sheet, and announced on 3 May 2019 that the restructuring had been implemented. The restructuring was achieved by way of a scheme of arrangement and a pre-pack sale of the group, and saw a reduction in New Look’s existing

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debt obligations to €350 million from €1.35 million, with the bondholders compromising their debts receiving 20 per cent of the shares in the New Look group. New Look also issued new notes in an amount of €150 million to provide additional liquidity, with holders of those notes receiving 72 per cent of the shares in the New Look group.

**Steinhoff Group**

Established over 50 years ago as a small South African outfit, Steinhoff Group has grown into a multinational retailer of furniture and household goods. On 6 December 2017, Steinhoff Group announced that it had begun an independent investigation into potential accounting irregularities led by PricewaterhouseCoopers, with profits and assets found to have been overstated by nearly US$12 billion.

In November 2018, as part of a broader restructuring of the group, Steinhoff proposed CVAs in respect of the obligations of two financial holding companies – Steinhoff Europe AG and Steinhoff Finance Holding GmbH. The key terms of the CVAs were as follows:

a. in respect of Steinhoff Europe AG, the approval of a new holding structure and hive down of assets to that holding structure;
b. restructuring of existing financial indebtedness into a payment-in-kind instrument;
c. provision of a new deferred contingent payment instrument for creditors previously benefiting from a guarantee; and
d. the implementation of an interim moratorium for the period following approval of the CVA and implementation of the CVA proposal.

The CVAs were approved, by majorities of 94 per cent in respect of Steinhoff Europe AG and 98 per cent in respect of Steinhoff Finance Holding GmbH, on 14 December 2018. The CVAs were implemented on 13 August 2019.

**ii Schemes of arrangement**

As discussed in Section I.iv, a scheme is not a specific insolvency tool, but its role in implementing complex cross-border restructurings cannot be overlooked. As these case studies demonstrate, it remains a popular restructuring tool for overseas companies.

**Nyrstar Group restructuring**

Nyrstar is a global multi-metals business, with a market leading position in zinc and lead, and growing positions in other base and precious metals. The Nyrstar business has mining, smelting and other operations located in Europe, the Americas and Australia and employs approximately 4,200 people in its various locations. Trafigura, the global commodities trader, which played an important part in Nyrstar’s restructuring, is a key shareholder, creditor and trade counterparty of Nyrstar.

Starting in 2009, at the peak of the commodities supercycle, Nyrstar purchased mines and zinc and lead smelters, which later struggled to make any kind of return and left the company facing significant debts and interest payments. More recently, Nyrstar had faced a challenging zinc market, particularly struggling with low zinc processing fees and metal prices that led to several huge profit warnings in 2018.

An English law scheme of arrangement was used to implement the deal eventually struck between Nyrstar and its bondholders. NN2, a Nyrstar group subsidiary and a newly incorporated English holding company, acceded to each of Nyrstar’s bond issuances as
England and Wales

c-o-issuer or co-obligor and proposed the scheme. This accession, in addition to amending the jurisdiction clause of each issuance of bonds to be governed by English law, was carried out to facilitate the restructuring and establish a connection with the courts of England and Wales.

The result of the scheme was an exchange of the Nyrstar note holders’ claims against Nyrstar for new instruments issued by Trafigura, comprising €262.5 million of new perpetual notes (subordinated securities), €80.6 million of new 2023 medium-term notes and the US dollar equivalent of €225 million guaranteed zero coupon commodity-linked principal amortising instruments.

The overall group restructuring resulted in a total deleveraging of Nyrstar of approximately €1.1 billion (from approximately €2.5 billion prior to the restructuring). In addition, the restructuring resulted in Trafigura increasing its equity stake in Nyrstar to 98 per cent and the provision of new liquidity by Nyrstar’s existing bank lenders.

Noble Group

Noble Group Limited is a major global commodities trader, incorporated in Bermuda, listed in Singapore and with its COMI in Hong Kong. In December 2018, it implemented a multi-billion-dollar restructuring involving shifting its COMI to London, implementing parallel English and Bermudan schemes of arrangement, obtaining recognition of the English scheme in the United States via Chapter 15 of the US Bankruptcy Code, and, as a final step in the process, implementing a light-touch Bermudan provisional liquidation procedure.

The scheme was novel for several reasons. First, in addition to compromising financial liabilities, the scheme also compromised certain contingent liabilities to non-finance creditors who had asserted claims against the company, including in respect of certain guarantees and certain litigation. In addition, certain steps relating to the implementation of the scheme (that had been sanctioned within the scheme order) were implemented by the Bermudan provisional liquidator, in the place of the company. This was required as following sanction of the schemes, the Singaporean authorities decided not to allow the company to transfer its listing status to a newly incorporated entity that was to act as the holding company for the restructured Group, which would have otherwise impeded the restructuring.

The English and Bermudan schemes of arrangement were approved by an overwhelming majority of scheme creditors: 99.98 per cent by value and 98.52 per cent by number. The English scheme was sanctioned on 12 November, the Bermuda scheme was sanctioned on 14 November and the schemes were granted recognition in the United States, via Chapter 15 of the US Bankruptcy Code, on 15 November.

The overall group restructuring reduced the debt burden of the Noble Group by more than US$2 billion and resulted in the transfer of 70 per cent of the equity in the group to creditors.

IV ANCILLARY INSOLVENCY PROCEEDINGS

As the prevalence of cross-border restructurings increases, the instances of recognition of foreign processes in the United Kingdom continues to increase. The Videology case demonstrates that recognition issues cannot be taken for granted, especially in instances where a COMI shift is being relied upon.
Re Videology Ltd

Videology Limited was an English incorporated company within the Videology Group, which operated from leased premises in London. Having faced setbacks – including increased competition, loss of funding and a number of litigation claims – Videology, with its US incorporated parent and a number of its subsidiaries, filed a petition under Chapter 11 of the US Bankruptcy Code to organise a sale of the group’s business and assets. Although protection from creditor action arose automatically under Chapter 11 for the companies subject to that process, protection needed to be sought under English law against Videology’s creditors in the UK.

Videology and its parent applied under the Cross-Border Insolvency Regulations for recognition of the Chapter 11 process as a foreign main proceeding under Article 17 of the UNCITRAL Model Law, and for the court to grant a discretionary moratorium and an extended moratorium pursuant to Articles 20 and 21 of the UNCITRAL Model Law, respectively, which would, taken together, prevent individual and collective actions by creditors in the UK.

In respect of the parent, the court was satisfied that its COMI was in the United States and that the Chapter 11 proceedings were foreign main proceedings. Discretionary relief under Article 20(6) and Article 21(1) therefore followed on a final basis. However, in respect of Videology, the company was required to demonstrate that its COMI was in the United States to obtain the relief sought, and so rebut the presumption that its COMI was in the UK. The company drew the court’s attention to the fact that senior management were based in the United States, there was no distinct branding from the US operations, strategic decisions were known by third parties to have been made in the United States and, finally, recent creditor meetings regarding the company’s financial situation took place in the United States.

These factors were insufficient to persuade the court that the presumption had been rebutted. The court noted that the UK was where the company’s ‘trading premises and staff are located, where its customer and creditor relationships are established, where it administers its relations . . . on a day-to-day basis using those premises and local staff, and where its main assets . . . are located’.

Ultimately, the court held that the Chapter 11 proceedings were, in fact, foreign non-main proceedings (on the basis that the COMI was not in the United States); nevertheless, it granted the discretionary relief sought under Articles 20 and 21 of the UNCITRAL Model Law. In reaching this conclusion, the court noted that:

a it was typical for extended relief under Article 21(1) to be given to foreign main proceedings which, by their nature, were debtor-in-possession proceedings;

b in situations where the proceedings were recognised as foreign non-main proceedings, the starting point would be to recognise the proceedings in the UK as the main insolvency proceedings, which is where the company’s COMI is; and

73 Re Videology Ltd [2018] EWHC 2186; [2019] BCC 195 (Ch) at [55].
74 ibid., at [62].
75 ibid., at [59] and [60].
76 ibid., at [70].
77 ibid., at [72].
78 ibid., at [83].
79 ibid., at [85].
to grant the relief sought, there would need to be evidence of obvious benefits to the creditors as a whole, and good reasons for preventing creditors in the UK from commencing an insolvency process in the country where the company had its COMI.\textsuperscript{80}

The evidence put forward by Videology persuaded the court that the sale of the group’s business was financially desirable, more so than a stand-alone administration or liquidation; the Chapter 11 proceedings would protect the creditors’ interests, the unsecured creditors had an effective voice in the sale negotiations and evidence was adduced from various unsecured creditors that they were in support of the Chapter 11 proceedings.\textsuperscript{81}

\section*{V. TRENDS}

\subsection*{Uncertainty regarding the EU referendum and the future of cross-border restructurings in Europe}

As discussed in Section I.i, the United Kingdom voted in favour of withdrawing from the European Union in a referendum on 23 June 2016 and on 29 March 2017, the UK government exercised its right under Article 50 of the Treaty on the European Union to notify the European Union of the UK’s intention to withdraw from the European Union.

At the time of writing, it remains unclear whether the terms of the UK’s withdrawal will be agreed before the scheduled departure date, currently 31 October 2019 (though this remains subject to change).\textsuperscript{82} In particular, negotiations regarding the treatment of the border between the Republic of Ireland and Northern Ireland continue to prove fractious, and a no-deal Brexit remains a possibility, absent concessions from the UK or the European Union, or both. Should the terms of withdrawal be agreed, a withdrawal agreement will address matters such as citizens’ rights, the financial settlement between the UK and the European Union, and arrangements for the transition period.

There remains considerable uncertainty (and there is likely to be uncertainty for some time to come) as to the effect the UK’s withdrawal will have on the regulatory environment in the European Union and the UK, and on the applicability of EU law in the UK. If a deal is not agreed, it is likely to be harder for UK office holders and UK restructuring and insolvency proceedings to be recognised in EU Member States and to deal effectively with assets located in the Member States, as the principles of mutual recognition of proceedings and judgments included within the Insolvency Regulation will fall away, and the need may well arise to open parallel proceedings, increasing the element of risk. In particular, in cases where the appointment of a UK office holder has been made in reliance on a UK domestic approach, it is much less certain that there will be recognition in the relevant Member State even if UK jurisdiction is taken on the grounds of a UK COMI or establishment (where such concepts are retained as a matter of UK domestic law).

\textsuperscript{80} ibid., at [86].
\textsuperscript{81} ibid., at [99].
\textsuperscript{82} We note that The European (Withdrawal) (No. 6) Bill, which gained royal assent on 9 September 2019, requires the Prime Minister to request an extension to this departure date. It remains to be seen whether the timetable will alter in light of this new legislation.
Even in a Brexit with an agreed deal, the latest draft of the withdrawal agreement\textsuperscript{83} (though this is still being negotiated) anticipates that the Insolvency Regulation and the Judgments Regulation will cease to apply at the end of any transition period. Nevertheless, the Insolvency Regulation will apply to insolvency proceedings if main proceedings were opened before the end of the transition period, the Judgments Regulation will afford recognition and enforcement of judgments in legal proceedings instituted before the end of the transition period, and the provisions of the Judgments Regulation regarding jurisdiction will apply to legal proceedings commenced prior to the end of the transition period.

As such, in a no-deal Brexit and, absent agreement on a permanent framework with Member States in an agreed Brexit, much will therefore depend upon the private international rules in the particular Member State. As described in Section I.vii, although the UNCITRAL Model Law is one avenue of bilateral recognition (there are others), not many EU Member States have implemented legislation based on the Model Law. Approaching each jurisdiction on a case-by-case basis would further complicate cross-border restructurings, but has the potential to offer the English courts a more flexible approach to exercising discretion as to jurisdiction, which could make schemes of arrangement an even more attractive restructuring tool (although this is far from certain).

The continued uncertainty regarding the UK’s relationship with the European Union after Brexit does not appear, as yet, to be affecting the UK’s popularity as a restructuring hub. However, this may change if it appears no deal will be reached prior to the currently scheduled departure date (31 October 2019 at the time of writing).\textsuperscript{84} It is difficult to say whether the popularity of the English restructuring and insolvency market will be dampened in the long term. Absent ongoing participation in a framework for mutual recognition (whether the Insolvency Regulation or a new framework), cross-border procedures may become more complex to implement or gain recognition for, which has the potential to affect the English courts as a forum for restructuring.

\textbf{ii Insolvency activity}

As discussed in Section II, the uncertainty surrounding Brexit continues to have a dampening effect on the economy, and may have greater consequences depending on the ultimate timing and nature of the withdrawal from the European Union. It is difficult to predict with any certainty what the effect might be on insolvency activity (as so much depends on this); however, there are certain sectors that are likely to be at risk regardless of the effects of Brexit.

\textit{Bricks-and-mortar retailers and restaurants}

As discussed in Section III.i, these sectors continue to face strong headwinds and we expect this to continue into 2020. If consumer spending continues to be muted, while input costs continue to increase, profit margins will fall further as competition between different retailers and restaurants continues to be fierce.


\textsuperscript{84} See footnote 82, above.
Automotive

It is our expectation that the automotive industry will come under increasing pressure, partially as a result of Brexit but also owing to the economic slowdown in Germany and reduced demand from China, and this will have a significant effect on operations within the industry. As such, we may see greater numbers of insolvencies and restructurings in this sector as suppliers face the effects of hampered demand in the coming years.

iii  Practical trends

As discussed in Section III.i, high street retailers and restaurant chains continue to use CVAs to address their portfolios of leases, but increasingly within broader restructurings of their financial liabilities (including through debt-for-equity swaps or schemes of arrangements), and to compromise their pension and business rate liabilities. We think this trend is likely to continue, but perhaps subject to the added pressures of challenges from landlords (as we have seen for House of Fraser, Debenhams and Arcadia Group, to name but a few).

Schemes of arrangement remain a popular restructuring tool within the restructuring sector and a number of international creditors have turned to schemes during the past year, including Nyrstar, Noble Group and Agrokor. That said, it remains to be seen what effect Brexit will have on the desirability of schemes as a flexible restructuring tool, particularly in light of the catalogue of reforms taking place across Europe and beyond. While views are mixed, there are indications that some jurisdictions, particularly Germany, may fail to grant recognition to the effects of schemes of arrangements, and as such their efficacy as a restructuring tool in a cross-border context may be somewhat tempered.

We also expect to see an uptick in the prevalence of administrations, or other adverse consequences, triggered by investigations by short sellers, in light of the movement towards covenant-lite instruments. The recent instance of litigation fund Burford Capital, which was the subject of short selling by US hedge fund Muddy Waters, seems to demonstrate that with lower levels of reporting in documentation, there is a growing trend for investors to review details such as accounts and investor presentations with a renewed focus to identify discrepancies, mis-descriptions and even fraudulent behaviour. We think this activity will increase in the coming years.

Another trend that is likely to continue is restructurings triggered by accounting investigations, such as the Steinhoff Group restructuring and the collapse of Pâtisserie Valérie. Increased focus is also likely to fall on directors’ duties and the challenge (after the fact) of transactions as fraudulent or voidable.

iv  Legislative developments

Reforms to insolvency and corporate governance rules

On 26 August 2018, the UK government published its response to detailed consultations carried out during 2017 and 2018 on reforms to insolvency and corporate governance rules. In its response, the government has proposed major changes to the existing regimes aimed at encouraging the recovery of viable companies, improving transparency in group structures, promoting responsible directorship and strengthening shareholder stewardship.

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85 A type of financing issued with fewer restrictions on the borrower and fewer protections for the lending party.
These changes represent the biggest reform of the UK’s domestic insolvency regime since the Enterprise Act came into force in 2002, and a significant change in focus for the UK’s rescue culture.

The main proposals are as follows:

\(a\) New restructuring plan: Creation of a new restructuring plan that will enable a company to bind all its creditors through a cross-class cramdown of dissenting creditors and the approval of the court. This is based on the existing scheme of arrangement but has elements of the US Chapter 11 process, albeit it is deliberately intended to be more flexible.

\(b\) Pre-insolvency moratorium: The introduction of a new moratorium process intended to give financially distressed (but ultimately viable) companies breathing space, free from creditor pressure, to develop a rescue plan. Initially for 28 days (but can be extended), directors will retain control of a company and a monitor (who will be a licensed insolvency practitioner) to ensure creditor interests are protected during this period.

\(c\) \textit{Ipso facto} rule: A prohibition on suppliers enforcing contractual termination rights (known as \textit{ipso facto} clauses) that would otherwise enable a contractual counterparty to terminate a contract as a result of a company going into an insolvency procedure.

\(d\) Enhanced recovery powers: The introduction of enhanced powers of recovery for insolvency office holders, including the ability to undo a transaction or a series of transactions that are deemed to have removed value from a distressed company in the period leading up to insolvency.

\(e\) Investigative powers: A new power of investigation into the conduct of former directors of dissolved companies, which will effectively enhance the existing powers of investigation into directors’ conduct and strengthen the ability to take rogue directors out of the marketplace.

\(f\) Distressed subsidiary sales: The consideration of sales of distressed subsidiaries whereby the government intends to make directors of holding companies that sell distressed subsidiaries liable for losses caused to creditors of the subsidiary in certain defined situations.

Overall, the proposed reforms are in line with the Preventive Restructuring Directive (approved in June 2019 by the European Union),\(^{86}\) which provides for increased moratorium protection, prohibition of the use of \textit{ipso facto} termination clauses and the introduction of a restructuring plan that can be confirmed with cross-class cramdown. Against the backdrop of Brexit, this clearly demonstrates the UK’s intention to remain competitive within the cross-border restructuring and insolvency market.

The government has stated that it intends to bring forward legislation to implement these proposed changes ‘as soon as parliamentary time permits’. At the time of writing, it is not clear when this will be addressed within the parliamentary timetable.

\(^{86}\) Directive (EU) 2019/1023 of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (on restructuring and insolvency).
I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law
French law provides for a well-constructed and well-tested legal framework to restructure distressed companies, with various pre-insolvency and insolvency proceedings intended to address a wide range of situations. A major reform took place in 2005, with the introduction of a Chapter 11-type debtor-in-possession procedure known as ‘safeguard’, and subsequent adjustments have significantly improved French insolvency law, which is now considered one of the most effective in Europe.

A French company is considered to be insolvent (in ‘cessation of payments’) when due and payable debts exceed available assets. It must file for insolvency within 45 days of the occurrence of such a situation.

Fraudulent conveyance rules apply to transactions entered into by a debtor between the date of the debtor’s cessation of payments (which the court can determine occurred up to 18 months before the insolvency filing) and the commencement of the insolvency proceedings. They provide that certain transactions or payments entered into during that period are void, and that any other transaction or payment entered into during that period is voidable if the counterpart was aware of the debtor’s cessation of payments.

ii Policy
Traditionally, French insolvency law favours the continuation of business and the preservation of employment over the interests of the creditors. However, several adjustments have been made to the law to improve the situation for creditors, in particular to facilitate pre-packaged sale plans, allow creditors to propose alternative reorganisation plans and facilitate debt-to-equity swaps when existing shareholders refuse to vote in favour of such a measure.

iii Insolvency procedures
Pre-insolvency proceedings include mandat ad hoc and conciliation. Both essentially consist of a mediation conducted under the authority of a mediator appointed by the court upon request of the company, to help it reach an agreement with its creditors, in particular by reducing or rescheduling its indebtedness. The debtor can determine, at its discretion, which creditors will be involved in the process. Agreements reached through these proceedings are

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1 Fabrice Baumgartner is a partner and Aude Dupuis a senior attorney at Cleary Gottlieb in Paris.
2 Transfers of assets without consideration, contracts that are significantly unbalanced, payments of debts that are not due, etc.
non-binding on third parties, and the court-appointed mediator has no authority to force the parties to accept an agreement. These proceedings are confidential, subject to one exception: if the conciliation culminates in an agreement that is approved by the court upon the request of the debtor company, then the approval becomes public. In addition, if such an approval is granted, creditors that provided new money during the conciliation proceedings or as part of the conciliation agreement will enjoy a priority of payment over all pre-petition and post-petition claims in the event of subsequent insolvency proceedings. Mandat ad hoc has no maximum duration, but typically lasts between a few months and a year. Conciliation cannot exceed five months.

Insolvency proceedings include safeguard proceedings, with the following variations: accelerated safeguard and financial accelerated safeguard, judicial reorganisation proceedings and judicial liquidation proceedings. These insolvency proceedings are similar to proceedings existing in other jurisdictions. They are not confidential and must involve all the creditors. They result in a stay on creditors’ enforcement actions for pre-petition claims.

Safeguard and judicial reorganisation proceedings are intended to reorganise a debtor through the implementation of a reorganisation plan that may provide for debt write-offs, debt rescheduling, debt-to-equity swaps, modification of interest rates, amendments of financial covenants or cash contributions to the debtor, by existing stakeholders or newcomers, by way of debt or equity. Plans also frequently contain downsizing commitments by the debtor, such as commitments to dispose of part of the business, or to downsize the workforce and to change all or part of the management team.

In the case of large companies (those with more than 150 employees or annual sales of more than €20 million), the reorganisation plan must be approved by two committees comprised of the financial creditors and the main trade creditors. In each committee, the majority required for approval is two-thirds of the creditors expressing a vote, based on value. In addition, if the debtor has issued bonds, bondholders must also approve the plan subject to the same two-thirds majority. All bondholders vote as a single group, even if there are several bond issues, series or tranches. In the absence of a creditors’ committee, or if the committees or bondholders did not vote in favour of the proposed reorganisation plan, creditors are consulted individually on the debt write-offs and debts rescheduling proposed by the debtor.

The maximum duration of the safeguard or reorganisation proceedings is 18 months. Accelerated safeguard and accelerated financial safeguard are significantly shorter, as there are pre-packaged proceedings intended to adopt a reorganisation plan negotiated during conciliation proceedings that is supported by at least two-thirds of the members of each creditors’ committee and of the company’s bondholders. The duration of the accelerated safeguard cannot exceed three months. Accelerated financial safeguard, which applies only to financial creditors and bondholders, has a maximum duration of two months.

Judicial liquidation proceedings are intended to liquidate the assets of the debtor and settle its liabilities when there is no prospect of recovery. This process has no maximum duration and generally lasts several years. In judicial reorganisation proceedings (if it appears that a reorganisation plan will not permit the recovery of the debtor) and in judicial liquidation proceedings, all or part of the debtor’s business can also be sold to a third party under a sale plan.

When main insolvency proceedings are pending in another EU Member State (except Denmark) and the debtor has an establishment in France, Regulation (EU) 2015/848 on insolvency proceedings (the Recast Insolvency Regulation) allows for the opening in France of
secondary insolvency proceedings (safeguard, judicial reorganisation or judicial liquidation). The effects of these secondary insolvency proceedings are limited to a debtor’s assets located in France.

iv Starting proceedings

Pre-insolvency proceedings (i.e., mandat ad hoc and conciliation) are available when a debtor anticipates legal, economic or financial difficulties and is not in cessation of payments (or has not been in cessation of payment for more than 45 days, in the case of the conciliation). They are commenced by order of the president of the court upon petition of the debtor.

Safeguard proceedings are available when a debtor experiences difficulties that it is not able to overcome and is not in cessation of payments. They are commenced by judgment of the court upon petition of the debtor.

Judicial reorganisation and judicial liquidation proceedings are available when a debtor is in cessation of payments and, with respect to liquidation proceedings, when a debtor’s recovery is manifestly impossible. They are commenced by judgment of the court upon insolvency filing by the debtor, or upon petition of an unpaid creditor or of the public prosecutor.

Secondary insolvency proceedings may be commenced by judgment of the court upon petition of the insolvency practitioner in a main insolvency proceedings, of a debtor, of an unpaid creditor or the public prosecutor (in the latter two situations, only if the secondary proceedings are judicial reorganisation or judicial liquidation proceedings).

Judgments commencing safeguard, judicial reorganisation or judicial liquidation proceedings or refusing to open such proceedings can be appealed by the debtor, by the creditor who requested the opening of the proceedings (if any), by the public prosecutor, and by interested third parties. The appeal of the judgment opening the proceedings does not stay such proceedings. It is not possible to obtain a stay of insolvency proceedings except for secondary proceedings, in which case the court that opened the proceedings must stay the process of realisation of assets if requested by the insolvency practitioner in the main insolvency proceedings.

v Control of insolvency proceedings

Insolvency proceedings are conducted under the supervision of the commercial court that has jurisdiction over the debtor.

When commencing safeguard or judicial reorganisation proceedings, the court usually appoints an administrator to supervise a debtor’s management and help in the preparation of a reorganisation plan and a representative of the creditors. In judicial liquidation proceedings, the court appoints a liquidator in charge of winding up the company. If a sale of the business is considered, the court will usually authorise a temporary continuation of the activity and appoint an administrator to manage the debtor during such continuation and organise the sale of the business. In addition, during insolvency proceedings, any disposal of assets made by the debtor outside the ordinary course of business, any mortgage, pledge, guarantee granted by the debtor, and any settlement entered into by the debtor must be authorised by the judge in charge of the insolvency proceedings.

At the end of the insolvency proceedings, any reorganisation plan, or plan for the sale of the business, must be approved by the court. In safeguard and judicial reorganisation proceedings, before approving a reorganisation plan that has been voted by the requested majority of the creditors’ committees and bondholders, the court has to verify that the interests
of all creditors are sufficiently protected. Once approved by the court, the reorganisation plan will be binding on all the members of the committees and all bondholders (including those who did not vote or voted against the adoption of the plan). If creditors were consulted individually (either because the creditors’ committees or the bondholders did not vote in favour of the plan, or because the company was too small to have creditors’ committees), the court that approves the plan can impose uniform debt deferrals for a maximum of 10 years on non-consenting creditors, but the court cannot impose debt write-offs or debt-to-equity swaps.

The main duty of the directors in connection with insolvency proceedings is to file for insolvency within 45 days of the company’s cessation of payments. After the commencement of insolvency proceedings, there is no shift of fiduciary duties whereby duties formerly owed by directors of a French company to the company’s shareholders would, post-petition, be owed to the company’s creditors. Rather, the duty of the directors will remain, before and after the commencement of a pre-bankruptcy or bankruptcy process, to promote the corporate interests of the debtor, that is, to promote the course of action that, on the whole, will best preserve the interests of all stakeholders, including the debtor’s employees, shareholders, creditors and customers.

vi Special regimes
The general insolvency regime provided by French law is applicable to all legal entities, but regulated entities such as credit institutions and insurance companies are subject to specific additional rules.

With respect to credit institutions, French law was amended to implement Directive 2001/24/EC on the reorganisation and winding up of credit institutions. Insolvency proceedings may be commenced with respect to a French credit institution only after prior authorisation of the Prudential Supervisory and Resolution Authority (ACPR). A specific ranking applies to claims against credit institutions, and specific rules are intended to protect certain kinds of financial arrangements, such as netting and repurchase agreements.

With respect to insurance companies, insolvency proceedings may only be commenced upon request of the ACPR, or upon request of the public prosecutor after prior authorisation of the ACPR.

Credit institutions and insurance companies also have to finance insurance funds intended to indemnify the depositors or insured party up to a certain amount in case of default.

There are no special insolvency rules relating to corporate groups under French law, except for the rules provided by the Recast Insolvency Regulation to ensure the efficient administration of insolvency proceedings relating to companies of a corporate group located in different EU Member States. Those rules provide for cooperation and communication of information between insolvency practitioners, between courts, and between insolvency practitioners and courts, and allow an insolvency practitioner to request the opening of group coordination proceedings.

vii Cross-border issues
Insolvency proceedings can be opened in France in respect of a foreign EU debtor in accordance with the Recast Insolvency Regulation, if the foreign debtor has its centre of main interests in France. Any insolvency proceedings opened in France (excluding pre-insolvency proceedings) will be recognised throughout the European Union.
As far as non-EU debtors are concerned, while a French court may agree to commence insolvency proceedings if a debtor has a significant presence in France, this happens quite rarely in practice, and the effect of such proceedings overseas would be subject to significant uncertainties.

II INSOLVENCY METRICS

Overall, France's economic situation remains favourable, although the forecasts for 2019 confirm the slowdown of economic growth that began in 2018, with an international environment that is less favourable than last year’s, in particular because of the possibility of a hard Brexit and commercial tensions with the United States:

- In 2018, economic growth reached 1.7 per cent, showing a moderate slowdown compared to 2017 (+2.3 per cent). This slowdown is expected to continue, with an economic growth for 2019 estimated at 1.3 per cent.
- Investments by French companies increased by 3.9 per cent in 2018 and are expected to reach 3.3 per cent in 2019.
- The French household investment level has improved moderately in 2018, with a growth of 0.9 per cent. This growth is expected to accelerate in 2019, with a 1.3 per cent forecast.
- Economic growth in 2018 allowed for a decline in the rate of unemployment in France from 9 to 8.8 per cent; this reduction is expected to accelerate in 2019, with an estimated unemployment rate of 8.3 per cent at the end of the year.

The number of insolvency proceedings opened in France in 2018 remained stable compared to 2017, at about 55,000. However, the second half of 2018 was less favourable than the first half: while company failures decreased during the first half by 11 per cent, they increased during the second half by 10 per cent. The first half of 2019 shows a slight improvement compared with the first half of 2018, with a decrease of 3.6 per cent of the number of insolvency proceedings opened during that period.

The principal features of recent French insolvency proceedings are as follows:

- with regard to the type of proceedings opened, judicial liquidation remains the most commonly used insolvency proceeding (68.1 per cent), followed by judicial reorganisation proceedings (29.9 per cent) and, far behind, safeguard proceedings (2 per cent);
- a quick overview of the companies undergoing insolvency proceedings shows that those employing fewer than three employees represent three-quarters of all the insolvency proceedings opened, whereas companies employing more than 100 people represent about 0.25 per cent of the total, representing only 136 insolvency proceedings opened in France in 2018; and
- while the first semester of 2018 has seen a decrease in the number of insolvency proceedings opened in almost all sectors, except in the agri-food industry, the second semester was less favourable, especially for the manufacturing sector.
III PLENARY INSOLVENCY PROCEEDINGS

Some of the most significant insolvency proceedings that took place in France during the past 12 months are described below.

i Ludendo/La Grande Récré

Ludendo is the parent company of France’s largest toy store chain, La Grande Récré, which achieved a turnover of €460 million in approximately 400 stores in 2017, but which also has debts in the order of €150 million. Owing to the shrinking toy market and increasing competition from online players, Ludendo was forced to file for insolvency in March 2018 and has been placed into judicial recovery proceedings by the Commercial Court of Paris.

The company worked on a reorganisation plan focusing on its French home market, which provided that only its 104 most profitable French stores would be retained, that 62 stores in France and all 16 stores in Belgium would be closed, and that the stores in Spain and Switzerland would be sold. One-third of all jobs in the chain’s headquarters would be cut under this plan and the repayment of the €150 million in debts would be spread over the next 10 years. This plan received the financial support of Financière Immobilière Bordelaise (FIB), a French investor specialised in commercial real estate, which committed to buy most of the company’s debt, to make a €10 million cash advance, and to take immediately a 36 per cent interest in the company, to be increased to 95 per cent by the end of 2018.

In parallel, Fnac Darty filed an offer for the purchase of part of the business (106 stores in France) for an amount of €16 million, offering to take over 833 employees and to invest €115 million in the business, in particular to renovate the stores.

In a judgment issued on 2 October 2018, the Commercial Court of Paris decided in favour of the reorganisation plan proposed by the company, and rejected Fnac Darty’s offer.

ii France Loisirs

France Loisirs is a book publisher and distributor founded in 1970 based on the model of the book club, whereby subscribers regularly receive books at discounted prices that are chosen in a quarterly catalogue. After a peak at the beginning of the 1990s, the number of subscribers began to decrease in the 2000s, owing, in particular, to the development of screen culture and of online book purchases.

After its revenue had fallen from €400 million in 1998 to €180 million in 2016, France Loisirs was forced to file for bankruptcy at the end of 2017, and the Commercial Court of Paris opened judicial recovery proceedings.

In December 2018, the court approved the reorganisation plan proposed by the company, which had two components. The first consisted of a savings plan that included a redundancy scheme to reduce the workforce from 1,800 to 1,350, the closure of 35 shops and the relocation of the head office. The second part of the plan provided for the group to refocus on the book, its historical business, after an unsuccessful diversification into cosmetics induced in 2013 by its former owner, the US group Najafi Companies.

iii Ascometal

Ascometal is a speciality steel maker employing 1,400 people in France with an annual turnover of €400 million. It was purchased in 2009 through a leveraged buyout by a US investment fund and was forced to file for bankruptcy in 2014 because it was not profitable
enough to support its level of debt. The business was purchased a few months later by a French consortium for €230 million through a sale plan approved by the Commercial Court of Nanterre.

However, the company was again forced to file for insolvency in November 2017 owing to a cash shortage resulting from weak steel prices and rising oil prices in the previous two years, despite the fact that the factories were operating at full capacity. Its subsidiary Ascoval (jointly owned with French steel pipe maker Vallourec), which employs 300 people, also filed for bankruptcy in January 2018. Several offers for the purchase of the business were filed with the Commercial Court of Strasbourg. UK-based Liberty House offered to invest €300 million in both Ascometal and Ascoval. The Swiss-based speciality steel maker Schmolz + Birkenbach offered to invest €195 million in Ascometal only, but promised to support Ascoval by purchasing its steel for two years.

Although Liberty House seemed to be the best bidder, both in terms of preserving employment and the price offered, the court approved the sale of the business to Schmolz + Birkenbach by a judgment dated 29 January 2018, because it considered that its offer was more credible, with respect to the industrial project and the financing of the investments to be made in the production facilities.

As Ascoval was excluded from the scope of Schmolz + Birkenbach’s purchase offer, offers from third-party bidders were expected for the Ascoval site. The Court of Strasbourg finally approved a sale plan in favour of the holding company of British Steel in April 2019. However, the insolvency of British Steel (in May 2019) may jeopardise the implementation of the plan.

iv Toyr R Us France

Further to the bankruptcy of US toy retailer Toys R Us in March 2018, its French subsidiary began to look for a buyer for its 53 stores, and was forced to file for bankruptcy in July 2018 owing to a cash shortage.

Several offers for the purchase of the business were filed with the Commercial Court of Evry. The first bidder, who was in negotiation with Toys R Us France for several months, was the owner of the French group Orchestra, which specialises in children’s wear and childcare products. It offered to take over 1,068 employees and 43 stores for a purchase price of €39.5 million (including €35 million to be paid to secured creditors of Toys R Us US for the release of their pledge over Toys R Us France’s real estate). Its competitor, Jellej Jouets (a company held by the US hedge fund Cyrus Capital, a creditor of Toys R Us US, in partnership with another French toy retailer, Picwic), made a very similar offer (to take over 1,036 employees and 44 stores for a purchase price of €40 million). A third offer was filed very late in the bidding process by Financière Immobilière Bordelaise (FIB) offering to take over 949 employees and 42 stores for a higher price (€46 million), and claiming that it should be able to create a French champion of the toy market by merging the activities of La Grande Récé (see above) with those of Toys R Us France.

Although it was the best bid, the commercial court of Evry disregarded FIB’s offer, mainly because it did not put the purchase price in escrow before the court’s hearing, as requested by law, and because its offer involved the relocation of the company’s headquarters to a distant site.

The Court acknowledged that the two other offers were very similar, finally choosing Jellej’s offer because it considered that the commercial project was easier to implement and the financing more secure.

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v Sequana/Arjowiggins

Sequana is the listed holding company of a specialist group in the paper sector, with its Antalis division operating in the distribution of papers, packaging products and visual communication materials, and its Arjowiggins division operating in the production of recycled and speciality papers.

Further to a decision of the High Court of Justice of London ordering Sequana to pay US$138 million to British American Tobacco (BAT), the Commercial Court of Nanterre opened safeguard proceedings upon the request of Sequana in February 2017. This led to the approval by the Court of a reorganisation plan providing that the repayment of Sequana’s debt would be spread over the following 10 years. However, this decision was annulled upon the request of BAT and the safeguard proceedings were reopened in September 2018 to allow Sequana to present a new reorganisation plan.

In the meantime, the situation for the Arjowiggins subsidiaries deteriorated as a result of unfavourable market conditions. Sequana tried to find solutions to reorganise its paper production activity through the sale of some facilities, but this did not succeed. As a result, the Commercial Court of Nanterre opened safeguard proceedings, or judicial recovery proceedings with respect to Arjowiggins companies, in January 2019, with the objective of trying to sell their businesses under a sale plan. For some of them, offers were made by third-party buyers and the Court was able to approve a sale plan. However, no serious offer was made for the main Arjowiggins facility, which led to the liquidation of the subsidiary operating it and the dismissal of its 580 employees.

In March 2019, further to the decision of the London Court of Appeal confirming the first instance judgment in the BAT litigation, the safeguard proceedings of Sequana were converted into judicial recovery proceedings. Finally, in May 2019, the Commercial Court placed Sequana in judicial liquidation as a result of the company’s inability to present a reorganisation plan.

The Antalis division of the group, which remains solvent, initiated a search process for a new shareholder structure to provide the means for its development and the implementation of its strategic plan.

vi Rallye

The listed holding company Rallye is the majority shareholder of French mass retailer Casino, ultimately held by Casino chairman and chief executive officer Jean-Charles Naouri. A large part of the group debt (about €3.3 billion), which resulted from various acquisitions, is held by Rallye and other holding companies. The crisis of the retail sector made it more difficult for the group to repay its debt. In addition, Rallye and Casino’s shares were subject to massive attacks from hedge funds speculating on the fall of those shares by short-selling them. Those attacks were particularly detrimental to the Casino group as Rallye pledged Casino shares to banks to secure its debt, and the number of shares to be pledged is affected by share price variations.

Under those circumstances, Rallye, its subsidiaries Cobivia and HMB, and their parents companies, Foncière Euris, Finatis and Euris, requested and obtained the opening of safeguard proceedings by judgments of the Commercial Court of Nanterre rendered on 23 May 2019. The purpose of these safeguard proceedings is to give the group time to restructure its debts within a secured framework. Safeguard proceedings suspend, pending the approval of a safeguard plan and for a maximum period of 18 months, the payment of the debts that arose prior to the opening of the proceedings, and the safeguard plan may allow the group to spread the repayment of its debts over 10 years.
IV  ANCILLARY INSOLVENCY PROCEEDINGS

We are not aware of any significant secondary proceedings for foreign-registered companies commenced in France during the past 12 months.

V  TRENDS

Insolvency activity is expected to increase during the coming year, as a result of a less favourable international environment.

Nevertheless, Brexit may contribute to an increase in insolvency activity in French courts regarding foreign EU companies. Indeed, a flourishing restructuring business has developed in the United Kingdom as English courts have approved schemes of arrangement affecting companies incorporated outside England. While the effects of Brexit on the availability of UK schemes of arrangement as a restructuring tool for foreign companies remains unclear, EU companies may be more reluctant to petition UK courts, owing to uncertainties regarding the recognition of their judgments within the European Union. As the French restructuring regime is one of the most effective in the EU, it could become an appealing alternative for foreign companies seeking a forum that offers flexible tools for distressed debtors.

In this respect, the transposition of Directive (EU) 2019/1023 of 20 June 2019 on preventive restructuring frameworks, which should take place in France within the coming year, could be key, as it will substantially affect French insolvency law.
I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

Germany’s insolvency law can be considered both old and new. It dates back to 1878, when the Bankruptcy Act established fundamental insolvency principles for the German Empire, which was founded just eight years before.

However, it can also be said to be modern because current insolvency law is mainly determined by the German Insolvency Act (GIA), which came into force in 1999 and was substantially amended in 2012. In 2017, a couple of reforms added some further nuances that are discussed in more detail later in the chapter.

Although the GIA always aimed to provide possibilities for in-court restructuring, including self-administration, besides general liquidation and post-sale creditor satisfaction, the prevailing principle was the liquidation of the insolvent company and sale of the assets. Thus, German insolvency practitioners felt that German insolvency law is not competitive to foreign insolvency laws that provide for better in-court and out-of-court restructurings.

Consequently, the GIA was amended (ESUG amendment) as of 1 March 2012. Since this amendment, the self-administration tools and influence on the appointment of insolvency administrators for debtors and creditors have improved, and an umbrella protection proceeding as a special feature of self-administration aimed at an in-court restructuring has been established. In October 2018, a review of the new regulations that was initiated by the German government concluded that the reform was successful and the overall goal to simplify in-court restructuring procedures has been reached. However, calls for the introduction of an out-of-court restructuring regime were not heard, although the discussion is continuing. The EU Council and EU Parliament adopted a new Directive (Directive (EU) 2019/1023 of 20 June 2019) for the harmonisation of restructuring frameworks in Europe. This Directive includes guidelines for out-of-court restructuring procedures and shall be implemented into German law by the end of 2021. In 2017, the powers of the insolvency administrator to set aside transactions (clawback provisions) were cut back, and

1 Andreas Dimmling is a partner at GSK Stockmann. The author would like to thank Ms Victoria Lisku and Mr Malte Baumann for their very valuable contributions to this chapter.
2 An English version of the GIA is available at www.gesetze-im-internet.de/englisch_insol/.
3 Law for the Further Facilitation of Corporate Restructurings – Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen (ESUG).
4 See Section V.iii for more details.
5 See Section V.ii for more details.
completely new provisions for group insolvencies were introduced. The general perception of insolvency practitioners is that German insolvency law is now more competitive than other European and non-European insolvency legislation, and the tools for restructuring insolvent companies through an in-court proceeding have been successfully amended.7 According to the European Commission, Germany's insolvency regime ranks second among EU Member States as regards effectiveness.8

Still, the general principle of German insolvency law is not the survival of the insolvent company at any cost, but to reach collective satisfaction of the debtor’s creditors on the most attractive terms – either by keeping the company running or by selling its assets (see Section 1 of the GIA).

**General insolvency proceedings (liquidation)**

The proceedings described in the following paragraphs cover the general insolvency proceedings. Special proceedings aimed at restructuring the debtor are discussed in Section I.iii.

**Preliminary insolvency proceedings**

After a filing for insolvency by a debtor or creditor, the insolvency court starts to examine whether the company is actually insolvent and if there are sufficient assets to meet the expenses of the proceeding in a preliminary insolvency proceeding. The insolvency court appoints a preliminary insolvency administrator (PIA). The debtor and a preliminary creditors’ committee (if established by the court subject to the fulfilment of certain thresholds) can suggest or even make a binding proposal for an individual person to be appointed. The PIA controls and limits the power of the management of the insolvent company or takes control of all actions of the debtor.

This preliminary phase is unknown to many foreign creditors and debtors and is regularly the source of legal questions such as ‘Who is representing the company now?’ and ‘Can we continue trading with the company?’ Essentially, and in very general terms, the insolvent company continues its business with its existing management but is controlled and limited by the PIA. The debtor can continue its business as long as transactions are confirmed or carried out by the PIA.

Preliminary proceedings do not usually exceed three months because during this time the debtor is released from paying its employees’ wages – instead, they are paid by the German state (up to a certain amount).9

**General insolvency proceedings**

If the court is positive that the debtor is insolvent and enough assets are available, regular insolvency proceedings start and the PIA is replaced by the (final) insolvency administrator (IA). The IA is usually the same person as the PIA.

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9 German Insolvency Act [GIA], Sections 165 to 172.
Once the general insolvency proceedings are open, the IA takes full control of all assets of the debtor. The management is still in place, but it loses control of the entity.

During the proceeding, all rights of taking decisions are with the IA, who needs the consent of the creditors’ committee or the creditors’ assembly for material actions.

Creditors of the company, who earned their claims before the opening of insolvency proceedings, file their claims against the insolvent estate with the IA and inform the IA about securities granted to them.

There are three classes of creditors:

a. Secured creditors are entitled to separate satisfaction, including from those secured by mortgages or security assignments. They can demand priority of receipt of the money up to full satisfaction of their claim (minus a fee for the IA, which amounts to 9 per cent in many cases) when the asset is sold. If their claim is not fully satisfied, the remaining part will be treated as an unsecured claim.

b. Unsecured creditors are typically suppliers or customers who dealt with the debtor prior to the opening of insolvency proceedings. They only receive the general insolvency quota at the final distribution of the insolvent estate. The average quota in corporate insolvencies is between 4 and 7 per cent of the claim.

c. Subordinated creditors include those with subordination agreements by statute, such as lenders of shareholder loans or by individual contract. These creditors usually do not receive any payment on their claims.

Creditors who have a right of segregation because they are the owner of the asset – it only happens to be in the possession of the debtor – are not creditors of the insolvent estate. As a general rule, they can claim return of their assets from the IA. Typically, this can apply to suppliers with extended retention of title clauses – a concept often unknown to foreign suppliers outside Germany.

A characteristic of German insolvency law is that claims against an insolvent estate that are established during the insolvency proceedings by the PIA or IA are preferential to all unsecured insolvency claims and have to be settled first, and in full, with the insolvency court fees and fees for the IA and creditors’ assembly.

With the exception of this particular feature, there are no other preferential unsecured creditors, such as tax authorities.

Once the IA has realised the assets of the company, collects outstanding claims, gives back assets that do not belong to the insolvent estate, settles preferential claims and sets aside unlawful transactions, the unsecured creditors receive the general insolvency quota and the insolvency proceedings end.

The insolvency proceedings are always supervised and led by the insolvency court, and the IA constantly reports to the insolvency court and to the creditors’ assembly.

**Right to set aside transactions (clawback)**

Another special feature of German insolvency law is the broad power of the IA to set aside transactions of the insolvent estate carried out before a filing for insolvency proceedings or

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10 ibid., at Sections 49 to 51.
11 ibid., at Section 38.
12 ibid., at Section 39A.
13 ibid., at Sections 53 to 55.
during preliminary insolvency proceedings. It is a German peculiarity as compared with other insolvency law systems that there always is a high risk of clawbacks for all contract partners of an insolvent estate that dealt with that insolvent estate years before the insolvency proceedings were initiated.

In the event of a successful clawback, the contractual party of the insolvent estate has to return what was received in full (e.g., purchase price) to the insolvent estate. In return, this party receives only an unsecured counterclaim against the insolvent estate (e.g., the value of the delivered goods), which will be satisfied with the regular insolvency quota.

After much debate for many years between German insolvency practitioners, a reform of the GIA to limit the power of IAs in this regard came into force in April 2017.

While the general intent of the clawback rules was not challenged, the reform restricts the rights of IAs in scope and time. There are three aspects of particular interest.

First, before the reform, an IA could set aside transactions that were carried out for a period of up to 10 years before insolvency proceedings were initiated under Section 133 of the GIA. This period is now reduced to a maximum of four years for almost all transactions and contracts (save for some exceptions, in particular when a debtor has taken actions deliberately to harm creditors while the other party knew of that purpose).

Second, the burden of proof for an IA to set aside a transaction under Section 133 of the GIA has been increased. In particular, when the contract parties had agreed on an instalment plan for payments, before the reform it was assumed that the creditor knew about an assumed bad faith. Now, by regulation of law, instalment repayment plans are no longer an indication of bad faith – on the contrary, instalment repayment plans are an indication that the creditor acted in good faith. This is an important swing for practitioners.

Third, transactions in which both parties fulfil their obligations within a short time – a maximum of 30 days – can only be set aside if the insolvent debtor acted in ‘an unfair manner’. This special variation of bad faith for short-term transactions is new to German insolvency law, and it will be up to the insolvency courts to determine the boundaries of this concept. Recent court rulings suggest that there is a change of direction for IAs when setting aside transactions. However, it is too early to tell if this is a permanent trend or just a coincidence.

ii Policy
Whenever insolvency proceedings start, it is the IA’s prevailing goal and obligation to seek out the best possible outcome for all creditors and present it to the creditors’ assembly. It is this assembly that decides whether to liquidate, sell or restructure the debtor’s business.

Liquidation, including a sale of the business assets to a buyer who continues part or all of the business, is still the most likely outcome of such a decision (approximately 90 per cent of all corporate insolvency proceedings).

In-court restructuring of the business through insolvency plans (up to 5 per cent) and self-management, including umbrella protection proceedings (3 per cent of all corporate insolvency proceedings in 2017), have become more popular and effective since 2012, and are regularly applied in large-scale insolvency cases. Some features of these restructuring tools are outlined in Section I.iii.

14 ibid., at Section 129 et seq.
iii Insolvency procedures

There are two main types of insolvency procedures: the general procedure, ending with liquidation and the winding up of the company, and an in-court restructuring through self-administration and an insolvency plan.

Liquidation

A general corporate insolvency proceeding over a German company typically lasts for three to four years, whereas the main assets of the company that still have value are usually sold within two to six months to one or several investors.

See also See Section I.i.

Self-administration and insolvency plan

Although these features have been in place since 1999, they are rarely used in practice, with rates of approximately 3 per cent of all corporate insolvencies until 2017 but amounting to 64 per cent for the top 50 corporate insolvencies in 2017.\(^\text{15}\)

In self-administration, a company’s management remains in control when:

\(a\) the company applies for self-administration in its petition for insolvency proceedings; and

\(b\) there are no circumstances that lead to the conclusion that self-administration will be detrimental to creditors.

Instead of a PIA or an IA, the insolvency court appoints an insolvency custodian. This person supervises the debtor and has, to some extent, limited rights similar to an IA (in particular to set aside transactions prior to filing for insolvency) but does not have a direct influence on the management or power of disposal over the assets.

A special type of self-administration is the umbrella protection proceeding that was introduced in 2012. A company can apply for the umbrella protection when it is not likely that the company can be restructured. Under the umbrella, the company is granted a grace period of up to three months by the insolvency court to present an insolvency plan to creditors. The insolvency court appoints an insolvency custodian as in general self-administration; however, the company is entitled to select that individual, if the chosen person is qualified. During the grace period, creditors of the company cannot pursue their rights by legal enforcement.

When the insolvency plan is presented to creditors, a normal self-administration insolvency proceeding starts and this full insolvency proceeding can be finalised within a few weeks when everything is prepared well. The insolvent company can return from insolvency proceedings without a substantial flaw of having been insolvent as the timescale can be very short, no IA was involved, the company’s management continued the business and the creditors consented to a restructuring result instead of an IA distributing the assets. Therefore, the umbrella protection proceeding has been highly marketed since 2012 as a proceeding that is not regarded as a ‘real’ insolvency by the public. From a legal viewpoint, however, it is an in-court insolvency proceeding.

Self-administration does not necessarily lead to a certain outcome of insolvency proceedings. Still, the assets of the company can be sold or the self-administration ends at some stage and is transformed into general insolvency proceedings (this happened in 22 per cent of proceedings that started in self-administration in 2017).16

An insolvency plan is an instrument that can be used in any of the described insolvency proceedings – in a general proceeding, in general self-administration and following the umbrella protection period. As a general principle, the creditors (divided into certain groups) decide on a distribution of the insolvent estate that may differ from an outcome under statutory law in a general proceeding.17 The plan, drawn up by the IA or the insolvency custodian, or the management of the company in cooperation with the insolvency custodian, displays the financial situation of the company and points out measures that should be taken and their expected effects. In particular, the plan can provide for a corporate restructuring of the debtor and conversion of debt into equity. The creditors who are affected by the plan are divided into voting groups. A negative vote from one group is irrelevant if there is proof that the insolvency plan is not worse for that group than a distribution under statutory law. After the court has confirmed the plan, too, the debtor supervised by the IA or insolvency custodian has to carry out the prescribed measures.

While self-administration and insolvency plans tend to lead to better satisfaction for creditors than ordinary insolvency proceedings, and tend to be faster and more acceptable to debtors and creditors, in practice they can only be applied to substantial insolvency cases. The reason for this is that they require:

a very professional advisers, which incurs substantial costs for the debtor;
b professional management who are experienced in insolvency; and
c substantial assets and a clear going-concern perspective that favours restructuring over liquidation.

Ancillary insolvency proceedings

If the centre of main interest (COMI) of a debtor is outside Germany but the debtor operates a branch office in Germany, rules on international insolvency apply. As far as the COMI of the debtor is in the European Union, Regulation (EU) 2015/848 applies.18 Under this Regulation, a secondary insolvency proceeding can be pursued in Germany if a debtor has a branch office in Germany regarding the assets in Germany. European secondary insolvency proceedings are not seen very often in Germany. However, the discussions regarding NIKI Luftfahrt GmbH, a subsidiary of Air Berlin plc, brought the spotlight back to this topic. A German court ruled that NIKI Luftfahrt’s COMI was in Germany. However, the appeal court and, at the same time, a court in Austria came to the conclusion that the COMI was in Austria. In the end, the insolvency proceedings in Germany came to a halt and new proceedings in Austria had to be initiated. This produced some chaos as the PIA in Germany had already signed a sale contract for major assets of NIKI Luftfahrt and was then forced to unwind this contract.19

17 GIA, Section 217.
If the COMI of a debtor is not within the European Union, the GIA provides in Section 354 et seq. for the possibility for creditors to file for a secondary insolvency proceeding regarding the German assets. Again, this procedure is not very common.

iv Starting proceedings

Essentially, the management of a company is obliged to file for insolvency in the event of illiquidity or over-indebtedness. The criteria for over-indebtedness are not met on a pure balance sheet perspective but primarily depend on the question of whether a company is likely to be prosperous in the future. Thus, companies regularly instruct accounting firms and lawyers to examine whether they are over-indebted.

Illiquidity occurs if a company is – at a certain point in time – unable to pay more than 90 per cent of its debt when due and this situation will not improve during the three weeks following that date. If illiquidity or (insolvency) over-indebtedness occurs, the management is obliged to immediately (or at least within three weeks) file for insolvency. If the management does not adhere to such an obligation, this is a criminal act and can lead to imprisonment for up to three years.

A company can opt to file for insolvency if the illiquidity is ‘threatening’ (impending illiquidity); in other words, if it is likely that the company will be illiquid once the debts become due.

A creditor must have a legal interest in the opening of insolvency proceedings to be entitled to file for insolvency of a debtor. That is the case if the creditor can prove its claim, and it is likely that the debtor is insolvent because, for example, legal enforcement measures against the debtor have failed. The debtor will be heard by the court before preliminary proceedings are commenced.

The competent insolvency court is the local court where the company has its COMI, which is usually the place of its registered business seat.

v Control of insolvency proceedings

The power to make decisions during insolvency proceedings lies mainly with the creditors and the IA. However, insolvency proceedings are started, supervised and ended by the insolvency court, which takes a more active role than in Anglo-Saxon countries.

Besides the basic obligation of a debtor’s management to file for insolvency when necessary, the members of management may also be personally liable for other violations of civil and criminal law before and during insolvency proceedings. Managing directors are more likely to be liable towards the insolvent company if they made payments out of the company even though the company was insolvent at that time from a legal perspective. After insolvency proceedings are opened, the management has to cooperate with the IA and provide him or her with the necessary information. In self-administration, the management stays in power but must coordinate certain actions with the insolvency custodian.

vi Special regimes

All entities are subject to the GIA. However, some peculiarities apply to financial institutions. Under the German Bank Reorganisation Act – a reaction to the financial crisis of 2008 – only the Federal Finance Supervisory Authority (BaFin) is entitled to file for insolvency proceedings over banks. Usually, before insolvency proceedings are started, BaFin tends to support a restructuring of the bank through a moratorium. With regard to ‘important’ banks from a European point of view, Regulation (EU) No. 806/2014, Council Regulation (EU)
No. 1024/2013 and Directive 2014/59/EU apply too (Single Resolution Mechanism). In Germany, the Restructuring and Liquidation Act 2014, in particular, incorporates the EU rules into national law. This includes the power to sell the assets of a bank or to order a compulsory bail-in of bank creditors.

Also, for insurance companies, the right to file for insolvency is limited. Again, only the supervising authority (usually BaFin) is entitled to file for insolvency. Although the proceedings are governed by the GIA, some special features of insurance law apply, such as automatic termination of insurance agreements one month after the opening of insolvency proceedings.

With regard to group companies, the GIA was amended in 2017 and now provides for the first time for special group insolvency rules. Now, under the reform, all insolvency proceedings of a group of companies can be pooled at one court. Furthermore, the possibility of a uniform appointment of one IA is provided.

The term ‘group of companies’ applies when one company has the possibility of exercising a dominant influence on the others or when various companies are subject to a uniform management.

vii Cross-border issues

German insolvency courts acknowledge foreign insolvency proceedings under Regulation (EU) 2015/848 or under Section 343 of the GIA as being valid in Germany as well. However, the German Federal Court does not acknowledge an English scheme of arrangement as being an insolvency proceeding, whereas, for instance, the US Chapter 11 or amministrazione straordinaria proceedings in Italy are recognised as being insolvency proceedings.

See also Section I.iii.

II INSOLVENCY METRICS

The number of corporate insolvencies in Germany is the lowest it has been for a long time. This is because of a strong and stable domestic economy (1.4 per cent growth in gross domestic product in 2018) and cheap terms for financing. The unemployment rate is also the lowest it has been for 28 years, and many regions of Germany profit from full employment. However, it seems that the wind is changing and some industries, such as retail, banking and automotive, are struggling with declining revenues, and unemployment rates are already rising.
Some 19,302 companies filed for insolvency in 2018 (almost 800 fewer than in 2017),\(^\text{24}\) which is the lowest number of insolvencies in more than 25 years.\(^\text{25}\) In the first quarter of 2019, 4,861 corporations became insolvent, a decrease of 3.2 per cent as compared with the same period in 2018.\(^\text{26}\) It is remarkable that most of the insolvent corporations are very small companies; more than 50 per cent of the insolvent companies have an annual turnover of less than €250,000. Slightly more than 83 per cent of the insolvent companies employed fewer than five people – in fact, most of them are likely to have been single-person companies.\(^\text{27}\) Just 0.6 per cent of the insolvent companies employed more than 100 employees.\(^\text{28}\)

Although all industry sectors show decreasing numbers of insolvency cases, there has been a significant drop in the manufacturing sector (of almost 12 per cent in 2018 in comparison to 2017).\(^\text{29}\) The service sector continues to have the most insolvencies (56.8 per cent of all corporate insolvencies).\(^\text{30}\) In contrast, the construction sector has one of the highest insolvency quotas in comparison with the number of companies (91 out of 10,000).\(^\text{31}\)

A person is most likely to be employed in an insolvent company if he or she works for a household moving company, a mail, courier or express service, or in a bar. More secure professions include being an accountant or a provider of kindergarten services.

The average insolvency quota was reduced from 62 to 59 insolvencies out of 10,000 companies in 2018 as compared with 2017.\(^\text{32}\)

### III PLENUM INSOLVENCY PROCEEDINGS

Since mid 2018, several of the insolvency proceedings that have occurred were significant or had substantial press coverage. The following cases are not exhaustive and serve only as an example for various peculiarities.

#### i Paracelsus-Kliniken-Deutschland GmbH & Co KGaA

Paracelsus-Kliniken-Deutschland GmbH & Co KGaA, of Osnabrück, was a private hospital operator running hospitals in 23 cities throughout Germany and employing more than 5,000 individuals. The company declared insolvency shortly before Christmas 2017.

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\(^{25}\) The total number of insolvency cases in Germany between 2010 and 2017 was 153,551. Thus, more than 80 per cent are individual bankruptcy proceedings or similar cases <https://www.destatis.de/DE/Themen/Branchen-Unternehmen/Unternehmen/Gewerbemeldungen-Insolvenzen/Tabellen/deckungsquoten-nach-art-des-schuldners.html>.

\(^{26}\) See https://www.destatis.de/DE/Presse/Pressemitteilungen/2019/06/PD19_217_52411.html.


\(^{32}\) ibid.
Paracelsus is a good example of how restructuring through insolvency proceedings in self-administration can work. The management and the insolvency custodian worked together to develop an insolvency plan that was accepted by the creditors on 23 May 2018. This plan included the closure of two of the clinics and the dismissal of 400 employees. The family-owned Porterhouse Group AG, of Switzerland, funded the insolvency plan and took over the insolvent company.

Quite remarkably, general insolvency creditors received an insolvency quota of 42 per cent of their unsecured insolvency claims, which is much more than the average quota, which ranges between 4 and 7 per cent.

The hospital sector remains a very difficult industry and, at the time of writing, it is not clear whether Paracelsus-Kliniken-Deutschland GmbH & Co KGaA has successfully completed the turnaround.

ii Solarworld Industries GmbH
Solarworld AG was founded in 1998 and was always run by the very charismatic but also rather unconventional Frank Asbeck as founder, shareholder and, for some time, chief executive officer. He was dubbed the ‘Sun King’ by the yellow press because of his wasteful lifestyle. Solarworld’s main business area was the development and sale of solar energy panels. It achieved a remarkable growth during the booming years in the early 2000s, when it had more than 3,000 employees.

But things changed in the years 2011 and 2012, and in 2013 only a major haircut of creditors saved the company from insolvency. In 2017, matters deteriorated even further and the company filed for its first insolvency proceedings on 11 May 2017.

During this first insolvency, Mr Asbeck established a new company called Solarworld Industries GmbH with the Qatar Development Bank and Qatar Solar. This newco took over the assets of Solarworld AG during the insolvency proceedings and continued the business. However, many creditors were very sceptical about the strategy of Mr Asbeck in taking another risk.

Fortune did not smile on the new business. Solarworld Industries GmbH filed for insolvency on 27 March 2018, being the second insolvency of the Solarworld business within one year. Christoph Niering was appointed as IA. He shut down the remaining production sites and the history of Solarworld ended in its liquidation by the end of 2018.
What made this insolvency so interesting is the story of the deep and rapid decline of a once rising star. Just a couple of years ago, Solarworld AG was a shining example of German energy transition \((\text{Energiewende})^4^1\), which eventually failed in a spectacular way. As some other German solar producers have found, Solarworld could not compete with very cheap products from Asia.

### iii Loewe Technologies GmbH

The roots of Loewe Technologies GmbH date back to 1923. The company soon became well known, because one of its employees conducted the first wireless television transmission. Since then the company has produced televisions and other consumer electronics hardware in Germany.

In July 2013, Loewe Technologies GmbH entered into insolvency proceedings for the first time. Loewe was one of the first companies making use of the new umbrella protection system\(^4^2\) and the insolvency ended within three months and without any major negative press coverage. The proceedings were recognised as a ‘camouflage’ insolvency. Some German family businesses and the former Apple manager Jan Gesmar-Larsen bought the Loewe assets in October 2013. However, the deal failed by the end of February 2014 when the purchasers withdrew from the contract.\(^4^3\) The financial investor Stargate Capital GmbH saved Loewe from liquidation at the very last moment.\(^4^4\)

Loewe’s business model for producing high quality televisions in Germany has failed again. On 3 May 2019, the company filed for insolvency for the second time.\(^4^5\) Similar to the first insolvency, the management first tried to handle the insolvency in self-administration, but again this failed and ordinary insolvency proceedings have now been declared open. By 1 July 2019, all production had been terminated and almost all the remaining 400 employees had been made redundant.\(^4^6\)

### iv P&R Container Vertriebs- und Verwaltungs GmbH

For decades, tens of thousands of private investors trusted in the business model of P&R containers, an investment fund company founded by Heinz Roth and based south of Munich. The investors bought shares in containers that P&R acquired and rented out to international shipping companies. The investors had received a good return on their investment for many years and P&R’s reputation was good.

Quite surprisingly for many investors, P&R filed for insolvency in March 2018. Michael Jaffé was appointed as PIA and the main proceedings were opened on 24 July 2018. Mr Jaffé resolved that P&R operated through a complex structure of companies. Only 600,000 of the 1.6 million containers that the company had sold actually existed; all others only existed on paper. Meanwhile, the Public Prosecution Office brought charges against the founder, Heinz Roth.

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\(^4^1\) This means the change from atomic and fossil energy to sustainable forms of energy.
\(^4^2\) See Section I.1.
\(^4^3\) See https://www.spiegel.de/wirtschaft/unternehmen/tv-hersteller-loewe-kaufer-machen-rueckzieher-a-955430.html.
\(^4^6\) See https://www.manager-magazin.de/unternehmen/industrie/loewe-ig-metall-fordert-regulares-insolvenzverfahren-a-1274158.html.
Mr Roth, accusing him of fraud in 414 cases. The trial was stopped, however, as Mr Roth is severely ill. More than 54,000 investors could have lost up to €3.5 billion of their life savings, which makes the P&R case one of the biggest cases in German insolvency history with regard to economic loss. In July 2019, more than 95 per cent of all creditors accepted settlement agreements suggested by the IA regarding the calculation of their claims. Mr Jaffé will disburse a first payment to creditors in 2020.

IV ANCILLARY INSOLVENCY PROCEEDINGS

Generally, ancillary insolvency proceedings do not have an important role in Germany. There have been no significant proceedings recently, although the German Federal Court has published one decision. The Federal Court states that creditors can still pursue their claims in an ancillary proceeding in Germany even if the debtor has already been discharged in a main procedure in England.

V TRENDS

On a general note, it is not expected that insolvency metrics will change substantially within the next 12 months. As the German economy is stable, corporate insolvencies are expected to remain at an historic low level. However, certain global economic risks, such as Brexit and tariff conflicts between the European Union and the United States, and between the United States and China have been fuelling some sceptical forecasts.

Apart from this, trends have been observed in other sectors.

i Tax relief of the restructuring profit

A ruling of the German Federal Tax Court towards the end of 2016 created wide uncertainty about tax relief on restructuring profit, although there is now less unease. The issue in question was whether the forfeiture of debt by a creditor in a restructuring would cause tax burdens on the company in crisis as its balance sheet was relieved from the forfeited debt. In contrast to a long-practised tax concession, the court ruled that these processes where taxable. As a reaction to this ruling, the German parliament passed a law in June 2017 that reinstated the situation before the court ruling by implementing a regulation in tax law. However, this law did not end the uncertainty, because it first needed clearance from the European Commission as to whether or not it violates European law.

The European Commission has now stated that the German tax law does not contradict European law. The former uncertainty thereby ceased to exist, and restructuring profits are no longer taxable.

47 See https://www.sueddeutsche.de/wirtschaft/p-r-container-heinz-roth-1.4522006.
48 See www.sueddeutsche.de/wirtschaft/staatsanwaltschaft-ermittelt-eine-million-container-einfachweg-1.3983498.
50 BGH NZI 2014, 969.
51 See https://www.bundesfinanzhof.de/content/10-2017.
ii Out-of-court restructuring initiative

On 12 March 2014, the European Commission published a recommendation calling for the implementation of a legal framework for efficient pre-insolvency restructurings as part of the general harmonisation of European insolvency law. According to the recommendation, national legislators should provide for out-of-court restructuring proceedings available to debtors that are likely to become insolvent. The European Commission pursued its goals by publishing an action plan in September 2015 and conducted a European consultation process in spring 2016.

This European initiative fuelled the long-existing discussion in Germany as to whether the country needs a special out-of-court restructuring regime. Many experts think Germany is lacking an important restructuring tool because cramdown proceedings in out-of-court restructurings are not possible under existing law. As a result, some companies use foreign restructuring rules, in particular the English scheme of arrangement. Several pressure groups started initiatives to persuade the German government to present an out-of-court restructuring bill.

In November 2016, the European Commission published a proposed Directive containing suggestions for such tools; this is now in the process of becoming law. From this point, the question in Germany is no longer if, but when, a legal instrument for pre-insolvency restructurings will be introduced. However, it will take another two years before the Directive becomes binding for all Member States. The German government that came into office in 2018 stated that it will accelerate the harmonisation of European insolvency law. This could mean that Germany will introduce an out-of-court-restructuring process soon.

On 20 June 2019, the European Parliament and the European Council passed Directive (EU) 2019/1023, which, inter alia, contains the introduction of preventive restructuring measures to avoid insolvencies at an early stage in the process. This Directive is due to be implemented in Germany by the end of 2021.

iii Review of insolvency act reform (ESUG)

When the GIA was reformed in 2012, the law makers included a compulsory review of the reform after five years. This review was carried out by an expert group in 2017 and into the beginning of 2018. The review report was published in October 2018.

The experts came to the conclusion that the reforms of the GIA in 2012 were successful. Nevertheless, they recommend some further steps to facilitate insolvency law and to make it more effective. In particular, the remuneration system for IAs in insolvency proceedings is opaque and needs reform. Furthermore, the report calls for the introduction of pre-insolvency restructuring tools.

German insolvency experts expect that the review results will be added to German insolvency law with the implementation of Directive (EU) 2019/1023 in the next year to 18 months.

54 See http://blog.handelsblatt.com/rechtsboard/2016/12/09/7718/.
Chapter 11

GREECE

Athanasia G Tsene

I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

Greek legislation and regulation pertaining to insolvency

The Bankruptcy Code was enacted by Law 3588/2007 (effective as of 10 July 2007), replacing older provisions on insolvency (both in connection with winding up and rehabilitation). The Bankruptcy Code has subsequently been amended several times, including by Laws 3858/2010, 4013/2011, 4336/2015, 4446/2016, 4472/2017, 4491/2017 and 4512/2018.

The Bankruptcy Code and each of the above laws amending it include transitory provisions concerning insolvency proceedings opened before the entry into force of the new legislation. This chapter is limited to the insolvency proceedings currently available under the Bankruptcy Code, as amended and in force following its amendment by Law 4512/2018.

The Code applies only to business undertakings, which include sole traders, partnerships, companies and unincorporated legal entities that pursue a financial purpose. Other laws specifically regulate the winding up and reorganisation of certain regulated entities (such as credit and financial institutions, as briefly referred to in Section I.vi).

In addition, Law 4307/2014 regulates certain pre-insolvency proceedings that are available for:

a the settlement of debts of small businesses and professionals, in each case for business loans; and

b the extraordinary debt settlement and special administration of businesses qualifying as merchants under the Bankruptcy Code.

Furthermore, Law 4469/2017, enacted in 2017, regulates out-of-court workouts available to debtors who are individuals and legal entities that are capable of being declared bankrupt, have revenues from business activities and are tax resident in Greece, provided that their financial indebtedness, tax indebtedness or other indebtedness to public law legal entities meets the criteria provided for in that law.

No analysis is included in this chapter on the proceedings of settlement of debts of small businesses and professional and extraordinary debt settlement of Law 4307/2014 and Law 4460/2017, as they apply if certain criteria are met and are more likely to be relevant to small businesses.

Furthermore, Law 3869/2010 (as amended and in force) applies to over-indebted debtors being individuals (consumers or professionals, but not being capable of being

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declared bankrupt under the Bankruptcy Code) and provides for separate proceedings, intended to partially discharge and restructure indebtedness arising from non-business bank loans and credit and (for applications submitted until 28 February 2019) is also available for the exemption from liquidation of the debtor’s primary residence, subject to certain criteria being met.

Law 4605/2019, which was enacted this year, applies to any indebtedness secured by mortgage or pre-notation of mortgage over a property located in Greece used by the debtor as the debtor’s primary residence, provided that the debtor is an individual (whether being capable of being declared bankrupt under the Bankruptcy Code or not) and certain criteria are met; commencing from 30 April 2019, any new applications of debtors for the exemption from liquidation of their primary residence may only be submitted in accordance with Law 4605/2019.

No analysis is included in this chapter on the proceedings of Law 3869/2010 or Law 4605/2019.

**Distributional priorities**

The Bankruptcy Code, the Code of Civil Procedure and the Code for the Collection of Public Revenues include specific provisions on the priority of claims of creditors and distinguish between (1) claims with a general privilege, which applies by operation of law and concerns, among others, claims on account of valued added tax and other taxes, claims of public law entities, claims of employees and social security funds and, under the Bankruptcy Code, also concerns credit facilities granted as rescue funding after the opening of insolvency proceedings subject to certain criteria being met, (2) claims with a special privilege, which include those of secured creditors, and (3) unsecured claims.

The opening of insolvency proceedings does not affect the priority ranking of validly created security (claims of point (2) above) and secured creditors (as opposed to unsecured creditors) can initiate individual enforcement proceedings for their secured claim following the opening of insolvency proceedings against the debtor (provided that, depending on the type and stage of the insolvency proceedings, a stay may be imposed in accordance with the Bankruptcy Code).

The distinction between claims with a general privilege, claims with a special privilege and unsecured claims is critical in the context of distribution of the proceeds of liquidation of the assets over which security has been created. Claims with a general or special privilege are satisfied in priority over unsecured claims.

If there are only claims with a general privilege and claims with a special privilege, the former may only be satisfied up to one-third of the proceeds of liquidation of the bankruptcy estate. If there are claims of all three categories, those with a general privilege are satisfied up to 25 per cent, those with a special privilege are satisfied up to 65 per cent and unsecured claims are satisfied up to 10 per cent of the proceeds of liquidation of the bankruptcy estate. If there are no claims with a special privilege, those with a general privilege are satisfied up to 70 per cent and unsecured claims are satisfied up to 30 per cent of the proceeds of liquidation of the bankruptcy estate. If there are only claims with a special privilege and unsecured claims, those with a special privilege are satisfied up to 90 per cent and unsecured claims are satisfied up to 10 per cent of the proceeds of liquidation of the bankruptcy estate.
There is a material exception from the above allocation, in that, under Article 156a of the Bankruptcy Code, if there are any new claims (arising after 17 January 2018) secured by a pledge or mortgage over assets that were not previously subject to security, allocation will be made in the following order:

a the generally privileged claims for rescue funding credit facilities;
b claims benefiting from special privilege (including secured claims);
c the other generally privileged claims (for taxes, etc.) and the claims benefiting from special privilege for expenses incurred for the collection of fruit from the asset; and
d unsecured claims.

The above are subject only to a super-priority of any claims of employees arising before the declaration of bankruptcy, for unpaid salaries of up to six months, subject to a cap specified in respect of those employees’ claims and following deduction of court expenses, costs for the administration of the bankruptcy estate, the remuneration payable to the receiver and the collective claims (i.e., those arising after declaration of bankruptcy).

**Vulnerable transactions**

Vulnerability of transactions is determined by reference to the date of cessation of payments, which is set by the bankruptcy court in its judgment declaring bankruptcy in respect of an insolvent debtor in accordance with the Bankruptcy Code. ‘Cessation of payments’ means the evidenced general and permanent inability of a debtor to pay its debts as they fall due. The date of cessation of payments so set by the court cannot fall earlier than two years prior to the date of the issue of the judgment declaring bankruptcy.

Under Article 42 of the Bankruptcy Code, certain acts carried out by the debtor during the suspect period (i.e., the period commencing on the date of cessation of payments and ending on the date of the declaration of bankruptcy by the court) are subject to compulsory rescission by the bankruptcy officer. These acts include:

a any acts of the insolvent debtor carried out without consideration being received in return and that have the effect of reducing the value of the debtor’s estate and any contracts entered into by the debtor for which the debtor received disproportionate consideration;
b any payment of debts that are not yet due and payable;
c any repayment of due and payable debts not made by payment in cash or in the pre-agreed manner; and
d any security interest created over the debtor’s assets to secure a pre-existing debt whereby the debtor had not pre-agreed to grant such a security interest.

In addition, under Articles 43 and 47 of the Bankruptcy Code, certain acts carried out by the debtor during the suspect period, which are not subject to compulsory rescission, as above, may be subject to rescission by the bankruptcy officer. Acts subject to challenge in this manner include:

a any payment of debts that are due and payable, or any transaction entered into by the debtor for consideration, if the relevant party or creditor (as the case may be) was aware of the cessation of payments and such a payment or transaction is detrimental to the other creditors (and, for these purposes, deemed awareness applies in respect of a person or entity being an affiliate of the debtor within the meaning of Article 32 of Law 4308/2014); and
payment of bills of exchange or promissory notes, if the issuer of the bill of exchange was aware, on the date of issue of the bill, that the payer of the bill had ceased to make payments as they fell due, or if the first endorser of the promissory note was aware of the cessation of payments of the issuer of the promissory note.

Exceptionally, certain transactions may be vulnerable even if concluded earlier than the set date of cessation of payments. Under Article 44 of the Bankruptcy Code, acts of the debtor concluded within the five years immediately prior to the declaration of bankruptcy, whereby the debtor intended the act to operate to the detriment of its creditors in general or to benefit certain creditors to the detriment of other creditors, are subject to rescission, if the relevant party was, at the time of the act, aware of the debtor's intention.

**Protection against rescission in certain circumstances**

The Bankruptcy Code further provides for protection against rescission in certain circumstances. Under Article 45, no rescission is available in respect of:

- acts falling within the scope of the debtor's business or of professional activities that are concluded in ordinary circumstances and in the ordinary course of the debtor's trade;
- acts of the debtor expressly excluded by law from the scope of application of the provisions on rescission during the suspect period (these include mortgages, pre-notations of mortgage and pledges created in favour of banks to secure credit and loan agreements or existing obligations);
- where a restructuring plan is cancelled because of a failure to implement the plan, acts of the debtor carried out during the implementation stage of the restructuring plan (as defined in the Bankruptcy Code); and
- payments or deliveries by the debtor made in return for consideration of equal value.

Further protection may be available under Article 46 of the Bankruptcy Code (in addition to the protection accorded by other laws transposing into Greek law EU Directives on settlement and payment systems and financial collateral), which provides that:

- in relation to a settlement made or security provided in connection with a transaction in securities on an exchange, the rules regulating that exchange will determine whether such a settlement or provision of security is valid or subject to rescission;
- the provisions that apply to a financial collateral arrangement determine whether the relevant financial collateral arrangement is valid or whether it is subject to rescission; and
- the rules regulating a payment or settlement system or a money market determine whether set-off rights exercised in connection with relevant payments or transactions have been validly exercised or are subject to rescission.

**Policy**

With respect to the treatment of businesses in financial difficulties, the tendency (on the part of both creditors and debtors) is to make efforts to keep failing businesses operating.

Partly because of the fact that the Bankruptcy Code was enacted fairly recently and has been repeatedly amended, and, as a result, insufficient market or court precedent could not provide safe guidance to all parties concerned, partly because of inefficiencies of the Greek court system and partly because of the lack of specialised insolvency practitioners, the rehabilitation provisions of the Bankruptcy Code have often been used by debtors as a means...
of delaying creditors and not in a genuine effort to rehabilitate their failing businesses. The latest amendments of the Bankruptcy Code (in 2017 and 2018) introduced material changes in the provisions regulating the rehabilitation agreement, which are in the right direction but have not yet been tested in practice.

Therefore, creditors (especially banks) have so far tended to prefer to consider out-of-court restructuring arrangements with debtors in financial difficulties well before an actual need to commence any insolvency proceedings under the Bankruptcy Code. These restructuring arrangements mostly concern the restructuring of existing financial indebtedness and may also provide for new funding (whether by existing lenders or shareholders or new investors) or business restructuring measures.

### iii Insolvency procedures

Under the Bankruptcy Code, as amended by the new provisions and the latest amendments, the following insolvency proceedings are available for debtors meeting the insolvency criteria of the Code (as amended):

a bankruptcy, which is regulated by Articles 1 to 98 of the Bankruptcy Code, except for the simplified bankruptcy proceedings in respect of small debtors (provided that the debtor meets at least two of the following three criteria: (1) the value of the bankruptcy estate does not exceed €150,000; (2) the net turnover based on the latest financial statements does not exceed €200,000; and (3) the employees are no more than five on average), which are regulated by Articles 162 and 163(γ) of the Bankruptcy Code;

b a rehabilitation agreement under the Bankruptcy Code (Articles 99 to 106(στ)) entered into between a debtor and its creditors and then submitted to the court for ratification, where there is evidence of the actual or foreseeable inability of the debtor to pay its debts as they fall due; and

c a restructuring plan under the Bankruptcy Code (Articles 107 to 131) following its approval by the court and the creditors.

In addition to the above, special administration is available under Articles 68 to 77 of Law 4307/2014 (as amended) in respect of business undertakings that are capable of being declared bankrupt and are domiciled in Greece and meet certain criteria.

Bankruptcy and special administration are liquidation proceedings; note, however, that special administration is primarily intended to transfer the assets (or groups of assets) of an undertaking as a whole (and may therefore manage to preserve the business but not the insolvent entity). Rehabilitation agreements (also available pre-bankruptcy in the case of a foreseeable inability to pay debts as they fall due) and restructuring plans (only available after declaration of bankruptcy) are rehabilitation proceedings.

The Bankruptcy Code provides that various steps of the proceedings need to be concluded within specified periods; however, the actual time limit for the proceedings may be longer than might be expected based on the letter of the law. Based on limited market precedent from successful rehabilitation proceedings, conclusion and ratification of a rehabilitation agreement can be concluded within eight months to one year. Bankruptcy has so far been primarily used for small or relatively small businesses (usually without prospects of rehabilitation) and completion of the proceedings by liquidation can take five years (if the proceedings are not prematurely terminated for lack of funds); there is insufficient precedent on restructuring plans to provide guidance as to whether the strict deadlines provided for under the Bankruptcy Code could be complied with in practice.
Special administration is a procedure that has been introduced as a replacement for the special liquidation that was made available under an amendment of the Bankruptcy Code; special administration is a procedure required to be completed within 12 months and, failing completion, bankruptcy proceedings must be opened.

However, the rehabilitation agreement, restructuring plan and special administration may prove useful in proceedings when there is a workable plan for the business or the assets (as the case may be) and readily available funding by new investors with the agreement of the creditors, in which case these proceedings could operate almost as a pre-pack process. The latest amendments of the Bankruptcy Code are intended to make these proceedings more expedient and efficient, including by setting stricter time limits for completion of various stages of these proceedings and by strengthening the requirements for documentation and expert evidence in connection with rehabilitation.

With respect to ancillary proceedings in Greece, the provisions of EU Regulation (EC) No. 1346/2000 (the Insolvency Regulation) and EU Regulation (EU) 2015/848 (the Recast Insolvency Regulation) and of the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency of 1997 (the UNCITRAL Model Law) are relevant.

Under the Insolvency Regulation, all the above proceedings are available in Greece for insolvent debtors having their centre of main interests (within the meaning of the Insolvency Regulation) in Greece. Council Implementing Regulation No. 663/2014 was adopted in June 2014, replacing Annexes A, B and C of the Insolvency Regulation. This Regulation amended the Greek Annex entries so that bankruptcy (including a restructuring plan under the Bankruptcy Code and the simplified bankruptcy proceedings for small debtors) and special liquidation are listed in Annex A and can, therefore, be main proceedings for the purposes of the Regulation. Note, however, that special liquidation is no longer available under the Bankruptcy Code and special administration of Law 4307/2014 is not included in the proceedings falling within the scope of the Insolvency Regulation.

Rehabilitation proceedings are listed in Annex A to the Recast Insolvency Regulation and, therefore, are available as main proceedings from 26 June 2017. Where main proceedings have been initiated in another EU country in respect of a debtor having its centre of main interests in that other EU country, ancillary proceedings are available in Greece under the Bankruptcy Code if that debtor has an establishment in Greece (within the meaning of ‘establishment’ under the Insolvency Regulation). Very limited court precedent is currently publicly available on ancillary proceedings in Greece in connection with an establishment in Greece of a debtor having its centre of main interests in another EU country.

The UNCITRAL Model Law, which applies to non-EU states, was ratified by Law 3858/2010 and may prove very helpful for the purposes of recognition by the Greek courts of insolvency proceedings commenced in another jurisdiction, with a view to protecting assets of the insolvency estate located in Greece.

iv Starting proceedings

Rehabilitation agreement

The rehabilitation procedure (Articles 99 to 106(οτ) of the Bankruptcy Code) is available on application by the debtor or any creditor for the court to ratify a rehabilitation agreement concluded between the debtor and its creditors (or between creditors of the debtor only).

This procedure is available (1) in respect of a rehabilitation agreement concluded by the debtor and its creditors, if there is evidence of an actual or foreseeable financial inability on the part of the debtor to pay its debts as they fall due in a general manner, or evidence that
there is a likelihood that the debtor will become insolvent unless rehabilitated, and (2) in respect of a rehabilitation agreement concluded only by creditors of the debtor, if there is evidence that the debtor is in cessation of payments at the time the rehabilitation agreement was entered into by its creditors.

The court may also sustain the debtor’s application if it assesses that the debtor is already in cessation of payments, provided that the debtor, at the same time, files for bankruptcy and files an expert report.

When a rehabilitation agreement has been concluded between a debtor and its creditors, the application for ratification of the rehabilitation agreement filed with the court must be supported by the following documents:

a. a copy of the signed private rehabilitation agreement;
b. the latest available financial statements of the debtor;
c. a certificate of outstanding indebtedness of the debtor towards the Greek state; and
d. an expert report on the financial condition of the debtor, a list of the debtor’s assets, the accuracy and completeness of the list of creditors, the market conditions and compliance with the legal criteria for ratification of the rehabilitation agreement, data provided by the debtor, the situation of the market and the satisfaction of the legal requirements for the ratification of the agreement. The expert is selected by the debtor and the contracting creditors.

If the rehabilitation agreement is concluded only by the debtor’s creditors, the documents in points (b) to (d), above, must accompany the application for ratification only if they are already available to the creditors; if there are any missing documents, the court may suspend the issue of its judgment and order the debtor to provide them to the appointed expert (who is selected by the creditors). Eligible experts are banking institutions, certified auditors and auditing firms.

The hearing of the application for the ratification of the rehabilitation agreement is set no later than two months after filing. If the debtor is not a contracting party to the agreement, the debtor must be notified at least 20 days prior to the hearing. The court may also order notification of one or more creditors within a set period before the hearing. Furthermore, a summary of the application should be published in the Bulletin of Judicial Publications within five days of the submission of the application to the court.

There are no particular restrictions on what may be included in a rehabilitation agreement, other than that the agreement cannot be against the law. Matters commonly covered may include:

a. amendment of the financial terms of the creditors’ claims (including, without limitation, changes with respect to the due dates or the interest rate, the replacement of interest payments with payments out of future profits, or a change in the ranking order of existing security interests);
b. conversion of debt into equity whether by the issue of new shares or by the issue of convertible bonds;
c. inter-creditor arrangements whether by reference to the status of the creditors as creditors or by reference to their status as shareholders following conversion of debt into equity, including, without limitation, designation of new or different classes of senior and subordinated debt;
d. reduction of the amount of the creditors’ claims, on account of principal or interest;
e. sale of the assets of the debtor;
f assignment of the administration of the debtor’s business to a third party, the transfer
of the business or part of the business of the debtor to a third party or to a company
established by the creditors, the stay of individual creditor enforcement following
ratification of the agreement for a specified period, such stay not being binding on
dissenting creditors beyond three months after ratification of the agreement;
g the appointment of a person who will monitor compliance with the terms of the
rehabilitation agreement, with the powers and duties provided for in the rehabilitation
agreement; and
h additional payments that must be made if the debtor’s financial condition improves.
The rehabilitation agreement may also include termination provisions and may also
provide that a breach of its terms operates as a resolutory condition (diaýtiki airesi)
cancelling the rehabilitation agreement.

It may also include conditions precedent (anavlitiki airesi) with respect to all or any of its
five terms, in which case there must be a longstop date within which any such condition
precedent must be satisfied. This longstop date must not extend beyond nine months from
the date of ratification by the court of the rehabilitation agreement.

The rehabilitation agreement is entered into as a private agreement unless the obligations
contemplated therein require the parties to enter into a notarial deed. If the approval of the
general meeting of shareholders of the insolvent debtor is required for the implementation
of the rehabilitation agreement, the Bankruptcy Code provides court protection seeking to
prevent unreasonable delays or objections on the part of the shareholders by appointing a
special representative authorised to exercise their voting rights, to efficiently enable the debtor
and the creditors to implement the rehabilitation agreement.

The rehabilitation agreement must be approved by the required majority of creditors,
being at least 60 per cent of all creditor claims including at least 40 per cent of the secured
claims. For quorum and majority purposes, all claims are evidenced on the basis of the books
and records of the debtor. Secured creditors vote as a single class.

The hearing of the debtor’s application is set no later than two months from filing. The
court will ratify a rehabilitation agreement duly approved by the creditors if the following
criteria are cumulatively met:
a it is likely that the debtor will remain viable following the ratification of the rehabilitation
agreement;
b the rehabilitation agreement is not likely to be detrimental to creditors’ collective
recoveries;
c the rehabilitation agreement is not the result of malicious, wrongful or unlawful
acts of the debtor, any creditor or third party, including acts committed in breach of
antitrust laws;
d the rehabilitation agreement treats creditors of the same class equally, provided that
deviations from the equal treatment principle may be permitted for a serious business or
social reason explained in detail in the court judgment, or where the affected creditors
have consented to unequal treatment; and
e where the ratification of a rehabilitation agreement is requested by the creditors, the
debtor is deemed to consent if it has not notified the court that it objects until the
hearing of the creditors’ application.
The court will ratify the agreement without assessing whether the criterion in point (a), above, has been met, if (1) the agreement includes an explicit statement by the contracting creditors that they agree to the content of the business plan accompanying the rehabilitation agreement, (2) the agreement includes a detailed list of the contracting and non-contracting creditors and of their respective claims, and specific reference to those creditors (contracting or non-contracting) who will be affected by the agreement and the way in which they will be affected, and (3) the agreement and the accompanying business plan have been duly notified to all non-contracting creditors affected by the agreement (including by publication in accordance with the requirements of the Bankruptcy Code).

The debtor, the creditors (as parties to the rehabilitation agreement) and a representative of any employees have a right to be heard at the ratification hearing. Any party having a legitimate interest may also join in the proceedings without any prior formalities. The court’s judgment ratifying the rehabilitation agreement is only subject to third-party opposition, a remedy available to persons who are not parties to the proceedings. The court’s judgment denying ratification is subject to appeal by a party to the proceedings. The court judgment ratifying or denying ratification of a rehabilitation agreement must be published, without undue delay, with the General Commercial Registry and the Bulletin of Judicial Publications of the Single Fund of Independent Professionals, on application of the debtor or any creditor.

Once ratified by the court, the rehabilitation agreement becomes fully binding on the debtor and on all creditors, including those who did not agree to it. However, it is not binding on creditors whose claims came into existence following the opening of rehabilitation proceedings.

Bankruptcy

Under the Bankruptcy Code, bankruptcy proceedings commence by a declaration of the court on the application of any creditor, the debtor or the attorney general, if the debtor is generally and permanently unable to pay its debts as they fall due. Furthermore, the debtor itself is obliged to commence bankruptcy proceedings within 30 days of the date on which it became unable to repay its debts; in addition, the debtor may apply for the commencement of bankruptcy proceedings if there is a likelihood of such inability, provided that the debtor’s application is accompanied by a proposal for a restructuring plan under Article 107 et seq. of the Bankruptcy Code. Third parties will not receive any notice of an application to commence bankruptcy proceedings.

The Bankruptcy Court declares bankruptcy if, based on the financial information made available to it, the debtor’s estate is sufficient to cover the costs of the proceedings. A judgment of the Bankruptcy Court declaring bankruptcy is enforceable from the morning of the date of its publication by the Bankruptcy Court. However, the bankruptcy declaration may be subject to revocation by the Bankruptcy Court or appeal before the Court of Appeals or the Supreme Court. The declaration may also be opposed or reinvestigated before the Bankruptcy Court. The initiation of any of these proceedings does not, of itself, suspend the enforceability of the bankruptcy declaration.

The purpose of bankruptcy is to ensure that the debtor’s property is liquidated for the satisfaction of the creditors’ claims in accordance with their respective rights of priority.

Once bankruptcy has been declared, a bankruptcy officer is appointed and is responsible for the administration of the debtor for the purposes of liquidating and distributing the proceeds of liquidation to the creditors, in accordance with their respective rights of priority. Commencing from 29 December 2016, the appointed receiver can be an individual (being
a lawyer, an auditor or first rank accountant) certified by the Committee of Insolvency Practitioners and registered with the Registry of Insolvency Practitioners. The debtor is deprived of the administration of its pre-bankruptcy estate but is not deprived of the administration of its post-bankruptcy estate.

A judge rapporteur (i.e., a judge of the Bankruptcy Court) is also appointed to supervise the procedure and submit reports when required; the bankruptcy officer will seek the prior approval of the judge rapporteur in relation to various actions during the performance of his or her duties.

During the bankruptcy procedure, creditors can give notice of their claims to the court and the bankruptcy officer. The latter is assisted by the committee of creditors (elected by the meeting of creditors), which also monitors the proceedings. Decisions of the meeting of creditors or of the committee of creditors (as the case may be) are required for various matters (including in respect of the continuation of the operation of the business, if considered necessary to preserve the value of the assets); specific majority percentages apply, depending on the stage of the proceedings and the matter on which the decision must be made. If at any stage it is determined that there is no cash available to finance the bankruptcy proceedings, the court may issue a judgment ordering the cessation of the proceedings. In any case, bankruptcy proceedings will lapse:

a after 10 years have elapsed since the stage of the proceedings that is called the union of creditors;
b after 15 years have elapsed since the declaration of bankruptcy;
c upon the final approval and ratification of a restructuring plan;
d upon completion of liquidation of the bankruptcy estate; or
e upon repayment of all debts (including interest and principal) which fell due before the declaration of bankruptcy.

Debtors that are individuals may apply to the court for their discharge towards their creditors in respect of debts that were not satisfied from the proceeds of liquidation of the bankruptcy estate. That application may be filed after the second anniversary of the declaration of bankruptcy or after the date of cessation of the bankruptcy proceedings (whichever comes first) and the discharge may be declared by the court if the debtor is found by the court to have acted in good faith and in a spirit of cooperation at the time of declaration of bankruptcy and throughout the bankruptcy proceedings. No discharge can be declared for debts resulting from wilful misconduct or grossly negligent conduct on the part of the debtor. These criteria are not examined and, in any case, the discharge is effective upon ratification of a restructuring plan.

Re restructuring plan

A restructuring plan may be initiated on the application to the court by:

a the debtor, either at the same time as its application to be declared bankrupt or within three months of the date of the declaration of bankruptcy (which may be extended by the court for a further period of not more than one month, provided that it is evidenced that the extension would not be detrimental to the creditors and there are serious indications that the creditors would accept the restructuring plan); or
creditors representing at least 60 per cent of the total liabilities of the debtor (including at least 40 per cent of secured claims and other claims with a special privilege), with their application to the court for the declaration of bankruptcy in respect of the debtor. Calculation of these percentages must be made and confirmed by a qualifying accountant or auditor on the basis of the latest published financial statements of the debtor (or the debtor’s accounting books and records, as the case may be).

For these purposes, the Bankruptcy Code includes specific requirements regarding the content of the draft restructuring plan. Creditors must approve a draft restructuring plan before it is implemented. Accordingly, creditors will receive notice of the meeting to discuss and vote on the restructuring plan. However, there is no general obligation to inform third parties of the meeting to consider the restructuring plan.

Creditors secured by a mortgage, pre-notation of a mortgage or a pledge will continue to be secured by that security interest except to the extent that the draft restructuring plan provides otherwise (i.e., the plan can affect secured creditors’ rights). The draft restructuring plan may not provide for the reduction of claims to less than 10 per cent of their original amount and must provide for repayment within three years.

The court will set a date not more than two months after the declaration of bankruptcy, or the initiation of a restructuring plan process (as the case may be under point (a) or (b), above), for the special meeting of the creditors (attended by the judge rapporteur), who will need to discuss and vote on the approval of the restructuring plan. Creditors not affected by the restructuring plan are not entitled to vote at the meeting. Creditors not attending the meeting are deemed to have voted in favour of the restructuring plan unless their claim is reduced to nil by the restructuring plan, in which case they are deemed to have rejected the restructuring plan. The restructuring plan must be approved by creditors representing at least 60 per cent of the total claims against the debtor (including at least 40 per cent of any secured claims).

Following its approval by the creditors, the restructuring plan is submitted to the court for ratification. The debtor and the bankruptcy officer may provide their comments to the court. Any party with a legitimate interest in the debtor’s restructuring may also intervene in the process. If the restructuring plan provides that specific obligations have to be performed or other steps have to be taken by the debtor or by other parties prior to the ratification of the restructuring plan by the court, the restructuring plan will only be ratified by the court following the performance of those obligations or the taking of those steps.

Following the hearing, the court may ratify the restructuring plan or reject the restructuring plan (of its own motion or on the application of a creditor having a legal interest in the plan) on the express rejection grounds provided for in the Bankruptcy Code. The ratifying or rejecting judgment of the court is subject to appeal. The filing of an appeal does not suspend the restructuring process contemplated by the restructuring plan.

When the judgment ratifying the restructuring plan becomes final and conclusive (i.e., it is no longer subject to appeal), the restructuring plan becomes binding on all creditors (including any dissenting creditors, any creditors that have not filed their claims and any creditors that have not attended the meeting of creditors) and the bankruptcy process is concluded. The restructuring plan will then form the basis for the reopening of individual enforcement proceedings against the debtor by creditors. Furthermore, the court’s judgment itself constitutes an enforceable right in respect of any obligation undertaken in the restructuring plan.
The Bankruptcy Code also provides for the circumstances in which a ratified restructuring plan may become void or voidable, and the consequences of cancellation. Furthermore, the restructuring plan is automatically cancelled if the debtor is declared bankrupt by the court after the ratification of the restructuring plan by the court. Following an automatic cancellation:

(a) any claims of creditors not fully discharged under the restructuring plan are restored to their status as it existed prior to the ratification of the restructuring plan by the court;

(b) security interests released under the restructuring plan will not revive unless expressly provided to the contrary in the restructuring plan and annotated in the public books of the competent land register or cadastre;

(c) security interests created pursuant to the restructuring plan continue to secure the relevant secured claims up to the amount and for the time agreed in the restructuring plan unless the restructuring plan provides otherwise; and

(d) claims arising from financing granted after the ratification of the restructuring plan by the court rank as generally privileged claims.

Special administration

Law 4307/2014 (Articles 68 to 77) introduced special administration in respect of business undertakings that are capable of being declared bankrupt and are domiciled in Greece. Special administration is available in respect of either a qualifying debtor that is generally and permanently unable to pay its debts as they fall due, or a debtor being a company limited by shares that meets the criteria for an application for dissolution of the company by court decision under Article 48 of Law 2190/1920 (currently Article 165 of Law 4548/2018) for at least two consecutive financial years (including on the basis that the own funds of the company have fallen below one-tenth of the paid-up share capital).

Special administration commences with the filing of an application to the court of first instance of the debtor’s principal place of business; the application is submitted by one or more creditors (including, at least, one credit institution or a financial leasing company or a factoring company supervised by the central bank of Greece), provided that the creditor or creditors represent claims of at least 40 per cent of the aggregate debtor’s indebtedness. The application must also nominate the proposed special administrator and be accompanied by a declaration by that proposed special administrator that it will agree to take on the role, if appointed by the court.

Upon filing of the application for the special administration, any pending insolvency proceedings are automatically suspended. During the period between the filing of the application and the issue of the court judgment on the application, the court may, on application by a third party with a legitimate interest, order a stay of individual enforcement proceedings against the debtor, a prohibition of disposals by the debtor or any other appropriate preventive measure.

If the debtor is placed under special administration, all enforcement proceedings are automatically suspended until completion of the special administration. Upon publication of the judgment placing a debtor into special administration, the powers of the constitutional bodies and of the management of the undertaking are transferred to the special administrator.

For the appointed special administrator to continue the operation of the business and to cover special administration expenses (including its remuneration), the special administrator may conclude financing agreements or agreements for the supply of goods or services that will benefit from the first ranking privilege of Article 154(a) of the Bankruptcy Code.
The special administrator is mandated to liquidate at least 90 per cent of the book value of the debtor’s business and assets through public tender within 18 months of the date of issue of the court judgment on the application for the placement of the debtor into special administration.

Liquidation may be effected either by sale of the business as a whole or by sale of operational parts of the business or by sale of individual assets. The results of the public tender must be ratified by the court. The claims of the creditors will be satisfied out of the proceeds of the liquidation of the debtor’s assets.

If the 18-month deadline is not met, the special administration proceedings are terminated and the special administrator must file an application for the declaration of debtor’s bankruptcy.

v Control of insolvency proceedings

All insolvency proceedings under the Bankruptcy Code are opened by court judgment (with the exception of the rehabilitation agreement, which is first entered into between the debtor and creditors and subsequently ratified by the court) and completion of each stage of the proceedings is under the supervision, and subject to a judgment or order, of the competent court.

Creditors can commence bankruptcy proceedings, reach a rehabilitation agreement between creditors and submit it to the court for ratification, and commence special administration proceedings. They can also participate in the proceedings by lodging their claims, supporting (or opposing) various steps of the proceedings (where permitted under the Bankruptcy Code, depending on the type of the proceedings), and in meetings of creditors; specific majority percentages are required by reference to the type and stage of the proceedings under the Bankruptcy Code. Creditors are also entitled to apply for temporary measures intended to preserve the business or the assets of the insolvent debtor (or to oppose any such measures applied for by the debtor, other creditors or other parties, as the case may be) in accordance with the provisions of the Bankruptcy Code.

Specific duties are provided for under the Bankruptcy Code for the members of the board of directors. Failure to file (or delay in filing) for bankruptcy upon cessation of payments exposes the directors to personal and criminal liability. The same applies if bankruptcy results from gross negligence or wilful misconduct of the directors, or in the event of loss-making or extraordinarily risky transactions, inappropriate borrowings, misleading or incomplete company books and records, failure to prepare and approve financial statements or inventories as required by law, undue disposals or deterioration of assets, or preferential payments to the detriment of other creditors. Furthermore, the directors have personal and criminal liability in the event of tax indebtedness, in accordance with tax legislation.

vi Special regimes

Banks, broker dealers, insurance companies and other regulated financial institutions are excluded from the general insolvency regime of the Bankruptcy Code. Specific provisions apply with respect to their reorganisation and winding up; these provisions transpose into Greek law the relevant EU Directives. Law 4335/2015 transposes into Greek law EU Directive 2014/59/EU on recovery and resolution of credit institutions and investment firms (the Banks Recovery and Resolution Directive (BRRD)).

The implementation of the BRRD by virtue of Law 4335/2015 has been material for the purposes of the recapitalisation of the Greek banks in 2015 and will provide the
authorities with a credible set of tools to intervene sufficiently early and quickly in an unsound or failing institution so as to ensure the continuity of the institution’s critical financial and economic functions, while minimising the impact of an institution’s failure on the economy and financial system. In particular, four resolution tools and powers (sale of business, bridge institution, asset separation and bail-in) will be immediately available (except that the general bail-in resolution tool did not apply before 1 January 2016) and may be used alone or in combination when the relevant resolution authority considers that:

a. an institution is failing or likely to fail;
b. there is no reasonable prospect that any alternative private sector measures would prevent the failure of such an institution within a reasonable amount of time; and
c. a resolution action is in the public interest.

No special insolvency rules apply to corporate groups outside the regulated financial sector.

vii Cross-border issues

The Insolvency Regulation, the Recast Insolvency Regulation and the ratified UNCITRAL Model Law are relevant (within their respective scopes of application) to territorial jurisdiction and cross-border insolvency requiring main proceedings in Greece and secondary proceedings outside Greece, or vice versa.

Furthermore, Law 3458/2006 transposes into Greek law EU Directive 2001/24/EC on the reorganisation and winding up of credit institutions with respect to relevant cross-border issues and Law 4335/2015 transposes into Greek law the BRRD.

There is limited Greek court precedent concerning cross-border insolvency cases and none of that precedent deals with matters that could be regarded as controversial in the context of the domestic legislation or of the aforementioned provisions that are relevant to cross-border insolvency.

There is market precedent to suggest that in the case of large corporates with activities in different jurisdictions, various structures have been used or considered (by means of a change of place of registered office outside Greece or by cross-border corporate transformations) with a view to enabling the debtor and its creditors to achieve restructuring under foreign law, primarily to ensure successful completion within a shorter period and protect against uncertainties resulting from the enactment and subsequent amendments of the Bankruptcy Code. However, the most recent amendments of the Bankruptcy Code are steps in the right direction and may also prove helpful for the purposes of restructuring, including of large or medium corporates.

II INSOLVENCY METRICS

Greece went into recession during the third quarter of 2008 and has proceeded with fiscal adjustments and structural reforms as required by the Economic Adjustment Programme under the financial support scheme agreed with the Troika (the International Monetary Fund (IMF), European Commission and European Central Bank). During these years of recession,
there has been a gradual but substantial decline in domestic consumption, investment and fixed capital formation, in parallel with a substantial increase in exports and an unprecedented increase in unemployment (27.8 per cent – the highest level on record).\(^2\)

The fiscal performance in 2013 resulted in a primary surplus (which allowed the Greek state to return to the international capital markets by issuing new bonds). At the same time, a decline in the interest rate of Greek bonds, a slight increase in household consumption and a slower decline in public consumption, with an expectation for a stable increase in public expenditure on investment and a strong upward trend in exports of services (outpacing the marginal contraction expected in exports of goods) were suggested by economists as indications that in 2014 the Greek economy was on the road to recovery after six years of recession.\(^3\) The political and economic uncertainty in the first semester of 2015 reversed that positive development; the capital controls imposed in June 2015 further strengthened the downward trend of the Greek economy in 2015.

In July 2015, the Greek government submitted a request for financial assistance to the European Stability Mechanism (ESM). An agreement was reached between Greece and the European institutions, with input from the IMF, and a financial assistance facility agreement with the ESM and the reform agenda set out in a memorandum of understanding were approved on 19 August 2015.

During the first semester of 2015, the political and economic uncertainty, the deterioration of the macroeconomic environment, the outflow of deposits, the increase in non-performing loans and capital controls all had a negative effect on Greek banks; the ESM financial assistance facility agreement provided for a specific buffer to be used for potential bank recapitalisation and resolution needs.\(^4\) The recapitalisation of the Greek systemic banks was successfully completed within 2015.

Within the context of the ESM financial assistance facility agreement, specific deliverables have been provided for on the part of the Hellenic Republic, including for the purposes of assessing the currently applicable provisions of the Bankruptcy Code with a view to introducing any further changes that may be considered appropriate. The most recent amendments were introduced as part of these deliverables.

Gross domestic product (GDP) remained flat for about three years, with a positive development since the first quarter of 2017, combined with an increase in investment costs and a positive growth in household consumption. The economy has now stabilised following the crisis in 2015. Unemployment rates are showing a slight but steady drop in (primarily because of an increase in part-time employment) and the primary fiscal balance has been in surplus in the past three years, supported by ongoing fiscal consolidation.

However, the remaining (though relaxed) capital controls, high taxation rates (combined with persistent estimated tax evasion rates), the volume of non-performing loans (in respect of which Greek banks in the last semester of 2017 started to take radical measures

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\(^3\) ibid.

by sales of non-performing portfolios, which are expected to continue) and the limited access to financing continue to present serious challenges and hold back investment, while poverty and inequality remain among the highest in the eurozone.\(^5\)

The final review of the ESM financial assistance facility agreement was successfully completed in June 2018 and the ESM programme has expired; in addition to the short-term debt relief measures that are already in place, medium-term debt relief measures are contemplated to ensure debt sustainability.\(^6\) On 11 July 2018, the European Commission activated an enhanced surveillance framework for Greece, in accordance with Regulation (EU) No. 472/2013 for Greece (Council Implementing Decisions (EU) 2018/11929 and (EU) 2019/33810), intended to ensure continuation of the implementation of all key reforms adopted under the ESM programme and to sustain their objectives, as well as to complete certain key structural reforms initiated under the ESM programme against agreed deadlines.

In the medium term, Greece needs to continue adopting measures to address the sources or potential sources of macroeconomic imbalances, while implementing structural reforms relating to fiscal and fiscal-structural policies, social welfare, financial stability, labour and product markets, privatisation and public administration. Greece is subject to quarterly reporting on progress with implementing its commitments under enhanced surveillance, whereby a favourable report can, on a six monthly basis, pave the way for the release of debt-relief measures worth 0.7 per cent of GDP per annum. The release of the first tranche of policy-contingent debt measures worth €970 million was agreed by the Eurogroup in April 2019. The third Enhanced Surveillance report assessing Greece’s progress with the implementation of its commitments was published on 5 June 2019.\(^7\)

### III PLENARY INSOLVENCY PROCEEDINGS

There is no publicly available Greek court precedent concerning recent and significant plenary insolvency proceedings in Greece involving large corporates or corporate groups. The available Greek court precedent involves small and medium insolvency cases, without any major controversial issues and not relevant to complex business or financial restructuring measures; therefore, no points worth noting can be drawn from the available court precedent.

However, during the past three years, there have been voluntary restructuring arrangements involving:

\(a\) multinational groups with a Greek subsidiary outside any insolvency proceedings under the Bankruptcy Code and without a closely foreseeable insolvency of the Greek subsidiary;

\(b\) Greek project companies within project finance schemes; and

\(c\) Greek corporates, as well as small and medium-sized enterprises, in respect of indebtedness under corporate loans and financial leases.

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In all these cases, the arrangements have been entered into in an effort to ensure the continuation of operations and to agree rescheduling of existing indebtedness, new funding (where required) and new inter-creditor arrangements in a timely manner, before the occurrence of any event or circumstance that could present a real risk to the creditors or to the debtor’s business.

IV ANCILLARY INSOLVENCY PROCEEDINGS

There is very limited publicly available Greek court precedent concerning ancillary insolvency proceedings in Greece for foreign-registered companies during the past 12 months.

V TRENDS

Law 4335/2015 (which, among other things, transposed the BRRD into Greek law) and the recent amendments (between 2015 and 2018) of the Bankruptcy Code and of the Code of Civil Procedure, the amendments of Law 4307/2014 (including on special administration) and of Law 3869/2010 on over-indebted individual debtors, as well as the introduction of the new legal and regulatory framework on servicing and transfers of non-performing exposures of credit and financial institutions under Law 4354/2015 (as amended and in force) and the relevant decisions of the Bank of Greece (as the competent financial supervision authority) were enacted as a prior action for the purposes of the ESM financial support facility agreement, with the intention of improving the legal framework pertaining to business and non-business insolvency in line with the reforms agreed with the European institutions and the IMF.

It is expected that these reforms will continue to be implemented, not least because of the enhanced surveillance framework activated by the European Commission in July 2018. Law 4605/2019 (replacing the debtor’s primary residence protection regime of Law 3869/2010) was enacted in this framework.

Commencing from the last months of 2017, Greek banks have launched sale processes for the sale of their non-performing exposures. Several non-performing bank loan and credit portfolios have already been sold and transferred to special purpose companies, with the servicing of the portfolios being assigned to licensed servicing companies; these transactions have been concluded under Law 4354/2015 (as in force) or Law 3156/2003 on securitisation, and more transactions are expected to close during the coming months. Two of the portfolios transferred so far concern secured corporate loan portfolios and further transactions are expected to close within the next few months. In addition, in 2018, the four systemic Greek banks created a servicing platform for their common non-performing exposures. The intention is for the Greek banks to clean up their balance sheets and for the buyers to maximise recoveries, whether through restructurings (in respect of viable businesses) or through enforcement before or after insolvency of debtors and liquidation of security assets.
Chapter 12

HONG KONG

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I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

Hong Kong insolvency law and practice is substantially based on insolvency law and practice in the United Kingdom. However, it does not benefit from the extensive reforms introduced in the United Kingdom by the Insolvency Act 1986 so that, for example, in Hong Kong there is, currently, no rescue procedure akin to administration in the United Kingdom. The concept of wrongful trading has also not been legislated for in Hong Kong.

Corporate insolvency in Hong Kong remains primarily governed by the remaining provisions of the old Companies Ordinance, renamed the Companies (Winding Up and Miscellaneous Provisions) Ordinance (CWUMPO), as amended by the Companies (Winding Up and Miscellaneous Provisions) Amendment Ordinance (the Amendment Ordinance), which came into effect on 13 February 2017.

The bulk of the provisions set out in the specialist resolution regime for financial institutions in Hong Kong (FIRO) came into effect on 7 July 2017, meaning that Hong Kong has now largely met its obligations as a member of the Financial Stability Board. Accordingly, while in theory the winding up in Hong Kong of an international bank remains possible, in the case of its financial distress, some form of resolution under FIRO is the most likely scenario. Although the Hong Kong Monetary Authority, the Securities and Futures Commission (SFC) and the Insurance Authority retain statutory powers to commence administrative proceedings, such as the appointment of special managers, as these powers do not relate to insolvency processes, they are generally beyond the scope of this chapter.

ii Policy

The Hong Kong legislature has not modernised Hong Kong insolvency law to keep pace with an increasingly globalised world. A corporate rescue regime was first raised in 1996: the Companies (Corporate Rescue) Bill was then proposed in 2001 but failed to gain legislative

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The operation of certain provisions (including those relating to clawback of remuneration, loss-absorbing capacity, the requirement for contractual bail-in and the suspension of termination rights) will come into force when further secondary rules are made or on a date to be appointed by the Secretary for Financial Services and the Treasury. Since the enactment of the Law, only provisions relating to the designation of lead resolution authorities for financial institutions have become effective.
acceptance. The Bill remains on the drawing board. Despite this lack of modernisation, Hong Kong has a workable restructuring culture largely as a result of judicial pragmatism. This pragmatism is in evidence all the more frequently as Hong Kong has not implemented the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law), and consequently there is no statutory process for the formal recognition of foreign proceedings.

The lack of any rescue procedure in Hong Kong leaves creditors with a stark choice: seek to agree an out-of-court restructuring or turn to a formal liquidation process that will mean the demise of the corporate entity and is likely to present severe difficulties in saving the underlying business. Prior to 2006, accepted practice in Hong Kong had been to appoint provisional liquidators (PLs) with a view to implementing a restructuring by way of a scheme of arrangement. However, in the decision in Re Legend International Resorts Ltd (Court of Appeal), the Court of Appeal effectively closed off this avenue for companies in distress if creditors could not also show a jeopardy to assets at the time of the PL appointment.

In recent years, there have been a number of cases in which the Hong Kong judiciary has shown itself to be proactive in developing procedures for assisting the restructuring of companies with a Hong Kong connection through a flexible interpretation of the existing legal framework, edging closer to the pre-Legend position. Rather than appoint a PL in Hong Kong, the current approach is to appoint PLs in the jurisdiction of incorporation, where soft-touch or restructuring PLs are either not prohibited or expressly permitted for the purpose of promulgating a restructuring. The PLs can then approach the Hong Kong court with letters of request and seek recognition orders for general or specific requirements. This is particularly relevant given the prevalence in Hong Kong for companies operating or listed in Hong Kong (or both) to have been incorporated in offshore jurisdictions such as the British Virgin Islands, the Cayman Islands or Bermuda.

Notwithstanding these developments, Hong Kong remains desperately in need of legislative reform for its insolvency processes. In this regard, there may be some light at the end of the tunnel. The Financial Services and the Treasury Bureau continues to consult with stakeholders on certain issues to be addressed in the amendment bill, the most recent consultation having taken place in April 2018. There is an intention to introduce a corporate rescue and insolvent trading bill to the Legislative Council during the 2018–2019 session.

The proposals are intended to introduce a method of corporate rescue (to be known as provisional supervision) akin to administration in the United Kingdom, with a moratorium on the commencement and continuation of proceedings. Critically, this would include the enforcement of security by secured creditors and would start automatically on the entry of the company into provisional supervision. An independent person (the provisional supervisor)

4 Note, however, the decision in Re China Solar Energy Holdings Ltd [2018] 2 HKLRD 338, in which the Hong Kong Court clarified that the decision in Re Legend did not prevent provisional liquidators [PLs] appointed on traditional asset preservation grounds from being granted restructuring powers and implementing such a restructuring through a scheme of arrangement.
5 For example, as at the end of 2017, of the 1,794 companies listed on the Main Board of the Hong Kong Stock Exchange, approximately 47 per cent were incorporated in the Cayman Islands and 26 per cent were incorporated in Bermuda (http://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/HKEX-Fact-Book/HKEX-Fact-Book-2017/FB_2017.pdf#la=en).
would be appointed to take temporary control of the company and consider options for rescuing it. The proposed insolvent trading regime would make a director of a company civilly liable for its insolvent trading, and require the director, on the order of the courts, to pay compensation to the company’s stakeholders. It is currently uncertain whether any bill will include proposals to implement the Model Law.

iii Insolvency procedures

Leaving aside less formal restructuring processes (which are fairly prevalent in the absence of a statutory corporate rescue regime), the insolvency regime in Hong Kong still revolves primarily around liquidation and provisional liquidation. These formal procedures are often combined with a scheme of arrangement to effect a cramdown of dissenting creditors within the same class where necessary. Hong Kong law relating to schemes of arrangement is largely based on English law, and the body of cases coming out of that jurisdiction are persuasive in Hong Kong. We do not discuss schemes of arrangement in any more detail in this chapter.

Liquidation

Liquidation is also referred to as winding up, of which there are two types:

- a compulsory winding up or winding up by the courts; and
- a voluntary winding up:
  - members’ voluntary winding up (i.e., solvent liquidation), which is not an insolvency process as the directors must file a declaration of solvency; and
  - creditors’ voluntary winding up (CVL), initiated by the shareholders of an insolvent company, once it is considered that there is no prospect of a viable restructuring.

Power also exists under Section 228A of the CWUMPO for a director (without first consulting shareholders) to commence a voluntary winding up of the company and seek the appointment of a provisional liquidator. This is rarely used, owing to the particular statutory requirement that no other form of winding up should be reasonably practicable, which the directors must state to be the case (with appropriate justification) in the winding-up statement to be delivered to the Registrar of Companies.

Provisional liquidation

The appointment of PLs can be sought at the time of the presentation of a winding-up petition by the official receiver or any creditor or contributory. The primary objective of such an appointment is to preserve the assets and records of a company, for the benefit of its creditors, in the interim period between the presentation of the winding-up petition and the granting of a winding-up order by a court. It is common for PLs to be appointed in this interim period when the winding-up petition is disputed, but stakeholders can also seek the appointment of PLs as an end in itself, provided the necessary criteria are met. The application to the courts for the appointment of PLs is often underpinned by a desire to combat the perceived risk that directors (or shareholders) may dissipate assets of the company in the period before a winding-up order is made and, indeed, it is necessary to satisfy the court that the assets of the company are in jeopardy for the appointment to be made. There is no moratorium on the enforcement of security by secured creditors during the period between the presentation of the petition for winding up and the making of the order for winding up,
or when PLs have been appointed, or when a winding-up order has been made. However, there is a general stay on proceedings against a company on the making of a winding-up order and on the appointment of PLs.7

In Re Legend International Resorts Ltd (Court of Appeal),8 it was held first that the traditional basis in Hong Kong for the appointment of PLs under Sections 192 and 193 of the CWUMPO (that there had to be a showing of assets in jeopardy) still had direct application. Further, the wording of Section 192 was very clear: the appointment of PLs had to be for the purposes of the winding up. Provided that purpose existed, there would be no objection to giving PLs restructuring powers as well.9 Second, there was still a significant difference between the appointment of PLs on the basis that a company was insolvent and that its assets were in jeopardy, which was permissible, and the appointment of a PL solely for the purpose of enabling a corporate rescue to take place, which was not. Finally, there was no basis in the particular circumstances for the appointment of PLs as the assets of the company were not shown to be in jeopardy.10 While the principles in Re Legend remain the law in Hong Kong, in the case of Re China Solar Energy Holdings Ltd,11 the court confirmed that PLs may continue in office to implement a restructuring once those asset preservation concerns cease to apply, holding that this did not defeat the principle of requiring the appointment to be for the purposes of the winding-up.

An alternative approach was adopted in Z-Obee Holdings Ltd,12 in which the Hong Kong winding-up petition of a company incorporated in Bermuda was stayed and the Hong Kong-appointed PLs ultimately dismissed to allow the appointment of PLs with a specific restructuring power (as allowed under the Bermudian legislation) in Bermuda. Once appointed, the Bermudian PLs were granted recognition in Hong Kong. The court subsequently approved a scheme of arrangement in Hong Kong promoted by the PLs appointed in Bermuda.13 This is of particular importance given that the rule in Gibbs14 continues to apply in Hong Kong, thereby preventing a foreign law scheme of arrangement from being used to compromise Hong Kong-law-governed debt.

**Ancillary proceedings**

Local procedures15 allow for ancillary proceedings when main proceedings are pending in another country. In this regard, unregistered companies (for example, a Hong Kong branch of a company incorporated overseas) that have some sufficient connection with Hong Kong can be wound up in what are called concurrent proceedings (see Section I.vii).

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7 Companies (Winding Up and Miscellaneous Provisions) Ordinance [CWUMPO], Section 186.
9 Re Ki review, Re Luen Cheong Tai International Holdings Ltd [2002] 3 HKLRD 610 considered.
12 HCMP 663/2017.
13 Re Z-Obee Holdings Ltd [2018] 1 HKLRD 165.
14 Antony Gibbs and sons v. La Société Industrielle et Commerciale des Métaux (1890) 25 QBD 399. Broadly, the rule is that, as matter of English law, a debt governed by English law may only be validly compromised by an English law process.
15 CWUMPO, Section 327.
iv  Starting proceedings

Creditors’ voluntary winding up

The CVL process is commenced by the passing of a special resolution to wind up the company at a general meeting of the members.16 A meeting of creditors (to be held in accordance with Section 241 of the CWUMPO) should then take place on a date not later than 14 days after the day of the meeting of members, and notice should be given of the meeting to all creditors at least seven days before the day on which the meeting is to be held.

The chair (usually a director of the company) will take creditors’ alternative nominees for the liquidator’s role (if any) – an initial nomination will have been made by the members at the general meeting – and a vote will be taken. In the event of any conflict, the creditors’ choice will prevail.17 The usual practice in Hong Kong is for two liquidators to be appointed who will act jointly and severally. A committee of inspection (COI) may also be established, which will take a prominent advisory role in the CVL, exercising a degree of supervision and control over the liquidator.

Court winding up

The vast majority of winding-up petitions are presented by unsecured creditors, and are most frequently brought on the grounds that a company is unable to pay its debts. However, it should be noted that winding up by the court is not limited to instances of a company being insolvent; a petition can be made to the court when there are ‘just and equitable grounds’ to do so,18 as in cases involving suspected fraud.

Under Section 178 of the CWUMPO, a company is deemed unable to pay its debts, in summary, when:

a) the company fails to satisfy – within three weeks of the service of a notice in the prescribed form – a debt exceeding HK$10,000;19
b) the enforcement of a judgment of the court against the company has not been satisfied; or
c) it appears to the court that the company is unable to pay its debts, taking into account the contingent and prospective liabilities of the company. Often, the test relied upon is a cash-flow test, but a balance-sheet test may also be used.

A total of 458 winding-up petitions were presented to the Hong Kong High Court in 2016, 403 were presented in 2017 and 213 were presented between the beginning of 2018 and 1 August 2018.20

The potential time lapse between the presentation of a winding-up petition and the declaring of a winding-up order may stretch to several months, in particular if the petition is

16 ibid., at Section 230: the special resolution is one pursuant to CWUMPO, Section 228(1)(b) that the company be wound up voluntarily. The meeting is called by the directors of the company, in the case of a limited company, on 14 days’ notice (or such longer period as is prescribed in the company’s articles of association); see also Companies Ordinance, Sections 562, 564 and 571.
17 CWUMPO, Section 242.
18 Under CWUMPO, Section 177(1)(f).
19 The Amendment Ordinance has introduced a prescribed form of statutory demand.
20 Numbers are taken from copies taken of the cause book for Company Winding-up Proceedings at the Hong Kong High Court. These numbers do not give an indication of how many of these companies were subsequently wound up, nor under which statutory grounds the petitions were submitted.
opposed. This may present difficulties for creditors and directors, particularly in light of the retrospective calculation of the date of the commencement of the winding-up (deemed to be the date of the presentation of the petition).

**Presentation of a winding-up petition**

The following parties may present a winding-up petition:

- the company;
- any creditor or creditors;
- a contributory or contributories;
- the official receiver in respect of a company that is being wound up voluntarily;
- the Registrar of Companies;
- the Financial Secretary (in a case falling within Section 879, Paragraph (1) or (3) of the Companies Ordinance, for example, where it is expedient in the public interest);
- the SFC can petition in the public interest in respect of listed companies and leveraged foreign exchange traders; and
- the Insurance Authority can petition in relation to insurers under the Insurance Companies Ordinance.

**Appointment of a liquidator**

On the making of a winding-up order, the official receiver becomes the liquidator of the company, pending (unless one has been previously appointed) separate meetings of creditors and contributories of the company to determine who will act as liquidator. Where no agreement can be reached, the official receiver will offer the name of the next person on the rota system of the Administrative Panel of Insolvency Practitioners for Court Windings Up (also known as Panel A or the ‘cab rank’ system). If further disputed, the court will decide who is to be appointed as it sees fit, in the interests of all parties, and it need not have regard for the recommendations of the meetings of either creditors or contributories.

**Control of insolvency proceedings**

The making of a winding-up order results in the termination of the company directors’ powers of management; the subsequent question of who will exercise control over the company and of the liquidation differs, to a degree, between a CVL and a court winding up.

**Creditors’ voluntary winding up**

Liquidators have wide-ranging statutory powers as regards the realisation of the assets of the company and the winding up of its affairs. However, those powers that are exercisable without an element of supervision, or prior sanction or permission, are narrowly defined (although more extensive in the context of a CVL). Under Section 199(2) of, and Schedule 25 to,

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21 The Securities and Futures Commission used its powers under Section 212 of the Securities and Futures Ordinance in July 2013 for the first time in relation to China Metal Recycling (Holdings) Limited: on 26 February 2015, the Hong Kong High Court ordered that China Metal Recycling (Holdings) Limited be wound up in the public interest.
the CWUMPO, a liquidator has the power to, *inter alia*, sell company property, execute documents and claim in the insolvencies of debtor companies and individuals. A creditor or contributory can refer questions on the exercise of these powers to the court.  

The COI, if appointed, will take a general supervisory role and the liquidator will report to or seek advice from the COI on the conduct of the liquidation. The COI also has the power to fix the remuneration of the liquidator. The liquidator can only take specified actions if he or she has first obtained the sanction of the COI or the court (or, if there is no COI, at a meeting of the creditors), for example, to pay any class of creditors in full or to make a compromise or arrangement with creditors. The potential exists, however, for the liquidator to apply to the court for such a sanction if this is not forthcoming from the COI, which may be granted if deemed in the best interests of the company. The Amendment Ordinance provides for the composition of the COI and procedures in relation to a COI meeting. A COI must consist of not less than three and not more than seven members, with the possibility that this might be varied upon application by the liquidator to the court.

**Court winding up**

Court supervision of the conduct of a liquidation is more far-reaching in the context of a compulsory winding up. Examples of the powers available to the court include the following:

- **Summary cases:** In instances where the assets of an insolvent company are likely not to exceed HK$200,000, the court may make an order for the company to be wound up in a summary manner; the order may be rescinded should further assets of the company come to light.

- **Regulating orders:** In the interest of efficiency or expediency, the court has the power to dispense with some of the procedural requirements (i.e., for certain meetings to take place).

- **Staying the winding up:** With good reason, the court has a general power to stay the winding-up proceedings at any time after a winding-up order has been made, either altogether or for a limited time.

- **Conversion of a compulsory liquidation into a CVL:** This concept is unusual, and it has rarely been used.

The powers that may be exercised by a liquidator without sanction are fewer in the case of a compulsory winding up. The general powers of a liquidator under Section 199 of the

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22 Such a power exists under CWUMPO, Section 255(1) in respect of a creditors’ voluntary winding up.
23 CWUMPO, Section 244(1); in the absence of the committee of inspection, the creditors may fix the remuneration of a liquidation.
24 CWUMPO, Section 251(1)(a) and Schedule 25.
26 CWUMPO, Section 243, Paragraphs (1) and (1A).
27 This could include the OR or existing PL being the liquidator without holding a meeting of creditors, and there being no COI. The goal of this approach is to minimise the costs of the liquidation.
28 Power of the court exists under CWUMPO, Section 227F.
29 Power of the court exists under CWUMPO, Section 227A.
30 Power of the court exists under CWUMPO, Section 209.
31 Power of the court exists under CWUMPO, Section 209A.
CWUMPO (which have been reframed by the Amendment Ordinance) are subject to the control of the court, and a request for the review by the court of any action of a liquidator may be submitted by any creditor or contributory.\(^{32}\)

The court also has the power to remove a liquidator. Creditors may apply for a liquidator to be removed, and may choose to do so if they were unable to secure the initial appointment of their preferred liquidator.\(^{33}\)

Guidance notes as regards a liquidator’s role and his or her investigation of the affairs or assets of a company have been produced by the Hong Kong Institute of Certified Public Accountants. The Amendment Ordinance expands the list of people disqualified from appointment as a liquidator or PL to avoid conflicts of interest.

**Reviewable transactions**

A liquidator in Hong Kong may seek to challenge the actions of a company (e.g., by invalidating security or voiding transactions) taken during the applicable risk period prior to the company commencing winding up. The length of the risk period varies, depending on the type of challenge and the circumstances of the transaction. The main reviewable transactions are summarised below, the notable exception being that Hong Kong has no wrongful trading provisions.

**Unfair preferences**

An unfair preference is an act (e.g., granting of security or guarantee) that has the effect of putting a creditor, a surety or a guarantor in a better position than it would otherwise have been in upon a winding up of the company. The general risk period is six months, but is increased to two years if the unfair preference is granted to a person who is connected with the company.

**Transactions at an undervalue**

A transaction is at an undervalue if the company makes a gift, or if there is no consideration, or if the consideration is significantly less than the value of the consideration provided by the company. The risk period is five years from the commencement of the winding up and the company must have been unable (or became unable) to pay its debts at the time of the transaction. It is a defence to show that the company entered into the transaction in good faith and for the purpose of carrying on its business and there were at the time reasonable grounds for believing that the transaction would benefit the company.

**Avoidance of floating charges**

A floating charge will be invalid except, broadly, to the extent of any consideration received by the company at the same time as, and in exchange for, the creation of the charge. The risk period is 12 months, or two years for a transaction with a connected party, from the date of the winding up. The company must also have been unable (or became unable) to pay its debts at the time of creation of the charge.

\(^{32}\) Creditors or contributories (or a liquidator himself or herself) may refer questions to the court on the conduct of a court winding up under Section 200 of the CWUMPO.

\(^{33}\) Power to remove a liquidator exists under the CWUMPO – Section 252 (CVL) and Section 196(1) (court winding up).
**Extortionate credit transactions**
A credit transaction is extortionate if (taking into consideration the credit risks) credit is provided for grossly exorbitant payments (either actual or contingent, e.g., on default) or the transaction grossly contravenes principles of fair dealing. The risk period is three years.

**Fraudulent conveyances**
Although rarely invoked, this transaction provides for the voidability of dispositions made with the intent to defraud creditors. There is no time limit, and the transaction applies whether or not the company making the disposition is being wound up or insolvent.

**vi Special regimes**
As stated in Section I.iv, the SFC has unique statutory power to commence liquidation proceedings in respect of particular types of entities. Hong Kong also now has a specialist resolution regime for financial institutions under FIRO.

Although the detail of FIRO and the changes wrought by its introduction are outside the scope of this text, it is useful to understand the broad scope of FIRO when considering the landscape of insolvency-related measures available in Hong Kong.

FIRO provides a comprehensive resolution regime for the banking, insurance, securities and futures sectors, including branches of financial institutions incorporated outside Hong Kong, locally incorporated holding companies and associated operating entities, clearing houses and recognised exchanges. FIRO provides a full menu of stabilisation options that are available to the resolution authority to use if:

- a within-scope financial institution has ceased, or is likely to cease, to be viable;
- b there is no reasonable prospect that private sector measures outside resolution would result in the institution becoming viable again within a reasonable period; and
- c the non-viability of the institution poses risks to the Hong Kong financial system.

These options include the transfer of the failing financial institution or some or all of its businesses to a commercial purchaser, the transfer of some or all of its businesses to a bridge institution, the transfer to an asset management vehicle, the statutory bail-in of certain obligations and, as a last resort, taking the financial institution into temporary public ownership. The objectives throughout are to promote the stability and effective working of the financial system in Hong Kong (including the continuity of critical financial functions), to protect deposits and insurance policies, to protect client assets and, subject to satisfying the preceding objectives, to protect public funds by containing the costs of resolution. Recognising the cross-border nature of the business of many financial institutions operating in Hong Kong, FIRO also gives the resolution authority the ability to recognise a foreign resolution process and to exercise its powers in support of a foreign resolution process.

**vii Cross-border issues**
As has already been noted, the Hong Kong courts have wide discretionary powers to wind up a company incorporated outside Hong Kong if the relevant company has some suitable connection with Hong Kong. Recent cases have confirmed that the court will examine closely the need for such proceedings.
In *Re Pioneer Iron and Steel Company Limited*[^34] the Court of First Instance reiterated that:

- Section 327, Paragraphs (1) and (3) of the CWUMPO give the courts a discretionary jurisdiction to wind up an unregistered company; and
- its jurisdiction would be exercised if the following three core requirements, which had been stated in *Re Yung Kee Holdings*,[^35] were satisfied:
  - there is a sufficient connection with Hong Kong. In the context of insolvency there is commonly the presence of assets, but this is not essential;
  - there is a reasonable possibility that the winding-up order would benefit those applying for it; and
  - the court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company’s assets.

The Court also stated that an exceptional case could arise when the connection with Hong Kong was so strong and the benefits of a winding-up order for the creditors of a company so substantial that the court would be willing to exercise its jurisdiction despite the third criterion not being satisfied. This was then tested in *Re China Medical Technologies Inc.*[^36] Here the Court of First Instance rejected a petition for winding up where it was not satisfied that it would be able to exercise jurisdiction over one or more persons interested in the distribution of the company’s assets (determining that a Hong Kong-based creditor with a low-value claim was not sufficient to meet this requirement) and that the connection with Hong Kong was not strong enough and the benefits of a winding up to the creditors of the company were not so substantial so as to enable the court to exercise its jurisdiction without the third criterion being satisfied. A few months later, new evidence came to light that suggested that persons and bank accounts in Hong Kong had played a key role in a suspected fraud in Hong Kong. The Cayman liquidators sought to reopen the hearing of the petition on the basis that a sufficient connection to Hong Kong was established by the presence of these persons and accounts; the Court held that the new evidence showed that there was a sufficient connection with Hong Kong and there was a benefit in making a winding-up order, and so an order was made, notwithstanding that the third core requirement was not satisfied. The Court of Appeal in Hong Kong has subsequently confirmed that this decision was correct, in particular noting that there did not need to be evidence of persons interested in the distribution of assets in Hong Kong to sustain such an outcome[^37].

The three-part test set out above was affirmed by the Court of Final Appeal in the long-running *Yung Kee Holdings*[^38] case; that Court also held that the same test applies whether the winding-up petition has been presented by a creditor or a shareholder. However, the Court noted that the factors to which a court will look in determining whether there is a sufficient connection between a (solvent) foreign company and Hong Kong in the context of a shareholders’ petition are different from those to which it looks in the context of a creditors’ petition to wind up an (insolvent) company because the nature of the dispute and the purpose for which the winding-up order is sought are different.

[^34]: HCCW 322/2010 unreported judgment of 6 March 2013.
[^38]: *Kam Leung Sai Kwan v. Kam Kwan Lai and Ors* (FACV No. 4 of 2015).
Two cases demonstrate that the court takes a dim view of what it sees as deliberate attempts to avoid its jurisdiction to wind up foreign companies. In *Penta Investments Advisers Ltd v. Allied Welni Developments Ltd*, the Court of Appeal found that (among other things) moving the company’s operations out of Hong Kong to the Marshall Islands to claim that it did not presently have a sufficient connection would not prevent a winding-up order being made. As the Court said: ‘The connection, once established, remains even after the matters giving rise to the original connection have ceased to exist.’ In *Re Shandong Chenming Paper Holdings Ltd v. Arjowiggins HKK 2 Ltd*, the company, which was listed in Hong Kong, had both refused to pay an undisputed judgment debt and attempted to remove its connection to Hong Kong by way of a corporate reorganisation. The Hong Kong court was not impressed with this behaviour and declined to make an order preventing the creditor from bringing a winding-up petition (see Section III.vi for more details).

While Hong Kong does not have a statutory provision enabling the courts to assist foreign insolvency proceedings, in addition to the power to wind up unregistered companies, as a matter of common law, the court has the power to recognise and grant assistance to foreign insolvency proceedings. In *Joint Official Liquidators of A Co v. B*, the Court of First Instance took the opportunity to issue a reminder that a court may, pursuant to a letter of request from a common law jurisdiction with a similar insolvency law, make an order of a type that is available to a provisional liquidator or liquidator under Hong Kong’s insolvency regime. In this case, a request had been made by the liquidators of a Cayman company, on a letter of application from the Grand Court of the Cayman Islands, for the production of certain documents to the liquidators. In making the order requested, the Hong Kong court noted that the status of a foreign liquidator of a foreign company is the same as that held by the directors of that company prior to the winding up, but that a distinction needed to be made between information and assets, and that in the case of property, an application would need to be made by the foreign liquidator for an order vesting him or her with title to the local property. This approach was followed, and the scope of the order granted was expanded, in a series of cases, including *Re Centaur Litigation SPC*. In making the requested orders in *Re Centaur*, the court included a provision that would require any person wishing to commence proceedings in Hong Kong against any of the companies to first obtain the court’s leave. The judge who made the order stated that the intention was to broadly replicate the impact of the making of a winding-up order in Hong Kong without the need for a petition and the engagement of the entire Hong Kong insolvency regime. Interestingly, in *Re Supreme Tycoon Ltd*, the court held that a foreign insolvent liquidation commenced in the British Virgin Islands by way of a shareholders’ resolution was eligible for recognition by the Hong Kong court (see Section III.iv).

In *The Joint Administrators of African Minerals Ltd (in administration) v. Madison Pacific Trust Ltd*, the Court of First Instance was asked, pursuant to a letter of request from the High Court of England and Wales, to consider providing assistance to insolvency proceedings in England that took the form of an administration of a non-English entity...
under the supervision of the High Court of England and Wales. The assistance sought was the recognition of the English proceedings and an order restraining the enforcement over security granted by the company in administration (the secured creditor being incorporated in, and carrying on business in, Hong Kong). For the purposes of the decision, the Court assumed (but without deciding) that the Hong Kong court can, in principle, recognise liquidators appointed in a jurisdiction other than the place of incorporation or administrators appointed by the High Court of England and Wales. However, the Court reiterated that although the Hong Kong court can take a generous view of its power to assist a foreign liquidation process, this is limited by the extent to which the type of order sought is available to a liquidator in Hong Kong under Hong Kong’s insolvency regime, common law and equitable principles: as Hong Kong does not have any statutory provision that provides for a moratorium on the enforcement of a secured debt, the court could not make the orders sought.

An important practical issue that arose during the course of 2016 was whether in addition to ordering the production of documents that a liquidator would expect to obtain as a matter of course, the court’s common law power extended to ordering the production of documents or examination of persons that would historically have required an application under Section 221 of the CWUMPO.\(^\text{45}\) In \textit{BJB Career Education Co Ltd},\(^\text{46}\) the Court of First Instance made an order, following a request from the Cayman Islands court for recognition and assistance, for the delivery of documents, answers to questions and oral examination of a director without requiring the foreign liquidators to commence an action under Section 221. This approach was followed in \textit{Re Pacific Andes Enterprises (BVI) Ltd}\.\(^\text{47}\) The court went further in \textit{Bay Capital Asia Fund LP v. DBS Bank (Hong Kong) Ltd},\(^\text{48}\) chastising the defendant bank (and its solicitor) for refusing to hand over documents relating to bank accounts that would ordinarily be freely available to the director of a company.

In practical terms, it is important to remember that Hong Kong does not have a specialist insolvency court. In practice, petitions for winding up and related insolvency law cases appear to be primarily directed to a handful of judges who have experience in this area.

II INSOLVENCY METRICS

There continues to be a distinct lack of significant formal liquidation processes in Hong Kong. As an indication of how the Hong Kong insolvency regime is viewed externally, the lowest score Hong Kong received from the World Bank’s \textit{Doing Business} report 2018\(^\text{49}\) was in the resolving insolvency section, ranking 43rd, compared to its overall ease of doing business ranking of 5.

\(\text{45}\) CWUMPO, Section 221 empowered the court to order the production of documents relating to a company or to summon any person who has information about a company’s affairs for an examination; the Amendment Ordinance repealed this section and replaced it with new Sections 286B and 286C.

\(\text{46}\) [2017] 1 HKLRD 113.

\(\text{47}\) HCM 3560/2016, [2017] HKEC 146.

\(\text{48}\) [2016] HKEC 2377.

The Hong Kong economy remains reasonably buoyant and there are, as a consequence, limited defaults on debt obligations. However, there has been a recent increase in defaults by companies either listed in or with connections to Hong Kong with significant business operations in China. This is considered further in Section V.

III PLENARY INSOLVENCY PROCEEDINGS

i Re Z-Obee Holdings Ltd

The Z-Obee case is a good example of both the flexibility of the Hong Kong courts and of judicial cooperation across common law jurisdictions. Initially, provisional liquidators had been appointed in Hong Kong to Z-Obee Holdings Limited (a Bermuda-incorporated, Hong Kong overseas registered company). However, concern about the impact of Re Legend (see Section I.iii, ‘Provisional liquidation’) and the inability to appoint PLs solely for the purpose of restructuring in Hong Kong meant that the parties had to adopt an unusual and novel approach to the restructuring.

A successful application was made by the company to appoint PLs in Bermuda for the purpose of facilitating a restructuring. (There is no equivalent restriction in Bermuda on appointing PLs solely for the purpose of restructuring, i.e., the restrictions in Re Legend do not apply.) The Bermudian PLs were then granted recognition by the Hong Kong court, which at the same time discharged the PLs who had been appointed in Hong Kong. The recognition expressly recognised that the Bermudian PLs had the power to carry out a restructuring of the company. The Hong Kong court then approved a scheme of arrangement proposed by the Bermudian PLs in Hong Kong.

This case is interesting for its novel and pragmatic approach to facilitating restructurings in Hong Kong in the absence of a formal corporate rescue regime and while the restrictions of Re Legend apply.

ii Re China Solar Energy Holdings Ltd

A creditor of China Solar Energy Holdings Ltd, a company incorporated in Bermuda and listed on the Hong Kong Stock Exchange (HKSE), issued a summons to remove the PLs who had been appointed to the company on the grounds that their sole remaining function was to complete the company’s restructuring. The main thrust of the creditor’s argument was that the decision in Re Legend prevented PLs from being appointed solely for the purpose of restructuring in Hong Kong. It should be noted that the PLs were originally appointed on asset preservation grounds but were also granted powers to promulgate a restructuring.

The court in this case disagreed with the creditor’s interpretation of Re Legend and held that there was nothing in Hong Kong to prevent PLs, properly appointed on asset preservation grounds, from both being granted restructuring powers (as explicitly stated in Re Legend) and using those powers to complete a restructuring. The asset in question was

50 [2018] 1 HKLRD 165.
51 [2006] HKCU 357.
52 Civil Appeal Nos. 207 and 210 of 2005 [2006] HKCA 75, [2006] 2 HKLRD 192; see also Section I.iii.
the listing status of the company, and the PLs were appointed in part to protect that listing status. As such, granting the liquidators restructuring powers in connection with preserving that asset was entirely appropriate.

iii  Re China Lumena New Materials Corp

This case\(^{54}\) clarified the requirements for foreign PLs to obtain the prior approval of the Hong Kong court to deal with assets of a company located in Hong Kong. Whereas the position in Hong Kong as regards information requests has been well established for a few years (see, for example, Bay Capital Asia Fund LP v. DBS Bank (Hong Kong) Ltd,\(^{55}\) in which the court held it was necessary to obtain a court order to obtain documents relating to a company’s bank accounts from the bank in question), the position around assets has been less clear.

By way of background, China Lumena New Materials Corp was a Cayman Islands company to which PLs had been appointed in that jurisdiction. The PLs had been granted formal recognition in Hong Kong but had sought a specific order to transfer amounts held in accounts of the company in Hong Kong out of the jurisdiction. Mr Justice Harris held that transferring assets out of the jurisdiction was a step too far for PLs to take without an order of the court. This tracked the position under the Model Law (albeit that it has not been implemented in Hong Kong).

iv  Re Supreme Tycoon Limited

The court in Hong Kong declined to follow the Privy Council’s decision in Singularis Holdings Ltd v. PricewaterhouseCoopers\(^{56}\) that common law powers of recognition in cross-border insolvency cases would not extend to voluntary liquidations. This was in line with the decision of the Singapore court in Re Gulf Pacific Shipping Ltd.\(^{57}\) The Hong Kong court held that a voluntary liquidation was still a collective insolvency proceeding for the benefit of the general body of creditors, and as such it was open to the Hong Kong court to recognise the proceedings under the principle of modified universalism. The court did state, however, that this would not be the case for a solvent winding up, which was more akin a private arrangement.

This case\(^{58}\) concerned a company, Supreme Tycoon Ltd, incorporated in the British Virgin Islands in respect of which the joint liquidators of its parent company had passed a shareholders’ resolution to place it into voluntary liquidation in the British Virgin Islands. The liquidators of Supreme Tycoon then sought a recognition order from the Hong Kong Court to obtain information, books and records about the company from third parties in Hong Kong. The case is of interest as it is the first time a court in Hong Kong has granted such a recognition order when a company has been placed into a voluntary liquidation process.

v  Re Southwest Pacific Bauxite (HK) Ltd

A creditor of Southwest Pacific Bauxite (HK) Ltd issued a petition to wind up the company on the basis of an unpaid statutory demand. Southwest Pacific opposed the petition on the

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\(^{54}\) [2018] HKCFI 276.
\(^{55}\) [2016] HKEC 2377.
\(^{56}\) [2014] UKPC 36.
\(^{57}\) [2016] SGHC 287.
\(^{58}\) [2018] HKCFI 277.
basis that the debt was the subject of a *bona fide* dispute on substantial grounds and relating to a management services agreement between the parties that contained a clause requiring any disputes to be resolved by arbitration.

The status of the law in Hong Kong as regards such a situation was that a company, in order to defeat a winding up petition after non-payment of a statutory demand, would have to demonstrate to the court a *bona fide* defence against the debt: the existence of an arbitration clause in the underlying contract would not itself be sufficient to stay the petition to allow for arbitration to be carried out. However, in this case, the court held that a petition should generally be dismissed when the following three elements are present:

1. A company disputes the debt relied on by the petitioner;
2. The contract under which the debt is alleged to arise contains an arbitration clause that covers any dispute relating to the debt; and
3. The company takes the steps required under the arbitration clause to commence the contractually mandated dispute resolution process and files an affirmation that demonstrates this.

The court also stressed that this was not a firm rule and that the court continued to retain its discretion whether or not to admit a petition, for example, to appoint PLs on asset preservation grounds notwithstanding that the above-mentioned tests were met.

**vi Shandong Chenming Paper Holdings Ltd**

Shandong Chenming Paper Holdings Ltd is a conglomerate with interests in papermaking, forestry, finance and real estate. The company is incorporated in China and listed on both the Shenzhen and Hong Kong stock exchanges. In November 2015, a creditor of Shandong Chenming obtained an arbitral award in Hong Kong and was subsequently granted leave by the Hong Kong court to enforce the award. The creditor served a statutory demand, which was not paid. However, the company first obtained an *ex parte* injunction to prevent the creditor from issuing a winding-up petition and subsequently sought a declaration from the Hong Kong court that the three core requirements to wind up an unregistered company would not be met, so as to prevent the creditor from presenting a petition. This was partly based on the company having undertaken a corporate restructuring whereby a direct subsidiary of the company incorporated in Hong Kong was moved to become an indirect subsidiary.

The court dismissed the company’s request for such a declaration. The court did so for a number of reasons and made its views on the company’s conduct very plain indeed.

The case turned on the second of the three core requirements: whether the creditor would derive sufficient benefit from the order (the other two requirements being accepted as having been met). The court found that such a benefit could well be derived from the pressure it would place on the company that was solvent and had not disputed its ability to pay the debt in question, given the severe consequences to the company of the appointment of a liquidator. Further, the court rebuked the company for its unethical conduct and found that there was a public interest reason to dismiss the application (over and above the requirement to demonstrate a benefit to the creditor), namely to prevent foreign companies listing on the

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59 [2018] 2 HKLRD 449.

60 *Shandong Chenming Paper Holdings Ltd v. Arjowiggins HKK 2 Ltd* [2017] 4 HKLRD 84.
The Company has chosen to have a second primary listing in Hong Kong. An arbitration award has been made against it, which has now become enforceable as a judgment of this Court. The Company does not suggest that it cannot pay the Award. It simply refuses to do so and takes the position that there is nothing the defendant can do about it in Hong Kong. This seems to me to be unacceptable. The Company wishes to take advantage of Hong Kong’s financial system and the legal system that underpins it. Hong Kong’s legal system and courts provide investors both domestically and internationally with confidence in the reliability and integrity of the financial system. The Company’s refusal to honour the Award shows disregard for the integrity of our legal system and, in a non-technical sense at least, contempt for the High Court of Hong Kong. If the Company wishes to be listed in Hong Kong, it should honour the Award. . . . There is a public interest in steps being taken to remedy this conduct and to disabuse other Mainland companies of the idea that they can take the benefit of access to Hong Kong’s financial system without the burden of complying with our laws. In the circumstances of this case, the obvious and appropriate step is the winding up of the Company in Hong Kong and the delisting of its H shares. 61

Ultimately, the petition was adjourned, with Shandong Chenming being required to pay into court the amount of the statutory demand plus interest, totalling HK$389,112,432.44. To date, no winding up of the company has been commenced in Hong Kong.

IV ANCILLARY INSOLVENCY PROCEEDINGS

The key cases involving ancillary insolvency proceedings in Hong Kong are discussed in Section I.vii.

V TRENDS

There is general anticipation that insolvency activity in Hong Kong will increase during the coming year. This is largely as a consequence of the commonly held view that the economic cold winds in China will inevitably lead to an upturn in formal insolvency processes in Hong Kong, given that there are a number of Hong Kong-incorporated entities and overseas incorporated entities that have their principal place of business in Hong Kong but conduct their key business activities in mainland China. Witness the continued growth in the number of bond defaults in China, hitting around 28.5 billion yuan by the end of July 2018. 62 This has fed into defaults by companies with connections to Hong Kong. For example, Hsin Chong Group Holdings Limited, listed on the HKSE with substantial exposures in China, failed to redeem its US$300 million 8.75 per cent senior notes in May 2018; a subsidiary of China Energy Resources Chemicals Group missed a redemption payment in May 2018 on its US$350 million 5.25 per cent guaranteed bonds due in 2018 (the notes are listed on the HKSE); and a subsidiary of CW Group Holdings Limited, listed on the HKSE, failed to pay interest on its S$75 million 7 per cent notes due in June 2018.

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61 ibid., at Paragraph 30.
I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law
Insolvency proceedings in Hungary are governed by Act No. XLIX of 1991 on Bankruptcy and Liquidation Proceedings (the Insolvency Act), which has been amended from time to time.

The procedural issues that are not otherwise provided for in the Insolvency Act, the provisions of Act CXXX of 2016 on the Civil Procedure on non-contentious judicial civil actions, shall apply, subject to the derogations stemming from the special characteristics of non-contentious proceedings, as well as the general provisions of the Act on the Rules Applicable to Non-Contentious Civil Actions and on Non-Contentious Court Proceedings.

ii Policy
Prior to initiating insolvency proceedings, business entities usually make attempts out of court for a restructuring or reorganisation, and comprehensive negotiations that can be considered as a prevailing attitude to rectify the financial situation of a business entity.

Under the Insolvency Act, pre-insolvency methods or other special court-administered proceedings at the early stage of business entities’ financial distress are not available.

The Insolvency Act allows a financially troubled business entity to initiate bankruptcy proceedings instead of liquidation proceedings, and thus the business entity may make an attempt to rescue the business. If the bankruptcy proceeding fails, it is transformed into a liquidation proceeding by the court.

iii Insolvency procedures
Under the Insolvency Act, there are two types of insolvency proceedings applicable for business entities controlled and supervised by the competent court:

a bankruptcy proceedings that aim at recovering the ordinary course of business, achieving a settlement between a financially troubled business entity and its creditors by granting a temporary relief (payment moratorium) for its financial obligations and enabling a reorganisation; and

b liquidation proceedings that aim at the dissolution of an insolvent business entity and the distribution of its assets to its creditors.
Bankruptcy proceedings
Bankruptcy proceedings allow the reorganisation and restructuring of a business entity in financial distress. In this context there is no insolvency test; the financially troubled business entity decides on the initiation of bankruptcy proceedings.

During the proceedings, the debtor is granted a temporary relief (payment moratorium) for a maximum of 365 days if agreed by the creditors. If the debtor and its creditors fail to agree on a settlement or if the settlement agreement fails to comply with the law, bankruptcy proceedings are terminated and the court will commence liquidation proceedings.

During a payment moratorium, the enforcement of financial claims against the debtor is suspended and the enforcement of such claims cannot be ordered.

Claims are categorised as follows:
- claims with regard to the payment obligations of the debtor during the payment moratorium (e.g., wages and other similar benefits, related taxes and other similar charges, value added taxes, exercise taxes, payment obligations assumed with a view to carrying on the economic activity, as endorsed by the administrator); and
- secured and unsecured claims notified within the mandatory deadline.

The creditors must file their claims and pay the registration fee within 30 days of the commencement date. The above categories of claims cannot be considered as the order of satisfaction; it is the settlement agreement concluded between the debtor and the creditors that lays down the satisfaction of each claim.

Liquidation proceedings
Liquidation proceedings require the insolvency of the debtor. The court orders the liquidation of the debtor if it determines that the debtor is insolvent. The debtor may only be qualified as insolvent in the following cases:
- the debtor failed to settle or contest its previously uncontested and acknowledged contractual debts within 20 days of the due date, and failed to satisfy that debt upon receipt of a creditor's written payment notice;
- the debtor failed to settle its debt within the deadline specified in a final court decision or order for payment;
- the enforcement procedure against the debtor was unsuccessful;
- the debtor failed to fulfil its payment obligation as stipulated in the settlement agreement concluded in bankruptcy or liquidation proceedings;
- the court has declared the previous bankruptcy proceedings terminated;
- the debtor's liabilities in proceedings initiated by the debtor or by the receiver exceed the debtor's assets;
- the debtor was unable and, it is presumed, will not be able to settle its debts on the date when they are due; and
- in proceedings opened by the receiver, the members (shareholders) of the debtor fail to provide a statement of commitment in relation to providing funds necessary to cover such debts when due.

A debtor cannot be declared insolvent in the above cases within the deadline specified by the court for the settling of debts.
When liquidation proceedings are commenced, all pending enforcement procedures are terminated by the court and the creditors can only satisfy their claims within the liquidation proceedings.

The proceedings must be completed within two years although, in certain cases they may take longer if there is a failure to sell the debtor's assets.

Creditors' claims are ranked in the following order of satisfaction:

- **a** costs of liquidation;
- **b** parts of claims secured by pledges established before the commencement date of liquidation proceedings, which were not satisfied under the rules applicable to priority;
- **c** alimony claims, life annuity payment claims and compensation benefits to private individuals;
- **d** other claims of private individuals not originating from economic activities (e.g., damages, warranty claims);
- **e** taxes and other public dues, and public utility charges;
- **f** other claims (e.g., any unsecured claims);
- **g** default interest and late charges, surcharges, penalties and similar debts; and
- **h** claims held by a shareholder (member) or executive officer or executive employee of the debtor business entity.

In addition, claims that are secured by pledges will enjoy priority in satisfaction irrespective of the order above. In the case of secured creditors (i.e., pledgees), a special order of satisfaction prevails; however, there are also costs to be taken into account before the secured creditor's claim.

The creditors must file their claims within 40 days of the commencement date and, at the same time, must pay the registration fee.

### iv Starting proceedings

Bankruptcy and liquidation proceedings are non-contentious proceedings falling within the competence and exclusive jurisdiction of the regional court responsible for the place where the debtor's Hungarian-registered seat is located on the day of submission of the request for opening proceedings.

Under the Insolvency Act, there is no mandatory deadline for filing a request on the commencement of bankruptcy or liquidation proceedings.

The commencement of both types of proceedings becomes effective as of the date they are published in the Company Gazette (a publicly available online platform).

Bankruptcy proceedings can only be initiated by the debtor business entity. The representatives (directors) of that entity, upon prior approval of its main decision-making body, may request the competent court to commence bankruptcy proceedings.

As of the commencement date of bankruptcy proceedings, the debtor is granted a temporary relief (payment moratorium) for 120 days, which may be extended to 240 days or a maximum of 365 days if agreed by the creditors.

Liquidation proceedings can be initiated by the debtor business entity, the creditor or the receiver. Further, the court commences liquidation proceedings *ex officio* following unsuccessful bankruptcy proceedings or upon request of the company court or the criminal court.
If the liquidation proceedings are requested by a creditor, the creditor must prove that the debtor is insolvent and specify the reasons for the debtor's alleged insolvency. A creditor can only request the commencement of liquidation proceedings if the amount of its claim exceeds 200,000 forint.

Upon request of the debtor business entity, the court may allow a maximum period of 45 days for the debtor to settle its debt, except in liquidation proceedings following unsuccessful bankruptcy proceedings. A debtor cannot be declared insolvent within the deadline specified by the court for the settling of debts.

v Control of insolvency proceedings

Although the bankruptcy or the liquidation proceedings will be controlled by the competent court that ordered them, responsibility lies with either the administrator who is conducting bankruptcy proceedings, or the liquidator who is conducting liquidation proceedings.

The main roles of the competent court are (1) adjudication on objections filed against the administrator or the liquidator during bankruptcy or liquidation proceedings, respectively, and (2) the transformation of unsuccessful bankruptcy proceedings into liquidation proceedings.

In both proceedings, the most effective procedural tool available for creditors is an objection. By way of filing an objection to the competent court, diligent creditors may contest the unlawful acts or omissions of the administrator or the liquidator (in practice, typically the classification of other creditors’ claims, or the proposal on the distribution of the debtor’s assets).

In both proceedings, creditors may form a creditors’ committee for the protection of their interests, representation before the competent court, and especially to monitor the activities of the administrator or the liquidator. Instead of forming a creditors’ committee, creditors may elect to appoint a representative from among themselves. The rules applicable to a creditors’ committee are also applicable to a creditors’ representative.

In bankruptcy proceedings, a creditors’ committee may be formed if it represents at least one-third of the creditors, provided that the number of claims controlled by those creditors is at least half of the aggregate number of claims. In liquidation proceedings, a creditors’ committee may be formed if it represents at least one-third of the creditors, provided that those creditors control at least one-third of the aggregate number of claims. The creditors’ committee must consist of a minimum of three and a maximum of seven members, and the creditors operating the select committee may elect a chairperson. The participating creditors must agree on the creditors’ committee’s rights, cost advancing method and accounting issues.

Voting rights shall be held by any creditor who registered its claim (in the case of bankruptcy, within 30 days of the commencement of the bankruptcy procedure), paid the registration fee and whose claim is shown under recognised or uncontested claims. Any creditor who failed to participate in person or by way of proxy shall be counted as having voted ‘no’. As regards voting rights, creditors shall have one full vote awarded for each recognised or uncontested claim of 50,000 forint. There shall be no fractional votes. Creditors holding claims below the 50,000 forint threshold shall also have one vote. Interest accrued during the term of the stay of payment will not be taken into consideration with respect to voting rights.

In the case of liquidation procedures, the votes of creditors who notified their claims after the 40-day time limit shall apply this calculation method at a rate of one-half. Decisions shall be adopted by simple majority.
The establishment of a creditors’ committee may have, the following practical advantages, among others:

a. the liquidator sends a quarterly report on his or her activity and the financial situation of the debtor (if there is no creditors’ committee, the information about the individual creditors will be verified by the liquidator’s intermediate balance sheet);

b. the liquidator informs the creditors’ committee (or creditors’ representative) regarding the contracts that exceed the scope of day-to-day operations and the termination of existing contracts;

c. if a creditors’ committee has been formed, the liquidator is obliged to obtain the consent of that committee to continue the economic activity of the debtor during liquidation;

d. the liquidator may rent the debtor’s assets only with the approval of the creditors (or creditors’ representative);

e. in respect of wage increases after the time of the opening of liquidation proceedings, the liquidator may assume any new obligations only upon the committee’s consent;

f. in the case of the sale of a debtor’s assets, the liquidator may forego the application of sale process by way of a tender or auction only with the prior consent of the creditors’ committee;

g. the creditors’ committee may instruct the liquidator to notify the committee on the sales procedure, or to make available the appraisal and the sales procedure for the creditors for inspection and for monitoring;

h. the creditors’ committee may also instruct the liquidator to present the invitation to tender and the auction notice in advance to the committee for inspection, including the appraised value of the assets offered for sale, subject to the right of consultation; and

i. the creditors’ committee may request that the court appoint an expert for the cross-verification of the appraised value, and shall advance the costs involved.

In bankruptcy proceedings, the directors of a debtor business entity, including its main decision-making body and owners, shall exercise their respective rights only if the powers vested in the administrator are not violated. Directors remain in control over the debtor; however, an administrator monitors, inter alia, the business of the debtor, the approval of the administrator is required for the new commitments of the debtor, and the endorsement of the administrator is required for the fulfilment of payments from the debtor’s assets.

The directors of a debtor business entity are obliged to:

a. cooperate with the administrator;

b. provide a statement (1) that the annual financial statement and the interim balance sheet give a true and fair view of the financial position of the debtor, and (2) regarding the significant changes in the debtor’s financial position since the financial statement and the interim balance sheet had been adopted;

c. provide a statement indicating the payment service providers holding the debtor’s accounts (including account numbers), and investment firms where the debtor has a savings account;

d. provide a statement of commitment (1) for notifying the payment service providers of the filing of the petition for the commencement of bankruptcy proceedings, and (2) refraining from initiating any payment transaction or credit transfer that would be contradictory to the purpose of the payment moratorium, and from taking any measures by which to provide preferential treatment to any creditor;
provide a data sheet on the debtor’s financial position, as prescribed by the relevant laws; and
inform the creditors or creditors’ committee, the employees, the trade unions and the works councils regarding the financial position of the debtor upon their request during the bankruptcy proceedings.

In liquidation proceedings, directors lose their management power over the debtor. As of the commencement date of liquidation, the court appoints a liquidator who becomes the sole representative of the debtor business entity (i.e., replacing the directors) and is responsible for conducting the entire liquidation proceedings. After the commencement of liquidation, only the liquidator shall be authorised to make any legal statements in connection with the assets of the debtor business entity.

The directors of the debtor business entity are obliged to:

- prepare a closing inventory, annual financial statements, closing balance sheet and tax return, and send them to the liquidator and the tax authority within 30 days of the commencement date of the liquidation, as well as provide a statement (1) that the closing inventory, the annual financial statement and the closing balance sheet give a true and fair view of the financial position of the debtor, and (2) regarding any significant changes in the debtor’s financial position since the balance sheet was adopted;
- prepare a list of the documents that may not be discarded, and deliver both those documents and archive materials to the liquidator within 30 days of the commencement date of the liquidation, with the assets according to an itemised inventory, and shall provide information regarding the pending affairs, and declare to have delivered all assets and documents as required;
- provide a statement to the liquidator and the environmental protection authority within 15 days of the commencement date of the liquidation regarding any environmental damage or hazards that may result in penalties or other payment obligations, and expenses relating to cleaning up any such damage;
- disclose information regarding all legal transactions and commitments;
- inform without delay the employees, the cooperative members, the trade unions and the works councils regarding the commencement of liquidation proceedings;
- inform the beneficiaries of the claims specified in the Insolvency Act regarding the opening of liquidation proceedings within 15 days of the commencement date of the liquidation;
- provide information at the liquidator’s request regarding the debtor’s activities prior to the liquidation and the placement of assets, and assist the liquidator in his or her activities;
- notify the service provider carrying the securities account of the debtor and the service provider managing other money-market instruments of the debtor regarding the ordering of liquidation proceedings within three business days of the commencement date of the liquidation, as well as the creditors holding a lien, right of enforcement and security deposit, and shall also verify the fulfilment of this notification requirement to the liquidator;
- inform the liquidator about fulfilling the obligation of provisioning;
provide to the liquidator a statement of property and other assets controlled by the debtor business entity, supported by documentary evidence, within 30 days of the commencement date of the liquidation, which are beyond the scope of liquidation assets, and shall make them available for the liquidator; and

inform the creditors or the creditors’ committee, the employees, the relevant trade unions and works councils regarding the financial position of the debtor upon their request during the liquidation proceedings.

vi Special regimes

The Insolvency Act contains special provisions regarding insolvency proceedings of business entities with strategic importance. The Hungarian government, acting in its sole discretion, may qualify any business entity as one that has strategic importance if it considers that the bankruptcy or the liquidation proceedings of such a business entity bears state interest (such as a special public interest, a significant project from a national economic perspective or a significant activity from a national economic perspective), and hence its creditors need to be satisfied under a special procedural regime. The Hungarian government is entitled to decide on the qualification of any business entity, even in the case of ongoing bankruptcy or liquidation proceedings, as a strategic business entity.

The most notable implications of such a special regime are the following:

a certain procedural rights granted to the creditors under the general regime are limited or excluded;

b different procedural deadlines are applied; and

c only a state-owned administrator or liquidator can be appointed to control the entire bankruptcy or liquidation proceedings (including the sale of the assets of the debtor business entity).

The Insolvency Act provides for the possibility of simplified liquidation proceedings. Simplified procedural rules apply to liquidation proceedings of a debtor business entity if its assets are not even expected to cover the costs of the liquidation proceedings, or to those liquidation proceedings that cannot proceed owing to deficiencies in the records or in the bookkeeping of the debtor business entity. If this is the case, the liquidator informs the creditors and requests them to provide any information they may have concerning the assets of the debtor business entity that are generally available, or to render assistance in conducting liquidation proceedings. If no information or no assistance has been provided upon this request of the liquidator and hence the liquidation proceedings cannot be conducted under the general rules, the liquidator prepares a report thereon and submits a request or recommendation to the court for the distribution of the debtors’ assets among the creditors.

Besides the foregoing special regime as regulated by the Insolvency Act, special insolvency rules are to be applied in the case of financial institutions, insurance companies and Hungarian branch offices of foreign business entities under the relevant legislation that defines the proceedings to be followed for insolvency.
vii Cross-border issues

Insolvency proceedings within the European Union are recognised pursuant to Regulation (EU) 2015/848 of the European Parliament and of the Council on insolvency proceedings (the Recast Insolvency Regulation).

Article 3(1) of the Recast Insolvency Regulation provides that the courts of the Member State within the territory of which the debtor’s centre of main interests (COMI) is situated shall have jurisdiction to open insolvency proceedings. The COMI shall be the place where the debtor regularly conducts the administration of its interests and which is ascertainable by third parties. In the case of a company, the place of the registered office shall be presumed to be the COMI in the absence of proof to the contrary. This presumption shall apply only if the registered office has not been moved to another Member State within the three months prior to the request for the opening of insolvency proceedings. With the re-tailored definition of COMI, the Recast Insolvency Regulation prevents bad or abusive forum shopping.

Pursuant to Article 3(2) of the Regulation, if the debtor’s COMI is situated within the territory of a Member State, the courts of another Member State shall have jurisdiction to open insolvency proceedings against that debtor only if it possesses an establishment within the territory of that other Member State. The effects of those proceedings shall be restricted to the assets of the debtor situated in the territory of the latter Member State.

Hungary has not adopted the UNCITRAL Model Law on Cross-Border Insolvency.

II INSOLVENCY METRICS

The total number of business enterprises\(^2\) in Hungary was 1,909,000 at the end of 2018, which represents an increase of approximately 38,000 in comparison with the previous year’s figures. The number of newly registered business enterprises was 126,000 in 2018, which is 4 per cent more than in 2017.\(^3\)

By contrast to the above trends, the number of liquidation proceedings newly ordered in a given year against partnerships decreased, with 13 per cent in 2018, in comparison to 2017; the total number of the newly ordered liquidation proceedings was 5,600. A drop-off with respect to the number of liquidation proceedings was noted in 2015 (after an increase between 2012 and 2014) and this tendency has continued since.

With regard to sectors, 28 per cent of liquidation proceedings were initiated in commerce and 14 per cent in construction, which is similar to previous years. The number of liquidation proceedings has increased only in the transport and warehousing sector, and that by 6 per cent; in other sectors, there was a slight decrease or no change.

The number of bankruptcy proceedings initiated is still surprisingly low and shows a decreasing trend. Only 15 bankruptcy proceedings were initiated in 2018 against financially troubled business entities.

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\(^2\) The term ‘business enterprises’ is used here to mean for-profit business associations, including business entities, private entrepreneurs and other forms of entities and businesses.

\(^3\) Source: Central Statistics Office.
III  PLENARY INSOLVENCY PROCEEDINGS

The insolvency proceedings that have opened in Hungary in recent years and are worth highlighting are the following.

i  Advenio Zrt

Advenio Zrt owned and operated Class FM, the most popular commercial radio station in Hungary. The Media Council of Hungary's National Media and Infocommunications Authority did not renew the licence of Class FM for the frequency it was using and thus it has gone silent. The Regional Court of Budapest ordered liquidation proceedings against Advenio Zrt and the court’s order was published in the Company Gazette on 13 November 2018. The bidding process regarding the sale of the company’s assets is still in progress.

ii  Est Media Vagyonkezelő Nyrt

Est Media Vagyonkezelő Nyrt is a B-category issuer at the Budapest Stock Exchange and is a Hungarian media company with two core businesses: media and telecommunications. The media sector, which is bundled in the EST Media Group Kft, includes print products, interior advertising, online media, and audio and video downloads (with the corresponding copyright). The telecommunications segment, which is managed through the subsidiary Externet Zrt offers internet and telecommunications services. The third division, asset management, is dedicated to establishing the corporate structure and offering new services based on the company’s network technology. Est Media Vagyonkezelő Nyrt filed a request on 1 March 2017 to the Regional Court of Budapest to have bankruptcy procedures initiated against itself. The Court ordered a payment moratorium (until 18 March 2018) based on the joint request of Est Media Vagyonkezelő Nyrt and its creditors. The reorganisation plan of the company was supported by its creditors and approved by the Regional Court of Budapest and therefore the bankruptcy proceeding was terminated.

iii  Sikér Malomipari Zrt

Owing to its financial troubles, Sikér Malomipari Zrt, formerly one of Hungary’s largest milling companies, filed a request for bankruptcy against itself and the procedure was initiated by the Regional Court of Tatabánya on 11 February 2016. The payment moratorium passed without the support of the company’s creditors for a reorganisation proposal. Therefore, the Regional Court of Tatabánya ordered the liquidation of Sikér Malomipari Zrt on 20 October 2016. Based on the notice published in the Official Gazette on 10 November 2016, the Hungarian government classified Sikér Malomipari Zrt as a business entity of strategic importance, and the National Reorganisation Non-profit Kft was appointed as a new liquidator for the company. Hence, a special procedural regime within the Insolvency Act has been applied. The liquidator advertised the sale of the Sikér Malomipari Zrt mill in Szekszárd. The public tender sale process started on 17 August 2018 and ended successfully on 1 September 2018. The successful tender amounted to 275 million forint.

iv  Eurovegas Kft and Ipari Terület Bezenye Kft

The unique Eurovegas casino, entertainment and hotel project would have been created near Hungary’s borders with Austria and Slovakia. However, the €300 million construction project suffered severe financial difficulties. Eurovegas Kft and Ipari Terület Bezenye Kft are the exclusive owners of the real properties in Bezenye and Hegyeshalom concerned in this
project. The two companies have been declared insolvent and liquidation proceedings have been ordered against them by the Regional Court of Győr and published in the Company Gazette on 22 July 2016. During the liquidation proceedings, the Hungarian government classified Eurovegas Kft and Ipari Terület Bezenye Kft as business entities with strategic importance under Government Decree No. 295/2016 (IX.29), and hence the satisfaction of the creditors’ claims needs to be completed under a special procedural regime within the Insolvency Act. New state-owned liquidators (National Reorganisation Non-profit Kft) were appointed by the court that controls the liquidation proceedings. The first round of the public tender was started on 13 January 2017 in both liquidation proceedings but was revoked on 7 February 2017. The call for the public tender sale process was published in the Company Gazette on 17 January 2019. The sale processes regarding the real properties of Eurovegas Kft and Ipari Terület Bezenye Kft were merged by the liquidators; therefore a joint sale process took place and interested parties had to submit a tender for all real properties in one package. The minimum price of the real properties was 6.45 million forint. The successful tender was submitted by FAKT Hungária Kft, with which the liquidators – in the name and on behalf of Eurovegas Kft and Ipari Terület Bezenye Kft – concluded the sale and purchase agreement. FAKT Hungária Kft belongs to the German FAKT AG group and a new project aims to create a €1 billion horticultural and logistics centre on the area covering 330 hectares. The satisfaction of creditors’ claims by the liquidators is still pending.

v Ikarus Egyedi Kft

Currently in the spotlight is Ikarus Egyedi Kft, a Hungarian manufacturer of buses used for urban transport. Ikarus Egyedi Kft filed for bankruptcy protection on 9 July 2018 to restore the company’s solvency. The Regional Court of Budapest ordered the bankruptcy proceedings, which was published in the Company Gazette on 13 July 2018. The government has classified Ikarus Egyedi Kft as a business entity with strategic importance under Government Decree No. 126/2018 (VII.11.) and therefore the bankruptcy proceeding is to be continued under a special procedural regime.

Ikarus Egyedi Kft's attempt to reach a settlement with its creditors failed because the main creditor refused the company’s proposal to settle all claims within seven years.

IV ANCILLARY INSOLVENCY PROCEEDINGS

Secondary and territorial insolvency proceedings may be opened in Hungary in the event that the main insolvency proceedings are pending in another EU Member State, subject to the Recast Insolvency Regulation. Secondary and territorial insolvency proceedings are not common in Hungary; no information is available regarding the commencement of any such insolvency proceedings during the past 12 months.

V TRENDS

In the majority of cases, creditors initiate liquidation proceedings against debtors. In practice, liquidation proceedings may lead to the sale of all or part of the debtor’s business as a going concern to a third party instead of the sale of the individual assets of the debtor’s business. If a debtor has several real properties with different values, it is quite common for the real property portfolio to be sold in its entirety. This usually leads to a much higher value being realised at the end of liquidation proceedings.
The number of business entities regarded as being of strategic importance is increasing and it seems that the Hungarian government is making an attempt to use this procedural tool to mitigate sectoral issues within the Hungarian economy (i.e., usually major players of a given industry area are classified as business entities with strategic importance).

As far as recent developments are concerned, in accordance with the Recast Insolvency Regulation, an insolvency register has been established in Hungary,\(^4\) which contains the particulars of insolvency proceedings falling within the scope of the Regulation that have opened in Hungary on or after 26 June 2018. We are of the view that this gap-filling insolvency register may play to the advantage of creditors and may also ensure the transparency and traceability of insolvency proceedings.

Looking beyond the recent acquisition targets, there is an appetite in the Hungarian market for further acquisition of distressed assets and companies that lack state-of-the-art technology. In particular, there are targets of interest within the energy sector.

\(^4\) Publicly available information on the Hungarian insolvency register can be accessed free of charge via https://fizeteskeptelenseg.im.gov.hu/#/.
Chapter 14

INDIA

Justin Bharucha

I INSOLVENCY LAW, POLICY AND PROCEDURE

Statutory framework and substantive law

The extant legal framework pertaining to bankruptcy and insolvency in India comprises several statutes.

The 2019 World Bank report on Doing Business \(^2\) ranked India at 108th of 190 countries on resolving insolvency, up from 136th in 2017. The report also notes that resolving insolvency takes about 4.3 years and costs 9 per cent of the debtor’s estate, with the most likely outcome being a piecemeal sale of assets. The average recovery is 26.5 cents per dollar. Notably, the strength of insolvency framework index has increased from 6 in 2017 to 8.5 in 2018.

In October 2014, the Ministry of Finance established a Bankruptcy Law Reforms Committee (BLRC) to review the law and suggest improvements. The BLRC’s report resulted in the Insolvency and Bankruptcy Code 2016 (the Insolvency Code), which was approved by Parliament on 12 May 2016 and has been brought into effect over the past 12 to 24 months. In August 2018, a Second Amendment to the Insolvency Code was passed, \textit{inter alia}, to address certain issues on which there had been significant litigation and divergent rulings.

Individuals and partnership firms

The Insolvency Code deals with insolvency for individuals and partnerships.\(^3\)

Companies


The Insolvency Code was approved by Parliament in 2016 and brought into force during 2016 and 2017. At present, the Insolvency Code addresses insolvency, creditors’ winding up

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1 Justin Bharucha is a partner at Bharucha & Partners.
2 See www.doingbusiness.org/rankings.
3 The Presidency Towns Insolvency Act 1909 and the Provincial Insolvency Act 1920 stand repealed.
as well as voluntary winding up,\textsuperscript{4} of entities other than those engaged in the financial and securities markets\textsuperscript{5} (financial sector entities) with a separate statute being contemplated to address the insolvency of financial sector entities.

The staggered implementation and repeal of the statutes concerned has resulted in some ambiguity as to the status of proceedings instituted under the Companies Act 1956, which remains to be resolved. However, the Insolvency Code stands as a complete code addressing insolvency, save for financial sector entities.

**Insolvency Code**

The Insolvency Code applies to companies, limited liability partnerships (LLPs), partnership firms and individuals. It provides for an insolvency resolution process first, then, if the resolution fails, liquidation. Separate procedures have been detailed for corporate persons (i.e., companies and LLPs) and for partnership firms and individuals.

The Insolvency Code also provides for insolvency professionals to be registered under the Insolvency Code, who shall be responsible for implementing the resolution and liquidation processes stipulated under the Code.

**Resolution and enforcement processes prescribed by the Reserve Bank of India**

The Banking Regulation (Amendment) Act 2017 of 14 July 2017 (the BR Act) empowered the central government to authorise the Reserve Bank of India (RBI) to direct banking companies to initiate the insolvency resolution process provided in the Insolvency Code in cases of defaults.

**Revised framework for resolution of stressed assets**

In February 2018, the RBI notified a revised framework for resolution of stressed assets (the Revised Framework) repealing the several schemes and mechanisms previously in force.\textsuperscript{6}

While the Revised Framework retained some of the key principles of the erstwhile RBI guidelines – including early recognition of stress, centralised reporting of credit information, elective right of lenders to convert outstanding balances into equity of the borrower – the resolution mechanism was significantly revised for consistency with the Insolvency Code, *inter alia*, by requiring lenders to mandatorily refer stressed accounts for resolution under the Insolvency Code if the debt was in excess of 20 billion rupees as at 1 March 2018 and the default on that debt continued for more than 180 days from 1 March 2018; and, if 100 per cent of the lenders agreed to resolve the debt outside the Insolvency Code process.

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\textsuperscript{4} That is, a winding up instituted and enforced by creditors that is now addressed by, *inter alia*, Sections 6, 7, 8, 9, 33 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 and the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016. Voluntary winding up of a company is addressed by, *inter alia*, Section 59 of the Insolvency Code and the Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017.

\textsuperscript{5} Under Section 3(7), the Insolvency Code does not apply to financial service providers who have been specifically excluded from the definition of corporate persons. A financial service provider is defined under the Insolvency Code as ‘a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator’.

\textsuperscript{6} The Reserve Bank of India has previously promulgated several schemes for resolution of stressed assets including, *inter alia*, the corporate debt restructuring scheme, strategic debt restructuring scheme, sustainable structuring of stressed assets, joint lenders forum, etc.
The Revised Framework was challenged in the Supreme Court and, in a judgment of 2 April 2019, was struck down as unconstitutional. The Revised Framework issued in exercise of powers under Section 35AA of the BR Act did not empower the RBI to issue general directions to reference all cases without considering specific defaults to the Insolvency Code. Therefore, all actions taken under the Revised Framework, including initiation of proceedings under the Insolvency Code against certain borrowers in default were declared as non est.

As a fallout of the Supreme Court's judgment, the RBI issued a press release on 4 April 2019 in which it intimated that, in light of the Dharani Sugars judgment, it would take necessary steps, including issuance of a revised circular, as may be necessary, for expeditious and effective resolution of stressed assets.

On 7 June 2019, in supersession of the erstwhile circular on Resolution of Stressed Assets dated 12 February 2018, the RBI issued a revised prudential framework for resolution of stressed assets (the Revised Circular). The Revised Circular applies to Scheduled Commercial Banks (SCBs), All India Term Financial Institutions, Small Finance Banks, Non-Banking Financial Companies (both non-deposit systemically important and those that accept public deposits). Lenders have been given the liberty to develop and adopt a board-approved policy for resolution of stressed assets with timelines for resolution. This policy is required to outline the signs of financial difficulty and set out qualitative and quantitative criteria for determination of any financial difficulty.

Lenders are required to take pre-emptive measures to initiate and implement a resolution plan even before a default occurs. In the case of default, lenders are required to undertake a review of the borrower within 30 days of the default (the Review Period).

Upon review, if the lenders pursue restructuring of debt rather than initiating insolvency proceedings under the Insolvency Code, the restructuring plan is required to be implemented within 180 days of the end of the Review Period.

For the implementation of the restructuring plan, all lenders are required to enter into an inter-creditor agreement during the Review Period. All decisions under the inter-creditor agreement, with the consent of 75 per cent, by value, of the total outstanding credit facilities and 60 per cent of lenders by number, will be binding on all lenders. All dissenting lenders are required to be paid at least the liquidation value.

Norms have also been prescribed for classification of assets as non-performing and provisioning in the books of the lenders.

Occurrence of default and resolution plan by lenders

Although the Revised Framework was struck down, all lenders must adopt policies for timely resolution of stressed assets. Immediately on the occurrence of default with respect to any lender, all lenders must take steps to cure that default. However, the right of the lenders to implement a resolution plan outside the realm of the Insolvency Code is unclear in light of the Supreme Court's April 2019 judgment.

Reference under the Insolvency Code

Under the Revised Framework, lenders were compelled to file reference under the Insolvency Code in two circumstances: (1) they were unable to agree a resolution plan within the 180-day time limit (including, pertinently if implicitly, the opinion of the credit rating agency, or

7 Dharani Sugars and Chemicals Ltd. v. Union of India & Ors, Transferred Petition (Civil) No. 1399 of 2018.
agencies, that the residual debt is classified below Resolution Plan 4); or (2) a resolution plan is established but the borrower defaults within the ‘specified period’. However, in light of the Supreme Court’s judgment of April 2019, the Revised Framework no longer applies and the RBI is expected to issue guidelines in this regard once again.

Notwithstanding this position, clearly, once the reference is made, the Insolvency Code will require that efforts be made to effect a resolution in terms of the Insolvency Code and that will result in further delay with concomitant deterioration of security. In essence, the consequence of failure to agree a resolution plan may well result in an untrammelled abnegation of the RBI’s intent to ensure a healthy book with Indian banks, and in measures that are suboptimal as compared to the standards set out in the Revised Framework.

ii Policy

Refreshingly, the policy on insolvency is well developed in India but, not unusually, and as discussed, there seems to be a dichotomy as to the preferred mechanism:

a the recovery imperative: the Securitisation and Asset Reconstruction and Enforcement of Security Interest Act 2002 (SARFAESI) permits secured creditors to enforce their security interest without the intervention of the courts. The Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill 2016 (the Security Bill) approved by Parliament on 9 August 2016 simplifies the recovery process by, *inter alia*, minimising court intervention. These statutes, with the RBI Guidelines, allow for relatively expeditious enforcement; and

b the route to resolution: the Insolvency Code.

iii Insolvency procedures

*Proceedings under the Insolvency Code*

The Insolvency Code provides for a two-stage process: an insolvency resolution process and, in the event that such resolution process is unsuccessful, a liquidation or bankruptcy process, as the case may be. Separate procedures have been detailed for corporate persons (i.e., companies and LLPs) and for individuals.

*Insolvency resolution process*

For corporate persons, the insolvency resolution process may be initiated by a creditor. The Insolvency Code distinguishes between ‘operational creditors’ and ‘financial creditors’. An application for resolution may be preferred by any creditor or group of creditors or by the company itself. The application is submitted to the adjudicating authority, which will admit the application if appropriate.

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8 A person to whom an operational debt is owed, including any person to whom a debt has been legally assigned or transferred. The Insolvency Code defines an operational debt as a claim in respect of the provision of goods or services, including employment or a debt in respect of the repayment of dues arising under any law for the time being in force, and payable to the central government, any state government or any local authority.

9 A person to whom a financial debt is owed, including a person to whom a debt has been legally assigned or transferred. The Insolvency Code defines a financial debt as a debt with interest, if any, that is disbursed against the consideration for the time value of money – see Section 5(8) of the Code for the full definition. The different rights of operational and financial creditors are set out in Annexure I – Rights of Operational and Financial Creditors, at the end of this chapter.
Application by financial creditors

When an application is made by a financial creditor to initiate the insolvency resolution process, there is no express stipulation providing the debtor with an opportunity to be heard. However, the principles of natural justice, including the right to be heard, must apply, and where the facts of any case require that an ex parte or interim order be passed, that ex parte order must record the reasons for derogating from the debtor’s right to be heard.

Application by operational creditors

Operational creditors may initiate the insolvency resolution process by serving a demand notice to the corporate debtor, upon receipt of which the corporate debtor may bring to the notice of the operational creditor the existence, if any, of a ‘dispute’ with respect to the underlying debt. Once the application is admitted, the following actions are prohibited:

- any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property, including any action under SARFAESI;
- transferring, encumbering, alienating or disposing of the debtor’s assets or legal rights or interest therein; and
- the institution of any suits or continuation of pending suits or proceedings.

Homebuyers with advances to builders undergoing the insolvency resolution process have been elevated to the status of financial creditors by the Second Amendment to the Insolvency Code.

An interim insolvency professional manages the company and, inter alia, constitutes a committee of creditors and formulates an information memorandum as to the prospects of the company. A resolution plan is drafted, based on the information memorandum, and must provide for, inter alia, repayment of debts and management of the company. The resolution plan, if approved by 66 per cent of creditors, is submitted to the adjudicating authority, which then approves or rejects the resolution plan.

The entire resolution process is to be completed within 180 days and only one extension of up to 90 days to that time limit may be provided by the adjudicating authority.

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10 In terms of Section 7 of the Insolvency Code.
11 The right of a party to present its case is an essential ingredient of natural justice under Indian law. As an example, see Union of India v. Shiv Raj (2014) 6 SCC 564.
12 Writ Petition 7144(W) of 2017, Sree Metaliks Limited and another v. Union of India and Anr.
13 In terms of Section 8 of the Insolvency Code.
14 The scope and meaning of the term ‘dispute’ has been subject to litigation. See Section I.iii, ‘Existence of a dispute’, below.
15 The committee of creditors may either confirm the appointment of the interim insolvency professional or replace the interim insolvency professional with a different insolvency professional.
16 Members of the suspended board of directors or the partners of the corporate person, as well as operational creditors (if the amount of their aggregate dues is not less than 10 per cent of the debt) are entitled to attend the meetings of the committee of creditors; however, they cannot vote at the meetings.
17 A creditor’s vote is determined pro rata to that creditor’s share of the total debt of the company. Note that debt is classified as ‘operating debt’ and ‘financial debt’ and the creditor’s pro rata share is calculated based on this classification.
Settlement by parties subsequent to admission of application

The Supreme Court has upheld the right of the parties to arrive at a settlement and record terms of settlement after an application for initiation of the insolvency resolution process under Section 7 of the Insolvency Code was admitted by the adjudicating authority.18

The position has now been settled by the Second Amendment to the Insolvency Code, which provides that the National Company Law Tribunal (NCLT) may permit the withdrawal of an application for initiation of the insolvency resolution process filed by a financial creditor, an operational creditor or the corporate debtor with the approval of 90 per cent or more of the committee of creditors.

Emerging issues

Although jurisprudence under the Insolvency Code is nascent, some issues that have already resulted in significant litigation are the meaning of ‘dispute’ in Section 8 of the Insolvency Code, and the subject of the moratorium protecting the debtor once an application for insolvency has been admitted.

Existence of a dispute

The Insolvency Code, under Section 9, permits an operational creditor to file an application with the adjudicating authority for initiation of the insolvency resolution process 10 days after a demand notice is served and the corporate debtor has not (1) made payment of the underlying debt, or (2) issued a notice19 informing the operational debtor of the existence of a dispute in relation to the underlying debt for which the demand notice has been served.

Further to the notification of the relevant provisions of the Insolvency Code, there had been a number of judgments allowing petitions for initiation of the insolvency resolution process in which a dispute was raised by the operational creditor after receipt of the demand notice and where no formal court or arbitration proceedings subsisted in respect of the claimed dispute.20

There have also been judgments adopting an inclusive definition of the term ‘dispute’ and holding that disputes raised subsequent to receipt of a demand notice from the operational creditor will bar the initiation of the insolvency resolution process even in the absence of formal court or arbitration proceedings in respect of the same.21 Subsisting appeal proceedings arising out of an arbitral award on a dispute relating to an operational debt have also been held to constitute a dispute.22

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19 In terms of Section 8(2) of the Insolvency Code.
22 Annapurna Infrastructure Pvt Ltd & Ors v. Soril Infra Resources Ltd.

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While the position remained in flux, the Supreme Court in September 2017\(^{23}\) considered the issue and, *inter alia*, held that the adjudicating authority need not examine whether the dispute is *bona fide* or whether formal dispute resolution has been invoked in respect of the dispute but must instead only consider the following: (1) there is a plausible contention that requires further investigation; (2) a dispute truly exists in fact and is not spurious, hypothetical, illusory, mere bluster, plainly frivolous or vexatious; and (3) the dispute raised by the corporate debtor should be ‘in existence’ (i.e., real as opposed to frivolous or illusory). The Supreme Court also held that the adjudicating authority must not consider (1) whether the dispute is likely to succeed, nor (2) the merits of the dispute except to the extent of it being patently feeble legal argument or an assertion of fact not supported by evidence.

The position was reiterated by the Supreme Court in August 2018,\(^{24}\) but the Court also clarified that the Insolvency Code cannot be used *in terrorem* to extract small amounts from corporate debtors and jeopardise the future of an otherwise solvent company.

*The scope of the moratorium*

The Insolvency Code provides for a moratorium to the corporate debtor during the pendency of the insolvency resolution process. Effectively, recovery actions by the creditors of the corporate debtor, including under SARFAESI, are prohibited to prevent hindrances to the resolution process.

However, there seem to be conflicting views arising with respect to the scope and extent of the properties covered by the moratorium.

The Mumbai bench of the NCLT has held on multiple occasions that the moratorium extends only to the property of the corporate debtor and not its promoters and directors.\(^{25}\) The bench relied on the words ‘its property’ used in Section 14 of the Insolvency Code and held, *inter alia*, that the court cannot add to the language used by the legislature under the umbrella of *ejusdem generis*.\(^{26}\)

However, the same bench, on a different occasion,\(^{27}\) held that a moratorium, if granted, would extend to the personal property of the promoters and directors of the corporate debtor. The position was clarified by the Second Amendment to the Insolvency Code, which amended Section 14 of the Insolvency Code to provide that the moratorium will not be applicable to a surety in a contract of guarantee. This position was also ratified by a judgment of the Supreme Court in August 2018.\(^{28}\)

It has also been held that the liability of a guarantor is coextensive with the liability of the principal debtor. Therefore, if a principal debtor fails to pay, insolvency proceedings against the guarantor can be admitted.\(^{29}\) If the debt is subject to the jurisdiction of a foreign court, even then there is no liability on the guarantor, provided that the orders of the foreign court show that there is no liability of the principal debtor.\(^{30}\)


\(^{25}\) *Alpha and Omega Diagnostics (India) Ltd v. Asset Reconstruction Company of India Ltd*.

\(^{26}\) *Sandria D’Souza and others v. Elektrans Shipping*.

\(^{27}\) *Leo Duct Engineers & Consultants*.

\(^{28}\) *State Bank of India v. V. Ramakrishnan & Anr* – Civil Appeal No. 3595 of 2018.


\(^{30}\) *EXIM Bank of India v. CHL Ltd* – 2018 146 SCL 43.
The issue is particularly significant in the Indian context, where personal guarantees from promoters and directors, and the creation of security over their assets for corporate borrowers, are common.

It has also been held that a financial creditor cannot exercise set-off once the moratorium is in force,\(^{31}\) while a performance guarantee can be invoked during pendency of the moratorium.\(^{32}\) It has also been held that rent due from a corporate debtor to a landlord prior to the commencement of the moratorium will not be included in the moratorium since the landlord is not prejudicially affected because of the moratorium.\(^{33}\)

**Strategic sale and restrictive timelines**

In furtherance to certain amendments made to rules governing the insolvency resolution process, liquidators are now authorised to undertake a strategic sale of the assets of the corporate debtor in parcels as well as collectively. However, currently, a timeline of 105 days has been prescribed within which the liquidator is required to identify applicants for the sale. While the intent is to complete the sale process within the 180-day period prescribed for the resolution process, it may be difficult to meet with the prescribed timeline especially in large insolvency proceedings where there are significant assets involved.

**Liquidation**

If the creditors or the adjudicating authority reject a resolution plan, the adjudicating authority must pass a liquidation order. The insolvency professional, acting as liquidator, will collect all claims from creditors, verify those claims and thereafter distribute the assets of the debtor in the following order of priority:

- \(a\) costs relating to the insolvency resolution process and liquidation;
- \(b\) workmen’s dues and a secured creditor who has relinquished his or her security to be treated equally;
- \(c\) unpaid dues to employees;
- \(d\) unsecured creditors;
- \(e\) amounts owed to the government and debts due to a secured creditor for unpaid amounts post the enforcement of security interest;
- \(f\) preference shareholders; and
- \(g\) equity shareholders.\(^{34}\)

Thereafter, the liquidator will apply to the adjudicating authority for a dissolution order in respect of the debtor.

**Enforcement of security interest**

In liquidation proceedings, a secured creditor may opt either to realise his or her security interest or to relinquish it, in accordance with the provisions of the Insolvency Code. The moratorium during the resolution process precludes the exercise of this right at that time, and the enforcement is possible only if the resolution plan fails or is rejected by the adjudicating

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\(^{32}\) *Nitin Parikh v. Madhya Gujarat Vij Company Ltd* – 2018 146 (SCL) 412 (NCLT – Ahmedabad).

\(^{33}\) *JAS Telecom Pvt Ltd v. Eolane Electronics Bangalore Pvt Ltd* – 2018 144 CLA 89 (NCLAT).

\(^{34}\) Insolvency Code, Section 53.
authority, both of which lead to the commencement of liquidation proceedings under the Code. Dissenting creditors (i.e., those who vote against the resolution plan) are nonetheless bound by that plan if it is duly approved.

For a secured creditor to realise its security interest, the secured creditor must inform the liquidator of the security interest and the relevant asset subject to which the security interest will be realised. The liquidator will verify this, and thereafter, the secured creditor may realise the security interest in accordance with applicable laws. In the event that the enforcement of security interest yields an amount exceeding the debts due to the secured creditor, the secured creditor must tender the excess amount to the liquidator. Alternatively, if the amount yielded is inadequate, the remaining unpaid debts of the secured creditor will be paid by the liquidator in accordance with the order of priority, as listed above.35

**Individuals and partnership firms**

The Insolvency Code provides for three mechanisms: the fresh start process, the insolvency resolution process and the bankruptcy process.

While the insolvency resolution process and the bankruptcy process for individuals and partnership firms is largely the same as for corporate persons, the fresh start process is unique to individuals and partnership firms. Note that, in real terms, the thresholds to be eligible for a fresh start are fairly low36 and, effectively, the remedy may be availed of only by those at the bottom of the pyramid.37 These provisions have not been notified and are not yet in force.

**Fast-track insolvency proceedings**

On 14 June 2017, the Insolvency and Bankruptcy Board of India (Fast-Track Insolvency Resolution Process for Corporate Persons) Regulations, 2017 were notified, providing for fast-track insolvency resolution for small companies. The fast-track resolution process is to be completed within 90 days, as opposed to the 180 days prescribed for non-fast-track proceedings. This time limit can be extended by the adjudicating authority by up to 45 days.

**iv Control of insolvency proceedings**

**Proceedings under the Insolvency Code**

The Insolvency Code provides that the NCLT is the adjudicating authority for matters pertaining to companies and LLPs, while appellate jurisdiction is exercised by the NCLAT. As far as individuals and unlimited partnerships are concerned, the adjudicating authority is the Debt Recovery Tribunal, while appellate jurisdiction is exercised by the Debt Recovery Appellate Tribunal (DRAT). Appeals against orders passed by the NCLAT and the DRAT will lie before the Supreme Court.

35 ibid., Section 52.
36 The eligibility criteria include, inter alia, a gross annual income not exceeding 60,000 rupees, no ownership of a dwelling unit, and an aggregate value of assets not exceeding 20,000 rupees.
37 For example, for the Startup India programme, thus far out of 728 applications for start-up recognition, 180 are recognised as start-ups; however, only 16 of these have been incorporated post 1 April 2016 and are therefore eligible for tax benefits. See article on The Hindu Business Online at www.thehindubusinessline.com/info-tech/16-startups-considered-for-benefits-under-finance-act/article8876630.ece.
As per the relevant stipulations set out in the Insolvency Code, control of insolvency proceedings, once initiated, shall lie with the relevant adjudicating authority and the appellate authority. The board of directors has no significant role in or control over insolvency proceedings.

v Special regimes
The Insolvency Code permits the government to stipulate a separate framework regulating insolvency for financial services firms, which is being proposed. The promulgation of this framework is expected in due course.

vi Cross-border issues
The Insolvency Code does not adopt the UNCITRAL Model Law on Cross-Border Insolvency. However, it permits the central government to enter into an agreement with the government of any other foreign country to enforce the provisions of the Insolvency Code. Further:

a the government may direct that the application of provisions of the Insolvency Code in relation to the assets or property of a corporate debtor or debtor, including a personal guarantor of a corporate debtor situated at any place in a country outside India with which reciprocal arrangements have been made, shall be subject to such conditions as may be specified;

b while applying the provisions of the Insolvency Code on assets situated outside India, the adjudicating authority may issue a ‘letter of request’ to a competent court of the foreign country where the asset is located,\(^{38}\) and

c the insolvency professional appointed, while taking custody of the assets of the bankrupt, shall also take control over assets of a corporate debtor that may be located in a foreign country.\(^{39}\) However, this does not include assets of a foreign subsidiary of the corporate debtor.\(^{40}\)

II INSOLVENCY METRICS

Presently, the banking sector in India is faced with a large number of non-performing assets (NPAs) and stressed accounts. However, since the bulk of the legacy of NPAs were recognised last year, leading to a peak in March 2018, the NPA cycle now seems to have turned around. In accordance with the Financial Stability Report released by the RBI on 27 June 2019, it is expected to reach 9 per cent in March 2020.

According to a press release issued by CRISIL on 25 June 2019, the asset quality of banks should witness a decisive turnaround in the fiscal year 2019–2020, with gross NPAs reducing by 350 basis points over two years to 8 per cent by March 2020 compared with a peak of 11.5 per cent in March 2018 and 9.3 per cent in March 2019. This will be driven by a combination of a reduction in fresh accretions to NPA as well as stepped-up recoveries from existing NPA accounts.

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\(^{38}\) Insolvency Code, Sections 234 and 235.

\(^{39}\) ibid., Section 18.

\(^{40}\) ibid., Section 36.
In October 2017, the central government announced a 2,100 billion rupee bailout plan for public sector banks (PSBs) in India in an attempt to resolve the high level of bad debt and to improve their capital position. With increased recapitalisation, the PSBs have shown a noticeable improvement and have registered a credit growth of 9.6 per cent in March 2019. Additionally, after the recapitalisation of PSBs, the capital adequacy of SCBs has improved. SCBs’ capital to risk-weighted assets ratio improved from 13.7 per cent in September 2018 to 14.3 per cent in March 2019 after recapitalisation of PSBs. Significantly, PSBs, which account for more than 80 per cent of the NPAs in the system, should see their gross NPAs fall by more than 400 basis points to 10.6 per cent by March 2020 from a peak of 14.6 per cent in March 2018.

In the past few years, the RBI has brought about various schemes aimed at addressing the issue of NPAs and stressed assets. The implementation of the Insolvency Code has greatly overhauled the regulatory measures in respect of the resolution of impaired assets and has contributed to a more efficient deployment of capital. The Financial Stability Report released by the RBI on 27 June 2019 estimates that of the 1,858 corporates in the resolution process up to March 2019, 152 were closed on appeal or review, 94 resulted in resolution and 378 yielded liquidation. Also, the revised prudential framework on stressed assets issued by the RBI on 7 June 2019 significantly extends the erstwhile stressed asset resolution framework as it also builds in an incentive for early adoption of a resolution plan.

III PLENARY INSOLVENCY PROCEEDINGS

The resolution process that has been made available under the Insolvency Code is plenary in the sense that it requires consent from the majority of all persons concerned. The RBI regulations are, necessarily, lender-centric.

Voluntary winding up is a plenary process.

IV ANCILLARY INSOLVENCY PROCEEDINGS

There have been no significant recent or pending ancillary insolvency proceedings in India in the past year.

V TRENDS

While discussing recent trends with respect to insolvency proceedings in Indian law, the ongoing proceedings in relation to the Kingfisher Airlines Limited (Kingfisher) bankruptcy controversy is relevant. Vijay Mallya is under investigation in connection with sums owed by Kingfisher to a consortium of lenders led by the State Bank of India, amounting to approximately 90 billion rupees. The consortium has initiated action under SARFAESI and has taken physical possession of Kingfisher House, the company headquarters, which is valued at 1 billion rupees.

United Breweries (Holdings) Limited (UB Holdings), the ultimate parent of Kingfisher, had provided corporate guarantees to secure contractual payments due from Kingfisher, inter alia, in connection with the sale and maintenance of aircraft and other operations. However, Kingfisher defaulted in making these payments in or around 2010 and 2011 and, consequently, the corporate guarantees were invoked. UB Holdings in turn defaulted on the payments to be made consequent to the invocation of the corporate guarantees. Accordingly,
several winding-up petitions were filed against UB Holdings between March and November 2012. Despite opposing the winding-up petitions, UB Holdings simultaneously filed an application before the Karnataka High Court pursuant to Section 536(2) of the Companies Act 1956 for leave to sell certain shares held in its subsidiary United Spirits Limited (USL) to Diageo PLC (Diageo).

The Karnataka High Court granted its leave and Diageo purchased USL shares. Diageo acquired a 55 per cent stake in USL during the course of 2012 and 2013. However, in February 2016, Vijay Mallya was asked to step down from USL’s board of directors, pursuant to an internal forensic audit enquiry, whereby various legal contraventions were discovered in relation to loans given by USL to the United Breweries Group.

Kingfisher has also defaulted in payment of its taxes and, accordingly, the service tax department has seized several of Kingfisher’s assets, including helicopters and other aircraft. Additionally, since Vijay Mallya is not presently in India (he is reportedly in London), the service tax department has initiated proceedings to impound his passport and compel him to return to India. In April 2016, the government revoked his passport and requested the UK government to deport him. However, the UK government informed the Indian government that, although it could not deport Mr Mallya, it is willing to assist and cooperate in exploring alternatives, such as extradition and mutual legal assistance. Presently, extradition proceedings are being heard by an English court, and while Mr Mallya had previously cited the poor conditions of Indian jails as one of the reasons for not returning to India, he has expressed his willingness to return to India, according to press reports, after proceedings were initiated under the Fugitive Economic Offenders Act 2018 (see below). He was declared a proclaimed fugitive economic offender in January 2019 and consequently the special court in India has attached all his properties.

Similarly, proceedings against diamantaire Nirav Modi have also been initiated under the Fugitive Economic Offenders Act for the 2 billion dollar Punjab National Bank fraud case. However, despite several attempts by the authorities in India, the application to declare Nirav Modi as a fugitive economic offender is still pending.

In April 2017, the RBI issued a notification advising banks to review and monitor their exposure to the telecommunications sector in view of the increased stressed levels in the sector and consider making provisions for standard assets at higher rates.

In April 2018 and subsequently the Fugitive Economic Offenders Act came into force from 21 April 2018, with the objective of deterring economic offenders from evading liability under Indian law by remaining outside the territorial jurisdiction of Indian courts, and forcing them to return to India to face trial for scheduled offences. Scheduled offences are offences of value of 1 trillion rupees or more and include, inter alia, dishonestly or fraudulently preventing debt being available for creditors and dishonouring a cheque. The Act empowers authorities to, inter alia, confiscate to the central government any property of the offender. The provisions of the

41 Section 536(2) of the Companies Act 1956 states, inter alia, that any transfer of shares in the company or alteration in the status of its members made after the commencement of the winding up, shall be void, unless the court otherwise orders.
42 See (1) https://www.livemint.com/Companies/d7F8krFtKqQPowIq0VuAAI/Vijay-Mallya-Fugitive-Economic-Offenders-Ordinance-Bill.html; (2) https://www.livemint.com/Companies/zijDYY77PbDUwJf7wHwvmM/Vijay-Mallya-willing-to-return-to-India-as-ED-moves-to-sei.html.
Act are wide both in scope and application and may, in our view, operate as a hindrance to the insolvency resolution process whereby a director, promoter or other key personnel of the corporate debtor is declared a fugitive economic offender.\textsuperscript{44}

The Insolvency Code is still in its early stages but, in the future, there may well be an increase in insolvency proceedings being initiated by the debtors themselves, since the Code is geared primarily towards revival and rehabilitation of insolvents. The insolvency resolution process may be effective, especially when debtors are facing genuine stress on account of, \textit{inter alia}, market conditions or unfavourable changes in regulatory policies. The resolution process and the subsequent resolution plan (if implemented well) will allow stressed businesses to recover, and the extent of financial distress\textsuperscript{45} makes this a particularly relevant development for the Indian economy.

\textsuperscript{44} For example, see https://www.jckonline.com/editorial-article/modis-specter-haunts-chapter-11/.

\textsuperscript{45} Measured in terms of stressed and non-performing assets on lenders' portfolios.
## ANNEXURE I – RIGHTS OF OPERATIONAL AND FINANCIAL CREDITORS

<table>
<thead>
<tr>
<th>Sr No.</th>
<th>Operational creditor</th>
<th>Financial creditor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Initiation of corporate insolvency resolution process</strong></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>May file an application on occurrence of default provided the operational creditor has sent a demand notice as per Section 8 and has not received payment or a notice of dispute within 10 days of issue of notice.¹</td>
<td>May file an application on occurrence of default.²</td>
</tr>
<tr>
<td>2</td>
<td>Default may only be with respect to debt owed to the applicant.³</td>
<td>Default includes a default in respect of debt owed not only to the applicant but any other financial creditor.⁴</td>
</tr>
<tr>
<td>3</td>
<td>It is optional for operational creditors to propose a resolution professional in the application.⁵</td>
<td>It is mandatory for financial creditors to propose a resolution professional in the application.⁶</td>
</tr>
<tr>
<td></td>
<td><strong>Committee of creditors</strong></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Operational creditors are not entitled to be a part of the committee of creditors.⁷</td>
<td>Financial creditors constitute the committee of creditors.⁸</td>
</tr>
<tr>
<td></td>
<td><strong>Meetings of committee of creditors</strong></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Operational creditors have the right to be notified by the resolution professional before any meeting of the committee of creditors provided the sum of their aggregate dues is not less than 10 per cent of the debt of the corporate debtor.⁹</td>
<td>All financial creditors have the right to be notified by the resolution professional before any meeting of the committee of creditors.¹⁰</td>
</tr>
<tr>
<td>6</td>
<td>Operational creditors are permitted to attend the meetings of the committee of creditors provided the sum of their aggregate dues is not less than 10 per cent of the debt of the corporate debtor.¹¹</td>
<td>All financial creditors are entitled to attend the meetings of the committee of creditors.¹²</td>
</tr>
<tr>
<td></td>
<td><strong>Voting rights</strong></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Operational creditors are not entitled to vote at the meetings of the committee of creditors.¹³</td>
<td>Financial creditors are allowed to vote in proportion to the debt owed to each financial creditor at the meetings of the committee of creditors.¹⁴</td>
</tr>
<tr>
<td></td>
<td><strong>Submission of financial information to the information utility</strong></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>It is optional for operational creditors to submit financial information to the information utility.¹⁵</td>
<td>It is mandatory for financial creditors to submit financial information to the information utility.¹⁶</td>
</tr>
<tr>
<td></td>
<td><strong>Punishment for false information</strong></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Imprisonment for a term ranging between 1 and 5 years or a fine ranging between 100,000 and 10 million rupees.¹⁷</td>
<td>Fine ranging between 100,000 and 10 million rupees.¹⁸</td>
</tr>
</tbody>
</table>

¹ See Insolvency and Bankruptcy Code, 2016, Section 9(1).  
² ibid., Section 7(1).  
³ ibid., Section 9.  
⁴ ibid., Explanation to Section 7(1).  
⁵ ibid., Section 9(4).  
⁶ ibid., Section 21(2).  
⁷ ibid., Section 21(2).  
⁸ ibid., Section 24(3)(c).  
⁹ ibid., Section 24(3)(a).  
¹⁰ ibid., Section 24(4).  
¹¹ ibid., Section 24(1).  
¹² ibid., Section 24(4).  
¹³ ibid., Section 24(4).  
¹⁴ ibid., Section 24(6).  
¹⁵ ibid., Section 215(3).  
¹⁶ ibid., Section 215(2).  
¹⁷ ibid., Section 75.  
¹⁸ ibid., Section 76.
Chapter 15

IRELAND

Julie Murphy-O’Connor and Kevin Gahan

I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

Insolvency and restructuring proceedings in Ireland are primarily governed by the Companies Act 2014 (as amended), the Bankruptcy Act 1988 (as amended) and the Personal Insolvency Act 2012 (as amended). These are supplemented by principles of common law.

The Irish legal framework is embedded in the EU framework under the Recast Insolvency Regulation, augmented by the provisions of the Rome Regulation and the Recast Brussels Regulation. The overall Irish framework is both creditor-friendly and flexible, featuring processes that facilitate rescue and restructuring of corporate groups with complex structures.

In terms of substantive provisions applicable to insolvency proceedings, a liquidator and any creditor may seek to set aside eligible transactions. Such powers arise when (1) the transaction occurred within specified periods before the company entered into liquidation and (2) the company was insolvent at the time it entered into the transaction.

Three types of transactions are particularly vulnerable in this regard:

a unfair preference: a transaction in favour of a creditor taking place within six months of the commencement of a winding up (or within two years if in favour of a connected person) and made with the dominant intention of putting the other party in a better position than they would be in if the company enters liquidation;

b avoidance of a floating charge: if a floating charge has been created within 12 months of the commencement of a winding up, it will be invalid unless it can be shown that immediately after the creation of the charge the company was solvent. However, it will not be invalid to the extent of money or goods or services actually provided as consideration for the charge; and

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1 Julie Murphy-O’Connor is a partner and Kevin Gahan is a senior associate at Matheson.

2 The Companies Act 2014, which came into operation on 1 June 2015, is primarily a consolidation of existing laws; however, certain provisions have been modernised and updated. As regards insolvency and restructuring, it has brought increased clarity of process and reduced court supervision of insolvency processes.

3 The EU framework is as follows: Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings for proceedings opened before 26 June 2017 (the original Insolvency Regulation); Regulation (EU) 2015/848 of 20 May 2015 on insolvency proceedings (the Recast Insolvency Regulation); Regulation (EU) No. 1215/2012 of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial (the Recast Brussels Regulation); and Regulation (EC) No. 593/2008 of 17 June 2008 on the law applicable to contractual obligations (Rome I) (the Rome Regulation).
c fraudulent transfers: a liquidator or creditor of a company can apply to the High Court for the return of assets or for compensation where they can establish that the transfer of the assets had the effect of the perpetration of a fraud on the company, its creditors or its members. However, transactions that are unfair preferences are excluded.

The underlying principle concerning distribution in a liquidation is that the property of a company should be applied *pari passu* in satisfaction of its liabilities. This allows for all creditors, particularly those within the same class, to be treated equally. If the realised assets of a company are insufficient to pay any class of creditors in full, they are paid in equal proportion to their debts.

A combination of legislation, contract law and common law establishes a ‘waterfall’ of claims in insolvency proceedings. The following order of priority is therefore a general guide only:

- a super-preferential claims (e.g., certain employees’ social insurance contributions);
- b remuneration, costs and expenses of an examiner that have been sanctioned by the court;
- c fixed charge holders (a fixed charge holder is entitled to realise its security outside a winding up of the company);
- d expenses certified by an examiner;
- e liquidation costs and expenses;
- f preferential debts (e.g., certain rates and taxes, wages and salaries);
- g holders of any charge created as a floating charge;
- h unsecured debts; and
- i deferred debts of members.

When proceeds are insufficient to meet the claims of one category in full, payments for that category are pro-rated.

**ii Policy**

The Irish restructuring regime lends itself towards rescue where appropriate. The threshold for each restructuring process is designed to ensure that only companies with a genuine prospect of survival can engage in a restructuring process.

‘Examinership’ is a court-supervised process whereby a court-enforced moratorium is in place on creditor action to facilitate the restructuring and survival of a company. However, although the Irish framework provides for and encourages restructuring regimes, and the vast majority of examinerships have a successful outcome, the level of examinerships remains relatively low. This is largely because of the fact that it can be a costly process and, therefore, is not suited to every company.

Like the United Kingdom, it is also possible for companies in Ireland to avail themselves of a statutory scheme of arrangement, which can be used to implement a variety of arrangements between a company and its creditors or its members. While schemes of arrangement can be used to implement even the most complex of debt restructurings, they are not used as often as the examinership process in Ireland, not least because in an examinership, there is a lower voting threshold.

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4 Companies Act 2014, Section 509.
iii Insolvency procedures

Liquidation

An insolvent company can be wound up by the High Court (compulsory liquidation) or by way of a shareholders’ resolution followed by a creditors’ meeting (creditors’ voluntary liquidation). The main criterion required to liquidate an insolvent company is that the company is unable to pay its debts. This usually entails an assessment of whether (1) the company is unable to pay its debts as they fall due (the cash flow test) or (2) the value of the company’s assets is less than its liabilities, taking into account its contingent and prospective liabilities (the balance sheet test).

The time frame for the completion of a winding up is dependent upon the size of the company and its trading patterns. A relatively straightforward liquidation can complete within a year; however, it is common for larger and more complex liquidation procedures to take significantly longer.

Examinership

Examinership is the main rescue process for companies in Ireland. Although there are a number of differences, international corporates will recognise examinership as being similar in many respects to the Chapter 11 procedures in the United States and, to a lesser extent, administration in the United Kingdom.

In an examinership, the maximum period in which a company may be under the protection of the court is 100 days. An examiner (a court-appointed insolvency practitioner) has to have formulated a scheme, convened creditors’ meetings and reported back to the court by day 100 and the approval of the scheme is typically heard by the High Court shortly thereafter. The scheme must be approved by more than 50 per cent (in value and number) of any one impaired class in order for it to be put before the court for approval.

Statutory schemes of arrangement

Although the statutory scheme of arrangement is not necessarily an insolvency process, its flexibility allows it to be used to restructure debt. However, the scheme is more commonly used in Ireland to give effect to a reorganisation of shareholdings of large corporates and has tended to be the tool of choice for effecting the large-scale corporate inversion transactions that have been in vogue in recent times with US and Irish pharmaceutical companies.

In a statutory scheme of arrangement, once a scheme proposal document has been finalised and circulated, it would not be unrealistic for the court process to be completed within eight to 10 weeks. The scheme must be approved by more than 75 per cent of value and a majority in number of each class of creditors or members.

Receivership

While a receivership is a method of enforcing security, it is in practice treated as a form of insolvency procedure. It is possible to restructure companies by way of a pre-pack receivership, in which case the sale of a distressed company’s business can be negotiated before it enters into receivership and executed shortly after the receiver is appointed. The aim is to minimise disruption and cost, and an advantage is that out-of-the-money junior creditors can be left behind in the insolvent company.

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5 ibid., Section 449.
Ancillary insolvency proceedings

The Recast Insolvency Regulation applies to all collective insolvency proceedings relating to a company with its centre of main interests (COMI) in an EU Member State. The regime under the Recast Insolvency Regulation allows for the opening of secondary proceedings in another Member State in which the company has an establishment where main proceedings have been opened and are pending in another Member State.

It is possible for the insolvency office holder in the main proceedings to give a unilateral undertaking to creditors in the secondary proceedings that local distribution and priority rules will be respected as though secondary proceedings were opened there, which generally negates the requirement for secondary proceedings.

It is possible for liquidators of companies in non-EU countries to apply to the court in Ireland under common law for an order in aid of the foreign proceedings. The court has discretion to grant such an order in appropriate cases.

iv Starting proceedings

The question of who may commence such proceedings depends on which procedure is used.

Compulsory liquidation

In a compulsory liquidation, the court has jurisdiction to appoint a liquidator if it is satisfied that the company is unable to pay its debts or that it is just and equitable to do so. Those entitled to petition the court to liquidate a company include the company itself, a creditor of the company, a contributory of the company and the country’s Director of Corporate Enforcement. A compulsory liquidation is deemed to commence at the time of filing the petition.

Notice of the petition must be advertised, which allows parties (including the company itself and its creditors) to object to the appointment of a liquidator at the hearing of the petition.

Creditors’ voluntary liquidation

A creditors’ voluntary liquidation is usually initiated by the directors of a company. A shareholders’ meeting and a creditors’ meeting are called. The shareholders resolve that the company is insolvent and a liquidator is appointed. A statement of affairs is compiled and presented by the directors at the creditors’ meeting, including a list of creditors and amounts owed.

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6 ibid., Section 564.

7 Section 571(5) of the Companies Act 2014 places a restriction on the right of a contributory to apply to have the company wound up. A contributory is not entitled to present a winding-up petition unless the shares of which the person is a contributory, or some of the shares, either (1) were originally allotted to the person or have been held by the person, and registered in the person’s name for at least six months during the 18 months before the commencement of the winding up, or (2) have devolved on the person through the death of a former holder.
Examinership
When a company is, or is unlikely to be, unable to pay its debts, the shareholders, directors or creditors may petition the court to appoint an examiner. It is generally the company itself that petitions the court for the appointment of an examiner. Notice of the petition must be advertised, and it is possible for interested parties to object at the hearing of the petition to the appointment of an examiner. If an examiner has formulated proposals for a scheme of arrangement for consideration by the creditors, it is possible to challenge the proposals on the basis that one class of impaired creditors has not voted in favour of the scheme (which could be based on arguments in relation to the composition of classes). Challenges are also possible on the basis that the proposals are unfairly prejudicial to a particular creditor or are not fair and equitable in relation to any class of creditors.

Statutory scheme of arrangement
It is generally the directors of a company who apply to the court to summon a meeting between the members and creditors to formulate a scheme of arrangement. However, the company itself, any creditor or member of the company, or in the case of a company being wound up, the liquidator, may also apply to the court to initiate the process.

Control of insolvency proceedings
Liquidation
Once an insolvent company is in liquidation, the directors’ powers cease and the liquidator assumes the management of the company.

The Companies Act 2014 places a compulsory liquidation on the same footing as a creditors’ voluntary winding up once the order for winding up is made, thereby reducing the supervisory role of the court in favour of greater creditor involvement and liquidator autonomy.

Examinership
In an examinership, the company will continue to trade and the directors usually remain in control of a company during the protection period. This is subject to the court’s discretion to direct, upon application, that the examiner assumes some or all of the director’s functions only for the period of examinership. In practice this is rarely done, and usually when there has been a suggestion of some sort of wrongdoing on the part of the directors. The examiner’s scheme of arrangement requires court approval before it becomes binding.

Statutory scheme of arrangement
The directors and shareholders are usually instrumental in putting together the scheme and running the process. As with an examinership, the company can continue trading and the directors can stay in control of the company.

8 Section 510 of the Companies Act 2014 provides that shareholders are those holding not less than 10 per cent of shares carrying the power to vote at general meetings at the time of presentation of the petition.
9 Section 510 of the Companies Act 2014 provides that a creditor includes a contingent or prospective creditor of the company.
10 Companies Act 2014, Section 451(3).
vi Special regimes
Modified insolvency regimes apply in certain sectors and special situations. Examples include the following.

The Insurance (No. 2) Act 1983 provides for the appointment of an administrator to non-life insurance insolvent companies at the request of the Central Bank in certain circumstances with a view to ensuring the survival of the company.

Ireland took a series of exceptional steps to contain the crisis in the banking sector that emerged in 2008. Its strategy included transferring non-performing eligible assets to a government-backed entity, the National Asset Management Agency, and to provide capital and liquidity to weakened and distressed banks and building societies.

The European Communities (Reorganisation and Winding up of Credit Institutions) Regulations 2011 (SI 48 of 2011) and the Central Bank and Credit Institutions (Resolution) Act 2011 apply to the winding up of credit institutions and banks and aim to provide an effective and expeditious regime for dealing with failing credit institutions.

The Irish Bank Resolution Corporation Act 2013 was enacted in February 2013 and provided for the immediate liquidation of Irish Bank Corporation Limited (formerly Anglo Irish Bank Corporation Limited) by way of ‘special liquidation’. As the special liquidators were appointed by the Minister for Finance, they are obliged to comply with instructions given to them by the Minister and are under an obligation to act in the interests of the Irish taxpayer, putting them in a somewhat different position than other liquidators, who are answerable primarily to the creditors of the company.

Ireland is an internationally recognised centre of excellence in aviation finance and recently gave effect to the ‘Alternative A’ insolvency remedy of the Aircraft Protocol to the Cape Town Convention on International Interests in Mobile Equipment, the primary purpose of which is to provide a protective regime for aircraft financiers and creditors in insolvency proceedings similar to the US Chapter 11 procedure.

vii Cross-border issues
The Recast Insolvency Regulation applies to all collective insolvency proceedings and some restructuring proceedings relating to a company with its COMI in the European Union. The Recast Insolvency Regulation provides for automatic recognition in Ireland of proceedings to which the Regulation applies.

Ireland has not adopted the UNCITRAL Model Law on Cross-Border Insolvency Proceedings (the Model Law). In November 2018, the Irish Company Law Review Group reported to the Minister for Business, Enterprise and Innovation on the Model Law and recommended that be adopted in Ireland. The report is currently under consideration by the minister’s department. For a company that does not have its COMI in the European Union, the foreign insolvency officeholder can apply to the High Court pursuant to common law for recognition and an order in aid of the foreign proceedings. In the exercise of that jurisdiction, the Court has given consideration to the following factors:

a. whether recognition is being sought for a legitimate purpose;
b. that there is no prejudice to any creditor in Ireland in affording recognition;
c. that there is no infringement of any local law in affording recognition;
d. where the insolvency procedure in the other state is sufficiently similar to that in Ireland; and
e. that to afford recognition would not infringe public policy in Ireland.
II INSOLVENCY METRICS

The Irish economy has emerged from the aftermath of the financial crisis and is currently experiencing a period of growth. Ireland’s gross domestic product grew by 6.7 per cent in 2018, which is well above the EU area average.11 The banking system continues to show positive signs of recovery, and the unemployment rate has been declining rapidly. Economic activity is expected to remain robust, driven by investment in construction and positive labour market developments, and the activity of multinational companies remains an important factor in Ireland’s growth.

Corporate insolvency activity decreased by 12 per cent in 2018 as compared with 2017, and the 2018 figures reflect the lowest level of formal insolvency appointments since 2012. As discussed above, the dominant reason for this is the fact that the Irish economy has been in a growth phase for the past few years. While the total number of insolvencies in the first quarter of 2019 shows a marginal increase as compared with the first quarter of 2018, it is anticipated that the 2019 figures will demonstrate that the steady decrease in corporate insolvencies is now levelling off.12

The services sector and the construction sector again accounted for the highest number of insolvencies. Nevertheless, the number of insolvencies of construction companies has decreased, which is likely to be a reflection of the increased economic activity in this sector in recent years. The motor retail sector recorded an increase relative to quarter one of 2018, at a time when this sector is facing significant change. Analysis by Deloitte of the insolvencies in the first quarter of the year reveal that ‘start-ups’ account for a notable percentage of insolvencies, with 21 per cent of insolvencies being companies less than five years old.

Overall there has been a slight decrease in personal insolvency applications during the past 12 months. However, the percentage of debtors securing arrangements continued to rise. Successful insolvency arrangements are designed to return debtors to solvency. In comparison with the first quarter of 2018, both the number of applications for arrangements and the number of bankruptcies decreased in the first quarter of 2019.13

III PLENARY INSOLVENCY PROCEEDINGS

i Re: MDY Construction Ltd (in examination)14

An interim examiner circulated proposals for a scheme of arrangement to the members and creditors of the company, unusually, before his appointment had been confirmed by the court.

The examiner was appointed as interim examiner on 20 September 2018 and the hearing of the petition to confirm his appointment was listed for 22 October 2018. Prior to the hearing of the petition, the interim examiner had formulated proposals for a scheme of arrangement with the meetings of the members and creditors to consider the scheme of arrangement scheduled for the day after the hearing of the petition. While Mr Justice Quinn noted that it was unusual, if not unprecedented, for an interim examiner to activate

14 [2018] IEHC 676.
Section 534(2) of the Companies Act 2014\(^{15}\) prior to the hearing of the petition, there was no suggestion that the interim examiner had acted beyond the powers conferred upon him by the Rules of the Superior Courts, or indeed the Companies Act 2014 in doing so.

Quinn J noted the importance for creditors and other interested parties to have an opportunity to be heard at the hearing to confirm the appointment of an examiner. However, the court was satisfied that there were compelling reasons in this case that justified the actions taken as being within the proper exercise by the examiner of his commercial judgement. Submissions were made on behalf of the company that time was of the essence, and that two significant clients were threatening to terminate their relationship with the company because of the uncertainty arising from the examinership. If this materialised, the survival of the company as a going concern would be gravely affected.

Interestingly, this case demonstrated that while it should be the exception and not the norm, it is not beyond the powers of an interim examiner to compile and circulate proposals for a scheme of arrangement and to call members’ and creditors’ meetings before his or her appointment has been confirmed, when there are compelling reasons to do so.

\[\text{ii} \quad \text{Re: Custom House Capital Ltd (in liquidation)}^{16}\]

This case concerned an application by the Official Liquidator of Custom House Capital Ltd to determine his interim remuneration, fees and expenses, as well as his solicitor’s legal costs. Ms Justice Finlay Geoghegan determined that the Official Liquidator was not required to produce contemporaneous timesheets and that an increase in the hourly charge-out rate of the solicitor involved was objectively justified.

Finlay Geoghegan J acknowledged that the onus is on the liquidator to satisfy the court, on evidence put before it, that the amount of remuneration sought is reasonable for the work done. The court accepted as a matter of principle that the liquidator is under an obligation to keep ‘proper contemporaneous records’ but held that it did not follow that all such records needed to be produced on an application for measurement of remuneration. On the facts, it was held that the production of such timesheets would not assist in assessing the value of the work done, nor whether the time spent was necessary to achieve the work actually done, nor whether that work was necessary for the particular aspect of the liquidation to which it related.

In relation to legal fees, there was a dispute in relation to an increase in the solicitor’s hourly charge-out rate from €285 to €300. In a previous decision, Finlay Geoghegan J held that an increase in a solicitor’s hourly charge out rate in the context of a liquidation, which arose as a result of a promotion, was not objectively justified.\(^{17}\) However in the present case, Finlay Geoghegan J was satisfied that there was objective justification for the increase. The solicitor had increased in seniority over the relevant period and was able to relieve a senior partner from certain work in relation to the liquidation.

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\(^{15}\) This section provides that the examiner shall (1) convene and preside at such meetings of members and creditors as he or she thinks proper to consider proposals for a scheme or arrangement, and (2) report on those proposals to the court, within 35 days of the date of his or her appointment or such longer period as the court may allow.

\(^{16}\) [2018] IEHC 652.

\(^{17}\) In the matter of Mouldpro International Ltd (in liquidation) [2018] UECA 88.
iii Re: Ballantyne Re plc & Companies Act 2014

In this case, Ballantyne Re plc sought an order sanctioning a proposed scheme of arrangement that provided for a compromise of the company’s obligations to certain noteholders under the relevant notes and the commutation of certain guarantees provided by guarantors under those notes.

One creditor, ESM Fund I LP (ESM) opposed the scheme on the grounds that, *inter alia*, the court had no jurisdiction to sanction any scheme of arrangement that makes provision for the release of third-party obligations. It was alleged that on the proper interpretation of Part 9 of the Companies Act 2014, with the property rights protected under Articles 40.3 and 43 of the Constitution of Ireland, it was not open to the court to sanction a scheme that made such a provision. The effect of the proposed scheme would be to release ESM’s (and other creditors’) recourse to the guarantor.

In assessing ESM’s objection, Mr Justice Barnville referred with approval to a number of decisions in other common law jurisdictions that were ‘pro-release’, such as Australia. Taking into account the legislation, Barnville J did not view Part 9 of the Companies Act 2014 as an attempt by the Irish parliament to exclude third-party releases from schemes of arrangement. Further, it was held that the proper balance had been struck between competing interests by virtue of the fact that a proposed scheme would not be sanctioned if it was unfair, inequitable, improperly coercive or unreasonable in the circumstances, together with the fact that this applied in tandem with a requirement to obtain the approval of the creditors. In this case, the overwhelming majority of the company’s creditors voted in favour of the scheme.

Ultimately, Barnville J held that the release of Ballantyne’s creditors’ recourse under the guarantees was necessary, having regard to the need to ensure finality in relation to the affairs of the company so that it may be wound up in due course, as was the intention in the event the scheme was sanctioned. The court held that it would make no legal or commercial sense to leave such claims outstanding.

iv Re Denis Moriarty the Kerries Limited (in examination)

Denis Moriarty the Kerries Limited, which provides civil engineering works, was placed under the protection of the High Court in January 2018 with significant debts to its creditors. The company, during the examinership period, remained involved in more than 30 construction projects around the country. A successful scheme of arrangement was proposed and implemented by the examiner, which required detailed negotiations with the company’s secured creditor and other contracting parties to get the scheme of arrangement approved by the court.

The company had approximately 900 creditors, which had to be dealt with during the examinership period, and the company had debts of approximately €20 million, which increased the challenge for the examiner in getting the scheme approved. To restructure the company, the examiner obtained approval from the High Court for a dividend to the trade creditors of 1.75 per cent, which was the lowest dividend ever approved by the High Court for an unsecured creditor class.

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In the matter of Sean Dunne (a bankrupt)\(^\text{19}\)

Ulster Bank, as one of the largest creditors of Sean Dunne, had applied to the Irish High Court to have Mr Dunne adjudicated bankrupt in Ireland in 2013, despite him having previously been made bankrupt in the United States of America. The Supreme Court confirmed that it is possible for a debtor to be adjudicated bankrupt under the laws of Ireland notwithstanding the fact that the debtor has already been adjudicated bankrupt in another jurisdiction that is not subject to the EU Insolvency Regulation.

The result has been a unique interplay between the US courts, the Chapter 7 Trustee (the bankruptcy official appointed in the United States), the Official Assignee (the Irish court-appointed officer to the estate of Sean Dunne) and the Irish courts, to ensure that the bankruptcy is handled in the most efficient way.

The case is of ongoing significance as proceedings were recently instituted in the United States by the Chapter 7 Trustee against Gayle Killilea, Mr Dunne’s spouse, seeking, \textit{inter alia}, orders reversing certain asset transfers effected by Mr Dunne prior to his adjudication. In June 2019, a jury in the US proceedings instituted by the Chapter 7 Trustee returned a verdict awarding the Chapter 7 Trustee €18 million in damages against Gayle Killilea in respect of cash and assets that had been transferred to her by Mr Dunne. The international aspect of this bankruptcy was further demonstrated when the Official Assignee in Ireland was successful in obtaining an order in aid from the South African courts restraining the sale of a hotel in South Africa, which had been transferred by the bankrupt for the benefit of his wife.

Irish bankruptcy laws have become far more ‘debtor friendly’ latterly, with the normal duration for bankruptcy being reduced from 12 years to three years (in 2013) and to one year (in 2016). However, in the case of Sean Dunne, the High Court in 2018 extended the bankruptcy for 12 years as a result of the bankrupt’s ‘wilful and deliberate’ failure to cooperate with the court official administering his bankruptcy.

\section*{The Bank of Ireland v. Eteams (in liquidation)\(^\text{20}\)}

In May 2019, Mr Justice Baker in the Court of Appeal upheld the judgment of Keane J in the High Court (and refused the reliefs sought by the liquidator of the company), in which he found that a debt purchase agreement entered into by Eteams (International) Ltd (in liquidation) and Bank of Ireland constituted a true sale of the company’s debts, and not a charge over the company’s book debts (as alleged by the liquidator), which would have required registration under Section 99 of the Companies Act 1963 (and which would have been void against the liquidator in light of non-registration).

Baker J acknowledged the attractiveness of construing debt factoring agreements as charges, in that such agreements are not readily ascertainable by other creditors and could be counterproductive to the transparent system of secured financing. However, following the logic set out by Keane J, Baker J dismissed the appeal by focusing on the substance and form of the agreement as a whole.

In arguing that Keane J had erred in law and in fact, the liquidator relied on (1) a fail-safe clause in the agreement whereby the company was deemed to be property held on trust for the bank where ownership had failed to transfer, (2) a clause enabling the bank to

\footnotesize{\textsuperscript{19} [2015] IESC 42.}

\footnotesize{\textsuperscript{20} \textit{The Governor and Company of The Bank of Ireland (the ‘Bank’) v. Eteams (International) Ltd (‘Eteams) (in liquidation)} [2019] IECA 145.}
require the company to repurchase any outstanding debt at the end of the credit period, and (3) the termination provisions whereby the bank was stated to own all debts until the recourse price has been paid.

On each point, Baker J agreed with Keane J that the effect was to reinforce an intention of the parties to transfer ownership of the debts and did not, therefore, have the effect of creating a charge that would have been void against the liquidator.

IV ANCILLARY INSOLVENCY PROCEEDINGS

The Recast Insolvency Regulation has not frequently been invoked in the Irish courts.

The High Court recently considered the scope of the Recast Insolvency Regulation in the case of *Healy v. Irish Life Staff Benefits Scheme & Anor*,\(^{21}\) in which the plaintiff had been adjudicated bankrupt in 2013 by the High Court of Manchester in the United Kingdom. The relevant court order stated that the proceedings are main proceedings for the purposes of the original Insolvency Regulation, which was applicable at that time. The defendant was an employee of the second named defendant and was party to a pension scheme (the Scheme).

The trustee in bankruptcy claimed an entitlement to the plaintiff’s rights and benefits under the Scheme. The plaintiff was discharged from bankruptcy in 2014 and was unsuccessful in his application to the High Court of Justice in England to have his pension under the Scheme excluded from his estate in bankruptcy. The plaintiff then sought injunctive relief from the Irish High Court in the form of an order preventing the defendants from liaising with the trustee in bankruptcy and from making any payments to the trustee. The defendants contested the jurisdiction of the Irish High Court on the basis of the plaintiff’s COMI.

In relation to whether a pension should form part of a plaintiff’s estate in bankruptcy, the Court confirmed that is a matter for determination in the UK proceedings and that, for the Court to make the reference to the Court of Justice of the European Union, as requested by the plaintiff, would in effect be precisely the type of interference with the UK bankruptcy proceedings that the EU regulations are designed to prohibit.

In the recent examinership case of the Vision Built Group, one of the companies had been incorporated in the United Kingdom. At the petition hearing to appoint an examiner to the three companies in the group, it was successfully argued that the UK company’s COMI was in Ireland, notwithstanding that a petition to wind up the UK company had been filed in the United Kingdom.

V TRENDS

It is not entirely clear what effect the continuing Brexit negotiations will have on the Irish economy as a whole. However, Ireland is an English-speaking jurisdiction, with a strong and long-standing common law jurisprudence. This provides familiarity of process and procedure regarding substantive legal principles to those accustomed to dealing with UK law. It is anticipated that these factors will enhance Ireland’s attractiveness as a location for a corporate to base its COMI.

It is anticipated that there will be a further divestment of non-performing loan (NPL) portfolios by Irish banks in the coming year, which is likely to result in further enforcement

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\(^{21}\) *Healy v. Irish Life Staff Benefits Scheme & Anor* [2018] IEHC 28.
proceedings, although not on the scale seen in the past, in circumstances where it appears that private equity acquirers of NPLs have worked through a significant number of the loan books acquired in recent years.

The Land and Conveyancing Law Reform (Amendment) Bill 2019 was passed by the Irish parliament on 2 July 2019. The original bill was put forward as a private member’s bill that was published in 2017, but was not substantially progressed (the Keeping People in their Homes Bill). The new bill was government-sponsored with a number of drafting changes and will result in a broadening of matters that a court must take into account when a lender applies for a possession order in respect of a borrower’s primary residence. It is expected to be signed into law by the President before the beginning of the next court term in October.

Pre-pack receiverships have been used very effectively in Ireland in recent years. They have also been successfully used in conducting loan-to-own schemes. There are no formal guidelines that govern pre-packs in Ireland and there has been little judicial consideration of the procedure.22

There has been an increased interest in the potential use of Irish schemes of arrangement to effect corporate restructurings, particularly with regard to large corporate groups with entities registered in foreign jurisdictions. The recent approval by the Irish High Court of a scheme of arrangement that restructured US$1.65 billion of liabilities of Ballantyne Re plc confirms Dublin as one of the most effective restructuring venues in the European Union, and is a clear endorsement that Irish schemes can be used to implement complex cross-border restructurings. Further evidence of this trend is the fact that Weatherford plc, a global company with more than 100 subsidiaries operating in 80 countries has recently entered into Chapter 11 proceedings in New York, the success of which will be conditional on the approval of the proposed scheme in Ireland through an examinership process. Weatherford plc is an Irish-registered company listed on the New York Stock Exchange. The process is intended to achieve a significant deleveraging of the company's capital structure, reducing its balance sheet liabilities from approximately US$8.35 billion to US$2.75 billion.

While economic activity in Ireland remains positive, the continuing uncertainty around the United Kingdom’s future relationship with the European Union makes it difficult to determine the potential impact of Brexit. Evidence does show that Ireland could be relatively more negatively affected than other EU countries, which could potentially have a significant effect on Ireland’s economic growth.23

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22 The sale of the Thomas Crosbie media group is an example of a high-profile pre-pack in which a firm acted for the secured lender. Although one creditor commenced proceedings challenging the process, the case did not proceed to trial, as the creditor was subject to an order to pay security for costs on the grounds that, among other things, the creditor plaintiff had failed to show that the secured creditor did not have at least a *prima facie* defence to the claims, on the grounds that the secured creditor was entitled to take steps to enforce its security in a manner that protected its legitimate interests. *Webprint Concepts Ltd v. Thomas Crosbie Printers Ltd* [2013] IEHC 359.


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Chapter 16

ISLE OF MAN

Miles Benham and Carly Stratton

I INSOLVENCY LAW, POLICY AND PROCEDURE

In the 2015 edition of this publication, we noted that there had been some significant movement in Manx insolvency law, especially in the area of the mechanisms available for challenging a sealed winding-up order. At that time, we noted that there was had been an increase in judicial criticism of the Isle of Man’s legislation and rules in respect of winding up. As these reforms do not appear to be high on the legislative agenda, there has not been any change to either the legislative framework or the winding-up rules. Nevertheless, the Isle of Man courts continue to do an admirable job of ensuring that the ageing rules continue to function in the modern world. Accordingly, the statutory framework and substantive law remain unchanged in this edition.

Statutory framework and substantive law

Insolvency law on the Isle of Man is governed primarily by the following legislation:

a. the Fraudulent Assignments Act 1736;
b. the Preferential Payments Act 1908;
c. the Preferential Payments and Other Acts (Financial Adjustments) Act 1973;
d. the Companies Act 1931–2004; and
e. the Companies Act 2006.

The primary legislation governing insolvent companies can be found in Sections 155 to 276 of the Companies Act 1931. This is supported by the Companies (Winding-up) Rules 1934.

The regime in the Isle of Man, perhaps not surprisingly given its proximity, shares many similarities with the regime in England and Wales and, indeed, with many common law jurisdictions. This is owing in part to the fact that the Isle of Man Companies Act 1931 was based on the Companies Act 1929 (an Act of Parliament). Nevertheless, there are certain idiosyncrasies and features unique to Isle of Man insolvency law and procedure that have developed over time. Added to the divergence in Manx and English and Welsh insolvency law and procedure as a result of the passage of time and interpretation is that English and Welsh legislation has been subject to amendment that the Manx legislation has not.

The Fraudulent Assignments Act 1736 states that 'all fraudulent Assignments of Transfers of the Debtor’s Goods or Effects shall be void and of no Effect against his just Creditors, any Custome or Practice to the contrary notwithstanding'.

1 Miles Benham and Carly Stratton are directors of MannBenham Advocates Limited.
2 The Spirit of Montpelier Limited (In Liquidation) and others v. Lombard Manx Limited (18 June 2015).
A transaction will be void under the 1736 Act if, and only if, it is entered into dishonestly (i.e., if the debtor enters into the transaction with the intention to defraud his or her creditors). The 1736 Act applies to present and ascertained future debts at the time of the transaction in question. However, it does not apply to claims filed after the transaction. Further, assignment or transfer of debtors’ goods is only void against existing creditors; it is not illegal to protect property against future creditors. Accordingly, one may enter transactions with a view to, and for the purpose of, protecting property against potential future creditors that do not presently exist.

ii Policy

In Donnell v. Siboney, Deemster Doyle, then Second Deemster of the Isle of Man, stated: ‘To present a petition to wind up a company is a very serious step to take. It can result in the death of the company.’

To present a petition to wind up a company is therefore considered to be a serious matter and not to be done lightly. It might therefore be argued that there should be some reluctance for the Isle of Man courts to decide to wind up a company. It is the case, however, that courts are routinely required to make serious decisions on a variety of important issues and the fact that presentation of a winding-up petition might be considered a last resort will not prevent the court from winding up a company if there are good grounds for doing so.

The Lehman Brothers Inc v. Navigator Gas Management Limited judgment states:

It is well-settled law that if a creditor with standing makes application to have a company wound up, and if the court is satisfied that such company is unable to pay its debts, a winding-up order will follow unless there is some special reason to the contrary. Further, in such circumstances and being so satisfied, the court would assume that a winding-up order should be made. The burden rests with any objector to show special reasons why such an order should not be made.

It follows that if a company is considered to be unable to pay its debts, the Isle of Man courts will not hesitate to wind it up unless that company or other objectors can show special reasons not to, and the burden is on them to do so.

The practicality is that if a winding-up petition is presented and a company is deemed unable to pay its debts, the chances of its survival are minimal. There are certain mechanisms that allow schemes of arrangement or receivership, but if a company is in financial difficulty and finds itself unable to pay its debts as they fall due, and a creditor in receipt of an undisputed debt wishes to wind up the company, there is a very good chance that the creditor will succeed.
iii Insolvency procedures

There are a variety of options available to an insolvent company on the Isle of Man:

a. it can be wound up either voluntarily by its creditors or by the court, or subject to the supervision of the court;

b. it can appoint a receiver by way of application to the court, or a charge holder can appoint a receiver in accordance with the terms of the security document; or

c. a liquidator may make an application to the court to sanction a compromise or a scheme of arrangement.

Winding-up proceedings by the court are discussed in Section I.iv, below.

There is no provision for the appointment of an administrator in the Isle of Man, nor is there a position of administrative receiver under Isle of Man law. However, foreign administrators are recognised and are likely to be assisted by the Isle of Man courts if such a request is made. The court has sought the assistance of the English High Court under Section 426 of the Insolvency Act 1986 to place an Isle of Man company into administration under the laws of England and Wales.

The Manx legal position on the appointment of receivers is by and large the same as the pre-1986 position in England and Wales. There is no requirement that a receiver should have any qualification as long as he or she has reached full age, although practically it would be difficult to envisage a situation in which a receiver would not be an experienced or appropriately qualified insolvency practitioner.

Unless the power to appoint a receiver has been granted by way of debenture or other appropriate agreement, it will be necessary to apply to the court for a receiver to be appointed. The court’s jurisdiction to appoint a receiver in the Isle of Man follows the common law position and will only be exercised to aid some legal or equitable right. The appointment must be of some advantage to the applicant and the property in question must have some value.

Appointment of a receiver by debenture or under a charge will be in accordance with the terms of the security document. Subject to any terms to the contract, the appointor may remove or replace the receiver at any point he or she chooses.

The jurisdiction of the Manx court to effect schemes of arrangement has been described as being ‘extremely wide’. A liquidator has power to apply to the court for convening a meeting of the creditors and contributories for a vote to be held upon the scheme. If three-quarters (in value) of the creditors or members present and voting agree to the scheme of arrangement or compromise then, if this is sanctioned by the court, it is binding on the creditors, members and liquidator.

7 Companies Act 1931, Section 214.
8 ibid., at Section 162.
9 ibid., at Section 243.
10 High Court Act 1991, Section 42.
11 Companies Act 1931, Sections 152 and 184(1)(e).
15 Companies Act 1931, Sections 152 and 184(1)(e).
The Manx courts have a history of proactively assisting overseas courts in respect of insolvency matters. The First Deemster\textsuperscript{16} stated\textsuperscript{17} in a case involving US Chapter 11 proceedings of an Isle of Man company that the ‘substantive insolvency proceedings should be confined to one jurisdiction with other courts worldwide, where necessary, acting in an ancillary capacity and recognising and assisting the jurisdiction of the primary court’. In this case the Manx court was content for the US court to be the primary court.

The island’s court system is modern and efficient and ancillary insolvency proceedings can be dealt with in a timely manner.

\textbf{iv \ Starting proceedings}

The language of the Companies Act 1931 is that insolvency proceedings before the court are commenced in the Isle of Man by way of a winding-up petition.\textsuperscript{18} The following parties may commence an application to wind up an Isle of Man company:

\begin{itemize}
  \item[a] the company;
  \item[b] the Isle of Man Treasury (in respect of public companies in limited circumstances);
  \item[c] any creditor or creditors (including contingent or prospective creditors);
  \item[d] any contributory or contributories; and
  \item[e] 10 or more policyholders in the case of an insurance company.\textsuperscript{19}
\end{itemize}

An application to wind up an Isle of Man company may be made by any or all of the above-listed parties either together or separately.

Notwithstanding the foregoing, there are further limitations on when a contributory or a contingent or prospective creditor may bring a winding-up petition. Contributories are only entitled to present a winding-up petition if their shares were allotted at least six months before the commencement of the winding-up petition (or they have devolved to the contributory through the death of the original holder).\textsuperscript{20} Contributories may present a petition if the members of the company have been reduced to below two.

Before an application for winding up by prospective or contingent creditors can be heard by the court, the creditors must establish a \textit{prima facie} case for winding up and provide security for costs.\textsuperscript{21}

In addition to the foregoing, the Financial Supervision Commission may present a winding-up petition if it is in the public interest for the company to be wound up.\textsuperscript{22}

The Isle of Man courts have discretion on hearing a winding-up petition to make such orders that they see fit and may dismiss, adjourn, make any interim order or any other order that they deem appropriate in the circumstances.\textsuperscript{23} The only limitation on the court’s discretion is that it may not refuse to make a winding-up order on the grounds that the only assets of the company have been mortgaged to or beyond their value, or that the company has

\begin{itemize}
  \item[16] Chief Judge of the High Court of Justice.
  \item[18] The new court rules brought in by the Isle of Man Courts of Justice in 2009 now refer to ‘claims’ rather than ‘petitions’, so – more accurately – a winding-up petition should now be a winding-up claim, but for ease of reference and consistency, this chapter makes reference to winding-up petitions.
  \item[19] Companies Act 1931, Section 164(1).
  \item[20] ibid., at Section 164(1)(a)(i) and (ii).
  \item[21] ibid., at Section 164(1)(c).
  \item[22] See Section III.iii, below.
  \item[23] Companies Act 1931, Section 165(1).
\end{itemize}
no assets. Indeed, those will ordinarily be reasons to wind up a company. Once a winding-up petition has been presented, the company or any creditor or contributory may apply for a stay of the winding-up proceedings or oppose the winding-up proceedings.

While the island’s insolvency legislation does not presently grant the court jurisdiction to review, rescind or vary a winding-up order, the Staff of Government Division has confirmed that the Manx courts have an inherent jurisdiction at common law to review, rescind or vary a winding-up order when such an order is necessary in the interests of justice. The manner in which the court will review a winding-up order, the area covered by the courts and how they will exercise their powers are all uncertain, although it is presumed that such a review will be on a similar basis to the powers granted under Rule 7.47 of the Insolvency Rules 1986 (an Act of Parliament).

v  Control of insolvency proceedings

Once the court has appointed a liquidator it is, for all intents and purposes, the liquidator that controls the insolvency proceedings subject to his or her compliance with statute and the Companies (Winding-Up Rules) 1934. The court is required to ‘take cognisance’ of the liquidator’s conduct, and must enquire into any failings by the liquidator and take such action as it may think expedient. The court has power to require a liquidator to attend before it and be examined on oath in respect of the winding up.

The directors of the company must provide the liquidator with a statement of the company’s affairs within 14 days of the winding-up order or the appointment of a provisional liquidator. As soon as is practicable after receipt of the statement of affairs, the liquidator must submit a preliminary report to the court giving, inter alia, the reasons for the failure of the company and whether, in his or her opinion, further enquiry is desirable into the promotion, formation or failure of the company or the conduct of its business.

vi  Special regimes

There are no special insolvency rules.

vii  Cross-border issues

Because of the size of the Isle of Man, its location and its role as an international business centre, many company liquidations involve cross-border issues.

The approach of the Manx court has been to provide assistance to foreign courts and to seek the assistance of foreign courts where necessary, such as by way of a letter of request. The Manx court has been prepared to extend the scope of Manx common law to assist overseas liquidators when there was no statutory power to provide such assistance.

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24 ibid., at Section 166.
26 Unlike in England, where Rule 7.47(1) of the Insolvency Rules 1986 provides that the court should have jurisdiction to review, rescind or vary a winding-up order.
27 The Spirit of Montpelier Limited (In Liquidation) and others v. Lombard Manx Limited, 18 June 2015, Staff of Government Division (Appeal Court). In this case, author Miles Benham appeared for the appellant and persuaded the Court that there was a common law power for the lower court to review a winding-up order.
28 Companies Act 1931, Section 189.
29 In re I mpec Services Worldwide Ltd 2003-05 MLR 115.
The principle of (modified) universalism is a principle recognised by Manx common law and provides that personal and corporate insolvency should be unitary and universal, a principle that was applied by the Privy Council in the case of *Cambridge Gas*. As the island’s insolvency case law continues to develop, there is a clear trend towards assisting overseas courts and claimants rather than putting hurdles in their way. The Manx court of appeal, known as the Staff of Government Division, in the case of *Obertor v. Gaetano*, interpreted the Judgments (Reciprocal Enforcement) (Isle of Man) Act 1968 (the 1968 Act) in a purposeful way so as not to require an English judgment creditor to have to register that judgment under the 1968 Act before being able to serve a statutory demand on the judgment.

In *Interdevelco v. Waste2energy Group*, the Manx court refused the application of a creditor to wind up an Isle of Man company as the company was already in Chapter 11 proceedings before the United States Bankruptcy Court for the District of Delaware. The court stated that, in the circumstances, there was no need for ‘additional substantive winding-up proceedings to take place in the Isle of Man’.

**II INSOLVENCY METRICS**

As Isle of Man companies are predominantly used for international trade or asset holding, it is the state of the global economy rather than the local economy that determines the number of insolvencies.

As a Crown Dependency, the political situation in the United Kingdom can also affect the Isle of Man. It is unknown what effect, if any, that leaving the European Union, with or without a deal, will have on the Manx, or indeed the UK, economy in the short, medium or long term and what effect, if any, it may have in respect of insolvencies.

**III PLENARY AND ANCILLARY INSOLVENCY PROCEEDINGS**

i Appointment of liquidators provisionally without notice pending the hearing of a claim to wind up a company

There have been two applications before the Manx courts for the appointment of provisional liquidators before the hearing of the winding-up claim that have been brought without notice. These applications have been made by the Isle of Man Financial Services Authority (FSA) (formerly the Financial Supervision Commission (FSC)).

In *Financial Supervision Commission v. UK Secured Finance Fund PLC*, the FSC sought an urgent without notice application pursuant to Section 178 of the Companies Act 1931 for the appointment of provisional joint liquidators in respect of UK Secured Finance Fund Plc.

The court heard that the company in question did not have a registered agent, in breach of Section 74(1) of the Companies Act 2006, and no longer had a manager. As a result of the company having no registered agent, the Registrar of Companies had issued notice under Section 183 of the Companies Act 2006 indicating that, unless cause could be shown to the

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33 See footnote 30.
34 10 June 2015.
contrary, the company would be struck off the register. Further, joint controllers had been appointed to the company by the FSC, who had reported that the company was cash-flow insolvent and had recommended to the FSC that the company be placed into liquidation as soon as possible. The FSC noted their belief that it was in the public interest that the company was wound up.

In *Isle of Man Financial Services Authority v. New Earth Recycling and Renewables (Infrastructure) PLC and others*, the FSA again sought appointment of provisional joint liquidators on a without notice basis.

In that case, the FSA sought appointment of provisional liquidators on the following basis: the companies in question had limited, if any, cash holdings and the directors had indicated that there were insufficient funds to operate day to day or to liquidate in an orderly manner; all payments had been frozen; it was not appropriate to allow the companies to continue trading without sufficient liquidity to operate day to day; and the directors had consented to the applications being made and to the provisional appointments. The FSA also believed that the liquidators could preserve any assets that might still be capable of preservation and make necessary enquiries to obtain information regarding the affairs of the companies.

In both cases the application was granted, despite it being an exceptional step to take. Reference was also made in both cases to the decision of the court in *Unicorn Worldwide Holdings Ltd and others v. P Court Ltd and others*, which sets out the tests to be applied in the appointment of provisional liquidators without notice.

The *Unicorn Worldwide Holdings* case, following a number of English and Welsh authorities, states that there is a two-stage test that must be satisfied before such an appointment can be made.

The ‘first and critical question’ is whether the creditor was ‘likely to obtain a winding-up order on the hearing of their petition’. The second discretionary stage is that the court should consider whether, in the circumstances of the case, it is right that the provisional liquidator should be maintained in office pending the hearing of the claim. The judgment in *Unicorn Worldwide Holdings* states:

> Factors that the court should consider include whether there are real questions as to the integrity of the Company’s management and/or as to the quality of the Company’s accounting and record keeping function, whether there is any real risk of dissipation of the Company’s assets and/or any real need to take steps to preserve the same, whether there is any real risk that the company’s books and records will be destroyed and/or any real need for steps to be taken to ensure that they are properly preserved and maintained (which may be so where, for example, there is clear evidence of fraud or almost irrefutable evidence of chaos), whether there is any real need for steps to be taken to facilitate immediate inquiries into the conduct of the Company’s management and affairs and/or to investigate and consider possible claims against directors (e.g. for fraudulent or wrongful trading), whether or not the Company has a realistic prospect of obtaining a validation order under s.127 of the Act (because if it has no such prospect, it may well not be realistically able to trade in any event), and generally which course seems likely to cause the least irremediable prejudice to one party or the other.’

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35 9 June 2016.
36 2014 MLR 563.
37 *Revenue and Customs Comrs v. Rochdale Drinks Distributors Ltd* [2012] 1 BCLC 748; *Re SED Essex Ltd* [2013] EWHC 1583 (Ch).
Interestingly, although a provisional liquidator was appointed in both *FSC v. UK Secured Finance Fund Plc* and *FSA v. New Earth Recycling and Renewables (Infrastructure) Plc*, the court noted in the latter case that it granted the application with some degree of reluctance as it felt that the risk of dissipation of assets simply was not there. However, the directors of the companies involved had essentially agreed to the FSA’s applications and, as such, the court was satisfied that the grounds were made out. Had the companies’ directors not been agreeable to the applications then it may well have been that the without notice application would not have been granted.

### Disclosure and specific disclosure in winding-up claims

Requiring disclosure or making an order for specific disclosure in a winding-up claim has been noted as a highly unusual step to take; however, there are two cases in which such orders have been sought. Those applications have not been successful, but the judgments make clear that the court does have the power to order such disclosure in a winding-up claim and, while it might be unusual, it will be prepared to make an order if there are good grounds for doing so.

The cases before the Manx courts regarding disclosure in winding-up claims are *Gittins and others v. Simpson*[^38] and *Secure Nominees Limited v. Origo Partners and others*.[^39]

Both cases confirmed that although such an order in a winding-up proceeding is unusual and exceptional, the court has the discretion to order disclosure and the tests and rules in respect of orders for specific disclosure are the same as they would be in any other application. ‘There is no jurisdiction to make an order for specific discovery unless (1) there was sufficient evidence that documents exist which have not been disclosed; (2) the documents related to matters at issue in the proceedings; and (3) there was sufficient evidence that the documents were in “the possession, custody or power” of the other person.’[^40]

Even when those prerequisites for the jurisdiction exist, the court still has discretion as to whether to order discovery. Again, the ordinary rules regarding the making of an order for specific disclosure apply. Documents and classes of documents must be defined precisely; discovery must be necessary to dispose of the matter fairly; and necessity, fairness and proportionality must be considered. The court will also not countenance ‘fishing expeditions’.

In most winding-up claims, disclosure is likely to be unnecessary and will not be ordered on the grounds that it is not required to dispose of the matter fairly. Where winding up is sought on the grounds of inability to pay a debt, there will ordinarily be evidence of such insolvency or inability to pay the debt such that disclosure is not needed, or if there is a genuine dispute over the alleged debt then, in the ordinary course, the winding-up claim would be dismissed. When a court is being asked to wind up on the just and equitable ground then, again, in most cases the evidence will be clear on its face. If, for example, the claim is brought because of deadlock in the management of the company, that deadlock either does or does not exist, and disclosure would not be required. However, there may be circumstances outside the normal course in which disclosure is necessary.

In *Secure Nominees Limited v. Origo Partners and others*,[^41] Deemster Doyle did not find helpful arguments put forward that because disclosure in winding-up matters were rare and exceptional that an order should not be made. While the learned Deemster did not make

[^38]: 10 December 2015.
[^39]: 29 July 2016.
[^40]: See *Gittins v. Simpson* JCPC 2016/0087, Paragraphs 11 to 14.
an order for disclosure in that case, he made clear that the fact that such orders are rare and exceptional is simply a statement of fact and does not form part of the test for determining whether a disclosure order should be made. The dispute must always be whether there is jurisdiction to make an order and, if so, whether the court should exercise its discretion to make one. It follows that if there are good grounds and reasons for making a disclosure order in the specific circumstances of a winding-up claim, highly unusual though they might be, then a disclosure order should be made.

iii Isle of Man FSA and Gordon Wilson (provisional liquidator and deemed official receiver of The Eco Resources Fund PCC Plc) and others CHP 2017/28

This case provides useful guidance as to the factors the court will take into account when determining who should act as liquidator in a public interest winding up when there are competing proposals for liquidator.

The court had ordered that Eco Resources Fund PCC Plc (Eco) be wound up and that Gordon Wilson be appointed provisional liquidator and deemed official receiver. Prior to his appointment as provisional liquidator, Mr Wilson had been appointed by the FSA as adviser and controller to Eco. As adviser and controller, Mr Wilson had all the powers to advise or to operate, manage and administer the affairs of Eco. At the first meeting of the creditors and contributories, Mr Wilson (as provisional liquidator) sought resolutions for his appointment as liquidator with no committee of inspection. The creditors and contributories voted against the resolutions, and one creditor subsequently sought the appointment of Mr Simpson as liquidator. Both Mr Wilson and Mr Simpson are highly experienced and respected liquidators, and the question of who should be appointed liquidator of Eco was brought before the court for determination.

After considering the facts, which included Mr Wilson having been very active in his roles as adviser to and controller of Eco, the court decided that Mr Simpson should act as liquidator.

In considering whom to appoint as liquidator when there are competing nominations, the court advised that it should consider the context within which the competing proposals arise.

His Honour the Deemster Doyle advised that, when considering competing contenders for appointment as a liquidator in a public interest winding up, the court should consider all the circumstances of the case, including the views of the FSA and the views of contributories and creditors. In a public interest winding up, the court will, no doubt, place significant weight on the views of the FSA but those views are not determinative as to who should be appointed liquidator. The court should consider the interests of those who support and oppose the appointment of the specified individual as liquidator. The court should also consider what is in the best interests of the company and its investors and the reputation of the island.

The court must consider the independence and impartiality of the proposed candidate. A liquidator, as an officer of the court, should be independent and above suspicion. There must not be any bias, nor any appearance of bias. If there are circumstances that might predispose a person to favour particular interests, those circumstances must be taken into account and the possibility of unconscious partiality should not be overlooked. The proposed candidate must be independent of interested parties, including the FSA.
His Honour advised:

The court must carefully consider whether the proposed liquidator is independent and impartial and is untainted by any inappropriate ‘baggage’, for example previous dealings with the company or those connected with the company or the FSA in respect of the company which make it difficult for such individual to be appointed liquidator over and above a more appropriate candidate. I accept that on occasions an individual’s previous dealings with, or experience of, the company prior to it going into liquidation may be appropriate ‘baggage’ and may in some cases be regarded as a positive factor in favour of appointing that person as liquidator. In other cases such previous dealings and experience with the company and the FSA may be inappropriate ‘baggage’ and would be regarded as a negative factor militating against that person being appointed as liquidator, in particular where there is a more suitable candidate who does not have the disadvantage of such inappropriate ‘baggage’.

His Honour concluded his judgment with the following advice: ‘The conduct of a liquidation (even a liquidation in the public interest) is not a matter for the FSA, it is a matter for the liquidator. He who pays the piper does not call the tune in liquidations, including public interest liquidations. The one who foots the bill does not have control of the liquidation. The liquidator acts, and must be seen to act, independently of the Treasury, the FSA, the contributories, the creditors, the officers of the company and any other interested parties.’

iv Isle of Man FSA and Michael Simpson (liquidator) CHP 2009/37

The liquidator sought the assistance of the court as to whether the provisions of Section 248 of the Companies Act 1931 applied to the liquidation even after the creditors had been paid the whole of their proved debts for the period up to the commencement of the liquidation. The liquidator was unclear as to whether Section 248 continued to apply if the company was no longer ‘an insolvent company’.

Section 248 of the Companies Act 1931 provides that in the winding up of an insolvent company, the rules of bankruptcy are to be applied with regard to the rights of secured and unsecured creditors and debts provable. The rules of bankruptcy are contained in the Bankruptcy Code 1892 and provide that if ‘there is any surplus after payments of the debts it shall be applied in payment of interest from the date of the receiving order’. If Section 248 continued to apply then unsecured creditors would receive interest at 4 per cent per annum on the amount of their proved debts from the commencement of the liquidation.

A review of English case law indicated that the courts in England had interpreted Section 248 in a manner that resulted in the Section having no application once the liquidation threw up a surplus, even though the company may have been insolvent at the commencement of the winding up.

The court advised that although Section 248 of the Companies Act 1931 is in the same terms as the English Section 317 of the Companies Act 1948 of Parliament, as the 1931 Act was not consolidating legislation, the Section did not need to be interpreted in the same restrictive manner as adopted in England and Wales and could be given its natural meaning.

His Honour Deemster Corlett held that it was inappropriate to follow the English line of authority and that it would be ‘illogical and unfair for the Isle of Man to have an insolvency regime in which different provisions apply in relation to the payment of statutory interest as between a creditor in a bankruptcy and a creditor in a winding up, in cases where there is a surplus’.

His Honour advised that ‘the imposition of statutory interest is the fairest manner of adjusting the rights of creditors’.
v Banners Broker International Limited (In Liquidation) CHP/2014/24

This case concerned an application by the joint liquidators of Banners Broker International Limited (In Liquidation) (the Company) for the liquidation in the Isle of Man to be stayed until further order and the Isle of Man joint liquidators to be released, as the centre of main interest of the liquidation was more closely associated with Canada than the Isle of Man.

In addition, the joint liquidators sought the sanction of the court to enter into the transition service and assignment agreement (the Assignment Agreement) that assigns, transfers and conveys to a Canadian receiver, on an ‘as is where is’ basis of the joint liquidators’ rights, titles and interests in and to the company estate and that the joint liquidators should sign the Assignment Agreement forthwith.

The joint liquidators had been installed following the granting of a Manx court order in respect of an Isle of Man-based company.

As the matter unfolded, a receiver was appointed in Canada, who, in turn, discovered that the centre of main interest of the Company was in fact not the Isle of Man but Canada.

The Court in analysing its jurisdiction to grant the orders subject to the application made reference to Section 194(1) of the Companies Act 1931 and relevant authority, stating:

4. Under section 194(1) of the Companies Act 1931 this court has a wide power to make an order staying winding up proceedings: ‘... either altogether or for a limited time, on such terms and conditions as the court thinks fit’.

5. Deemster Kerruish in Navigator Gas Transport plc (judgment 4 July 2006) did not consider that the permanent stays sought by the Committee of Inspection in that case were detrimental to any creditor. The learned Deemster noted that the continuation of the liquidations would be against the wishes of the secured creditors. The learned Deemster saw no prejudice to anyone in granting permanent stays. The learned Deemster also considered the ‘commercial morality and the interests of the public at large’.

6. Derek French, in Applications to Wind Up Companies, second edition at page 369, states: ‘A stay may be ordered if it is more convenient to wind up the company in another jurisdiction. [Footnote 265: Re Oriental Bank Corporation (1884) 10 VLR (E) 154; Re Stewart and Matthews Ltd (1916) 26 Man R 277 – in both cases no creditor objected.’

7. At page 1071 of McPherson’s Law of Company Liquidation, third edition by Andrew R Keay, it is stated: ‘The effect of an order staying the winding up, if expressed in unlimited terms, is that the winding-up process comes to an end – the whole effect of the winding up ceases, and the company can thereupon resume the conduct of its business and affairs as if no winding up existed. The liquidator is entitled to a discharge.’

The court also noted that:

9. Under section 184(2)(h) of the Companies Act 1931, the liquidator in a winding up by the court shall have the power ‘to do all such other things as may be necessary for winding up the affairs of the company and distributing its assets’. The Joint Liquidators have power to enter into the Assignment Agreement. Moreover, under section 184(3) of the Companies Act 1931, the exercise by the Joint Liquidators of the powers conferred by section 184 is subject to the control of the court.
The court, having analysed its jurisdiction under the Companies Act 1931 and case law, and having taken consideration of the circumstances of the specific case, ordered that the liquidation of the Company in the Isle of Man be stayed in favour of the continuation of the receivership in Canada, that the joint liquidators be released, subject to compliance with the various other orders made by the court, sanctioned to entry into of the assignment agreement and required the joint liquidators to enter into the assignment agreement forthwith.

This was the first reported case in the Isle of Man of the transfer of the centre of main interest from the Isle of Man to another competent jurisdiction.

vi The Isle of Man FSA v. Louis & Ors (CHP 2016/73)

This case related to an application surrounding a legal argument focusing on whether an application by the FSA for disqualification orders against two parties under the Company Officers (Disqualification) Act 2009 (the 2009 Act) was within time and, if it was not, whether this court should grant leave for the application to proceed.

One point that fell to consideration by the court was in relation to the interpretation which should be given to the wording ‘wound up’ within Section 5(3) of the 2009 Act and hence the time period within which a claim should be brought under that Section.

Section 5(3) of the 2009 Act provides that an application under that Section ‘may only be made before the end of the period of 2 years beginning with the day on which the company is wound up or dissolved, unless the High Court grants leave for an application to be made later’.

The advocate for the seventh and eight defendant, relying on Section 169 of the Companies Act 1931, submitted that ‘for the purposes of section 5(3) “wound up” means the date of the presentation of the winding up claim and that the two-year time period in respect of companies subject to a winding up order would begin to run on that date’.44

The advocate for the seventh and eight defendant further submitted that, ‘in respect of companies placed into creditors’ voluntary liquidation, the two-year time period would begin to run from the date of the completion of the winding-up process and in respect of companies placed into creditors’ voluntary liquidation, the time would begin to run from the date of the completion of the liquidation’.45

In contrast, the advocate for the claimant submitted that ‘in respect of those companies subject to a winding-up order, the time would begin to run at the completion of the winding-up process and in respect of companies placed into creditors’ voluntary liquidation, the time would begin to run from the date of the completion of the liquidation’.46

Drawing support from the Appeal Division’s helpful judgment in Taylor and another v. AG,47 the court considered that, in construing the words in Section 5(3) of 2009 Act, regard be had to the language of the Section, its purpose and its context.

The court considered that Section 5 of the 2009 Act has the dual purpose of the protection of the public from unfit officers of insolvent companies and the protection of defendant officers of insolvent companies from stale claims.48

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44 See CHP 2016/73, Paragraph 79.
45 ibid., at Paragraph 79.
46 ibid., at Paragraph 80 79.
47 2012 MLR 199.
48 ibid., at Paragraph 82 79.
In considering the point, His Honour stated in his judgment:

The use of the words ‘wound up or dissolved’ has created a difficult case of statutory construction, but in my judgment the Manx two-year clock starts to tick under section 5(3) of the 2009 Act:

1. in cases where a winding-up order is made, from the date when the company is completely wound up;
2. in cases where the company is in creditors’ voluntary liquidation, from the date of the completion of the liquidation; and
3. in respect of companies struck off the register without being wound up, from the date of dissolution.

vii Summoning liquidators for court examination

This case related to three applications by the liquidator seeking orders that the two other parties to the application, who are former directors of all three companies, be summoned to appear before the court to be examined on oath concerning the promotion, formation, trade, dealings and affairs of each company pursuant to Section 206 of the Companies Act 1931.50

Section 206 of the Companies Act 1931 gives a court power to summon before it any officer of a company that is being wound up by the court, or any person whom the court deems capable of giving information concerning the promotion, formation, trade, dealings, affairs or property of the company. Such a person may be examined on oath ‘either by word of mouth or on written interrogatories’. The court may also require parties to produce any relevant books and papers.51

The court noted that the wording of Section 236 of the Insolvency Act 1986 of Parliament is very similar to that of Section 206 of the Companies Act 1931 and considered it appropriate to follow the approach set out in the English authorities, there being no exceptional local conditions that should lead the court to a different approach in this case.52

In considering the applications made by the liquidators, His Honour Deemster Corlett stated in his judgment that ‘Tynwald has vested in liquidators this “extraordinary” and “sui generis” power, and the court should not hesitate to use it in a proper case, it might be said especially in a case such as this where so many investors have lost so much money’.53

His Honour Deemster Corlett further stated that, when considering Section 206 of the Companies Act 1931:

The liquidators have the burden of proof. They must satisfy me at this time that there exists a reasonable requirement for information which can be obtained by way of oral examination under section 206. I accept that the liquidators do not have to make out the requirement in detail, but the liquidators nonetheless must make out the requirement.54

49 ibid., at Paragraph 104 79.
50 Alex Adam and David Peter Craine acting as liquidators of New Earth Recycling and Renewables (Infrastructure) Plc (in liquidation) and Alex Adam and David Peter Craine acting as liquidators of The Eclipse Investments Fund Protected Cell Company Plc (in liquidation) and Alex Adam and David Peter Craine acting as liquidators of The Premier Investments Opportunities Fund Protected Cell Company Plc (in liquidation) and Michael John Richardson and John Charles Bourbon (CHP 16/076 & CHP 16/077).
51 ibid., at Paragraph 19.
52 ibid., at Paragraph 20.
53 ibid., at Paragraph 43.
54 ibid., at Paragraph 44.
Until the court sees the areas of questioning, it is simply unable properly to evaluate whether the reasonable requirement test is met.\textsuperscript{55}

While I accept that the proposed form of order may be based on those set out in the schedule to the 1934 Winding-up Rules (it being noted that they refer to a public examination), I do not accept that such an order is nowadays a proper one to make. It fails in my judgment to take account of the body of case law to which both counsel have referred.\textsuperscript{56}

The court requires to be satisfied that the liquidators have a reasonable requirement for the information, that it is not already in their possession, that they have conducted a search and analysis of the documents already in their possession and that specific gaps require to be filled by way of an oral examination of Messrs Bourbon and Richardson.\textsuperscript{57}

\textsuperscript{55} ibid., at Paragraph 46.
\textsuperscript{56} ibid., at Paragraph 48.
\textsuperscript{57} ibid., at Paragraph 49.
INSOLVENCY LAW, POLICY AND PROCEDURE

Statutory framework and substantive law

The statutory framework for insolvency-related procedures in Italy is primarily set out in Royal Decree No. 267 of 16 March 1942 (the Bankruptcy Law). Other pieces of legislation are provided with regard to specific sectors or situations.

The Bankruptcy Law has undergone extensive revisions in the past decade, which have shifted the focus from the protection of creditors through the liquidation of assets to a wider range of opportunities for discharging debts via composition.

By the recently enacted Legislative Decree No. 14 dated 12 January 2019, the Italian Council of Ministers has significantly reformed Italian bankruptcy law, by taking into account EU Regulation No. 848/2015 (the Recast Bankruptcy Regulation), Commission Recommendation 2014/135 and the UNCITRAL principles on insolvency (the Reform), with the aim of rationalising and reorganising the legislative picture.

The Reform has introduced an ‘alert mechanism’ to be used at the first signs of bankruptcy to press the management of a company to intervene promptly in the event of a crisis. For this purpose, a special body to oversee the composition of business crises, an OCRI, is to be set up at every Chamber of Commerce. Thus, as soon as the crisis signals put in place by the new provisions are detected, a company’s board of statutory auditors and external auditors shall be responsible for reporting them first to the managing body and then, should the managing body fail to take any action, to the OCRI. The Italian National Institute for Social Security and the Italian Tax Authority shall also have similar obligations if a debtor reaches certain thresholds of indebtedness towards those organisations.

Specific amendments have also been introduced to the Civil Code, to increase the liability of a company’s managing body, in light of its duty to give a proper structure to the company, to avoid a crisis occurring or to intervene promptly in the event of a crisis, as well as a specific duty to protect the company’s assets. Moreover, the Reform has widened the circumstances in which a company has a duty to appoint a supervisory body or a statutory auditor.

The Reform has also provided stricter requirements for access to the pre-bankruptcy composition procedures. Furthermore, the appointment of a specialist judge for minor bankruptcy cases is being considered.
The Reform has also filled an important gap in the current Italian legislation, by introducing a specific discipline applicable to the insolvent groups. In particular, the Reform has introduced the possibility for an insolvent group of companies to file a single application for debt restructuring agreement or for composition with creditors.

According to the new provisions, priority shall be given to those proceedings the aim of which is to overcome the crisis by carrying on the business as a going concern, provided that they are in the interest of creditors. The Reform, therefore, boosts debt restructuring arrangements and out-of-court debt restructuring plans.

The Reform has also introduced a special register, to be kept by the Ministry of Justice, including the names of all entities (either partnerships or companies) qualified to be appointed by the competent courts as trustees, liquidators or commissioners in insolvency procedures.

Except for a few provisions applicable as from 16 March 2019 (in particular the special register and the amendments to the Civil Code indicated above), the Reform shall enter into force on 15 August 2020. Therefore the insolvency procedures opened before that date shall continue to be governed by the previous rules outlined below.

ii Policy

The aim of insolvency proceedings is usually to liquidate an insolvent entrepreneur's assets with full discharge in terms of all creditors.

In recent years, alternative in-court and out-of-court arrangements have been introduced, with the purpose of facilitating the discharge of insolvent companies through compositions with creditors.

iii Insolvency procedures

Traditional Italian insolvency proceedings are formal and require the involvement of courts or other public authorities, regardless of the size of the bankruptcy estate. Consequently, they are usually lengthy and costly, the average duration currently being about seven years.³ Currently, under Italian law, the main insolvency procedures for rehabilitation or liquidation of a company are the following:

- bankruptcy;
- pre-bankruptcy composition; and
- debt restructuring arrangements.

Bankruptcy

Bankruptcy is a court-supervised procedure for the liquidation of an insolvent company's assets and distribution of the proceeds. It results in the company's dissolution. Bankruptcy applies to business undertakings, with the exception of state entities and small businesses.

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³ Official data updated as at April 2019 are reported by Cerved on https://know.cerved.com/wp-content/uploads/2019/04/OSSERVATORIO-chiusure.pdf. This article points out in particular that the average duration of insolvency procedures has significantly decreased over the years. On this subject, see also _Il nuovo diritto delle crisi d'impresa_, Alberto Jorio, Giuffré Editore, 2009.
The prerequisite for a declaration of bankruptcy is a irreversible state of insolvency. This exists where (1) the company is in default on its payment obligations, or (2) other evident indications exist that the company is unable to meet its current liabilities regularly.4

Pursuant to Article 15 of the Italian Bankruptcy Law, bankruptcy cannot be declared if the company’s overdue debt amounts to less than €30,000.

The petition for bankruptcy must be filed with the bankruptcy court of the district where the debtor has its ‘main place of business’ in Italy.

The delegated judge is appointed by the bankruptcy court at the time of adjudication. In the adjudication judgment, the bankruptcy court also appoints a bankruptcy receiver, an accountant or lawyer experienced in insolvency matters and enrolled on a special register maintained by the bankruptcy court. The bankruptcy receiver acts in conjunction with a creditors’ committee, consisting of three to five creditors appointed by the delegated judge, which has an advisory as well as a supervisory role in the bankruptcy procedure. The bankruptcy receiver fixes his or her seal on the assets of the bankrupt entity shortly after his or her appointment. He or she must prepare a liquidation plan within 60 days of the fixing of the seal and not later than 180 days after the bankruptcy judgment for the approval of creditors’ committee members.

The aforesaid plan must indicate the deadline for completing the liquidation of the assets, which in any case cannot go beyond two years from the filing of the judgment declaring bankruptcy, unless the receiver deems it necessary to ask for a longer term and, therefore, specifically justifies this request.

From the time of the adjudication, the debtor is dispossessed. The bankruptcy receiver manages and disposes of the assets under the direction of the delegated judge. The debtor may no longer act in court validly as plaintiff or defendant in relation to the assets. The bankruptcy receiver is vested with such powers upon the authorisation of the delegated judge. However, all pending proceedings in which the debtor is involved are automatically stayed from the date the adjudication is issued.

From the date of the adjudication, no attachment, garnishment or other enforcement action may be initiated or continued against assets of the bankrupt estate. Where such actions have been commenced prior to adjudication, they will be automatically stayed and absorbed in the bankruptcy procedure.

Creditors are required to submit their proofs of claim at least 30 days before the hearing for the verification of the claims. At the hearing, the delegated judge either admits or rejects the claims. Once a review of all claims is completed, the delegated judge issues a statement of liabilities by decree. Creditors may challenge the decree both in connection with their own and other creditors’ claims before the bankruptcy court.

If proofs of claim are submitted later than 30 days before the hearing, they are considered ‘late claims’; however, no late claims are entertained that are submitted later than one year after the judge’s decree issuing the statement of liabilities. Late-admitted creditors share only in distributions made after the time of admission.

By default, adjudication involves the cessation of all the activities of the company with a view to a sale of all assets. However, the bankruptcy court may order that business operations be continued whenever cessation could cause ‘serious harm’, provided that the continuation

4 As regards the non-reversibility of the state of insolvency see, among others, Il fallimento e le altre procedure concorsuali, Luciano Panzani, UTET, 2012, and Italian Supreme Court, Judgment No. 4455 dated 28 March 2001.
does not adversely affect the creditors of the bankrupt debtor. As an alternative, the delegated judge may, with the consent of the representatives of the creditors, authorise the lease of the business as a going concern to a third party. This can be authorised whenever useful for the purpose of eventually selling the business under more favourable terms.

Finally, the business of the bankrupt company could be sold to a third party en bloc as a going concern, rather than through a sale of the individual assets that comprise it.

A fundamental principle of the Italian Bankruptcy Law is the equal treatment of all creditors (*par condicio creditorum*), according to which, absent statutory priorities, no creditor may be paid a higher percentage of his or her claim than other creditors. As a consequence, any transaction or payment that has the effect of putting a creditor into a better position than it would otherwise have been as compared with other creditors amounts to a violation of the *par condicio* principle and, therefore, potentially subject to clawback actions.

The statute of limitations for initiating clawback action proceedings is three years from the declaration of bankruptcy or, if earlier, five years from the act or transaction to be clawed back. A few exemptions from clawback are specifically provided for by the Bankruptcy Law.

Note that the equality principle described above applies only to those creditors who have an unsecured and non-preferred claim. There are in fact two groups of creditors that enjoy preferential treatment: creditors who hold a security interest and creditors who have a preference under law.

Once all the assets have been liquidated and the relevant payments made to creditors, upon request of the bankruptcy receiver or of the debtor, the bankruptcy court declares the bankruptcy closed and the company ceases to exist. 5

**Pre-bankruptcy composition**

Pre-bankruptcy composition is a court-supervised procedure, the purpose of which is to discharge a debtor’s debts and avoid bankruptcy. The debtor must submit a plan, which can provide for:

a. the restructuring or discharge of debts in whatever form, including transfer of assets, assumption of debts or any other transaction, including the sale of assets to creditors in satisfaction of their claims, the issuance of shares, quotas or bonds (including convertibles) or other financial instruments;

b. the transfer of the assets to a third party (*assuntore*) who also assumes the debt, or to creditors of the debtor (or subsidiaries of such creditors), or to new companies to be established during the course of the procedure, the shares of which are allocated to the creditors, and which can act as *assuntore*; and

c. the division of creditors into classes based on criteria (such as legal position, economic interests, etc.).

A pre-bankruptcy composition plan is available to debtors who are in a ‘state of crisis’ (which can be, but is not necessarily, insolvency). 6

To strengthen the position of unsecured creditors, Article 160 of the Italian Bankruptcy Law provides that the pre-bankruptcy proposal shall have to grant the payment of at least

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20 per cent of the unsecured creditors’ claims. This provision does not apply to pre-bankruptcy proposals that contemplate business continuation pursuant to Article 186 bis of the Italian Bankruptcy Law.

The pre-bankruptcy composition plan must be submitted to the bankruptcy court of the district where the debtor has its main place of business in Italy.

The debtor must attach to the petition, among other things, a plan containing an analytical description of the necessary means and timing for the implementation of the proposal. The restructuring plan and the documents indicated above must be accompanied by a report drawn up by a qualified professional (one who is enrolled on the register of auditors and satisfies certain requisites), who is appointed by the debtor and who certifies the truthfulness of the company’s data and the feasibility of the restructuring plan.

Moreover, to give the company in distress more time to prepare a viable pre-bankruptcy proposal, it is also provided that the debtor may file an application for the composition with creditors simply attaching the three most recent financial statements, postponing to a later time the filing of the proposal, the plan and the other documents to be annexed thereto.

These other documents must be filed within a term fixed by the delegated judge (between 60 and 120 days). This term can be extended by no more than an additional 60 days. During this period, creditors are prohibited from starting or continuing enforcement and foreclosure proceedings over the debtor’s assets (the automatic stay). The automatic stay will be extended for the whole period of the procedure if the debtor is admitted to the pre-bankruptcy composition.7

If the bankruptcy court determines that the conditions are met, it will start the procedure, appoint a delegated judge and judicial commissioner, and schedule a creditors’ meeting within 120 days. On that occasion, the unsecured creditors are called to vote on the proposal.8

The pre-bankruptcy composition plan is approved if the proposal obtains the favourable vote of the majority of the unsecured creditors.

After the creditors’ approval, the bankruptcy court homologates the pre-bankruptcy composition plan and appoints one or more liquidators to fulfil the approved plan, if it has to be realised by means of a transfer of assets.

In cases of breach of the pre-bankruptcy composition plan or fraud, bankruptcy may follow, at the behest of the bankruptcy court.

If the pre-bankruptcy composition plan is implemented, the debts are discharged and the debtor may return to ordinary operations (if the assets of the company are still in his or her possession).

Claims arising in the course of the implementation of the plan – either before or after homologation (conditional upon the bankruptcy court confirming such priority in the decree of admission) – are granted highest priority and must be paid in full.

A debtor may also, subject to bankruptcy court approval:

a enter into first priority financing agreements to support the plan, even before having produced all the documentation to be filed with the request of pre-bankruptcy;

b according to Decree No. 83/2015, obtain urgent interim finance that is necessary for their business needs without having to file a certification issued by an independent expert; and

7 For further information on this special type of pre-bankruptcy procedure, see Il concordato con riserva, Edoardo Staunovo-Polacco, Giuffrè Editore, 2016.

8 Secured creditors do not vote, as they have priority over the proceeds of the sale of their security.
c pay pre-existing claims relating to the purchase of goods and services, to the extent that the expert confirms that the purchase is essential for the continuation of the business activity and to ensure the best satisfaction of creditors.

Throughout the procedure, the debtor remains in possession and retains management powers under the supervision of the judicial commissioner and the delegated judge.

The creditors must file a proof of claim with the judicial commissioner. Any disputes regarding these claims will be settled by the bankruptcy court. The creditors’ participation in the proceedings is crucial, since they have to vote for or against the debtor’s proposal at the creditors’ meeting.

The pre-bankruptcy composition plan can also include a tax settlement, applicable also to value added tax and unpaid withholding taxes.  

**Debt restructuring arrangements**

The Italian Bankruptcy Law allows for debt restructuring arrangements whereby a debtor ‘in a state of crisis’ enters into a composition with creditors that is binding on all the debtor’s creditors, provided that:

a the debt restructuring arrangement is agreed by creditors representing at least 60 per cent of the value of the debts; and

b the reasonableness and feasibility of the debt restructuring arrangements, the truthfulness of the company’s accounting data and the suitability of such arrangements to ensure repayment of those creditors that did not agree with the arrangements are certified by an independent expert, who fulfils the requirements established in Article 67 of the Italian Bankruptcy Law.

In any case, the debtor must guarantee the full satisfaction of creditors who have not approved the arrangements.

The Italian Bankruptcy Law does not mandate a specific format for the debt restructuring arrangement. The parties can freely determine the specific obligations and how these are to be performed. For example, they may include the waiver of interest, guarantees, total or partial transfer of assets, different treatments between different classes of creditors or simple rescheduling.

The debt restructuring arrangement is subject to homologation. If the bankruptcy court does not homologate the debt restructuring arrangement, it does not automatically declare the bankruptcy of the debtor, as ‘state of crisis’ does not necessarily amount to insolvency.

During the phase of the filing with the court of the request for a formal confirmation of the debt restructuring arrangement, the company may request court permission to obtain new credit, which would be granted first priority and which may also be secured through pledge, mortgage or by an assignment of receivables by way of security. An opinion of an expert, certifying that the credit is ‘functional to the best satisfaction of creditors’, is required.

Debt restructuring arrangements can also include a tax settlement, applicable also to value added tax and unpaid withholding taxes.  

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9 For further details on tax settlement, see *La transazione fiscale*, Mario Cardillo, Aracne, 2016.

10 A more in-depth analysis of debt restructuring arrangements may be found in *Gli accordi di ristrutturazione dei debiti*, Carlo Trentini, Ipsoa, 2012.

11 See footnote 9, above.
iv  **Starting proceedings**

Bankruptcy procedure is started on the basis of a petition which may be filed by (1) the debtor itself, (2) the public prosecutor or (3) a creditor.

A different regime is, of course, provided for pre-bankruptcy procedure, composition with creditors and restructuring arrangements, which may only be started by the initiative of the debtor himself or herself.

v  **Control of insolvency proceedings**

During bankruptcy proceedings, the debtor is deprived of the authority to manage and dispose of its assets; these powers are delegated to a bankruptcy receiver under the direction and supervision of the delegated judge. The judge must approve any extraordinary transactions proposed by the official receiver and appoints a creditors’ committee.

In a composition with creditors, the company is controlled by its management during the whole procedure, even if there is still a supervision of the judicial commissioner (usually an accountant or a lawyer having the powers of a public officer). To carry out specific extraordinary transactions, however, court approval is always required. Finally, in debt restructuring arrangements, the debtor continues to control its business.

vi  **Special regimes**

**Forced administrative liquidation**

Forced administrative liquidation is a special bankruptcy procedure provided by the Bankruptcy Law that applies, in particular, to insurance companies, credit institutions (banks, investments firms, fund management companies, open-end investment companies and financial intermediaries), cooperative companies, trusts and auditing companies, cooperative consortia granting public contracts and mandatory consortia. Its aim is to liquidate the debtor.

The procedure may be started by a debtor, the directors of an insolvent company, or one or more creditors. The bankruptcy court must seek the advice of the government agency responsible for supervising the debtor’s company. The judge may initiate proceedings by declaring the debtor insolvent and appointing a liquidator. All legal actions started by creditors against the debtor are then stayed.

The liquidator is assisted by a supervisory committee consisting of between two and five experts from the debtor’s industry. In the case of large businesses, up to three liquidators may be appointed. Unlike other procedures, there is no delegated judge, as the procedure is mainly administrative in nature.

The liquidator must review claims and consider whether a composition is feasible. If so, he or she will prepare a plan of repayment with the debtor, to be submitted to the creditors. If a composition does not appear feasible, arrangements are made for the disposal of the debtor’s assets and the distribution of proceeds among the creditors in the same order of priority as in bankruptcy.\(^\text{12}\)

\(^{12}\) For more details on this special procedure, see *Trattato delle procedure concorsuali – Vol. V: L’amministrazione straordinaria e la liquidazione coatta amministrativa*, Lucio Ghia, Carlo Piccininni, Fausto Severini, Utet Giuridica, 2011.

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Extraordinary administration

Extraordinary administration, which is regulated by Law No. 270 of 8 July 1999 (the Prodi-bis Law), applies only to companies (and their affiliates) that had at least 200 employees in the previous year and with total liabilities of at least two-thirds of either their total assets or their turnover in the previous financial year. According to Article 27 of Law No. 270, this procedure is open solely to companies that demonstrate ‘concrete possibilities of recovery of economic balance of their activities’.

According to the Reform, effective from 16 March 2019, the business specialised section of the court located where the company has the centre of its main interests shall be competent in respect of extraordinary administration.

The procedure is in two phases.

The first is mainly focused on ascertaining the requisites for the admission of the debtor to this special procedure and is aimed at a declaration of the state of insolvency. In its judgment, the specialist court:

- appoints the delegated judge who will supervise the procedure and one or three judicial commissioners;
- sets the deadline for the creditors to present their proofs of claim and the date of the hearing at which those claims will be examined by the delegated judge; and
- decides whether the management of the insolvent company should remain with the debtor or pass to one or three judicial commissioners.

A declaration of the state of insolvency produces certain immediate effects, such as the automatic stay of all legal actions by creditors against the debtor’s assets and the freezing of the accrual of interest.

The second phase results in the admission of the insolvent company either to the extraordinary administration procedure or to adjudication in bankruptcy. No later than 30 days from the filing of the judicial commissioner’s report, and taking into account the opinion of the Ministry of Economic Development, the specialist court, should the conditions provided by Law No. 270 be met, declares the opening of the procedure. Otherwise, it declares the debtor company bankrupt. Should the company be admitted to the procedure, the stay of actions continues and clawback actions become possible.

The extraordinary commissioners are empowered to manage the company and its assets under the supervision of the Ministry of Economic Development. They act on the basis of a recovery plan prepared by them and authorised by the Ministry.

Any debts incurred in the continuation of the business generally will have priority over any other secured and unsecured claim pursuant to Article 111 of the Bankruptcy Law.

Creditors can file their proofs of claim and have a right to distribution of proceeds.

Should the recovery programme underpinning the transfer of the business be completed within the term set, the specialist court, upon request of the extraordinary commissioners or ex officio, declares the closing down of the business. The extraordinary administration can at any time be converted into bankruptcy upon request by the extraordinary commissioner, or even ex officio, if the procedure cannot positively be continued. At the end of the procedure, the specialist court will declare the conversion of the procedure into bankruptcy when either the sale of the assets has been not performed within the term stipulated in the programme, or the business has not recovered its ability to regularly perform its obligations.

In the wake of the Parmalat case, the Marzano Decree (Law Decree 347/2003) introduced a faster procedure aimed at saving and turning around large insolvent companies.
to preserve their technical, commercial, productive and employment value. This procedure restructures the company’s debts and sells those assets that are not strategic or do not form part of the company’s core business.

The procedure is focused on restructuring rather than on the liquidation of the debtor’s assets. It is based on the implementation of a two-year recovery plan subject to the minister’s approval.

The recovery plan can provide for the satisfaction of creditors’ claims through a composition, which must specify any conditions of its implementation and describe any offered guarantees.¹³

vii Cross-border issues

On 20 May 2015, the European Parliament and the Council enacted EU Regulation No. 848/2015 (the Recast Bankruptcy Regulation), which entered into force on 25 June 2015 and is applicable to insolvency proceedings starting from 26 June 2017, with few exceptions. The new rules also apply to proceedings that provide for the restructuring of a debtor, the ‘hybrid proceedings’, for example the Italian debt restructuring arrangements pursuant to Article 182 bis of the Bankruptcy Law.

This reform does not change the main framework of cross-border insolvency proceedings as set out under Council Regulation (EC) No. 1346 of 29 May 2000 (the EC Bankruptcy Regulation), but anyway introduces some important changes. The ‘centre of the debtor’s main interests’ pursuant to Article 3 of the EC Bankruptcy Regulation – according to which the court of the Member State within the territory of which the centre of the debtor’s main interests is situated is competent to commence the main insolvency proceedings – has been more precisely defined as ‘the place where the debtor conducts the administration of its interests on a regular basis and that is therefore ascertainable by third parties’.¹⁴

Another important amendment is set forth in Article 4 of the Recast Bankruptcy Regulation, stating that the court before which a request to start insolvency proceedings has been filed shall have to examine ex officio whether it has jurisdiction on the case. Should the court decide to open the proceedings, it shall have to specify in its decision if the proceedings are the main proceedings or secondary proceedings, pursuant to Article 3.

Immediate recognition of foreign bankruptcy judgments and measures are denied by Italian courts (only) if they may produce effects that are contrary to Italian public policy, for example if they do not grant all creditors equal treatment.¹⁵

Where the EC Bankruptcy Regulation is not applicable, the Italian Bankruptcy Law applies. Article 9, Paragraph 1 thereof provides that bankruptcy can be declared by the court

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¹³ See footnote 12.
¹⁴ UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation, Glossary, Paragraph 2(c).
¹⁵ Italian Supreme Court, Judgment No. 12,031 of 19 December 1990. Italian legal commentators distinguish between ‘international public policy’ (which refers to the general principles that are universally enforceable, namely the inviolable rights of the individuals) and ‘internal public policy’ (which includes the ethical, economic, political and social principles peculiar to the Italian legal system). Only the first is relevant with respect to the recognition of proceedings. Article 33 of the Recast Bankruptcy Regulation prevents any Member State from recognising an insolvency proceeding and enforcing a judgment relating to it if they are manifestly contrary to the relevant state’s public policy, ‘in particular to its fundamental principles or the constitutional rights and liberties of the individual’. It is worth underlining that Article 33 contains a general definition of ‘international public policy’, which is deemed to be a fundamental principle of any Member State, as well as the constitutional rights and liberties of the individual.
in the place where the debtor has its main office. To give emphasis to the notion of ‘main office’, Italian case law does not make reference to the place where the productive activity is usually carried out, but to the management centre of the business (i.e., the place where the business decisions of the company are taken).

Pursuant to Article 9, Paragraph 2, the transfer of the registered office of a company in the year prior to the filing of a petition for bankruptcy is disregarded for the purpose of determining the venue and jurisdiction of the bankruptcy proceedings of the company.

According to Article 9, Paragraph 3, the debtor who has its main office abroad can be declared bankrupt in Italy, even if a declaration of bankruptcy has been rendered abroad. Furthermore, the relocation of the business to a foreign country does not exclude the jurisdiction of Italian courts, if it occurred after the filing of a petition for bankruptcy or the request of the public prosecutor.

II Insolvency Metrics

During the first three months of 2019, we witnessed a downward trend in bankruptcies – the number registered was the smallest in the past 10 years. In general, about 2,823 companies were declared bankrupt, 6.5 per cent fewer than in the first quarter of 2018 and well below the 3,700 recorded in 2016. Many of the companies who went bankrupt during the past year are located in the centre and north-east of Italy (most particularly in the regions of Veneto, Marche and Umbria).

However, the number of pre-bankruptcy procedures has increased (25 per cent more than last year), including the voluntary liquidation of companies in bonis (more than 17,000 companies have been closed by voluntary liquidation, which is 6.2 per cent more than last year).16

III Plenary Insolvency Proceedings

The following examples are some of the most significant insolvency procedures that have been opened in recent years. The last three cases demonstrate very clearly the serious difficulties currently faced by real estate companies in Italy.

i Ilva SpA

Ilva SpA is a company engaged in the production, processing and marketing of steel products. It is the biggest steel plant in Italy and one of the largest steel producers in Europe. By decree of the Minister of Economic Development of 21 January 2015, Ilva was admitted to an extraordinary administration procedure. The company was subsequently declared insolvent by judgment of the Court of Milan. Messrs Corrado Carrubba, Piero Gnudi and Enrico Laghi have been appointed as official receivers for the company. By decree issued on 30 June 2017, the assessment of Ilva’s credits has been declared final and enforceable by the Court of Milan. The procedure is still ongoing.

ii Alitalia SpA
Alitalia SpA is a company based in Italy and engaged in the aviation sector. As of 29 July 2009, Alitalia is the top airline for domestic flights in Italy. By decree of the Minister of Economic Development of 2 May 2017, Alitalia was admitted to an extraordinary administration procedure provided by Law Decree 347/2003. By judgment of the Court of Civitavecchia dated 11 May 2017, Alitalia was declared insolvent. Messrs Luigi Gubitosi, Stefano Paleari and Enrico Laghi have been appointed as official receivers for the company. The procedure is still ongoing.

iii Grandi Molini Italiani SpA
Grandi Molini Italiani SpA is the biggest producer of soft wheat flour and durum wheat semolina in Italy and one of the biggest in Europe. Through a petition filed on 3 November 2015, the company requested authorisation to enter into a composition with creditors pursuant to Article 161 of the Bankruptcy Law. By decree issued by the Court of Rovigo on 5 November 2015, the company received the court's approval, and Ms Stefania Traniello Gradassi and Messrs Stefano Ambrosini and Carlo Salvagnini were appointed by the court as commissioners. The procedure is still ongoing.

iv Borsalino Giuseppe & Fratello SpA
Borsalino Giuseppe & Fratello SpA is a luxury Italian hat maker, founded in 1857. Through a judgment issued on 14 December 2017, the company was declared bankrupt by the Alessandria Bankruptcy Court. The first hearing for the examination of the creditors’ claims was held on 17 April 2018. The procedure is still ongoing.

v Acqua Pia Antica Marcia SpA in liquidation
Acqua Pia Antica Marcia SpA is an important real estate group of companies with headquarters in Rome. The group operates in the airport, construction and tourism sectors and includes the first real estate company founded in Italy. It handles five national airports (Milan Malpensa, Milan Linate, Venice, Bologna and Catania). It also develops residential and commercial centres, with a focus on the reconstruction of the architecture of old disused industrial sites. Finally, it manages several luxury hotels (e.g., Grand Hotel Villa Igiea, Grand Hotel et Des Palmes, San Domenico Palace Hotel, Excelsior Palace Hotel and Excelsior Grand Hotel, in Sicily). By decree issued on 3 July 2013 by the Court of Rome, the company was authorised to enter into a composition with creditors pursuant to Article 161 of the Bankruptcy Law. At the same time, all subsidiaries filed analogous requests and were authorised to start a pre-bankruptcy procedure.

Following approval by the creditors, the pre-bankruptcy composition plan filed by the company was homologated by the Rome Bankruptcy Court on 17 December 2014, which appointed a liquidator to fulfil the approved plan. The procedure is still ongoing.

vi Porta Vittoria SpA
Porta Vittoria SpA was founded in 2005. The company owned and operated the Porta Vittoria project, one of the most important real estate development projects in Italy, covering an area of about 42,000 square metres and including both commercial and residential buildings, offices and one hotel. Through a judgment issued on 29 September 2016 by the
Milan Bankruptcy Court, the company, whose debts amounted to about €400 million, was declared bankrupt. The first hearing for the examination of the creditors’ claims was held on 20 February 2017. The procedure is still ongoing.

vii Astaldi SpA

Astaldi SpA is part of an international construction group with a leading position in Italy and is one of the top 100 international contractors.

Through a petition filed on 28 September 2018, the company requested authorisation to enter into a composition with creditors pursuant to Articles 161 and 186 bis of the Bankruptcy Law with business continuity. By a decree issued by the Court of Rome on 18 October 2018, the company was granted a deadline to file the necessary documentation to be evaluated by the Court with a view to admission to a pre-bankruptcy procedure (i.e., the financial documents and the proposed plan to be approved by the creditors).

The Court of Rome appointed Messrs Stefano Ambrosini, Vincenzo Ioffredi and Francesco Rocchi as commissioners with the aim of monitoring the company’s activities.

Astaldi SpA is waiting to receive the Court’s approval of the filed pre-bankruptcy plan.

IV ANCILLARY INSOLVENCY PROCEEDINGS

Ancillary or secondary proceedings may be opened in Italy in the event that the main insolvency proceedings are pending in another EU Member State, subject to the EC Bankruptcy Regulation (see Section I.vii).

V TRENDS

At this very early stage we cannot foresee the effects of the Reform, but the expectation is that, once the Reform comes fully into force on 15 August 2020, debt restructuring arrangements and out-of-court restructuring plans will increase, and the number of bankruptcy procedures should decrease.

Moreover, in general, we expect bankruptcy and pre-bankruptcy procedures to decrease, considering that the pre-alert mechanism that will be introduced should allow companies to intervene at the first signs of bankruptcy and thus to prevent insolvency. One of the main underlying purposes of the Reform is in fact to compel the management body of a company to deal promptly with a potential crisis.
LUXEMBOURG

Clara Mara-Marhuenda, Sébastien Binard and Grégory Minne

I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law
Insolvency proceedings in Luxembourg are governed by the following legislation.

General insolvency regime
a the Law of 14 April 1886 on composition with creditors, as amended;
b the Grand Ducal Regulation of 24 May 1935 on controlled management;
c the Code of Commerce, which deals more specifically with stays of payments and bankruptcy proceedings; and

Main special insolvency regimes
a Banks and professionals of the financial sector: Law of 18 December 2015 on resolution, recovery and liquidation measures of credit institutions and some investment firms, on deposit guarantee schemes and indemnification of investors.
b Insurance and reinsurance companies and pension funds: Law of 7 December 2015 on the insurance sector, as amended.
c Regulated investment funds and fund managers:
• Law of 17 December 2010 relating to undertakings for collective investment (UCIs), as amended;
• Law of 13 February 2007 on specialised investment funds, as amended;
• Law of 15 June 2004 on the investment company in risk capital (SICAR), as amended;
• Law of 23 July 2016 on reserved alternative investment funds (RAIF); and
• Law of 12 July 2013 on alternative investment fund managers.
d Regulated securitisation entities: Law of 22 March 2004 on securitisation, as amended.

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The insolvency procedures provided for under Luxembourg law may be divided into those intended to preserve the business of the debtor (i.e., stay of payments, controlled management and composition with creditors) and procedures intended to wind up and realise the assets of the debtor (i.e., bankruptcy and compulsory liquidation).³

Each procedure is further analysed under Sections I.iii and III.vi, below, with the substantive provisions of Luxembourg insolvency law relating thereto.

ii Policy

Luxembourg insolvency law boasts three specific reorganisation procedures, which are essentially designed to keep failing businesses operating and to facilitate their restructuring into proper going concerns; however, in practice, there have been few cases of these procedures being opened. For instance, there have been just over 100 cases of controlled management in the past 25 years, roughly half of which ended up in formal bankruptcy proceedings.⁴ Neither have there been any cases of composition with creditors nor of stays of payments (relating to general commercial or holding companies)⁵ during this time.

There are many reasons for this situation, although it may be more a case of inadequacy of the available instruments for restructuring distressed businesses than the authorities’ willingness to favour bankruptcy and liquidation procedures over reorganisation measures. One of the obstacles to resorting to reorganisation procedures is the requirement generally expressed by the Luxembourg courts that, at the time of the opening of the reorganisation proceedings, the distressed business should still have sufficient assets to settle the estimated costs of the restructuring process, which is not always realistic. The formal conditions for allowing procedures such as compositions with creditors are also too restrictive, as – for example – the approval of a majority (in number) of the creditors representing at least three-quarters of the debts (i.e., a fairly high threshold) is mandatory.

Importantly, the courts are also entitled to verify at any time during the processing of a request for controlled management proceedings, or during the course of the reorganisation itself, whether the conditions for opening formal bankruptcy proceedings are met and, under such circumstances, to declare the debtor bankrupt ex officio.⁶ Finally, a business in whose name acts of gross negligence or fraud have been committed would typically be denied the benefit of reorganisation measures.⁷

The Luxembourg courts have so far dealt with more formal bankruptcy (i.e., liquidation) proceedings than reorganisation measures, but a change appears to be imminent.

A significant number of bankruptcies (which rose from the 935 in 2017 by more than 27 per cent in 2018 to a record 1,195),⁸ and the general public acknowledgement of a shortage of appropriate instruments to deal with companies experiencing financial difficulties, led the

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³ Article L-1200-1 of the Law on Commercial Companies dated 10 August 1915, as amended, provides for an additional compulsory liquidation procedure that may be opened by the district court at the initiative of the public prosecutor in the event of substantial breach of this law. This procedure, being unrelated to the solvency of the company in relation to which it is opened, is not analysed in this chapter.


⁵ There have, however, been some cases with regard to regulated entities (see Section I.vi, below).

⁶ See Luxembourg Court of Appeal, 26 July 1982, Moyse.

⁷ See Luxembourg Court of Appeal, 17 February 1982, Reding et Kunsch and Luxembourg Court of Appeal, 10 February 1982, Paragraphs 25, 301.

government to act and propose an ambitious reform of Luxembourg insolvency law as part of its programme for 2009 – under which ‘efforts will be made to favour reorganisations over liquidation’.9 This proposed change of policy was debated by the Chamber of Deputies in February 2011, where it was expressed that ‘in a period of crisis, the creation of appropriate instruments to deal with businesses facing financial difficulties became a matter of national priority that could not be overlooked’.10

So far, the government’s work on this matter has resulted in Draft Bill No. 6539 on business preservation and modernisation of bankruptcy law, dated 26 February 2013. The legislative process is continuing; the latest amendments to the project were published on 6 March 2018 (see Section V.iii for further discussion about this draft legislation).

Finally, during the period from the financial crisis of 2008 to date, Luxembourg courts have resorted more to stay of payments proceedings in the form applicable to regulated entities, which were opened in some notable cases.11

### iii Insolvency procedures

#### Main proceedings

The procedures available in Luxembourg under the general insolvency regime are (1) compositions with creditors, (2) controlled management proceedings, (3) stays of payments (which all fall within the category of reorganisation procedures (i.e., with the aim of restructuring a business experiencing financial difficulties rather than winding it up)), and (4) bankruptcy proceedings, which essentially involves a liquidation procedure (i.e., a procedure involving the realisation of the assets of the debtor with a view to settling the debtor’s liabilities, either in full or, if there are insufficient assets, in part).

All the foregoing insolvency procedures are judicial procedures, which means they are all subject to the control of the district court of competent jurisdiction.

#### Compositions with creditors

A company against which bankruptcy proceedings have been initiated may avoid a declaration of bankruptcy through the approval by the district court of a voluntary arrangement between the debtor and its creditors. Once approved, the voluntary arrangement is binding upon all creditors but will only be applied to the commitments made before the arrangement.

#### Controlled management

A company that is not bankrupt may request that a controlled management procedure be initiated, under which the management of the company is placed under the control of one or more commissioners designated by the court. The aim of an application for controlled management is to allow either a reorganisation or an orderly winding up of a company. Creditors are asked to vote on a reorganisation or liquidation plan, which, if approved, is enforceable against all creditors. Finally, creditors’ enforcement rights are suspended for the duration of the controlled management.

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9 Luxembourg 2009 government programme, p. 108.
11 See, for example, failed banking institutions Lehman Brothers (Luxembourg) SA, Landsbanki Luxembourg SA, Glitnir Luxembourg SA and Kaupthing Bank Luxembourg SA in 2008–2009, and more recently ABLV Bank.
Stay of payments

A stay of payments may be granted when a company is suffering temporary liquidity problems, preventing them from settling their due and payable liabilities. As in the case of controlled management, the board of directors (or relevant management body) of the debtor stays in place during the proceedings but acts under the supervision of a commissioner. Creditors’ rights are suspended for the duration of a stay of payments.

Bankruptcy

Bankruptcy proceedings are governed by Article 437 et seq. of the Luxembourg Code of Commerce and result in the winding up of a company in relation to which proceedings have been opened and the recovery of value from its underlying business or assets (if any).

Once bankruptcy proceedings have been opened, the members of the board of directors (or relevant management body) are discharged from their duties and replaced by one or more court-appointed receivers, who administer and realise the debtor’s assets and then distribute the proceeds to the creditors according to the order of priority provided for by law. All enforcement actions carried out by unsecured creditors are suspended. Beneficiaries of in rem security over assets of the bankrupt company, which are governed by the Law of 5 August 2005 on financial collateral arrangement, may enforce their rights despite the existence of the bankruptcy proceedings.

Certain ‘abnormal’ transactions (e.g., payments of non-matured debts or transfers of assets for no actual consideration) entered into by the company will be declared null and void if they have been performed during the ‘hardening period’, which starts at the moment when the company is presumed to have ceased paying its creditors, or during the 10 days prior to the hardening period. The starting point of the hardening period may at the earliest be set at a date six months prior to the bankruptcy judgment.

Agreements entered into by the debtor are not automatically terminated, except those contracted intuitu personae with regard to the debtor and those including a clause of early termination upon insolvency.

Luxembourg law does not set out any mandatory timing in respect of the liquidation of a bankrupt company, which typically takes between several months and several years, depending on the size and complexity of the business.

Ancillary proceedings

Ancillary or secondary proceedings may be opened in Luxembourg in the event that main insolvency proceedings are pending in another EU Member State, subject to the provisions of Council Regulation (EC) No. 848/2015 on insolvency proceedings. These proceedings will be restricted to the assets of the debtor located in Luxembourg.

12 Code of Commerce, Article 593.
14 Code of Commerce, Article 442.
15 Courts most often set the hardening period to six months, unless positive evidence is brought that payments ceased at a later time.
16 Council Regulation (EC) No. 848/2015 on insolvency proceedings, Article 34 et seq.
In main insolvency proceedings opened in a foreign non-EU jurisdiction with respect to a Luxembourg company, Luxembourg courts would, in principle, not agree to open ancillary proceedings in Luxembourg on the basis of the ‘unity of the bankruptcy’ principle resulting from case law, according to which the main effects of the foreign bankruptcy will automatically apply to the debtor. To give effect to the enforcement measures contained in the foreign judgment in relation to assets located in Luxembourg, however, recognition (exequatur) proceedings will be necessary in Luxembourg.

iv Starting proceedings

Since composition proceedings and stays of payments (under the general insolvency regime) have hardly ever been used in Luxembourg, this section is limited to an analysis of controlled management and bankruptcy proceedings.

Controlled management

Controlled management may only be applied for by the debtor and will be granted if the district court of competent jurisdiction deems that (1) the credit of the debtor is undermined, (2) the settlement in full of the debtor’s liabilities is in jeopardy, and (3) controlled management allows the recovery of the debtor’s business or improves the position of the debtor in respect of the sale of its assets. Case law considers that a debtor must also act in good faith when making a request for an order of controlled management.

Bankruptcy

A commercial company is considered bankrupt if (1) it can no longer pay its debts as they fall due, and (2) it can no longer raise credit. These two conditions must be met cumulatively. A company may only be declared bankrupt by the district court of competent jurisdiction. The decision can be taken on the petition of the company itself, one or more creditors (with respect to a due and payable claim for which a judgment has been notified to the debtor) or the district court, on its own initiative. Most bankruptcy decisions are taken upon petition of creditors, which, in 90 per cent of cases, are public authorities.

Companies that meet the above-stated criteria must file for bankruptcy within one month of the cessation of payments. Failure to do so will create a liability risk for the board of directors (or relevant management body). If the court deems that a bankruptcy situation exists, it will declare the company bankrupt and appoint a receiver who will, inter alia, manage the affairs of the company in bankruptcy and represent the interests of the creditors of the company, generally.

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18 ibid.
19 Grand Ducal Regulation of 24 May 1935 on controlled management, Article 1.
20 See Luxembourg Court of Appeal, 17 February 1982, Reding et Kunsch and Luxembourg Court of Appeal, 10 February 1982, Paragraphs 25, 301.
21 Code of Commerce, Article 437.
22 Code of Commerce, Article 442.
23 Draft Bill on Business Preservation and Modernisation of Insolvency Law, No. 6539, p. 5.
24 Code of Commerce, Article 440.
v Control of insolvency proceedings

This section is limited to an analysis of controlled management and bankruptcy proceedings, given the limited number of compositions with creditors and stays of payments.

Controlled management

As with composition proceedings, the court will delegate one of its judges to examine a debtor’s affairs and determine whether there are realistic prospects for a reorganisation. If, after having reviewed the delegated judge’s report, the court comes to the conclusion that reorganisation is possible, it will grant the application for controlled management.25

The court will then appoint one or more commissioners, who do not replace the company’s management body but supervise its actions. The members of such a body, therefore, continue to manage the company with a view to reorganising its affairs, subject to certain acts that may not be undertaken without the consent of the commissioners. After having heard the creditors and reviewed the debtor’s situation, the commissioners will draw up their report, which will contain either a reorganisation plan or a liquidation plan. Creditors will then be convened to vote on the proposal, with the majority (in number) of creditors representing more than half of the debtor’s aggregate debts. The approved plan will finally need to be sanctioned by the district court.

Bankruptcy

The receiver appointed by the district court, having opened the bankruptcy proceedings, must manage the company in good faith during the proceedings under the supervision of a supervisory judge designated by the same court. The board of directors (or relevant management body) may no longer act on behalf of the bankrupt company as of the date of the bankruptcy judgment and, therefore, plays no active role in the administration of the bankruptcy, but the members of the management body are still obliged to assist the receiver whenever necessary.

Certain actions taken by the receiver will be subject to the approval of either the supervisory judge or the district court. The receiver may, for instance, proceed to the sale of movable or perishable assets of the debtor only with the prior authorisation of the supervisory judge in charge of the bankruptcy. The sale of other assets (non-perishable and immovable) require the approval of the district court, which will determine the conditions for such a sale following a report by the supervisory judge and a hearing with the debtor.26 Finally, after all proceeds of the assets of the bankrupt company have been distributed among the creditors, the receiver will submit a detailed report about the bankruptcy proceedings to the district court.

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25 If reorganisation is deemed not to be possible, a bankruptcy order would usually be made shortly thereafter.
26 Code of Commerce, Article 477.
Special regimes
The main special insolvency regimes under Luxembourg law are listed in Section I. The key differences between the general and special insolvency regimes are that creditworthiness issues are sufficient for opening proceedings under the special regimes and the courts have more freedom under the special regime than the general regime to determine the terms of the reorganisation or liquidation.

No special insolvency rules apply to corporate groups. 27

Banks and financial sector professionals
Two separate insolvency procedures are provided for under the Law of 18 December 2015, which may apply to credit institutions and professionals within the financial sector:

a. the stay of payments procedure, which will apply in the event that the creditworthiness of the relevant entity is impaired (whether or not it has ceased its payments) and has the aim of helping the entity to restore its financial situation by suspending all the payments due to its creditors; and

b. the judicial liquidation procedure, which will be applied in the event it becomes apparent that the stay of payments procedure did not restore the relevant entity’s financial situation or when the entity is undermined to such an extent that it may no longer meet its commitments. 28

Stay of payments
A stay of payments, which may be viewed as an observation phase prior to the commencement of formal liquidation proceedings, may only be applied for by the national financial sector regulator, the CSSF, 29 or by the relevant entity itself. This request will automatically result in the suspension of all payments by the entity and a prohibition on the entity taking any action without CSSF consent, with the exception of safeguarding measures.

If the district court considers the conditions for a stay of payments to be fulfilled, it will rule accordingly and determine the period for which the stay of payments will be granted (a maximum of six months), 30 as well as the terms of the stay. The court will also appoint one or more provisional administrators, who will monitor the entity’s estate and will need to approve any action in respect of the distressed entity, failing which any such actions will be deemed null and void.

27 Parent companies and subsidiaries are separate entities to which independent insolvency proceedings apply. However, Luxembourg courts may consolidate the assets of two companies in the event that those companies are actually managed as a single entity, and consider that these companies represent a single legal entity for the purposes of the insolvency proceedings.
28 Professionals of the financial sector (PFS) are all entities regulated by the Commission for the Supervision of the Financial Sector that are not banks (investment firms such as investment advisers, brokers in financial instruments or wealth managers), specialised PFS (e.g., registrars, custodians, regulated markets operators or debt-recovery professionals) and support PFS (pursuing an activity related to a financial sector activity (e.g., domiciliation agent or IT operator for the financial sector).
29 Commission de Surveillance du Secteur Financier.
30 Law of 18 December 2015, Article 122(10). Note, however, that in a more recent case involving Kaupthing Bank Luxembourg SA, the district court agreed to extend the initial stay of six months by a further two months.
Judicial liquidation

If the conditions for a judicial liquidation procedure to be opened are met, a request may be made for such purposes by the CSSF or the public prosecutor.

In the event that the district court orders a judicial liquidation, it will appoint a supervisory judge and one or more liquidators. It will then determine the terms of the liquidation, in particular, whether the extent to which the rules governing general insolvency proceedings should apply (which make judicial liquidation proceedings a flexible instrument). Finally, the liquidation decision will automatically result in the withdrawal of any licence to operate granted to the relevant entity by the CSSF.

Other regulated entities

Insurance companies

The insolvency regime applicable to insurance companies, reinsurance companies and pension funds, as provided for by the amended Law of 7 December 2015 on the insurance sector, substantially mirrors the regime applicable to banks and professionals of the financial sector (PFS).

Regulated investment funds, fund managers and securitisation entities

The insolvency procedures applicable to regulated investment funds, management companies and securitisation entities essentially take the same form as those applicable to banks and PFS: stays of payments and judicial liquidation proceedings. The main difference from the regime described above is that the stay of payments is automatically triggered by the withdrawal of the licence of the relevant entity by the CSSF. Judicial liquidation proceedings may be opened at the request of the CSSF or the public prosecutor following the withdrawal. Investors have no rights to request the opening of insolvency proceedings from Luxembourg courts.

vii Cross-border issues

Formal insolvency proceedings opened in an EU jurisdiction prior to 26 June 2017 were subject to Regulation (EC) No. 1346/2000 on insolvency proceedings. This Regulation generally consisted in a good and proven instrument, but there were some uncertainties, and constantly evolving case law in particular, around the key concept of the centre of main interests (COMI) of a debtor, which is used to determine which EU jurisdiction is entitled to open the main insolvency proceedings against such a debtor.

It could also be difficult to identify a debtor's COMI in certain cases, which called for a more precise definition of the concept to be adopted, notably to avoid undesirable forum shopping. The European Commission tackled this issue in the form of a proposal

31 Undertakings for collective investment operating as SICAVs (open-ended investment companies), SICAFs (closed-ended investment companies) or FCPs (mutual funds), SICARs (investment companies in risk capital) or SIFs (specialised investment funds).
32 They may, however, refer the situation to the CSSF, which may in turn withdraw an entity's licence if it deems that the conditions for such withdrawal have been met.

The main issues addressed by the Insolvency Regulation (recast) are:

a. extension of the scope of the Regulation to pre-insolvency and hybrid proceedings;
b. the amendment of the definition of the COMI and clarification of the circumstances in which the presumption that the COMI is located at the registered office of the debtor may be rebutted;
c. the ability of the courts to refuse the opening of secondary proceedings (which may cause practical difficulties and inefficiencies) if they are not necessary to protect the interests of local creditors;
d. the obligation on Member States to organise the publication of cross-border insolvency decisions in a publicly accessible national register and to provide for the interconnection of national insolvency registers; and
e. strict cooperation obligations bearing on courts and insolvency practitioners involved in the insolvency of a corporate group.

Concerning insolvency proceedings opened in a non-EU jurisdiction, the ‘unity of the bankruptcy’ principle applicable in Luxembourg would result in the main aspects of those proceedings automatically applying to the debtor, with no possibility of opening ancillary proceedings in Luxembourg. This has the advantage of resolving most conflicts of jurisdiction between Luxembourg and foreign jurisdictions, but there could be instances when the rights of creditors (e.g., employees) would be better protected if the Luxembourg courts were entitled to open territorial proceedings.

II INSOLVENCY METRICS

Luxembourg’s economy has coped relatively well with the economic crisis and even shows moderate growth prospects. However, the levels of unemployment and insolvencies are high.

i General economic climate

According to the International Monetary Fund, the projected growth of Luxembourg’s gross domestic product (GDP) for 2019 and 2020 is estimated to be 2.7 per cent and 2.8 per cent, respectively, whereas according to the Luxembourg Institute of Statistics and Economics,

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36 That is, to the extent the foreign jurisdiction applies the same conflict of jurisdiction principle. It is otherwise conceivable that main insolvency proceedings be opened in both jurisdictions.
GDP growth is predicted to be 3.4 per cent in 2019 and 3.3 per cent in 2020.\footnote{Statec, Macroeconomic Forecast 1995–2020, Note de conjuncture, 6 June 2019.} This is fairly consistent with the known growth between 1995 and 2018, which is an average of 3.5 per cent per year.\footnote{ibid.}

The unemployment rate is estimated to remain at 5 per cent for 2019 and 2020.\footnote{International Monetary Fund, 'World Economic Outlook, April 2019: Growth Slowdown, Precarious Recovery', April 2019, p. 45.} The balance of public finances is likely to fall from 2.4 per cent of GDP in 2018\footnote{Statec, 'Déficit et dette publique des administrations publiques et provision de données associées 2000–2018'.} to approximately 1 per cent in 2019,\footnote{Conseil national des finances publiques, 'Assessment of Public Finances – March 2019'.} in line with a forecast decline in tax income.

Among the country’s strengths are its limited public debt, highly skilled workforce and high standard of living, whereas the dependence on the financial services industry, the fiscal impact of an ageing population and, to a lesser extent, the steel industry may be seen as weaknesses.\footnote{Source: Coface.}

Inflation is predicted to be 1.7 per cent in 2019 and 2020.\footnote{Statec, Conjoncture Flash, 26 February 2019.}

The total net assets of undertakings for UCIs were estimated at €4,404.936 trillion as at April 2019 against €4,350.4 trillion as at March 2019, which represents an increase of 1.3 per cent over one month. Considering the period from April 2018 until March 2019, the volume of net assets was generally increased by 4.85 per cent.\footnote{Commission de Surveillance du Secteur Financier [CSSF], ‘Development of net assets and number of UCIs’, 31 March 2019.}

The aftermath of the Brexit referendum in the United Kingdom also raises questions, with certain studies predicting that its consequences for the United Kingdom and the European Union will be considerable.

### ii Insolvencies

The annual number of Luxembourg companies declared bankrupt increased steadily between the 1990s and 2013 – the figure was around 100 in 1990 but by 2000 was in excess of 500, passed 1,000 in 2012 and 2013 – and rose to 1,195 in 2018.\footnote{Creditreform Luxembourg, communiqué de presse: ‘Analyse de Creditreform sur l’évolution des faillites en 2018 au Luxembourg, Baisse des faillites au Luxembourg’, 9 January 2019.}

### III PLENARY INSOLVENCY PROCEEDINGS

The past eight or nine years have been substantially quieter on the insolvency front than 2008–2010, when there were dramatic cases, such as those involving the Luxembourg subsidiaries of the failed Icelandic banks and Lehman Brothers Inc,\footnote{Landsbanki Luxembourg SA, Glitnir Luxembourg SA and Kaupthing Bank Luxembourg SA and Lehman Brothers (Luxembourg) SA.} and certain investment funds that had invested in Bernard Madoff’s funds.\footnote{Luxalpha SICAV, Luxembourg Investment Fund SICAV and Herald (Lux) SICAV.} There are nevertheless a few notable...
cases during the past 10 years that have remained active during the period of review; however, there is limited public information available about insolvencies in Luxembourg compared with some larger jurisdictions.

i  **ABLV Bank**

ABLV Bank, the largest independent private bank in Latvia and its Luxembourg subsidiary, ABLV Bank Luxembourg SA (ABLV Lux), were considered as ‘failing or likely to fail’ by the European Central Bank (ECB) on 24 February 2018. This follows a suspicion of involvement in money laundering linked to one of the illegal arms development programmes in North Korea as alleged by the US Treasury.

The ECB then forced the two entities to liquidate in accordance with local legislation. The ECB justified its decision, alleging that ABLV Bank was probably no longer in a position to honour its creditors and to resist massive withdrawals of deposits, and that ABLV Lux presented a foreseeable failure. As a result of this statement, the shareholders of ABLV Bank in Latvia decided to go through a voluntary liquidation process.

Meanwhile in Luxembourg, on 19 February 2018, the CSSF filed an application with the Luxembourg District Court dealing with commercial matters for stay of payments by ABLV Lux in accordance with Article 122(6) of the Law of 18 December 2015 on resolution, recovery and liquidation measures of credit institutions and some investment firms, on deposit guarantee schemes and indemnification of investors. The CSSF alleged that this decision followed that of the ECB to impose a moratorium on ABLV Bank for cause of deterioration of the bank’s financial position. On 9 March 2018, the CSSF request was rejected by the Luxembourg Commercial Court, which nevertheless decided to grant ABLV Lux the benefit of the stay of payments process but only for a ‘protective’ purpose and for an initial period of six months. Although this period was extended to 26 July 2019 and negotiations with Duet Group about a potential takeover have failed, ABLV Lux declared in June 2019 that it agreed to the commencement of the judicial liquidation process to minimise further losses.

ii  **Espirito Santo Group**

Banco Espirito Santo SA (BES), whose main shareholders are based in Luxembourg, has reportedly been in financial distress since May 2014. On 20 June 2014, the CSSF requested the Luxembourg Stock Exchange to suspend the shares of Espirito Santo Financial Group SA (ESFG), which at that moment held 25.1 per cent of BES, since the ESFG shares had lost 51 per cent of their value.

Irregularities in the financial statements of Espirito Santo International SA (ESI), one of the shareholders of ESFG through its wholly owned subsidiary Rio Forte Investments SA

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49 Source: ABLV Bank official website.
52 Source: ABLV Bank official website.
(RF), appear to be the main source of the group’s difficulties. The amount of the financial manipulation is thought to be around €1.3 billion. ESFG was accused of a loss of €1.549 billion in 2013 as compared with a profit of €775 million in 2012.

ESI asked the District Court to be put under controlled management, a request to which the court promptly acceded. ESI had to present a restructuring plan to sell its assets and raise funds to pay its creditors. RF in turn announced on 23 July 2014 that it was not able to honour a €897 million debt owed to Portugal Telecom, and asked the district court to place it under controlled management.

Following the submission of reports by the delegate judge and experts, the District Court rejected the controlled management requests of ESI and RF by two judgments of 17 October 2014, since the restructuring plans did not convince the Luxembourg judges that ESI and RF would be able to reorganise themselves successfully.

BES was transformed into a bad bank to liquidate toxic assets, in particular the debt securities of the rest of the group. At the same time, the Portuguese authorities regrouped the healthy assets into a new bank called Novo Banco, which benefited from an equity injection of €4.9 billion financed through a loan of €3.9 billion by the Portuguese government.

At the time of writing, the bankruptcy proceedings relating to the Luxembourg-based Espirito Santo companies are ongoing.

iii Telecom Luxembourg Private Operator

Telecom Luxembourg Private Operator SA (TLPO), a major network operator, submitted an application on 26 September 2016 to be placed under controlled management.57

In 2015, despite having a turnover of more than €10 million, TLPO recorded a loss of €2.9 million, bringing its cumulative losses to €12.1 million.58 While acknowledging the situation in its annual report and keeping a close eye on a potential bankruptcy, the board of directors of TLPO approved the continuation of the company. This survival was sustainable thanks to the support of the main shareholder, BIP Investment Partners SA (BIP); however, BIP’s later withdrawal led TLPO to insolvency. At the same time, negotiations were undertaken with interested investors (including Nomotech, a French network operator) and the controlled management submission was filed in parallel to enable TLPO to carry out its essential business in the meantime. This was deemed to be of significant importance since an interruption to internet access for TLPO’s customers, which included certain large financial institutions, could have been dramatic for the Luxembourg financial sector.59

On 16 November 2016, the Tribunal d’arrondissement de Luxembourg delivered a judgment declaring the insolvency of TLPO following a bankruptcy petition submitted by the company.60 Nevertheless, TLPO’s activity was first taken over by Nomotech through its Luxembourg subsidiary, Luxnetwork SA.61

58 ibid.
60 Tribunal d’Arrondissement de Luxembourg, Extrait, Inscription d’une décision judiciaire au RCS, 17 November 2016.
IV ANCILLARY INSOLVENCY PROCEEDINGS

No secondary insolvency proceedings were initiated in Luxembourg during the period of review.62 The only apparent case relates to a German company called Schuring Beton GmbH, which had nine employees at its Luxembourg branch. After Schuring Beton GmbH was declared bankrupt in Germany, those employees successfully requested the opening of secondary proceedings in Luxembourg, at which the District Court deemed that Schuring Beton GmbH operated an establishment there.63

V TRENDS

i Predicted level of insolvency activity in the coming year

The first results for 2018 show an upsurge in the number of bankruptcies, with 611 insolvencies during just the first six months of the year,64 following a fall in numbers to 983 insolvencies in 2016 and 935 insolvencies in 2017.65

ii Practical trends

In the past 10 years, courts have resorted more often to stay of payment proceedings, when deemed necessary, to allow failed banks to reorganise themselves under reduced creditor pressure. This was seen as a positive thing by practitioners as it resulted in useful case law, clarifying the practical conditions under which such proceedings could take place.

The status quo was maintained under the general insolvency regime, with the courts agreeing to the opening of only a few reorganisation proceedings, preferring straightforward bankruptcy declarations. However, there is a political willingness to promote restructurings over liquidations and appropriate draft legislation is in circulation to that effect.66

Cases of criminal liability opened against directors (or members of the relevant management body) have remained low.67

iii Expected legislative developments

Expected changes in insolvency law result from Draft Bill No. 6539 on business preservation and modernisation of bankruptcy law, dated 26 February 2013 (the Draft Bill). This is currently under analysis by several commissions within Parliament.

As discussed in Section II, on 6 March 2018 the government published a modified version of the Draft Bill, in response to opinions from various bodies, including the Council of State, which is intended to provide new and tailored tools to distressed companies, and

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62 Based on an oral exchange with a clerk of the bankruptcy chamber of the District Court of Luxembourg.
66 The reader will find additional information on these issues under Sections II and V.iii.
the main objectives of which are the preservation of distressed companies’ activities and the protection of stakeholders (e.g., employees), notably by favouring reorganisations over liquidations.68

The Draft Bill, strongly inspired by the Belgian law on business preservation dated 31 January 2009, is built around four guiding principles: a preventive aspect, a restorative aspect, a repressive aspect and a social aspect.

Preventive aspect

The preventive measures contained in the Draft Bill essentially allow for the gathering of information from businesses to identify those experiencing financial difficulties at a stage when they may still benefit from efficient reorganisation procedures, and provide for instruments designed to preserve and reorganise business activities while taking the rights of creditors into account, which entrepreneurs will be able to request on their own initiative.

The information to be gathered on Luxembourg businesses and to be used to determine whether a given business experiences financial difficulties relies on various indicators (e.g., a list of debts required by tax and social security authorities), to be collected by two separate public entities: the Secretariat of the Economic Committee (SEC), which has a central role concerning non-judicial reorganisation proceedings, and the Evaluation Committee for Businesses in Difficulties, which analyses on behalf of its members – the public authorities – whether a bankruptcy petition is appropriate.

The reorganisation measures to be made available to distressed businesses under the Draft Bill encompass out-of-court procedures and judicial procedures, which are adapted to the size of the relevant business, and are largely voluntary (i.e., upon request of the business in financial distress).

The first out-of-court procedure available is the conciliation process, whereby the company in financial distress may require from the SEC the appointment of a business arbitrator, whose task may be defined by the interested parties. The second is a mutual agreement under which the debtor tries to reach an agreement with two or more of its creditors, possibly with the assistance of a business arbitrator.

If the viability of a company’s activities is threatened, the debtor also has the right to apply for a judicial reorganisation procedure with the relevant district court, which is appropriate when there is a need for measures that may be enforced against third parties. The procedure has three possible outcomes:

a a stay of payments in respect of measures that are aimed at collecting outstanding debts from a distressed business;

b a collective agreement, which is enforceable against all creditors, including those that have opposed such an agreement, if a certain number of creditors representing at least half of the aggregate amount of liabilities of the debtor have given their consent; or

c a transfer under judicial control, whereby a court-appointed agent will organise the transfer of all or part of the assets of the relevant company to ensure the continuity of its activities.

68 Luxembourg 2009 government programme, p. 108.
Luxembourg

**Restorative aspect**

The entrepreneur exercising its activity as a natural person (i.e., without limitation of liability) and whose venture has failed may be given a ‘second chance’ under the Draft Bill if he or she is deemed to have acted in good faith, and accordingly not be held personally liable for the outstanding debts of the failed business.

**Repressive aspect**

The object of the repressive part of the Draft Bill is to prevent entrepreneurs who act in bad faith from abandoning their business and starting a new one with impunity. The Draft Bill also introduces an administrative dissolution procedure without liquidation inspired by Swiss law and with the aim of eliminating ‘empty shells’ in a timely and cost-efficient manner by avoiding formal bankruptcy proceedings.

**Social aspect**

Under the Draft Bill, as a matter of principle, all the rights and obligations resulting from employment contracts are transferred to the purchaser of the assets of the relevant distressed company. However, the Draft Bill also allows the purchaser to choose the employees that it wants to take over, as long as its choice is supported by technical, economic and organisational reasons.

Although this project is ambitious, authors have already highlighted some difficulties that could arise in term of material resources allocated to the undertakings involved. Additionally, according to the Chamber of Commerce, the Draft Bill is not going far enough and should implement a prevention comity, the purpose of which would be to help companies before they get into difficulty.

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70 Avis de la Chambre du Commerce, 2 December 2013.
I INSOLVENCY LAW, POLICY AND PROCEDURE

Statutory framework and substantive law

The Commercial Insolvency Law (LCM), enacted on 12 May 2000 and amended as of 14 January 2014, governs commercial insolvency. It is a federal law that applies to merchants and traders, individuals and legal entities, including commercial companies, trusts engaged in business activities, financial institutions and state-owned commercial companies, and in connection with small businesses with written agreements.

The federal district courts are the only courts with jurisdiction over commercial insolvency proceedings for traders. Non-traders are subject to state and local civil jurisdiction, and there are no specialist insolvency courts. Instead, special federal district courts are set up to hear insolvency cases.

Insolvency proceedings for traders start when relief begins – that is to say, when it is adjudicated – which creates the bankruptcy estate. Insolvency adjudication creates a special legal situation for the debtor and the stay, subject to the LCM.

Claims being pursued by a debtor and claims against the debtor before the insolvency proceeding adjudication may not be joined to the insolvency proceeding, including those involving arbitration.

Post-insolvency declaration claims, including post-arbitration claims, against a debtor adjudicated in concurso mercantil (bankruptcy) must not join the insolvency proceeding.

The final judgment on pre- and post-insolvency actions will be recognised by the insolvency court without review of the amount of the claim and its priority.

Transactions that may be annulled

In general, all fraudulent transactions executed against creditors and the insolvency estate may be set aside. The LCM defines as ‘felonious’ those fraudulent acts that cause or aggravate the cessation of payments, as provided by law. Such acts may also be set aside.

The LCM prescribes a 270-calendar-day review period, counting backwards from the date on which the order for relief was made. This term may be doubled in the case of related subordinated creditors (intercompany or insiders’ debt). A request for a longer review period of up to three years must be filed before the judgment on recognition, ranking and priority is entered. The burden to prove is more flexible to obtain an extension of the suspicious period.

1 Darío U Oscós Coria is a senior partner and Darío A Oscós Rueda is a partner at Oscós Abogados.
without the need to prove the actual fraud, which is a separate cause of action. The new retroactive period must be announced by publication in the court’s list of orders and in the Official Gazette of the Federation.

**Directors’ and officers’ liability regime**

Legal standing to enforce action seeking civil liability (damages) when related to fraudulent transactions (voidance actions) may be brought by:

- one-fifth or more of the allowed creditors;
- allowed creditors that jointly represent 20 per cent of the total allowed credits;
- receivers (interventors);
- the debtor; and
- shareholders holding 25 per cent of the debtor’s shares. The time bar on damages actions is five years.

In the context of an insolvency proceeding, the LCM now provides a regime of strict civil and criminal liability for the debtor, debtor’s general director, sole administrator, board of directors, legal representatives and key employees, including insiders and relatives when causing damage in regard to the facts and circumstances provided by the LCM. Damages shall be to the benefit of the estate. Civil liability is joint and several and is independent from criminal liability, which may be sanctioned by imprisonment for between three and 12 years.

**Policy**

As a matter of public policy, the LCM favours maximising the value of an insolvent estate’s assets, and the rehabilitation of enterprises (preservation) and creditor’s rights. Consequently, liquidation only takes place when rehabilitation is impossible, reflecting the government’s priorities of the preservation of jobs and of businesses as going concerns. During previous periods of systemic financial distress, the government has set up rescue programmes to assist companies to recover or start afresh, but these programmes have mainly applied following insolvency proceedings.2

**Expedited reorganisations**

Pre-packaged reorganisation is allowed by an agreement between a debtor and those of its creditors holding a simple majority (51 per cent) of the total debt. The debtor and creditors execute the petition. The debtor must state under oath that it is already in a state of insolvency and explain why, or state that insolvency is imminent within 90 working days and that the creditors signing the petition hold at least a simple majority of the total debt. A proposal for a reorganisation plan must be enclosed with the petition, with a preservation plan for the business as an ongoing concern. Full insolvency proceedings will be followed without an audit. Protection measures and stays may be requested and granted upon the filing of the petition.

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2 The FICORCA (Foreign Exchange Risk Coverage Trust Fund) programme was instigated in 1982, and the FOBAPROA and UCABE programmes in 1995.
iii Insolvency procedures

The insolvency of non-merchants, such as individuals and consumers (civil insolvency), is governed by the state civil codes and state codes of civil procedure. Insolvency proceedings for merchants consist of a single process, comprising two major stages: conciliation and bankruptcy (liquidation). In conciliation, a conciliator is appointed and seeks to establish a reorganisation plan. If no reorganisation plan is agreed, the process is converted into bankruptcy (liquidation). A trustee is appointed for liquidation. Conciliation has a 185-calendar-day time limit, counted from the *concurso mercantil* adjudication, with two possible renewals of 90 calendar days each. It is mandatory that conciliation may not exceed 365 calendar days.

There is also a sub-stage – the initial audit (inspection) – wherein an auditor is appointed to inspect a debtor’s premises and accounts to confirm that the standard for insolvency is met and to report accordingly to the competent district court, which may judge the debtor to be in an insolvency proceeding (known as an insolvency proceeding adjudication).

The LCM is the law providing for the general insolvency procedures available to wind up and rescue companies. The Corporations Law also provides for private out-of-court corporate dissolution and liquidation of a company. In essence, these are very similar, again effecting the liquidation of assets to pay creditors; any remaining balance goes to shareholders. However, corporate liquidation does not provide court orders to stay payments and executions. Liquidators may apply for a voluntary insolvency proceeding seeking a stay.

During a conciliation proceeding, the debtor remains in possession of the assets, as judicial depositary, and may continue in its ordinary course of business as a going concern. Assets may be used for such purposes, but the conciliator oversees the management of the debtor.

Creditors that supply goods and services may continue to do so. Post-petition creditors may be paid, and have priority against estate assets and post-financing. Creditors may supervise the debtor by means of a receiver (interventor), who represents and protects creditors’ rights and has the authority to be given the debtor’s information, supervise the debtor and report to the court accordingly. The court has full authority to supervise debtors.

From this point, upon *concurso mercantil* adjudication, the procedural steps of the insolvency proceedings are as follows:

- **a** pre-debt payment is stayed. No interest is borne on unsecured debt. Secured debt bears interest up to the security’s value and the deficiency becomes unsecured debt. Debts shall be converted to unit of investment (UDI) value. The UDI is a unit subject to inflation adjustments. Its value is announced daily and published in the Daily Gazette of the federation and major national newspapers;
- **b** the debtor is ordered to surrender its financial statements and accounts;
- **c** the debtor is ordered to cooperate and allow an auditor (visitor) and conciliator to perform their duties;
- **d** executions and attachments are stayed, except for labour credits (salaries of the past two years);
- **e** a review period is set (see Section I.i);
- **f** a summary of the order for relief is published;
- **g** the order for relief is recorded in public registries;
- **h** notice is given to creditors to file their claim (proof of claims);
- **i** the proof of claims process begins; and
- **j** a certified copy of the order of relief is issued upon request.
As has already been mentioned, the LCM favours rehabilitation of the enterprise and liquidation only takes place when rehabilitation is impossible. A reorganisation plan requires approval from 51 per cent of the creditors holding approved claims.

The purpose of the conciliation phase is to create the best conditions for a reorganisation plan. The LCM does not regulate terms or conditions for the plan, but sets out minimum rules to ensure its legality. The LCM also now provides mandatory notices and access to information to enable interested parties to exercise and protect their rights. Accordingly, the conciliator may recommend that appraisals and studies be conducted when they are necessary to achieve a reorganisation plan, which would be given to creditors through the court. When the conciliator considers that there is an agreement of 51 per cent of the recognised creditors in the plan, he or she will give the plan to the other recognised creditors to give their opinions thereon or to execute the plan.

To approve a viable reorganisation plan that favours all, or most, creditors under the circumstances, the LCM provides mechanisms to protect the rights of minority creditors by giving them the most favourable terms possible under the plan. This avoids unnecessary or burdensome objections by minorities that will actually benefit from the plan.

Only those creditors with accepted claims may agree on the plan. Labour and tax creditors do not participate in the plan (see Section I.vi). To facilitate approval of the plan, both unsecured and participating secured creditors must be taken into account to determine the necessary majority.

The reorganisation plan, regarding non-participating creditors holding recognised debt, may only provide an extension of time to pay the debt or debt discount, or a combination of both, provided that terms and conditions are equal to those agreed by at least 30 per cent of creditors holding unsecured permitted claims.

The plan may provide for an increase of capital, and shareholders must be notified so that they may exercise their rights of first refusal. If shareholders do not exercise their rights, the court may simply approve the capital increase.

Dissenting recognised unsecured creditors holding a simple majority, or recognised unsecured creditors holding 50 per cent of the debt, may veto the proposed plan. If there are no objections, the plan may be approved by the court. Since the approved plan is binding upon absent and dissenting creditors, they will be allocated the most favourable terms and conditions of the plan.

Upon the court’s approval of the plan, the insolvency process terminates and parties cease to perform their functions.

The plan must provide payment for:

- labour creditors – up to one year’s wages (the highest priority);
- consumer creditors;
- creditors (administration costs and fees of the insolvency estate) whose claims are secured by assets of the estate;
- claims for burial costs in the event that the debtor dies before the commencement of the insolvency proceeding;
- claims for costs of the sickness that caused the death of the debtor, when death occurs after the commencement of the insolvency proceeding;
- secured creditors with a mortgage or pledge;
- claims holding a special privilege in law;
- tax credits;
- funds for challenged claims and tax credits that have not been determined;
unsecured creditors (common creditors);
subordinated creditors; and
stockholders.

Private agreements between a debtor and any creditor are null and void once relief is granted and the creditor will lose such rights against the debtor. The plan may not release non-debtor parties, such as guarantors; it may only bind a debtor and its creditors. However, the liabilities of officers, directors, advisers and lenders may be released in writing by the interested party or parties taking legal action against them. At this stage, recognised creditors may only oppose the plan if due process has not been followed and if mandatory plan standards are not met. (Due process encompasses access to supporting information and plan viability, and full disclosure of the plan’s terms and conditions.)

A majority of unsecured creditors whose proofs of claim have been allowed may veto the plan. Unsecured creditors not signing the plan may not object to the plan if they are to be paid in full.

Court approval of a plan may be appealed, without a stay, up to the constitutional level of appeal. A successful appeal dismissing the plan on legal grounds is sent back to court. A new plan may be proposed if they are still at the conciliation stage. The plan is subject to approval of 50 per cent of allowed credits otherwise the case turns into a liquidation. In this situation, a reorganisation plan may still be approved, but by a requisite of more than 50 per cent of creditors holding allowed claims and if the plan provides for payment for all creditors holding allowed claims, including those not executing the plan. A default on the plan by the debtor also turns the case into a liquidation.

A pre-packaged reorganisation is allowed by agreement between a debtor and creditors holding a simple majority of more than 50 per cent of the total debt. The debtor and creditors will execute the petition. It is required that the debtor states under oath that it is already in a state of insolvency and explains why, or states that insolvency is imminent (within 90 working days) and that the creditors signing the petition hold at least a simple majority of more than 50 per cent of the total debt. The proposed reorganisation plan must be enclosed with the petition. A full insolvency proceeding will be followed without an audit. Protection measures and stays may be requested and granted upon filing of the petition. The court must approve the plan, whereupon the proceeding ends.

As a reaction to the well-known Vitro case, the 2014 amendments of the LCM now provide for intercreditors’ debt (subordinated debt), providing for a new ranking of creditors holding subordinated debt, namely subordinated creditors, that may be created by:

- contractual agreement or provided by statute law;
- the unsecured intercompany and insider debt; except for claims of a parent company and individuals that only have control over the debtor for claims ranking. This exception does not include, inter alia, casting votes for the reorganisation plan or fraudulent conveyances; and
- late-claim filings.

To prevent fraudulent conveyance of intercompany indebtedness and to give certainty to investors and creditors that their debt would be paid first before certain intercompany
obligations, the 2014 amendment provides that where the debtor is a corporation, the following unsecured creditors (statutory insiders) shall be characterised as subordinated in ranking:

\[ a \] subsidiaries and affiliates of the debtor;
\[ b \] the director, members of the board of directors and key officers of the debtor, as well as those of its subsidiaries and affiliates; and
\[ c \] corporations with the same managers, members of the board of directors or key officers similar to those of the debtor (commonality of management).

In the event that the insolvent company is put into liquidation, all the aforementioned creditors shall receive payment only after senior debt claims are paid in full. Claims held by controlling individual shareholders and by the holding company of the debtor are excluded from subordination in payment as law makers considered that including such claims would impair their ability to obtain financing from lenders.

**Voting of intercompany claims**

In an intercompany claim, there may be no cramdown of legitimate third-party claims on the basis of an intercompany or insider-debt casting vote. The plan must be agreed by the debtor, creditors representing more than 50 per cent of the sum of all the debtor’s unsecured and subordinated claims, and creditors representing more than 50 per cent of the debtor’s secured or priority creditors.

Further, if intercompany claim holders and insiders (including controlling individual shareholders and holding companies), as subordinated creditors, hold at least (jointly or severally) 25 per cent of the total amount of the credits held by those listed in points (a) and (b), above, to become effective, the plan must be accepted by creditors representing at least 50 per cent of such credits, excluding from this amount the claims of the insiders.

This rule will not apply when intercompany claim holders and insiders accept the plan as agreed by the rest of the voting claim holders, in which case the simple majority rule applies.

The voting of insider or intercompany claims, with third-party claims, will only be sufficient to approve a reorganisation if at least half the non-insiders vote in favour of the plan.

**Subordinated debt and subordinated creditors**

Creditors’ agreement may provide for the total or partial extinction of subordinated debt or other type of treatment thereto, including its subordination or another form of particular treatment.

**Interaction before the Mexican courts of indenture trustees and bondholders**

Proof of claims may be filed individually by a bondholder, which will be subtracted from the overall proof of claim filed by an indenture trustee representing bondholders. Each bondholder, and the trustee, is entitled to pursue allowed claims, rights, objections and voting rights.

Bondholders’ meetings shall be conducted as provided under the indenture agreement, the law governing the indenture or by the LCM; the decisions made at bondholders’ meetings will have a binding effect.
The extinction of debts
The restructuring plan and the judgment approving it shall be the only document governing a debtor’s obligations towards allowed creditors.

Mandatory enforcement of a restructuring plan
Any allowed creditor may request the mandatory enforcement of a restructuring plan by means of a summary proceeding before the court that adjudicated the commercial insolvency.

Amendment of the plan
In the case of a change of circumstances that materially affects the fulfilment of the plan, it may be amended to satisfy the need to preserve the enterprise.

Recognition of foreign proceedings
Chapter 12 of the LCM incorporates the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (the Model Law), as discussed in Section I.vii. The LCM allows for ancillary (non-main) insolvency proceedings if main proceedings are pending in another country. There is no automatic recognition of foreign insolvency proceedings.

If a debtor has an establishment in Mexico, recognition follows a full insolvency proceeding that, in theory, may take up to one year for conciliation and up to one further year in the case of liquidation in bankruptcy. If there are appeals up to the Supreme Court, final res judicata decisions may take a further year.

If the debtor lacks an establishment but has assets in Mexico, no full insolvency proceeding need be pursued. For a recognition proceeding, there is a summary proceeding with the debtor that may last up to three months. Again, appeals to the Supreme Court may take another year.

iv Starting proceedings
Plenary insolvency proceedings may be voluntary or involuntary. In a voluntary petition or pre-packaged insolvency, there is no initial visit; the debtor may voluntarily, and creditors may involuntarily, request an insolvency proceeding in the event of bankruptcy. In an involuntary petition, a full insolvency proceeding must be pursued if the debtor opposes. Bankruptcy allows for a reorganisation plan that may be approved by the same voting requirements as in conciliation, provided further that 100 per cent of creditors holding allowed claims are paid, including those not signing the plan.

The LCM provides for the use of standard forms issued by the Mexican trustee’s office to speed petition filings and other motions during the proceedings. The 2014 amendments provide for specialised courts and online proceedings, which have yet to be set up.

Liquidation may now be involuntary. Bankruptcy relief becomes available when the debtor (merchant) requests his or her bankruptcy. Voluntary bankruptcy is adjudicated without full insolvency proceedings; there is no conciliation phase. For a debtor to be placed in bankruptcy by a creditor (i.e., involuntarily), a full insolvency proceeding must be pursued – if the debtor opposes the involuntary proceeding, there is a conciliation phase. A debtor is declared bankrupt by the court if a plan is not agreed upon during the conciliation proceeding or if the debtor does not cooperate with the plan and the conciliator requests a declaration of bankruptcy.
The conditions for initiating an insolvency proceeding are that the debtor must be a merchant, individual or legal entity and that there has generally been a failure to make payments when due. The criteria (insolvency standard) for establishing a general default on payment obligations are that:

a. there is a failure to meet payment obligations to at least two creditors;

b. the obligations are more than 30 days overdue;

c. overdue obligations represent 35 per cent or more of the total amount of the debtor’s obligations as of the petition filing date; and

d. the debtor lacks the cash assets, as defined by the law, to pay at least 80 per cent of the total debts due as of the petition filing date. Cash assets are:

- cash to hand and deposits on site;
- deposits and investments due within 90 days of the date of the petition being filed;
- accounts receivable due within 90 days of the date of the petition being filed; and
- securities that are regularly registered sell-or-buy operations in relevant markets, saleable within 30 banking business days.

Once a declaration of an insolvency proceeding has been made, the conciliation phase commences (unless the debtor has itself requested the bankruptcy or a creditor has requested it without the debtor’s opposition), the substantive effects of which are as follows:

a. payments are stayed, except those necessary during the ordinary course of business;

b. pre-existing contractual obligations must be performed as agreed by the parties, except for those to which special provisions apply under the LCM;

c. all pre-existing obligations become due and have to be fixed in UDIs\(^3\) to determine their amount; and

d. matured debts stop accruing interest (all obligations of the debtor are considered matured and interest stops accruing on obligations, but interest will continue to accrue on obligations secured by a mortgage or a pledge, even after the insolvency declarations to the extent of the collateral).

The adjudication of a commercial insolvency is not binding and lacks effect towards third-party debtors, such as guarantors.

The 2014 amendments state clearly that assets settled under a business trust (fideicomiso) are not comprised within the estate and may be separated while in possession of debtor, including when the debtor is settlor.

Adjudication against a debtor in an insolvency proceeding may be subject to appeal. A petitioner-creditor is entitled to appeal without stay and, as a general rule, the adjudication may not be stayed. The reasoning behind the ‘no stay in proceedings’ rule is based upon the criteria that continued prosecution of insolvency proceedings follows public policy. The appeal is decided by a court of appeals. The decision of the court of appeals may be further challenged by means of a constitutional action (amparo). Under certain circumstances, the amparo decision may be challenged even further before the Supreme Court of Justice. The insolvency proceeding adjudication may be revoked as of the petition filing date, after all these levels of appeal are exhausted.

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3 The UDI is a unit subject to inflation adjustments, whose value is announced daily and published in the Daily Gazette of the Federation and major national newspapers.
Commercial insolvency adjudications may be revoked, based upon the finding of violations of law contemporaneous to the adjudication, with effect as of the petition filing date, even if a full insolvency proceeding has been prosecuted and is virtually finished.

On the other hand, if there is a bankruptcy adjudication based upon voluntary petition seeking insolvency proceeding at the stage of bankruptcy, creditors holding allowed claims may appeal the bankruptcy adjudication without stay. Further levels of appeal asserted by such creditors may not stay proceedings. As in the plenary insolvency proceeding, the bankruptcy proceeding may get up to its termination and be revoked with effects as of the voluntary petition filing date.

Upon the dismissal of a commercial insolvency, the acts of management and bona fide third-party acquisition rights shall be preserved.

Upon dismissal of a commercial insolvency, legal costs and fees may be awarded against the petitioner.

No main foreign insolvency proceeding may be commenced by a foreign representative. If the debtor has an establishment in Mexico, a full insolvency proceeding must be pursued. Upon concurso mercantil adjudication, main foreign proceedings may be recognised, if the recognition petition meets legal requirements. If the debtor lacks an establishment in Mexico, a summary proceeding will be pursued between the foreign representative and the debtor (see Section I.vii).

v Control of insolvency proceedings

Plenary insolvency proceedings are directed and controlled by the court. The court interacts in an insolvency judicial proceeding with all parties with an interest: debtor, creditors, conciliator (while at the conciliation stage), trustee (while in liquidation at the bankruptcy stage) and interventor. The court provides and approves orders and judgments, and enforcement thereof. The conciliator and trustee should conduct management functions and provide support to the court to pursue and finish the respective stages of the insolvency proceeding.

Upon the filing of a petition for commercial insolvency, the board of directors must assist and cooperate with inspectors, conciliators and trustees in the performance of their duties, and must disclose all relevant information relating to the insolvency estate. The board of directors in this situation is the debtor-in-possession, namely the judicial depositary, and may continue to run the company as a going concern under the supervision of the conciliator.

vi Special regimes

Workers who are owed wages are excluded; such workers are governed by the Federal Labour Law. Tax claims and claims equivalent to tax claims by the tax authorities (federal, state and municipal) – the Mexican Institute of Social Security (IMSS) and the National Workers’ Housing Fund Institute (INFONAVIT) – are excluded from general bankruptcy proceedings. The term ‘claims equivalent to taxes’ includes the IMSS and INFONAVIT tax quotas that employers must pay, which are considered equivalent to taxes. Federal tax credits are governed by the Federal Tax Code, and state and municipal tax credits are governed by state tax laws. Labour creditors and tax creditors do not join bankruptcy proceedings and are paid and liquidated by their labour chambers and tax authorities, respectively.

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4 Labour credits are claims by employees and may include unpaid wages and employment indemnity.
Tax credits and labour credits are included within the total liabilities of the debtor. Tax credits have priority over unsecured credits and over credits secured by a pledge or mortgage, even if these secured credits were perfected and recorded after notice is given to the debtor of the tax credits. Tax credits have no priority over labour credits or over alimony for which a lawsuit has been filed before a court.

By law, tax creditors do not join general bankruptcy proceedings. The tax law provides that if a debtor is adjudicated against in an insolvency proceeding, the court must notify tax creditors of the adjudication. Enforcement of tax creditors may be stayed by this adjudication, provided tax creditors had been notified of the filing of the insolvency proceeding petition.

Some assets are excluded from execution, attachment and liquidation in bankruptcy such as alimony, child support, family patrimony, common land, and life insurance in the case of an irrevocable appointment of a beneficiary.

Labour credits are included within the total liabilities of the debtor. However, labour creditors are not obliged to join the insolvency proceeding. Instead, labour credits are considered under the jurisdiction of the labour courts and are enforced and paid before the labour courts rather than joined to federal or state insolvency courts. The same applies to tax credits, which are considered under the jurisdiction of the tax courts.

Insolvency for companies performing a federal, estate or municipal public service may be adjudicated in insolvency proceedings pursuant to special laws and the provisions of the LCM that do not conflict with those laws. The authority granting the concession may appoint the conciliator and trustee, and oversee the performance of the company. This authority may gain from the court the removal of debtor-in-possession and have the court appoint a person to take possession of and manage the situation. Reorganisation plans may also be vetoed by such authority, and in the event of a sale that includes the concession, this authority must approve it.

Under the new financial regime, the banking law provides for an autonomous, independent and special insolvency regime known as judicial banking liquidation, in addition to the administrative control regulations. These proceedings will be the federal district court-directed liquidation of a bank, and the trustee will be appointed by the Banking Commission. Accordingly, amendments to banking legislation, relating to administrative regulation, give greater powers to the financial regulators and provide additional tools for control, investigation, overview, preventive and protective measures, requirements and sanctions over banks and financial institutions, aimed at more efficiently preventing and remedying situations of financial distress.

Insolvency for insurance, bonds and reinsurance companies is also governed by separate special laws.

**Corporate groups**

The LCM now regulates groups of companies, and there is no piercing of the corporate veil. The LCM provides that insolvency proceedings involving holding and subsidiary companies will be combined under the same commercial insolvency proceeding, but each company’s insolvency will be conducted in a separate court docket file. The LCM does not provide for these to be combined or consolidated for administrative purposes, nor may their assets or liabilities be pooled for distribution. However, creditors or debtors of the same group of companies may file for joint commercial insolvency as long as one or more of the enterprises of the same group meet the insolvency standard. The court may appoint the same auditor, conciliator or trustee, should it benefit the proceedings.
Mexican corporate law does not provide for the insolvency of corporate groups. Corporate groups consolidate for tax purposes, and labour law recognises a substitute employer among a group of companies. The Law on Financial Groups provides for financial groups of companies, with joint and several liabilities without consolidation. Regarding groups of companies, assets may not be transferred from administration in Mexico to another country.

Based upon case law jurisprudence, the corporate veil may be lifted under certain circumstances of fraud.

vii Cross-border issues

Mexico has incorporated the Model Law, and accordingly provides recognition and full cooperation on cross-border insolvency. Foreign creditors are granted equal treatment with domestic creditors. The federal judiciary has granted relief sought in support of the Model Law.

Mexico was the first jurisdiction in the world to recognise foreign bankruptcy proceedings and grant international insolvency cooperation thereto, in the Xacur case and the IFS case filed and prosecuted by Oscós Abogados, on behalf of the foreign representative.

Outbound Mexican cases have sought US Chapter 15 ancillary recognition (secondary proceedings) to stay executions, as in Aeromexico, and recognition of reorganisation plans, as in Satmex, Metrofinanciera, Corporación Durango, Grupo Iusacel and Vitro. The drilling company Oro Negro is being prosecuted.

Mexico is not party to any international treaties on insolvency, bankruptcy or reorganisation matters, but has executed two treaties on the recognition of foreign judgments that expressly exclude insolvency, reorganisation, bankruptcy and liquidation.

The LCM incorporates the Model Law in Chapter 12, and defines the following terms:

a foreign proceedings: collective judicial or administrative proceedings in a foreign country, including interim proceedings, under a law relating to insolvency, or adjustment of debt proceedings in which the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purposes of reorganisation or liquidation;
b main foreign proceedings: foreign proceedings pursued in the jurisdiction where the debtor’s centre of main interests (COMI) is located;
c no main foreign proceedings: foreign proceedings pursued in the jurisdiction where the debtor has an establishment, as described in point (f);
d foreign representative: a person or body, including provisional persons or bodies, empowered in foreign proceedings to administer the reorganisation or liquidation of a debtor’s assets and affairs or to act as a representative of foreign proceedings;
e foreign court: a judicial authority or other body with jurisdiction over the control or supervision of foreign proceedings; and
f establishment: any place of operations where a debtor carries out a non-transitory economic activity with employees and goods and services.

Reciprocity is mandatory. International cooperation may be conducted through Mexican courts and Mexican representatives. Foreign courts and foreign representatives may only act through a Mexican court or Mexican representative, but recognition is not automatic. If a debtor has an establishment in Mexico, full insolvency proceedings under the LCM must be conducted, otherwise foreign proceedings may be recognised in summary proceedings. In interpreting and applying Chapter 12, consideration must be given to avoiding any violation of the LCM and public policy – Chapter 12 allows the rejection of recognition when there
is any violation whatsoever of the LCM or of any principles of public policy. Protection measures (stay of payments or execution) may be granted following a request being filed for recognition. Upon recognition, additional protective measures may be granted. Foreign proceedings will be recognised as main or non-main proceedings, subject to the debtor’s COMI. Chapter 12 must be interpreted considering its international origin and the need to promote uniformity in its application and the observance of good faith. Chapter 12 may be applied, unless otherwise provided for under international treaties executed by Mexico, except where there is no international reciprocity. Mexico has not executed any international treaties regarding liquidations or reorganisations.

Chapter 12 aims to provide effective mechanisms for dealing with cases of cross-border insolvency with the following objectives: cooperation between Mexican and foreign courts, the increase of legal certainty for trade and investment, fair and efficient administration of cross-border insolvency cases, protection and maximisation of a debtor’s assets, and facilitation of the rescue of financially troubled businesses, thereby protecting investments and preserving employment.

Chapter 12 applies where:

a. assistance is sought in Mexico by a foreign court or a foreign representative in connection with foreign proceedings;
b. assistance is sought in a foreign country in connection with a case under Mexican insolvency law;
c. both foreign proceedings and a case under Mexican insolvency law with the same debtor are concurrently pending (parallel proceedings); or
d. creditors, or other interested parties, in a foreign country want to commence or participate in a case under Mexican insolvency law.

Cooperation and communication between Mexican courts and foreign courts and between Mexican representatives and foreign representatives may be direct, without the need for letters rogatory or any other formality.

In the Xacruz and IFS cases, simplified written requests from the US bankruptcy courts were fully enforced by the Mexican courts.

II INSOLVENCY METRICS

The real economy is strongly tied to the US markets. Trade between the United States and Mexico grew by 6.9 per cent in the first five months of 2019. During that period, the amount traded was US$257.7 million dollars. Mexico is the first commercial partner of the United States, Canada being second and China third. Mexico is the second export market for the United States. The United States recommends investing in Mexico for great opportunities, including in the amended energy and telecommunications industries. Mexico is ranked as the 15th world economy. It is the most open market worldwide with the potential to trade with 46 countries under free trade agreements. However, there is some uncertainty about the future, owing to the current NAFTA renegotiation and the outcome of 1 July 2018 presidential elections. Andrés Manuel López Obrador owns Morena, the political party that won the majority vote in Congress, which has enabled him to control Congress, in general terms, since he took office on 1 December 2018. This president intends to change the country under what is being called the Fourth Transformation (the first being the conquest of Mexico by Spain, the second, independence and the third, revolution), within which,
inter alia, there is a severe austerity budget programme, a strong fight against corruption in all levels of the government, including the closing of construction of the new international airport in Mexico City.

The gross domestic product (GDP) in Mexico fell 0.2 per cent in the three months to March 2019, which is in line with the preliminary figure and there having been no growth in the prior quarter. Services and industry shrank and the primary sector lost steam. Inflation in July 2019 was at 3.78 per cent and the international reserves of the central bank, Banxico, were US$175.236 billion as at June 2019. Chinese and global GDP have decreased in recent years, and the global fall in oil prices, the stronger US dollar and China’s yuan devaluations have generally affected exchange rates throughout the world, especially those of undeveloped countries such as Mexico.5

Mexico’s investment ranking has increased and is showing a positive tendency. Public deficit has increased to levels that are still sustainable but it must be prevented from increasing any further. The state of the country’s capital markets following global capital markets also has an impact, increasing most stock prices. The new stock exchange created in 2017, Bolsa Institucional de Valores (BIVA), to provide a more flexible, stronger and open competition with the Mexican Stock Exchange, started operations in July 2018. The markets are still very volatile and financial forecasts are uncertain, even in the short term. As expected, the US Federal Reserve has continued to increase interest rates and, given the world’s financial distress, inflation is becoming a major concern of the central bank. Major structural amendments have been implemented (in education, energy, oil and gas, tax and finance, telecommunications, tourism, and to the rule of law, security and anti-corruption). However, it is hoped that the structural amendments will stimulate a fast-growing economy and an increase in economic performance from 2019 to 2020, notwithstanding the world’s financial distress. The Mexican government urgently needs to create effective internal incentives to increase domestic growth, and additional vehicles to reduce the deep poverty of 41.9 per cent (extreme poverty of 7.4 per cent) of the population, and the public deficit. If President Trump imposes tax on Mexican imports, it will have a lose dynamic, but for Mexico that negative effect will be much worse. Currently most of the commercial trade between the United States and Mexico is free of tariffs. Many industries, businesses and enterprises holding derivatives, bonds and foreign currency debt were affected by the 2006 subprime mortgage crisis and the financial crisis of 2008–2009, and were ultimately forced to restructure their debt, mostly by out-of-court settlements and, for a small number, by a reorganisation plan approved within an insolvency proceeding. Most of these enterprises have been in the process of recovery.

In 2018 and the first five months of 2019, Mexico reached historic levels of maximum exports with the United States and the United States has increased its sales with Mexico. The economy was generally weak during 2018, which has continued in the first half of 2019. The economy has not only experienced a contraction but also a strong devaluation and lower oil production and oil prices. The oil sector has been materially hurt generally, and most businesses have had to shut down.

There has been a decrease in the tourism industry, which represents 8.5 per cent of Mexico’s GDP. During the first trimester of 2019, the domestic industry was down by 0.6 per cent, unlike tourism involving foreign visitors, which increased by 3.2 per cent.

In the short term, the financial situation looks unfavourable, and businesses may face actual or imminent insolvency distress (mostly those that carry heavy debts in foreign

5 The peso was at 19.46 to the US dollar as at 14 August 2019.
currency). These businesses will require reshaping and reorganisation in out-of-court or insolvency proceedings. The Mexican insolvency regime is now better equipped to provide effective tools for convenient restructurings that distressed businesses should take advantage of in a timely manner, for a fresh start, preventing further financial distress.

In August 2017, ICA, a major Mexican construction company worldwide, with a 65.151 million peso debt until March 2017, filed for pre-package *concurso mercantil*. ICA agreed a reorganisation plan with its creditors in a timely manner, which was approved by the court.

In the first quarter of 2013, large housing construction companies such as Corporación Geo, SAB de CV (2014), Desarrolladora Homex, SAB de CV (2014), Obras y Desarrollos Urbi, SA de CV (2014), Promoción y Desarrollos Urbi, SA de CV, Urbi Constructora del Pacifico, SA de CV Urbi Desarrollos Urbanos SAB de CV defaulted on payment of interest under bond issuances and their stock listings in the stock exchange were suspended. Related businesses and enterprises in the construction industry have been strongly affected by the fall in the construction market and are in deep financial distress. They completed reorganisation plans with creditors in a *concurso mercantil* proceeding. However, the reorganisation plans have been challenged and are still in *concurso mercantil*. Corporación Geo, SAB de CV, affiliated and its subsidiaries’ reorganisation plan was found not to be financially viable and failed in bankruptcy. Other cases, such as *Iusacell*, have been successfully reorganised in a *concurso mercantil* proceeding. The *Vitro* case was settled (2013) after the Mexican reorganisation plan was rejected by a US court because of a violation of US public policy, *inter alia*, since it included the release of a third-party debtor, and its corporate and financial restructuring was not fully disclosed to creditors.

Oceanografía, a large Mexican supplier of Pemex (a state-owned oil company), was charged for fraudulent transactions on a number of accounts receivable, owed allegedly by Pemex and assigned to Citi Bank Mexico, and was involuntarily placed in *concurso mercantil* upon by a petition filed for the first time by the federal attorney general. Oceanografía agreed a reorganisation plan, which was approved by the court. However, that plan was challenged and revoked. Consequently, Oceanografía is in bankruptcy.


Insolvency statistics are provided every six months by the Federal Institute of Specialists in Bankruptcy Proceedings (IFECOM), the trustee's office created under the LCM. IFECOM’s statistics relate only to commercial insolvency. Since the enactment of the LCM (May 2000 until 15 May 2019), statistics show that 751 filings have been prosecuted, of which 57.25 per cent were voluntary (430) and 42.75 per cent involuntary (321). The total number of proceedings being prosecuted are 198: 20 (10 per cent) in the verification subphase, 32 (36 per cent) in the conciliation phase and 142 (72 per cent) in the bankruptcy phase. The number of terminated insolvency proceedings in this period is 15.7

Many feel that the LCM has proved so inadequate that debtors and creditors strive to avoid having to involve themselves with it, and opt to settle out of court instead or face long and costly litigation. There is a tradition in Mexico of out-of-court settlement of insolvency cases, closure of businesses, hide and convey assets, runaway and long and costly litigation

6 There are no statistics whatsoever regarding consumers’ and non-traders’ insolvency (civil insolvencies).

because the nationwide aversion to taking insolvency actions through the courts is a symptom of a serious lack of faith in the Mexican insolvency system. The 2014 amendments to the LCM are still being tested, and begin to show that this phobia may be overcome rather than allowed to worsen. Labour claims (super-priority) by constitutional provision do not join the insolvency proceedings. Tax claims also do not join the concurso mercantil.

III PLENARY INSOLVENCY PROCEEDINGS

Vitro’s concurso mercantil is the case that has led to the highest number of amendments made to the LCM as of January 2014 (see Section V). Mutatis mutandis, Vitro had a major impact on the Altos Hornos de Mexico case, which led to the abrogation of the former Bankruptcy and Suspension of Payments Act and the enactment of the LCM. Vitro SAB is a Mexican holding that conducts international operations through many subsidiaries, including in the United States, and whose manufacturing facilities and distribution centres extend throughout the Americas and Europe. It has annual net sales approaching US$2 billion, maintains a workforce of about 17,000 (mostly concentrated in Mexico) and exports its products to more than 50 countries.

In early 2009, Vitro failed to pay US$293 million in derivative contracts, and interest payments on bonds maturing in 2012, 2013 and 2017, triggering a default on approximately US$1.5 billion in debt held by banks and unrelated bondholders around the world. Subsequently, Vitro filed for voluntary bankruptcy in mid December 2010 hoping to gain court approval for a restructuring plan.

To gain majority support for the restructuring plan, which would be much more favourable to shareholders than creditors, Vitro created, post-default, US$1.9 billion of intra-company loans from various subsidiaries, an amount greater than their obligations to the company’s bona fide creditors. The company’s intention was to enable the subsidiary creditors that had lent virtual money to the holding company to cast votes in support of Vitro’s restructuring plan, thereby imposing a majority in the reorganisation plan over dissenting creditors. Moreover, its affiliates had entered into a lock-up agreement with the holding company that required them to vote in favour of a restructuring that would release them from payment guarantees they had extended to outside creditors.

Despite strong opposition from genuine creditors, Vitro’s intercompany debts were recognised as unsecured claims by the Monterrey District Court. The decision was appealed and the Court of Appeals confirmed it (Second Unitary Court Fourth Circuit, appeal dockets 5/2012 and 45/2012). An amparo action (i.e., constitutional action – further appeal) was filed by dissident genuine creditors, but was not ultimately necessary as a settlement was reached between Vitro and the genuine opposing creditors. Being pending without stay, first an appeal and then an amparo action challenging the allowed intercompany claims judgment and the reorganisation plan was submitted for court approval. Dissenting genuine creditors objected to the reorganisation plan for a number of violations, including release

10 Fourth District Court in Civil and Labour Matters in the city of Monterrey, Nuevo Leon, Docket No. 38/2010, Vitro Sociedad Anonima Bursatil de CV.
of third-party guarantors’ obligations, lack of complete and correct information thereto and the intercompany debt casting. The plan was imposed using the casting votes of the intercompany debt held by Vitro’s subsidiaries. The district court approved the reorganisation plan. This court approval was challenged by an appeal, which was not decided because the parties reached a subsequent settlement.

It was very likely that an amparo action would have revoked the order of the district court recognising the intercompany debt subordination, and the reorganisation plan was only approved by a majority based on these allowed intercompany claims.

Upon adjudication of the insolvency proceeding, Vitro sought its recognition under US Chapter 15 as a non-main proceeding, which was granted. The approval of the Monterrey court of the reorganisation plan was at the time subject to a pending decision by the Mexican court of appeals, when Vitro also sought recognition before the US Bankruptcy Court, which the district court rejected. Vitro appealed before the Fifth Circuit Court of Appeals,11 which, in turn, confirmed the original rejection of recognition of the reorganisation plan. The court of appeals determined, in essence, that the reorganisation plan was contrary to US public policy since the plan extinguished third-party obligations without them having been adjudicated on in any insolvency proceeding whatsoever.

The Vitro case highlighted many of the deficiencies and possible abuses of the LCM and may be underlined as the most notable insolvency case in recent years, owing to the serious cross-border insolvency dispute between the Mexican and US courts on intercompany debt issues as to recognition of and voting rights of intercompany debt for approval of a reorganisation plan and enforcement thereof.

The bankruptcy of Mexicana de Aviación (2014), one of Mexico’s biggest airline companies, led to a number of the 2014 amendments to the LCM, notably that the conciliation phase of a concurso mercantil may not, under any circumstances, last more than a non-extendable period of 365 calendar days. If a reorganisation plan is not agreed in a timely manner, the proceedings turn automatically by law into liquidation in bankruptcy.

IV ANCILLARY INSOLVENCY PROCEEDINGS

There is no record of the commencement of any ancillary (main or non-main) insolvency proceedings in Mexico during the past 12 months. Two prior ancillary insolvency proceedings, the Xacur case12 and the IFS Financial Corporation (Interamericas) case,13 were US bankruptcy

11 US Court of Appeals for the Fifth Circuit, No. 12-10542, Vitro SAB de CV (debtor and appellee) v. ad hoc group of Vitro noteholders (appellant).
adjudications, main proceedings, which were recognised in Mexico under Chapter 12 as main proceedings. Recognition was granted based upon the estate assets located in Mexico, as the debtors lack establishment thereunder. These cases have both been fully enforced in Mexico.

The Xacur case has established several precedents in Mexican jurisprudence, regarding the Model Law, which is also applicable worldwide in foreign jurisdictions. The most significant of these precedents, which may be found in the Semanario Judicial de la Federación, are the following:

a. Direct amparo 98/2003, Direct amparo 97/2003 and Direct amparo 96/2003 of 13 March 2003, regarding a foreign bankruptcy proceeding and the recognition and declaration of international cooperation. A judgment that recognises and grants international cooperation may be revoked;

b. Amparo in revisión 282/2003, amparo in revisión 283/2003 and amparo in revisión 289/2003 of 5 September 2003, regarding a foreign bankruptcy proceeding and the recognition and declaration of international cooperation. Indirect amparo may not be allowed against an order that decides a revocation remedy, derived from a decision entered in a judgment enforcement that recognises it, since it is not the last decision in this stage;

c. Amparo in revisión 1588/2005 of 26 October 2005, regarding a commercial insolvency. Chapter 12 of the LCM is constitutional because it grants equal treatment to foreign and domestic creditors;

d. Amparo in revisión 361/2004 of 27 October 2006, regarding the LCM. Standards for the recognition of foreign proceedings in Mexico; and

e. Amparo in revisión 361/2004 of 27 October 2006. International treaties only bind the states that are a party to the treaty.

The IFS case has also led to case law jurisprudence regarding the interpretation and enforcement of the Model Law worldwide. These cases have proved the effectiveness in general of cross-border insolvency cooperation under the Model Law regime. There are also the cases of Perforadora Oro Negro, SRL de CV and Integradora de Servicios Petroleros Oro Negro, SAPI de CV concurso mercantil, which as main proceedings have been recognised under US Chapter 15.

V TRENDS

i. New legislation

As expected, to improve the domestic economy, important amendments of more than 34 financial laws, including the Commercial Insolvency Regulations, were enacted by Congress and published in the Daily Gazette of the Federation, dated 10 January 2014. Amendments have taken into account some of the experiences of the global 2008–2009 financial crisis, and domestic experience, to equip the country better to face and overcome situations of systemic financial distress.

The amendments, in essence, aim to greatly increase credit availability and make it cheaper, especially for small and medium-sized businesses. The amendments provide legal tools for the efficient and prompt enforcement of the financial regulators’ powers, and optimise estate asset liquidation, and distributions and creditors’ collection rights, in a swift and efficient manner.
These legislative amendments are made in the context of several major structural amendments already approved in Congress, concerning labour, education, finance, gas, oil and energy, communications and tax.

The most important amendments to the LCM, as enacted on 10 January 2014, include the mandatory protection of creditors’ rights in addition to the preservation of enterprises and the estate, and equipping the LCM with the legal tools it previously lacked that are necessary to conduct orderly, effective and efficient insolvency proceedings.

ii LCM

After 19 years in effect, the legislator should recognise that Mexico is still in urgent need of a 21st-century insolvency system and should introduce major amendments to the LCM or, even better, enact a new insolvency statute.

The amendments implemented are not all that were originally proposed or expected, but at least they aim to improve the commercial insolvency regime. Many of the amendments were forced through by high-profile cases that exposed the LCM’s weaknesses and deficiencies and the fact that it was open to abuse – notably the Vitro and Mexicana de Aviación cases, which have given rise to most of the amendments. They also adopt some of the tools used in the financial crisis of 2008–2009 to assist in overcoming situations of domestic and cross-border financial distress.

The main aim of the amendments being implemented is to protect creditors and the bankruptcy estate, and to make the entire insolvency process more transparent. These amendments concern, inter alia:

a filing of petitions when insolvency is imminent;
b involuntary bankruptcy;
c post-financing;
d provisions for managers and directors’ liability;
e joint petitions for groups of companies;
f subordination debt as a new claim ranking;
g limited allowance of voting on reorganisation plans of intercompany debt, as subordination debt;
h full access to information and documents relating to a reorganisation plan, voidance actions and clawback period;
i insolvency damages claims;
j the strictness of the deadline for the conciliation phase; and
k the treatment of fraudulent transactions performed by related parties.

Experience still shows that very few insolvency cases are brought as formal insolvency proceedings (a total of 751 filed cases in the 19 years that the LCM has been in force), which clearly showed the need for a new, comprehensive and structured system – or at least a major change. The new system should encompass automatic stay as an immediate bankruptcy protection, without the standard of being insolvent, discharge, joint labour and tax creditors to a unitary universal insolvency proceeding, among other issues that go beyond the scope of this chapter.
Chapter 20

NETHERLANDS

Lucas P Kortmann and Vera G M Leferink

I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

Bankruptcy law for corporations is mainly laid down in the Dutch Bankruptcy Act 1893 (DBA). The DBA contains rules of both procedural law and substantive law, including provisions on fraudulent preference, the right to set off claims and the right of retention of a creditor.2

Other statutes also contain provisions relating to insolvency law matters, such as directors’ liability and on the position of secured creditors in the Civil Code,3 the preferred creditor position of the tax authorities in the Collection of State Taxes Act, and criminal law issues in the Criminal Code.4 Furthermore, specific regulations applicable to financial institutions are laid down in the Act on Financial Supervision (AFS).


ii Policy

The DBA provides for both rescue and liquidation proceedings. However, Dutch law does not have a mechanism to cram down dissenting creditors outside insolvency proceedings (however, a draft bill to introduce a cramdown procedure in the Netherlands is pending). Therefore, business rescues are mainly done through a going concern sale of the company. In actual insolvency proceedings, the focus is more on liquidation than rescue.

In the past 10 to 15 years, there has been a gradual shift towards rescuing businesses through formal insolvency proceedings. Furthermore, there has been a tendency for companies to use pre-packaged insolvency restructurings to rescue businesses.

1 Lucas P Kortmann is a partner and Vera G M Leferink is a senior associate at Resor NV.
2 Dutch Bankruptcy Act 1893 [DBA], Articles 42 to 49, 53 to 54 and 60.
3 In particular, Articles 2:138 to 140 and 2:248 to 2:250 on directors’ liability and Article 3:277 et seq. on rights in rem.
4 Such as Articles 340 to 345 relating to fraudulent trading.
Insolvency procedures

Insolvency procedures can be commenced in the Netherlands if the Dutch court has jurisdiction, based on the fact that (1) it has its centre of main interest (COMI) in the Netherlands or (2) it has an establishment in the Netherlands, or (3) if the COMI is located in a non-Member State, the company has (had) its corporate seat or place of business in the Netherlands. Whether a company has its COMI or an establishment in the Netherlands is a matter of fact.

Pursuant to Dutch law, two types of insolvency proceedings exist under the DBA: restructuring proceedings involving suspension of payments (moratorium) and liquidation proceedings, being bankruptcy.

Suspension of payments

Suspension of payments can be used to restructure debts due to non-preferred, non-secured creditors that are subject to the suspension of payments (ordinary creditors). Preferred and secured creditors fall outside the scope of suspension of payments. If the composition plan is accepted by the (required majority of) ordinary creditors and confirmed by the court, the suspension of payments proceedings are terminated and the debtor emerges from the insolvency proceedings.

The contents of the composition plan can be flexible (debt-to-equity swaps are allowed). Dutch law does not differentiate between classes of ordinary creditors (and secured creditors cannot be bound by a composition plan). Nonetheless, different treatments of different ordinary creditors have been accepted in practice to a certain extent.

The thresholds for adoption of a composition plan are (1) a simple majority of creditors representing at least 50 per cent of the claims recognised and admitted. Even if the composition plan does not reach the required thresholds, a plan may be deemed approved by the court if three-quarters of the recognised and admitted creditors voted in favour, but the plan was rejected because one or more creditors voted against who, in the circumstances, could not reasonably have voted in favour.

In a suspension of payments, payments to ordinary creditors (other than through the plan) can only be made pro rata. Ordinary creditors are prohibited from taking recourse against assets of the debtor. Existing seizures are suspended (and cancelled once suspension of payments or ratification of a composition plan becomes final). A suspension of payments does not suspend or affect pending court proceedings, nor does it prevent the commencement of new ones.

A suspension of payments has no effect in favour of guarantors and other co-debtors of the debtor.

During the suspension of payments, the court can impose a temporary stay, which also binds preferred and secured creditors.

The right of set-off is not adversely affected by the suspension of payments proceedings – if anything, the possibilities for set-off are increased.

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5 Note that Denmark is not a party to Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) [Recast Insolvency Regulation].

6 DBA, Articles 214 to 283.
Suspension of payments does not alter the validity or the contents of an agreement to which the debtor is a party, but the administrator is not obliged to perform executory contracts. The counterparty can request that the administrator and the debtor declare within a reasonable period of time whether they will perform the agreement.

**Bankruptcy**

Bankruptcy\(^7\) can be considered a general statutory seizure of the assets of a debtor followed by liquidation thereof. Although bankruptcy is a liquidation proceeding, it is also used to restructure businesses.

In principle, all creditors have an equal right to be paid out on a pro rata basis. An exception applies to preferred creditors (such as tax authorities), secured creditors and creditors with a subordinated claim. Dutch law does not contain a principle of statutory subordination of shareholder loans.

Secured creditors may foreclose on their collateral as if no bankruptcy exists, but a temporary stay can affect the right of secured creditors to foreclose on their collateral. The receiver is entitled to set a reasonable period of time during which a secured creditor must foreclose on its collateral.

Lawsuits pending against a debtor are automatically suspended, and claims are to be filed in the bankruptcy. If the claim is challenged, the lawsuit is continued. Since the bankrupt debtor has lost its right to administer and dispose of its assets, lawsuits can only be conducted by the receiver.

Bankruptcy alters neither the validity nor the contents of an agreement to which a debtor is a party; however, the receiver is not obliged to perform the contract. The counterparty may request that the receiver declare in writing whether he or she will perform the agreement within a reasonable period of time. If not, the receiver loses his or her right to claim performance. In practice, this will result in the counterparty filing a claim for damages as a result of the receiver not performing the contract. The DBA provides for termination provisions only in respect of certain specific types of agreements (such as including employment agreements, lease agreements, hire purchase agreements and future trades).

The law provides for clawback action by the bankruptcy receiver, invalidating voluntary acts performed by the debtor prior to insolvency proceedings, in situations where such acts were detrimental to the joint creditors and the counterparty knew or ought to have known about that detriment. In certain circumstances, even obligatory acts of the debtor can be challenged.

The right to set off claims remains valid in bankruptcy and the possibilities for set-off are increased.

Bankruptcy proceedings can last as long as several years, depending on the kind and size of the bankruptcy, and usually end with the dissolution of the company.

**Ancillary proceedings – international context**

When Dutch main insolvency proceedings have been opened, the insolvency administrator, as well as the creditors, can apply for the opening of secondary proceedings in other EU Member States.\(^8\) When foreign main proceedings have been opened under the Recast

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7 ibid., at Article 1-213.
8 Recast Insolvency Regulation, Article 34.
Insolvency Regulation, secondary proceedings may be opened in the Netherlands if an establishment exists. Under the Recast Insolvency Regulation, secondary proceedings can be liquidation proceedings (i.e., leading to bankruptcy) or rescue proceedings. The Regulation also provides rules for coordination between insolvency proceedings relating to different companies forming part of a group of companies (such as rules on cooperation between the actors involved in those proceedings and rules on the coordination of group insolvencies, such as the possibility to appoint a group coordinator).9

iv  Starting proceedings

Suspension of payments

A company (i.e., its directors) can file for suspension of payments if it foresees that it will not be able to continue to pay its debts as and when they become due, and that restructuring (instead of liquidation) as a going concern, if need be following an arrangement with creditors, is possible in the future. This is a liquidity test. Dutch law does not provide for a formal balance-sheet test as grounds for the opening of insolvency proceedings.

No shareholder approval is required, unless the articles of association provide otherwise. An application for suspension of payments cannot be made by a creditor or a third party.

Upon request, the court will immediately grant a provisional suspension of payments and appoint an administrator (usually a lawyer specialising in insolvency law) and usually a member of the court as supervisory judge. No other stakeholders, such as creditors or shareholders, are heard prior to the court granting the provisional suspension of payments.

The provisional suspension of payments may only be converted into a definitive suspension of payments if a meeting of creditors has taken place (to vote thereon). Appeals to the Court of Appeal and subsequently to the Dutch Supreme Court can be lodged by the debtor, or by the creditors who did not vote in favour of the suspension of payments.

If, in the course of a suspension of payments, the administrator does not foresee that all claims will be settled, or dealt with through a composition plan, he or she must file for termination of the suspension of payments; equally, creditors may request termination of the suspension of payments. The court can (and generally will) open bankruptcy proceedings when terminating the suspension of payments. Thus, once the company has filed for suspension of payments, there is a risk that an administrator will file for bankruptcy against the directors’ intentions.

When a request for suspension of payments and a prior third-party request for bankruptcy are pending concurrently, the request for suspension of payments will be heard first.

Bankruptcy

If a debtor has ceased to pay its debts as they fall due, it will be declared bankrupt by the court, either at its own request or at the request of one or more creditors. To have ceased to pay its debts, there must be at least two creditors, one of whom has a claim that is due and payable and which the debtor cannot pay or refuses to pay. If the petitioner is a company, the directors need shareholder approval to file. If the petitioner is a creditor, the petition must

9 ibid., at Chapter V.
contain *prima facie* evidence of the petitioner’s claim against the debtor. Again, the test for bankruptcy is a liquidity test. Dutch law does not provide for a formal balance-sheet test for the opening of insolvency proceedings.

If the bankruptcy request is filed by a creditor, the court will hear the debtor before deciding on the request. Usually, such a hearing takes place within two to three weeks of the filing of the petition, and the decision is taken within a week of the hearing. If the debtor objects to the filing, the court may adjourn the hearing, for example, to see whether the filing creditor and the debtor can find an alternative solution.

If the debtor files voluntarily, it is at the court’s discretion whether it wants to hear the debtor before deciding on the request. In principle, creditors and other stakeholders are not invited to be heard prior to deciding on a voluntary filing. A decision on a voluntary filing (albeit including hearing the debtor) will usually be made within a few days or, at most, one week of filing.

Upon declaring bankruptcy, the court will appoint one or more receivers (usually lawyers specialising in insolvency law) and a supervisory judge.

Appeals to the Court of Appeal and subsequently to the Dutch Supreme Court can be lodged by the debtor, the creditors or interested parties against a judgment declaring or refusing to declare the bankruptcy of the debtor.

All suspension of payments and bankruptcies are published in the register of the District Court where they were ordered, in a central public register that is accessible on the internet and in the Government Gazette.

### v Control of insolvency proceedings

#### Suspension of payments

Dutch insolvency law does not provide for a true debtor-in-possession procedure. During suspension of payments, the managing board of the debtor is entitled only to administer and dispose of the company’s assets with the consent or cooperation of the administrator, and vice versa. However, only the debtor is entitled to propose a composition plan to its creditors, giving the debtor control over the contents of the composition plan.

The supervisory judge in a suspension of payments has a purely advisory role.

#### Bankruptcy

A debtor loses the right to dispose of its assets and such power is vested in the receiver, albeit subject to certain actions requiring the approval of the supervisory judge.

The supervision of the supervisory judge entails, *inter alia*, that, for a number of actions (e.g., a private sale of assets of the bankrupt estate or the (temporary) continuation of the business of the debtor), consent of the supervisory judge is required. In addition, each creditor (as well as the debtor itself) may file a petition with the supervisory judge to object to any act by the receiver or to request an order that the receiver perform an act or refrain from performing an act.

Although the directors of a bankrupt company keep their corporate authorities, they can no longer control, administer or dispose of the assets of the bankrupt company. An important duty of the board of directors is to provide the receiver with necessary information and the bookkeeping of the company.

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10 Central Insolvency Register of the Dutch judiciary <http://insolventies.rechtspraak.nl>.
Dutch law does not grant a right to creditors to appoint or replace an administrator or receiver. This decision is conferred on the supervisory judge and replacement is subject to the administrator not fulfilling his or her task properly. Creditors may request that the supervisory judge do so, but this is rare.

vi Special regimes
The DBA contains specific provisions for the bankruptcy of credit institutions and insurance companies. Furthermore, the AFS contains specific provisions on the recovery of, and resolution plan proceedings for, financial institutions and insurance companies.

On 13 June 2012, the Intervention Act was incorporated into the AFS. The Intervention Act allows the Dutch Central Bank and the Dutch Minister of Finance to intervene in situations where major financial institutions are in financial difficulties. The Act relies on the ‘no-creditor-worse-off’ principle in the event of the transfer of part of the assets or liabilities. The Act gives the Dutch Central Bank powers that relate to the sale of the shares in the struggling institution, its deposits (with funding from the deposit guarantee scheme) or its assets or liabilities to a private party. Furthermore, if there is a serious and immediate threat to the stability of the financial system as a result of the struggling institution’s situation, the Minister of Finance has the power to intervene in the internal powers of the financial institution or to expropriate the assets of, or shares in, that financial institution. The Minister of Finance exercised this power in February 2013 with the expropriation of SNS Bank (which led to much litigation, which is still ongoing).

If insolvency proceedings are initiated in the Netherlands with regard to several companies within one group, the courts may appoint one administrator for all the entities; however, if the interests of the different entities do not coincide, the courts can appoint separate administrators. In the latter case, each administrator will have to act primarily in the interests of the creditors of his or her estate. Substantive consolidation is not recognised under Dutch insolvency law.

vii Cross-border issues
The Netherlands has not adopted the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law).

Dutch private international law applies the principle of territoriality, meaning that foreign insolvency proceedings (outside the European Union) will not automatically be recognised in principle. A general seizure of assets pursuant to foreign insolvency proceedings does not affect the assets of an insolvent debtor located in the Netherlands and the consequences of a foreign insolvency cannot be invoked in the Netherlands to the extent that this means that the creditors could no longer take recourse from the assets located in the Netherlands.

It is generally accepted and confirmed in case law, however, that foreign insolvency law rules relating to the authority of a foreign administrator to represent the insolvent debtor and to dispose of its assets are recognised in principle, provided that the foreign insolvency proceedings have not been opened in a manner contrary to Dutch public policy.

11 DBA, Article 212, Paragraphs g to nna.
12 ibid., at Article 213 to 213kk.
13 Act on Financial Supervision, Article 3:135-3:149 and 3a:1:-3a138.
14 Dutch Supreme Court, 13 September 2013 (ECLI:NL:HR:2013:BZ5668), also known as the Yukos case.
In practice, Dutch courts are generally open to assisting foreign courts, provided that the assistance is not contrary to the rules of public policy. With regard to issues such as forum shopping, the Dutch courts tend to take a critical approach; international principles of COMI and establishment are given due consideration when hearing a request for the opening of insolvency proceedings.

**European insolvency regulation**
Foreign insolvency proceedings within the European Union are recognised pursuant to the Recast Insolvency Regulation. Thus, insolvency proceedings opened in the other EU Member States (except Denmark) are automatically recognised in the Netherlands in accordance with the Recast Insolvency Regulation.

## II INSOLVENCY METRICS

The Dutch economy has been showing signs of sustained improvement. According to Statistics Netherlands (CBS), the Dutch economy grew by 2.7 per cent in 2018, which is the second highest growth since 2007. Gross domestic product is forecast to continue to grow less steadily in the coming years (1.5 per cent in 2019 and 2020). The growth seen in 2018 is mainly as a result of domestic spending, such as consumption and investment, which is mainly due to increased employment. The unemployment rate fell from 4.9 per cent in 2017 to 3.8 per cent in 2018.

As the economy has picked up, the number of bankruptcies has continued to decline. The number of businesses and institutions (excluding one-man businesses) that were declared bankrupt in 2018 was 3,145, which is more than 4 per cent less than in 2017 and the lowest number so far this century. The decrease is much smaller than in the four previous years. The number of bankruptcies reached a peak of 8,376 in 2013, since when the number has decreased steadily in line with the improving economic situation during this period.

## III PLENARY INSOLVENCY PROCEEDINGS

### i Pre-packs – silent administrators

Possibly the most significant development in the past few years in Dutch insolvency proceedings has been the increasing use of pre-packs (i.e., pre-packaged insolvency restructurings) and the use of silent administrators (and recognition of the added value thereof across the Dutch legal profession).

Although it currently has no formal basis in Dutch statute (though a draft bill has been submitted to Parliament), the courts have been willing to hear a debtor’s request for (and in rare cases, even upon a formal application by a creditor) and to appoint (informally) a silent insolvency administrator prior to the opening of formal procedures. This allows for the debtor and the silent administrator to try to restructure the entity outside formal proceedings. If this is not feasible, it allows for a sale or restructuring of the debtor’s business.

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to be pre-arranged with the assistance of the informal administrator and under the supervision of an (informal) supervisory judge. This increases the chances of a successful restructuring in formal insolvency proceedings.

In the past, all types of businesses – retail, fashion and flower exports, healthcare and hospitals, media and entertainment – have made use of the involvement of (silent) administrators prior to bankruptcy to restructure the business. Furthermore, a diversity of courts and administrators have been involved, meaning that the use of silent administrators and pre-packs has developed throughout the Netherlands.

Most cases that have made use of this tool concerned operational businesses (many of which had suffered as a result of the economic crisis) that were in need of (considerable) debt reduction but, in principle, were viable businesses. The successful restructurings were mostly done in cooperation with the secured creditors (mostly senior bank debt) and the debtor.

After a rather positive start, with a lot of success stories, Dutch pre-pack practice has faced growing criticism during the past five years. Critics mainly claim that the bidding process lacks transparency and that pre-packs are misused to shed jobs (owing to non-applicability of the rules on transfer of undertaking). This has led to a judgment of the European Court of Justice (ECJ) dated 22 June 2017 in the Estro case described in Section III.ii. The negative publicity regarding the case and the ECJ Estro ruling has resulted in the reluctance of courts to facilitate pre-packs and silent administrations, and in a draft bill concerning the rights of employees in the event of the transfer of a company into bankruptcy (see Section V.ii).

**ii Estro Groep BV**

Estro Groep BV et al (Estro), the largest Dutch childcare provider, was declared bankrupt on 5 July 2014. Of Estro’s 380 locations, 130 were closed, and the employment contracts of about 1,000 employees (of a total of roughly 3,600) were terminated. By means of a pre-packed bankruptcy sale, and immediately upon the opening of the formal bankruptcy proceedings, the viable parts of the underlying business of Estro were transferred as a going concern to Smallsteps BV, so as to continue the business in a smaller form. The owner of Smallsteps BV is HIG Capital, which also owns Estro.

This pre-packed bankruptcy sale is one of many transactions and restructurings that have taken place by means of a pre-pack. Nonetheless, and possibly since the bankruptcy of Estro caused a lot of employees to lose their jobs, the case has received a lot of press attention and criticism.

In February 2015, the trade union AbvaKabo FNV initiated legal proceedings against Estro/Smallsteps for abuse of bankruptcy proceedings (merely) for the termination of the employment of roughly 1,000 employees. The trade union based its claim on the fact that the European rules of transfer of undertakings should apply in this case, despite those rules not being applicable, in principle, in a Dutch bankruptcy. Council Directive 2001/23/EC relating to the safeguarding of employees’ rights in the event of transfers of (or parts of) undertakings provides that the requirement to assume all employment contracts does not apply when the

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16 Early examples are Schoenenreus BV (January 2013), DEPT BV (December 2012), Opinion Test en Taste BV (October 2012), Van Straten Bouw BV (October 2012), Harense Smid BV (July 2013), Ruwaard van Putten Ziekenhuis (June 2013), Weijmans Media Groep BV (May 2013), Het Groene Kruis (June 2013), Moes Bouw BV (August 2012), Prime Champ Productions BV (April 2013), Ciccolella (February 2013), Drukkerij Dijkman (June 2013), Pelican Tijdschriften (March 2013), Marlies Dekkers (August 2013).
transferor is the subject of bankruptcy proceedings or any analogous insolvency proceedings that have been instituted with a view to the liquidation of the assets of the transferor. Based on that Directive, Dutch law stipulates that the rules of transfer of undertakings do not apply in the case of a transfer of undertaking by a transferor in bankruptcy.

AbvaKabo FNV has asserted that the Estro case was not a bankruptcy instituted with a view to the liquidation of the assets of the company and a subsequent sale of a viable part of an otherwise bankrupt enterprise, but a bankruptcy and subsequent sale with the aim of restarting the business. Therefore, the actions of Estro should be considered a proper transfer of an undertaking to which the regular rules of the transfer of undertakings should apply, which were circumvented through an abuse of Dutch bankruptcy law. On 24 February 2016, the court of first instance asked for a preliminary ruling from the ECJ on whether a pre-pack sale has to be considered a transfer of undertaking. The ECJ delivered its judgment on 22 June 2017. It ruled that the protection of workers guaranteed by Directive 2001/23/EC does apply in a situation, such as in the main proceedings, in which the transfer of an undertaking in the context of a pre-pack prepared before the declaration of insolvency and put into effect immediately after the declaration of insolvency.

The exact consequences and legal implications of this ruling for future pre-packs and pre-packs that have been carried out in the past remain unclear. As a result of this ruling, Dutch courts have become more reluctant to facilitate pre-packs without a clear legal basis (for which a draft bill is still pending). The ruling also resulted in a separate draft bill concerning the rights of employees in the event of the transfer of a company into bankruptcy. This bill is described in Section V.ii.

The bankruptcy of Estro Group BV is interesting since it is the first Dutch bankruptcy in which the receiver has requested the Enterprise Chamber, on the basis of a new statutory provision, to investigate the policy of the company. In the Netherlands, a receiver is obliged to investigate the causes of the bankruptcy and the DBA provides him or her with the tools to do so. However, an investigator appointed by the Enterprise Chamber has more investigative powers than a Dutch receiver. The request is still pending before the Enterprise Chamber and a decision on the opening of the investigation is expected in 2019.

iii Oi Group

The Oi Group is one of the world’s largest integrated telecommunications service providers, with its operations primarily located in Brazil. Oi’s shares are listed on the São Paulo and New York stock exchanges. Oi Group has two main financing companies incorporated in the Netherlands.

Owing to a combination of factors, the financial situation of the Oi Group has been declining in recent years.

The largest debts of the Oi Group stem from loans and bonds (the total debt was reported to be approximately 65 billion reais). Around April 2016, Oi Group entered into negotiations with its creditors (including the note holders of the Dutch special purpose vehicles) to reach an agreement on an out-of-court restructuring.

As the Oi Group was unable to reach such an agreement, it filed for in-court restructuring proceedings in Brazil (reconvenção judicial (RJ)) for certain entities within the Group, including the two Dutch companies, being the first Dutch entities to be subjected to Brazilian insolvency proceedings. This filing is considered the largest reorganisation petition in Brazil’s history. In June 2016, the Brazilian court opened the RJ proceedings for certain entities in the Oi Group, including the two Dutch companies. Since Brazilian insolvency
proceedings are not automatically recognised in the Netherlands, the Dutch companies were subjected to Dutch suspension of payment proceedings, and both the composition plan offered and the creditors’ meeting due to vote on the plan have been aligned with the Brazilian RJ, meaning that the aim is for the Brazilian and Dutch insolvency proceedings to run concurrently and in cooperation. Further, the suspension of payments proceedings was preceded by a silent administration period, to allow the administrator and the court to be informed of the contemplated alignment of the Brazilian and Dutch proceedings, which was a new purpose for using silent administration in Dutch insolvency practice (rather than for a pre-packed sale). On 19 April 2017, the suspension of payments granted to the two Dutch companies were converted into bankruptcy proceedings by the Amsterdam Court of Appeal at the request of a group of bondholders. The two Dutch companies also remained in the Brazilian RJ within which the Oi Group still strived to come a restructuring of the Oi Group. On 19 and 20 December 2017, Oi Group creditors voted in favour of a restructuring plan (the RJ Plan) in the Brazilian RJ proceedings.

As mentioned in Section I.vii, Dutch private international law applies the principle of territoriality, meaning that foreign insolvency proceedings (i.e., outside the European Union) will not be recognised automatically, in principle. Therefore, to ensure that all material aspects of the RJ Plan are given binding effect in the Netherlands, as part of the Dutch bankruptcy proceedings the Dutch entities offered a composition plan to their creditors that mirrors the RJ Plan. The creditors of the Dutch companies voted in favour of the Dutch composition plan on 1 June 2018 and the court approved the plan on 11 June 2018. As the Dutch composition plan has now become final and binding, the Dutch bankruptcy of the Dutch companies has ended successfully, with the companies emerging from bankruptcy.

iv Steinhoff Group

Steinhoff is a South African international retail holding company that has dual listing in Germany. Steinhoff deals mainly in furniture and household goods, and operates in Europe, Africa, Asia, the United States, Australia and New Zealand. Two Dutch companies are part of the Steinhoff Group (International Holdings NV, the head of the group, and Hemisphere International Properties BV).

In December 2017, Steinhoff’s chief executive officer (CEO) resigned after the company announced possible accounting irregularities. The share price dropped by 66 per cent and later by more than 90 per cent as it became public knowledge that the company had overstated profits and assets by nearly US$12 billion. From an investigation by PwC, it followed that eight people, including former Steinhoff executives, were involved in a scheme whereby potential intercompany transactions worth €6.5 billion were fraudulently recorded as external income to prop up profits and hide costs in money-losing subsidiaries. In March 2019, the company share price was still 96 per cent down on its value before the scandal erupted.

Steinhoff is now under new management and is working to clean up its balance sheet following the fraud, with a view to implementing a financial restructuring of the group to restructure almost US$12 billion of debt. Steinhoff itself initiated legal proceedings against its former CEO.

Steinhoff is subject to several investigations and is facing a string of law suits. The Dutch court assumed jurisdiction to review class actions against the group. The case concerns a group of investors who claim to have suffered losses as a result of the accounting fraud. From this decision, it follows that the Netherlands can play a part in cross-border class
actions when Dutch group companies are included as defendants (or co-defendants). As many multinationals use Dutch companies as holding or finance companies within their group, this is noteworthy. The judgment further illustrates how Dutch courts are willing to take on cases even when similar proceedings are pending in other jurisdictions (in this case Germany and South Africa).

v Agrokor Group

Agrokor was a conglomerate, largely centred in agribusiness and with headquarters in Croatia. The company was founded in 1976 and expanded its operations significantly by acquiring a number of large companies in Croatia and south-east Europe. The Agrokor Group had an annual sales revenue of €6.465 billion in 2015, making it the second largest retailer and the eleventh largest of all companies in south-east Europe. As at 31 December 2017, Agrokor employed around 50,900 people.

Early in 2017, it became clear that Agrokor was suffering financial difficulties. To avoid a collapse that would have badly affected Croatia’s economic stability, the government, in March 2017, hastily drafted and passed the Law on Extraordinary Administration Procedure in Enterprises of Systematic Importance for the Republic of Croatia, introducing a court-supervised restructuring procedure on the basis of a going concern. Eventually, a successful settlement plan was constructed and the group revived after a major and complex restructuring in respect of its €5.8 billion of debt.

Although the company is mainly centred in south-east Europe, the restructuring also had a Dutch law angle. The group’s companies were transferred to the Fortenova Group on 1 April 2019. The holding structure of the Fortenova Group comprises three legal entities based in the Netherlands. Under the settlement plan, claims by Agrokor’s creditors have been assigned to the Fortenova Group, in consideration of new equity in the form of depositary receipts issued by a Dutch foundation (stichting administratiekantoor) and convertible bonds issued by the top Dutch holding company within the Fortenova Group. The purpose of the ‘foundation’ structure is to separate legal and beneficial ownership of the shares. The sole legal shareholder exercises the voting rights and other meeting rights corresponding with such shares and will be obliged to pass on all the financial benefits it derives from the shares to the holders of the depository receipts.

vi Bankruptcies in the non-food retail industry

The past few years have been tough for companies within the non-food retail sector and many well-known companies have gone bankrupt. Examples include retail chains selling bike and car accessories (Halfords, 102 locations and more than 530 employees), women’s clothes (Etam Groep, 200 locations and around 2,000 employees), shoes (Schoenenreus, 206 locations and 1,500 employees; Fred de la Bretoniere), jewellery (Siebel, 36 locations and 170 employees), sports goods (Unlimited Sports Group, which owned Perry Sport and Aktie Sport with a total of 2,300 employees), toys (Intertoys, 286 locations and 3,200 employees), fashion and homeland (Sissy-Boy, 45 locations and 600 employees), as well as fashion houses (Mexx, 315 locations throughout Europe and 1,500 employees in 50 countries; McGregor; Coolcat; Men At Work; Supertrash) and budget pharmacies (Op=Op Voordeelshop, 130 locations and 1,164 employees).

There have been three main causes for this trend. The first is the fierce competition from online shopping. Many of the above-mentioned companies followed a traditional model with a main focus on sales from physical shops rather than via the internet. The second reason
is that these companies were still suffering the effects of relatively low consumer trust. The third reason is the high cost of premises. Most of these companies have been renting premises at high market prices that date from before the economic crisis. These high running costs (combined with the low sales) often pose a threat to the continuity of the business. Whereas Dutch law does not yet provide for a mechanism to cram down creditors outside insolvency proceedings, these companies had to go through formal bankruptcy proceedings to try to restructure their businesses. Most notably, V&D, one of the largest Dutch department store groups (63 locations in the Netherlands and more than 10,000 employees) was unable even to be restructured or partially sold during its bankruptcy (with the exception of the La Place food and restaurant division), resulting in the piecemeal liquidation of assets and loss of all jobs.

vii Hospitals
In June 2013, the Ruwaard van Putten Ziekenhuis was the first hospital to be declared bankrupt in the Netherlands for more than 20 years. It was suffering financial problems during 2011 and 2012, partly as a result of changes in the national arrangements for financing healthcare, whereby, since 2011, hospitals have to negotiate with insurers themselves about the reimbursements for the care provided. In addition, the financial burden for hospitals had become heavier because the government was no longer contributing to premises costs. At this time, liquidity problems arose at the Ruwaard, which were alleviated with advances from insurers. Further, there was tension between the hospital’s management and the partnerships of specialists. The reputation of the Ruwaard suffered at a time when public perception was not positive anyway. This reputational damage became irreversible following the immediate closure of the cardiology department following an order issued by the Healthcare Inspectorate in November 2012.

Two other hospitals in the Netherlands were declared bankrupt in 2018 – the MC Slotervaart and the IJsselmeerziekenhuizen. The financial situation at both hospitals had been deteriorating rapidly in recent years. According to the institutions, this was mainly due to the fact that it became more expensive to hire staff, because of the tight labour market. The receivers are still in the process of investigating the causes of the bankruptcies of these two hospitals.

IV ANCILLARY INSOLVENCY PROCEEDINGS
As the Netherlands has not adopted the Model Law, the concept of ancillary proceedings does not apply. However, there have been a number of cases in which insolvency proceedings were opened in the Netherlands as the main proceedings over a Dutch finances company.

To a certain extent, these types of proceedings are ancillary to foreign insolvency proceedings. Several foreign groups use Dutch corporates as finance vehicles to extract funds from the market by means of issuing bonds, the proceeds of which are subsequently on-lent to the group. In the past, several of these groups have faced financial difficulties and sought to restructure outside or through formal insolvency proceedings. If, and to the extent, an out-of-court restructuring failed for the group, this inevitably led to the insolvency of the Dutch finance company. High-profile cases include Oi Group, Petroplus International BV, Pfeiderer Finance BV and Global PVQ Netherlands BV, the finance vehicle of the German company Q Cells. These finance companies hold major claims in the insolvency of their group companies, and their major creditors often include bondholders or other financial creditors.
Since the only asset of the Dutch company is usually the inter-company claim against the insolvent group members, it is in the immediate interests of the creditors of the Dutch insolvent companies that the insolvencies of the foreign group companies are successfully conducted. Furthermore, as major creditors, the Dutch companies may have a large influence on the conduct of such foreign proceedings. Thus, these Dutch insolvency proceedings can play an important part in these pending foreign insolvency proceedings.

In the case of the Oi Group, the Dutch companies were subject to both Brazilian and Dutch proceedings. It is currently not clear whether the Dutch proceedings were ancillary or main proceedings compared to the Brazilian proceedings, since both courts have assumed jurisdiction to open main proceedings, and as there is no treaty in place and since the Netherlands has not adopted the Model Law, there is no formal necessity to establish which proceedings are the main proceedings. However, the petition that the Dutch companies filed to open suspension of payments proceedings indicated that the companies aimed to have the Dutch proceedings assist the successful restructuring of Oi Group in the Brazilian proceedings.

V TRENDS

The Netherlands Commercial Court

The Netherlands Commercial Court (NCC) has been set up to settle international trade disputes. The NCC, which has been operating since 1 January 2019, enables parties to conduct their Dutch legal proceedings in English. This allows foreign English-speaking parties and lawyers to be actively involved in the proceedings, and decreases the costs of translating pleadings and other documents.

The NCC will apply Dutch civil procedural law.

The judges at the NCC are specialists in international trade law and experts in handling commercial disputes, such as contract disputes, pre-contractual issues and contract breaches. The NCC will focus on international trade disputes in a broad sense, and will not judge cases or claims that fall within the exclusive competence of another court (such as the Patent Court).

A matter may generally be submitted to the NCC when the following requirements are met:

a the action is a civil or commercial matter within the autonomy of the parties and is not subject to the jurisdiction of the subdistrict court or the exclusive jurisdiction of any other Dutch chamber or court;

b the matter concerns an international dispute;

c the parties to the proceedings have designated the Amsterdam District Court as the forum to hear their case or the Amsterdam District Court has jurisdiction to hear the action on other grounds; and

d the parties to the proceedings have expressly agreed in writing that court proceedings will be before the NCC in English.

All parties can lodge an appeal against a judgment by the NCC to the competent Dutch court of appeal and the Supreme Court. The first decision rendered by the NCC concerned the NCC approving an enforcement on shares by the security agent by means of a private sale.

17 See https://www.rechtspraak.nl/English/NCC/Pages/default.aspx.
ii Improvements to bankruptcy law

In November 2012, the Minister of Justice launched a legislative programme named the Recalibrating Insolvency Law. The programme aims to improve Dutch insolvency law, with a focus mainly on three areas: insolvency fraud, modernising Dutch bankruptcy law, and the ability to restructure companies.

With regard to insolvency fraud, two bills entered into force on 1 July 2016. The first increases the possibilities for using criminal law in cases of insolvency fraud by, *inter alia*, simplifying the rules on fraudulent bankruptcy and increasing the penalties for failing to comply with information duties. The second bill concerns the disqualification of directors for five years if they have manifestly improperly performed their tasks during the three years prior to insolvency. A third bill concerning the strengthening of the fraud alert duties of receivers entered into force on 1 July 2017.

With regard to modernising Dutch bankruptcy law, a bill entered into force on 1 January 2019, the main purposes of which are improving the provision of information to creditors and making bankruptcy proceedings more transparent and better aligned with digital developments.

With regard to restructuring companies, the government is working on several bills. One of these offers a statutory basis for a Dutch law pre-pack or silent administration. The government introduced the Draft Bill on Continuity of Undertakings I on 22 October 2013. The aim of this draft bill is to regulate the pre-pack without stripping away its advantages, but still granting restructuring practitioners sufficient leeway to apply the pre-pack to very different cases. The draft bill was adopted by Parliament in July 2016 and sent to the Dutch Upper House subsequently.

Subsequent to the opinion issued by the advocate general to the ECJ in the aforementioned Estro case, the Dutch Upper House asked Parliament how the case might affect the draft bill in terms of creating a legal basis for pre-packs. In a letter of 11 April 2018, Parliament responded that, despite the Estro case, there was still a need for a Dutch pre-pack and, therefore, it requested the Dutch Upper House to resume the debate on the bill. This debate has resulted in a first draft bill concerning the rights of employees in the event of the transfer of a company into bankruptcy. In short, it is proposed that employees who are employed by a bankrupt employer at the time of a declaration of bankruptcy will, at the time of the transfer of the company, in principle be employed under the same employment conditions for the person who takes over and continues the company in the bankruptcy (hereinafter, the transferee). The transfer itself cannot be a reason for the transferee to deviate from this principle. Only if jobs disappear during the transition, and those losses result from economic circumstances, is the transferee allowed to take on fewer employees. In that case it is determined, in an objective and transparent way, which employees will and will not go. The first draft bill is open for consultation. It is expected to receive a lot of criticism from insolvency lawyers.

Another draft bill introduces a cramdown mechanism outside formal insolvency proceedings, similar to a UK scheme of arrangement. On 8 July 2019, the Dutch government sent a draft bill to Parliament titled ‘Act on the confirmation of a private restructuring plan in order to prevent bankruptcy’.18 This draft bill introduces a statutory framework for a pre-insolvency restructuring similar to the UK scheme of arrangements. The previous drafts

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18 The draft bill replaces an earlier similar draft bill titled ‘Continuity of Undertakings II’, which was introduced on 14 August 2014.
of the bill were generally well received. The exact timing for implementation of the Dutch bill remains uncertain, but it is expected that it will enter into force in the course of 2020. The bill fits within the framework of Directive (EU) 2019/1023, which is a minimum harmonisation directive on preventing restructuring frameworks, on discharge of debt and disqualifications, on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132.

iii Brexit

A major development in larger restructuring cases, which started in 2012 and 2013, is the use of English law schemes of arrangement to restructure Dutch corporate entities.19 Thus far, the recognition of such a scheme by the Dutch courts has not yet been tested, but across Europe a number of large restructurings have successfully taken place in that manner. It is expected that, after Brexit, the English courts will still be willing to sanction foreign company schemes. However, the more difficult question is whether the English law schemes will be recognised in the Netherlands (and other EU Member States) after the United Kingdom has left the European Union.

19 For example, Re NEF Telecom Co BV [2012] EWHC 2944 (Comm) and Re Van Gansewinkel [2015] EWHC 2151 (Ch); [2015] WLR (D) 326 and other cases involving Dutch corporates are currently pending. The scheme of arrangement of Van Gansewinkel, a large Dutch waste management company, was sanctioned in July 2015. The group consisted of five Dutch companies and one Belgian company, headed by the Dutch Van Gansewinkel Groep BV.
Chapter 21

POLAND

Bartłomiej Niewczas and Dominik Hincz

I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

Since 1 January 2016, insolvency in Poland has been regulated by the provisions of the Bankruptcy Law of 28 February 2003 (known as the Bankruptcy and Reorganisation Law until 1 January 2016) and the Restructuring Law of 15 May 2015, which is an entirely new legal act.2

These two Acts regulate the situation of companies that are struggling with insolvency – both at an early stage (the threat of liquidity loss) and at its very advanced stage (bankruptcy). Together, the Acts provide a comprehensive set of rules of conduct used in cases of insolvency or the threat of insolvency of the debtor, and introduce substantial reform to Polish insolvency law.

The main purpose of the amendment of the Bankruptcy and Reorganisation Law was to adjust Polish law to internationally applied and accepted practices, and thus to provide companies with access to procedures providing both effective restructuring of liabilities and tools to protect creditors.

The key changes, apart from separating restructuring and reorganisation procedures from insolvency proceedings, include, inter alia:

a introducing four new restructuring proceedings (arrangement approval proceedings, accelerated arrangement proceedings, arrangement proceedings, remedial proceedings);3
b changing the definitions of ‘debtor insolvency’ and ‘threatened with insolvency’;4
c clarification of bankruptcy prerequisites;5
d introduction of pre-packaged liquidation;6
e the increased role of the Council of Creditors;7
f changes to claims categories and lists of claims.8

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1 Bartłomiej Niewczas is a counsel and Dominik Hincz is an associate at Bird & Bird Szepietowski i wspólncy sp. k. The authors would like to thank Patrycja Piotrowska, a former associate at the firm, for her contribution to this chapter.
3 Restructuring Law, Articles 210 to 323.
4 Bankruptcy Law, Article 11.
5 ibid., at Articles 11 to 13.
6 ibid., at Article 56, paras. a to h.
7 ibid., at Articles 201 to 213.
8 ibid., at Articles 239 to 245a and 342.
Respective provisions concerning insolvency law matters are contained in other legal acts, such as the Civil Code (provisions concerning a creditor’s protection in the event of a debtor’s insolvency), the Penal Code (regulations on crimes involving thwarting the satisfaction of a creditor) and the Commercial Companies Code (provisions governing the liability of board members for non-compliance with the Bankruptcy Law), which also underwent changes owing to the reform of Polish insolvency law.

ii Policy

In recent years, there has been a clear trend indicating primarily a change in attitudes towards businesses that have fallen into insolvency.

The legislator considered that the preferred form of resolving insolvency problems was restructuring, the purpose of which is to conclude an arrangement with creditors, and consequently the survival of the business within the market.

For these reasons, the need to change existing insolvency regulations has become obvious. The source of the chronicity and ineffectiveness of insolvency proceedings was recognised in the regulations in force up to 1 January 2016.

At the heart of changes to the Bankruptcy Law, and the introduction of the new Restructuring Law, is the regulator’s idea that liquidation of a debtor’s property should be the last resort. Therefore, bankruptcy proceedings should be implemented only when it is obvious that it is the only path to ensure creditors can recover at least part of the amounts due. As long as there are chances for reaching an agreement with creditors through debt restructuring, the preferred form of the regulator is an arrangement.

According to the legislator, restructuring is beneficial owing to its twofold action: it allows the debtor to repair its business and the creditors to collect their receivables, while at the same time benefiting the economy, primarily by maintaining employment.

It is not yet possible to make a comprehensive assessment of the effects of introducing the new provisions of law since it is still only a short time since their entry into force. However, early experiences confirm that the overall goal of the new legislation has been achieved. This is reflected in the data derived from the Court and Economic Monitor, according to which there was a significant increase in 2016–2018 in the number of initiated restructuring proceedings.

iii Insolvency procedures

Restructuring proceedings

General overview

Polish insolvency law contains four separate procedures for concluding an arrangement with creditors – ranging from the less formalised, conducted to a large extent outside the court, to profound legal and factual restructuring carried out by the trustee under the strict supervision of the restructuring court.

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9 ibid., at Articles 230 and 343.
10 Restructuring Law, Article 5.
In general, both in commencing restructuring proceedings and preparing arrangement proposals, laying down the methods of restructuring a debtor’s liabilities are on the debtor’s side. Nevertheless, after the restructuring proceedings commence, alternative arrangement proposals may also be submitted by the court supervisor, administrator, sole creditor, creditors’ group or the council of creditors.

The restructuring court refuses to open restructuring proceedings if their effect would be detrimental to creditors, or when a decision on the declaration of bankruptcy is final and binding.

Arrangements may provide a wide range of restructuring methods, including, *inter alia*, spreading repayment of the debt by instalments, postponement of payment deadlines, conversion of receivables into shares, or a liquidation plan.

Each restructuring proceeding requires approval from the restructuring court of the arrangement accepted by the majority of the creditors. The court is entitled to reject the arrangement if it violates the law, if it is obvious that the arrangement will not be performed, or if it is detrimental to the creditors who voted against the arrangement and expressed reservations.

*Arrangement approval proceedings (Articles 210 to 226 of the Restructuring Law)*

This is the most informal and the simplest restructuring procedure, which is available to debtors who are able to reach an agreement with the majority of their creditors without involving the court. It does not require a list of creditors to be established. The main prerequisite for this procedure is that the sum of disputed claims does not exceed 15 per cent of the total claims.

This procedure involves the debtor’s continued management of its business, but subject to the appointment of a licensed supervisor, who acts as supervisor of the arrangement.

The debtor determines the arrangement date immediately after the arrangement supervisor begins performing its function.

This procedure does not include a creditors’ meeting for voting. The debtor presents the proposed restructuring plan to the creditors and collects their votes in writing (with the assistance of the licensed supervisor). Subject to obtaining the required majority of approving votes, the debtor submits an application to the court for approval of the agreement. This submission is required to be made within three months of the date of voting.

*Accelerated arrangement proceedings (Articles 227 to 264 of the Restructuring Law)*

This procedure is available if the sum of disputed claims does not exceed 15 per cent of the total claims. In comparison to arrangement proceedings, this procedure is simplified, mainly in the terms of the procedure for determining the claims carrying the voting rights.

Within this procedure, all enforcement proceedings regarding the claims to be covered by the arrangement are suspended by law. From the opening of the proceedings, the debtor is not allowed to perform any pecuniary and non-pecuniary obligations that are to be covered by the arrangement. The procedure consists of management of the debtor’s estate (arrangement estate) by the debtor, subject to this management being supervised by the court supervisor. However, in some cases, the court may not agree to the debtor’s self-administration and will appoint an administrator. The court’s involvement in this procedure is much greater than in arrangement approval proceedings. The restructuring court examines the debtor’s application
for opening the accelerated arrangement proceedings (not longer than one week after the application is filed), and issues a decision to open the accelerated arrangement proceedings, or to refuse such (the latter the debtor may appeal).

Arrangement proceedings (Articles 265 to 282 of the Restructuring Law)
This procedure applies only if the sum of disputed claims exceeds 15 per cent of all claims.

These proceedings are also commenced once a debtor’s application is filed before the restructuring court. The application should be accompanied by copies of the arrangement proposals.

This procedure involves an interim period (from filing the debtor’s application until the procedure commences) within which the restructuring court is entitled to appoint a temporary court supervisor to secure the debtor’s estate. In certain cases, the court may not agree to the debtor’s self-administration and will appoint an administrator to take over management of the debtor’s assets.

Analogous to accelerated arrangement proceedings, this procedure also assumes that all enforcement proceedings regarding the claims to be covered by the arrangement are suspended by law.

The main difference between this and accelerated arrangement proceedings is that, owing to the higher percentage of the disputed claims, the allowance of claims is more formalised, and consequently much longer. According to the assumptions, arrangement proceedings should be completed in approximately 10 months.

Remedial proceedings (Articles 283 to 323 of the Restructuring Law)
This is the most formalised of the restructuring procedures, but it ensures the broadest range of restructuring options, and the widest range of protection of a debtor’s assets against creditors. This procedure is also commenced once a debtor has filed an application with the restructuring court.

This procedure involves the mandatory appointment of an administrator (zarządcia) to take over the full management of the debtor’s assets (remedial estate), unless management by the debtor is necessary for successful restructuring and ensures proper management.

All enforcement proceedings regarding the claims to be covered by the arrangement are suspended by law. Remedial proceedings enable the debtor to carry out remedial actions and conclude the arrangement after the table of claims has been prepared and approved. Remedial actions include legal and business acts that aim to improve the debtor’s economic situation and restore the debtor’s capacity to perform its obligations, while protecting it against debt enforcement proceedings.

Bankruptcy proceedings
Pursuant to the regulations of Polish law, the only available insolvency proceeding is the procedure that stipulates the liquidation of a debtor’s assets. However, even in this far-reaching procedure, it is possible for a debtor to enter into arrangement with creditors.
Pre-packaged liquidation (Article 56, paragraphs a to h of the Bankruptcy Law)

This procedure introduces the possibility of filing an application for the court’s approval of the terms of the sale of the debtor’s enterprise or its substantial part, with the petition for bankruptcy. The application must specify at least the price and the purchaser, and be accompanied by a description and valuation of the assets prepared by an expert.

The court may accept or reject the application for approval of terms of sale in the bankruptcy order. The decision to accept the application may be contested by each of the creditors within one week of the date of its publication.

The sale agreement on terms specified in the court’s order must be concluded no later than 30 days after the date the decision becomes final, unless the terms and conditions of the agreement accepted by the court provide for a different time limit. Funds from such sales are used up in bankruptcy and are distributed among creditors appropriately. The speed of the sale is intended to increase the debtor’s enterprise’s chances of survival.

Main and ancillary proceedings

The Polish Bankruptcy Law provides for ancillary (non-main) insolvency proceedings in Poland, where the main proceedings are pending before a foreign court. Polish courts have exclusive jurisdiction over bankruptcy cases if the principal place of the debtor’s business is located in Poland. Ancillary bankruptcy proceedings occur when the Polish courts have no exclusive jurisdiction (i.e., if the principal place of the debtor’s business is not located in Poland). Polish courts are competent if the debtor is engaged in an economic activity, or has its place of residence or registered office or assets, in Poland. If Polish courts have exclusive jurisdiction, bankruptcy proceedings are considered to be main bankruptcy proceedings. In other cases, bankruptcy proceedings are considered to be secondary.

If a ruling to initiate foreign main bankruptcy proceedings has been recognised, bankruptcy proceedings initiated in Poland are always secondary bankruptcy proceedings.

iv Starting proceedings

Restructuring proceedings

The preconditions for commencing restructuring proceedings are insolvency or the risk of a debtor’s insolvency and restructuring capacity. The restructuring capacity is granted to the following types of entities:

- entrepreneurs,\(^{12}\)
- both limited liability companies and joint-stock companies that are not engaged in business activity;
- partners in commercial partnerships who are liable for the obligations of the partnership without limit with the entirety of their assets; and
- partners in a professional partnership.

Restructuring proceedings may be initiated only by an insolvent debtor or a debtor at risk of insolvency. Restructuring proceedings, unlike bankruptcy proceedings, are conducted only at the debtor’s request. Unless the Restructuring Law provides otherwise, restructuring

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11 Bankruptcy Law, Articles 379 and 382.
proceedings are instituted on the basis of a debtor's restructuring application construed as an application for the opening of the restructuring proceedings, and an application for approval of the arrangement adopted in the arrangement approval proceedings.

In an accelerated arrangement proceedings, the debtor is obliged to pay an advance to cover the expenses of the procedure to an amount equal to the average monthly remuneration in the sector of companies; however, the court may demand a higher amount. Also, in the proceedings for the opening of arrangement proceedings and remedial proceedings, the court may demand that a debtor make an advance payment towards the expenses thereof.

Bankruptcy proceedings

The main prerequisite for opening bankruptcy proceedings is the debtor's insolvency. A debtor is considered insolvent if it is no longer able to pay its debts as they fall due. It is presumed that the debtor is unable to pay its due debts if the delay in the payment of debts (towards at least two creditors) exceeds three months. Also, a debtor who is a legal person, or an organisational unit without legal personality that is granted legal capacity by a separate act of law, is considered insolvent when its debts exceed the value of its assets. The liabilities of a debtor are presumed to exceed the value of its assets if the balance sheet liabilities, excluding provisions for liabilities and liabilities owed to related entities, exceed the value of the debtor’s assets, and that situation continues for more than 24 months.

Bankruptcy can be announced against specific entities (bankruptcy capacity), namely:

a. entrepreneurs, unless otherwise provided for in the Bankruptcy Law;

b. limited liability companies and joint-stock companies that are not engaged in any business activity;

c. partners in commercial partnerships who are liable for the obligations of the partnership without limit with the entirety of their assets; and

d. partners within a professional partnership.

The regulation states that a petition to declare bankruptcy may be filed by a debtor or any of its personal creditors.

According to the amended Polish regulations, a petition to declare bankruptcy should be submitted to the court competent for the main centre of the debtor’s business. In the case of organisational units, it is presumed that the main centre of the debtor’s business is its registered office, and in respect of natural persons the place of business, or if a person does not conduct business, the place of his or her habitual residence.

The debtor shall make an advance payment for expenses arising in the course of proceedings in the matter of declaration of bankruptcy, in the amount of a single average monthly remuneration in the sector of companies.

Currently, bankruptcy proceedings are largely identical to liquidation bankruptcy, as it was known in legal terms before 1 January 2016.

Concurrent applications for restructuring and bankruptcy

Pursuant to the Bankruptcy Law, a company may not be declared bankrupt during the period between the commencement of restructuring proceedings and the termination or those proceedings or final discontinuance.
In the case of filing a restructuring application and a bankruptcy application at the same time, the restructuring application should be given priority and be examined first.

v Control of insolvency proceedings

Insolvency proceedings are conducted by the respective courts – restructuring courts in the case of restructuring proceedings, and bankruptcy courts in relation to bankruptcy proceedings. Both types of courts are special units of the district courts (the lowest tier of courts in Poland). Bankruptcy courts are long-established institutions, whereas restructuring courts were introduced on 1 January 2016.

Control of restructuring proceedings

Restructuring court

Restructuring proceedings always take place under court supervision. The role of the court depends on the type of restructuring proceedings, and varies from agreement approval in the arrangement approval proceedings, to active participation of the court in the process of repairing the company in remedial proceedings.

The restructuring court is made up of one judge. After the opening of restructuring proceedings, judicial acts in the proceedings are performed by the judge-commissioner, with the exception of those acts that are subject to the court that has jurisdiction.

The judge-commissioner

The judge-commissioner directs the course of restructuring proceedings, supervises the actions of the court supervisor and administrator, designates actions that the court supervisor or administrator are not permitted to perform without his or her permission, or without the permission of the creditors’ committee, and admonishes them for any misconduct they have committed. The judge-commissioner, in the scope of his or her acts, has the rights and duties of the court and presiding judge.

The judge-commissioner remains in office until the end of the proceedings, or until a decision to discontinue the proceedings becomes valid.

Control of bankruptcy proceedings

Cases involving a declaration of bankruptcy are heard by a bankruptcy court consisting of a panel of three professional judges. However, bankruptcy proceedings are conducted by a bankruptcy judge assisted by a bankruptcy receiver with the occasional involvement of the court.

Duties of management boards and boards of directors

The duties of a board of directors in connection with insolvency proceedings are regulated in the Bankruptcy Law and in the Commercial Companies Code of 15 September 2000. As a rule, pursuant to the Bankruptcy Law, a debtor is obliged to file a petition for bankruptcy with the court within the 30 days after the date on which the circumstances that give grounds to declare bankruptcy occurred.

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In the event that the debtor is a legal person or an organisational unit without legal personality that is granted legal capacity by a separate act of law, this obligation rests on each person, who is authorised to represent the debtor and manage its affairs, and is mainly applicable to members of boards of directors and liquidators. In the case of limited liability companies, these persons are liable for any damage caused as a result of their failure to file a petition within the established time limit, unless they are not at fault. Similar liability rests on the management board and liquidators of a joint stock company under the Bankruptcy Law. However, these regulations do not apply to proxies.

Additionally, under the provisions of the Commercial Companies Code, a member of a management board or a liquidator who fails to file a bankruptcy petition in the name of a commercial company, despite the occurrence of circumstances that give grounds for bankruptcy of the company or partnership under legal regulations, is liable to a fine, penalty of restriction of freedom or imprisonment of up to one year.

Central Register of Restructuring and Bankruptcy

Under the provisions of Regulation (EU) 2015/848 of the European Parliament and of the Council of 25 May 2015 on insolvency proceedings (the Recast Insolvency Regulation), as of 26 June 2018 Poland is obliged to create and maintain a register of restructuring and bankruptcy proceedings. EU Member States have committed to keep in their territory at least one register in which information regarding insolvency and restructuring proceedings is to be published (Article 24(1) of the Regulation).

According to the Restructuring Law of 15 May 2015, the Central Register of Restructuring and Bankruptcy kept by the Ministry of Justice in electronic form was to be operational in Poland from 1 February 2018. However, despite the expiry of this deadline, the Central Register has not yet been established.

On 6 December 2018, the Polish Parliament passed the Act on Central Register of Debtors, which will enter into force as of 1 December 2020 and will implement provisions regarding the Central Register of Restructuring and Bankruptcy (under Article 5 of the Restructuring Law). The Central Register of Debtors will disclose information about the entities for which restructuring or bankruptcy proceedings have been carried out, information about entities that were subject to ineffective enforcement proceedings, and information about natural persons who are still recovering from maintenance for a period of more than six months.

vi Special regimes

Restructuring proceedings

The provisions of the Restructuring Law do not apply to the following entities:

- the State Treasury and local government units;
- domestic banks;
- Bank Gospodarstwa Krajowego;
- branches of foreign banks;
- cooperative savings and credit unions;

15 Article 586.
The Restructuring Law has introduced a separate restructuring regime for developers and bond issuers.

**Bankruptcy proceedings**

Pursuant to the Bankruptcy Law, the following entities may not be declared bankrupt:

- the State Treasury;
- local government units;
- independent public healthcare institutions;
- institutions and legal persons established by an act of law;
- natural persons running a farmstead who do not conduct any other business or professional activities;
- higher education institutions; and
- investment funds.

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16 Referred to in Article 2(14) of the Act on the Bank Guarantee Fund of 10 June 2016, the Deposit Guarantee Scheme and Mandatory Restructuring (J L item 996).

17 Under Article 4(1)(26) of the Regulation of the European Parliament and of the Council (EU) No. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms, amending Regulation (EU) No. 648/2012 (O J of EU L 176 of 27 June 2013, p. 1) with the registered office in a Member State of the European Union, if they are subsidiary undertakings within the meaning of Article 4(1)(16) of Regulation No. 575/2013 in relation to the credit institution referred to in Article 4(1)(16) of Regulation No. 575/2013, the entity referred to in subsections 3 to 9, and/or investment firm are supervised on a consolidated basis in accordance with Articles 6 to 17 of Regulation No. 575/2013.

18 Under Regulation No. 575/2013 with the registered office in a Member State of the European Union, Article 4(1)(20).

19 ibid., at Article 4(1)(21).

20 ibid., at Article 4(1)(22).

21 Under Regulation No. 575/2013, Article 4(1)(30).

22 ibid., at Article 4(1)(31).

23 ibid., at Article 4(1)(32).

24 ibid., at Article 4(1)(33).

25 Unless otherwise provided for in that act, and established by execution of an obligation imposed by an act of law.
Under Polish law, special bankruptcy regimes exist for respective entities. The Bankruptcy Law recognises separate bankruptcy proceedings in the following circumstances:

- when instituted after the death of an insolvent debtor;
- against developers;
- against banks and credit unions;
- with respect to mortgage banks;
- with respect to credit institutions, foreign banks and domestic banks operating internationally;
- with respect to insurance and reinsurance undertakings;
- with respect to bond issuers; and
- with respect to natural persons not engaged in economic activities.

The above-mentioned special bankruptcy regimes are described in detail in the provisions of the Bankruptcy Law. The main differences from the standard procedure concern, *inter alia*, entities authorised to file a petition for bankruptcy, the order of satisfaction of claims and the composition of the adjudicating court.

### vii Cross-border issues

The respective provisions in this regard are provided in the Restructuring Law and the Bankruptcy Law. In general, these provisions apply only if an international agreement to which the Republic of Poland is a signatory, or the law of an international organisation of which the Republic of Poland is a member, provides otherwise. In practice, in the absence of international agreements on insolvency proceedings for which Poland would be a party, its meaning is reduced to the priority of EU law. The acts of EU law that apply prior to the above-mentioned provisions are Regulation No. 1346/2000 on insolvency proceedings (applied from 25 June 2017) and the Recast Insolvency Regulation (applied from 26 June 2017).

National jurisdiction is regulated in Article 342 of the Restructuring Law and Article 382 of the Bankruptcy Law. In both restructuring and bankruptcy insolvency proceedings, Polish courts have exclusive jurisdiction if the main centre of the debtor’s interests is in Poland. Moreover, Polish courts also have jurisdiction if the debtor conducts his or her business activity in Poland, or has a place of residence or registered office or property in the country. Consequently, if the Polish court’s jurisdiction is exclusive, the restructuring or bankruptcy proceedings have the nature of the main proceedings. In other cases, restructuring or bankruptcy proceedings have the nature of secondary proceedings.

In this context, the content of the resolution of the Supreme Court of 20 January 2010 issued under Signature III CZP 115/09 deserves special attention. Although this resolution was issued on the basis of the legal status before 1 January 2016, it remains current in terms of determining the groups of entities authorised to institute secondary bankruptcy proceedings in Poland. Pursuant to this resolution, the groups of entities authorised to initiate secondary insolvency proceedings before a Polish court is defined in Article 407 of the Bankruptcy and Reorganisation Law (currently Article 407 of the Bankruptcy Law) and not in Article 20 of the Bankruptcy and Reorganisation Law (currently Article 20 of the Bankruptcy Law).

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26 Title III – Provisions on international restructuring proceedings, Articles 338 to 348.
27 Second Part – Provisions within the scope of international bankruptcy proceedings, Articles 378 to 417.
There is no doubt that, under the principle of *lex specialis derogat generali*, in the scope of secondary insolvency proceedings, Article 407 prevails over Article 20 of the Bankruptcy and Reorganisation Law (currently the Bankruptcy Law).

**II  INSOLVENCY METRICS**

According to the Coface 2018 Annual Report, the number of bankruptcies and restructuring of Polish companies amounted to 975, which constitutes 10 per cent more than in 2017 and 28 per cent more than in 2016. The majority of these proceedings were declarations of bankruptcy (558, or 57 per cent).

Restructuring proceedings introduced at the beginning of 2016 and the new Bankruptcy Law are being used increasingly. Their participation in all proceedings is growing – in 2018, it amounted to 43 per cent, compared with 39 per cent in 2017 and 27 per cent in 2016. Most of the restructuring proceedings that were commenced were accelerated arrangement proceedings (259 compared to 209 in 2017) whereas only five were arrangement approval proceedings. A significant increase was recorded in the case of remedial proceedings – their number increased by as much as 30 per cent compared with the previous year. The sector in which the highest number of bankruptcy and restructuring proceedings were recorded (267) was production (7 per cent more than in 2017).

**III  PLENARY INSOLVENCY PROCEEDINGS**

The details of neither insolvency cases nor court insolvency registers are available for public disclosure. Partial information about pending insolvency proceedings can be found online at www.portal-bankrut.pl.

**IV  ANCILLARY INSOLVENCY PROCEEDINGS**

See Section III.

**V  TRENDS**

According to KUKE (Export Credit Insurance Corporation), assuming that the level of economic growth in 2019 will be below 4 per cent, it is likely that around 1,200 companies will enter into bankruptcy or restructuring proceedings this year, which is about 11 per cent higher than in 2018. It may be also envisaged that there will be a further increase in the number of entities subjected to remedial proceedings and accelerated arrangement proceedings, and a decrease in the number of bankruptcy proceedings.
I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

The principal statute governing insolvency of legal entities and individuals in Russia is Federal Law No. 127-FZ on Insolvency (Bankruptcy) dated 26 October 2002 as amended (the Insolvency Law). The Insolvency Law contains a detailed description of insolvency proceedings, insolvency criteria and the regulation of the activities of insolvency administrators.

Apart from the Insolvency Law, certain other laws regulate financial rehabilitation and insolvency issues. For example, the Commercial Procedure Code contains rules for the administration of insolvency cases by commercial courts. The Federal Law on Banks and Banking Activities and the Federal Law on the Central Bank of the Russian Federation govern the financial rehabilitation procedures applicable to banks and some matters relating to their insolvency. The Federal Law on Self-Regulated Organisations and the Federal Law on Non-Commercial Organisations are both applicable to the activities of self-regulated organisations operating as insolvency administrators.

The Supreme Court of Russia and the Supreme Commercial Court of Russia (which merged with the Supreme Court in 2014) have issued various interpretations and clarifications. These interpretations and clarifications concern, inter alia, such issues as the payment of interest in the course of insolvency, challenging transactions of the insolvent party, the appointment and dismissal of insolvency administrators, the liabilities of the owners of insolvent entities and procedural issues. The lower courts generally follow the legal precedents set by the Supreme Court and the Supreme Commercial Court.

Under the Insolvency Law, the state commercial courts administer all insolvency proceedings. The powers of the courts are described in Section I.v.

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1 Pavel Boulatov is counsel at White & Case LLC. The author would like to thank Daria Scheglova, associate, for her assistance with this chapter.


3 Articles 32 and 33 of Federal Law No. 127-FZ on Insolvency (Bankruptcy) dated 26 October 2002 as amended [Insolvency Law]. In Russian arbitrazhnie sudi, which are state commercial courts and should not be confused with arbitration courts because of consonance.
This chapter discusses the general regulation of the insolvency procedure and priorities applicable to legal entities. For specific types of legal entities and individuals, the regulations may differ, as discussed in Section I.vi.

Russian insolvency law sets distributional priorities for the claims of the creditors of an insolvent party. All claims to an insolvent party are divided into three categories: (1) post-commencement claims that arise after the start of insolvency proceedings; (2) claims that arise prior to the start of insolvency proceedings and must be registered on the register of creditors’ claims; and (3) claims that may not be registered on the register of creditors’ claims because they were filed late.

Post-commencement claims include court expenses relating to the insolvency of the debtor, the fees and expenses of an insolvency administrator, taxes and utilities, and maintenance payments necessary for the debtor’s activities. These claims are to be paid when they become due and ahead of the registered claims with the insolvent’s funds. The general purpose for giving priority to such claims is to keep the debtor operating during the course of the insolvency proceedings. There is a separate priority for post-commencement claims that applies if the debtor does not have sufficient funds to make payment of all post-commencement claims.4

Claims that must be registered on the register of creditors include monetary claims and claims for specific performance that may be evaluated, such as claims for performance of works or services.5 These claims may be satisfied only in the course of the insolvency proceedings after they are registered on the register of creditors. (This is discussed in greater detail later in this subsection.)

With a few exceptions,6 these claims are registered after the court has ruled on the matter of their registration. The hearings at which the court rules whether to register creditors’ claims are separate trials within the insolvency proceedings. All registered creditors, creditors that have filed applications for registration of their claims, the insolvency administrator and representatives of the debtor have a right to attend these hearings and contest, or support, the creditors’ claims under consideration.7 The representative of the debtor’s employees has a right to contest claims that have higher or equal priority.8

If the claims have not been confirmed by a previous court decision, the court must consider the applications and the objections on their merits. This is a similar process to the consideration of claims for collection of debt in an insolvency case. The ruling of the court on the registration of the claims is immediately enforceable and may be appealed.9 A pending appeal does not suspend the registration of the claims unless the appellate court issues a separate order to that effect upon the request of the appellant.

If the claims have already been reviewed and confirmed by a court in the earlier ordinary proceedings, the court is bound by that court’s decision and cannot reconsider it. In such a

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4 Article 134(2) of the Insolvency Law.
5 Non-monetary claims, such as proprietary claims and claims for specific performance must be registered at the receivership stage.
6 For example, claims by employees for payment of salary that are registered by the insolvency administrator without a court decision.
7 Insolvency Law, Article 71(2).
9 Insolvency Law, Article 71(5).
case, however, other creditors or the insolvency administrator have a right to appeal the initial court decision. This appeal must be filed in the relevant court proceedings rather than in the insolvency proceedings. A creditor’s right to appeal the initial court decision arises after the court accepts the creditor’s application for registration of the claim.11

If the claims are confirmed by an arbitration award or foreign judgment that has not been recognised and enforced in separate proceedings, the court may consider only those limited objections relating to the grounds on which the arbitral award or foreign judgment may be denied recognition in Russia.12 For instance, the creditors may object to registration of the claims confirmed by an arbitration award on the grounds that the claim is fraudulent or artificial and its registration would violate public policy and other creditors’ rights.13 If the court finds one of these objections well-grounded, it may fully reconsider the creditor’s claim on the merits.

Other claims, such as for declaratory relief or to request that the debtor returns assets belonging to the creditor (e.g., leased assets), may be considered and granted in separate proceedings rather than in the course of the insolvency case.

The Insolvency Law sets out the following general order of priority for satisfying the claims on the register of creditors:14

a claims of compensation for damage to health or loss of life;
b employees’ salaries, severance payments and royalties (with certain exceptions for claims by top management);
c all other claims (including taxes and other mandatory payments); and
d claims for contractual and any other penalties, and any lost profits by creditors.

The Insolvency Law provides that lower priority claims against a debtor cannot be satisfied earlier than higher priority claims. If the debtor’s assets are insufficient to satisfy the claims of one priority, the claims of that priority will be paid pro rata.

As a general rule, secured claims against a debtor are included in the third priority claims. However, the Insolvency Law stipulates a special order of payment for secured claims. Secured creditors receive 70 per cent of the proceeds from the sale of the pledged assets (80 per cent if the secured claim arose out of a loan agreement with a credit institution) to compensate for the principal debt and any accrued interest. Secured claims for contractual penalties do not have priority over other creditors’ claims with respect to principal debt, but they have priority over other creditors’ claims with respect to penalties.16 If there are no claims of the first and second priority, the secured creditor may receive up to 90 per cent of the proceeds from

10 Section 24 of the Guidance on Certain Procedural Issues Related to Insolvency Proceedings adopted by the Plenum of the SCC on 22 June 2012, No. 35. The SC ruled that a creditor may also file an application to reconsider the judgment in view of new facts (Ruling of the SC No. 305-ЭС16-7085, dated 3 October 2016).
12 Same objections as set out in Article V of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.
13 Resolution of the SCC Presidium dated 2 February 2013 No. 12751/12. Resolutions are decisions on specific cases. In the resolutions, the SCC Presidium expressed its legal positions on specific matters. The courts follow these interpretations of law.
14 For specific types of enterprises the ranking may differ. See Section I.vi.
15 According to recent case law, the retentor that has a right of lien over the assets of the debtor enjoys the rights of a secured creditor (Ruling of the SC No. 301-ЭС19-2351, dated 27 June 2019).
the sale of the pledged assets (or 95 per cent for claims out of a loan agreement with a credit
institution). If the proceeds from the sale of the collateral are insufficient to pay the secured
claim, the balance of the claim will be paid under the same priority as an unsecured claim.17

With a number of exceptions,18 claims filed after the register of creditors’ claims is
closed (i.e., two months after the publication of the judgment to declare the debtor insolvent
and to open the receivership procedure (see Section I.iii)) would fall to the lowest priority
and would only be satisfied after all registered creditors’ claims. Claims by other creditors
may also fall to the lowest priority, for example, creditors arising out of the consequences of
a transaction aimed at the fraudulent transfer of assets or claims of creditors that aimed to
receive undue preference.19

As a special remedy, the Insolvency Law provides the insolvency administrator (at the
receivership stage) and major creditors of the debtor (those owning 10 per cent or more of
the common value of the debt of the insolvent) with a right to challenge certain transactions
of the debtor.20 The following may be challenged in court:

a transactions for unequal consideration (including if the transaction price or other terms
deviate materially from those of similar transactions to the detriment of the insolvent),
if entered into within the 12 months prior to the registration of the insolvency
application by the court or after that date;21

b transactions aimed at violating creditors’ rights and interests, provided that the other
party was aware of such intent by the insolvent entity, if made within the three years
prior to the registration of the insolvency application by the court or after that date;22

and
c transactions leading to preferential treatment of certain creditors.23

17 This does not apply to collateral provided by third parties.
18 Despite the strict rule that claims filed late fall to the lowest priority, case law developed a number of ad hoc
exceptions, such as where application of the strict rule is manifestly unjust or where the claims became due and
payable after the time limit for filing claims for registration expired. For example, if a bank makes a payment
to a beneficiary under a bank guarantee after the register of creditors of the principal has been closed, the bank
may file its redress claims for registration in the register of creditors of the principal within two months of the
date they became due. Such claims would not fall to the lowest priority (Ruling of the SC No. 307-ЭС14-100,
dated 24 September 2014). Tax inspectorates are given an additional six months after the date the register is
closed to file their claims if the decision to collect taxes enters into force after the date the register is closed.
The time limit for filing claims for compensation of damage a controlling person caused a legal entity starts
running from the date when the limitation period to hold the controlling person liable started running
(i.e., from the date the claimant became aware of the grounds to hold the controlling person liable).
19 Accordingly, creditors against the surety may fall to the lowest priority if their claims against the principal
debtor arise out of a void transaction and will only be satisfied after all other registered creditors’ claims
(Ruling of the SC No. 303-ЭС16-6738, dated 8 September 2016).
20 Insolvency Law, Article 61.9(1).
21 ibid., at Article 61.2(1).
22 ibid., at Article 61.2(2).
23 ibid., at Article 61.3. This category includes, among others, transactions intended to secure previously existing
obligations of the debtor or a third party to a particular creditor; transactions that have resulted, or may result,
in a change in the order of priorities for satisfying creditors’ claims; transactions that have resulted, or may
result, in the satisfaction of unmatured claims of some creditors while there are unsatisfied matured claims
of others; and transactions that have resulted in a particular creditor enjoying more preference than it would
enjoy if the statutory order of priorities applied.

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The court may refuse to declare a transaction invalid if the value of the property acquired by the debtor under the transaction in question exceeds the value of the property that may be returned to the insolvency estate upon such invalidation or if the transaction counterparty returns everything to the insolvency estate.24

The court will not deem a transaction by a debtor invalid as a transaction providing unequal consideration (point (a), above) or a transaction leading to preferential treatment of certain creditors (point (c), above) upon a relevant application, if this transaction has been made in the course of usual business of the debtor and the value of this transaction is less than 1 per cent of the assets of the debtor.25 This rule does not apply to transactions by a debtor that were aimed at violating the creditors’ rights and interests (point (b), above).

Article 61.6 of the Insolvency Law provides for consequences of the invalidity of a transaction of a debtor. All assets transferred by a debtor to its counterparty under an invalid transaction must be returned to the debtor’s estate. If the restitution of the debtors’ assets is not possible, the counterparty under the invalid transaction is obliged to pay to the debtor the market price of the assets at the moment of the transaction and damages incurred as a result of changes in the market price of the assets, if any. Claims of the counterparty under the invalidated transaction connected with the invalidation are to be satisfied in two ways depending on the basis of invalidation.

Claims of a counterparty under an invalid transaction arising in connection with its invalidation will be registered as third priority claims if this transaction was invalidated because of a provision of unequal consideration (point (a), above) or because of the preferential treatment of a creditor (point (c), above) that was not aware of the signs of the debtor's insolvency. If the transaction was invalidated because of the violation of other creditors’ rights and interests (point (b), above) or because of the preferential treatment of a creditor (point (c), above) that was aware of the signs of the debtor’s insolvency, the claims arising in connection with invalidation of the transaction will be paid after the third priority claims (lowest priority).

In addition to the special grounds set by the Insolvency Law, fraudulent transfers may violate the rules of Articles 10 and 168 of the Civil Code, which prohibit the abuse of rights and the exercise of civil law rights aimed at evading the law for an illegitimate purpose, as well as other intentional exercise of civil law rights in bad faith.

The Russian courts interpret the concept of abuse of rights very widely and treat as such any exercise of rights in bad faith, including transactions aimed at dissipation of a debtor’s assets to make them unavailable to creditors, including gifts or sales below value.26 Based on this interpretation, the Supreme Commercial Court Presidium declared that the transfer of

24 ibid., at Article 61.7.
25 ibid., at Article 61.4(2).
26 The Plenary Session of the SCC declared that a transaction of a debtor concluded before or after commencement of insolvency proceedings aimed at breach of creditors’ rights, e.g., to decrease the value of the insolvency estate by dissipation of the debtor’s assets below value to third parties may be declared invalid on the grounds of Article 10 of the Civil Code on request of the insolvency administrator or a creditor (Clause 10 of the Resolution of the Plenary Session of the SCC No. 32, dated 30 April 2009, on certain issues related to challenge of transactions on grounds set by the Federal Law on insolvency (bankruptcy)).
assets by a debtor to a company providing asset management services null and void under Articles 10 and 168 of the Civil Code because the purpose of the transfer was to conceal assets from creditors.27

ii Policy

Insolvency legislation and insolvency proceedings in Russia have a tendency to liquidate a failing business rather than restore a debtor’s solvency. Accordingly, receivership is the most used insolvency procedure, rather than financial rehabilitation and external management aimed at supporting and restoring a debtor’s business (see Section I.iii, ‘Receivership’).

One of the reasons for this emphasis on receivership is that creditors are granted a wide discretion as to the choice of the insolvency procedure to be applied to the debtor. In practice, the financial rehabilitation procedures are usually introduced only at the creditors’ initiative. Thus, in most cases the main aim of insolvency proceedings is the sale of a debtor’s assets and the settlement of the creditors’ claims.

According to the statistics of the Judicial Department of the Supreme Court, in 2018, financial rehabilitation proceedings were introduced in 0.13 per cent of cases and the debt was repaid in approximately 17 per cent of these cases; in 2017, financial rehabilitation proceedings were introduced in 0.2 per cent of cases (the debt was repaid in none of them); in 2016, financial rehabilitation proceedings were introduced in 0.28 per cent of cases and the debt was repaid in approximately 2 per cent of the cases; in 2015, financial rehabilitation proceedings were introduced in 0.23 per cent of cases (the debt was repaid in none of them); in 2014, financial rehabilitation proceedings were introduced in 0.14 per cent of cases and the debt was repaid in approximately 18 per cent of the cases.28

For the purpose of creditors’ protection, other measures for which the Insolvency Law provides include:

a the liability of a debtor’s management for unpaid creditors’ claims if their actions led to insolvency; and

b the right of creditors to challenge a debtor’s transactions with respect to fraudulent transfers, undue preferences, transactions at low value and other transactions that aim to cause damage to creditors.

Creditors may also use Russian insolvency proceedings to hold beneficial owners and other controlling persons of a debtor liable for the debts of a subsidiary. For example, creditors may seek to hold controlling persons liable for a company’s debts without pursuing a full insolvency procedure. The creditors may file for insolvency, refuse to finance the insolvency proceedings and, after the court terminates the insolvency proceedings, file an application

27 Clause 10 of the Information Letter of the SCC President No. 127, dated 25 November 2008, ‘Review of practice of application by courts of Article 10 of the Civil Code of the Russian Federation’. The information letters issued by the SCC President summarised court practice and contained guidelines to lower commercial courts. Russian commercial courts usually follow these guidelines. Formally, however, there is no provision in Russian law that stipulates that the information letters of the SCC President are mandatory.

The SC gave the same interpretation to Articles 10 and 168 of the Civil Code when considering particular cases. See Rulings of the SC No. 309-ЭС14-923, dated 15 December 2014, and No. 305-ЭС18-9309, dated 8 October 2018.

to hold controlling persons liable. Creditors of non-operating companies excluded from the state register of legal entities pursuant to an administrative procedure may also file an application with the court to hold controlling persons liable.

Another particularity of insolvency proceedings in Russia is that they are frequently used to enforce a judgment debt regardless of the debtor’s solvency. The reason for that is that the insolvency legislation provides creditors with more control over the procedure for the sale of a debtor’s assets and includes tools to recover assets, including clawback actions, unlike the general enforcement procedure. Further, the general enforcement procedure is run by the state bailiffs, who not infrequently act slowly and inefficiently, unlike the insolvency administrators who are usually selected by creditors, as discussed in Section I.v. Creditors have wide discretion to decide on the procedure for the sale or appropriation of assets and to make it more flexible and respond to their needs. For instance, they may decide to sell the assets in one lot and, if unsold, have them sold piecemeal.

iii Insolvency procedures

The Insolvency Law provides that the following procedures may be applied in the course of the insolvency proceedings: supervision; financial rehabilitation; external management; receivership; and amicable settlement.

Each of these types of insolvency procedures is further explained later in the chapter. The particularities of the procedures applied to the insolvency of individuals and certain types of legal entities are described in Section I.vi.

Supervision

Supervision is an insolvency procedure applied to a debtor with a view to preserving its property, analysing its financial position, preparing a register of creditors’ claims and holding the first meeting of creditors. As a general rule, supervision is the first, and mandatory, stage of insolvency proceedings. Supervision should be completed within seven months of the submission of the insolvency petition. Note that the durations of insolvency procedures mentioned herein are for indicative purposes only, and the court may exceed the time limits if necessary and appropriate.

When the court orders the commencement of the supervision procedure, it will appoint an insolvency administrator. The debtor’s management will remain in office and continue to perform its functions (although the insolvency administrator is authorised to petition in court for the replacement of the debtor’s current management). Once supervision has commenced, the debtor’s management is prohibited from making certain types of transactions and decisions. Other matters, such as alienation of assets valued at more than 5 per cent of the balance sheet, granting or receiving loans, issuing guarantees and sureties, and assignments of rights, require prior written consent from the insolvency administrator.

29 In some cases, supervision does not apply and the court commences receivership if it finds that the insolvency application has merit. For example, this happens if the debtor commences voluntary liquidation before the insolvency proceedings or if a debtor is missing from their place of location and no longer operates.
30 Insolvency Law, Article 51.
31 ibid., at Article 69. In this case the shareholders will select a new director according to the general procedure.
32 Such as reorganisation and liquidation of the debtor, establishing or acquiring equity interests in other legal entities, the creation of branches and representative offices, making dividend payments and issuing securities.
33 Insolvency Law, Article 64.
Once the supervision has commenced, creditors’ claims for payment – other than post-commencement claims – may only be filed against the debtor pursuant to the procedures outlined in the Insolvency Law. Enforcement proceedings that have already commenced are stayed (with some exceptions). Court proceedings for recovering funds from the debtor are stayed upon a creditor’s petition. In addition, upon commencement of the supervision, no contractual interest or penalties shall accrue on any claims that can be registered irrespective of whether or not they are already registered. Rather, a ‘moratorium interest’ shall accrue on the principal debt at the Russian Central Bank’s refinance rate applicable at the date the supervision is introduced. The rate as at 29 July 2019 was 7.25 per cent per annum.\textsuperscript{34}

The insolvency administrator must convene the first creditors’ meeting no later than 10 days before the end of the supervision. Only those creditors that presented their claims within 30 days of the date of publication of the commencement of supervision, and were registered on the debtor’s register of claims, have the right to take part in the first meeting of creditors.\textsuperscript{35} Although missing the aforementioned 30-day deadline will preclude a creditor from participating in the first creditors’ meeting, it will not preclude the creditor from submitting its claims to the register of creditors’ claims at a later stage.

The creditors at the first creditors’ meeting are authorised to decide which procedure (financial rehabilitation, external management, or receivership) should be applied, although the court makes the final decision on this matter.\textsuperscript{36}

\textbf{Financial rehabilitation}

Financial rehabilitation is an insolvency procedure that is applied to a debtor for the purpose of restoring its solvency and discharging its debts in accordance with an approved debt repayment schedule.\textsuperscript{37} Financial rehabilitation lasts for no more than two years.\textsuperscript{38}

Financial rehabilitation may only commence once a petition is submitted by a debtor’s shareholders or any third party interested in the restoration of the debtor’s solvency. The petition must be accompanied by a debt repayment schedule and financial rehabilitation plan, as well as an appropriate security for performance, such as a pledge, a suretyship or a bank guarantee provided by a relevant shareholder or third party. The petition may either be presented at the first creditors’ meeting or, under certain circumstances,\textsuperscript{39} directly with the court, which may decide to commence financial rehabilitation in the absence of, or contrary to, a decision of the first creditors’ meeting.\textsuperscript{40}

As with supervision, the management retains control of the debtor but its powers are restricted. The court must appoint an insolvency administrator, who will maintain the register of claims, convene the creditors’ meetings, and supervise the implementation of the debt repayment schedule and the financial rehabilitation plan.\textsuperscript{41}

\textsuperscript{34} The refinance rate is published at www.cbr.ru/.
\textsuperscript{35} Insolvency Law, Article 72, Paragraphs 1 and 2.
\textsuperscript{36} ibid., at Article 73.
\textsuperscript{37} ibid., at Article 80(3).
\textsuperscript{38} ibid., at Article 80(6).
\textsuperscript{39} If the amount of security exceeds more than 20 per cent the amount of creditors’ registered claims, and the schedule provides for first payments to be made to creditors not later than one month after its approval, and complete repayment to creditors within a year. Insolvency Law, Article 75(2).
\textsuperscript{40} Insolvency Law, Articles 77, 78 and 80.
\textsuperscript{41} ibid., at Articles 82 and 83.
The consequences of commencing financial rehabilitation are generally similar to those of supervision, where certain actions by the debtor are prohibited, and other actions require the consent of the administrative manager or of the creditors’ meeting.\textsuperscript{42}

Based on the results of financial rehabilitation, the court will decide either to terminate insolvency proceedings (if the debts have been discharged) or to commence external management (if the debtor may still become solvent) or receivership.\textsuperscript{43}

\textit{External management}

External management is an insolvency procedure applied to a debtor for the purpose of restoring its solvency. As a rule, the court introduces external management on the basis of a decision taken at the creditors’ meeting. External management is usually limited to an initial period of up to 18 months and can be extended by a further six months.\textsuperscript{44} The aggregate term of external management and financial rehabilitation cannot exceed two years.\textsuperscript{45}

Upon commencement of external management, the court must appoint an insolvency administrator, who takes over the management of the debtor’s business, may dispose of the debtor’s property (subject to a decision made at the creditors’ meeting in certain cases, e.g., the alienation of assets valued at more than 10 per cent of the balance sheet value of all assets) and may refuse to perform certain transactions concluded by the debtor if those transactions impede the restoration of the debtor’s solvency or their performance would cause loss to the debtor. The insolvency administrator maintains the register of claims, recovers funds due to the debtor, and develops and implements an external management plan that is approved by a decision made at the creditors’ meeting and contains measures necessary to restore the debtor’s solvency.\textsuperscript{46}

The measures for restoring a debtor’s solvency may include restructuring the debtor’s business, disposing of part of the debtor’s estate, assigning the debtor’s claims, discharging the debtor’s obligations by its shareholders, issuing additional shares to increase the debtor’s capital, selling the debtor’s entire business or substituting the debtor’s assets.\textsuperscript{47}

Based on the outcome of the external management plan, the commercial court will either terminate insolvency proceedings (if the debts have been discharged), order settlement with the creditors according to the register of claims (if the debtor’s solvency has been restored) or commence receivership.\textsuperscript{48}

\textit{Receivership}

The court introduces receivership by its judgment to declare the debtor insolvent. The aim of receivership is to satisfy the creditors’ claims according to the priorities established by law. Receivership lasts for up to six months and may be extended for a further six months.\textsuperscript{49}

\textsuperscript{42} ibid., at Article 81.
\textsuperscript{43} ibid., at Article 88(6).
\textsuperscript{44} ibid., at Article 93.
\textsuperscript{45} ibid., at Article 92(2).
\textsuperscript{46} ibid., at Article 99.
\textsuperscript{47} ibid., at Article 109.
\textsuperscript{48} ibid., at Article 119, Paragraphs 6 and 7.
\textsuperscript{49} ibid., at Article 124(2).
An insolvency administrator replaces the director general of the debtor. The insolvency administrator draws up an inventory of the debtor’s assets and takes measures for their protection, appoints an appraiser to value the debtor’s estate, arranges for the sale of the debtor’s assets, recovers funds due to the debtor, searches for and returns any of the debtor’s assets that are in the possession of third parties, informs the debtor’s employees of their prospective dismissal, maintains the register of claims and makes payments to the creditors according to the register.

Pursuant to the Insolvency Law, all a debtor’s assets must be included in the insolvency estate. Recently, the courts have ruled that such assets include bitcoins and required the insolvent debtor to disclose to the receiver the access details to a bitcoin wallet.

Based on the results of receivership, the commercial court will rule either to terminate insolvency proceedings (if the debts have been discharged by the debtor’s shareholders) or to complete receivership. The receivership is deemed completed when the liquidation of the debtor is registered with the Unified State Register of Legal Entities.

**Amicable settlement**

A debtor and its creditors may agree on an amicable settlement at any stage of the insolvency proceedings. Third parties may also participate and accept certain rights and obligations according to an amicable settlement. Creditors may reach a decision on amicable settlement at a creditors’ meeting. This decision is made by a simple majority of unsecured creditors’ votes in existence, provided that all the secured creditors vote for the amicable settlement. A settlement agreement may provide for a discount on the claims of a creditor, a lower applicable interest rate, or settlement of claims by way of transfer of assets (rather than monetary funds) only if the relevant creditor agrees. Any amicable settlement must be approved by the court.

The court may withhold approval for a number of reasons, including a failure to make full payment of claims of the first and second priority, a breach of third parties’ rights or breach of the rights of creditors who voted against the settlement or did not agree to it. An amicable settlement is not binding on any creditors whose claims were not registered as of the date it was concluded and who did not participate in it for this reason.

If a debtor fails to comply with an amicable settlement, the creditor may either request the court to issue an enforcement order and request the bailiffs to enforce it, or the creditor (or several creditors) may request the court to terminate the amicable settlement, provided that its (their) claims exceed 25 per cent of all the registered creditors’ claims at the time of approval of the amicable settlement, and the breach of the amicable settlement is material. If the court finds that an application to terminate an amicable settlement has merit, it would terminate the amicable settlement for all creditors and reopen the insolvency proceedings. The court would introduce the insolvency procedure in the course of which the amicable

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50 Ibid., at Articles 127 and 129.
52 Insolvency Law, Article 149.
53 Ibid., at Article 156.
54 Ibid., at Articles 150 to 167.
55 Ibid., at Article 164(2).
settlement was approved. The creditors who participated in the amicable settlement may file their claims for registration in the course of the new insolvency in the amount set by the amicable settlement (to the extent that the claims remain unpaid). 56

iv Starting proceedings

Commencement of insolvency proceedings by the debtor

A debtor may file for insolvency if it anticipates such owing to the circumstances in which it will not be able to discharge its debts at the due time. 57 In certain instances (e.g., if a debtor's funds or assets are insufficient to discharge all its debts), a debtor must file for insolvency. 58 The debtor is required to publish a notice of its intention to file an insolvency petition 15 days in advance. 59

Commencement of insolvency proceedings by creditors or employees

Creditors, current or former employees (if payments of salary or severance are in arrears), or a tax authority may also file for a debtor's insolvency by submitting a petition to the court at the place of the debtor's location. Creditors are required to publish a notice of their intention to file an insolvency petition 15 days in advance. 60 Creditors must also confirm their claims with a judgment or an arbitral award enforceable in Russia, save for creditors whose claims arise out of banking operations (such as providing loans, mortgages and guarantees). 61

The tax authorities may also file for insolvency of a debtor without prior receipt of a court judgment. Insolvency proceedings will only be initiated if the debtor's liabilities are at least 300,000 roubles and are three months overdue. 62

The court will consider the merits of the insolvency petition for a period of between 15 and 30 days. 63 Upon the petitioner's request, the court may introduce injunctive measures available under the procedural rules. 64 If the court finds that the petition has merit, it will issue an order to begin the first stage of the insolvency proceedings (i.e., supervision).

Special requirements apply to the commencement of insolvency proceedings of certain types of legal entities and individuals (see Section I.vi).

If two or more insolvency petitions are filed in relation to the same debtor, the court will accept the second and all subsequent applications as applications to participate in the insolvency proceedings. 65 If the petitioner (including the debtor) reaches settlement with the debtor or withdraws its insolvency petition before the court considers it on the merits, or if

56 ibid., at Article 166(1).
57 ibid., at Article 8.
58 ibid., at Article 9.
59 ibid., at Article 7(2.1) (as amended by Federal Law No. 218 FZ dated 29 July 2017).
60 ibid.
61 ibid., at Article 7. The SC interpreted this rule as giving right to any person whose claims arise out of banking operations (as defined in Article 5 of Federal Law No. 395-1 dated 2 December 1990 on Banks and Banking Activities) to file for insolvency of its debtors using the simplified procedure. This may apply to persons who acquired claims from the banks (Ruling No. 306-ЭС16-3611, dated 12 October 2016). The banks, however, cannot use the simplified procedure if their claims do not arise out of banking operations (e.g., claims related to lease or construction agreements) (Ruling No. 305-ЭС16-18717, dated 27 March 2017).
62 ibid., at Articles 3(2) and 6(2).
63 ibid., at Article 42(6).
64 ibid., at Article 42(7).
65 Resolution of the SCC Plenum, No. 35 dated 22 June 2012, Article 7.
the court finds that the application has no merit, the court will consider the next application to have been filed. If no other insolvency applications are filed, the court will terminate the proceedings.66

Following the withdrawal of an insolvency petition, the creditor cannot file another insolvency petition based on the same claim; however, it can register this claim if an insolvency procedure is introduced by a petition by another creditor or the debtor.67

The court should not accept a withdrawal of an insolvency petition after the supervision stage is introduced. However, the court can terminate insolvency proceedings following the withdrawal of all creditors’ claims after the term for filing them has expired.68

To prevent insolvency, a debtor has to settle its creditor’s claims before the court considers the insolvency petition on the merits and demonstrate to the court that the criteria for introducing supervision are not met.

v Control of insolvency proceedings

The court, the insolvency administrator and the creditors (generally through the creditors’ committee or the creditors’ meeting) control the insolvency proceedings.

The court’s discretion and powers to control the insolvency proceedings are wide. The court takes the final decision on which insolvency procedures would apply, on the matter of removal of the insolvency administrator, the registration of creditors’ claims, declaring transactions of the debtor invalid, and resolving any differences between the insolvency administrator and the creditors (such as matters relating to the valuation and sale of assets). Any decisions made by the insolvency administrator, the creditors’ meetings69 and creditors’ committee may be challenged in court by the parties to the insolvency proceedings.

The insolvency administrator’s powers vary depending on the stage of the insolvency proceedings. In general, their functions include the following:70

a to control a debtor’s business, assets, accounting and other documents, and related information;
b to request information from third parties regarding a debtor’s activities and operations;
c to contest or agree with creditors’ applications for registration of claims;
d to hold the register of creditors’ claims and distribute the proceeds from the sale of assets;71
e to arrange for the sale of assets. For this purpose the insolvency administrator is empowered to draw up an inventory of assets, prepare draft conditions of sale, select the valuer and auctioneer;
f to challenge a debtor’s transactions;
g to prepare and file applications to hold a debtor’s controlling persons liable for their actions; and
h to call creditors’ meetings and arrange them.

66 ibid., at Article 12.
67 ibid., at Article 11.
68 ibid.
69 Insolvency Law, Article 15(4).
70 ibid., at Articles 10(5), 12(1), 20.3(1), 69.9(1), 71(2) and 139.
71 The insolvency administrator generally includes claims to the register upon a court decision. The exceptions include employees’ claims.
Further, as has been discussed in Section I.iii, under an external management plan or receivership, the insolvency administrator replaces the debtor’s management.

Given these wide powers, the character and the fidelity of the insolvency administrator are important for proper conduct of insolvency proceedings.

As regards supervision, a creditor who files for insolvency selects either a candidate to act as insolvency administrator or the self-regulated organisation to nominate a candidate as an insolvency administrator.72 If a debtor files for insolvency, it does not select the insolvency administrator. In this case, the court selects a self-regulated organisation, which nominates a candidate, until the Ministry of Economic Development approves a procedure for the selection of insolvency administrators. The court approves the candidate administrator if he or she meets all the criteria required by law.73 The creditors at their meeting may decide to change the insolvency administrator and to select another for further insolvency procedures (such as financial rehabilitation, external management and receivership).74 Apart from that, the creditors cannot decide to remove an insolvency administrator at any stage at their discretion in the absence of any misconduct on the part of the insolvency administrator. If the insolvency administrator breaches the law, the creditors may request the court to hold him or her liable and to remove him or her and nominate another insolvency administrator.

The creditors’ meeting is a primary body through which the creditors exercise control over the insolvency proceedings. At such meetings the creditors may decide upon the strategy of the proceedings (e.g., to choose the insolvency procedures to be applied for)75 to enter into a settlement agreement and its conditions.76 It is through this body that the creditors control the insolvency administrator. For instance, the sale of the debtor’s non-encumbered assets by the administrator should be approved by a decision passed at the creditors’ meeting.77 At these meetings, the creditors are also empowered to nominate the administrator or request the court to remove the current administrator (provided that he or she has breached the law).78

The rights of creditors to control the proceedings depend on their status, since the secured creditors’ voting rights are limited to voting at the supervision and the financial rehabilitation or external management if they decide not to enforce the collateral in the course of these insolvency procedures.79 However, in general, secured creditors have very limited voting rights at the receivership unless they prefer to waive their secured rights and register their claims as non-secured.80 Nonetheless, the secured creditors have the right of veto with respect to certain matters (e.g., settlement agreement,81 sale of pledge or mortgage).82 Further, secured creditors have voting rights on the matters of nomination of insolvency administrators and their removal.83

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72 Insolvency Law, Articles 45 and 65(1).
73 ibid., at Article 37(5). The Ministry of Economic Development has not approved the procedure for selection of insolvency administrators.
74 ibid., at Article 12(2).
75 ibid., at Article 12.
76 ibid.
77 ibid., at Article 139(1.1).
78 ibid., at Article 12(2).
79 ibid., at Article 18.1(3).
80 ibid., at Article 12(1).
81 ibid., at Article 150(2).
82 ibid., at Article 138(4).
83 ibid., at Article 12(1).
The role of the creditors’ committee is to streamline the creditors’ control over the actions of the insolvency administrator. The creditors’ meeting may also delegate certain powers to the creditors’ committee,\(^{84}\) such as to request information about the debtor’s financial situation and the status of the receivership from the insolvency administrator, to challenge the administrator’s actions in court and to approve conditions for a sale of assets.\(^{85}\)

The managerial bodies of a debtor may also exercise certain functions in the course of the insolvency (depending on the stage of the proceedings, as discussed in Section I.iii).

vi Special regimes

Individuals and certain entities are excluded from the general insolvency regime. For individuals, a special insolvency regime applies. The following groups of legal entities are treated differently from the general insolvency regime:

- a. legal entities that may not be declared insolvent;
- b. legal entities to which special rules apply within the framework of the general regime; and
- c. financial institutions whose insolvency procedure is governed a special regime that materially differs from the general regime.

A high-level overview of the specific regulations is given below.

**Legal entities that may not be declared insolvent**

The following legal entities cannot be declared insolvent\(^{86}\) according to Russian law:

- a. state-owned enterprises established for special purposes;\(^ {87}\)
- b. public law legal entities (non-commercial legal entities established by the state to exercise public functions);\(^ {88}\)
- c. political parties;
- d. religious organisations;
- e. state corporations or state companies, if the federal law according to which the relevant entity was established does not permit insolvency; and
- f. funds, if the federal law according to which the relevant fund was established prohibits insolvency.

The same applies to international organisations with headquarters in Russia that are exempt from Russian domestic regulation and governed by public international law.

\(^{84}\) ibid., at Article 17(1).

\(^{85}\) ibid., at Article 17(4).

\(^{86}\) Russian Civil Code, Article 65(1).

\(^{87}\) Known as *kazennoe predpriatie* in Russian.

\(^{88}\) Article 65 of the Civil Code as amended by Federal Law No. 236 FZ, dated 3 July 2016, on public law companies in the Russian Federation and amendments to certain legal acts of the Russian Federation (effective as of 2 October 2016).
Legal entities to which special insolvency rules apply

The Insolvency Law establishes specific regulations on insolvency of the following types of debtors:

a. town-forming enterprises (i.e., enterprises that employ more than 25 per cent of the working population of the relevant community);  
b. agricultural enterprises (i.e., companies that receive more than 50 per cent of their profit from agricultural business);  
c. strategic enterprises and enterprises of importance to state security;  
d. natural monopolies;  
e. developers dealing with the construction of residential buildings; and  
f. clearing participants who are professionals in the securities markets and financial institutions participating in clearing.

There are no special insolvency rules relating to corporate groups. However, the courts continue to develop case law in this area. For example, courts have classified inter-group loans as contributions to a debtor’s charter capital, and have ruled that such claims must not be registered as ordinary creditors’ claims or satisfied in the course of an insolvency.

The Supreme Court also ruled that it is possible to challenge the following types of transactions in the course of a debtor’s insolvency on the grounds set by the Insolvency Law: (1) transactions aimed at the disposal of the assets of a subsidiary of the debtor; and (2) fraudulent dilution of shares in a subsidiary of the debtor aimed at causing damage to the creditors.

The most important differences in the insolvency regime include:

a. an increased insolvency test: an agricultural enterprise may be declared insolvent if the amount of outstanding claims exceeds 500,000 roubles, and a strategic enterprise or a natural monopoly may be declared insolvent if the amount of creditors’ claims exceeds 1 million roubles, and the claims are overdue for more than six months;

89 Insolvency Law, Article 168.
90 ibid., at Article 169.
91 ibid., at Article 177.
92 ibid., at Article 190. A list of strategic enterprises is established by the Decree of the Government of the Russian Federation No. 1226-p dated 20 August 2009 (as amended).
93 ibid., at Article 201(1).
94 ibid., at Article 201(16).
98 Insolvency Law, Article 177.
99 ibid., at Article 190(3).
100 ibid., at Article 197(2).
b competent state or municipal authorities participating in the insolvency proceedings of town-forming enterprises,\textsuperscript{101} strategic enterprises,\textsuperscript{102} natural monopolies\textsuperscript{103} and developers;\textsuperscript{104}

c the competent state or municipal authorities’ ability to request the court to take measures aimed at restoration of solvency of a town-forming enterprise\textsuperscript{105} or a strategic enterprise,\textsuperscript{106} give a guarantee of repayment of debts of the relevant enterprise and request the court to introduce external management procedure;

d the special requirements to insolvency administrators (e.g., concerning matters relating to state secrets, experience in certain areas, such as construction);

e special procedures that apply to the sale of assets of town-forming,\textsuperscript{107} agricultural\textsuperscript{108} and strategic enterprises\textsuperscript{109} and natural monopolies, which are as follows:\textsuperscript{110}
  • a debtor’s assets necessary for its activities are first sold together as a single lot;
  • certain persons may have pre-emptive rights to acquire a debtor’s assets; and
  • the special requirements applicable to the buyer (e.g., a licence to engage in certain activities) or to its activities after acquisition of the assets (such as preservation of jobs at the town-forming enterprise, continuation of activities of the natural monopoly, etc.), which may be in place; and

f special regimes applicable to specific assets. For example, client assets held by brokers in a special brokerage account or trade account are not included in the broker’s insolvency estate. The insolvency administrator cannot dispose of funds the debtor deposited on an escrow account but the insolvency administrator may still challenge the escrow agreement or transfer of the funds to the escrow agent in insolvency. In general, the Insolvency Law provides for the possibility to perform an escrow agreement within six months of the introduction of receivership in respect of the depositor. After the six months have elapsed, the escrow agent shall transfer the escrow funds to the depositor.\textsuperscript{111}

There is special detailed regulation of the insolvency of developers aimed at completing the construction of the residential premises and the transfer of the residential premises to the persons who have acquired them.\textsuperscript{112} For this reason there is a separate register of the claims of these persons, whose claims have priority with respect to the premises they have acquired and their other unpaid claims are of higher priority than other creditors’ claims. There are detailed provisions on the transfer of the unfinished construction to a building society set by the creditors who acquired premises from the debtor.

A new mechanism for rehabilitation of development companies engaged in construction of residential buildings has been established in a public fund for protection of interests of

\textsuperscript{101} ibid., at Article 170.
\textsuperscript{102} ibid., at Article 192.
\textsuperscript{103} ibid., at Article 198.
\textsuperscript{104} ibid., at Article 201(2).
\textsuperscript{105} ibid., at Articles 171 to 174.
\textsuperscript{106} ibid., at Articles 191, 194 and 195.
\textsuperscript{107} ibid., at Articles 175 and 176.
\textsuperscript{108} ibid., at Article 179.
\textsuperscript{109} ibid., at Article 195 and 196.
\textsuperscript{110} ibid., at Article 201.
\textsuperscript{111} ibid., at Article 131(2).
\textsuperscript{112} ibid., at Article 201, Paragraphs 4 and 15-2.
individual buyers of residential premises – the Fund for the Protection of the Rights of Citizens Participating in Shared Construction. Development companies must deposit 1.2 percent of the value of every contract with an individual to this fund. Receivers of development companies must be accredited with the Fund. The Fund may finance the completion of construction of the residential building.113

Constituent units of the Russian Federation may also establish non-commercial funds for completion of construction in their regions. Only an authorised bank may process the payments between a regional fund and its counterparties (legal entities). There is a unified public register containing the information about all residential premises in all regions whose completion is significantly delayed.114 Currently, this register contains information about 833 developers and 2,318 residential premises in 77 regions.

Legal entities whose insolvency procedure is governed by a special regime

The regulation of insolvency of financial institutions materially differs from the general insolvency regime. ‘Financial institutions’ include:
a credit institutions;
b insurance companies;
c professional participants of securities markets;
d private pension funds, including pension funds that are engaged in mandatory pension insurance (there is special regulation of insolvency);
e management companies of investment funds, mutual investment funds and private pension funds;
f clearing houses;
g market operators;
h consumer credit cooperatives; and
i micro-finance institutions.115

The Insolvency Law provides for a number of special measures aimed at restoring the solvency of financial institutions that may be approved by the Central Bank.116

The Central Bank may appoint a temporary administration of a financial institution for three to six months, with the possibility of a three-month extension.117 The temporary administration consists of an insolvency administrator and other members selected by the Central Bank. Its functions and powers are similar to those of temporary administration of a credit institution (discussed later in this subsection). There are limitations on performing certain transactions; however, there is no general moratorium on payment to creditors.

There is a separate insolvency test for financial institutions.118 A financial institution may be declared insolvent if it has failed to perform claims confirmed by a court judgment for more than 14 days, irrespective of the amount of the claim or if it did not become solvent.

115 Insolvency Law, Article 180.
116 ibid., at Articles 180(4) and 183(1).
117 For example, if a financial institution repeatedly during one month fails to make a payment within 10 days when due, or fails to make a mandatory payment (such as taxes) within 10 days when due, or does not have enough funds to make a payment when due. ibid., at Article 183, Paragraphs 2 and 5.
118 ibid., at Article 183(16).

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after temporary administration. There are special requirements applicable to claims against an insurance company based on insurance contracts, and claims do not have to be confirmed by a court judgment. However, some courts decide that such claims must be undisputed. In addition to creditors and the debtor itself, temporary administration and the Central Bank may file for insolvency.

As a general rule, only supervision procedure and receivership are applied to financial institutions. However, the supervision procedure is not applicable to pension funds engaged in mandatory pension insurance, insurance companies or once the temporary administration of the financial institution has been appointed. If the court finds that an insolvency petition filed by a creditor of an insurance company has merit, the insolvency proceedings will be suspended until the Central Bank or the temporary administration files for insolvency of the insurance company.

The Central Bank nominates an insolvency administrator, and there are special requirements applicable to him or her. In the case of an insolvency of a pension fund, which is engaged in mandatory pension insurance or an insurance company, the State Corporation Deposit Insurance Agency (DIA) acts as the insolvency administrator.

There is a special procedure for the registration of creditors’ claims. The insolvency administrator includes the creditors’ claims on the register unless there are objections to their registration. If there are objections, the court considers whether the claims have merit and rules on the matter of their registration. If the number of creditors of a professional participant of securities markets, a management company or a clearing house exceeds 100, the insolvency administrator is obliged to engage a professional registrar.

Assets belonging to clients of a professional participant of securities markets, a management company or a clearing house held on special accounts are not included in the insolvency estate. The insolvency administrator transfers the relevant assets to the clients if they were duly paid for the services of the debtor.

Special rules regulate the sale of assets belonging to pension funds. Assets aimed at securing pension reserves are not included in the insolvency estate and there is a special regulation regarding their use for payment of compensation to the depositors. In certain cases, obligations to make payment of pensions may be transferred to another pension fund.

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119 ibid., at Article 184(2).
120 For example, Resolution of the Ninth Commercial Appellate Court No. 09ЭС-58561/2015, dated 3 February 2016.
121 Insolvency Law, Article 173(19).
122 ibid., at Article 187(6).
123 ibid., at Article 183(17).
124 ibid., at Article 184(4)-3 (as amended by Federal Law No. 222-ЭС dated 23 June 2016, effective as of 21 December 2016).
125 ibid., at Articles 183(19) and 183(25).
126 ibid., at Article 187.8.
128 Insolvency Law, Article 183(26).
129 ibid., at Article 185(3).
130 ibid., at Article 185(6).
131 ibid., at Article 186(5).
132 ibid., at Article 187(10).
The Insolvency Law contains specific rules regulating the sale of assets of an insurance company that include the insurance portfolio and the assets that are supposed to cover insurance reserves. They may be sold in one lot to another insurance company that has the necessary licences and assets to cover them.133

There are also specific distributional priorities that depend on the type of insurance (e.g., claims relating to old age and survivors insurance are of the first priority and other claims are of lower priority).134 As regards pension funds, the distributional priorities depend on whether the pension payments are already due;135 there are specific priorities applicable in the course of insolvency of pension funds that are engaged in mandatory pension insurance.136

The insolvency of credit institutions, such as banks, is governed by very detailed special rules, which differ from the rules regulating the insolvency of other financial institutions.

In general, if a credit institution faces financial difficulties,137 the Central Bank may decide, before revoking that credit institution’s banking licence, to use financial rehabilitation measures, including the appointment of temporary administration headed by a representative of the Central Bank.138 If the Central Bank appoints temporary administration, it may limit or suspend the powers of the credit institution’s management. The temporary administration performs an analysis of the debtor’s financial situation to make a decision on whether there are grounds to revoke the banking licence or use rehabilitation measures; it controls the assets of the credit institution and gives consent to some of the transactions by the management of the debtor.139 If the Central Bank decides to suspend the powers of the debtor’s management, the temporary administration assumes its functions. It may ask the Central Bank to introduce a moratorium on payments by the credit institution. The temporary administration may file applications with the court to challenge transactions by the credit institution or to hold the credit institution’s controlling persons or chief financial officer liable.140

If the Central Bank decides to revoke the banking licence, for any reason relating or unrelating to insolvency,141 the credit institution must be liquidated. Accordingly, it must appoint temporary administration that generally acts until the date the credit institution is declared insolvent, or until a liquidator is appointed if there is no need for first declaring insolvency.142

A credit institution may be declared insolvent if it fails to perform its obligations within 14 days of them becoming due or if its assets are not sufficient to fulfil its financial obligations.143

133 ibid., at Article 184(7).
134 ibid., at Article 184(10).
135 ibid., at Article 186(7).
136 ibid., at Article 187(11).
137 Grounds to use financial rehabilitation measures are set by Article 189.10 of the Insolvency Law and include, *inter alia,* failure to meet criteria of liquidity or sufficiency of its assets, failure to make a payment when due.
138 Insolvency Law, Article 189(9).
139 ibid., at Article 189(30).
140 ibid., at Article 189(31).
141 The Central Bank may revoke a banking licence in response to events unrelated to insolvency, such as giving false information while receiving the licence, materially wrong accounting statements and breach of money laundering legislation, etc. See Article 20 of the Law on Banks.
142 Insolvency Law, Article 189(43).
143 ibid., at Article 189(8).
A credit institution or a creditor may file an application to declare the credit institution insolvent only after the Central Bank decides to revoke the banking licence. In any event, if the credit institution meets the insolvency criteria at the date of revocation of the banking licence, the Central Bank must file for insolvency within five days of publication of the revocation of the banking licence, or within five business days of the temporary administration informing the Central Bank about it.

If the court finds that the insolvency petition has merit, the credit institution is declared insolvent and the receivership procedure is commenced. If the credit institution had a licence to engage deposits from individuals, the DIA would act as the insolvency administrator.

There are special rules regulating post-commencement claims of credit institutions, registration of creditors’ claims, challenge of transactions and directors' liability. There is also detailed regulation concerning specific issues relevant to financial markets, such as subordinated loans, completion of relations under financial contracts and clearing relations.

There are specific distribution priorities:

- **First priority claims**: for compensation for damage to health or loss of life; individuals’ claims arising from deposit agreements and bank account agreements (except for claims of individuals engaged in commercial activities related to accounts used for such commercial activities); claims by the DIA that it has received as a result of subrogation upon payments of the insurance compensation made to individual depositors; and claims by the Central Bank for amounts it has paid to individuals as compensation for their claims.

- **Second priority claims**: employees’ salaries, severance payments, royalties (with a number of specific exceptions).

- **Third priority claims**: all other claims.

Secured creditors do not have any priority over first and second priority claims.

Amendments to the law introduced new resolution mechanisms applicable to major banks, insurance companies and construction companies.

The Central Bank established the Fund for Consolidation of the Bank Sector. The Central Bank is the 100 per cent shareholder of the management company of this fund (the Management Company). The Management Company may decide to finance the resolution of major banks and becomes the controlling shareholder of the distressed bank. If the bank has negative net assets, the bank's shareholders must transfer their shares to the Management Company for 1 rouble. The Management Company finances resolution procedures by way of contributions to the bank's charter capital (from the loans it receives from the Central Bank) and acts as the bank's crisis manager. After resolution measures are complete, the Management Company must sell its shares in the bank on the market.

Pursuant to recent amendments to the Insolvency Law, a similar Fund for consolidation of the insurance sector was established. The Management Company manages this fund.

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144 ibid., at Article 189(61).
145 ibid.
146 ibid., at Article 189(77).
147 ibid., at Article 189.92.
Management Company is authorised to manage the resolution procedures of insurance companies, similar to those applicable to banks, and finance them from the Fund for Consolidation of the Insurance Sector.\textsuperscript{149}

**Insolvency of individuals**

A creditor may file for insolvency of an individual if the amount of his or her debt exceeds 500,000 roubles and is overdue for more than three months.\textsuperscript{150} The individual is obliged to file for insolvency if a payment to a creditor makes it impossible to pay other creditors and the amount due exceeds 500,000 roubles. The debtor has a right to file for insolvency if it is manifestly unable to pay its debts on time or the amount of its debts exceeds the value of its assets (there is no minimum threshold).\textsuperscript{151}

In general, the following insolvency procedures may apply: restructuring of debts; a sale of assets; and a settlement agreement.\textsuperscript{152}

If the court finds that the insolvency petition has merit, it introduces, as a general rule, the procedure of debt restructuring and appoints an insolvency administrator.\textsuperscript{153} In the course of this procedure, the insolvency administrator analyses the financial situation, a moratorium on the payment of debts is introduced, and no interest or penalties accrue on any claims (except for post-commencement claims). The debtor cannot enter into any transactions for a value exceeding 50,000 roubles without the consent of the insolvency administrator.\textsuperscript{154} The debtor or the creditors may work out a debt restructuring plan providing for repayment of debts for no more than three years.\textsuperscript{155} The court approves this plan if it meets the criteria set by the Insolvency Law, it is realistic and does not breach third parties' rights. In certain cases, the court may approve the debt restructuring plan without the consent of the debtor or the creditors.\textsuperscript{156}

If there is no basis for the approval of a debt restructuring plan, the court declares the debtor insolvent and commences the procedure for the sale of assets.\textsuperscript{157} The aim of this procedure is to have the debtor's assets sold and the creditor's claims repaid.

Certain assets of an individual do not constitute a part of the insolvency estate.\textsuperscript{158} Such assets include the only residential premises of the individual and land plots on which the premises are situated (provided that the land plots are not mortgaged) and the equipment necessary for the debtor to conduct his or her professional activities worth not more than 750,000 roubles.\textsuperscript{159}

The distributional priorities applicable in the course of insolvency of individuals differ from the general priorities. The major difference is that the claims of the first priority include

\begin{itemize}
\item Amendments introduced by Federal Law No. 87-FZ, dated 23 April 2018.
\item Insolvency Law, Article 213(3)-2.
\item ibid., at Article 213(4). Clauses 8 to 10 of the Resolution of the Plenary Session of the SC, No. 45, dated 13 October 2015.
\item Insolvency Law, Article 213(2).
\item ibid., at Article 213(6).
\item ibid., at Article 213(11).
\item ibid., at Article 213(14.2).
\item ibid., at Article 213(17.4).
\item ibid., at Article 213(24).
\item ibid., at Article 213(25.3); Civil Procedure Code, Article 446.
\item 100 minimum salary rates set by the Russian government, which is 9,489 roubles as of 1 January 2018.
\end{itemize}
alimony claims and that a secured creditor receives 80 per cent of the proceeds from the sale of the pledged assets and in addition may receive up to 10 per cent of the secured claims if they are not used for payment of court fees or the insolvency administrator's expenses.  

Once the sale of assets is complete, the court must rule on the discharge of the debtor from unsettled claims. The court will not release the debtor from obligations if it acted unlawfully or in bad faith while undertaking or performing its obligations, which serve as a ground for the creditor's claims. For instance, the court will not issue a discharge order if it finds that the debtor intentionally gave false information to the insolvency administrator or the court in the course of the insolvency proceedings. If this becomes known after insolvency proceedings have been completed, the decision to release the debtor from its obligations may be set aside.

In any event, the debtor cannot be released from certain types of debts, including post-commencement claims, claims for compensation of harm to life or health, claims for payment of salary or alimony, and claims to hold a debtor liable for his or her actions as a director of a legal entity or for damage caused as an insolvency administrator. Upon completion of insolvency proceedings, the court issues enforcement orders and the creditors may enforce their claims via the general enforcement procedure.

vii Cross-border issues

Russian insolvency law does not contain detailed regulation of cross-border issues. Insolvency of legal entities registered in Russia is subject to the exclusive jurisdiction of the Russian courts. Both foreign citizens residing in Russia and Russian citizens residing abroad may be declared insolvent in Russia. These proceedings will be treated as plenary insolvency proceedings. In practice, Russian courts have permitted insolvency of German, Chinese and Uzbek citizens residing in Russia. The courts ruled that foreign citizens may be declared insolvent in Russia if (1) their centre of main interests is in Russia, (2) the matter is in accordance with the principle of effective jurisdiction, and (3) the case is closely connected to Russia, for example if the creditor, the debtor and its assets are in Russia, or if the debtor is a registered individual entrepreneur in Russia.

However, there is no publicly available information about any case relating to a foreign legal entity that has been declared insolvent in Russia. A Russian court terminated the insolvency proceedings concerning a Cypriot company, which had a representative office in Russia, on the grounds of lack of jurisdiction. The court also ruled that the Russian Insolvency Law does not apply to foreign companies because their insolvency is governed by foreign lex personalis.

160 Insolvency Law, Article 213(27).
161 ibid., at Article 213(28).
162 ibid., at Article 213(28.3, 5 and 6).
163 Commercial Procedure Code, Articles 38 and 248(1.5).
164 Clause 5 of the Resolution of the Plenary Session of the SC No. 45, dated 13 October 2015.
166 According to Resolution of the Commercial Court for the Moscow Circuit No. A40-15873/17, dated 15 November 2017, Russian insolvency law does not apply to foreign companies.
The Insolvency Law does not regulate non-main or ancillary proceedings in Russia with respect to a foreign person.

However, a final judgment of a foreign court to declare the debtor insolvent and to appoint an insolvency administrator may be recognised and enforced on the grounds of an international agreement, or absent such agreement, on the grounds of international comity and reciprocity.167 If the judgment does not require enforcement, it may be recognised without any special procedure. Interested parties may file objections against the recognition with a Russian court within one month of learning about the judgment.168 Non-final court decisions and preliminary orders (such as orders to appoint a temporary administrator as an interim measure) may not be recognised and enforced.169 However, powers of the temporary administrator of a foreign entity or individual to act in Russia may arguably be recognised as a part of lex personalis or lex concursus of the foreign person.170 However, there is contradictory court practice on this matter.171

If the judgment of a foreign court to declare a debtor insolvent and to appoint an insolvency administrator is recognised in Russia, the foreign insolvency administrator may exercise his or her powers to seize assets located in Russia, vote with shares in Russian legal entities, request interim measures in support of foreign court proceedings172 and file applications with the Russian courts to declare transactions of the debtor invalid, provided that he or she does not exceed his or her powers granted by foreign lex concursus. While making requests to declare transactions invalid, the insolvency administrator may either refer to the grounds set by Russian law (Articles 10 and 168 of the Russian Civil Code discussed


168 Commercial Procedure Code, Article 245(1).

169 Clause 33 of Resolution of the Plenary Session of the SCC No. 55, dated 12 October 2006.


172 Ruling of the SCC No. 2860/10 dated 4 May 2010.
in Section I.i (abuse of right)) or foreign insolvency law. The Russian courts have allowed the claimants to seek a declaration of the invalidity of the transactions made by the debtors in violation of foreign insolvency law applicable to the transactions.173

Between 2010 and 2014, Russian courts recognised three Kazakh judgments on restructuring proceedings in respect of BTA Bank and Alliance Bank, which provided, among other things, for a stay against creditors’ claims and a partial debt write-off.174 The courts granting such relief relied on the Kiev Treaty on Settling Disputes Related to Commercial Activities (dated 20 March 1992).

However, in a more recent case, Russian courts refused to recognise an Azerbaijani court decision on the restructuring of the International Bank of Azerbaijan upon request from its Russian creditor, Sberbank. The courts focused on procedural deficiencies (e.g., no proper notice to Sberbank concerning the hearing on the restructuring). However, the courts also held that (1) unilateral (even partial) write-off of Sberbank’s debt contravened Russian public policy and (2) recognition of foreign judgments on restructuring in Russia required proof of mutual recognition of Russian insolvency judgments in Azerbaijan.175

If a foreign person is declared insolvent and the judgment is recognised in Russia, the Russian court may dismiss proceedings against the foreign debtor on procedural grounds.176

If the claims of a creditor filed for registration in the course of Russian insolvency proceedings are governed by foreign substantive law (for example, the law of the contract, or law governing statutory interest), the Russian courts must apply the foreign law.177

Claims on challenging a Russian debtor’s transactions under the Russian Insolvency Law are not arbitrable and fall within the exclusive jurisdiction of the Russian courts. However, when these transactions fall within the scope of the arbitration agreements, a foreign arbitration tribunal may find that it has jurisdiction to consider the claims on their validity and a foreign state court may grant interim measures in support of the arbitration proceedings.178 Therefore, parallel proceedings may arise in Russia and abroad.

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173 Resolution of the Presidium of the SCC No. 10508/13 dated 12 November 2013, Ruling of the SCC No. VAS-11777/13 dated 17 March 2014. The Twenty-First Commercial Appellate Court has considered this matter (Resolution No. 21AP-864/2016, dated 12 August 2016). One of the creditors of an insolvent Ukrainian company filed a claim with the Commercial Court of the Crimea Republic to declare invalid disposal of lease rights to a land plot located in Crimea by the insolvent company. The court of the first instance satisfied the claim. It recognised the Ukrainian insolvency without a special procedure and referred to Ukrainian rules of insolvency law. The appellate court set this ruling aside and declared the transaction valid. The reason was that the insolvency of the debtor did not per se lead to invalidity of the transaction.

174 Ruling of the Moscow Commercial Court in Case No. A40-24334/10-25-170, dated 23 April 2010 (not appealed); Ruling of the Moscow Commercial Court in Case No. A40-108389/2012, dated 15 October 2012 (not appealed); Ruling of the Moscow Commercial Court in Case No. A40-53374/14, dated 24 July 2014 (not appealed).

175 See Resolution of the Commercial Court of the Moscow Circuit dated 8 November 2018 in Case No. A40-185979/2017 (petition for review by the Supreme Court denied).

176 The court dismissed a claim against a Dutch debtor on the grounds that the creditor has already had its claims registered in the course of the foreign insolvency proceedings. Ruling of the SCC No. 14334/07, dated 11 March 2008.


II  INSOLVENCY METRICS

Economic development in development has been slowing down during the past year.

According to a report prepared by the Ministry of Economic Development of the Russian Federation, in April 2019, the dynamics of economic activity for the first quarter of 2019 deteriorated. There was a fall in gross domestic product (GDP) for this period of 0.8 per cent as compared to the first quarter of 2018.179 Following the increase in VAT, a slowdown in retail sales has had negative effect on economic growth. A decrease in industrial production (2.1 per cent in the first quarter of 2019 after 2.7 per cent in the fourth quarter of 2018 as compared to the same periods in the previous year) was determined by the moderate dynamics in manufacturing industry.

The Bank of Russia lowered its GDP growth forecast for 2019 from between 1.2 per cent and 1.7 per cent to between 1 per cent and 1.5 per cent.180

The Federal Service of State Statistics reported that the index of industrial production increased by 4.6 per cent in April 2019 as compared to the relevant period in the previous year. The production of natural resources increased by 4.2 per cent and manufacturing increased by 4.7 per cent.181

The economic situation is different in other economic sectors.

Retail sales fell by 1.6 per cent in April and 1.2 per cent in May, which was mainly caused by a decrease in sales of food products.182

The unemployment rate was 4.6 per cent in April 2019 and 4.5 per cent in March 2019, excluding seasonal variation.183

The data released by the Supreme Court in 2018 shows that 95,820 new insolvency petitions were filed and 83,164 insolvency petitions were accepted for consideration by courts, including 42,440 petitions filed by debtors, 32,538 petitions filed by private creditors and 8,186 petitions filed by tax authorities. These include 49,767 petitions to declare individuals insolvent.

In 10,478 cases, the courts introduced supervision. In 8,672 cases, after the completion of the supervision, the courts declared the debtors insolvent and introduced receivership. In 9,129 cases, receivership was completed, and in 2,182 cases the proceedings were terminated. The courts introduced 254 external management procedures and 18 cases of financial rehabilitation. In 2018, only three cases were terminated as a result of repayment of debts in the course of financial rehabilitation. In most cases, the courts introduced a receivership stage after expiry of the term of the financial rehabilitation or terminated the proceedings upon approval of a settlement agreement. The claims were fully repaid after the external management procedures in nine cases only. In most cases (214), debtors were declared insolvent and receivership was introduced, the receivership procedure was terminated after the sale of the debtors’ assets, and the debtors were liquidated following it.

180 See https://www.cbr.ru/eng/press/keypr/.
182 ibid., at p.19.
183 ibid., at p. 22.
In 2018, the courts received 34,434 applications to declare transactions invalid, 2,048 requests to remove insolvency administrators and 4,295 applications to hold debtors’ controlling persons liable.

According to statistics published by the Centre of Macro-Economic Planning for the fourth quarter of 2018, the number of insolvencies decreased by 2.3 per cent as compared to the third quarter of 2018 and by 10.7 per cent as compared to the fourth quarter of 2017. However, the total number of insolvencies in the fourth quarter of 2018 was 10.4 per cent higher than the similar (pre-crisis) indicator for the fourth quarter of 2013. There was a significant decrease in insolvencies in non-industrial sectors, in particular in transport and communications. There were also some improvements in retail, business services, construction and development. At the same time, the situation has not changed significantly for companies in the agricultural and industrial sectors, in particular, electric power, food, metal and engineering industries. Two pharmaceutical trade companies are on the list of the top three largest insolvent companies in terms of the proceeds.

As discussed Section I.vii, Russian law does not permit non-main proceedings in respect of foreign debtors. There are no publicly available statistics regarding requests for ancillary proceedings (i.e., requests for interim measures to declare transactions invalid or other).

III PLENARY INSOLVENCY PROCEEDINGS

i Antipinsky Refinery

JSC Antipinsky Refinery is a private refinery with a capacity of more than 9 million tonnes per year. According to the company’s website, it ‘occupies its rightful place among the largest players of the Russian oil refining industry, forming the Urals and West-Siberian oil refinery market’.185

According to publicly available information, the refinery faced financial difficulties because of a decrease in its revenue, growth in cost of sales, currency fluctuations and increase of payments for the use of loans. The total amount of its indebtedness was estimated at US$5 billion, including a US$3 billion debt to Sberbank. In 2018, the refinery breached the covenants to Sberbank. As a result, the bank was entitled to demand early repayment of all debts and to conduct operational control of the plant.

In April 2019, another creditor, VTB Commodities Trading, initiated proceedings against the refinery at the London Court of International Arbitration, seeking €197 million for the failure to deliver petroleum products that had been paid for in advance. The claimant obtained evidence that the refinery sold the pre-paid petroleum products to a third party in breach of agreements.

VTB Commodities Trading applied to the High Court of Justice in England seeking freezing injunctions against the refinery’s assets worth €225 million in support of pending arbitration proceedings. The court granted the application and imposed interim measures. As a result, it attached the refinery’s property in the Tyumen region and petroleum reserves stored in the port of Murmansk. It also prohibited the respondent from selling its petroleum products.

185 See https://www.annpz.ru/en/about/.
186 See https://www.vedomosti.ru/business/articles/2019/05/29/802698-krupneishii-npz.
As part of its claims, VTB Commodities Trading also filed applications for interim measures with the Commercial Court of Murmansk Region\(^\text{187}\) and the Moscow Commercial Court.\(^\text{188}\) However, the Russian courts refused to grant interim measures.

On 20 May 2019, the refinery filed an insolvent petition. The Commercial Court of the Tyumen Region is considering the insolvent case.\(^\text{189}\) Reportedly,\(^\text{190}\) the refinery asserts that some traders, including VTB Commodities Trading, stopped making advance payments for oil products, which caused a decrease in the amount of purchased oil and halts in operations. Moreover, the attachment of assets imposed by the High Court of Justice under the application of the VTB Commodities Trading led to the refinery’s insolvency.

In June 2019, SOCAR Energoresurs, a joint venture between Sberbank and Azerbaijani state oil company SOCAR, acquired Cyprus-based Vikay Industrial, the owner of an 80 per cent stake in Antipinsky Refinery.\(^\text{191}\) Reportedly, the new owner aims to restart the plant.\(^\text{192}\)

On 12 July 2019, a criminal case was opened against the former controlling shareholder of Antipinsky Refinery, Dmitry Mazurov, under a claim by Sberbank. The court granted a request by investigators to hold Mr Mazurov in custody until 12 September 2019 pending trial on suspicion of embezzling 1.8 billion roubles.\(^\text{193}\)

### ii Urban Group

Urban Group was one of the largest developers of the Moscow region. The Group included five subsidiaries: Ivastroy LLC (development projects with an area of 1.7 million square metres), Highgate LLC (two development projects with a total area of 1 million square metres), Continent Project LLC (development project with an area of 460,000 square metres), Ekoquartal LLC (development project with an area of 450,000 square metres) and Vash Gorod LLC (development project with an area of 370,000 square metres).

In spring 2018, Urban Group faced financial difficulties because its management unlawfully disposed of assets. In April 2018, the Federal State Registration Service refused to register its share participation agreements. In May 2018, Sberbank withdrew accreditation for its mortgage programmes.

According to publicly available information,\(^\text{194}\) the Group concluded about 14,600 share participation agreements. Around 67.6 billion roubles are needed to complete the construction of about 3.5 million square metres of the problem facilities.

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\(^{189}\) Case No. A70-8365/2019, https://kad.arbitr.ru/Card/e0a069f-7e35-4bf3-827f-956551e23f0f.

\(^{190}\) See https://www.vedomosti.ru/business/articles/2019/05/20/801830-antipinskii-npz.

\(^{191}\) See https://www.vedomosti.ru/business/articles/2019/06/05/803420-socar-poluchil-dolyu-v-antipinskii-npz.


In July 2018, the Commercial Court of the Moscow Region declared insolvent all the Group’s subsidiaries (Ivastroy LLC, Highgate LLC, Continent Project LLC, Ekoquartal LLC and Vash Gorod LLC). The applicant in these proceedings was the Fund for the Protection of the Rights of Citizens Participating in Shared Construction (the Fund). Following the introduction of insolvency proceedings, the insolvency administrator challenged a number of transactions concluded with the debtors’ business customers.

Participants of shared constructions voted for the Fund’s support and passed a decision to use the new mechanism of resolution involving the Fund to complete construction of the residential buildings. The Government of the Moscow Region is going to allocate state resources to the Fund for this purpose.

iii Angstrem-T

JSC Angstrem-T is a company incorporated to implement the investment project of establishing a submicron semiconductor manufacture foundry based on 130nm and 90nm technologies, with a prospect to shift to 65nm node. The chairman of its board of directors is the former Minister of Communications, Leonid Reiman. The total amount of investments in the project is €896 million.

In 2008, Vnesheconombank (State Corporation VEB, now VEB.RF) issued a loan of €815 million for development of the project. According to publicly available information, US sanctions on the delivery of dual-use technologies was one of the reasons that prevented Angstrem-T from repaying its debt.

In January 2019, VEB.RF received 100 per cent of the company and filed for its insolvency. On 19 March 2019, the court granted the insolvency petition and commenced the supervision stage of the insolvency. The court also registered claims by VEB.RF in the amount of 14.3 billion rubles.

The Ministry of Industry and Trade has developed a draft strategy for the electronic industry in Russia until 2030, through which it proposes to implement the production of microelectronics based on Angstrem-T.

195 Case No. A41-44410/2018, considered by the Commercial Court of the Moscow Region <http://kad.arbitr.ru/Card/3bbbdac2-4257-48e4-82ff-0a8157cd9046>.
196 Case No. A41-44405/2018, considered by the Commercial Court of the Moscow Region <http://kad.arbitr.ru/Card/a3316190-539f-4350-97da-cfc41b78c0be>.
199 Case No. A41-44408/2018, considered by the Commercial Court of the Moscow Region <http://kad.arbitr.ru/Card/c6b91200-2127-4e2f-8676-93c1f2eb4754>.
201 See https://www.angstrem-t.com/eng/about-us/.
203 Case No. A40-323/2019, considered by the Commercial Court of the Moscow Region <http://kad.arbitr.ru/Card/10c120e2-4257-48e4-82ff-0a8157cd9046>.
iv  Domashnie Dengi

Domashnie Dengi LLC was one of the largest micro-finance companies that provided retail micro-loans via a network of agents.

At the end of April 2018, Domashnie Dengi refused to redeem the offered bonds for 1.25 billion roubles. In June 2018, the company announced that most of the bondholders supported the proposed restructuring terms. However, in July 2018, it made a new technical default on its obligations under restructured bonds.205

In August 2018, the Central Bank excluded Domashnie Dengi from micro-finance organisations because of the violation of professional standards, non-fulfillment of the Central Bank’s requirements and submission of false reports.

On 23 August 2018,206 the DIA, on behalf of the bank Intercommerz, filed an insolvency petition in relation to Domashnie Dengi. On 28 February 2019, the court granted the insolvency petition and introduced the supervision stage of the insolvency. The court registered claims by Intercommerz in the amount of 2.8 billion roubles. The total amount of all creditors’ claims is about 10 billion roubles.207

The beneficial owners of the company are Evgeny Bernstam and his wife. In August 2018, the DIA initiated insolvency proceedings in relation to Mr Bernstam. In July 2019, Mr Bernstam was arrested in connection with a criminal case on suspicion of fraud.208

v  E4 Group

OJSC E4 Group was an engineering company controlled by the former Russian minister Mikhail Abyzov. It was incorporated in 2006 during the reform of the Russian energy sector and the launch of large-scale investment projects in the electric power industry. The Group comprised 12 holding companies and more than 50 business units in all federal districts of Russia.209

By 2013, E4 had a 20 per cent share in the Russian market of the electric power industry. The Group was involved in the production of equipment for power facilities with a total capacity of almost 7GW and a total cost of 160 billion roubles.210

In 2014, according to the company’s annual report, deterioration of the financial and economic situation in the country, fluctuations of currency exchange rates, and an increase in bank rates gave rise to the company’s problems with payments on loans and contracts.211 In 2015, more than 200 claims were filed against the company.

206  Case No. А40-197447/2018, considered by the Commercial Court of the Moscow Region <http://kad.arbitr.ru/Card/d4a9db33-059c-4dbe-9e7a-a-01c02bd31a8b>.
208  See https://www.rbc.ru/society/04/06/2019/5c46539a794745e947950;
209  See https://www.rbc.ru/business/07/04/2015/54c315829a7947067d751a4.
210  See https://www.vedomosti.ru/business/articles/2016/10/31/662955-e4-sdalas-kreditoram.
211  See https://www.rbc.ru/business/articles/2016/10/31/662955-e4-sdalas-kreditoram
On 28 November 2014, the Moscow Commercial Court registered the first insolvency petition by CJSC Axioma Prava. On 17 June 2015, the court granted the insolvency petition and commenced the supervision stage of the insolvency. On 18 November 2016, E4 was declared insolvent and the receivership stage commenced.\footnote{Case No. A40-171885/2014, considered by the Commercial Court of the Moscow Region <http://kad.arbitr.ru/Card/4917fB32-c772-42a3-b998-cc0a46a77a5>}

In December 2018, Alfa-Bank filed a claim to hold liable Mikhail Abyzov, his ex-wife (from whom Mr Abyzov was divorced in 2016) and former E4 president Andrei Malyshev. Similar claims were filed by Redeliaco Holdings (the E4 insolvency creditor) in February 2019 and by the public joint stock company T Plus (controlled by Viktor Vekselberg) in May 2019. The creditors claim about 34 billion roubles.\footnote{See https://www.rbc.ru/society/04/06/2019/5cf4fa539a794745e9479508?utm_source=yxnews&utm_medium=desktop} On 27 March 2019, Mr Abyzov was arrested in connection with a criminal case on suspicion of fraud and organisation of a criminal network.\footnote{See https://www.rbc.ru/society/27/03/2019/5c9b84e69a79473c78505633?from=from_main.}

### IV ANCILLARY INSOLVENCY PROCEEDINGS

Russian law does not permit non-main proceedings, as discussed in Section I.vii. There is no information available regarding ancillary proceedings for foreign-registered companies.

### V TRENDS

Russian insolvency proceedings generally aim for liquidation of the debtor and enforcement of pledges. Unsecured creditors rarely get any significant amounts from the process.

There are no effective general rehabilitation mechanisms. Long-discussed and expected developments to legislation relating to financial rehabilitation proceedings have not been adopted. The government of the Russian Federation developed a draft law on restructuring proceedings and introduced it to the Duma in August 2017.\footnote{According to the draft, a debtor or a creditor is able to file for debt restructuring. If the court grants an application, a debtor and its creditors will have four months to develop a restructuring plan. The plan should provide for the repayment of all debts within the four years of its approval by the court or within up to eight years if the creditors approve it. The restructuring plan may provide for different options for the debtor’s management: its shareholders may still appoint the directors, or a court-appointed insolvency administrator may replace them, in addition to the appointment of two directors, one selected by the shareholders, and the other by the creditors.} The Duma proposed amendments to this draft law but, in November 2018, the government did not support the amendments. It is unclear to what extent and when this draft law will be adopted.

In the absence of effective regulation concerning rehabilitation, the legislator has founded \textit{ad hoc} solutions for companies that are too big to fail, are important for the economy, or whose insolvency would otherwise have negative social effects (such as the insolvency of large construction groups dealing with the construction of residential premises). The state has created the funds to finance the resolution of major companies in return for their shares. The state further acts as crisis manager and seeks to restructure the business of the companies to make them profitable or to complete the failed construction projects. Such mechanisms are available for large banks, insurance companies and construction companies. The Central
Bank has applied this mechanism to three major Russian banks (Otkritie, Binbank and Promsvyazbank). The restructuring of Otkritie’s business was completed within three and a half months instead of the estimated six months.

At the same time, the Central Bank exercises its control functions very actively, and there have been a large number of cases in which the Central Bank revoked the banking licences of less important banks and filed for their insolvency.

Major insolvency cases are often considered in parallel with criminal investigations. Law enforcement agencies actively exercise their investigative powers in large-scale insolvency-related frauds and arrest the controlling persons.

Trends in court practice include increasing liability and the number of cases in which the beneficial owners of a debtor are held liable for the debtor’s debts. In the absence of regulation of inter-group insolvencies, courts attempt to fill the lacuna and develop case law on this matter to prevent the registration of artificial inter-group claims and the dilution of the assets of a debtor’s subsidiaries. In almost every significant insolvency case, there are disputes about the registration of claims of creditors affiliated with the debtor, including non-existent or fraudulent claims. Sometimes such claims are confirmed by court judgments or arbitral awards, and the insolvency administrators or other creditors have to object to such claims so as not to lose control over insolvency proceedings. In many cases there are disputes regarding voidable transfers or fraudulent transfers.
In August 2018, a new Bankruptcy Law was created as a balanced modern means to protect both debtors and creditors in Saudi Arabia. It was also part of a series of Saudi judiciary reforms through the issuance of new commercial laws and regulations such as the new Companies Law of 2015 and the amended law of Civil Procedures. One of the country’s targets is to attract foreign investors by modernising Saudi law to match international laws and business practice. As a result of the economic crisis the country has undergone during the past few years because of low oil prices, it was necessary to create a Bankruptcy Law for the benefit of all parties doing business in Saudi Arabia. Historically, declarations of bankruptcy are very rare in Saudi. In most instances, such a declaration would require the imprisonment of the bankrupted individual for five to seven years, not as a penalty but to ensure that the bankruptcy claim was genuine and not fraudulent.

I INSOLVENCY LAW, POLICY, AND PROCEDURE

Statutory framework and substantive law

The two main documents in relation to bankruptcy in Saudi Arabia are the following:

a Bankruptcy Law, dated 28/05/1439H (corresponding to 13/2/2018G) issued by Royal Decree No. M05/1439 and Cabinet Decision No. 264/1439, published in the Official Gazette on 06/06/1439H (corresponding to 21/2/2018G); and


The new law replaced the following documents:

a Royal Decree No. M/16 dated 04/09/1416H regarding the Law of Settlement against Bankruptcy;

b Chapter 10 of Royal Decree No. 32 dated 15/01/1350H on Commercial Courts Law; and

c all other provisions relating to Bankruptcy.

The new Bankruptcy Law focuses on the following main insolvency procedures:

a preventative settlement;

b preventative settlement for small debtors;

c

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financial restructuring;  
financial restructuring for small debtors;  
voluntary liquidation;  
administrative liquidation; and  
liquidation for small debtors.

One of the major new elements in this Law that was not covered by previous laws is the creation of a clear priority of debts, with a higher priority debt being paid before a lower priority debt, as follows:

- **in-kind guaranteed debts** (real estate property mortgage and collateral);
- **certain types of ‘guaranteed finance’** obtained in preventive settlement and financial restructuring procedures;
- **wages due to employees equivalent to 30 days’ remuneration**;
- **family living allowance ordered by the family court**;
- **expenses necessary for the continuation of the debtor’s usual business activity during the bankruptcy procedure**;
- **non-guaranteed debts**; and
- **non-guaranteed government fees, subscriptions, taxes and dues as specified in the Regulations**.

Another major element of the new law is the creation of a Bankruptcy Committee under the Ministry of Commerce and Investment (MOCI). The Committee is responsible, among other things, for creating a register to record all bankruptcy applications, which is open to public inspection. However, the information on the register is not detailed enough and many aspects of the procedure remain confidential, such as the nature and amount of debts.

The Implementing Regulations of the Bankruptcy Law organise the insolvency procedures and supplement the statute. They provide additional detail on matters such as the threshold for small debtors, which is two million Saudi riyals (any debts above this amount should not follow the procedures for small debtors). The Regulations also give clear rules for the method of resignation and dismissal of the trustees, required documents for the initial petition and each stage of the application, notification and announcement procedures, the method of documentation and access to information about the bankruptcy procedures.

Under Article 4 of the Bankruptcy Law, those to whom the Law and its Implementing Regulations apply are the following:

- **individuals and corporations** carrying on commercial, professional or for-profit businesses in Saudi Arabia; and
- **non-Saudi investors** who have assets in Saudi Arabia or carry on commercial, professional or for-profit business through a licensed entity.

The Law has taken into consideration that certain transactions might be entered into with an intent to defraud or harm creditors, conceal a debtor’s assets or harm stockholders, all of which are prohibited and punishable. The court may set aside actions or transactions that are found to meet one of these criteria and order the recovery of any debtor’s assets discharged under a spacious transaction and the payment of compensation to the harmed creditors.
Violations of the Law are subject to strict penalties that include imprisonment for a term not exceeding five years or a fine not exceeding five million Saudi riyals, or both, and restrictions on carrying on, managing or co-founding certain businesses.²

ii Policy

The prevailing attitude regarding the treatment of businesses in financial difficulties is to avoid liquidation by introducing preventative settlement and financial restructuring. Liquidation of a business is used as a last resort, which can be effected in a separate procedure to the bankruptcy procedure. Efforts are made to keep failing businesses in operation, as described by one Saudi lawyer: ‘Distressed or potentially distressed investors will have the opportunity to re-evaluate their financials, fulfil the pending obligations to creditors and continue their operations with eased and sufficient procedures.’³

The purposes of the Bankruptcy Law and its Implementing Regulations are the following (as listed under Article 5 of the Law):

a to reduce the financial difficulties on bankrupt or distressed debtors by encouraging them to fulfil their obligations;
b to allow debtors to reorganise their financials in order to continue their business operations aiming to support and develop the economy;
c to protect the creditors’ rights;
d to reduce the costs and time frame of the bankruptcy procedures;
e to encourage small and medium businesses to invest in the commercial market; and
f to promote transparency and predictability.

iii Insolvency procedures

Preventative settlement

The aim of this procedure is to facilitate a debtor in agreeing terms with its creditors without losing control of the management of the business. The debtor would be able to continue running its business. Only the debtor can file for this procedure under the Law. The claims of the creditors taking legal action against the debtors would be suspended for between 90 and 180 days. This procedure is aimed at those who will be able to pay off their debts, but need additional time to do so.

The debtor must provide a proposal to the creditors to repay the debt within a reasonable period, who will therefore vote on the proposal. For the procedure to be approved, creditors who represent two-thirds of the value of the same class of debt must vote on the financial proposal and support it. Failure to get the necessary number of votes would impede the preventative settlement and the procedure would be declined by the court. If a court declines one of the bankruptcy procedures, it does not mean that the debtor cannot refile and the court may order the commencement of another bankruptcy procedure it finds suitable.

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The debtor must request the court for the suspension of the claims of the creditors upon application for a preventative settlement. This is unlike the other two insolvency procedures that automatically suspend the claims of the creditors upon application of the procedure.

Once the court approves of the procedure, the debtor must perform its contractual obligations as declared under the settlement documents. Some of the debtor’s duties during this period include providing information to the bankruptcy register, such as the court’s decisions and extensions. If it is in the interests of the debtor’s business activity, the debtor may terminate a contract to which it is a party by submitting a petition for termination to the court under Article 37 of the Implementing Regulations.4

There are special arrangements for a preventative settlement for small debtors, although they are very similar to the regular procedure for preventative settlement.

Financial restructuring

The aim of this procedure is to facilitate a debtor in agreeing terms with its creditors regarding the financial restructuring of its business under the supervision of a financial restructuring adviser or bankruptcy trustee, who must be duly licensed to carry out such a role.

The Bankruptcy Committee has been given the authority to issue licences to financial restructuring advisers and bankruptcy trustees. One of the main requirements for obtaining such a licence is having the necessary qualifications in finance and auditing.

Unlike preventative settlement, a debtor loses full control over the business and must operate it under the guidance of a financial restructuring officer or bankruptcy trustee. Any debtor, creditor or related third party, such as a government authority, can file for financial restructuring.

A preventative settlement should not last longer than 180 days. However, there is no limit to the duration of a financial restructuring procedure, which can last for years, so long as the restructuring plan is approved. The debtor must provide a proposal to the creditors to repay the debt within a certain period, such as five or seven years with a grace period. The creditors will vote on the proposal. In addition, creditors comprising two-thirds of the same class of debt will have to vote on the approval of the financial restructuring plan.

Another effect of an application for financial restructuring is the suspension of the creditors’ legal claims or court proceedings from the time the application is made until the request is either rejected or approved by the court. This protects the debtor from creditors making any claims or taking legal action, such as foreclosure of assets or closure of business throughout this period.

Once the court approves the financial restructuring plan, or proposal, it will appoint a trustee (the financial restructuring officer) who will, among other things, supervise the debtor’s activity during the financial restructuring to ensure fairness of the procedure and its execution. The debtor will also need to obtain the trustee’s approval before undertaking any of a large number of specified actions that may have an impact on his asset and liability position. Once the court approves the financial structuring, it applies to all the creditors.

There are special arrangements for the financial restructuring of small debtors, but they are very similar to the regular procedure for financial restructuring.

Liquidation

This is the process of bringing a business to an end because of its inability to pay back its debts and distributing its assets to the creditors. Given the alternative forms of insolvency procedures provided by the new Bankruptcy Law, liquidation should be considered as the last resort. The liquidation procedure can be initiated by a debtor, creditors or a related third party, such as a competent government authority. The process can be initiated for debtors that are either insolvent or bankrupt. The claims of the creditors will automatically be suspended upon applying for liquidation. The time frame for liquidation does not have a limit and may take from several months to several years. However, once a liquidation request has been approved, it is the duty of the liquidator to finalise the liquidation within five years as required under Article 205 of the Companies Law.

As with financial restructuring, the debtor no longer has full control over its business. A liquidation trustee is appointed, who assumes the management of the debtor’s assets. Other duties of the trustee include liquidating the debtor’s assets, listing debts, and distributing the proceeds according to the debt’s priority.

The assets of the debtor will be sold and the proceeds from the sale are distributed by the liquidation trustee to the creditors under the supervision of the court. The Bankruptcy Law and Implementing Regulations do not specify whether the sale of assets is through a public auction or not.

Administrative liquidation

Articles 1 and 167 of the Bankruptcy Law define administrative liquidation as the process of selling the liquidation assets that are not expected to cover the expenses of the liquidation procedure. This process may be requested by a debtor or the competent authority, in the event that the debtor’s business is in distress, is bankrupt or the assets will not cover the expected expenses of the liquidation process. If this is the case, the government will intervene to manage the liquidation process rather than an independent liquidator.

A committee is appointed by the court to manage the liquidation procedure, which should be finalised within 12 months of the date of commencement of the administrative liquidation. The committee may extend this period, if needed, but for no more than 90 days.

iv Starting proceedings

Different players can file for different proceedings: only a debtor can apply for a preventative settlement or commence a proceeding for administrative liquidation, whereas a debtor, creditors or a third party such as a government authority can file for administrative liquidation.

Proceedings are commenced through an application to the court for the appropriate procedure. This must be done online, via a link on the Ministry of Justice website and the applicant must provide the requested information.

If the application is approved, a date for a court hearing is determined within five days. The hearing must be held within 40 days of the date the request was submitted. The court may commence the procedure, reject it or postpone the hearing. If all requested documents are provided and approved, then the court can commence the procedure. If the documents...

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are not complete, the court will give the applicant 21 days to submit the missing or correct documents. The court will either announce its approval for commencement of the procedure or reject it. It may also order the commencement of a more suitable bankruptcy procedure when appropriate.

After commencement of the procedure, a trustee will be appointed for financial restructuring and liquidation. The creation of a plan, voting among the creditors, shareholders of the company, and other steps will then take place.

All demands or legal actions by the creditors will be stopped automatically, except in the case of preventative settlement, when a separate request to stop the claims must be submitted with the preventative settlement request.

v Control of insolvency proceedings
Insolvency proceedings are under the control of the commercial courts and the Bankruptcy Committee, each of which has a distinct role in the bankruptcy procedure. It is up to the court to decide whether to approve or reject the commencement of any of the procedures. Applications are submitted directly to the courts. However, it is the Bankruptcy Committee that undertakes the tasks necessary for the organisation and effectiveness of the procedures.

One of the major substantive clauses of the new Bankruptcy Law, which did not exist in the previous law, is the setting up of the Bankruptcy Committee. It is an independent, specialised and administrative body that is responsible for overseeing all bankruptcy matters and reports directly to the MOCI. As per Article 9 of the Law, the Committee is composed of at least five competent and authorised persons nominated by the Minister of Commerce and Investment. The members of the Committee will serve a term of three years, which can be renewed. The Committee’s tasks include, but are not limited to, the following:

a setting up a special bankruptcy register;
b issuing licences for bankruptcy experts and trustees who assist in the insolvency procedure;
c issuing implementing regulations governing the framework of the licensed bankruptcy experts and trustees; and
d coordinating the relevant liquidation procedures and inspecting the ongoing bankruptcy procedures.6

The court has the most powerful and significant role in the proceedings, as it determines whether proceedings are approved or rejected. According to Article 6 of the Bankruptcy Law: ‘The Court shall issue judgments and decisions necessary for the application of the procedures provided for in the Law, supervising its implementation, adjudicating the disputes arising therefrom and imposing the prescribed penalties in the system.’

vi Special regimes
According to Article 3 of the Bankruptcy Law, the following entities must obtain special permission from the authorised body to apply for any of the insolvency procedures:

a banking, finance and insurance companies;
b persons authorised to practise securities business;
c the financial market, and settlement and clearing companies;

6 ibid.
credit rating companies;

- information companies and credit records;
- telecommunications, water, electricity and gas companies;
- companies that carry out explorations of energy sources and minerals;
- companies operating in airports, rail services, ports and others as specified in the Implementing Regulations;
- special purpose facilities; and
- any other person outlined in the Implementing Regulations.

The Law does not specify what the authorised body is for each of the above. However, we would expect that in the case of banks, for example, the authorised body would be the Saudi Arabian Monetary Authority, which regulates and supervises financial institutions in Saudi Arabia. The authorised body must give its permission within 30 days. If it fails to respond with approval within this time frame, its silence will be considered acceptance and approval. Once an entity acquires the required permission, it can apply for the appropriate insolvency procedure and proceed through the stages in the same way as the beneficiaries of the bankruptcy procedure.

II INSOLVENCY METRICS

The Saudi economy is going through a period of recovery after the economic slowdown and hardships it has faced in the past few years. Interest rates are expected to decline in the next 12 months. The growth in gross domestic product is expected to be 2 per cent in 2019, a slight decline from the 2.2 per cent in 2018, but is expected to increase in 2020. The unemployment rate was down slightly in 2019, to 12.4 per cent, as compared with 12.8 per cent in 2017 and 12.9 per cent in 2018. The rate is expected to reduce further in 2020, to 12.1 per cent.

Other indicators also demonstrate positive progress. Inflation dropped from 2.5 per cent in 2018 to 1.1 per cent in 2019, but is expected to increase to 1.6 per cent in 2020. Government revenue and spending have both increased. Government revenue increased from 895 billion Saudi riyals in 2018 to 938 billion Saudi riyals in 2019, and is expected to reach 973 billion Saudi riyals in 2020. Government spending rose from 1,030 billion Saudi riyals in 2018 to 1,106 billion Saudi riyals in 2019, and is expected to reach 1,143 billion Saudi riyals in 2020.

No official statistics are available regarding the number of entities that have started plenary insolvency proceedings. However, an article published in May 2019 states that there are 25 bankruptcy cases ongoing in the country. The bankruptcy requests were filed in numerous cities, including Riyadh, Makkah, Jeddah, Madinah, Dammam, Jazan, Najran, Taif, Yanbu and Buraidah.

8 ibid.
9 ibid.
The number of bankruptcies in the past 12 months is higher than in the past, perhaps as a result of the Bankruptcy Law being published in August 2018 as an attempt to boost reform and attract foreign investors. One reason is sure to be the financial difficulties the country has gone through in the past couple of years because of the reduction in oil prices and other factors. Many of the bankruptcies filed are by some of the biggest companies in the country, previously worth millions or billions of riyals, as demonstrated in the examples that follow.

According to Turki Al-Ruwaili, a spokesman for the Bankruptcy Committee, the firms that are filing for bankruptcy are in the construction, administrative affairs, insurance and food industries.\(^{12}\) Other industries affected include real estate and health.

### III PLENARY INSOLVENCY PROCEEDINGS

Although the Law requires the setting up of a bankruptcy register, and that the information therein must be available to the public, the register does not provide a detailed level of information about proceedings. Thus, some of the examples we now discuss are current proceedings that have been commenced, while others are major bankruptcies that have taken place but have yet to be filed for in the courts.

The following are some of the most significant completed and pending plenary insolvency proceedings during the past 12 months.

#### i Financial restructuring of SAAD Group

Owned by the Saudi billionaire Maan al-Sanea, who was ranked by Forbes in 2007 as one of the 100 richest people in the world, SAAD Group and another conglomerate, Ahmad Hamad al-Gosaibi and Brothers (AHAB), defaulted on loans worth billions of dollars in 2009. For the past 10 years, creditors have been chasing the company for the repayment of their debts, estimated to be between US$11 and US$16 billion, although the total amount of debt is believed to be US$22 billion.

The company, whose activities range from construction and engineering, real estate development, financial services and banking to healthcare, filed for financial restructuring in the Dammam Court under the new Law in February 2019; the court approved and appointed an independent trustee, Saleh Al-Naim. The trustee sent a notice to creditors, the majority of which are banks, announcing the beginning of the financial restructuring proceedings, and asked them to submit their claims within 90 days.\(^{13}\)

SAAD Group’s filing is one of the first to be accepted under the new Law.

The majority of the creditors are regional and international banks that have obtained non-appealable judgments against Maan al-Sanea, Saad Group, or both, from a Saudi court. The number of banks awaiting repayments from SAAD Group has passed 100.\(^{14}\)

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considerable number of the creditors, both local and international, are being represented by the accounting firm EY.\textsuperscript{15} Ancillary proceedings have been commenced across three continents,\textsuperscript{16} in countries such as the Cayman Islands.

According to Simon Charlton, a corporate finance expert at the global accounting firm Deloitte, who was working on the case, decided in consultation with lawyers and consultants that the blame lay with Al-Sanea. Al-Sanea was accused of forging the signatures of family members to create a huge Ponzi scheme, through which he siphoned several billion dollars into ghost companies. The practice of ‘name lending’, whereby a bank approves loans on the strength of a family reputation instead of the strength of its credit rating, has long been used in Saudi Arabia and aided Al-Sanea in carrying out his Ponzi scheme. The fact that a bankruptcy code was missing made the situation even more problematic – the existence of a bankruptcy code would have aided in the liquidation process.\textsuperscript{17}

Events and efforts prior to the filing for financial restructuring include the appointment of London-based Orchard Corporate Strategy in 2018, a financial firm specialising in debt restructuring services, to advise the company. Mr Al-Sanea had been detained for the unpaid debts in 2017. Later that year, a three-judge tribunal established to resolve the company’s debt dispute appointed a consortium, Etqaan Alliance, to liquidate assets owned by Mr Al-Sanea. The consortium held three auctions – in Saudi Arabia’s Eastern Province, Riyadh and Jeddah – at which it sold the billionaire’s vehicles, warehouses and real estate assets, raising approximately 350 million Saudi riyals.\textsuperscript{18}

ii Financial restructuring of AHAB

Ahmad Hamad al-Gosaibi and Brothers, the conglomerate mentioned above in relation to SAAD Group, also filed for financial restructuring at the First Instance Court of Dammam, which the court approved on 19 May 2019. The Court appointed Mr Badr Al-Tamimi as trustee to oversee the activities of the business and assist in the bankruptcy procedure.

The events that led to the bankruptcy and the amount of debt overlap with the information provided in relation to SAAD Group. Ancillary proceedings have taken place in the international courts in several countries, including the Cayman Islands.\textsuperscript{19}

iii Potential filing by Saudi Oger

It is not clear whether Saudi Oger has started bankruptcy proceedings, as there are no announcements to this effect in the bankruptcy register, but the company is expected to use the current law for assistance.

\begin{itemize}
\item \textsuperscript{16} Frank Kane, ‘Saudi Arabia’s multibillion corporate collapse: Al-Gosaibi exec on his role in 8-year saga’, \textit{Arab News}, 2 July 2017 <www.arabnews.com/node/1122941/business-economy>.
\item \textsuperscript{17} ibid.
\end{itemize}
Low oil prices and state spending cuts have resulted in a slowdown in the Saudi construction sector. As one of the major players in the construction sector in Saudi Arabia, Saudi Oger has faced serious financial difficulties from this slowdown. Mismanagement of the company, as well as corruption, which is often found in Saudi construction companies, have greatly contributed to the creation of this debt. The company owed medical insurance and fees to the General Organization for Social Insurance and was forced to lay off thousands of its employees.20

There are currently approximately 45,000 creditor claims against Saudi Oger. The amount of debt they are suffering is between 25 billion and 30 billion Saudi riyals. Included in this amount is nearly 13 billion Saudi riyals owed to Saudi banks.21

It is expected that the company will file for one of the procedures of bankruptcy under the Bankruptcy Law.

iv Liquidation for Al-Mashfa Medical Center

Another industry that has suffered from cuts in government spending, unregulated competition and mismanagement is the health industry. Following several medical mistakes that have resulted in scandals at the Al-Mashfa Medical Center, the legitimacy of this fairly new hospital was questioned, leading to a reduction in profit.

In April 2019, one of the creditors for the hospital, a company called Takniyat Medical Services, filed for liquidation. On the 31 May 2019, the Fourth Circuit at the Commercial Court of Jeddah announced the appointment of Mr Mazen Batarji as trustee to manage the company’s activities and oversee its duties until the court announces the commencement of the liquidation procedure.22

The bankruptcy register does not include details regarding the number of creditors or the amount of debt, neither has any additional information on the matter been published by the media.

v Liquidation for Ghassan Al Sulaiman Autos

The automotive industry has also suffered from a shortage of cash and unregulated competition. Following an expansion plan to distribute luxury cars, such as Bentleys and Lamborghinis – which caused a severe liquidity crunch – the legitimacy of Ghassan Autos was questioned, leading to closure of the business.

In March 2019, the owner of the business filed for liquidation. On 31 March 2019, the Fourth Circuit at the Commercial Court of Jeddah announced the appointment of Mr Mazen Batarji as trustee to manage the business’s activities and oversee its duties until the court announces the commencement of the liquidation procedure.23

The bankruptcy register does not include details regarding the number of creditors or the amount of debt, neither has any additional information on the matter been published by the media.

IV ANCILLARY INSOLVENCY PROCEEDINGS

As far as we know, there is no bankruptcy law in Saudi Arabia that regulates ancillary insolvency proceedings. We are not aware of any ancillary insolvency proceedings for foreign-registered companies taking place in Saudi Arabia in the past 12 months.

V TRENDS

We anticipate that insolvency activity will increase during the coming year, because many companies and individuals in many industries are suffering as a result of the economic crisis the country has experienced in the past couple of years. Since the Bankruptcy Law is less than a year old and creates a balance between protecting debtors and creditors, many debtors and creditors suffering from insolvency or bankruptcy are likely to file for one of the procedures. Now that liquidation is no longer the only available option, debtors and creditors will want to file for the procedures from which they will benefit most.

The companies that are most likely to file for insolvency or bankruptcy proceedings will be those in the construction and building, real estate, health and medication, car and food industries. However, it is possible for companies across all sectors to benefit from these proceedings. It will be especially interesting to watch how major companies, such as SAAD Group, which has been going through liquidation for the past 10 years, may benefit from the new legislation.

Since the new Law and its Implementing Regulations have replaced the old laws that governed bankruptcy, it is unlikely that there will be any further legislative development in the coming year. However, we might see directives from the Bankruptcy Committee to deal with any new developments or situations not provided for under the Law.
Corporate insolvency in Singapore is primarily governed by the Companies Act, supplemented by the Companies (Winding Up) Rules and the Companies Regulations. Certain provisions of the Bankruptcy Act and the Bankruptcy Rules also apply to corporate insolvency in Singapore.

Apart from the general corporate insolvency provisions, Singapore has also provided for industry-specific insolvency or winding up rules for certain industries, including the banking industry. These rules apply to the relevant industry in addition to the insolvency provisions under general company law.

A new, omnibus Insolvency, Restructuring and Dissolution Act 2018 (IRDA) (which consolidates the provisions of the Bankruptcy Act and the corporate insolvency provisions in the Companies Act into one statute) has been passed by Parliament. It is anticipated that the IRDA will come into effect later this year, once the relevant subsidiary legislation is finalised.

The IRDA is a culmination of wide-ranging reforms that began in May 2017, when the Companies Act was amended to implement significant changes to the insolvency regime with the stated objective of attracting more foreign debtors to restructure their debts in Singapore, thereby positioning the state as an international centre for debt restructuring. The IRDA will build on the reforms implemented in 2017.

Policy

The Companies Act provides for a range of insolvency and reorganisation options for companies in distress, namely liquidation, judicial management and receivership, as well as schemes of arrangement between companies and their creditors and shareholders.

In October 2013, the Insolvency Law Review Committee (ILRC) (appointed by the Ministry of Law in December 2010) issued a report, setting out various recommendations on the provisions of the new insolvency statute to be enacted. The recommendations by the ILRC included proposals to enhance the insolvency and reorganisation mechanisms, and the management of cross-border insolvency issues.

Subsequently, the Committee to Strengthen Singapore as an International Centre for Debt Restructuring (DRC) was established and issued its recommendations on 20 April 2016.

1 Nish Shetty is a partner and Elan Krishna, Keith Han and Loh Tian Kai are associates at Clifford Chance Asia.
The recommendations of the ILRC and the DRC were broadly accepted by the Singapore government, leading to the following more significant amendments to the Companies Act in May 2017:

a. amended jurisdictional requirements to give foreign companies increased access to the debt restructuring regime in Singapore;

b. enhanced moratoriums granted by the Singapore courts in support of restructurings which can be expressed to have *in personam* worldwide effect and be extended to related entities of a debtor company;

c. improved features of the judicial management and scheme of arrangement regimes in Singapore;

d. the introduction of provisions governing grants of super-priority to lenders who provide much needed rescue financing to debtors-in-possession during the restructuring process; and

e. the adoption of the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law).

The IRDA, upon coming into operation, will introduce, among other things:

a. restrictions on the operation of *ipso facto* contractual clauses (i.e., clauses automatically terminating or modifying a contract upon the occurrence of certain insolvency-related triggering events) during the course of a scheme of arrangement or judicial management;

b. a process for creditors to place a company under judicial management without having to apply to court;

c. early dissolution of a company if the realisable assets of the company are insufficient to cover the winding-up expenses and the affairs of the company do not require any further investigation;

d. express powers of a liquidator or judicial manager to assign the proceeds of certain actions that are instituted to recover monies or assets for the company, facilitating the procurement of third-party funding for such actions; and

e. a new licensing and regulatory regime for insolvency practitioners such as liquidators, judicial managers and receivers.

### Insolvency procedures

#### Liquidation

Liquidation is also referred to as winding up. Singapore law provides for both compulsory winding up (or winding up by the court) and voluntary winding up (consisting of creditors’ voluntary winding up or members’ voluntary winding up).²

The objective of compulsory winding up is to realise a company’s assets and distribute them to creditors in order of priority. Any company can be compulsorily wound up, regardless of whether it is registered in Singapore, provided that it has some connection with Singapore and meets the relevant criteria under the Companies Act. For example, a foreign company may be wound up under the Companies Act if a creditor can demonstrate that the company’s centre of main interests (COMI) is in Singapore or that the company has substantial assets in Singapore.³

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² Companies Act, Section 247.

³ ibid., at Section 351(2A).
A creditors’ voluntary winding up aims at winding up a company without reference to the courts. The creditors have the right to nominate a liquidator. If they do not, a liquidator will be nominated by the company.⁴ Any company registered in Singapore can be wound up in this way.

The objective of a members’ voluntary winding up is to wind up a company when its shareholders no longer wish it to continue in business, to pay all the company’s creditors in full and to distribute any surplus to the shareholders. Members’ voluntary winding up can only be effected when the company is solvent. The company has the right to appoint a liquidator in a members’ voluntary winding up.⁵

**Provisional liquidation**

A provisional liquidator will be appointed by the High Court pending determination of the winding-up application⁶ if the applicant can demonstrate a *prima facie* case for the granting of a winding-up order and the High Court is satisfied in the circumstances of the case that a provisional liquidator should be appointed.

The provisional liquidator is obliged to preserve the status quo so as to protect the company’s assets. A provisional liquidator’s powers are prescribed by the court order appointing him or her.⁷

Upon the making of a winding-up order or the appointment of a provisional liquidator, all the property of the company vests in the liquidator (or the provisional liquidator as the case may be).⁸

**Judicial management**

A company or its creditors may apply to the High Court for an order that the company be placed under judicial management if the company is or is likely to become unable to pay its debts, and there is a reasonable probability of rehabilitating the company or of preserving all or part of its business as a going concern, or that otherwise the interests of creditors would be better served than by resorting to a winding up.⁹

Any company, including foreign companies, can be placed under judicial management provided that the High Court is satisfied that the company is or is likely to become unable to pay its debts, and it considers that the making of the judicial management order would be likely to achieve one or more of the following purposes:

a  the survival of the company, or the whole or part of its undertaking as a going concern;

b  the approval under Sections 210 or 211I of the Companies Act of a compromise or scheme of arrangement; or

c  a more advantageous realisation of the company’s assets than would be effected by a winding up.¹⁰

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⁴ ibid., at Section 297(1).
⁵ ibid., at Section 294(1).
⁶ ibid., at Section 267.
⁷ ibid.
⁸ ibid., at Section 269.
⁹ ibid., at Section 227A.
¹₀ ibid., at Section 227B.
The judicial manager has the power to manage the business and property of the company.\textsuperscript{11} In addition, during the period for which a judicial management order is in force:

\textit{a} the company cannot be wound up;
\textit{b} no receiver or manager of the whole of the company’s property can be appointed;
\textit{c} there is a moratorium on legal proceedings against the company; and
\textit{d} no security can be enforced against the company’s property except with the consent of the judicial manager or with leave of the court.\textsuperscript{12}

An interim judicial manager may be appointed by the court pending determination of the judicial management application.

\textbf{Receivership}

The High Court may order the appointment of a receiver, or a receiver and manager, in ‘all cases in which it appears to the Court to be just and convenient’.\textsuperscript{13} The Court has relatively wide discretion to make such appointments and usually does so when there is genuine concern that a company’s assets are in jeopardy and may be dissipated to the detriment of the debenture holders.

Often, a secured creditor may also enforce its security rights against the debtor company by appointing a receiver, or a receiver and manager. A receiver’s primary duty is to realise the assets for the benefit of the secured creditors that appointed him or her, or in the case of a receiver and manager, to manage and realise the assets that come within the ambit of his or her appointment.

\textbf{Schemes of arrangement}

A scheme of arrangement is often used as a means of corporate rescue. It is a binding arrangement between a company and its creditors or shareholders, who may, among other things, seek to compromise the company’s debts and liabilities.\textsuperscript{14}

A scheme of arrangement is binding on all creditors or classes of creditors, or shareholders or classes of shareholders, as the case may be, if:

\textit{a} a majority in number representing three-quarters in value of those creditors, or classes of creditors or shareholders, or classes of shareholders, agrees to the scheme of arrangement and the High Court approves the scheme of arrangement;\textsuperscript{15} or
\textit{b} a majority in number representing three-quarters in value of the creditors meant to be bound by the scheme of arrangement have agreed to the scheme of arrangement, and the High Court is satisfied that the compromise does not discriminate unfairly between two or more classes of creditors, and is fair and equitable to each dissenting class (commonly known as a ‘cross-class cramdown’).\textsuperscript{16}

\begin{itemize}
\item \textsuperscript{11} ibid., at Section 227G.
\item \textsuperscript{12} ibid., at Section 227D.
\item \textsuperscript{13} Civil Law Act, Section 4(10).
\item \textsuperscript{14} Companies Act, Section 210.
\item \textsuperscript{15} ibid., at Section 210(3AB).
\item \textsuperscript{16} ibid., at Section 211H, Paragraphs (2) and (3).
\end{itemize}
A scheme of arrangement will not be fair and equitable to a dissenting class if, among other reasons, a creditor in the class that has dissented to the scheme would receive an amount that is lower than that creditor is estimated by the High Court to be most likely to receive if the scheme of arrangement does not pass.17

The Singapore Court of Appeal appears to have adopted an expansive view of the scheme jurisdiction, recently observing that when one company has guaranteed a debt owed by a second company, a scheme of arrangement in respect of the guarantor’s debts can validly compromise the debts of the primary obligor if there is a sufficient nexus or connection between the debts.18 The decision may be significant for group restructurings as it facilitates the use of a scheme of arrangement in respect of one group company to compromise related debts (particularly, corporate guarantees) owed by other group companies.

iv Starting proceedings

Liquidation

Compulsory winding up

An application may be presented to the High Court for an order that a company be wound up compulsorily if it is unable to pay its debts.19 A company is deemed to be unable to pay its debts when:

- it is served with a statutory demand for a sum in excess of S$10,000 and it is unable, within three weeks of the date of service of the statutory demand, to pay the sum or to secure or compound the sum to the reasonable satisfaction of the creditor;20 or
- it is unable to pay its debts if execution or other process issued on a judgment in favour of a creditor of the debtor company is returned unsatisfied in whole or in part.21

Generally, a winding-up application can be presented to the High Court by either the company or the company’s creditors.22 Winding up is deemed to have commenced when the winding-up application is made.23

After the application is made, the company, or any creditor or contributory, may apply to the High Court to stay any further proceedings in any pending actions against the company.24

Creditors’ voluntary winding up

A company’s directors can begin the procedure to wind up the company voluntarily if they believe that there is no real prospect of its debts being paid.

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17 ibid., at Section 211H(4)(a).
18 Pathfinder Strategic Credit LP and another v. Empire Capital Resources Pte Ltd and another appeal [2019] SGCA 29 at [77] to [79].
19 Companies Act, Section 254(1)(c).
20 ibid., at Section 254(2)(a).
21 ibid., at Section 254(2)(b).
22 ibid., at Section 253(1).
23 ibid., at Section 255(2).
24 ibid., Section 258.
A statutory declaration of the company’s inability to carry on business by reason of its liabilities and a statement of affairs pertaining to the company must be filed with the Accounting and Corporate Regulatory Authority (ACRA). Within one month of the date of the statutory declaration, the company must hold (1) an extraordinary general meeting (EGM) of shareholders to pass a special resolution for winding up by at least 75 per cent of votes cast, and (2) a meeting of the company’s creditors within one day of the special resolution to appoint a liquidator (and possibly a committee of inspection). Voluntary winding up is deemed to have commenced when the resolution for voluntary winding up is passed or on the date of the making of the statutory declaration in the situation where a provisional liquidator is appointed before the resolution for voluntary winding up is passed.

Members’ voluntary winding up

The company’s directors must make a statutory declaration of solvency within the five weeks before the EGM of the company’s shareholders is convened to vote to pass the special resolution to wind up the company. The directors must also prepare a statement of affairs. At an EGM (convened with at least 21 days’ notice), the shareholders must pass a special resolution to resolve to wind up the company voluntarily and appoint a liquidator. In the event that the liquidator in a members’ voluntary winding up forms the view that the company is unable to make payment of its liabilities as originally envisaged in the statutory declaration of solvency, the members’ voluntary winding up can no longer proceed as such. The liquidator may then summon a meeting of the company’s creditors and lay before them the company’s statement of assets and liabilities. At this meeting, the creditors will also have the option to appoint some other person to act as liquidator. Thereafter, the winding up shall proceed in the form of a creditors’ voluntary winding up.

Judicial management

An application for a judicial management order may be made by a company, a creditor (or creditors jointly), including a contingent or prospective creditor, or a director of the company if authorised by a resolution of the members or of the board of directors.

There is an automatic moratorium on all proceedings against the company starting from the time the application for judicial management is made until the High Court makes a determination on the application. The moratorium is wide-ranging and restrains, among other things, the passing of a resolution for winding up the company and enforcement actions against any charge or security held over the company’s property, except with the leave of the High Court.

25 The statutory declaration is made by the company’s directors.
26 Companies Act, Section 291(1)(a).
27 ibid., at Section 290(1)(b).
28 ibid., at Section 291(1)(b).
29 ibid., at Sections 296 to 298.
30 ibid., at Section 291(6).
31 ibid., at Section 293, Paragraphs (1) and (3).
32 ibid., at Section 291(6).
33 ibid., at Section 294(1).
34 ibid., at Section 295.
35 ibid., at Section 227B.
36 ibid., at Section 227C.
Following the May 2017 amendments to the Companies Act, the High Court may also grant the application despite the opposition of a person who has appointed or is entitled to appoint a receiver and manager of substantially the whole of the company’s property under the terms of any debenture, unless the prejudice that would be caused to such person if the order was made would be disproportionately greater than the prejudice that would be caused to unsecured creditors of the company if the application were dismissed.\(^\text{37}\) This represents an alteration of the absolute veto right such a person previously enjoyed.

** Receivership **

Holders of debentures that contain an express power to appoint a receiver, or a receiver and manager, can make such an appointment privately. The powers of the receiver, or receiver and manager, are prescribed by the terms of the debenture.

Where the debentures do not provide for the appointment of a private receiver, or receiver and manager, the holders of the debentures may make an application for the High Court to appoint a receiver.\(^\text{38}\)

** Scheme of arrangement **

An application to the High Court for approval of a scheme of arrangement may be made by a company, any creditor or member of the company, or the liquidator of the company (where the company is being wound up).\(^\text{39}\) The application is made by way of originating summons supported by an affidavit.

A company may apply for a moratorium to restrain or stay proceedings against the company if it is proposing a scheme of arrangement.\(^\text{40}\) An automatic 30-day stay of all proceedings against the company arises upon the filing of an application for a moratorium under Section 211B of the Companies Act.\(^\text{41}\) The moratorium may also restrain the appointment of a receiver or receiver and manager. If a company has already proposed a scheme of arrangement, in applying for a moratorium it is required to provide evidence of creditor support for the proposed scheme and an explanation of the importance of that support to the proposed scheme.\(^\text{42}\) If a company intends to propose a scheme of arrangement but has yet not done so, the company applying for a moratorium is required to provide evidence of creditor support for the moratorium sought,\(^\text{43}\) a brief description of the intended scheme and sufficient information relating to the company’s financial affairs, which will place the creditors in a better position to assess the feasibility of any proposed scheme of arrangement.\(^\text{44}\) The company is also required to provide the High Court with an undertaking

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\(^{37}\) ibid., at Section 227B(5).

\(^{38}\) Singapore Rules of Court, Order 30, Rule 1.

\(^{39}\) Companies Act, Section 210, Paragraphs (1) and (2).

\(^{40}\) ibid., at Sections 210(10) and Section 211B.

\(^{41}\) ibid., at Section 211B, Paragraphs (8) and (13).

\(^{42}\) ibid., at Section 211B(4), as interpreted by Re IM Skaugen SE and other matters [2019] 3 SLR 979 [IM Skaugen] at [48] to [54].

\(^{43}\) ibid., at Section 211B(4)(a), as interpreted by IM Skaugen at [50].

\(^{44}\) ibid., at Section 211B(4)(b), as interpreted by IM Skaugen at [53].
that it will make the application for the scheme of arrangement as soon as practicable.\textsuperscript{45} A creditor may apply to the High Court to vary or terminate the moratorium, especially if the applicant company has not filed the information required.\textsuperscript{46}

A moratorium under Section 211C can be granted on the application of a subject company’s ‘related company’ (i.e., subsidiary, holding company or ultimate holding company) where, among other things, the related company plays a necessary and integral role in the compromise or arrangement relied on by the subject company to make the moratorium application.\textsuperscript{47} The High Court may extend the moratorium to acts taking place in Singapore or elsewhere as long as the creditor is in Singapore or within the jurisdiction of the Court.\textsuperscript{48} In contrast, moratoriums granted under Section 210(10) cannot have extraterritorial effect.\textsuperscript{49} In any event, in granting an extraterritorial moratorium, the High Court should not make an omnibus order but should instead target a specific act, or acts, of a specific party.\textsuperscript{50}

A scheme of arrangement that has been approved by the High Court may only be amended by way of an order of court. A scheme of arrangement approved by the Court will need to be lodged with the ACRA before it becomes binding.\textsuperscript{51}

\section*{Control of insolvency proceedings}

The Singapore courts have assigned certain judges with the requisite expertise as docketed insolvency judges to hear applications relating to insolvency and restructuring, including when the matter is urgent. Generally, the various insolvency procedures will be administered by the respective insolvency professionals appointed. However, the High Court does retain a certain degree of oversight.

\subsection*{Liquidation}

Upon the making of a winding-up order by the High Court, the liquidator may only carry on the business of the company so far as is necessary for the beneficial winding up of the company for a period of four weeks after the date of the winding-up order. Thereafter, the liquidator can only do so with the leave of the Court or the committee of inspection.\textsuperscript{52} The powers of the company’s directors also effectively cease when the winding-up order is made by the Court.

In the case of voluntary winding up, upon the appointment of a liquidator, all the powers of the company’s directors cease except to the extent approved by the liquidator, or by the members of the company with the consent of the liquidator in the case of a members’ voluntary winding up, or the committee of inspection in the case of a creditors’ voluntary winding up.\textsuperscript{53}

The liquidator is regarded as an officer of the High Court and is, therefore, expected to discharge his or her duties accordingly. All private liquidators are subject to the supervision of

\begin{thebibliography}{53}
\bibitem{45} ibid., at Section 211B(2)(b).
\bibitem{46} ibid., at Section 211B, Paragraphs (4), (10) and (11).
\bibitem{47} ibid., at Section 211C(1).
\bibitem{48} ibid., at Sections 211B(5) and 211C(4).
\bibitem{49} Pacific Andes Resources Development Ltd and other matters [2018] 5 SLR 125 at [16] and [17].
\bibitem{50} IM Skauagen at [86].
\bibitem{51} ibid., at Section 210(5).
\bibitem{52} ibid., at Section 272(1)(a).
\bibitem{53} ibid., at Sections 294(2) and 297(4).
\end{thebibliography}
the Official Receiver. The Official Receiver may take cognisance of the conduct of a liquidator to determine whether the liquidator has faithfully performed his or her duties and observed all the requirements imposed on him or her by law in relation to the performance of his or her duties. In the event that a complaint is made against a liquidator, the Official Receiver shall make enquiries about the complaint and take the appropriate action.54

The liquidator in a compulsory winding up is required to seek the High Court’s leave to be released from his or her office as liquidator.55

**Judicial management**

Upon appointment, a judicial manager steps into the shoes of the company’s directors and is deemed to be the company’s agent, with the ability to exercise the powers of the company’s officers.56 The judicial manager is also regarded as an officer of the High Court and is therefore expected to discharge his or her duties accordingly. A judicial manager may be removed at any time by the High Court and he or she is required to seek the Court’s leave to be released from that office.57

A judicial manager is obliged to table a statement of his or her proposals to achieve one or more of the purposes stated in the judicial management order (a Statement of Proposals) for the company’s creditors. The Statement of Proposals must be sent to the Registrar of the ACRA as well as all creditors of the company.58 Thereafter, the judicial manager is obliged to summon a meeting of all the company’s creditors to consider and vote on the Statement of Proposals. The judicial manager is required to report to the Court the proceedings of the creditors’ meeting and the results of the voting on the Statement of Proposals.59

A judicial manager may be held personally liable for any contracts entered into by him or her on behalf of the company, or for any contracts previously entered into by the company and which he or she had adopted.60

**Receivership**

A receiver or manager (regardless of whether he or she is appointed privately or by the High Court), may apply to the Court to seek directions for any matter connected to the performance of his or her functions.61

Any creditor, contributory or liquidator of a company may also apply to the High Court to examine the conduct of a receiver or manager who appears to have misapplied, retained or become liable or accountable for any money or property of the company; the same applies if the receiver or manager appears to have committed any misfeasance or breach of trust or duty in respect of the company.62

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54 ibid., at Section 265(1).
55 ibid., at Section 275.
56 ibid., at Section 227G(2).
57 ibid., at Section 227J.
58 ibid., at Section 227M.
59 ibid., at Section 227N.
60 ibid., at Section 227I.
61 ibid., at Section 218(3).
62 ibid., at Section 227(2).
Scheme of arrangement

The High Court has the power to supervise scheme meetings and it is open to the scheme manager to apply to the Court for directions and other ancillary orders as may be appropriate.

vi Special regimes

Singapore has enacted additional industry-specific legislative provisions for insolvency. Examples include the resolution regime for a bank licensed under the Banking Act, as set out in the Monetary Authority of Singapore Act, and the resolution regime for insurance companies, as set out in the Insurance Act.

vii Rescue financing

The May 2017 amendments to the Companies Act have introduced provisions on rescue financing, which refers to any financing that is either necessary for the survival of the company as a going concern, or to achieve a more advantageous realisation of the assets of the company than if the company were to be wound up.63

When there is a judicial management order in force, or when a company has made a scheme application or moratorium application, the High Court is empowered to grant one of four levels of priority over other secured and unsecured debts, that is for the rescue financing to (1) be treated as part of the costs and expenses of the winding up, (2) have ‘super priority’ over preferential debts, (3) be secured by a security interest on property not otherwise subject to any security interest or that is subordinate to existing security, or (4) be secured by a security interest, on property subject to an existing security interest, of the same or a higher priority than the existing security interest.64

For the rescue financier to be granted priority levels 2, 3 or 4, above, it must be shown that the company is unable to obtain financing from other persons unless the rescue financier is accorded that particular level of priority. Further, for an existing security interest to be overridden (i.e., level 4, above), the existing secured creditor must be adequately protected.

In its first decision on whether to grant super priority for debts arising from rescue financing, the High Court declined to grant priority status to funds to be advanced to the Attilan Group.65 It held that an applicant must first demonstrate that it has expended reasonable efforts to seek out non-priority sources of financing, before seeking super priority rescue financing – which would otherwise disrupt the expected priority of existing creditors.66 The applicant cannot merely assert that such efforts would be futile because of its weak financial position.67

On 8 April 2019, in an unreported decision, the High Court granted level 2 priority to S$1.5 million of ‘business quick-start financing’ to Asiatravel.com Holdings Ltd and its subsidiary (collectively, ATH Group). It is notable that ATH Group, besides approaching its existing lenders who refused to provide any further financing, had engaged a third-party

63 ibid., at Sections 211E(9) and 227HA(10).
64 ibid., at Sections 211E(1) and 227HA(1).
65 Re Attilan Group Ltd [2018] 3 SLR 898.
66 ibid., at [61], [62] and [72] to [75].
67 ibid., at [74].
investment banking and financial advisory firm, DHC Capital Pte Ltd, which was also unsuccessful in approaching the market and identifying other potential lenders willing to offer financing.\(^{68}\)

viii **Cross-border issues**
Pursuant to Section 354B(1) of the Companies Act, the Model Law has the force of law in Singapore and facilitates the resolution of cross-border insolvencies by, among other things:

a. streamlining and clarifying the process for recognition in Singapore of foreign insolvency proceedings;

b. facilitating access by foreign insolvency representatives to the Singapore courts, as well as the granting of relief in Singapore to assist foreign proceedings; and

c. promoting cooperation and coordination between courts of different jurisdictions and insolvency administrators.

With the abolition of the ring-fencing rule in respect of foreign companies under Part XI of the Companies Act, the introduction of the Model Law is a marked departure from the traditionally territorial conception of cross-border insolvency and is emblematic of the shift towards the principle of modified universalism that was embraced by the High Court in *Re Opti-Medix Ltd*\(^ {69}\) as the golden thread running through cross-border insolvency law, which requires courts, as far as is consistent with justice and public policy, to cooperate with the courts in the country of the principal liquidation to ensure that all the company’s assets are distributed to its creditors under a single system of distribution.

The adoption of the Model Law also provides clarity in respect of the recognition of foreign insolvency proceedings and coheres neatly with pre-Model Law decisions in which the inherent jurisdiction of the court was invoked as a basis for recognition of foreign winding up proceedings.\(^ {70}\)

II **INSOLVENCY METRICS**

There were 312 compulsory winding up petitions and 207 companies in compulsory liquidation in 2018. This was a slight increase compared with the 256 compulsory winding up petitions filed and 168 companies that were compulsorily liquidated in 2017.\(^ {71}\)

Between January and April 2019, a total of 87 compulsory winding up petitions were filed and 66 companies were wound up.\(^ {72}\)


\(^{69}\) *Re Opti-Medix Ltd (in liquidation) and another matter* [2016] 4 SLR 312.

\(^{70}\) For example, *Re Taissu Suk (as foreign representative of Hanjin Shipping Co Ltd)* [2016] 5 SLR 787.


\(^{72}\) ibid.
III  PLEINARY INSOLVENCY PROCEEDINGS

On 29 May 2019, the creditors of Swiber Holdings Limited voted on and approved the restructuring proposal set out in the judicial manager’s statement of proposals. Among other directions issued by the High Court in the lead-up, the court in Re Swiber Holdings held that the general rule that a creditor shall not vote in respect of the part of its claim secured over the debtor’s property did not extend to security over property provided by a third party (e.g., the debtor’s subsidiary or associate).

In a separate proceeding, the Court of Appeal set aside an order granting leave to Empire Capital Resources Pte Ltd to convene a creditors’ meeting to vote on a proposed scheme of arrangement. As the applicant had failed to provide sufficient disclosure for the Court to be satisfied that fair conduct of the creditors’ meeting is possible, the Court would not even allow the proposed scheme to be put before the creditors for their consideration.

IV  ANCILLARY INSOLVENCY PROCEEDINGS

The US Chapter 7 bankruptcy trustee of Zetta Jet Pte Ltd and Zetta Jet USA Inc successfully obtained recognition of the US Chapter 7 bankruptcy proceedings under the Model Law as enacted in Singapore, on his second attempt.

In January 2018, the High Court (per Justice Aedit Abdullah) refused general recognition of the trustee and the US proceedings because of an extant Singapore injunction enjoining Zetta Jet Pte Ltd and its shareholders from carrying out any further steps in the US proceedings. The Court held that recognition would undermine the administration of justice in Singapore and be contrary to public policy. However, the Court granted limited recognition to the trustee only for the purpose of applying to set aside or appeal against the injunction.

In March 2019, following a consensual discharge of the injunction, the High Court granted recognition of the US proceedings as a foreign main proceeding (i.e., a foreign proceeding taking place where the debtor has its COMI). The Court clarified that a debtor’s COMI is to be determined as at the date the recognition application was filed. The Court added that the assessment of a debtor’s COMI focuses on where the primary commercial decisions are made for the debtor and involves the consideration of various factors, such as the location of creditors, location of operations, and representations made to third parties.

74 Re Swiber Holdings Ltd and another matter [2018] 5 SLR 1130 (per Justice Kannan Ramesh).
75 Companies Regulations, Regulation 74.
76 Re Swiber Holdings at [37].
77 Pathfinder Strategic Credit LP and another v. Empire Capital Resources Pte Ltd and another appeal [2019] SGCA 29 at [96].
78 ibid., at [71].
79 Re Zetta Jet Pte Ltd and others [2018] 4 SLR 801 at [5].
80 ibid., at [21] to [29].
81 ibid., at [34].
82 Re Zetta Jet Pte Ltd and others (Asia Aviation Holdings Pte Ltd, Intervener) [2019] SGHC 53 at [126] and [127].
83 ibid., at [53].
84 ibid., at [27].
85 ibid., at [85] to [107].
V  TRENDS

As discussed in Section I, so as to position Singapore to meet the anticipated increase in demand for insolvency and restructuring services in the Asia-Pacific region, the DRC was appointed by the Ministry of Law to build on the work of the ILRC and recommend initiatives and legal reforms to cement Singapore’s status as a leading centre from which to coordinate a multi-jurisdictional restructuring.

Key recommendations by the DRC report have been implemented through the amendments to the Companies Act that came into effect on 23 May 2017, and the passing of the IRDA.

Notably, several of the key changes to the insolvency framework were adapted, with appropriate modification, from jurisdictions that possess more mature and highly developed insolvency processes, such as the US Chapter 11 debtor-in-possession regime. It is anticipated that more companies (including foreign companies) will avail themselves of the features under the enhanced insolvency regime.
Chapter 25

SPAIN

Iñigo Villoria and Alexandra Borrallo

I

INSOLVENCY LAW, POLICY AND PROCEDURE

i

Statutory framework and substantive law

The Spanish Law of Insolvency 22/2003 (SIL), dated 9 July 2003, was published on 10 July 2003 and entered into force on 1 September 2004. It has undergone a series of amendments between 2009 and 2015. At the time of writing, the Spanish legislator is working on a new reform.

Insolvency law encompasses all regulations applicable to court insolvency proceedings as opposed to out-of-court liquidations, which only apply when a debtor is still able to meet all its liabilities.

The main features of Spanish insolvency law are the classification of debts, the challenge of prior transactions, the general effects of the insolvency on debts and bilateral agreements, and the liability regime.

Classification of debts

Secured claims represent attachments on assets (subject to in rem security) and entail separate proceedings, subject to certain restrictions to commence enforcement proceedings (or to continue such proceedings if they have already been commenced). When the secured asset is necessary for the debtor’s activities, enforcement by the creditors may be subject to a delay of up to a year after the declaration of insolvency.

The creditors are not subject to an arrangement (see further at Section I.v, ‘Second stage: arrangement or liquidation’), except if they vote in favour of it or certain qualified majorities are met. In the event of liquidation, they will collect payment against the secured assets.

Claims benefiting from general priority include those of public authorities (generally, for half their amount), certain labour claims and the claims of the creditor initiating the insolvency proceedings (up to 50 per cent of its claim and 50 per cent of the fresh money received by the company in protected refinancing agreements).

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The holders of general privileges are not affected by an arrangement (if they do not consent) unless certain qualified majorities are met and, in the event of liquidation, they will be the first to collect payment.

‘Ordinary claim’ is the residual category; it includes trade creditors and lenders, when not secured or subordinated.

Subordinated claims are classified by virtue of an agreement or pursuant to law, including debt held by related entities. Subordinated creditors may not vote on arrangements and have very limited chances of recovery. When subordination arises from a special relationship, the creditor will also lose any security over assets belonging to the debtor.

There will be other claims that are not subject to the insolvency proceedings and that are, therefore, neither acknowledged nor classified. These include claims accrued after the insolvency proceedings to continue the business, 50 per cent of the fresh money received by means of protected refinancing agreements (100 per cent if fresh money is received before October 2016), and other claims prescribed by law, even if accrued earlier (i.e., salaries accruing during the 30 days before the insolvency proceedings were initiated).

**Prior transactions: clawback**

Under the SIL, there are no prior transactions that automatically become void as a result of the initiation of insolvency proceedings. However, the court receivers may challenge those transactions that could be considered as having been detrimental to a debtor’s interests, provided they have taken place within two years of the declaration of insolvency.

Damage exists, in any event, in the case of gifts and prepayment of obligations that are due after the declaration of insolvency, if unsecured. Damage is also deemed to exist in the case of security created to protect existing obligations and transactions with related entities; however, the defendant may prove otherwise.

Any transactions that can be considered as transactions in the ‘ordinary course of business’ are not subject to challenge.

To avoid the risk of a challenge, a debtor and its creditors (by a three-fifths majority) may subject a refinancing agreement to the provisions of Article 71 bis of the SIL. It is also possible to apply the terms of such an extension to the dissenting financial lenders if certain conditions are met.

The rescission of intra-group guarantees is a complex matter. Most courts, applying the individual concept of ‘company’ as a basis, have reached the conclusion that guarantees granted through third-party debt are transactions that are cost-free and, as such, rescindable. Minority case law has considered that the granting of a guarantee through the debt of a company in the group is not a cost-free transaction, with the effect that the insolvency receivers would have to provide evidence of the damage.

**Effects on debts: interest and set-off**

Following the initiation of insolvency proceedings, interest no longer accrues, with the exception of secured debt (if the proceeds allow it to be settled). Interest already accrued is considered a subordinated debt.

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3 Shareholders owning at least 10 per cent of the share capital (5 per cent if a listed company) or group companies.

4 Additional Provision 4 of the SIL.
Set-off is applicable provided that the legal requirements have been met before the company is declared insolvent; set-off will no longer be possible after insolvency proceedings are initiated.

Hedge agreements are subject to specific regulations (allowing close-out netting and enforcement of collateral).

**Effects on bilateral agreements**
The declaration of insolvency does not, per se, allow the parties to terminate a bilateral agreement, notwithstanding what may have been agreed between the parties.

As a general rule, the declaration of insolvency does not alter the general contractual rules on termination but, under the SIL, the judge may decide to remedy an eventual default of the insolvent party by reinstating an agreement, with the effect that any outstanding amounts and further payments under the agreement will be post-insolvency claims. If the court deems it appropriate for the interests of the insolvent party, it is entitled to terminate the agreement, with compensation for damages.

There are specific rules for employment agreements, mainly affecting collective dismissals, which are dealt with by an insolvency judge.

**Directors’ liability**
Under Spanish company law (in the absence of a case of insolvency), directors are liable for damages and for debts, under certain circumstances.

Aside from the insolvency proceedings, a criminal claim may be filed against the directors of the company. In general, criminal liability would not arise as a result of financial distress unless the directors had committed criminal offences in such a context, such as unfair or fraudulent management or false accounting.

In the event of insolvency, as a general rule, incidental proceedings may be initiated to investigate the reasons leading to the insolvency, which may conclude by declaring the insolvency as negligent or fortuitous. Negligent insolvency may be based either upon a causal analysis (directors having caused or aggravated the insolvency fraudulently or through gross negligence) or upon certain presumptions, set out by law. In this regard, the status of the accounts and compliance with legal duties (including the duty to apply for insolvency) is essential.

If the insolvency is deemed negligent, the directors or third parties (as accomplices) may be liable for damages covering any losses caused to creditors as a result of their actions. In a case of negligent insolvency leading to liquidation, the directors of the company may also be liable for outstanding company debts – the judge enjoys a wide discretion. The scope of this provision is pending clarification by the courts.

Shareholders may also be held liable when an insolvency is deemed negligent because of their unreasonable refusal to accept a debt-for-equity swap with lenders and this refusal leads to the failure of the refinancing negotiation.

**Policy**
Although the SIL was thought to be a step forward in the development of the Spanish insolvency system, in practice it has not been useful as a restructuring tool. Recourse to the insolvency process is usually triggered by the directors’ fear of facing liability if they unduly
postpone the insolvency filing when the company is already in financial distress; however, they should try to avoid this at all costs, as it is understood in the market that a company that is declared insolvent very rarely survives.

One of the reasons for this negative view of restructuring is that companies usually reach the insolvency stage when their financial position has already deteriorated too far. In this context, lenders are generally unwilling to face further risk, so the debtor’s ability to keep on trading becomes subject to its own ability to generate cash.

In addition, while the SIL has tried to find a reasonable balance between the different interests involved, in practice, courts and receivers tend to be very debtor-friendly (in particular, when dealing with insolvency clawback claims). This introduces uncertainty as regards the lenders’ positions, making them unwilling to expose themselves further. This was the main reason why the legislator introduced a ‘clawback shield’ in 2009 for certain refinancing agreements, and introduced certain incentives in 2011 for refinancing, such as priority ranking for fresh money or cramdown for dissenting creditors within refinancing agreements.

Still, liquidation is the most likely outcome of insolvency (occurring in more than 90 per cent of cases). Recovery from liquidation is difficult; in most insolvency proceedings, usually only post-insolvency debts are settled, as the proceeds of the secured assets are generally not enough to meet the secured obligations. Privileged creditors are usually paid in part, and ordinary creditors are rarely paid a substantial proportion of their debts.

iii Insolvency procedures

A debtor (or in the case of a company, its directors) is legally obliged to file for insolvency when it becomes insolvent (i.e., when it fails regularly to meet its current outstanding obligations). This obligation must be fulfilled within two months of the time the debtor became or should have become aware of the insolvency situation. Failure to comply with this obligation triggers the assumption that the directors have acted negligently (see further, Section I.i, ‘Directors’ liability’).

A debtor is entitled to apply for insolvency proceedings when it expects that it will shortly become insolvent. In this sense, insolvency proceedings are available as a type of legal protection that a debtor may request to avoid the attachment of its assets by its creditors. As a general rule, insolvency proceedings are not compatible with other enforcement proceedings or injunctions.

A debtor is also allowed an extra four-month moratorium upon application to the court (Article 5 bis of the SIL), during which it is allowed to continue to do business normally and keep negotiating with its creditors to reach an agreement that will avoid definite insolvency. Insolvency application by creditors is prevented and enforcement of credits against assets necessary for the business is banned.

Although it is difficult to indicate an average time, the insolvency process will rarely last less than 18 months. Liquidation can take longer when there are significant assets to be sold.

iv Starting proceedings

Insolvency proceedings are formally initiated when the court declares insolvency, following an application filed by either a debtor or its creditors. The application is classified as ‘voluntary insolvency proceedings’ when filed by a debtor, and as ‘necessary insolvency proceedings’ when filed by creditors.
Application

An application for insolvency proceedings may be filed either by a debtor (in the case of a company, the managing body, not the shareholders) or by its creditors.

When a debtor files an application, it must include several documents (including a power of attorney, an explanation of the situation of the company, and a list of its assets and liabilities).

When a creditor files an application, it must provide evidence of its debt, and of the insolvency situation. If the application is dismissed, the creditor has to pay the corresponding legal costs and fees (and, eventually, damages caused). If accepted, the creditor who initiated the process has a priority ranking amounting to 50 per cent of its unsecured debt.

Declaration of insolvency

When a debtor files an application, the judge will issue a decision by virtue of which the insolvency proceedings will be initiated – this may take, on average, two to four weeks. If the court considers that the application does not comply with the legal requirements, the debtor must remedy the deficiency within the time limit specified by the court.

For creditor applications, the debtor must be heard by the court before any declaration of insolvency is made (unless the application is based on an unsatisfied judgment).

The initial court decision will determine the identity of the receiver appointed by the court and the scope of the restrictions imposed on the debtor.

Control of insolvency proceedings

The general rule is that, in the event of voluntary insolvency proceedings, the court receiver supervises the company’s activities, authorising (or refusing to authorise) any payment or transaction. In compulsory insolvency proceedings, the debtor will cease to manage its estate and the court receiver will take control of the company, being in charge of all further decisions.

First stage (determination of assets and liabilities)

The objective of the first stage of the insolvency proceedings is to determine the assets and liabilities of the debtor, leading to the preparation by the court receiver of an inventory and list of creditors.

The insolvency order contains an express request for creditors to give notice of their claims within a month of the insolvency declaration appearing in the Official Gazette. Creditors must then send their statement of claim directly to the court receiver (by email), and original documents are no longer required.

Based on the documentation provided by the creditors and held by the debtor, the court receiver will draw up a list of acknowledged creditors and classify them according to the categories used (privileged, ordinary and subordinated). The court receiver is obliged to inform the creditors of their classification before submitting the report to the court, so that they have the chance to make allegations.

Additionally, the creditors and the debtor may challenge any details on the list of creditors by appealing before the insolvency judge.

Second stage (arrangement or liquidation)

The second stage leads either to an arrangement between the debtor and its creditors, or to the liquidation of the debtor’s assets.
As an exception, in certain cases the debtor may propose an advanced arrangement in the course of the first stage of the proceedings. Liquidation may be requested at any time during the proceedings.

An arrangement may be entered into between the debtor and the majority of the creditors, involving a delay in payment or a partial cancellation of debts. It is not effective until the court gives its approval. The court may refuse to do so when there has been a breach of the law or when the parties have shown that the debtor will not be able to fulfil the arrangement.

The arrangement may be imposed on creditors with a general priority, and on secured creditors if certain majorities are met within categories. For this purpose, the SIL divides secured creditors and creditors with a general priority into four categories:

1. employees;
2. public authority creditors;
3. financial creditors (regardless of whether they are supervised by a regulatory body, such as the Bank of Spain); and
4. any other creditors – mainly commercial creditors.

Although upon approval of the arrangement most of the effects of the insolvency proceedings cease, the proceedings do not terminate until the terms of the arrangement are completely fulfilled.

In the case of liquidation, a debtor ceases to manage its assets (in the case of a company, its directors would cease to act). The court receiver liquidates the debtor’s assets by selling them to distribute the money obtained among the creditors according to the priority rules established by the SIL.

vi  Special regimes

The same insolvency proceedings apply to both people and entities (excluding public administrations, which cannot become insolvent). These proceedings may lead either to the restructuring of the business or to the liquidation of the debtor’s assets.

The SIL is based on the assumption that a company’s insolvency does not always imply the insolvency of other companies within the group; however, certain rules try to coordinate the various proceedings being carried out in relation to companies pertaining to the same group.

Financial institutions and insurance companies are subject to specific regulations, in two senses: when insolvency is declared, certain special conditions apply (e.g., regarding the appointment of the insolvency receivers), and they can be subject to intervention by the Bank of Spain to avoid the insolvency process. In practice, only one financial entity has reached the insolvency stage in Spain.

vii  Cross-border issues

From 26 June 2017, the new Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (the Recast Insolvency Regulation) has been applicable to all the EU Member States except Denmark. This means that this new Regulation shall be applicable to all those insolvency proceedings that are initiated in an EU Member State (except Denmark), when the centre of main interests (COMI) of the debtor is located in one of those countries.
Aside from new information duties between the countries (e.g., those that must create an insolvency registry), the most relevant aspects of this regulation are as follows.

The types of proceedings to which the Recast Insolvency Regulation applies have increased, and pre-insolvency proceedings are now included. With regard to Spain, the Regulation includes homologation proceedings, extrajudicial payment proceedings and anticipated arrangement proposals.

The determination on the judicial competence to declare the principal insolvency proceeding is explained in more detail. In this sense, the definition of COMI is now foreseen under an Article (not under an introductory statement) and includes a series of presumptions to determine where it is located (in the case of companies, where its main centre is located, and in the case of people, where he or she usually lives).

A new Chapter on the insolvency of companies that belong to the same group has been included. The Recast Insolvency Regulation pretends to provide for improved cooperation and coordination between the insolvency receivers, courts, and others in charge of each proceeding, and has even included a new 'group coordination proceeding’, which is voluntary and enables the insolvency proceedings of group companies to be processed jointly.

II INSOLVENCY METRICS

Since 2013, the number of insolvency proceedings steadily decreased until 2018, when the number increased slightly as compared with 2017.

In 2013, 9,937 proceedings were filed; 6.5 per cent more than in 2012. The number of proceedings declared decreased to 7,074 in 2014 then dropped to 4,916 in 2015. During 2016, the number of insolvency proceedings that were initiated decreased to 4,060, which is significantly lower than the corresponding numbers in other European jurisdictions (e.g., nearly 58,000 in France). In 2017, just 3,943 proceedings in total were filed. However, in 2018, the number increased to 4,131. Geographically, most of the proceedings are declared in the Mediterranean area (mainly in Barcelona and Valencia), followed by Madrid.

Real estate and construction have traditionally been the sectors with most insolvency proceedings. However, the numbers of proceedings in these sectors are now lower compared with those declared in the service sector (27 per cent), and the distribution and commerce sector (22 per cent).5

The improvement in the Spanish economic situation has resulted in a reduction in the number of insolvency proceedings overall, and some companies, such as Grupo DIA, have avoided being declared insolvent after reaching refinancing agreements with their main debtors.

III PLENARY INSOLVENCY PROCEEDINGS

During 2018 and 2019, insolvency proceedings have continued to progress; they include the proceedings relating to Grupo Isolux, Marme Inversiones 2007 SL (owner of Banco Santander’s headquarters) and Zed Worldwide, SA.

All figures quoted in Section II are according to information provided by the National Statistics Institute.
Other companies that have been declared insolvent are Bultaco Motors, SA (motorcycles and accessories), Home Meal Replacement, SA (owner of the food chain Nostrum), the political party Iniciativa Per Catalunya Verds and Pili Carrera (children’s clothing).

IV  ANCILLARY INSOLVENCY PROCEEDINGS
There is no information regarding relevant ancillary insolvency proceedings pending before the Spanish commercial courts.

V  TRENDS
It is expected that, as the Spanish economy continues to recover (there has been a slight increase in consumer expenditure), the number of insolvency proceedings being declared in the coming months will stabilise as compared with 2018, or at least not increase dramatically. This situation may be reinforced by a growing tendency to arrange refinancing agreements (such as Grupo Prisa). However, political uncertainty may lead to a slowdown in the economic recovery, partly because foreign investors may be reluctant to invest in Spain.

The levels of activity in the distressed loan market have continued to increase, with transactions involving the acquisition of debt held by insolvent companies at a discount, and management of third parties’ debt. Although traditionally in these cases the purchaser would not hold voting rights in the event of a creditors’ arrangement (when not a financial institution), an amendment of the SIL removed this provision, clearly with the aim of encouraging an injection of liquidity in the Spanish market by foreign investors. This has been the case in respect of Spanish toll roads and Marme Inversiones 2007, SL. The outcome of these proceedings will affect international markets’ view of Spain.
Chapter 26

SWITZERLAND

Daniel Hayek and Mark Meili

I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

Swiss restructuring and insolvency proceedings are mainly governed by the Swiss Debt Enforcement and Bankruptcy Law (DEBA), which entered into force in 1892. A number of other laws and ordinances further regulate special aspects of restructuring and insolvency proceedings, such as specific provisions relating to the nature of the debtor (e.g., financial institutions).

The recognition of foreign restructuring and insolvency proceedings is governed by the Swiss Private International Law (PILA), which entered into force in 1989.

The DEBA provides for two main types of insolvency proceedings against corporate debtors:

a bankruptcy proceedings pursuant to Article 197 et seq., aimed at the full liquidation of the debtor’s assets and the debtor’s dissolution by realising the entire estate and distributing the proceeds proportionately to all creditors; and

b composition proceedings pursuant to Article 293 et seq., aimed at enabling the debtor to reach a restructuring agreement with its creditors.

The Swiss Code of Obligations (SCO), which entered into force in 1912, provides for in-court and out-of-court measures supporting the restructuring of a financially distressed debtor, for example, by way of the corporate law moratorium for over-indebted companies pursuant to Article 725a of the SCO. Further, the SCO requires immediate implementation of restructuring measures, when a company’s financial statement shows that half of the share capital and statutory reserves are no longer covered by the company’s assets, pursuant to Article 725, Paragraph 1 thereof.

ii Policy

The collapse of Switzerland’s national airline, Swissair, in 2001 sparked a public debate about the need to amend Swiss insolvency laws. There was wide criticism that the DEBA failed to deal effectively with the restructuring of financially distressed companies and with insolvencies.
of large group companies, resulting in the vast majority of restructuring processes ending in liquidation rather than in survival of the companies. Subsequently, the DEBA provisions were discussed in Parliament, and the revised DEBA entered into force on 1 January 2014. The primary objective of the revision was to promote the restructuring of companies over liquidation.

Inspired by the US Bankruptcy Code’s Chapter 11 procedure, the revised DEBA facilitates companies’ access to protection under a moratorium for mere restructuring purposes. The rules governing the moratorium thus create incentives to apply for a provisional moratorium in a timely manner. Companies shall have enough time to adopt restructuring measures without the public being aware of their financial difficulties. Changes in employment law in relation to business takeovers should further facilitate the process. In addition, the provisions on terminating long-term agreements were revised. Since 2014, a debtor can extraordinarily terminate long-term agreements, other than employment agreements, in composition proceedings. Thus, debtors can now free themselves from long-term commitments, which may jeopardise the financial stability of the entire company. However, we have yet to see any increase in restructurings leading to company survivals under the revised DEBA.

iii Insolvency procedures

Bankruptcy proceedings

Once a debtor is declared bankrupt by the competent court, all the debtor's creditors take part in the bankruptcy proceedings.

The aim of the proceedings is to satisfy all the creditors in proportion to their claims against the debtor. This requires the full liquidation of the debtor’s estate, including all assets and liabilities. During the bankruptcy proceedings, the debtor remains the beneficial owner of its estate until the estate is realised. However, the debtor loses the right to dispose over its assets. This right is transferred to the bankruptcy estate, which exercises it through the bankruptcy administration.

As a first step, the bankruptcy office prepares an inventory listing all the debtor’s assets. If that inventory shows that the proceeds from the assets will cover the costs of bankruptcy proceedings, the bankruptcy office will commence ordinary bankruptcy proceedings. Otherwise, the bankruptcy office will initiate summary proceedings, which generally do not entail creditors’ meetings.

Subsequently, the bankruptcy office publicly announces the opening of bankruptcy proceedings against the debtor and summons the creditors to file their claims within one month, whereby the filing deadline is extended for foreign creditors.

The first creditors’ meeting should be held within 20 days of the public announcement of the bankruptcy proceedings against the debtor. The purpose of this meeting is to decide

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4 The right to termination by the debtor exists only during the moratorium and only if refraining from terminating the long-term agreement would make the restructuring aim impossible and the liquidator has consented to the termination.

5 In Switzerland, insolvencies are handled by insolvency courts, which are a special section at the district court in most cantons. Therefore, district court judges, in certain cantons single judges, may have to deal with complex finance-based insolvency litigation without having the same level of expertise as commercial courts.

6 The subsequent remarks about Swiss bankruptcy proceedings relate to ordinary bankruptcy proceedings.
on organisational issues, such as appointing either the public bankruptcy office or a private bankruptcy administrator as the administrator of the estate. It further decides on urgent administrative action, such as the continuation of the debtor's business activities.

The first creditors’ meeting may elect a creditors’ committee, which, among other things, is generally in charge of supervising the bankruptcy administrator, deciding on the continuation of business operations, and authorising the continuation of court proceedings and the conclusion of settlement agreements. The meeting requires a quorum of at least 25 per cent of the known creditors, or at least 50 per cent of the creditors if there are four or fewer known creditors. Decisions in the first creditors’ meetings are reached by an absolute majority of the represented votes.

The bankruptcy administrator administers the bankruptcy estate's assets and decides on the admission of filed bankruptcy claims in the schedule of claims, as well as the extent and the class in which the claims are admitted. The schedule of claims is open for inspection at the bankruptcy office and can be contested before the competent court by way of a statement of claim within 20 days. Creditors may contest either that their claims were rejected, that their claims were not admitted in the filed amount or that their claims rank in the wrong class of claims. A distinct feature of Swiss insolvency proceedings is that a creditor may also contest the admittance (regarding admitted amount or class of claim) of another creditor's claim, which – if successful – results in a negative declaratory judgment. If this negative collocation suit action is successful, the amount by which the defendant's share of the bankruptcy estate is reduced is used to satisfy the claimant's full claim, including legal fees. Any surplus is distributed among the creditors according to the rectified schedule of claims.

The second creditors’ meeting is entrusted with passing further resolutions, in particular, a decision about the realisation of the debtor's assets. The bankruptcy administrator will realise the assets by way of public auction, private sale or assignment of claims to a creditor.

The proceeds resulting from the realisation of the debtor’s estate are then used to satisfy the bankruptcy claims. Distribution of the proceeds to the creditors follows the principle of equal treatment. However, certain creditor claims are privileged and are satisfied prior to other claims.

Claims by pledgees are satisfied before the three other classes of claim under the DEBA. If the proceeds exceed the claims of the pledgees, the surplus is used to cover claims that are not asset-backed. These unsecured claims are divided into three creditor classes. The creditors in a subsequent class will only be satisfied if and to the extent the creditors of the previous class have received full coverage of their claims. If the proceeds from the realised assets do not fully suffice to cover all claims in one class, the proceeds are distributed to the creditors on a pro rata basis according to the amounts of the claims (the bankruptcy dividends). The first class of creditors mainly comprises claims arising from employment relationships with the debtor, accrued within the six months prior to the opening of the bankruptcy proceedings. The second class of claims encompasses claims from social security, health and unemployment institutions. All other types of claims against the debtor accrued before the opening of the bankruptcy proceedings fall into the third creditor class.

After the distribution of the bankruptcy estate among the creditors, the bankruptcy administration files a concluding report to the bankruptcy court. If the court finds the bankruptcy proceedings to have been fully completed, it declares the proceedings closed.
Bankruptcy proceedings necessarily lead to the dissolution of a bankrupt corporation. During the proceedings, ‘in liquidation’ is added to the company name in the register of commerce. Upon conclusion of the bankruptcy proceedings, the company is deleted from the register of commerce, whereby it ceases to exist legally.

**Composition proceedings**

The main aims of composition proceedings are to protect a debtor from bankruptcy proceedings and to alleviate financial distress. At the end of the composition proceedings, the debtor should reach a composition agreement with its creditors, which either provides for a genuine restructuring of the debtor (Prozentrückvergleich, Dividendenvergleich) or for the (partial) realisation of the debtor’s assets outside of bankruptcy proceedings (Nachlassvertrag mit Vermögensabtretung, Liquidationsvergleich). Both types of composition agreements can be achieved either with the assistance of a court or extrajudicially.

Out-of-court composition agreements are based on private transactions, which the debtor concludes with each creditor individually, whereas judicial composition agreements are the result of proceedings regulated by law, by which the debtor can settle its debts with the approval of a majority of its creditors with judicial assistance. Such an agreement then has a binding effect on all the debtor’s creditors.

Composition proceedings begin with a provisional composition moratorium, pursuant to Article 293a et seq. of the DEBA, of up to four months, granted by the composition judge upon request of the debtor, a creditor or upon transfer from a bankruptcy court to which the debtor or a creditor submitted a proposal for a composition agreement. The composition court appoints a composition administrator to assess the prospects of restructuring or approval of the composition agreement. If such prospects exist, the composition court will grant a definitive composition moratorium of an additional four to six months, pursuant to Article 294 et seq. DEBA. In particularly complex cases, the moratorium may be extended to up to 24 months. In the absence of any prospect of a restructuring or approval of the composition agreement, the composition court will open bankruptcy proceedings ex officio.

Upon granting of the definitive composition moratorium, the court appoints a composition administrator (known as a Sachwalter). In contrast to bankruptcy proceedings, the right to disposal of the debtor’s assets remains – with some limitations – with the debtor. The debtor’s daily business runs under the supervision of a court-appointed composition administrator. The composition court will also appoint a creditors’ committee when necessary. The disposal of certain assets by the debtor may require the approval of the composition judge or the creditors’ committee.

The provisional and the definitive composition moratoriums protect the debtor from further financial distress, insofar as no enforcement proceedings may be initiated or continued during the moratoriums.

There are two principal types of judicial composition agreements:

1. a dividend agreement pursuant to Article 314 et seq. of the DEBA, the aim of which is payment of a certain percentile of the claims and a waiver of the residual amounts. This allows the debtor to eventually resume its business operations and regain the right to fully dispose of its assets; and
an agreement with assignment of the assets to the creditors pursuant to Article 317 et seq. of the DEBA, whereby the debtor assigns its assets fully or partially to the creditors, and a court-appointed and creditor-elected liquidator realises the assets. As opposed to bankruptcy proceedings, composition proceedings allow for more flexibility in realising the assets. The proceeds of the realisation are distributed among the creditors in proportion to the amounts of their filed claims and in accordance with the hierarchy of claim classes set out by the DEBA. To this end, the appointed administrator prepares a schedule of claims that can be contested by creditors as in bankruptcy proceedings. If all the debtor’s assets are assigned to its creditors, the composition agreement leads to the dissolution and liquidation of the debtor.

Both types of judicial composition agreements require approval by a majority of the creditors and the composition court.

The revised DEBA is focused on facilitating access to restructuring procedures by, inter alia, granting more time for moratoriums (four months instead of two previously) and allowing a distressed company to sell parts of its business to generate funds, subject to the approval of the composition judge or the creditors’ committee.

**Corporate law moratorium**

A corporate law moratorium is an additional measure provided for in Article 725a of the SCO, the aim of which is to enable a distressed debtor to restructure.

The board of directors of a company is legally obliged to request the opening of bankruptcy proceedings when the financial statement shows that creditor’s claims are no longer covered by the debtor’s assets, neither on a going-concern nor on a liquidation-value basis and the corporation is, therefore, over-indebted, pursuant to Article 725, Paragraph 2 of the SCO. The court may stay the opening of bankruptcy proceedings if restructuring is a possibility and may order measures to preserve the company’s assets. To this end, the court can appoint an administrative receiver and define his or her duties. A corporate law moratorium is only published publicly, which is necessary to protect third-party interests.

It is notable that the SCO provides for an exception to the board of directors’ duty to notify the court of any over-indebtedness: if certain creditors subordinate their claims to those of all other company creditors to the extent of the capital deficit, the board is exempt from its obligation to notify the court.

**Ancillary insolvency proceedings**

Recognition of foreign insolvency proceedings and foreign arrangements with creditors are dealt with in the PILA.
### Starting proceedings

**Bankruptcy proceedings**

The right to request the opening of bankruptcy proceedings is available to several parties, while the right to officially open bankruptcy proceedings is reserved for the bankruptcy court.

A creditor may file a request to open proceedings if:

- it has either fully enforced its claims in debt collection proceedings and remains in possession of a claim against the debtor; or
- other reasons justify the immediate opening of bankruptcy proceedings against a debtor (i.e., without prior debt collection proceedings), such as fraudulent behaviour or cessation of payments by the debtor.

A debtor has the right to request the opening of bankruptcy proceedings if it is insolvent and there are no prospects of reaching a private settlement of debts. A board of directors is legally obliged to request the opening of bankruptcy proceedings against an over-indebted company.

Last, bankruptcy proceedings can also be opened *ex officio* by courts, for example in cases of organisational deficiencies of companies. In the event that a composition agreement cannot be agreed by creditors, the composition court will open the bankruptcy proceedings.

**Composition proceedings**

Composition proceedings are often initiated by a debtor by supplying the court with financial statements, profit and loss statements and a provisional restructuring plan. Composition proceedings can temporarily protect the debtor from further debt enforcement proceedings being initiated against it and can enable it to restructure its business. Certain creditors may also request composition proceedings.

Both the debtor and the creditors may always request composition proceedings in ongoing bankruptcy proceedings and even the bankruptcy court may stay ongoing bankruptcy proceedings if there are sufficient indications of a successful conclusion of a composition agreement.

**Corporate law moratorium**

The bankruptcy court may stay bankruptcy proceedings against an over-indebted corporation upon request of the board of directors or of a creditor, when there is the likelihood of a successful restructuring.

### Control of insolvency proceedings

**Bankruptcy proceedings**

As has been stated, a debtor loses the right to disposal of its assets once bankruptcy proceedings have been opened against it. This right is assumed by the bankruptcy administrator, who will be either a state administrator or an elected private administrator. The bankruptcy administrator is legally obliged to preserve and realise the bankruptcy estate. Certain important rights remain with the creditors, such as appointing and confirming the bankruptcy administrator and deciding how to realise the estate’s assets. Additionally, the creditors may appoint a creditors’ committee at the first creditors’ meeting.\(^\text{11}\)

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\(^{11}\) See Section I.iii, above.
**Composition proceedings**

The composition court will appoint a provisional composition administrator for the provisional composition moratorium period and a definitive composition administrator, once the definitive composition moratorium has been granted. The administrator is entrusted with several tasks by the DEBA, including overseeing the debtor’s day-to-day business and drafting a composition agreement. The composition court can appoint a creditors’ committee, which supervises the administrator. The right to dispose of the debtor’s assets and conduct day-to-day business generally remains with the debtor.

Creditors have few controlling rights in composition proceedings. Their main right is the approval of the composition agreement by double majority. In composition proceedings with assignment of assets, the creditors can also determine the liquidators, and the number and the members of the creditors’ committee.

**Corporate law moratorium**

A court may stay bankruptcy proceedings against an over-indebted company, in the event of prospects of restructuring, pursuant to Article 725a of the SCO. The court will take measures to preserve a debtor’s assets while the right to dispose of assets remains with the debtor. The SCO gives the court much discretion on how to achieve this. It may appoint an administrative receiver and deprive the board of directors of its power of disposal or make the board’s resolutions conditional on the consent of the administrative receiver.

Creditors have no specific rights in a corporate law moratorium; they may not even be aware of an ongoing moratorium, as public notification is not always necessary.

**vi Special regimes**

Swiss law provides for special bankruptcy and restructuring rules for specific debtors. The most notable special regime deals with the insolvency of banks, security dealers and mortgage bond institutions.

The regime is governed by the Swiss Federal Banking Act of 1934 and the Ordinance of the Swiss Financial Market Supervisory Authority on the Insolvency of Banks and Securities Dealers of 2012. The competent authorities for managing the proceedings are not state courts, but the Financial Market Supervisory Authority (FINMA). The privileged second-class claims are further expanded to bank deposits with the bankrupt bank in the maximum amount of 100,000 Swiss francs, as opposed to including only social security claims in ordinary bankruptcy proceedings.

The aforementioned legal provisions in the Ordinance on the Insolvency of Banks and Securities Dealers provide for a completely autonomous restructuring procedure according to the procedure set out in the DEBA. Notably, FINMA has the authority to transfer assets located in Switzerland to a foreign bankruptcy estate when bankruptcy proceedings have been opened against a foreign bank or other financial institution, without opening Swiss ancillary proceedings. This stands in contrast to the ordinary treatment of foreign bankruptcy proceedings in Switzerland, which are further outlined below.12

Compared to a creditor’s rights in ordinary bankruptcy proceedings, creditors have limited rights in proceedings governed by FINMA. In particular, they have limited rights to appeal the bankruptcy administrator’s actions: creditors can only appeal acts relating to the

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12 See Section I.vii, below.
realisation of assets. A creditor intending to appeal any other acts may file a notification to the Federal Banking Commission (FBC). The FBC then decides whether or not it will examine the appealed act. Further, a creditor’s right to inspect the liquidator’s files are limited by banking secrecy. This right may further be restricted to specific stages of the proceedings, or it may be limited or refused if opposing interests take precedence. Further, any information gathered by way of file inspection may solely be used to preserve the rights of creditors.

There are no provisions in Swiss law that specifically govern insolvent group companies.

vii Cross-border issues

The recognition of foreign insolvency proceedings in Switzerland is regulated by PILA, as the Council Regulation (EC) No. 2015/848 of 20 May 2015 (the Insolvency Regulation) does not apply to proceedings in Switzerland, and Switzerland has not adopted legislation based on the UNCITRAL Model Law on Cross-Border Insolvency.

When bankruptcy proceedings are opened abroad, these foreign proceedings are recognised in Switzerland on condition that the PILA requirements are met, which are that the foreign bankruptcy must have been declared by the competent court at the seat of the debtor or at the centre of main interests (COMI), the foreign bankruptcy must be enforceable in the issuing country, and there are no general grounds for refusal according to the PILA.

Upon meeting these requirements, a foreign insolvency administrator is not entitled to file claims against a Switzerland-domiciled debtor before the Swiss courts. Rather, Swiss authorities conduct separate Swiss proceedings and appoint a local liquidator for the purpose of liquidating the assets (ancillary proceedings, known as a Minikonkurs). This means that, in effect, a foreign bankruptcy decree triggers Swiss bankruptcy proceedings. However, unlike Swiss bankruptcy proceedings, which include any debtor’s assets located abroad, these ancillary proceedings relate only to assets located in Switzerland. Further, not all a debtor's creditors participate in the ancillary proceedings; participation is restricted to creditors with pledge-secured claims, creditors with privileged (first-class and second-class) unsecured claims domiciled in Switzerland and creditors of non-secured and non-privileged claims of a Swiss branch of a foreign insolvent entity.

Once the claims of all creditors have been fully satisfied and a surplus remains, this surplus can be distributed to the foreign insolvency administration or to the entitled bankruptcy creditors directly. This distribution requires the recognition of the foreign schedule of claims by the same Swiss court that recognised the foreign bankruptcy proceedings. The foreign schedule of claims will be recognised when Switzerland-domiciled creditors have

13 The principle of reciprocity has been deleted by the revision of the Swiss Private International Law [PILA] that came into force on 1 January 2019.
14 The definition of a centre of main interests [COMI] in the revised PILA matches the definition in Regulation (EU) No. 2015/848 (the Insolvency Regulation).
15 Foreign bankruptcy decrees that are in apparent breach of Swiss public policy or that are not in accordance with basic Swiss procedural principles will not be recognised according to Article 27 PILA.
16 If there are no privileged or secured creditors or creditors of a Swiss branch, and if the claims of non-privileged and unsecured creditors in Switzerland are adequately taken into account in foreign proceedings and these creditors were granted their right to be heard, Swiss courts can waive ancillary proceedings in favour of a foreign insolvency trustee upon a request by the foreign bankruptcy administration.

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been appropriately considered in the schedule of claims. The PILA provides for distribution among Swiss third-class creditors, when the Swiss court does not grant recognition of the foreign schedule of claims.\textsuperscript{17}

viii Additional topics

\textit{Clawback actions}

The success of insolvency proceedings largely depends on the value of assets that can be brought into the estate, and if the estate can be adequately secured. There is always a risk of the debtor diminishing its assets. The DEBA deals with this risk extensively and provides for legal remedies either to secure the estate or to repatriate assets belonging to the estate, for example by way of clawback actions.

Only acts committed by the debtor prior to the opening of bankruptcy proceedings can be subject to clawback actions. The bankruptcy administrator or the composition liquidator is entitled to bring forward clawback actions against the contractual party of the debtor, or the debtor itself in the name of the bankruptcy estate, within two years of the opening of bankruptcy proceedings or within two years of the confirmation of the composition agreement. A creditor may only bring such a claim in its own name after assignment of this right from the bankruptcy estate.

The DEBA provides for three types of clawback actions, in relation to:

\textit{a} gifts or gratuitous acts of a debtor, pursuant to Article 286 of the DEBA. Any gifts, gratuitous acts or dispositions by the debtor for which it did not receive adequate compensation are voidable, if they were made up to one year prior to the opening of bankruptcy proceedings or one year prior to the notification of the debt moratorium against the debtor;\textsuperscript{18}

\textit{b} certain acts by an over-indebted debtor, pursuant to Article 287 of the DEBA. The granting of collateral for existing obligations, to which the debtor was not obligated, the settlement of monetary debt by unusual means and the payment of undue debt is voidable, if carried out by an over-indebted debtor up to one year prior to the opening of bankruptcy proceedings or one year prior to the notification of the debt moratorium against the debtor;\textsuperscript{19} and

\textit{c} acts by a debtor with the deliberate intent of disadvantaging creditors, pursuant to Article 288 of the DEBA. All acts carried out by a debtor up to five years prior to the initiation of bankruptcy proceedings or five years prior to the notification of the debt moratorium are voidable, if carried out with an intent to harm the debtor’s creditors or to favour certain creditors to the detriment of the others, and if that intent was apparent, or should have been apparent, to the contracting party.\textsuperscript{20}

\textsuperscript{17} Swiss law provides for more flexible rules on the recognition of foreign bankruptcy decrees on banks and other financial institutions.

\textsuperscript{18} The burden of proof that there is no disproportion between performance and consideration lies with the related party of a debtor or the group company (Article 286, Paragraph 3 DEBA).

\textsuperscript{19} Actions are not possible if the beneficiary can prove that it did not know the debtor was over-indebted and was not required to have such knowledge.

\textsuperscript{20} The burden of proof generally lies with the plaintiff. However, the burden of proof is reversed when the beneficiary is a related party or a group company, which must then prove that it was not in a position to recognise the debtor’s intent to harm (Article 288, Paragraph 2 DEBA).
**Liability claims**

The SCO holds that a board of directors has a duty to safeguard the interests of the company in good faith; specifically, the SCO lists two duties that will ensure the continuity of a company in a difficult financial situation.

First, if the latest annual balance sheet shows that half of the share capital and the legal reserves are no longer covered (capital loss), the board of directors must convene a general meeting without delay and propose financial restructuring measures, pursuant to Article 725, Paragraph 1 of the SCO.

Second, an interim balance sheet must be drawn up if there is good cause to suspect over-indebtedness. If the interim balance sheet shows that claims by the company’s creditors are not covered, whether the assets are appraised at going concern or liquidation values (over-indebtedness), the board of directors must notify the court, unless certain company creditors subordinated their claims to the extent of the capital deficit, pursuant to Article 725, Paragraph 2 of the SCO. Further, the Swiss Supreme Court has stated that the board of directors may abstain from notifying the court, if immediate restructuring measures are available. The chances of restructuring must be tangible (in other words, highly likely) and delaying the notification of the court may not endanger the financial situation of company creditors.

If members of the board of directors fail to comply with any of these legal obligations, they may become personally liable to the company, the creditors or the shareholders, where an intentional or negligent breach of duty led to a financial damage of any of these parties.

**II INSOLVENCY METRICS**

Switzerland’s gross domestic product (GDP) increased by 0.6 per cent in the first quarter of 2019. This is mainly attributable to growth in domestic demand and foreign trade. The Swiss federal government’s expert group on economic forecasts expects GDP to grow by 1.2 per cent in 2019 and by 1.7 per cent in 2020. The expert group cites the growth in the global economy and world trade (provided the international trade conflict does not intensify dramatically) as well as a favourable situation within the labour market as the main reasons for continuing GDP growth.

The Swiss National Bank predicts an inflation rate of 0.3 per cent for 2019. For 2020, the expected rate has been revised downwards from 1.0 per cent to 0.6 per cent.

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21 The board of directors’ general duty of care and loyalty is described in Article 717 SCO.
22 Restructuring measures may for example be a capital increase, cutting the capital combined with an immediate increase (Kapitalschnitt) or a rescue merger.
23 Contrary to restructuring measures in connection with a capital loss, restructuring measures in connection with over-indebtedness must be available immediately, as the board of directors must notify the court within a short time frame.
24 Decision of the Swiss Supreme Court of 2 October 1990, BGE 116 II 533.
The Swiss National Bank further predicts an inflation rate of 1.2 per cent for 2021. This prognosis is based on the assumption that the three-month LIBOR will remain unchanged at minus 0.75 per cent during the entire forecast horizon.

Statistics on insolvency activity are not yet available for 2019. In 2018, 15,291 bankruptcy proceedings were opened, which represents a slight increase of 0.15 per cent compared to 2017. This number is an all-time high for commenced bankruptcy proceedings. Nonetheless, the losses resulting from concluding bankruptcy proceedings have generally been decreasing since 2015, and decreased sharply by 20.6 per cent in 2018 as compared with 2016, to approximately 2 billion Swiss francs.

The strength of the Swiss franc has specifically hit the retail sector and the tourism industry. Companies in these sectors have had to undergo more restructurings to reduce their costs and secure a profitable continuation of their businesses. Further, the price of oil has remained at an historic low and has put the commodity sector under financial stress for some time. This has affected both companies engaging in exploration and companies higher up in the production chain. However, most of the commodities traders, such as Glencore, who were thought to be at risk at the beginning of 2016, were able to successfully restore their balance sheets.

III PLENARY INSOLVENCY PROCEEDINGS

In the past 12 months, no new landmark bankruptcy or restructuring cases have been opened to our knowledge. However, ongoing cases that have been discussed in this Review in previous editions have proceeded. The following are the most high-profile bankruptcy and restructuring cases.

i Petroplus

The oil refining company Petroplus Holdings (PHAG), which has its headquarters in Zug, Switzerland, was the parent company of the Petroplus group, which operated refineries in several European countries. Petroplus Marketing AG (PMAG) occupied a central position within the Petroplus group as it was responsible for acquiring the required crude oil and having it processed by the refineries, to eventually sell the products directly or through local marketing companies. Insolvency proceedings were commenced in late January 2012 with regard to numerous Petroplus group companies, including PHAG and PMAG, following a failure to secure a revolving credit facility (RCF) of up to US$2 billion. PMAG requested composition proceedings with assignment of assets while PHAG entered into bankruptcy proceedings. Since the lenders under the RCF were satisfied in full, the bondholders became the most important group of the Petroplus entity asserting claims based on bonds of approximately US$1.75 billion against the issuer and guarantors. They further asserted claims based on an assigned security against PMAG. The PMAG liquidators dismissed these claims, contesting the validity of relative subordination in favour of the bondholders.

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26 ibid.
The issue of relative subordination against PMAG was settled with the security agent of the bondholders and several Petroplus group entities involved. This settlement became effective in March 2016, shortly after the global settlement between the RCF banks and Petroplus group companies became effective. The RCF global settlement provided for the payment of US$211 million from the RCF banks’ security agent to PMAG.

In February 2018, two settlements entered into force: (1) between PMAG, the English group company Petroplus Refining and Marketing Ltd (PRML), PRML’s Swiss ancillary bankruptcy estate and the PRML liquidators; and (2) between PMAG, the English group company, Petroplus Refining Teesside Ltd (PRTL), PRTL’s Swiss ancillary bankruptcy estate, the PRTL liquidators and Deutsche Bank Trust Company Americas as security trustee for Petroplus bond creditors. The settlements concluded ongoing actions to contest the PMAG schedule of claims instigated by PRML and PRTL, the aim of which was to achieve the admittance of an additional third-class claim of the PRML ancillary bankruptcy estate to the amount of 131 million Swiss francs and to relegate a claim of 23.8 million Swiss francs by the PRTL ancillary bankruptcy estate from subordinated to normal-third class. The settlements took into account the risks of all parties involved and permitted a far-reaching validation of PMAG’s schedule of claims, which led to the distribution of a further interim payment to third-class creditors of PMAG.

ii Swissair
The holding company of Swissair, SAirGroup AG, and its subsidiary companies have been in composition proceedings since 2001. The liquidation proceedings advanced during 2016, when the intra-company claims (Flightlease AG, SAirLines AG and Swissair AG) were settled and a property belonging to SAirGroup was sold, generating 72 million Swiss francs for the bankruptcy estate. By settling the intra-group claims, only one action to contest the schedule of claims of SAirGroup remains pending. This action of 2,358,783,548.45 Swiss francs by the Belgian airline Sabena in liquidation against SAirGroup is currently pending before the second instance court. SAirGroup further asserted claims based on directors’ liability under corporate law against several corporate bodies of SAirGroup (members of the board, chief executive officer, chief financial officer). The composition liquidator argued, in particular, that these bodies transferred shares in possession of SAirGroup to the subsidiary SAirLines, without receiving adequate compensation for the transactions.

The Swiss Federal Supreme Court rejected the claims in 2012, as SAirGroup could not prove over-indebtedness of SAirGroup and SAirLines.29 Further directors’ liability claims of the group companies remain pending before several Swiss courts. Five advance payments on bankruptcy dividends have been made and the expected bankruptcy dividend amounts to 23 per cent, according to the liquidator.

29 BGer 4A_410/2011.
Lehman Brothers

Lehman Brothers Finance SA, the Swiss Lehman Brothers entity, was declared bankrupt in 2008. The bankruptcy proceeding is governed by the special regime for insolvent banks as outlined in Section I.vi, above. Currently, one objection against the schedule of claims of Lehman Brothers Finance SA is still pending before the competent Swiss court. Twelve dividend payments, with a total dividend of more than 61 per cent for third-class creditors, have been paid out to creditors as of 30 June 2019.

IV  ANCILLARY INSOLVENCY PROCEEDINGS

Official statistics on ancillary insolvency proceedings in Switzerland are not published. To our knowledge, within the past few years, several foreign insolvency administrators of Petroplus group companies requested Swiss ancillary bankruptcy proceedings to be opened, including Petroplus International BV in liquidation and Petroplus Finance 2 Ltd in liquidation. Swiss ancillary proceedings allow the foreign group companies to assert and enforce their claims against the Swiss Petroplus companies.

V  TRENDS

The revised PILA that came into force on 1 January 2019 remedies costly and burdensome recognition proceedings of foreign insolvency proceedings. We expect the new PILA to have a positive effect on the efficiency of Swiss proceedings in cross-border insolvencies between the European Union and Switzerland.

Since the global financial crisis, banks in Switzerland have become stricter with regard to providing loans to companies. This trend is reinforced by the Basel III legislation, which requires banks to hold more equity. Notably, it is becoming harder for small and medium-sized companies without investment grade ratings to refinance and renegotiate existing debt structures in the current market. Thus, companies are looking for alternative lenders, such as funds, pension funds, insurance companies and family offices. The restructuring market could benefit from the increased presence of such non-traditional creditors, who are less conservative than banks and are therefore willing to take more risk.

Alternative distressed debt investors are also actively using litigation as a strategy to pursue their interests and achieve recoveries in insolvency and restructuring proceedings. We therefore expect to see more litigation in the restructuring and bankruptcy market in Switzerland.

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30  See Section I.vii for further details.
I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

Although individual states in the United States have laws that govern the relationship between debtors and their creditors, insolvency law is primarily dictated by federal law because Article 1, Section 8 of the United States Constitution grants Congress the power to enact ‘uniform Laws on the subject of Bankruptcies’. While over time several different bankruptcy statutes have been passed by Congress, the US bankruptcy regime is currently set forth in Title 11 of the United States Code (the Bankruptcy Code), which codified the Bankruptcy Reform Act of 1978 and subsequent amendments. The most recent significant amendment to the Bankruptcy Code was the 2005 Bankruptcy Abuse and Consumer Protection Act.

The Bankruptcy Code is composed of nine chapters. Chapters 1, 3 and 5 provide the structural components that generally apply to all bankruptcy cases, and Chapters 7, 9, 11, 12, 13 and 15 lay out general procedures specific to certain types of bankruptcies. In general terms, these specific types of bankruptcies are:

a trustee-administered liquidation (Chapter 7);

b municipality bankruptcy (Chapter 9);

c debtor-in-possession (DIP) managed reorganisation or liquidation (Chapter 11);

d family farmer and fisherman bankruptcies (Chapter 12);

e individual bankruptcies (Chapter 13); and

f cross-border cases (Chapter 15).

In general terms, with respect to plenary corporate bankruptcies, US insolvency law provides for two distinct regimes: a trustee-controlled liquidation under Chapter 7 and a DIP-controlled reorganisation or structured liquidation under Chapter 11. This chapter focuses on Chapter 11 proceedings. Certain key provisions of US insolvency law are discussed in the remainder of this section.

1 Donald S Bernstein and Timothy Graulich are partners and Christopher S Robertson and Thomas S Green are associates at Davis Polk & Wardwell LLP.


6 Individuals can also seek relief under Chapters 7 and 11 of the Bankruptcy Code.

7 A trustee can be appointed in Chapter 11 for cause. 11 U.S.C. § 1104(a)(1).
The automatic stay

One of the most important provisions of the US insolvency regime is the ‘automatic stay’, which is codified in Section 362 of the Bankruptcy Code. The automatic stay is a statutory injunction that applies immediately upon the commencement of a bankruptcy proceeding. Generally, the automatic stay operates to enjoin most creditors from pursuing actions or exercising remedies to recover against a debtor’s property. There are limited exceptions to the automatic stay and it can be modified by a court upon a showing of cause. The automatic stay provides the breathing room necessary for the debtor or trustee to assess and assemble all the property of the estate without creditors seeking remedies to protect their own self-interests. Accordingly, the automatic stay allows for the preservation of a debtor’s assets and the maximisation of their value, and for an equitable distribution of those assets to creditors.

Safe harbours

One important exception to the automatic stay is that it generally does not apply to contracts that are colloquially referred to as ‘financial contracts’. Specifically, the automatic stay does not apply to certain delineated counterparties’ ability to offset, net, liquidate, terminate or accelerate securities contracts, commodities contracts, forward contracts, repurchase agreements, swap agreements or master netting agreements with a debtor, provided that the counterparty may be required to exercise its remedies promptly. In addition, a debtor may not avoid as a fraudulent transfer a transfer to such a counterparty under one of these contracts unless the transfer is intentionally fraudulent.

The absolute priority rule

The absolute priority rule provides that creditors with higher priority must be paid in full before creditors of lower priority receive any distribution from a bankruptcy estate, and thereby ensures a ‘fair and equitable’ distribution of the debtor’s property consistent with the priorities under the applicable non-bankruptcy law. As a result, in the absence of consent, secured claims must be paid in full from collateral before general unsecured creditors receive any recovery. Similarly, because equity holders have the lowest priority, in the absence of consent, they cannot receive any distribution until all creditors have received payment in full on account of their allowed claims. Consent to the payment of a junior class can be obtained through a vote of the senior class on a plan of reorganisation.

Avoidance actions

The Bankruptcy Code also provides a number of procedures that allow a debtor or trustee to avoid a pre-bankruptcy transfer of property from the bankruptcy estate. This allows the

10 ibid.
14 See In re Lehman Brothers Holdings Inc., Case No. 08-13555 (JMP) (Bankr. S.D.N.Y. 15 Sep. 2009).
15 A plan of reorganisation is approved by a class when a majority in number of the class members vote in favour of it and the class members who voted in favour hold at least two-thirds of the total value of the claims in that class. 11 U.S.C. § 1126.
debtor to maximise the value of the bankruptcy estate and prevent a depletion of the estate prior to the commencement of the bankruptcy proceeding that may favour certain creditors over others. These protections are found in Chapter 5 of the Bankruptcy Code. The most commonly used of these actions are:

- **Avoidance of preferential transfers**, which enables an insolvent debtor, subject to certain defences, to avoid and recover payments based on antecedent debt made to creditors within the 90 days prior to the debtor’s filing for bankruptcy – up to one year for payments made to insiders of the debtor;\(^{16}\)
- **Avoidance of fraudulent transfers**, which enables the debtor to avoid and recover transfers of property that were actually fraudulent or were made while the debtor was insolvent and for less than reasonably equivalent value;\(^{17}\) and
- **Avoidance of unperfected security interests**, which enables a debtor to avoid liens on property if those liens were not perfected under the applicable non-bankruptcy law prior to the commencement of the bankruptcy case.\(^{18}\)

**ii Policy**

The goal of US insolvency law is to provide maximum return to the creditors (and, if possible, equity holders) of a debtor and, in that context, to reorganise rather than liquidate business debtors to preserve employment and to realise the ‘going concern surplus’ of reorganisation value over liquidation value. This is accomplished by reorganising a debtor corporation under the provisions of Chapter 11 of the Bankruptcy Code. However, if a reorganisation is not possible – or if it would not result in a maximisation of value for creditors – the debtor company can be liquidated either under Chapter 11 or Chapter 7 of the Bankruptcy Code. Chapter 7 transfers the control of the liquidation process from the debtor’s management, who are likely to have greater familiarity with the assets and their value, to a trustee appointed by the US Trustee\(^{19}\) or elected by the debtor’s creditors. Chapter 7 liquidations usually result in lower recoveries for creditors. Therefore, companies are more likely to be liquidated under Chapter 7 if there are not sufficient funds in the estate or available to the estate to run a Chapter 11 process.

**iii Insolvency procedures**

As discussed in Section I.ii, the Bankruptcy Code provides for two main types of insolvency proceedings available to businesses with assets in the United States: Chapter 7 and Chapter 11.

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17 11 U.S.C. 11 544(b), 548. Under Section 548, the trustee can avoid a fraudulent transfer of an interest of the debtor in property that took place within two years before the date of the filing of the petition. Under Section 544(b), a trustee can avoid a transfer of an interest of the debtor in property under applicable state law, which can extend the look-back period beyond two years. However, a debtor might not be able to avoid and recover subsequent transfers of property received abroad by a foreign transferee from a foreign transferor. See Securities Investor Protection Corp v. Bernard L. Madoff Inv Sec LLC, Case No. 12-00115 (S.D.N.Y. 7 Jul 2014).
19 The United States Trustee Program is a component of the Department of Justice that seeks to promote the efficiency and protect the integrity of the federal bankruptcy system. The Program monitors the conduct of parties in interest in bankruptcy cases, oversees related administrative functions and acts to ensure compliance with applicable laws and procedures. It also identifies and helps investigate bankruptcy fraud and abuse in coordination with various law enforcement agencies. The US Trustee is distinct from the trustee appointed to administer Chapter 7 and certain Chapter 11 cases.
Chapter 7
Chapter 7 is a trustee-controlled liquidation. The goal of Chapter 7 is to ensure the most efficient, expeditious and orderly liquidation of a debtor’s assets to be distributed to the creditors and equity holders. Companies cannot reorganise under Chapter 7.

The Chapter 7 liquidation procedure is administered by a Chapter 7 trustee who is selected either by the US Trustee or by an election conducted by certain creditors. The Chapter 7 trustee is responsible for realising upon all the property of the estate and coordinating the distribution of that property or the proceeds of sales of that property.

Chapter 11
Chapter 11 provides for an insolvency proceeding in which the directors and management of the debtor company remain in control (the DIP) unless a trustee is appointed for cause. Chapter 11 proceedings allow for the reorganisation of a debtor’s operations and capital structure in the hope that the company will emerge from the bankruptcy process as a healthier, reorganised company. Chapter 11 gives the debtor the exclusive right to propose a plan of reorganisation for the first 120 days after commencement of the bankruptcy proceedings. This date may be extended until 18 months after the order for relief (the petition date of a voluntary case) if the debtor is making progress with a plan of reorganisation and can show cause why the court should extend the exclusivity period. The plan of reorganisation provides for how the debtor’s assets will be distributed among the classes of creditors and equity holders. It is also possible for a debtor to liquidate its assets through Chapter 11, which is typically a more structured liquidation than one under Chapter 7.

The culmination of a Chapter 11 proceeding is the filing of the plan of reorganisation. The Chapter 11 plan provides how creditors’ claims will be treated by the estate. Under the Chapter 11 plan, creditors and shareholders are divided into classes of holders sharing substantially similar claims or interests. Chapter 11 plans must meet certain standards to be confirmed. Even if a plan is accepted by the requisite vote of all impaired classes, it must be found by the court to be in ‘the best interests of creditors’ (providing each dissenting class member with at least what would have been recovered in a liquidation). As to a class that rejects the plan, the plan must satisfy the Bankruptcy Code’s ‘fair and equitable’ requirement (described in Section I.i).

The plan of reorganisation is submitted to a vote of the various creditor and shareholder classes. If at least one class that stands to receive less than their asserted claim (an impaired class) votes in support of confirmation, excluding insider ‘yes’ votes, the plan can be confirmed over the dissent of another impaired class. Dissenting classes can thus be crammed down so long as the plan is fair and equitable and does not discriminate among creditors in a similar situation. Once the plan is approved by the necessary stakeholders, a court can confirm a plan, so long as certain other prerequisites of Section 1129 of the Bankruptcy Code are satisfied.

Chapter 15
Chapter 15 is the Bankruptcy Code’s codification of the United Nations Commission on International Trade Law (UNCITRAL) Model Law and allows a foreign debtor, through its ‘foreign representative’, to commence an ancillary proceeding in the United States to support its foreign insolvency proceeding.

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iv Starting proceedings

As set forth in Section I.i, the US Bankruptcy Code provides for different types of insolvency proceedings, not all of which are available for all types of companies. Specifically, insurance companies and banking institutions cannot file for Chapter 7 or Chapter 11 bankruptcy; a railroad can be a debtor under Chapter 11 but not Chapter 7, and stockbrokers and commodity brokers can file for bankruptcy under Chapter 7 but not Chapter 11. Regardless of the type of bankruptcy case, under Section 301(a) of the Bankruptcy Code, a debtor voluntarily commences a plenary insolvency proceeding by filing a petition with the bankruptcy court.

A bankruptcy proceeding can also be commenced against a debtor company, which is known as an ‘involuntary’ bankruptcy case. An involuntary case is commenced upon the filing of a petition with the bankruptcy court by three or more holders of non-contingent, undisputed claims, and those claims aggregate at least US$15,775 more than the value of any lien on property of the debtor securing such claims. A bankruptcy court will order relief against the debtor in an involuntary case only if the debtor is generally not paying its debts as they become due, unless those debts are the subject of a bona fide dispute as to liability or amount, or if a custodian as described in Section 303(h)(2) of the Bankruptcy Code has been appointed.

A Chapter 15 case is commenced when the foreign representative of the debtor company files a petition for recognition of the foreign proceeding with the US bankruptcy court.

v Control of insolvency proceedings

Under Chapter 7, the insolvency proceeding is controlled by a trustee who is appointed by the US Trustee or elected by the debtor’s creditors to administer the debtor’s assets. The Chapter 7 Trustee is responsible for, among other things, ‘collect[ing] and reduc[ing] to money the property of the estate for which such trustee serves, and closes such estate as expeditiously as is compatible with the best interests of parties in interest’. Although the Chapter 7 Trustee can continue business operations for a short period if value is maximised by doing so, generally, once a Chapter 7 Trustee has been appointed, the debtor company is expeditiously liquidated.

Chapter 11 proceedings allow for a debtor’s existing management and directors to stay in place and operate the business during the bankruptcy case. For this reason, a debtor in a Chapter 11 proceeding is referred to as the ‘DIP’. The board of directors’ primary duties in connection with an insolvency proceeding are the same as they are outside bankruptcy.

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21 Only a single holder is necessary to commence an involuntary case if there are fewer than 12 overall holders of claims against the debtor.
26 The Supreme Court has observed that ‘the willingness of courts to leave debtors in possession’ is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee. Commodity Futures Trading Comm’n v. Weintraub, 471 US 343, 355 (1985), citing Wolf v. Weinstein, 372 US 633, 651 (1963). Officers and directors may therefore owe fiduciary duties to the estate even if their fiduciary duties to the company were limited under state law prior to the bankruptcy. In re Houston Regional Sports Network, LP, Case No. 13-35998 (Bankr. S.D. Tex. 12 Feb. 2014).
to maximise the value of the company. The key distinction is that when a company is insolvent, the creditors, not the shareholders, are the residual beneficiaries of the board’s fiduciary duties to the corporation and are, thus, able to bring actions for breach of fiduciary duty. If it is in the best interests of the estate and its creditors, a trustee may be appointed to replace the DIP and administer a Chapter 11 case.

During a Chapter 7 or Chapter 11 case, the DIP or trustee may take actions that are in the ordinary course of the debtor’s business without approval of the bankruptcy court. Actions after entry of the order for relief outside the ordinary course of business are subject to bankruptcy court approval.

Bankruptcy courts in the United States are courts of limited jurisdiction. This is because, unlike federal district and circuit courts, they were not created under Article III of the United States Constitution. Instead, Congress created the bankruptcy courts because they were ‘necessary and proper’ to effectuate Congress’s enumerated powers to enact bankruptcy law. For this reason, bankruptcy courts may only oversee matters that are ‘core’ to the bankruptcy case unless the parties knowingly and voluntarily consent to adjudication of a ‘non-core’ matter by the bankruptcy court. Without consent, matters that are not ‘core’ to the insolvency proceeding must be decided by a federal district court. Appeals of bankruptcy court decisions are generally heard, in the first instance, by the federal district court sitting in the same jurisdiction as the applicable bankruptcy court. Bankruptcy court jurisdiction is the subject of much debate under a series of recent Supreme Court cases.

Among other things, the bankruptcy court manages filing deadlines, hears evidence on contested issues and issues orders regarding requests for relief by the parties. Nevertheless, and despite the involvement of the court, many aspects of the bankruptcy process are negotiated by the parties outside the courtroom and the DIP or trustee is free to enter into settlement agreements, which are then subject to the approval of the bankruptcy court.

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27 ‘Even when [a] company is insolvent the board may pursue, in good faith, strategies to maximise the value of the firm.’ Trenwick America Litig Trust v. Ernst & Young, 906 A.2d 168, 175 (Del. Ch. 2006), aff’d, 931 A.2d 438 (Del. 2007).


30 The 1st, 6th, 8th, 9th, and 10th circuits have established Bankruptcy Appellate Panels (BAPs), which are panels composed of three bankruptcy judges who are authorised to hear appeals of bankruptcy court decisions. These panels are units of the federal courts of appeals. BAP judges continue to serve as active bankruptcy judges in addition to fulfilling their BAP duties. If a BAP has been established in a given circuit, the BAP will hear an appeal of a bankruptcy court decision unless a party to the appeal elects to have it heard by the district court. Decisions of a BAP may be appealed to the appropriate circuit court of appeals. United States Courts, Bankruptcy Appellate Panels, available at www.uscourts.gov/FederalCourts/UnderstandingtheFederalCourts/CourtofAppeals/BankruptcyAppellatePanels.aspx.

31 See Stern v. Marshall, 546 U.S. 462 (2011) (holding that the bankruptcy court lacked constitutional authority to enter a final judgment on a debtor’s tortious interference counterclaim even though the counterclaim was a ‘core proceeding’ under 28 U.S.C. § 157(b)(2)), Exec. Benefits Ins. Agency v. Arkison, 134 S. Ct. 2165 (2014) (providing that, when a ‘Stern claim’ is encountered, the bankruptcy court may issue proposed findings of facts and conclusions of law to be reviewed de novo by the district court), Wellness Int’l Network, Ltd v. Sharif, 135 S. Ct. 1932 (2015) (holding that bankruptcy judges may enter final judgment on claims that seek only to add to the bankruptcy estate and would exist outside bankruptcy proceedings if the parties knowingly and voluntarily consent).

Special regimes

Securities broker-dealers are not eligible for relief under Chapter 11. Instead, insolvent broker-dealers may liquidate under Chapter 7 of the Bankruptcy Code, but are more likely to be resolved in a proceeding under the Securities Investor Protection Act of 1970 (SIPA). SIPA proceedings are liquidation proceedings, and upon commencement thereof, the broker-dealer will cease to conduct business as a broker-dealer, subject to certain limited exceptions. In SIPA proceedings, a trustee (the SIPA trustee) will take control of all property, premises, bank accounts, records, systems and other assets of the broker-dealer and displace management. The SIPA trustee’s primary duties are to marshal assets, recover and return customer property (including through effectuating bulk account transfers to a solvent broker-dealer) and liquidate the broker-dealer.

In SIPA proceedings, the provisions of Chapters 1, 3 and 5 and Subchapters I and II of Chapter 7 of the Bankruptcy Code will also apply, to the extent consistent with SIPA, and the SIPA trustee will generally be subject to the same duties as a trustee under Chapter 7 of the Bankruptcy Code, with certain limited exceptions regarding securities that are the property of customers of the broker-dealer. If the broker-dealer is a registered futures commission merchant under the Commodity Exchange Act of 1936, the SIPA trustee will have additional obligations under the Part 190 regulations promulgated by the Commodity Futures Trading Commission, with respect to any commodity customer accounts that have not been transferred to another futures commission merchant prior to the filing date.

Although bank holding companies can file for Chapter 11 relief, their subsidiary depository institutions are not eligible for relief under the Bankruptcy Code, and are typically resolved by the Federal Deposit Insurance Corporation (FDIC) under the Federal Deposit Insurance Act. The FDIC has the authority to market a failed depository institution for sale to another depository institution, or the FDIC can insert itself as a receiver, close the bank and liquidate its assets to pay off creditors. The powers of the FDIC as receiver are very similar to those of a trustee in bankruptcy.

Additionally, the Dodd–Frank Wall Street Reform and Consumer Protection Act established the Orderly Liquidation Authority (OLA), which provides that the FDIC may be appointed as receiver for a top-tier holding company of a failing financial institution that poses a systemic risk to financial stability in the United States. OLA sets forth the procedures that the federal government can take to cause the wind-down of financial institutions that were once considered ‘too big to fail’. Pursuant to OLA, the FDIC can exercise many of the same powers it has as a bank receiver to liquidate systemically risky financial institutions. Moreover, under the Dodd–Frank Act, institutions that may be subject to OLA must provide the FDIC with resolution plans (commonly known as living wills) to serve as road maps in the event that the financial institution requires resolution.

33. 11 U.S.C. §§ 741 to 753.
36. 17 C.F.R. Part 190.
State law governs all regulation of insurance companies, including the resolution of insolvent insurance companies.\textsuperscript{40} The Bankruptcy Code has mechanisms for dealing with the insolvency proceedings of corporate groups and there is no special regime to address these types of filings. If multiple affiliated companies in the same corporate group seek relief under the US Bankruptcy Code, they will file separate bankruptcy petitions but will often seek joint administration of the various bankruptcy proceedings, meaning that the bankruptcy cases of each member of the group will be overseen by the same judge, which provides for greater efficiency in the administration of the cases. Importantly, joint administration does not mean that the assets and liabilities of the group will be combined. Rather, corporate separateness will be observed despite the joint administration of the cases, unless there is cause to breach corporate separateness and ‘substantively consolidate’ the assets and liabilities of the debtor.

\textbf{vii Cross-border issues}

As part of the 2005 Bankruptcy Abuse and Consumer Protection Act, the United States enacted Chapter 15 of the Bankruptcy Code, which is based on the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law).\textsuperscript{41} Chapter 15 governs how a US court should treat a foreign insolvency proceeding when no plenary proceedings have been commenced in the United States and provides a mechanism for the cooperation between the US court and the foreign court overseeing a debtor’s plenary insolvency proceeding. Generally, Chapter 15 allows for the commencement of an ancillary proceeding upon recognition of the debtor’s foreign proceeding. Once the foreign proceeding is recognised by the US bankruptcy court, the automatic stay applies to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States\textsuperscript{42} and the debtor’s foreign representative enjoys certain powers and privileges under the Bankruptcy Code, such as the right to intervene in any court proceeding in the United States in which the foreign debtor is a party, the right to sue and be sued in the United States on the foreign debtor’s behalf, the authority to operate the debtor’s business and the authority to initiate avoidance actions in a case pending under another chapter of the Bankruptcy Code.

The bar for accessing plenary proceedings in the US bankruptcy courts is relatively low. A company can be eligible to commence a Chapter 11 proceeding in a US bankruptcy court so long as it is incorporated or has any property or operations in the United States. Because of the perceived debtor-friendliness of US bankruptcy courts and the courts’ vast experience in restructuring large multinational companies, many multinational companies are filing for Chapter 11, even if their principal place of business, or centre of main interest, is located outside the United States. This trend has been particularly prevalent in the shipping

\textsuperscript{40} 11 U.S.C. § 1011.
\textsuperscript{42} 11 U.S.C. § 1520.
industry. For example, the Taiwan-based TMT Group opened an office in Houston only a few days before filing for Chapter 11 protection in the United States Bankruptcy Court for the Southern District of Texas.43

II INSOLVENCY METRICS

Since the global financial crisis, when gross domestic product adjusted for inflation (real GDP) dropped by 2.8 per cent from 2008 to 2009, the US economy has experienced a period of slow growth. Real GDP increased in the fourth quarter of 2018 at an average annual rate of 2.2 per cent and at an average annual rate of 2.1 per cent in the second quarter of 2019.44 Furthermore, reported unemployment continues to abate: the rate for July 2019 was 3.7 per cent, down slightly from 3.9 per cent in July of the previous year and from its October 2009 high of 10 per cent.45

Additionally, credit has been readily available to US businesses. In 2018, US corporations issued almost US$1.53 trillion in bonds, a decline from the US$1.81 trillion issued in 2017 but still more than the US$1.49 trillion issued in 2016.46 During the first five months of 2019, more than US$750 billion worth of bonds were issued.47 The 10-year Treasury rate has ranged between 1.52 per cent and 2.79 per cent in the current calendar year, while in 2018, the range was between 2.44 per cent and 3.24 per cent.48

US equity markets have remained robust during July 2019, though volatility has been increasing in recent months. Specifically, US equity and equity-related proceeds totalled US$213.3 billion on 898 deals in 2018,49 which represents a 3.4 per cent increase in proceeds compared to the US$206.2 billion raised in 2017,50 though the number of deals declined by approximately 1.8 per cent from the 914 in 2017.51 US equity and equity-related proceeds in 2017 were approximately 14.5 per cent more than the US$180 billion raised in 2016 and

43 In re TMT Procurement Corp., No. 13-33763 (MI) (Bankr. S.D. Tex. 20 Jun. 2013). There are limits to a foreign-based company’s ability to seek Chapter 11 protection. See In re Yukos Oil Co., 321 B.R. 396, 410 and 411 (Bankr. S.D. Tex. 2005) (the bankruptcy court declines to exercise jurisdiction over Chapter 11 case of a Russian oil company seeking to use the automatic stay to prevent a foreclosure sale by the Russian government).
47 ibid.
50 ibid.
51 ibid.
7.5 per cent less than the US$229.3 billion raised in 2015. Similarly, the number of deals in 2018 was 25.4 per cent greater than the 716 in 2016 and 5.4 per cent more than the 852 in 2015.

US corporate default rates have fluctuated since 2018. Moody’s measured the US speculative-grade default rate in March 2019 at 2.4 per cent, compared to default rates of 2.8 per cent at the end of 2018 and 3.4 per cent at the end of 2017. Moody’s indicated that the leveraged loan default rate has held steady at 1.9 per cent from December 2018 to March 2019, compared with the March 2018 rate of 2.9 per cent and 2017 first quarter rate of 2.2 per cent.

The frequency of business bankruptcy filings remains well below its peak in 2010, and although many businesses continue to seek bankruptcy relief as a result of significant challenges in sectors of the US economy, 2018 marked a significant decrease in filings as compared to recent years: 58 public companies filed Chapter 7 or Chapter 11 bankruptcy proceedings, representing an 18.3 per cent decrease from 71 public companies in 2017. Aggregate pre-petition assets totalled approximately US$52.056 billion in 2018, down from 2017’s aggregate pre-petition assets of approximately US$106.931 billion. Following downturns in 2017, filings in the oil and gas/energy/mining sector and the retail industry represented seven of the top 10 public company Chapter 7 and Chapter 11 filings in 2018. As described in further detail in Section V.i, the energy/oil and gas and retail industries have continued to produce many of the most significant bankruptcies in the early part of 2019.

53 ibid.
55 ibid.
58 ibid.
62 ibid.
63 ibid.
Ninety-eight companies commenced Chapter 15 proceedings in the 12 months ending on 31 March 2019, compared with the 64 Chapter 15 cases that were initiated during the 12 months ending on 30 June 2018. Further, tariffs and trade wars hang over the economy but have not yet materially affected filings.

III PLENARY INSOLVENCY PROCEEDINGS

i iHeartMedia, Inc

iHeartMedia, Inc is a media, entertainment and data company that is largely known for its 849 radio stations but is also engaged in numerous consumer-focused platforms, including social media, live concerts and events, and independent media representation, among others.

iHeartMedia, Inc, with 38 direct and indirect subsidiaries, filed for bankruptcy in the US Bankruptcy Court for the Southern District of Texas, Houston Division on 15 March 2018. The company had been acquired in a leveraged buyout in 2007 that contributed to the debtors’ US$16 billion in funded debt, and both the 2008 financial crisis and industry-specific issues contributed to declining cash flows and limited growth. The restructuring was framed as a balance sheet reorganisation, designed to set up the business for long-term success. As of the petition date, iHeartMedia, Inc was the borrower/issuer of the following amounts:

- an asset-based lending (ABL) facility with approximately US$371 million of outstanding borrowings;
- a term loan facility with two tranches of loans in an aggregate amount of approximately US$6.3 billion;
- approximately US$6.752 billion in priority guarantee notes (PGNs);
- approximately US$2.235 billion in senior unsecured notes; and
- approximately US$532 million in three series of senior unsecured ‘legacy’ notes.

Certain of iHeartMedia’s subsidiaries guaranteed each of the obligations listed above except for the legacy notes, which were not guaranteed by any subsidiaries of iHeartMedia.

Although the debtors went into their first-day hearing with a restructuring support agreement in place with at least 67 per cent of the aggregate outstanding principal amount of term loan, PGN and junior debt claims, a group of approximately US$190 million of legacy noteholders opposed the agreement from the outset. Shortly after the petition date, Wilmington Savings Fund Society (WSFS), as indenture trustee for the legacy notes, filed an
adversary complaint against debtors alleging violations of the legacy notes indenture ‘by not granting ‘equal and ratable’ mortgages’.\(^70\) This dispute with the legacy noteholders was the primary hurdle to confirmation of a plan.

In its adversary complaint, the indenture trustee noted that the indentures governing the PGNs contained provisions under which the debtors were required to grant ‘springing liens’ on certain ‘principal property’ to the PGN holders if and when the outstanding balance of the legacy notes fell below US$500 million. This trigger would have occurred following the repayment of a series of legacy notes due in 2016 (the 2016 Legacy Notes). However, rather than paying the principal on the 2016 Legacy Notes at maturity, the issuer directed a subsidiary to purchase a portion of the notes and then intentionally failed to repay the principal amount due, taking the position that 2016 Legacy Notes remained outstanding. As such, the balance of the legacy notes remained in excess of US$500 million, and the debtors asserted that they were not required to grant the springing liens.\(^71\)

WSFS asserted that (1) iHeart was required to grant springing liens to the PGN holders and (2) pursuant to the equal and ratable clause, holders of legacy notes were entitled to mortgages on the same principal property securing the PGNs.\(^72\) On 15 January 2019, Judge Isgur issued his long-awaited opinion, concluding that the springing lien trigger had not occurred and, therefore, the equal and ratable clause had not been breached.\(^73\)

The court’s ruling in the legacy notes adversary proceeding paved the way for confirmation of the debtors’ proposed plan, which contemplated that the iHeart business would be separated from the businesses of non-debtor subsidiary Clear Channel Outdoor Holdings, Inc, which was 89.5 per cent owned by the debtors (the other 10.5 per cent was publicly traded). iHeart would emerge substantially delevered, with US$5.75 billion of new debt, including new term loans, new secured notes and new unsecured notes, plus a new ABL facility.\(^74\) On 22 January 2019, the court confirmed the debtors’ fifth amended plan.\(^75\) The settlement with WSFS became effective when the debtors emerged from bankruptcy on 1 May 2019.\(^76,77\)

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\(^71\) ibid.
\(^72\) ibid.
\(^74\) Amended Joint Chapter 11 Plan of Reorganization of iHeartMedia, Inc. and its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy Code, Case No. 18-31274, ECF No. 1213 (Bankr. S.D. Tex. 5 Aug. 2018).
\(^77\) Notice of (I) Entry of Order Confirming the Modified Fifth Amended Joint Chapter 11 Plan of Reorganization Of iHeartmedia, Inc. and its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy Code and (II) Occurrence of the Effective Date, Case No. 18-31274, ECF No. 3298 (Bankr. S.D. Tex. 1 May 2019).
Pacific Drilling

Pacific Drilling SA and its affiliates (known collectively as Pacific Drilling) operate an international offshore drilling business that specialises in ultra-deepwater and complex well construction services. Pacific Drilling employs a fleet of high-specification drill ships, specialist management and technical teams, and proprietary technology and business processes. On 12 November 2017, Pacific Drilling SA and certain of its affiliates commenced bankruptcy proceedings in the US Bankruptcy Court for the Southern District of New York. The debtors entered Chapter 11 with approximately US$3 billion in pre-petition funded debt.78

One of the key disputes in the Chapter 11 cases involved the structure of the debtors’ rights offering. After rounds of mediation, the debtors negotiated the key terms of a reorganisation plan and rights offering with their major stakeholders. This rights offering included, among other things, a US$100 million allocation that was exclusively available to an ad hoc group of bondholders.79

At a hearing held on 18 September 2018, the court rejected the terms of the original rights offering, finding that the deal (particularly the US$100 million private placement to the ad hoc group) improperly amounted to paying a large group of creditors in exchange for their support of the plan.80 In response to the court’s decision, the debtors subsequently modified the terms of the rights offering and eliminated the exclusive subscription rights of the ad hoc group. Consistent therewith, the entirety of the equity rights offering and a majority of the equity issuance were made available on a pro rata basis to holders of undersecured claims, as defined in the equity rights agreement, including the members of the ad hoc lender group.81

In its ruling approving the modified equity commitment agreement, the court noted that it took issue with ‘special allocations and rights offerings or private placements that are limited to the bigger creditors who sit at the negotiating table, or big fees for backstops that are provided by the bigger creditors who are at the negotiating table but that are not even open to other creditors, and in particular to other creditors in the same class’ finding that ‘it is far too easy for the people who sit at the negotiating table to use those tools primarily to take for themselves a bigger recovery than smaller creditors in the same classes will get’.82

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79 Motion of Debtors Pursuant to Sections 105(a), 362, 363, 503 and 507 of the Bankruptcy Code for an Order Authorizing the Debtors to Enter into Equity Commitment Agreement and Pay Related Fees and Expenses, Case No. 17-13193 (MEW), ECF No. 535 (Bankr. S.D.N.Y. 28 Aug. 2018).
80 Hr’g Tr., Case No. 17-13193 (MEW), ECF No. 622 (Bankr. S.D.N.Y. 18 Sep. 2018).
The plan was confirmed on 31 October 2018 and came into effect on 19 November 2018.

iii PG&E

PG&E Corporation is a holding company whose primary operating subsidiary is Pacific Gas and Electric Company (the Utility). The Utility provides natural gas and utility services to approximately 16 million customers. As at 30 September 2018, PG&E Corporation, the Utility, and their debtor affiliates (the Debtors or PG&E) had reported approximately US$71.4 billion in consolidated total assets and approximately US$51.7 billion in consolidated total liabilities. As a result of numerous wildfires in California, the Debtors determined that their potential exposure with respect to the 2017 and 2018 northern California wildfires could exceed US$30 billion, exclusive of potential punitive damages, fines and penalties, or damages with respect to future claims. Consequently, PG&E’s credit profile deteriorated severely. During 2018 and 2019, the Debtors’ credit ratings were subject to multiple downgrades by the rating agencies, and are currently rated below ‘investment grade’ by all three major rating agencies. On 13 November 2018, PG&E Corporation and the Utility drew all amounts available under their respective revolving credit facilities to assure access to additional liquidity.

After a comprehensive review, PG&E concluded that temporarily extending the Debtors’ liquidity runway was not in the best interests of its economic stakeholders and would not address — and indeed would merely postpone addressing — the fundamental issues facing PG&E and jeopardise its long-term viability. Accordingly, the Debtors commenced the Chapter 11 cases on 29 January 2019.

Excluding potential wildfire liabilities, the debtors pre-petition debt structure included approximately US$3.15 billion under multiple unsecured revolving credit facilities, US$600 million in multiple unsecured term loan obligations, US$17.5 billion in senior unsecured notes, US$860 million in pollution control bonds, and US$2.1 billion in trade payables.

On 25 June 2019, the ad hoc committee of senior noteholders filed a motion to terminate the debtors’ exclusive periods to file a Chapter 11 plan. The motion included a term sheet for a ‘viable, confirmable plan of reorganization, the centrepiece of which is up to US$30 billion of new money investment (the vast majority of which is equity) in the Debtors by members of the Ad Hoc Committee’. The term sheet provides that US$16 billion (or
‘up to US$2(+) billion more’ in certain circumstances) of this new investment will be used to compensate all holders of pre-petition wildfire claims.90 The new investment would also fund a US$4 billion contribution to a long-term California state-wide wildfire fund.91 On 17 July 2019, the ad hoc senior noteholder group filed a revised commitment letter through which the group commits to fund up to US$25.4 billion in new PG&E equity and new PG&E senior unsecured notes.92

In their opposition to the exclusivity termination motion, the Debtors referred to the term sheet as an ‘aspirational value grab, with no ability to satisfy the requirements for confirmation under section 1129 of the Bankruptcy Code’.93 The Debtors further noted that they are in the process of developing a Chapter 11 plan that would fully address each recent legislative enactment and ensure that they emerge from Chapter 11 by 30 June 2020.94 The Debtors emphasised that they have received commitments, in connection with their plan, from more than 20 financial institutions for approximately US$10.25 billion in equity capital as at 12 August 2019.95 The court would eventually side with the Debtors in denying the motion to terminate exclusivity.96

At the time of writing, the PG&E Chapter 11 cases remain pending. Among the many challenges presented by these cases are (1) how to quantify the wildfire claims97 and (2) the 30 June 2020 deadline for the Chapter 11 cases to be resolved, pursuant to a plan, for the debtors to be eligible to participate in a new wildfire insurance fund, established pursuant to recent California legislation intended to ‘support the creditworthiness of electrical corporations, and provide a mechanism to attract capital for investment in safe, clean, and reliable power for California at a reasonable cost to ratepayers’.98

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91 ibid.


93 Debtors’ Objection to Motion of the Ad Hoc Committee of Senior Unsecured Noteholders to Terminate the Debtors’ Exclusive Periods Pursuant to Section 1121(d)(1) of the Bankruptcy Code, Case No. 19-30088 (DM), ECF No. 3075 (Bankr. N.D. Ca. 18 Jul. 2019).


95 ibid.

96 Memorandum Decision Regarding Motions to Terminate Exclusivity, Case No. 19-30088 (DM), ECF No. 3568 (Bankr. N.D. Ca. 16 Aug. 2019).

97 See Debtors’ Motion Pursuant to 11 U.S.C. §§ 105(a) and 502(c) For the Establishment of Wildfire Claims Estimation Procedures, Case No. 19-30088 (DM), ECF No. 3091 (Bankr. N.D. Ca. 18 Jul. 2019).

98 ibid.; also A.B. 1054, 2019 Assemb. (Cal. 2019).
iv FullBeauty

FullBeauty is a leading direct-to-consumer retailer in the growing US plus-size apparel market with approximately US$825.3 million in sales in 2018. It serves both women and men, offering an assortment of plus-size apparel, swimwear, footwear and home décor.99

FullBeauty’s pre-petition capital structure consisted of (1) a US$68.9 million ABL facility, (2) a US$75.0 million first-in, last-out (FILO) facility, (3) a US$781.6 million first lien credit facility, and (4) a US$345 million second lien credit facility. In the face of deteriorating liquidity, the debtors engaged restructuring advisers to address their balance sheet concerns.100 Prior to the petition date, FullBeauty negotiated a reorganisation plan with its stakeholders that would result in the following recoveries:

a ABL claims: unimpaired;
b FILO claims: pro rata share, at the debtors’ election of either:
• US$75 million of the new first lien term loan and payment of any accrued but unpaid interest, fees and expenses in cash; or
• US$75 million plus any accrued but unpaid interest, fees and expenses of the new first lien term loan;
c first lien claims: a pro rata share of:
• US$175 million of the new first lien term loan; and
• subject to Article III.B.6.c of the reorganisation plan, 87.5 per cent of the new common stock, subject to dilution; provided that holders of an allowed first lien claim had the option to elect to receive new junior loans in lieu of new common stock on the terms set forth in the reorganisation plan; and

d second lien claims: a pro rata share of:
• US$15 million of the new junior loan;
• 10 per cent of the new common stock, subject to dilution; and
• the second lien warrant package described in the warrant documents.101

On 3 February 2019, FullBeauty filed for Chapter 11 to implement the pre-packaged plan. The debtors immediately scheduled a confirmation hearing for 4 February 2019.102 In opposition to plan confirmation, the Office of the United States Trustee (the US Trustee) filed an objection noting, among other things, that the debtors failed to provide sufficient notice of the commencement of the Chapter 11 cases.103 The US Trustee articulated that the Federal Rules of Bankruptcy Procedure require at least 28 days’ notice to all holders of claims and

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100 ibid.
101 ibid. The foregoing represents a partial summary of the plan. All capitalised terms are as defined in the FullBeauty First Day Declaration.
102 ibid.
103 Objection of the United States Trustee to Confirmation of the Plan and Related Relief, Case No. 19-22185 (RDD), ECF No. 34 (Bankr. S.D.N.Y. 4 Feb. 2019).
interests of (1) the hearing on approval of the disclosure statement and (2) for filing objections to the plan. 104 The debtors, on the other hand, asserted that they provided all impaired creditors with notice of the confirmation hearing 28 days prior to the petition date. 105

In siding with the debtors and rejecting the US Trustee’s arguments, the court confirmed FullBeauty’s plan on 4 February 2019. 106 The court noted that ‘Congress specifically contemplated pre-packaged bankruptcy plans and did not provide for a specific date after the commencement of a case for plans to be confirmed’. 107 The confirmation of FullBeauty’s plan, which occurred less than 24 hours after the company filed for Chapter 11, is the fastest in the history of the Bankruptcy Code. 108

IV ANCILLARY INSOLVENCY PROCEEDINGS

i Ballantyne Re Plc

Ballantyne Re Plc (Ballantyne) is a public limited company that operated as a special purpose vehicle for providing reinsurance with respect to life insurance policies issued in the United States. In summer 2019, Ballantyne completed a restructuring of more than US$1.65 billion in funded debt obligations.

In 2006, Ballantyne had issued secured notes among Ballantyne, as issuer, and The Bank of New York Mellon Corporation, as indenture trustee, to fund its obligations under an existing indemnity reinsurance agreement. 109 Ballantyne issued multiple series of Class A notes, in an aggregate amount of US$1.65 billion, with a series of Class B notes, Class C notes and Class D notes that totalled US$270.5 million. Ambac Assurance UK Limited (Ambac) or Assured Guaranty (Europe) plc (Assured) provided guarantees for the scheduled interest payments and the ultimate repayment of principle of certain series of Class A notes but not others. During 2007–2009, the assets in the reinsurance trust account that were held to satisfy Ballantyne obligations for reinsurance were invested in subprime and Alt-A securities. Ballantyne suffered severe losses that totalled approximately US$1 billion. 110

On 12 April 2019, Ballantyne entered into a lock-up support agreement with numerous parties, including Ambac, Assured, Security Life of Denver Insurance Company and Swiss Re Life and Health America Inc. Pursuant to the lock-up support agreement, Ballantyne and its stakeholders agreed to support the terms of a restructuring to be implemented through an

104 ibid.
107 ibid.
110 ibid.
Irish scheme of arrangement (the Scheme).\textsuperscript{111} The restructuring involved, among other things, the novation of Ballantyne’s reinsurance obligations, disbursement of its assets to Class A noteholders in satisfaction of their claims, the commutation of the obligation under the Ambac guarantees, and the extinguishment of the Class B notes, Class C notes and Class D notes.\textsuperscript{112} In exchange for the release of the Ambac guarantees, holders of applicable Class A notes received a portion of Ambac’s commutation payment.\textsuperscript{113} The Assured guarantees were preserved through a holding period trust.\textsuperscript{114}

To implement the restructuring, Ballantyne commenced a proceeding on 25 April 2019 to convene the Scheme in the High Court of Ireland (the Irish Court). On 17 May 2019, Ballantyne petitioned the US Bankruptcy Court for the Southern District of New York (the Bankruptcy Court) for recognition of the Scheme under Chapter 15 of the US Bankruptcy Code and enforcement of the terms thereof, which included third-party releases and the Ambac commutation.\textsuperscript{115}

On 7 June 2019, the Irish Court entered an order sanctioning the Scheme and overruling all objections thereto, and on 12 June 2019, the Bankruptcy Court granted recognition of the Scheme and all other relief sought by the foreign representative, including enforcement of the Scheme and the third party releases.\textsuperscript{116,117}

\section*{ii Constellation}

Servicos de Petróleo Constellation SA (with its debtor affiliates, Constellation) was incorporated in 1980 and primarily provides services to Petrobras. The company’s main operational activities include offshore drilling, onshore drilling and investments in several joint ventures related to operating floating production storage and offloading (FPSO) units. Its assets consist of nine onshore rigs, eight offshore rigs and drillships, and five FPSO units.\textsuperscript{118} On 29 November 2018, the company entered into a plan support agreement for a

\begin{thebibliography}{99}
\bibitem{111} ibid.
\bibitem{113} Recognition Motion.
\bibitem{114} Recognition Motion.
\bibitem{115} Motion for (I) Recognition of Foreign Main Proceeding, (II) Recognition of Foreign Representative, (III) Recognition of Sanction Order and Related Scheme, and (IV) Related Relief Under Chapter 15 of the Bankruptcy Code, Case No. 19-11490 (JLG) (Bankr S. D. N.Y. 12 Jun. 2019).
\bibitem{117} In light of the uncertainty over Brexit, future debtors may also choose Ireland over the United Kingdom as a preferred forum to restructure their debts. This was the case with Indah Kiat Pulp & Paper, who recently used an Irish scheme of arrangement to restructure US$612.4 million in debt that remained from the 2011 collapse of Asia Pulp & Paper. Declan Bush, ‘Indonesian debtor chose Ireland to restructure amid Brexit uncertainty’, Global Restructuring Review (19 August 2019) <https://globalrestructuringreview.com/article/1196497/indonesian-debtor-chose-ireland-to-restructure-amid-brexit-uncertainty>.
\bibitem{118} Memorandum Opinion Recognizing Foreign Debtors’ Foreign Main and Foreign Nonmain Proceeding, Case No. 18-13952 (MG), ECF No. 86 (Bankr. S.D.N.Y. 9 May 2019).
\end{thebibliography}

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reorganisation plan to be implemented through a Brazilian bankruptcy (RJ) proceeding, with lenders holding at least 97.5 per cent of the combined amount of principal under certain loans and certain other stakeholders.\textsuperscript{119}

On 6 December 2018, the company commenced the RJ in Brazil and filed a petition for Chapter 15 recognition in the US Bankruptcy Court for the Southern District of New York.\textsuperscript{120} On 29 January 2019, Alperton Capital Ltd (Alperton), a contingent creditor of one of the 10 Chapter 15 debtors (Constellation Overseas), filed a limited objection to the petition for recognition of the Brazilian RJ proceeding, arguing, among other things, that the centre of main interests (COMI) for certain debtors was not in Brazil.\textsuperscript{121}

On 9 May 2019, the Court granted the petitioner’s recognition motion, concluding that, with respect to seven of the 10 Chapter 15 debtors, the COMI was located in Brazil.\textsuperscript{122} Accordingly, the Court recognised these proceedings as foreign main proceedings. The Court determined that the proceeding of the parent company was a foreign non-main proceeding as its COMI was located in Luxembourg, and abstained from ruling on the two debtors whose cases were dismissed by the Brazilian court.\textsuperscript{123}

Shortly thereafter, creditors holding approximately 90 per cent of affected claims approved the amended Brazilian restructuring plan in a general creditors’ meeting. On 1 July 2019, the Brazilian bankruptcy court approved the plan.\textsuperscript{124} Two weeks later, the petitioner filed a motion with the US Bankruptcy Court seeking to enforce the plan.\textsuperscript{125} Both Alperton and PIMCO (a major creditor) subsequently objected to the motion for enforcement.\textsuperscript{126} On 1 August 2019, the Court entered an order staying the motion to enforce, noting that ‘two objections to the Motion to Enforce have been filed’ and ‘[i]t is enough at this point to say that many of the arguments raised by the two objections to recognition and enforcement of the Brazilian Reorganization Plan in the United States are challenging and substantial. Many of those same issues are also raised in the pending appeals in Brazil. These are serious issues bearing on the fairness of the RJ Proceedings, whether due process standards

\textsuperscript{119} Case Summary: 97.5% of A/L/B Lenders Enter Into QGOG RSA, Bondholders Expected to Support Restructuring; Shareholders Invest $27M, Reorg Research (7 December 2019) <https://app.reorg.com/file/18561/QGOG_Constellation_-_2018-12-07_14_42_56_-_CASE_SUMMARY_97_5__of_A_L_B_Lenders_Enter_Into_QGOG_RSA__Bondholders_Expected_to_Support_Restructuring__Sh-37038-0.pdf>.

\textsuperscript{120} ibid.

\textsuperscript{121} Limited Objection of Alperton to the Petition for Recognition of the Brazilian RJ Proceeding, Case No. 18-13952 (MG), ECF No. 35 (Bankr. S.D.N.Y. 29 Jan. 2019).

\textsuperscript{122} See Recognition Opinion.

\textsuperscript{123} See Recognition Opinion.

\textsuperscript{124} ‘Creditors Approve Amended QGOG Restructuring Plan, Enter Second Amended PSA; Olinda Excluded From RJ’, Reorg Research (4 July 2019) <https://app.reorg.com/file/18569/QGOG_Constellation_-_2019-07-04_08_07_15_-_Creditors_Approve_Amended_QGOG_Restructuring_Plan__Enter_Second_Amended_PSA__Olinda_Excluded_From_RJ-37038-0.pdf>.

\textsuperscript{125} Motion for Order Pursuant to 11 U.S.C. §§ 105(a), 1145, 1507(a), 1521(a) and 1525(a) (I) Enforcing the Brazilian Reorganization Plan and (II) Granting Related Relief, Case No. 18-13952 (MG), ECF No. 100 (Bankr. S.D.N.Y. 17 Jul. 2019).

\textsuperscript{126} ‘Constellation Former JV Partner Alperton Files Objection to Enforcement Motion, Intends to Request Arbitral Tribunal Reinstate Injunction Against Constellation’, Reorg Research (30 July 2019) <https://app.reorg.com/file/18570/QGOG_Constellation_-_2019-07-30_13_29_-_UPDATE_2__Constellation_Former_JV_Partner_Alperton_Files_Objection_to_Enforcement_Motion__Intends_to_Reques-37038-0.pdf>. 

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were satisfied in the RJ Proceedings, and whether the interests of creditors and interest holders such as PIMCO and Alperton are sufficiently protected'. Accordingly, the Court stayed the motion to enforce until the pending appeals of the Brazilian plan are resolved.

V TRENDS AND OTHER RECENT DEVELOPMENTS

While bankruptcy filings in the United States increased in 2015 and 2016 following a steady decline from their 2009–2010 peak, the number of public company bankruptcy filings in 2018 represented an 18.3 per cent decline as compared with 2017. While certain observers believe that there will be an increase again in 2019 and certain industries, notably retail, have already experienced a significant number of filings, other indicators suggest that the number of bankruptcy filings may decline further or remain stable.

The sections below highlight recent trends in the energy and retail sectors, and offer some detail on recent decisions and other developments that may be relevant in US bankruptcy practice in the coming years.

i Industry downturns

Energy industry downturn

The energy industry has experienced a high number of bankruptcies in the past few years despite the general availability of cheap credit. According to reports by Haynes and Boone LLP, 185 oilfield services companies and 192 oil and gas producers filed for bankruptcy between the beginning of 2015 and August 2019. In 2017, the pace of oil and gas bankruptcies slowed as many companies have cycled through Chapter 11 and higher commodity prices provided some relief. Exploration and production bankruptcy filings decreased by 67 per cent year-on-year in 2017. However, in 2018, the number of oil and gas bankruptcies began to increase again as natural gas prices remained depressed from historical highs and crude oil prices remained depressed.

127 ibid.
prices remained as volatile as ever. In the fourth quarter of 2018, oil prices fell by 40 per cent
to around US$46 per barrel. Since January 2019, however, oil prices have rebounded and are
above US$60 per barrel as at 1 May 2019.

Despite the continued challenges facing the industry, there has been growing optimism
that the energy industry is rebounding. As noted above, one of the determinative factors
that could facilitate (or hinder) an industry recovery is the price of oil. To drill profitably
at low oil prices, oil producers must cut costs. But realising these cost savings could prove
challenging, as service companies must raise prices to support taking rigs and hydraulic
fracturing equipment out of storage and hiring capable professionals to operate them, driving
up the break-even oil price for operators.133  For these and other reasons, the price of oil will
continue to play a determinative role.

Despite the improved market environment, there remains plenty of bankruptcy activity
in the energy industry. Recent notable cases include Parker Drilling Company,134  Arsenal
Energy Holdings LLC,135  Weatherly Oil & Gas LLC,136  Vanguard Natural Resources, Inc,137
Southcross Energy Partners, LP,138  EdgeMarc Energy Holdings, LLC,139  Jones Energy, Inc,140
Legacy Reserves, Inc,141  Weatherford International plc142  and Halcón Resources Corporation.143

Retail industry downturn

While the energy industry has shown some signs of life, the retail industry finds itself squarely
in the midst of what has been called a ‘retail apocalypse’ (or, perhaps more charitably, a ‘retail
pandemic’).144  By one count, as at 13 June 2019, 19 major retailers had filed for bankruptcy
in 2019, up from 14 for the same period last year.145  Notable examples include Beauty
Brands, LLC,146  Payless Holdings LLC,147  Charlotte Russe Holding, Inc,148  Diesel USA,149
FullBeauty Brands Holding Corporation,150  Gymboree Group, Inc,151  Innovative Mattress

138 Case No. 19-10702 (Bankr. D. Del.; filed 1 Apr. 2019).
140 Case No. 19-32112 (Bankr. S.D. Tex.; filed 14 Apr. 2019).
<https://www.ft.com/content/4e3a2138-9282-11e9-a3a1-2b1d33ac3271>.

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Solutions, LLC, and Barneys New York, Inc. Furthermore, certain high-profile retail Chapter 11 debtors have been unable to reorganise as going concerns and have been wound down or liquidated.

While bankruptcies in the retail space in 2018 and early 2019 have been occurring with striking frequency, the trend has been developing for some time. In March 2016, Sports Authority sought Chapter 11 protection, ushering in a wave of retail bankruptcies. In April 2016, Vestis Retail Group, which manages Eastern Mountain Sports, Bob’s Stores and Sports Chalet, also filed for protection under Chapter 11. Aeropostale, an apparel company, filed in May 2016. The trend continued in 2017; a number of well-known brands sought bankruptcy protection, including Gymboree, rue21, Payless Shoes and Toys ‘R’ Us. Underscoring the pressure on bricks-and-mortar operations, JCPenney, Staples and Abercrombie & Fitch, among others, have closed several hundred stores in the past few years. Retail store locations closed at an even faster rate in the first half of 2018 than they did in 2017.

Dynamics in the retail industry have created myriad operational challenges for retailers, despite the overall health of the economy. Recent market headwinds for retailers include a shift from traditional bricks-and-mortar stores to online shopping sites, a highly competitive market with an oversaturation of shopping malls and a shift in consumer spending from goods to travelling and dining. These dynamics have left some retailers with insufficient revenue to cover high fixed costs such as leases for their stores, in addition to the costs of servicing excessive amounts of debt.

**ii Gifting**

A trend in bankruptcy settlements for many years has been the increasing use of gifting, that is to say, a consensual arrangement in which a senior creditor class gives a junior class

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160 At least one commentator has suggested that, in addition to the market forces driving the downturn, the mandatory 210-day limit on the time by which a debtor must assume or reject a commercial real estate lease under Section 365(d)(4) of the Bankruptcy Code leaves retailer debtors with insufficient time to negotiate with their landlords and properly emerge from Chapter 11 as a stand-alone entity. See Lawrence C Gottlieb, ‘The Disappearance of Retail Reorganizations Under the Amended Section 365(d)(4)’ <http://business-finance-restructuring.weil.com/wp-content/uploads/2013/06/Gottlieb-Paper.pdf>.
or equity some of its share of recoveries otherwise due to it under a reorganisation plan. The rationale underlying this practice, at first glance, seems benign, as sophisticated parties with bargaining power seemingly may opt to transfer their rights to junior parties in exchange for a more swift resolution to the bankruptcy proceedings. However, this analysis becomes more complicated when an intermediate creditor is involved and the priority regime outlined in Section 507 of the Bankruptcy Code is considered. Under Section 507, there is a hierarchy in resolving the claims of various creditors against the assets of the debtor. Viewed in this light, a creditor with intermediate priority can object that junior creditors are receiving distributions before senior claims are paid in full, in violation of the absolute priority rule.

In 2011, the US Court of Appeals for the Second Circuit handed down a decision in *In re DBSD North America*, which limited the ability of senior creditors to gift their share of a distribution to more junior creditors. In *DBSD*, the court considered whether the decision by senior creditors to gift some of its cash distribution to equity holders, bypassing junior creditors with claims of higher priority relative to the equity holders, ran afoul of the absolute priority rule. The Court invalidated the plan, holding that the senior creditors had no right to gift property of the debtor’s ‘estate’ in contravention of the statutorily contemplated hierarchy. The decision left unresolved the propriety of a senior creditor bypassing an intermediate creditor in gifting non-estate property to a junior creditor. In a decision that limited the scope of the DBSD holding, the Third Circuit held that the holding was limited to gifting estate property. However, senior creditors remained free to gift non-estate property.

An arrangement known as a ‘structured dismissal’ has become an increasingly popular technique for parties seeking to implement a gifting arrangement without running afoul of the absolute priority rule. A structured dismissal is a dismissal of a Chapter 11 case combined with additional provisions in the dismissal order, which often include mutual releases, procedures for claims reconciliation, gifting of funds to junior creditors and retention of jurisdiction by the bankruptcy court. Structured dismissals are often employed in situations where the debtors have insufficient unencumbered assets to finance a confirmable Chapter 11 plan (e.g., after a sale of all or substantially all of such debtors’ assets pursuant to Section 363 of the Bankruptcy Code). However, the Supreme Court’s decision in *Czyzewski v. Jevic Holding Corp* indicates that priority deviations implemented through non-consensual structured dismissals may not be allowed. Commentators and courts are still grappling with the ultimate scope of *Jevic*; while some courts have interpreted *Jevic* broadly to deny priority-skipping distributions that are not tied to ‘a significant Code-related objective’, others have read *Jevic* narrowly and approved priority-skipping distributions in connection with a Chapter 11 plan or a settlement.

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162 *In re DBSD North America, Inc*, 634 F.3d 79 (2d Cir. 2011).
164 137 S. Ct. 973, 986 (2017).
166 *In re Fryar*, 570 B.R. 602, 610 (Bankr. E.D. Tenn. 2017); see also *In re Pioneer Health Svcs., Inc.*, 570 B.R. 228, 235 (Bankr. S.D. Miss. 2017) (requiring a ‘significant offsetting bankruptcy related justification’ to justify critical vendor payments, citing *Jevic*).
Many large corporate bankruptcies involve the debtor securing post-petition debtor-in-possession financing (a DIP loan). A DIP loan provides the debtor with the cash necessary to continue its operations throughout the bankruptcy and to cover the costs of the bankruptcy. The lender extending a DIP loan to the debtor, often a pre-petition creditor of the debtor interested in protecting its pre-petition position, will place covenants in the DIP loan, setting milestones that the debtor must meet under the terms of the loan. These milestones can include, among others, deadlines to file a disclosure statement and solicit votes on a reorganisation plan and deadlines to obtain critical relief (e.g., the filing of a motion under Section 1113 of the Bankruptcy Code seeking to modify collective bargaining agreements, deadlines to file sale procedures and sale motions, if applicable, and deadlines to obtain confirmation of a plan).

There is an inherent tension in the restrictiveness of these milestones, which can be constraining and onerous for a debtor and the need for financing. On the one hand, debtors need DIP financing, and lenders need assurances as inducement to make these loans to a bankrupt company. On the other hand, strict covenants can tie the hands of debtors and add additional complexity and expense if other creditors contest the plan supported by the DIP lenders.

The trend has been towards more DIP lenders insisting on more restrictive milestones in DIP covenants (though there have been recent exceptions to this trend, notably Toys ‘R’ Us). However, striking the right balance on the restrictiveness of milestones in DIP loans is still an open question. For instance, in response to the trend towards more restrictive covenants, the ABI Commission to Study the Reform of Chapter 11 recommended adding to the Bankruptcy Code that no milestones can require actions within 60 days of the petition date. It will be interesting to see where the market settles on this issue.

In a pre-packaged bankruptcy, a debtor negotiates a plan with its key creditors prior to the commencement of a Chapter 11 case. Solicitation of votes on the plan commences before the actual bankruptcy filing. While the Bankruptcy Code expressly contemplates this type of proceeding, there has been a trend towards increasingly fast-paced cases in which the debtors spend minimal time in bankruptcy. For example, the 2017 cases of Roust Corporation and Global A&T Electronics Ltd represented two of the shortest pre-packaged Chapter 11 cases since the enactment of the Bankruptcy Code. In fact, both of the aforementioned cases involved Chapter 11 plans that were confirmed in less than one week.


170 ibid.


This trend continued in the first half of 2019, when debtors have been entering and emerging from Chapter 11 faster than ever before. As discussed in Section III.iv, FullBeauty Brands filed for Chapter 11 on 3 February 2019. Its plan was confirmed the next day and the company emerged from bankruptcy on 7 February 2019.173 Two months later, Sungard Availability Services Capital, Inc filed its pre-packaged Chapter 11 case. Less than one day after the filing, the court confirmed the debtors’ pre-packaged reorganisation plan. The debtors emerged from bankruptcy less than 40 hours after filing.174

Although each of the four cases discussed above took place in front of Judge Robert Drain of the US Bankruptcy Court for the Southern District of New York, this trend is not limited to this venue. On 4 February 2019, Arsenal Energy Holdings LLC and its debtor affiliates filed for Chapter 11 in the US District Court for the District of Delaware.175 One week later, the Court confirmed Arsenal’s pre-packaged plan.176

Proponents of these expedited procedures argue that swifter pre-packaged bankruptcies minimise disruptions to a company and its trade creditors, critical vendors and employees.177 However, critics assert that such cases short-circuit the bankruptcy process and undermine the notice requirements of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure.178 As debtors continue to seek out more efficient methods of effectuating balance sheet restructurings, the trend towards faster pre-packaged bankruptcies is likely to continue in the short term.

178 Objection of the United States Trustee to Confirmation of the Plan and Related Relief, Case No. 19-22185 (RDD), ECF No. 34 (Bankr. S.D.N.Y. 4 Feb. 2019).
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An attorney with over 20 years of experience, Bartłomiej Niewczas has supported some of the largest corporations on the Polish market in the construction, automotive, energy, chemicals and food and beverage industries. He has successfully led Bird & Bird’s dispute resolution team since 2012. The team recently successfully defended the Polish state against a €1 billion-plus claim by Cypriot investors in investment arbitration (Poland–Cyprus BIT). Bartłomiej is known for his commitment and dedication to every case. He is particularly experienced in complex technical disputes, and is recognised as one of the best construction dispute lawyers. He advises clients on dispute resolution strategies and policies, represents them and leads contract negotiations, especially infrastructure contracts based on FIDIC conditions.

His experience includes representation in dozens of litigation and arbitration proceedings, and advice on issuing and defending claims. He also has extensive experience in cross-border bankruptcy.

In 2014, he was honoured by The British Guide to the World’s Leading Lawyers – Construction and Real Estate in the construction category, being placed in a narrow group of eight leading Polish specialists in this area. He is a recommended lawyer for dispute resolution in The Legal 500 2016 and 2017.

He has been a speaker in debates, conferences and panel discussions devoted to the problems of international arbitration of investment and economic development, and is co-author of the publication Current Economic Agreements – Agreement in the Course of Trade, published by Verlag Dashofer.

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Michael Nowina practises in the areas of commercial and insolvency law. He acts for unsecured creditors, secured creditors, debtors, receivers, trustees-in-bankruptcy and court-appointed officers, purchasers of distressed assets, equity investors and financiers in insolvency and restructuring proceedings. Michael has extensive experience in employment and pension law issues arising from corporate liquidations or restructurings.
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Darío U Oscós Coria is a legal counsel and practitioner specialising in insolvency, restructuring, creditor rights, litigation, arbitration, and mergers and acquisitions. He is the director, founder and senior partner at Oscós Abogados.

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He is an International Insolvency Institute delegate before Working Group V, Insolvency of UNCITRAL, United Nations Commission of International Trade Law.

He has also been professor of procedural law at Ibero-American University, professor of insolvency at Panamerican University at master’s degree level and professor of arbitration at the Autonomous Technological Institute of Mexico (ITAM). He is a member of the American College of Bankruptcy, the American Law Institute (and Mexican delegate and adviser in its transnational insolvency project), the International Insolvency Institute, the International Bar Association, INSOL International, INSOL Europe, the National Association of US Bankruptcy Trustees, the Mexican Bar Association and the Illustrious and National Bar Association of Mexican Lawyers. He is a lecturer and author of juridical literature.

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John Riihiluoma is a senior counsel in the dispute resolution department in Bermuda. He recently retired from his position as a partner at Appleby.

John’s practice includes reinsurance disputes, directors’ and officers’ liability actions, shareholder and corporate disputes. He has also been active in insolvency and restructuring litigation. In recent years his practice has included a number of significant contentious trust matters.

He was appointed as an assistant justice of the Supreme Court of Bermuda for a one-year term on 30 July 2012 to sit from time to time as may be required in civil and commercial matters. John has also sat as an acting puisne judge on an ad hoc basis in the past few years.
SAM RIHIHILUOMA

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Sam Riihiluoma is an associate in Appleby’s dispute resolution department. He has developed an expertise and achieved notable successes in a number of areas of civil and commercial litigation. Sam regularly advises and represents liquidators in winding-up proceedings of Bermuda companies for liquidation and for restructuring purposes. He also has a proven track record in regulatory matters, contractual disputes and professional liability claims. His depth of knowledge and analytical skills mean he is well equipped to give sound advice on the substantive merits and procedural aspects of any claim or defence.

Sam is a co-author of the Bermuda chapter in Litigation & Dispute Resolution, 6th edition (2017), Global Legal Insights.

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Nish Shetty is a partner at Clifford Chance Asia in Singapore and heads Clifford Chance’s litigation and dispute resolution practice in Asia. He has worked on many of the largest and highest-profile insolvency and restructuring cases in Singapore of the past 20 years, including Barings, Asia Pulp & Paper, Econ Corp, Drydocks World, TT International, OW Bunker Far East (Singapore) Pte Ltd and EMAS. These cases represent in many instances the locus classicus for many aspects of insolvency law in Singapore.

Nish is a member of the board of directors of the Insolvency Practitioners Association of Singapore and a former vice chairman of the Law Society’s Insolvency Practice Committee. He has been listed for many years in a number of directories as a leading practitioner for restructuring and insolvency work.
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Carly Stratton is a director of MannBenham Advocates Limited. She was admitted to the Manx Bar in January 2008, having graduated from Durham University and completed her postgraduate diploma in legal practice at the Oxford Institute of Legal Practice.

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Mrs Stratton is the chair of the Isle of Man Wealth and Funds Association (www.iomfunds.com/contacts.php) and is recommended by *The Legal 500* as ‘very efficient’, ‘professional, easy-to-work-with and thorough’ and for providing ‘advice in a friendly and professional manner – responses are timely, with considerable knowledge of Manx corporate law backed up with commercial acumen’.


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Athanasia joined the firm in 2001 and is joint head of the banking, finance and capital markets group. At the core of her practice is vast experience in structuring, drafting, negotiating and advising on the feasibility and implementation of international financial transactions, including on security and hedging arrangements. She has been working on the legal and regulatory aspects of the development of a secondary market of non-performing loans in the portfolios of Greek banks and has been involved in most transactions of this type in the Greek market. Athanasia has significant experience in advising corporates and international and domestic credit and financial institutions on financial restructurings and insolvency proceedings. Her clients include all the major banks and financial institutions that are active in the Greek market and she has acted in innovative deals that have broken new ground and paved the way for future transactions in the banking sector.
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Lalita Vaswani is a senior associate in Appleby’s dispute resolution department. She has a background in commercial and corporate litigation with a focus on restructuring and insolvency. Lalita completed her law degree at Warwick University and her LLM at the London School of Economics. She practised for seven years at a top-tier firm in Barbados and was admitted in Barbados and the Eastern Caribbean. During her tenure in Barbados, she played a pivotal role in several high-profile cross-border bankruptcy and insolvency matters, including one of the largest insolvency matters in the history of the Caribbean.

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He specialises in the areas of commercial litigation, restructuring, insolvency litigation, funds litigation and regulatory matters. He has represented clients in a wide variety of commercial disputes in Bermuda, England, the United States, Europe and Asia. He is also frequently involved in major arbitrations in Bermuda and internationally in both commercial, and insurance and reinsurance matters.

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He has extensive theoretical and practical experience in the field of insolvency and restructuring. He has led his team in handling dozens of insolvency and restructuring cases of large enterprises groups, involving debts of more than 100 billion yuan, covering real estates, shipping, oil storage, manufacture, hotel and other industries. During the reorganisation proceedings, he and his team overcame lots of practical problems, and designed and implemented many innovative mechanisms. Mr Ren also focuses on studying theoretical and difficult practical problems regarding the provisions of China’s Enterprise Bankruptcy Law. The thesis he wrote on those problems have been published in a number of core legal journals.
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