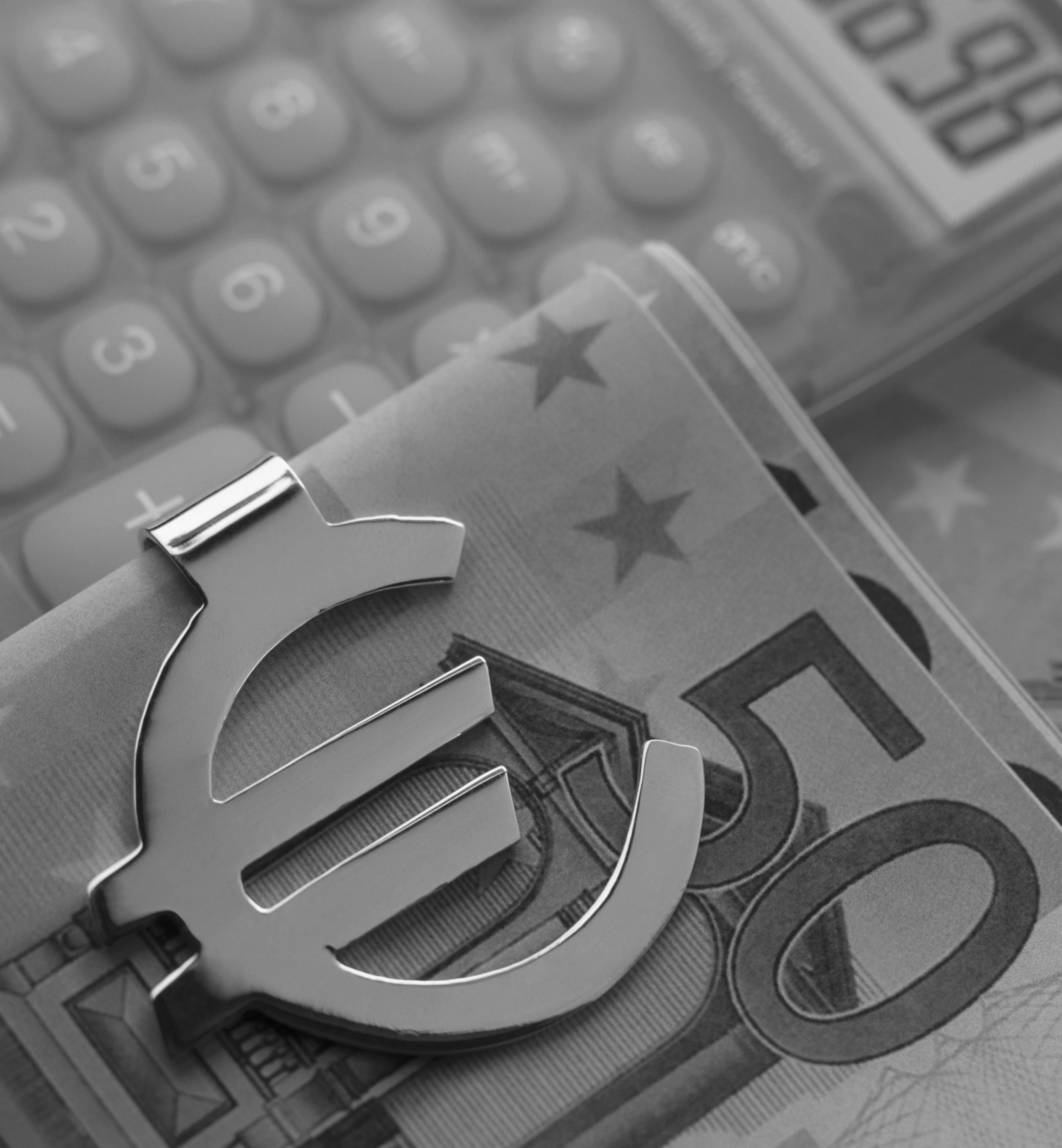

CLIFFORD CHANCE

European Insolvency Procedures
2008 Edition

contents

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Please note that this briefing does not address the EU Directive on Financial Collateral Arrangements (2002/47/EC) ("the Directive") which EU Member States were obliged to implement by 27 December 2003 (though some Member States have yet to implement it.) The Directive aims to simplify the procedures for taking and realising financial collateral across the EU and provides (amongst other things) for the disapplication of certain insolvency provisions which could invalidate or impede collateral arrangements. The Directive is the subject of separate client briefings. If you would like to know more about the Directive, please contact your usual Clifford Chance contact.

THE EUROPEAN INSOLVENCY REGULATION

Key Elements:

- Effective since May 2002
- To promote recognition and co-operation between different insolvency regimes of individual member states within the EU
- Unified code for governing law rules
- Concept of "centre of main interests" to determine opening of main proceedings
- Jurisdiction for the opening of territorial or secondary proceedings
- Carve outs include rights in rem and rights of set-off
- Differences in legal regimes for individual member states to remain

Introduction

This note primarily focuses on the insolvency considerations and legislation in specific European jurisdictions. However, before considering the individual jurisdictions, it is important to recognise the influence of the pan-European legislation.

The European Regulation on Insolvency Proceedings (Council Regulation 1346/2000) ("the Regulation") came into effect on 31 May 2002. It applies to all EU member states except Denmark (now including the ten European countries that joined the EU on 1 May 2004.)

The Regulation does not provide uniform substantive law provisions for members of the European Union. The purpose of the Regulation is primarily to codify how a member state should determine whether it has jurisdiction to open insolvency proceedings, whilst also imposing a uniform approach to the governing law which is applicable to those proceedings. Once these factors have been determined, the procedural rules of the member state in which proceedings are opened will generally apply. The Regulation also provides for the automatic recognition of insolvency proceedings throughout the EU.

Scope

The Regulation applies to all collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator or similar insolvency officeholder. The Regulation primarily applies to corporates and individuals within the member states. This encompasses various corporate entities such as trading companies, special purpose vehicles and group treasury companies. Its scope of application is confined to parties with their centre of main interests within a member state of the EU. (It therefore applies to entities whose place of incorporation may be outside of the EU, but whose centre of main interests is within a member state.)

The Regulation does not apply to entities who do not have their centre of main interests within a member state. The extent to which insolvency proceedings from outside of the EU are recognised, depends upon the domestic legislation and practice of each particular member state. (See the separate sections for individual member states.)

The Regulation does not apply to banks, credit institutions, insurance companies, investment undertakings which hold funds or securities for third parties, or collective investment schemes. The reorganisation and winding up of credit institutions is addressed in Council Directive 2001/24 and the reorganisation and winding up of insurance undertakings is addressed in Council Directive 2001/17. These two directives are beyond the scope of this note.

Jurisdiction

The primary jurisdiction for insolvency proceedings, as provided by the Regulation, is the court of the member state where the debtor's centre of main interests is located. In the case of a company or other legal person, in the absence of proof to the contrary, there is a rebuttable presumption that this is where the registered office of the company is located.

The Regulation allows for the courts in countries other than the home state to open "territorial" insolvency proceedings or, after the commencement of main proceedings "secondary" proceedings, in the event that such debtor possesses an establishment in the territory of such other member state. The applicable law of such territorial or secondary insolvency proceedings will be the law of that other member state. However, territorial insolvency proceedings or secondary insolvency proceedings are limited in scope to the debtor's assets in that member state and so will not extend beyond the member state where they are opened. Furthermore, under the Regulation, secondary proceedings are limited to winding-up proceedings.

Governing law

The Regulation imposes a unified code for the governing law which, in conjunction with the mandatory regime of jurisdiction rules, aims to enable those who have dealings with a debtor whose centre of main interests is within the EU to identify with greater certainty the substantive legal provisions by which their rights will be determined in the event of the debtor's insolvency. The general rule is that the law applicable to the insolvency proceedings and its effects shall be that of the member state within the territory in which such proceedings are opened.

So, unless secondary or territorial proceedings can be initiated as well, the law of the home state is likely to dominate. Once the proceedings are opened the specific jurisdictional considerations set out in the latter part of this note assume relevance.

The Regulation recognises that there will be cases where strict adherence to the general rule will interfere with the rules under which transactions are carried out in other member states, and therefore the general rule is subject to a number of exceptions and carve outs.

These exceptions include 'rights in rem' including rights of security (to include holders of floating security over a fluctuating pool of assets), rights of set-off permitted by the law applicable to the insolvent debtor's claim, rights under a reservation of title clause, contracts relating to immovable property, rules of payment systems and financial markets, contracts of employment etc.

Disagreements between member states

Different jurisdictions may interpret the Regulation in ways inconsistent with each other. This has been apparent from the case law which has been generated since the introduction of the Regulation, which has primarily focused on the determination of an entity's centre of main interests. No guidance is given in the Regulation itself. Different member states' interpretation of what constitutes the centre of main interests has resulted in main proceedings being opened in more than one member state. This is something that the Regulation was designed to avoid.

Any disagreement between member states as to where the centre of main interests is located would ultimately have to be resolved by the European Court of Justice ("ECJ").

Reference to the European Court of Justice

The first significant reference was made in the Summer of 2004 to the ECJ in respect of the Irish incorporated subsidiary of the Parmalat group, Eurofood IFSC ("Eurofood"). In relation to that company, a difference of interpretation led to two different courts asserting that the centre of main interests for Eurofood was in their respective jurisdictions. The Irish court considered that Eurofood's centre of main interests was in Ireland, based on the following: it was incorporated in Ireland and subject to the fiscal and regulatory controls there; the day to day administration was carried out in Ireland where the company's accounts were also maintained; the company's board meetings took place in Ireland; and, the creditor's perception was that the centre of main interests was in Ireland. The Italian courts asserted that the centre of main interests was in Italy, based on the following: the company was merely a conduit for the financial policy of the Italian parent; its exclusive point of reference was to the Italian parent; its operating office was in Italy; and, the central management function was carried out in Italy. The Irish Supreme Court referred a number of questions in relation to this issue to the European Court.

The ECJ held that the registered office presumption could only be rebutted if there were factors ascertainable by those dealing with the company that objectively established that its administration was conducted elsewhere. The ECJ further held that the presumption could not be rebutted simply by producing evidence that the headquarters of the parent company (that has the ability to make or influence economic choices for its subsidiary) was elsewhere. It is to be noted that the burden of proof is placed on those seeking to rebut the presumption that the location of the registered office determining the centre of main interests is a high one.

Discrepancies in the interpretation of the Regulation (in respect of extending a member state court's jurisdiction) may in some circumstances result in forum shopping, something the Regulation was designed to prevent. On a positive note, there have been examples where the Regulation has been used to facilitate pan-European restructurings by implementing local compositions in main proceedings.

ENGLAND & WALES

Key Elements:

- Limited application of administrative receivership regime
- Administration procedure with focus on company rescue
- Practical guidance for lenders and shadow directors
- Ranking of claims in different procedures

Introduction

This section is designed to provide a general outline of the main corporate insolvency procedures in England and Wales. Most of the legislation relevant to insolvency is contained in the Insolvency Act 1986 (the "Act") and the Insolvency Rules 1986 as amended by the Enterprise Act 2002 (the "EA 2002").

The main procedures encountered in corporate insolvencies are administrative receivership, administration and liquidation. We also consider very briefly company voluntary arrangements and schemes of arrangement pursuant to the Companies Act 2006. We consider each of these procedures in turn, the legal basis for challenges to antecedent transactions, and the personal liability of directors.

Receivership and administrative receivership

Administrative receiver

This is a receiver appointed over all or substantially all of the assets and undertakings of the company pursuant to a debenture which includes a floating charge. It is not technically an insolvency procedure, it is an enforcement mechanism used by a secured lender most notably at a time when a company is actually insolvent.

The introduction of the EA 2002, which was effective as of 15 September 2003[1], brought about substantial reforms. The most significant reform was the prohibition of the appointment of administrative receivers by debenture holders other than pursuant to floating charges created prior to 15 September 2003 and certain other exceptions[2]. The exceptions to the prohibition, mean that the administrative receivership regime will still be used as an enforcement mechanism.

Function and duties of receiver

The main function of the receiver is to realise the assets subject to the charge. His duty is to obtain the best price reasonably obtainable at the time of realisation. The receiver owes his primary duty to his appointor, but also has subsidiary duties of good faith to guarantors of the company's debts and to the company. He has very little responsibility to the unsecured creditors of the company and is entitled to act in what he considers to be the best interests of his appointor[3].

The powers of the receiver

These derive from two sources:

(a) express powers granted in the debenture or charge under which he is appointed; and

(b) statute, as an administrative receiver has the extensive powers conferred by schedule 1 of the Act. It should be noted that schedule 1 does not apply to fixed charge receivers, who have to rely on the express powers in the charge under which they were appointed and the limited statutory powers in the Law of Property Act 1925.

Power to sell charged property

The most significant of the powers of an administrative receiver is the power to dispose of charged property. An administrative receiver has wide powers to dispose of charged property and may do so by public auction or by private agreement. This is generally on such terms as he sees fit. The assets may be sold separately or as part of a sale of the business as a whole. However, since the receiver will generally sell without any warranty or other recourse, the price he can obtain for assets is generally less than that which would be obtained in a normal sale by the company.

Fixed charge receiver

This is a receiver appointed under a fixed charge (i.e. a specific security interest over specific property). His role is to realise security and he is known as a "bare receiver" or "fixed charge receiver".

Administration

Administration is principally a procedure intended to rescue companies which are or may become insolvent. The procedure has been streamlined by the EA 2002. A company can be placed into administration by way of an application to the court for an administration order made by either: the company; or its directors; or by a creditor (including contingent and

1 Save for the provisions relating to individual insolvency situations, which were effective from January 2004.

2 The exceptions are set out in s72B-GA of the Act. They include exceptions relating to capital market arrangements; public private partnerships; utilities; project finance; financial market; urban regeneration projects; social landlords and railway companies.

3 Under the EA 2002 an administrator appointed by the qualifying floating charge holder owes a duty to all the creditors of the company.

prospective creditors); or in certain circumstances by a clerk of a Magistrates Court. Administration may also be commenced without the need for a court order initiated by the filing of requisite notices by: the holder of a qualifying floating charge as defined by paragraph 14 of schedule B1 of the Act; or the company; or its directors.

The overriding purpose of an administration is to rescue a company as a going concern. If this is not reasonably practicable, then an administrator may perform his functions with a view to achieving a better result than would be achieved if the company were wound up. Again if this is not reasonably practicable, he may realise the property in order to make a distribution to one or more secured or preferential creditors.

Effect of administration

Administration creates a moratorium during which no insolvency proceedings or other legal proceedings, including enforcement of security, can be taken without the consent of the administrator or the permission of the court.

The effect of this moratorium is to enable the administrator sufficient breathing space to formulate proposals for rescuing the company, or in the event that this does not prove possible, an orderly realisation of the company's assets.

Qualifying charge holder has choice of administrator

A qualifying floating charge holder has the power to choose the identity of an administrator, whether by making the appointment himself (if the floating charge is enforceable) or by intervening in an application to court. An administrator appointed by a qualifying charge holder owes a duty to act in the best interests of the general body of creditors, not simply his appointor. A qualifying floating charge holder may also be able to block the appointment of an administrator in certain circumstances by appointing an administrative receiver (see above).

Powers of an administrator

The powers vested in the administrator are extensive. He is authorised to do all such things as may be necessary for the management of the affairs, business and property of a company. He may dismiss directors. Also, powers of directors which might interfere with the exercise by the administrator of his powers will only be exercisable with his consent. Most importantly, an administrator has the power to sell the assets of the company, even if they are subject to security (see below). He also has the power to make distributions to the creditors of the company (in the instance of distributions to unsecured creditors, he must first obtain the permission of the court).

Property subject to fixed charge

Where the property which the administrator seeks to dispose of is subject to a fixed charge, or is property held by the company under a hire purchase agreement, the administrator is first required either to obtain the leave of the court (who will need to be satisfied that the disposal is likely to promote the legitimate purposes of the administration) or the consent of the charge holder.

It will be a condition of the court permitting the disposal of property subject to a fixed charge or hire purchase agreement that the net proceeds of the disposal must be applied by the company first towards meeting the debt of the secured creditor. The administrator must sell the assets at "market value", failing which he will have to make up the deficiency to the secured creditor.

Property subject to a floating charge

If the security, as created, took the form of a floating charge, the administrator is free to deal with and dispose of the property without permission of the charge holder and without the sanction of the court. The floating charge holder's claims transfer to the proceeds of sale of the charged property but his claims rank after (a) administration liabilities, (b) costs and expenses of the administrator, and (c) claims of preferential creditors.

Importantly the administrator is entitled to use floating charge assets to fund the continuation of the business during the administration. This is one of the reasons why administrators sometimes challenge the legal nature of fixed charges (i.e. contending the charge to be floating rather than fixed).

Liquidation

There are two forms of liquidation, namely:

(a) winding-up by the court (sometimes called compulsory winding-up); and

(b) voluntary winding-up.

Winding-up by the court

A compulsory liquidation begins by a winding-up order of the court made on the presentation of a petition by a creditor, the company, its directors, or a shareholder.

Grounds for a winding-up order

A company may be wound-up by the court in a number of circumstances although the two most common are:

(a) that the company is unable to pay its debts; or

(b) that the court considers that it is just and equitable that the company should be wound-up.

Although it is unusual for a solvent company to be wound-up by the court, it can happen in certain circumstances on the 'just and equitable' ground. For instance where minority shareholders are being unfairly treated or where there are, for example, only two shareholders neither of whom has effective control and who cannot agree how the affairs of the company should be conducted.

Winding-up is, however, an extreme remedy and minority shareholders who are being unfairly treated are usually better advised to seek alternative remedies under section 459 of the Companies Act 1985 which gives the court a broad discretion so that it can, for example, order the purchase of a minority shareholder's shares.

Inability of a company to pay debts

A company is deemed unable to pay its debts if:

(a) a creditor, to whom the company is indebted in a sum exceeding £750 then due, has served on the company a written demand (known as a statutory demand) requiring the company to pay the sum so due, and the company has for three weeks neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor; or

(b) a judgment against the company is unsatisfied; or

(c) it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.

A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

In order to obtain a winding-up order it may not be necessary for a creditor to have served a statutory demand on the company or to have an unsatisfied judgment debt, if it has other evidence that the company is insolvent.

Provisional liquidation

After the presentation of a petition, where the company's property is in danger or where it is alleged that those in control of the company are misappropriating or wasting the company's assets, an application may be made by any creditor or contributory or by the company itself for the appointment of a provisional liquidator, and the court in a proper case will at any time before the making of a winding-up order appoint one.

Duties and powers of the liquidator

The liquidator in a compulsory liquidation is an officer of the court and subject at all times to the control of the court. He is responsible to the creditors for the conduct of the liquidation and remains so responsible until his release as liquidator. The functions of a liquidator in a compulsory liquidation are to ensure that the company's assets are got in, realised and distributed to the company's creditors, and to pay any surplus to the persons entitled to it. The liquidator or the provisional liquidator (as the case may be) takes into his custody, or into his control, all the property to which the company is or appears to be entitled. The powers of the directors cease. The liquidator has very broad powers some of which may only be exercised with the sanction either of the court or of the liquidation committee of creditors. However, the liquidator only has a limited power to carry on the business (to the extent necessary to collect and realise the assets) and in practice it is relatively unusual for a liquidator to achieve a sale of the business as a going concern.

Power of disclaimer

In addition to his general powers a liquidator has a special power to disclaim onerous property. It is important to note that the power to disclaim applies to any unprofitable contract or any other property of the company which is unsaleable, or is not readily saleable, or is such that it may give rise to liability to pay money or perform any other onerous act. Property subject to onerous burdens may be disclaimed even though it is not actually unsaleable. The most typical exercise of disclaimer is in respect of a low value leasehold. The effect of disclaimer is that it effectively terminates the rights and liabilities of the company on the property disclaimed but does not affect the rights and liabilities of any other person. Any interested party is entitled to request the liquidator to decide whether he intends to disclaim and can apply to the court to have the disclaimed property vested in him. A person suffering loss or damage as a result of the liquidator exercising his statutory power of disclaimer, will have an unsecured claim for any loss or damage in the liquidation.

Secured creditors may enforce rights

Although liquidation has the effect of suspending legal proceedings against the company, liquidation does not override the rights of secured creditors who remain free to enforce their security and to retain the proceeds of enforcement in priority to the claims of unsecured creditors.

Unsecured creditors are generally paid *pari passu*, although preferential creditors, as defined by section 386 and schedule 6 of the Act, have a priority over general unsecured creditors and there is a limited class of deferred creditors.

Voluntary winding-up

There are two types of voluntary winding-up, a members' voluntary winding-up and a creditors' voluntary winding-up, the essential difference being that the former applies to solvent companies and the latter to insolvent companies. Accordingly voluntary liquidation is not always an insolvency procedure. Members' voluntary winding-up is often used to effect a corporate reorganisation or reconstruction.

Powers of the liquidator

One consequence of both members' and creditors' voluntary liquidation is that the powers of the directors cease. The liquidator has a number of powers set out in the Act some of which, in the case of a creditors' voluntary liquidation, must be exercised with the sanction of a liquidation committee appointed by creditors, and some of which require the sanction of the court. There are also a number of enabling provisions which entitle the liquidator to, for example, apply to the court for guidance on questions arising in the winding-up. As with a compulsory liquidation, the liquidator's general function is to realise the assets and to pay creditors in accordance with their entitlements (and the liquidator in a voluntary winding-up also has a similar power regarding the disclaimer of onerous property). The order of priority of debts is the same as in a compulsory liquidation.

Company Voluntary Arrangements

A Company Voluntary Arrangement ("CVA") might take the form of a rescue plan or may simply be used to facilitate a distribution to creditors. The objective of such arrangements is to bind dissenting creditors to the proposals.

The Insolvency Act 2000 introduced, amongst other things, a new regime for CVAs of small companies which are eligible for a moratorium period of up to three months when a CVA is proposed by its directors. A small company is one which satisfies at least two of the following three requirements: turnover of not more than £6.5m; assets of not more than £3.26m; and less than 50 employees. Although the moratorium is only available to small companies, a CVA can be used by the directors of any company to come to an arrangement with its creditors. For larger businesses that do not qualify for the small company moratorium, the administration process (which has the benefit of a moratorium) may be used in conjunction with a CVA.

There are a number of exceptions and certain companies will not be treated as eligible for a moratorium, for example, insurance companies, banks, and building societies. During the moratorium, amongst other things, security cannot be enforced and proceedings cannot be commenced or continued against the company or its property except with the consent of the court. Again, the effect of this moratorium is to allow a company time to formulate a proposal so that it can come to an arrangement with its creditors.

The arrangement proposal

The proposal cannot affect the rights of secured creditors to enforce their security without the concurrence of the creditors concerned; this effectively gives the secured creditors a veto on a scheme if it involves their rights. A meeting may not approve a scheme under which a preferential debt of the company is to be paid otherwise than in priority to non-preferential debts, unless the preferential creditor consents to such a change in priorities. In order for the proposal to be approved more than one half majority in value of the shareholders and more than three quarters in value of the creditors must vote in favour of the CVA. (Although if the decisions of the creditors and the shareholders differ, the decision of the creditors will prevail subject to the right of a member to apply to the court.)

Schemes of arrangement

This is not an insolvency procedure but a mechanism contained in Part 26: sections 895-901 of the Companies Act 2006 which allows the court to sanction a "compromise or arrangement" that has been agreed between the relevant class or classes of creditors or members and the company.

A scheme of arrangement binds members or creditors within a class, including unknown creditors who fall within a class of creditors. The power of the majority to bind a minority in the class operates regardless of any contractual restrictions (e.g. requirements for amendments and variations set out in the loan document which governed the debt being compromised.) For the scheme to be approved there needs to be a majority in number, representing three quarters in value, of those voting for the scheme.

A scheme of arrangement requires the sanction of the court to summon a meeting or meetings of the relevant class or classes of creditors or members. Assuming the scheme has been approved by the requisite majority of creditors at the meetings, the court should sanction the scheme itself.

Challenges to antecedent transactions

Transactions at an undervalue: section 238 of the Act

An administrator or liquidator may apply to the court to set aside transactions entered into at an undervalue within two years of the onset of insolvency. For this purpose a transaction is at an undervalue if it constitutes a gift or if the value of the consideration received (in money or moneys worth) is significantly less than the consideration provided by the company.

It is a defence to a challenge under section 238 to show that the company was solvent at the time it entered into the relevant transaction or that it was entered into in good faith and that there were reasonable grounds for thinking the transaction would benefit the company. Although historically the view of the court was that granting security did not deplete a company's assets and therefore did not constitute an undervalue, secured creditors should be aware that following the Court of Appeal's decision in Hill v Spread Trustee Company Limited [2006] EWCA 542, the grant of security may now be the subject of a challenge as a transaction at an undervalue.

Preferences: section 239 of the Act

An administrator or liquidator may apply to set aside transactions which occurred within six months of the onset of insolvency (this period is extended to two years for transactions involving connected parties) which had the effect of putting the creditor, surety or guarantor in a better position in the liquidation than would otherwise have been the case and where the company was influenced by a desire to produce that (i.e. preferential) effect. A company must have been influenced in deciding to give the preference by a desire to produce the effect of putting the creditor in a better position. If this desire is missing the security will not be invalidated.

It is a defence to a challenge under section 239 to show that the company was solvent at the relevant time (taking account of the effect of the relevant transaction, act or omission).

Transactions defrauding creditors (section 423)

Under section 423 of the Act the court may, on the application of the liquidator of a company (or with the leave of the court, on the application of a "victim of the transaction" even if the company is not in liquidation), set aside a transaction entered into by the company "at an undervalue" if the company entered into the transaction for the purpose of putting assets beyond the reach of a person who is making, or may at some time make, a claim against it or of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make. It is not a condition of the making of such an order that the company was insolvent at the time of the transaction.

A transaction at an undervalue is defined under section 423 of the Act in substantially the same terms as under section 238 of the Act (i.e. lack of/inadequate consideration). The principal differences are:

(a) To set aside a transaction under section 423, the court must be satisfied that it was entered into for the purpose of putting assets beyond the reach of creditors or otherwise prejudicing the interest of creditors.

(b) The remedy is available not only to administrators and liquidators, but also to "a victim of the transaction".

(c) There is no requirement that the company be subject to a formal insolvency proceeding.

Avoidance of floating charges: section 245 of the Act

A charge, which as created was a floating charge, entered into by a company within 12 months (the period is extended to two years if the transaction was in favour of a connected party) of the onset of insolvency is invalid except to the extent of any new money advanced (or the value of goods or services provided) or the discharge reduction of indebtedness which occurs at the same time or on or after the creation of the charge.

It is a defence to a challenge under section 245 to show that the company was solvent when it entered into the charge.

Extortionate credit transactions: section 244 of the Act

An administrator or liquidator may challenge credit transactions entered into within three years of the onset of insolvency if, having regard to the risk accepted by the counterparty, the terms were such as to require "grossly exorbitant" payments (whether unconditionally or in certain circumstances) or if the terms of the transaction otherwise "grossly contravened" ordinary principles of fair dealing.

Personal liability for directors

Directors can incur civil and criminal liability for the debts of an insolvent company in a number of ways under the Act. For this purpose, director includes, any person in accordance with whose directions the appointed directors are accustomed to act.

The principal areas of risk for directors are breach of duty, fraudulent trading and wrongful trading.

Breach of duty: section 212 of the Act

This section enables the court on the application of a liquidator, creditor or shareholder to make an order requiring any officer of the company (or any person who has taken part in the promotion, formation or management of the company), liquidator or administrative receiver who has mis-applied or mis-appropriated or wrongfully retained money or property of the company or been guilty of misfeasance or breach of any fiduciary duty, to repay or restore the mis-applied or mis-appropriated or wrongfully retained property or contribute to the company's assets by way of compensation for breach of duty. This statutory provision compliments the common law liability of directors for breach of fiduciary duty.

Fraudulent trading: section 213 of the Act

This section enables a liquidator to apply for contributions from any persons (i.e. not just directors and shadow directors) who were knowingly parties to the carrying on of business with the intent to defraud creditors. The section requires "actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame".

The facts supporting a claim under section 213 will also render every person knowingly party to the carrying on of the business with intent to defraud creditors liable to criminal penalties under section 993 of the Companies Act 1985.

Wrongful trading: section 214 of the Act

A liquidator may apply to the court for contributions towards the assets of the company from any person who held office as a director (this includes shadow directors) from the point at which that person "knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation".

It is a defence for a challenge under section 214 for a director to show that from the point that he knew or ought to have known that insolvent liquidation was unavoidable he "took every step with a view to minimising the potential loss to the company's creditors". This may include directors initiating insolvency proceedings.

It should be noted that resigning does not necessarily enable a director to avoid liability under section 214 and that under section 214 there is no need to prove an intention to defraud creditors.

Part 10 of the Companies Act 2006 (the majority of which came into force on October 2007[4]) attempts to codify the duties of directors. It provides a list of seven general duties aimed to provide greater clarity to directors, and also a non-exhaustive list of factors that directors must take into account when exercising their duties. In particular the factors include a duty to consider not just shareholders, but employees, suppliers, consumers and the environment. The codification is, however, incomplete and the statutory duties do not cover all the duties that a director may owe to a company. Further the Companies Act 2006 provides that common law rules and equitable principles still apply to the directors in fulfilling their duties. The Companies Act 2006 also contains a new procedure for enforcement of directors' duties by shareholders on behalf of the company. This may mean that there is more scope for strategic / activist challenges where directors are second-guessed by the courts.

Lender liability

Generally speaking, the risk in England of lenders being held liable to pay their customers' debts is small. The principal risk for a lender, however, arises where it is found to be acting as a shadow director of a company that becomes insolvent. In such circumstances it is conceivable that a lender may be made liable to make a contribution to an insolvent company's assets for wrongful trading under section 214 of the Act.

"Shadow Director" is defined in section 251 of the Act as meaning "...a person in accordance with whose directions or instructions the directors of the company are accustomed to act (but so that a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity.)"

Consequences of being a shadow director

A lender's 'deep pockets' are an obvious reason why a liquidator or creditor of an insolvent company might seek to pursue a lender on the basis that it is a shadow director. As previously mentioned, a lender may be made liable to make a contribution to an insolvent company's assets for wrongful trading where it is held to be a shadow director of that company. Wrongful trading occurs from the point in time that a reasonable director ought to have concluded that the company would not avoid insolvent liquidation. From that point on the directors, including shadow directors, run the risk of being ordered to contribute to the company's assets in its liquidation.

Defences available to lenders

One line of defence for a lender accused of shadow directorship lies in the wording of the definition. The directors of the insolvent company are required to be accustomed to act in accordance with directions or instructions received from the shadow director. The word "accustomed" implies that there has been a course of dealings between the parties. If the lender has a constant presence in the company, for example where the lender has appointed a company doctor who is exercising management authority, the position may be different. The key to the definition is the idea that it is the shadow director, not the board of directors, who is exercising the management discretion of the company.

Practical advice for lenders

There is no authority as to what activities are safe for a lender to conduct. This question remains largely unanswered by the courts. Although yet to be tested by the courts, lenders to a company in financial difficulty may be entitled to take action to protect their interests, such as sending in an investigating team; demanding a reduction in the overdraft; demanding security or further security; calling for information, valuations of fixed assets, accounts, cash flow forecasts etc; requesting the customer's proposals for the reduction of the overdraft, including the submission of a business plan, schedule of proposed sales etc; advising on the desirability of strengthening management, and seeking fresh capital. In doing all these things the lenders may well expect their demands to be met, firstly because they are likely to be commercially sensible, and secondly because the customer has no option if it wants its facility continued. This should not be sufficient to constitute the lenders being regarded as shadow directors.

So long as the lenders can be viewed to be merely setting out what conditions attach to their continued support they should not incur liability. Crucially, the decision as to whether to continue trading in the face of these conditions, or to cease trading or go into liquidation rests with the directors.

The Pensions Act 2004, which came into force on 6 April 2005 may also affect a lenders' liability where there is a defined benefit pension scheme. Lenders should take care not to become "connected with" or associates of a borrower with such a scheme, as doing so could put them at risk of incurring obligations under financial support or contribution notices issued by the Pension's Regulator. One of the tests of whether a lender is connected or associated is the ability to control one third of the voting rights in a relevant borrower. Security over shares therefore, needs to be carefully drafted to avoid a lender being liable.

4 ss 175-177 (duty to avoid conflicts of interest, duty not to accept benefits from third parties and duties to declare interest in transactions are due to come into force on 1 October 2008).

Guarantees

Guarantees are available in most circumstances e.g. downstream (parent to subsidiary), upstream (subsidiary to parent) and cross-stream (between sister companies within a group).

Corporate benefit issues need to be addressed especially in the context of upstream and cross-stream guarantees.

A guarantee is a secondary obligation by a third party relating to a primary obligation by a contracting party (i.e. a borrower under a loan agreement). If the primary obligation is altered, discharged or fails the guarantee may not be enforceable. Usually the document containing a guarantee will also contain a direct indemnity as an independent primary obligation. This should survive even if the guarantee is not enforceable.

A guarantee must be in writing to be enforceable.

Generally speaking, if security or guarantees are granted at the time a loan is drawn, and at that time it is not contemplated that the company will become insolvent, the requisite desire to prefer the creditor/guarantor is usually missing and therefore it should not constitute a preference (see above).

Following the Court of Appeal the decision in Hill v Spread Trustee Company Limited the granting of security/guarantee may be challenged as a transaction at an undervalue (see above).

Priority

Security usually ranks by order of creation, but to preserve the priority position, notice may need to be given. For some assets registration is required in an asset register and security will rank by date of registration.

Subject to the rights of the creditors to agree their relative priority, the order for payment of claims depends upon the type of insolvency procedure.

Broadly speaking in the context of receivership from the charged assets, rank as follows:

(a) Holders of security which ranks prior to the security under which the receiver is appointed;

(b) Holders of security (from the proceeds of which the receiver will recover costs, remuneration and expenses (as prescribed in the charge appointing the receiver));

(c) Preferential creditors (ranks ahead of floating charge only, fixed charges take priority);

(d) Unsecured creditors up to a maximum of £600,000 if the company's net property is £10,000 or more (ranks ahead of floating charge only, fixed charges take priority);

(e) Holders of a floating charge;

(f) Any surplus is payable to subsequent charge holders (if any) or to the company or its liquidator.

A recent amendment to the law has been made which affects the priority of the costs and expenses of a liquidation. Section 1282 of the Companies Act 2006 introduced a new section 174ZA into the Insolvency Act 1986 that has the effect of making the expenses of a liquidation rank ahead of a floating charge. The change in priority was effective from 6 April 2008 and applies to all liquidations commenced after that date where there are insufficient unsecured assets to meet the payment of liquidation expenses. Claims in a liquidation after 6 April 2008 will rank as follows:

(a) Holders of fixed charge security (usually dealt with outside of the liquidation process);

(b) Costs and expenses of the liquidation in accordance with the order stipulated by the enacting legislation;

(c) Preferential creditors[5];

(d) Unsecured creditors up to a maximum of £600,000 if the company's net property is £10,000[6] or more (payable out of floating charge assets);

(e) Holders of floating charge;

(f) Unsecured creditors;

(g) Post liquidation interest on debts;

(h) Deferred creditors;

(i) Shareholders (only if there is a surplus after the debts are paid).

Claims in administration rank as follows:

(a) Fixed charge security;

(b) Costs and expenses of the administration in accordance with the order stipulated by the enacting legislation;

(c) Preferential creditors;

(d) Unsecured creditors up to a maximum of £600,000 if the company's net property is £10,000 or more;

(e) Holder of a floating charge;

(f) Unsecured creditors;

(g) Post administration interest on debts;

(h) Deferred creditors;

(i) Shareholders[7].

5 To the extent to which preferential claims in a liquidation are unpaid out of free assets, they will be payable out of the floating charge holders fund.

6 This will also be payable out of the floating charge holders fund.

7 Only if there is a surplus after all the debts are paid.

New money lending

Normally lenders will insist on additional security or priority (ahead of debts incurred prior to the proceedings) before any new monies are advanced to companies after the opening of any insolvency proceedings.

Recognition of foreign insolvency proceedings

Within the EU

The Regulation applies, see first part of this note.

Recognition of foreign insolvency proceedings outside of the EU

The Model Law On Cross Border Insolvency promoted by UNCITRAL was adopted in Great Britain on 4 April 2006 in the form of the Cross Border Insolvency Regulations in 2006. This extends the English court's ability to recognise foreign insolvency proceedings outside of the EU, to jurisdictions such as the US. In addition to the Cross Border Insolvency Regulations 2006 there are statutory provisions allowing the English court to exercise its jurisdiction if the foreign entity has a sufficient connection with England (section 221 of the Act) or if a specific request for assistance is made by the court from one of the territories specified in section 426 of the Act (largely commonwealth countries). Further, a recent House of Lords decision in the case of McGrath and others v Riddell and others [2008] UKHL21 held that pursuant to section 426 of the Act, the English Court could direct the remittal of assets realised in an English liquidation to another jurisdiction and absent any manifest injustice to creditors, the English Court has the ability to make an order, even if the effect of that order will facilitate the application of an insolvency regime which differs from English insolvency law. Where remittal is to a jurisdiction whose court cannot make a request pursuant to s426, the English Court's inherent jurisdiction may only facilitate a transfer where the foreign court's rules do not infringe the principles of English insolvency law. Under the general principles of comity, foreign proceedings may also be recognised, and in a recent Privy Council decision (which as a matter of English law is persuasive but not binding), Cambridge Gas Transport Corporate -v- the official committee of unsecured creditors of Navigator Holdings Plc and others [2006] UKPC26, it was held that it was not necessary to open ancillary proceedings in the Isle of Man, to facilitate the implementation of a US plan of reorganisation.

FRANCE

Key Elements:

Considers:

- court-assisted pre insolvency proceedings
- court-controlled insolvency proceedings
- lenders' liability
- directors' responsibilities
- enforcement of security
- guarantees
- priority ranking for lenders of new money
- recognition and enforcement of foreign insolvency proceedings outside of the EU
- a reform of the law is currently contemplated

Summary

French insolvency law provides for (i) court-assisted pre-insolvency proceedings and (ii) court-controlled pre-insolvency and insolvency proceedings, which trigger a stay of individual claims and actions. Such proceedings are available for corporate bodies, individuals performing a commercial or agricultural activity and self employed persons having non-commercial activities (such as lawyers, doctors, auditors etc.)

Pre-insolvency proceedings

Mandataire ad hoc

The *mandataire ad hoc (mandat ad hoc)* procedure involves the appointment by the President of the Commercial Court, at the request of the debtor, of a third party officer (most often an insolvency practitioner) with the view to assisting the debtor in difficulty. The purpose is most often to facilitate an agreement between the debtor and its main creditors that aims at resolving the difficulties the business may face. The President of the Court has discretion to determine the scope of the brief of the *mandat ad hoc*. The *mandat ad hoc* is generally vested with no specific powers but can have substantial influence in bringing about a resolution. In practice, a *mandat ad hoc* most often precedes a Conciliation Procedure. It takes place upon the petition of the manager/legal officers of the debtor in difficulty.

Mandats ad hoc are confidential procedures unless there is a necessity/interest for the debtor to disclose the appointment of the *mandat ad hoc*.

Mandats ad hoc do not entail a stay of individual claims. However, provisions of the French Civil Code (Article 1244-1 et. Seq.) enable Presidents of the Courts to order a stay or deferral of payments for a period of up to two years if a creditor has started legal action against the debt (except for certain debts such as salaries, alimony, certain social security contribution and taxes). When deciding whether to grant such a stay, the judge must make an equitable assessment of the situation of the debtor and that of the creditors.

Conciliation

The Conciliation *(Procédure de Conciliation)*, originally known as "*Règlement Amiable*", was introduced in 1984 and is governed by articles L. 611-4 et seq. of the French Commercial Code.

The Conciliation Procedure is open to debtors which face actual or foreseeable legal, economic or financial difficulties, and that are not in a state of cessation of payments (i.e. are not unable to pay their debts when due with their liquid assets) or have not been in such a state of cessation of payment for more than 45 days.

The President of the Commercial Court appoints a conciliator to facilitate an agreement between the company and its creditors.

Basically, like the *mandat ad hoc*, the Conciliation Procedure aims to allow the debtor to negotiate confidentially, under the auspices of a conciliator who liaises with the President of the Court, and to reach a contractual arrangement with its creditors with a view to avoiding insolvency proceedings.

The Conciliator can only be appointed for a maximum of 4 months with an exceptional extension of 1 month (i.e. a maximum of 5 months) (unlike the *mandat ad hoc* whose length of office is at the discretion of the President of the Court).

The President of the Court having opened the Conciliation Procedure can order deferral of payments of up to two years against certain creditors on the basis of Articles 1244-1 et. seq. of the French Civil Code (see above *mandat ad hoc* section).

The Conciliation Agreement binds the parties to it and stays any legal actions by such parties for obtaining payment.

The Conciliation Agreement can either be acknowledged by an order of the President of the Court *(accord de conciliation constaté)*, or approved by a formal judgment upon request of the debtor *(accord de conciliation homologue)*.

If the Conciliation Agreement is only acknowledged, it binds only the parties thereto and the agreement remains confidential.

Alternatively, the Conciliation Agreement can be approved by a formal judgment if (i) the debtor is not in a state of "cessation of payments" or if the Conciliation Agreement cures such a state, (ii) the terms of the Conciliation Agreement are of a nature to ensure the perennial operation of the business and (iii) the terms of the Conciliation Agreement do not harm the rights of third party creditors.

If the Conciliation Agreement is approved by judgment, lenders making new money and/or suppliers making trade credit available to the debtor under the Conciliation Agreement rank in priority before (i) most of the pre-insolvency debts originating prior to the commencement of the Conciliation Proceedings, and (ii) most of the liabilities generated by the insolvency estate (e.g. the liabilities that arose in connection with the operation of the business after the insolvency judgment) in the event of subsequent insolvency proceedings.

Approval of the Conciliation Agreement also prevents the Court from fixing the starting point of the "suspect" period (see Antecedent Transactions/Preferences section below) at a date earlier than the date on which the judgment became final in cases where there is a subsequent insolvency proceeding.

The drawback of approval by way of a judgment is that confidentiality is lost.

In the case of subsequent insolvency or safeguard proceedings, the Conciliation Agreement is terminated and creditors recover in full their claims and security, subject to payments already received and to the new money preference rights discussed above.

If no agreement is reached, the Conciliation Proceedings terminate. If the debtor is not in a state of "cessation of payments", it can apply for Safeguard Proceedings *(Procédure de sauvegarde)*.

Formal Insolvency and Safeguard Proceedings

Under French law, a business is insolvent when it is unable to meet its outstanding liabilities with its available assets (being cash plus assets that can be immediately realised for cash). This situation is known as "cessation of payments".

In such a case, formal insolvency proceedings are initiated by the debtor filing a declaration of "cessation of payments" within 45 days (unless it has elected a Conciliation Procedure within such time frame) with a view to opening a Rehabilitation Procedure or a Liquidation Procedure ("Insolvency Proceedings"). A petition can also be made by an unpaid creditor, by the Public Prosecutor or by the court of its own motion.

The law further allows the filing of a petition for formal safeguard (*sauvegarde*) proceedings that triggers an automatic stay of payments and is aimed at recovery if the debtor establishes that, although not being in an actual state of "cessations of payments", is unable to overcome difficulties which are likely to lead to a state of "cessation of payment". This procedure is referred to as "*Procédure de Sauvegarde*" (Safeguard Proceedings).

Common features of Formal Insolvency and Safeguard Proceedings

Formal insolvency and rescue proceedings are essentially court-driven proceedings where most of the key decisions are made or authorised by the court.

French Insolvency law is aimed essentially at the preservation of the enterprise and of employment (by rescue of the company or the business of the company) and to a lesser extent the repayment of the creditors, although the 2005 Act has indisputably reinforced the involvement and interests of creditors in the proceedings.

The possible outcomes of formal insolvency proceedings are as follows:

If recovery is possible, the court decides either on a Safeguard Plan (in the case of Safeguard Proceedings) or a Rehabilitation Plan (in the case of a Rehabilitation Procedure) which both provide for the rehabilitation and continuation of the operations of the debtor.

In both Rehabilitation and Safeguard Proceedings, after having verified that the debtor is eligible for the relevant procedure, the court orders the commencement of a time period allowing continuation of the operations of the debtor under the protection of the court whilst the situation of the debtor is assessed and an arrangement with creditors is sought. This time period is known as the Observation period *(Période d'observation)*. The Observation period can last for up to 12 months with a possible extension up to a maximum total duration of 18 months.

The process for implementing the Safeguard or Rehabilitation Plan is essentially as follows:

The restructuring of the debt is approved, where applicable, by the creditors' committees (please see below), and as the case may be, bondholders' assemblies, both of which are empowered to decide on a compromise and/or a repayment schedule that is binding on their members.

If there are no creditors' committees or if the proposed restructuring of the debt is not approved by the creditors' committees, and in all cases, with regard to creditors who are neither members of creditors' committees or bondholder assemblies, the court may impose a rescheduling of the debt which cannot exceed 10 years (15 years for agricultural businesses). The court is not empowered to compromise a debt at its own initiative, and has thus no ability to impose a "cram down".

Alternatively, the court may decide that recovery is impossible, and proceed with liquidation. The court can order liquidation either (i) from the beginning of the insolvency proceedings without allowing an Observation Period, if the debtor is in a state of "cessation of payments" and any recovery is obviously impossible, or (ii) at any time during the Observation Period if it becomes obvious that recovery is impossible.

In a Liquidation Procedure, the outcome is as follows:

The realisation of the business and assets of the debtor, or a substantial part thereof, as a going concern may take place thus preserving a certain number of employment positions. In such case the court can decide a Sale-of-Business Plan (plan de cession) in the framework of the Liquidation procedure.

If no realisation of the business as a going concern is likely to take place the business assets can be realised.

Automatic stay of payments and other restrictions on rights of creditors

During Insolvency Proceedings, the rights of the creditors of the debtor are restricted, *inter alia*, as follows:

(i) Subject only to very limited exceptions, any payments of debts incurred prior to the insolvency judgment are prohibited;

(ii) Subject only to very limited exceptions, the commencement of insolvency proceedings freezes all legal actions of the creditors to enforce a payment obligation incurred prior to the insolvency judgment or to foreclose on the assets of the bankrupt debtor;

(iii) Contracts cannot be terminated for reasons originating prior to the insolvency judgment, and clauses providing for termination or acceleration in the event of insolvency are of no effect. Contracts, which the administrator elects to continue, must be performed in accordance with their terms;

(iv) Creditors must prove their claims originating prior to the commencement of the proceedings against the debtor within 2 months (4 months for creditors residing outside of France) from the date of the publication of the judgment opening insolvency proceedings in a legal gazette. In case of failure to file such a statement of claim in a timely manner, the creditor is not allowed to participate in the distribution of proceeds (guarantees securing the debt would be preserved). Certain post-judgment claims must also be proved;

(v) The right to set off reciprocal debts with the insolvent debtor is limited to "related debts" *(créances connexes)* i.e. debts which arose in the framework of the same contract (and, to a certain extent, of the same group of contracts);

(vi) When the insolvency proceedings result in an insufficiency of assets (e.g. in a liquidation) and are closed, the remedies of the creditors in order to obtain payment are, as a general principle, extinguished, subject to certain exceptions e.g. fraud, "insolvency second offenders", etc.

Safeguard Proceedings *(Procédure de Sauvegarde)*

Safeguard Proceedings are only available to debtors who, although not in an actual state of "cessations of payments", establish that they are unable to overcome difficulties, which, if unresolved, would lead to a state of "cessation of payment".

The purpose of Safeguard Proceedings is to facilitate, at an early stage of the difficulties, a consensual restructuring in the framework of formal proceedings, triggering a stay of pre-judgment actions and payments.

The court can appoint an administrator in the framework of Safeguard Proceedings, but the rationale is to allow sufficient flexibility to enable the management of the debtor to remain in possession.

By contrast with Rehabilitation and Liquidation Proceedings, Safeguard Proceedings do not provide for simplified redundancy procedures, and the redundancy regime is the same as for non-distressed business.

Safeguard Proceedings are therefore more appropriate for financial restructurings and debt work-outs (e.g. over leveraged situation, distressed LBO, etc.) rather than industrial reorganisations requiring not only debt restructuring but also broad scale redundancies.

However, if a redundancy scheme is needed, and if the debtor is not in a position to finance the cost of its implementation, a State-organised insurance scheme provides the necessary financing, subject to certain criteria and limitations. The repayment of the advances made by the insurance scheme must be made within a limited period of time, which is to be agreed with the insurance scheme, generally one to two years after the approval by the court of the Safeguard Plan.

On the debt side, in addition to the appointment of (i) a representative of creditors who is a court officer appointed to act on behalf of the creditors and represent their collective interests and (ii) controllers chosen amongst the creditors, Safeguard Proceedings provide for the creation of two creditors' committees, if the debtor (i) has more than 150 employees or (ii) has a turnover of more than EUR 20,000,000 and (iii) its accounts are certified by a Statutory auditor or carried out by a certified public accountant. Upon request of the debtor or the administrator, the court can decide to lower this threshold.

One committee is comprised of creditors who are the main suppliers of goods and services, and the other is comprised of creditors that are credit institutions and in particular, banks, local public credit institutions, finance companies *(sociétés financières)* or special purpose financial institutions. There is no distinction between classes of creditors within each committee. Reading from the literal wording of the legislation, whether a creditor forms part of one or the other committee is determined by the "nature" of the creditor rather than the nature of the debt, although the issue is currently under review by the courts and also in the context of a contemplated reform of the law, in particular in the context of assignments of debts.

The powers of the committees are mainly to approve or reject the debtor's restructuring proposal. In this respect, the debtor has a wide flexibility in structuring such proposals. In particular, these proposals may include the debt being written off or the partial closure or disposal of the business. The creditors' committees have the power to compromise the debt of its members. The plan can provide for the rescheduling of the claims of the members of the committees over a period longer than ten years, without any minimal instalment amount. Within each committee, approval is achieved by an ordinary majority in number, representing not less than two thirds of the relevant debt. For the plan to be adopted by the court, the two committees must approve the restructuring plan. The legislator is contemplating introducing debt-equity swaps within the reform of the law.

The committees must be formed within 30 days following the judgment opening the Rehabilitation or Safeguard Proceedings. Submission of proposals for a Rehabilitation or Safeguard plan must be made within 2 months and this deadline may be extended once, to the creditors' committees after they have been formed. The decision of the committees on the Safeguard plan must take place within 6 months following the opening of the Observation period. If both creditors' committees have not approved a Safeguard plan within this 6-month period from the commencement of the Safeguard proceedings, they no longer have any role in the procedure.

In parallel, non-committee creditors are consulted either individually or collectively on the options for the payment of their claims (e.g. reduction of the debt with shorter deferral or full repayment over a longer period). The court cannot impose a reduction of the debt, but only a rescheduling or deferral of payment. The rescheduling cannot exceed ten years. After the second year, the minimum annual instalment is 5% of the total liabilities (except in the case of agricultural businesses).

Bondholders are not members of either creditors' committees. French insolvency law provides that (i) they must be consulted in the framework of the assemblies of bondholders and (ii) that such assemblies have the power to decide part or all of the bond debt of their members. If French law governs the bond debt, it provides that decisions of bondholders' assemblies must be made with a 2/3 majority in number. On first convening notice, the quorum must be 20% of the bondholders present or represented. On second convening notice, there is no quorum requirement. The regime of bondholders is currently under review in the context of the proposed reform of the law.

State creditors (such as the tax administration) are not members of either creditors' committees. They may however waive or reduce their debt. Rescheduling of their debt can also be imposed, under the conditions mentioned above.

After approval of the Safeguard plan by the committees, and before sanctioning the plan, the court must satisfy itself that the interests of all the creditors (which includes minority committee creditors) are sufficiently protected. After the sanction of the Safeguard plan by the court, members of the committees are bound by the plan. At the same time, the court acknowledges any waiver of debts granted by non-committee creditors and/or orders a rescheduling or deferral of payment.

If both creditors' committees have not approved the Safeguard plan within 6 months of the opening of the Safeguard proceedings, the court can only impose a rescheduling or deferral of payment on their members but not a waiver of the debt.

At any time during the Observation period, the court can either order Rehabilitation Proceedings or a Judicial Liquidation, if it is shown that the debtor was actually in a state of "cessation of payments" (see below) when it applied for Safeguard Proceedings, or if the debtor finds itself in a state of cessation of payments after the opening of the procedure.

Rehabilitation Proceedings

Rehabilitation Proceedings are available to businesses which are in a state of "cessation of payments" but appear viable.

This procedure is commenced by a court judgment appointing an administrator. As with Safeguard Proceedings, a representative of creditors is appointed to act on the creditors' behalf and represent their collective interests. Controllers are also appointed. Most of the organisational provisions of the Safeguard Proceedings apply to the Rehabilitation Proceedings (in particular the limitations imposed on the rights of the creditors). The administrator is required to make an assessment of the company's financial situation, the causes of that situation and the possible solutions e.g. whether the business should be continued, assigned in whole or in part to a third party or put into liquidation. Depending on the scope of his duties, as determined by the court, the administrator may either assist or replace the officers/managers of the debtor.

The procedure can last for up to 12 months with an exceptional extension of 6 months upon request of the public prosecutor (i.e. a maximum of 18 months).

The creditors' committees and bondholders' assembly are consulted and can compromise the debt of their members in the same manner as with the Safeguard Proceedings.

As in the Safeguard Proceedings, if the creditors' committees do not approve the proposals of the debtor for the reorganisation of the debt, the court may determine a repayment schedule for all pre-insolvency debts (including secured debts) over a period of up to 10 years (15 years for agricultural business). The repayment schedule may provide for different options, i.e. shorter deferral and reduction of debt or full repayment over a longer period. The court cannot order the compromise of debt without the consent of the creditors.

The law provides for simplified redundancy procedures in the case of rehabilitation proceedings. If the debtor is not in a position to finance the redundancies a state organised insurance system provides the necessary financing, subject to certain criteria.

For a Rehabilitation Plan to be approved by the court, the debtor must show that its recovery scheme is viable, and on the basis of the past and forecasted operations' accounts, that the debtor will be able to generate sufficient operational profits to repay the rescheduled liabilities and finance its day-to-day operations and business plan.

The rehabilitation can also include partial closure or disposal of the business. From the date of the judgment opening the procedure, third parties can make offers for the acquisition of part or all of the business as a going concern, under a Sale-of-Business Plan (see below).

At any time during the Observation period, the court can order the liquidation of the debtor, if the business appears not to be viable.

Liquidation

Judicial liquidation is available for companies which are in a state of "cessation of payments" and for which recovery through a rehabilitation plan is not possible.

The court appoints a liquidator, who exercises all the powers of management (the directors' functions end). The appointed liquidator is also the court appointed representative of the creditors.

In a Judicial liquidation the court decides either to order the sale of part or of all of the business and assets of the debtor as a going concern (i.e. pursuant to a Sale-of-Business plan (*plan de cession*)) or, if it considers that no sale of the business as a going concern is likely to take place, the court can realise the assets either individually or by sale of self-contained groups of assets.

Liquidation by means of Sale of Business Plan

If the court determines that the debtor's business can be realised as a going concern pursuant to a Sale-of-Business Plan, the liquidation judgment imposes a time period for the implementation of such realisation (3 months, renewable once upon request of the public prosecutor).

During such time period the debtor basically operates its business as if it were in the framework of an Observation period. The court may decide that an administrator remains in office in addition to the liquidator.

Further to bids by third parties (including creditors, but excluding the officers of the debtor and their relatives) the court may also order the sale of the entire business of the debtor, or of a substantial part thereof.

A Sale of Business Plan is in essence an asset transfer. Therefore, the purchaser is only liable to (i) pay a price as ratified by the court and (ii) to comply with the undertakings as included in the offer and at the court hearing (e.g. commitments in relation to level of employment, level of investments, etc.)

As a matter of principle, the purchaser of the business in the framework of a Sale of Business Plan is not liable for the liabilities of the debtor (either pre or post the insolvency judgment). The payment of the price clears all mortgages, charges and other security over the assigned assets, except security in connection with the financing of the acquisition of the secured assets, where failing agreement with the secured lender, the purchaser of the relevant assets must assume the debt instalments remaining due as from the date of its coming into possession of the assets.

The court can decide which contracts are "necessary for the rehabilitation of the business". These contracts are transferred to the assignee of the business notwithstanding any contractual prohibitions. They must be carried out on the terms in force as at the date of the start of the procedure.

Employees whose employment is not continued by the purchaser are made redundant at the expense of the debtor. If necessary the cost of redundancy is assumed by the insurance system mentioned in the Safeguard Proceedings Scheme.

The Sale-of-Business Plan judgment triggers the acceleration of all the debtor's liabilities, but individual claims remain stayed in most cases.

The residual assets are realised individually or by groups of assets.

The creditors are repaid from the proceeds of the sale of the business pursuant to the secured/unsecured nature of their debts.

Liquidation of assets

The aim of the liquidation of the assets is to realise the debtor's assets at the best available price and distribute the proceeds to the creditors pursuant to their priority ranking.

The judgment ordering this procedure triggers acceleration of all the debtor's liabilities, but individual actions remain stayed in most cases.

Under the liquidation procedure, secured creditors cannot, as a general rule, pursue their individual rights of action. Security rights are enforced by the liquidator and proceeds are distributed according to the priority provided by law. In this case, preferential creditors (such as employees) may supersede secured creditors, except for certain pledges featuring a right of retention. However, in certain types of pledge, the pledgee can be attributed ownership of the relevant asset.

Certain secured creditors are allowed to enforce their security if the liquidator has not taken steps to realise the secured assets within 3 months from the date of the judgment ordering liquidation. If the court authorised the debtor to continue its operations during the liquidation procedure with the view of implementing a Sale-of-Business-Plan, no enforcement can take place before the expiry of the time period imposed to implement such plan.

Directors' responsibilities

Potential liabilities extend to those persons who are in effect responsible for the running of the company, including "shadow directors". In particular, French insolvency law provides that the *de jure* and *de facto* directors/managers of a company which is subject to insolvency proceedings may be held personally liable for the deficiency of assets of the company, in case of proven management "faults" having contributed to such deficiency. A *de facto* director/manager is a person (individual or corporate) who performs positive acts of management. A shareholder may be held to be a shadow director/manager if the *de jure* managers of the company are employees of such shareholder.

If a liquidation (either ordered *ab initio* or as a result of the failure of Safeguard Proceedings or of a Rehabilitation Proceedings) shows a deficiency of assets against liabilities and the court determines that the deficiency is attributable to management faults and that such faults have contributed to the insolvency of the company, the court may decide that such directors/managers/officers shall bear jointly or severally whole or part of the liabilities of the company.

The statutory limitation period is three years from the date of the court judgment that pronounces rescission of the Rehabilitation/Safeguard plan, or that orders Judicial liquidation. The action may be brought by the Representative of the creditors, the Liquidator and/or the Public Prosecutor. A majority of the creditors appointed as "controller" (*Contrôleur*) are entitled to initiate such a claim if they unsuccessfully requested the Representative of the creditors or the Liquidator to initiate such claim.

Directors/managers/officers can further be prohibited from directing, managing, administering or controlling any other commercial business.

Other civil sanctions may be imposed in circumstances where there may have been fraud, trading whilst insolvent, etc.

Criminal liability

Directors/managers/officers may be punished by imprisonment for up to five years and/or a fine and/or other sanctions (including the deprivation of civil rights) in certain circumstances, essentially in case of fraudulent mismanagement or embezzlement.

Lenders' liability

A lender can incur liability on the basis of tort for granting or extending credit to a borrower in irredeemable financial difficulties. The civil liability for lenders is not limited to financial institutions, but also relevant to shareholders (on the basis of shareholder loans), or suppliers (in connection with their trade debt) and more generally, any lender.

However, the 2005 Act provides for a limitation of the civil liability of lenders in connection with the granting of credit facilities except in the case of (i) fraud, (ii) interference in management, or (iii) disproportionate security. If the lenders are held liable, security securing the relevant debt is nullified.

The limitation of liability does not seem to apply in the event of "abusive" termination of credit facilities *(rupture abusive de crédit)* (i.e. termination of credit without prior notice except if (i) the borrower's behaviour is "seriously reprehensible" or (ii) the borrower is in an "irremediably deteriorated situation").

French criminal law provides that having obtained ruinous means to finance the operations of a business, with the intention of avoiding or delaying the opening of insolvency proceedings, is one of the grounds for fraudulent bankruptcy. Lenders having provided such ruinous financing can be held both civilly and criminally liable as accomplices on this basis.

Antecedent transactions/preferences

Certain transactions entered into or payments made between the actual date of the "cessation of payments" (which the court can "backdate" to up to 18 months prior to the judgment opening insolvency proceedings) and the judgment opening insolvency proceedings (the "suspect period") may be declared null and void. For transactions made for no consideration, the 18 months period can be extended for an additional six months.

Certain transactions entered into or payments during the above period are automatically voidable by their nature, namely:

(a) transaction made without consideration;

(b) "unbalanced" transactions i.e. the obligations of the debtor are notably in excess of those of the other party;

(c) prepayment;

(d) payment made otherwise than in a manner commonly accepted in business transactions;

(e) deposit, or escrow of money without a final court decision;

(f) security in relation to pre-existing debt;

(g) attachment or other remedial measure in favour of a creditor; or

(h) authorisation, exercise or resale of "stock options".

In addition, any payment or transaction for consideration entered into or made after the date of "cessation of payments" may be nullified by the court if those who dealt with the debtor were aware of its "cessation of payments" situation.

Security

French law recognises various types of security (including mortgages, pledges, and preferential rights) over specific assets. It does not, however, recognise the concept of a floating charge. A general charge over the business can be taken, but cannot cover all the company's assets. To date, a French court will not recognise a foreign floating charge over assets located in France.

Enforcement of security

Enforcement generally involves the sale of the asset by way of public auction. In the case of asset pledges, however, a court can award the secured assets to the secured creditor following a valuation by a court-appointed expert, in which case the secured creditor escapes competition with other creditors.

The commencement of insolvency proceedings freezes the enforcement of security, subject only to limited exceptions.

All creditors must file a "declaration of claim" within two months (four if they are domiciled outside France) of the publication of the judgment. Creditors claiming rights of ownership over assets in the debtor's possession must lodge a further claim with the administrator within three months of (i) the date of the publication of the judgment or (ii) the termination of the contract if it is an ongoing contract (i.e. a contract that is not terminated on the commencement of the proceedings). Failure to do so results in rights becoming unenforceable in most cases.

When the court sanctions a Sale-of-Business Plan, the assets are assigned free from security interests, thus preventing the creditors from taking action against the assignee, except for certain specific security interests. The payment of the sale price by the assignee clears most mortgages, charges and other security, except those relating to the financing of the acquisition of the secured asset, where the assignee has to assume the instalment remaining due as from its coming into possession. The sale price is fixed by the court at its discretion, and does not need to correspond to any given proportion of the liabilities.

Under the liquidation procedure, secured creditors do not as a general rule pursue their individual rights of action, and security rights are enforced by the liquidator.

Guarantees

Guarantees are available in most circumstances. However, financial assistance/corporate benefit issues must be considered. Case law may permit cross-stream and upstream guarantees only in limited circumstances, and usually only in the context of a genuine group structure, as generally these will be considered as a misuse of corporate assets. Strict conditions must be met, particularly concerning the financial capabilities of the guarantor companies.

Procedural requirements for granting a guarantee vary depending on the type of company involved.

Priorities

Certain salary payments, court fees, and post-judgment debts arising from the rehabilitation proceedings or from the activity of the business during the Observation Period are paid in priority to all other debts (whether secured or unsecured). Unpaid salaries and certain employment-related items originating prior to the opening of the procedure supersede all other creditors (secured and unsecured), and those originating after the opening of the procedure have a preferential ranking depending upon the outcome of the procedure. Priorities between legal liens and security interests depend on the nature of the preference and the type of assets (movable or immovable). Generally, the priority of mortgages and other types of security over real estate depend on the date of registration at the Land Registry. Preferred creditors rank ahead of pledges unless the secured creditors request attribution of ownership of the pledged assets.

New money lending

Debts incurred by the company after the opening of formal insolvency proceedings for the purposes of the Observation Period or the professional activity of the debtor during that period are preferred by law and must be paid in priority to all pre-procedure debts, excepting super-preferred debts to employees, certain legal costs, new money made available pursuant to a Court approved Conciliation Agreement (see Conciliation Section above), and excepting also debts secured by a retention of title or certain other security (mortgage etc.), in particular in the event of a Liquidation.

Recognition of foreign insolvency proceedings

Within the EU

The Regulation applies, see first part of this note.

Recognition and enforcement of foreign insolvency proceedings outside of the EU

There exists a bilateral international convention between France, on the one hand, and Monaco and Austria, on the other. In addition, France is bound to Turkey pursuant to a multilateral convention (known as the Istanbul Convention of June 5, 1990).

Besides the provisions of these conventions, the enforcement of a foreign judgment issued outside the EU requires a formal enforcement order by French courts (by means of "exequatur" proceedings).

A French court will not re-open the merits of the case in the enforcement proceedings but it may refuse to give the foreign judgment effect, in particular, on the following grounds:

(a) the foreign court did not have jurisdiction to make the order; or

(b) the foreign insolvency judgment was not rendered by a body or person having a judicial function and does not appear on its face to be a judgment or an award.

ITALY

Key Elements:

- Significant legislative reforms 2003–2008.
- Amendments to claw-back provisions and the so-called "*concordato preventivo*" (Pre-bankruptcy Creditors' Composition).
- Extraordinary Administration Procedure for the Industrial Restructuring of Large Insolvent Businesses.
- Potential civil and criminal liabilities of directors;
- "*Esdebitazione*";
- Debt Restructuring Arrangements under the new article 182 bis of the Bankruptcy Act;

Introduction

Under Italian law a company can be wound up either through a liquidation procedure, applicable when the company is solvent, or through a "*procedura concorsuale*" (procedure affecting creditors' rights generally), applicable when the company is insolvent.

The statutory framework for insolvency-related procedures is primarily set out in Royal Decree no. 267 of 16 March 1942 (the "Bankruptcy Act"), as amended by law no. 80 of 2005 and Legislative Decree no. 5 of 2006 (as further amended by Legislative Decree n. 169/2007), in Legislative Decree no. 270 of 1999 ("the Law on Extraordinary Administration") and by law no. 39 of 23 December 2003 ("Urgent Measures for the Industrial Restructuring of Large Insolvent Businesses", the so-called "Marzano Decree").

The first amendments to the Italian Bankruptcy Act are in force as of 17 March 2005.

In light of the above, (i) the new claw-back regime is applicable to any claw-back action enforced within any Bankruptcy proceedings which are commenced after 17 March 2005; and (ii) the provisions relating to the Pre-Bankruptcy Creditors' Composition are applicable to any pending and unapproved pre-bankruptcy creditors' composition from 17 March 2005.

The rules reformed by Legislative Decree no. 5 of 2006 are applicable to all the Bankruptcy proceedings which began after 16 July 2006 while the previous law is still applicable to cases pending as of that date.

The rules reformed by the corrective Legislative Decree no. 169/2007 are applicable to all the outstanding Bankruptcy proceedings at the moment in which it came into force and to which that began after 1st January 2008.

Most Important Reforms

The changes to the principles of the Italian Bankruptcy Procedure have been carried out in different phases; the first step was taken in 2004 when the decree "Urgent Measures for the Industrial Restructuring of Large Insolvent Businesses" was enacted. It was aimed at the financial restructuring of large insolvent companies meeting specific requirements as to the number of employees and the amount of their debts: its purpose is therefore to allow such companies to continue their operations and return to a sound financial position on the basis of a 2-year restructuring plan. Secondly, in 2005, the Bankruptcy Act was partially amended by the reforms relating to claw-back action, the pre-bankruptcy creditors' composition and the introduction of the Debt Restructuring Arrangements. Finally, 2006 saw the almost total reform of the Bankruptcy Act (except the aspects that contain criminal sanctions) fully completed by the Legislative Decree 169/2007. After the reforms, the Italian Bankruptcy Act focuses to a greater extent on allowing companies to continue their operations and, consequently, protecting investments in Italy. This decision by the Italian legislators is aimed at reviving the Italian economy which has been beset by considerable difficulties in the last few years.

It will take some years to be able to assess the impact of this reform on the Italian economy.

The principal aim of the reform is to allow companies to continue their operations and many changes have been made to such an end, for example:

- increasing the number of entities excluded from Bankruptcy Proceedings;
- changing and widening the powers of the bankruptcy receiver;
- extending the powers of the committee of creditors;

In addition, the position of the debtor has been improved by the:

- abolition of the public register of debtors declared bankrupt;
- introduction of the so-called "*esdebitazione*".

Great changes have also been made with regard to:

- the provisions relating to claw-back action;

- the pre-bankruptcy creditors' composition .

Winding up Procedures

Liquidation – voluntary and mandatory

The liquidation procedure is governed by company law. The decision to put a company into voluntary liquidation must be taken by shareholders. A liquidator is appointed at the shareholders' meeting to sell the assets, pay off creditors and prepare a final liquidation balance sheet and report. Shareholders may object to the balance sheet within ninety days. If no objection is raised, approval is deemed to have been given and the liquidator can distribute any proceeds to shareholders. Ultimately, the company is struck off the companies' register.

Companies are subject to mandatory liquidation when their equity capital is reduced below the legal minimum, and also (at least in principle, although in practice this very rarely occurs) when the object for which the company was formed is attained or for any other reason set out in the by-laws.

Bankruptcy proceedings (*fallimento*)

This court-supervised procedure is governed by the Bankruptcy Act. After the recent reform, the Bankruptcy Act applies to all entities that carry on a commercial activity, except public bodies. The recent reform (D. Lgs. 169/2007) has introduced a number of criteria to identify the entities and the entrepreneurs that cannot be declared bankrupt. The entities and the entrepreneurs that can be declared bankrupt are the ones that:

- have reached in the last three years (from the bankruptcy petition or from the beginning of the enterprise) an annual balance sheet revenue higher than €300,000.00;

- have reached in the last three years (from the bankruptcy petition or from the beginning of the enterprise) an annual gross proceeds higher than €200,00.00;

- have debts (included not overdue debts) for an amount higher than €500,000.00,

The companies and the entrepreneurs that want to avoid being declared bankrupt must demonstrate that they have not exceeded all the three above-mentioned requirements.

A receiver is appointed who will usually, but not necessarily, be a lawyer or a certified accountant. Following the recent reforms, the receiver may also be a law firm as long as there is no conflict of interest. The main goal of the Bankruptcy Procedure (and therefore of the receiver) is to liquidate the assets of the company in order to satisfy the creditors.

Bankruptcy Administration

The reforms have modified the roles and duties of the administrative bodies that operate in a bankruptcy. First of all, following the reforms, the bankruptcy judge no longer has any managerial powers, but only supervisory and control functions. These supervisory functions have been improved in order to avoid uncontrolled management by the receiver. The receiver on the other hand now has more duties: he administers the debtor's assets and is responsible for the procedure. He must produce a report on the causes of the insolvency to the judge within sixty days of the bankruptcy declaration. The role of the committee of creditors has been greatly modified by the reforms and now possesses powers of authorisation and control over the receiver in addition to its advisory functions.

Once the procedure has commenced, no individual actions by any creditor are allowed. The company's directors lose the right to manage the business or deal with the corporate assets. Continuation of operations may, however, be authorised by the court if an interruption would cause greater damage to the company, but only if the continuation of the company's operations does not cause damage to creditors. After the reform, it is possible to lease the business or a part of it, the lessee, chosen by the receiver, decides upon the best solution in order to prevent the dispersion of company assets, workers and their professional skills. The aim of the company lessor is to save and restructure the company.

The transactions pending as of the date of the bankruptcy declaration are suspended until the receiver decides whether to take them over, this is unless the ruling on the declaration of bankruptcy allows the company to continue its operations on a provisional basis. The possibility of allowing the company's operations to continue, as regulated by the new art. 104 of the Bankruptcy Act, is one of the most important reform measures aimed at avoiding the dispersal of the insolvent company's assets and protecting creditors.

If the bankruptcy of the company does not allow it to continue its operations, then the loans intended for a specific activity (introduced into the Italian legal system by the recent reform of the Company Law) are terminated. The continuation of such funding is instrumental in the continuation of the company's operations. The receiver shall provide, pursuant to article 107, for the transfer to third parties of the assets in order to allow the company to continue operations. The receiver can decide to delegate the judge to sell movable, immovable and registered movable. If transfer is not possible, the receiver will provide for the liquidation of the assets in accordance with the liquidation rules of the company to the extent compatible with the procedure.

As regards to the liquidation phase, according to the reformed art. 105, individual assets of the company may be sold but only when the sale of the whole company or part of it does not satisfy creditors in a more advantageous manner.

The Bankruptcy proceedings end when: (i) all the assets have been distributed amongst the company's creditors or all debts and expenses have been paid; or (ii) a post-bankruptcy composition has been finalised (see below); or (iii) in the fixed term, after the Bankruptcy declaration no creditors have filed a claim; or (iv) all creditors have been paid in full; or (v) the company's assets have been liquidated but they are insufficient to satisfy all or a part of outstanding claims. In (iv) and (v) if the bankrupt entity is a company, it is removed from the Companies Register. In the past, Bankruptcy proceedings could last for up to five or more years but following the reforms, the procedure will probably be quicker.

Post-Bankruptcy Creditors' Composition

This procedure is an alternative way of bringing the Bankruptcy proceedings to an end. One or more creditors or a third party are authorised to propose the composition but it cannot be proposed by the debtor or by a company in which it holds a stake or companies subject to the same control if less than six months have passed since the bankruptcy declaration or if less than one year has passed since the order enforcing the insolvency. The proposal for post-bankruptcy composition with creditors can include (art. 124 of the Bankruptcy Act):

- the subdivision of creditors into different classes;
- different treatments of different kinds of creditors;
- the restructuring of debts and the satisfaction of claims in any way, including through the supply of goods, takeover (*Accollo*) or other extraordinary transactions.

The proposal may provide that the creditors that hold a preference, a pledge or a mortgage are not satisfied in full on the condition that the plan provides for their satisfaction in an amount not lower than the best possible price which may be obtained from the winding-up taking into consideration the market value of the goods or rights on which there is the preference as estimated by a qualified consultant. The treatment established for each class of creditors may not have the effect of changing the ranking of the preferential claims as laid down by the law.

This procedure must be approved by the creditors that represent the majority of the claims admitted to the vote. In the absence of any objections a creditor's consent to the composition is deemed to have been given.

Bankruptcy of Companies

According to article 146 of the Bankruptcy Act, the directors and liquidators of companies must observe the obligation imposed upon the debtor. The receiver can bring actions for liability against directors, statutory auditors, general managers and liquidators.

The judgment which declares a company bankrupt will also involve the members of the company who have unlimited liability, (art. 147 of the Bankruptcy Act). Unlimited liability members cannot be declared bankrupt if a year has passed since the end of the relationship or since the end of the unlimited liability.

The summary procedure (governed by articles 155-156 of the Bankruptcy Act) has been eliminated and this abrogation is due to the streamlining of procedures provided for by the Bankruptcy Act. The new articles 155-156 regulate the assets intended for a specific activity (art. 2447 bis of the Italian Civil Code). The receiver can transfer them to third parties in order to preserve their initially intended use or he can liquidate them. The proceeds from the liquidation will be part of the assets.

The Extraordinary Administration Procedure and the Marzano Procedure for the Industrial Restructuring of Large Insolvent Businesses

The Legislative Decree 270/1999 regulated the "Extraordinary Administration for Large Insolvent Businesses" ("Extraordinary Administration Procedure") that is a sort of insolvency procedure for large businesses.

The Extraordinary Administration Procedure is applicable to large businesses in a state of insolvency when there is the expectation that the company's situation may be rebalanced either through (a) the sale of its assets, undertakings or going-concerns (provided that the duration of the relevant programme cannot exceed 1 year); or (b) the execution of a restructuring programme, the duration of which cannot exceed 2 years.

The Extraordinary Administration Procedure applies to companies meeting the following cumulative criteria:

- more than 200 employees during the preceding 12 months; and
- aggregate debts[8] no lower than two thirds of each of (i) the assets on the company's balance sheet and (ii) the incomes deriving from the sales made and the services provided during the latest accounting period.

Whilst the admission to the Marzano Procedure usually precedes the declaration of insolvency, the Extraordinary Administration Procedure requires petition for the insolvency declaration to be filed before the competent Court, which may be then followed, according to the below steps, by admission to the Extraordinary Administration Procedure.

A petition for the insolvency declaration and the successive admission to the

8 As to the meaning of "debts", the notion appears to refer to the overall indebtedness of the company as resulting from its balance sheet, which inter alia includes (amongst other things) bonds, convertible bonds, shareholder's loans, bank finance and intercompany debts.

Extraordinary Administration Procedure may be filed by the company, its creditors, the public prosecutor (*pubblico ministero*) or ex officio by the Bankruptcy Court.

In the judgement declaring the state of insolvency, the Court, *inter alia* appoints one to three judicial commissioner(s) for the management of the company from the date on which it is declared insolvent until the appointment of the extraordinary commissioner(s), after the company has been admitted to the Extraordinary Administration Procedure[9]: within 30 days from the declaration of insolvency, such judicial commissioner(s) must file before the Bankruptcy Court a report describing the reasons leading to the insolvency of the company and a reasoned evaluation of the existence of the conditions set forth by law for the admission of the company to the Extraordinary Administration Procedure. A copy of such report is sent to the Minister of Economic Development.

From the date of the report, the Bankruptcy Court has an additional delay of 30 days to resolve on the opening of the Extraordinary Administration Procedure, to which the company is admitted if there is a concrete expectation that its financial situation can be rebalanced upon one of the possible alternative mentioned above at letter (a) and (b): where this is not the case, the Bankruptcy Court declares the company bankrupt and the Bankruptcy Procedure will apply.

Within 5 days from the decree of the Bankruptcy Court declaring the opening of the Extraordinary Administration Procedure, the Minister of Economic Development appoints one to three extraordinary commissioner(s) which, within the following 55 days must deliver to the Minister of Economic Development the recovery plan of the company. Such term can be postponed for a further period of 60 days.

Within 30 days from the date of its delivery, the Minister of Economic Development authorises the recovery plan, which must also contain an indication of the method and timing of repayment of outstanding debts. Once approved, the plan must be carried out by the extraordinary commissioner(s) under the supervision of the Minister of Economic Development.

Assets can be sold according to the plan on a going-concern basis or sold individually. The distribution of the realisation proceeds will be generally carried out in the order of priority provided for in the Bankruptcy Act. However, there may be cases where, should the continuation of the business so require, the extraordinary commissioner is entitled to make advance payments to unsecured creditors in preference to secured creditors on the basis of the estimated available funds.

If its goals have been achieved and the company, after the implementation of the plan, has returned to a sound financial condition and has repaid outstanding debts, the Court will terminate the proceeding and the company may return to its normal corporate activity.

If the above-mentioned requirements are not met, and in any other moment in which, upon admission thereto, the Extraordinary Administration Procedure may not be usefully continued, the Bankruptcy Court may declare the company bankrupt.

On 23 December 2003, the Italian government approved the Decree "Urgent Measures For The Industrial Restructuring Of Large Insolvent Businesses" (the so-called "Marzano Decree"), which came into force on 24 December 2003 when it was published in the Italian Official Gazette.

The Marzano Decree introduces a faster procedure which aims to save and turn around an insolvent company in order to maintain its technical, commercial, productive and employment value. The purpose is mainly the continuation of the company's operations by restructuring the company's debts and selling assets which are not strategic or which do not form part of the company's core business (some minor amendments have been introduced by law no. 166 of 2004 and no. 6 of 2005).

The above mentioned extraordinary administration procedure is available to large insolvent businesses which have:

(a) actual prospects of recovery, through the economic and financial restructuring of the business on the basis of a restructuring plan whose duration cannot be more than 2 years;

(b) a minimum of 500 employees for at least one year; and

(c) debts, as well as obligations arising from guarantees, for an aggregate amount not lower than EUR 300,000,000.

A company which meets the requirements set out above may request the Minister of Production (*"Ministro delle Attività Produttive"*, formerly the Minister of Industry), with a_ concurrent application of insolvency to_the competent court, for admission to the Marzano Procedure. The admission to the Marzano Procedure may be requested even before the declaration of insolvency by the competent court. In this case the competent court will verify the insolvency of the company at a later stage. Further to the request of admission, the Minister of Production, who is the procedure's supervisor, will designate by decree an extraordinary commissioner setting out his/her specific powers. Such decree must be

9 The date of declaration of insolvency of the company could be considered the date of the commencement of the Extraordinary Administration Procedure.

notified to the competent court within 3 days.

Once the company has been admitted to the procedure, no individual action may be brought by any creditor.

The extraordinary commissioner is in charge of running the company and managing its assets. He/she also carries out the duties entrusted to the preliminary commissioner (*commissario giudiziale*) under the Law on Extraordinary Administration. In particular, the extraordinary commissioner must notify the creditors of the company, and the parties who have security over assets in the possession of the company, of the deadline by which the company's creditors must file their statements of claim with the competent court.

Within 60 days from his/her appointment, the extraordinary commissioner files a report with the competent court together with the following documents: (i) accounting records, (ii) the balance sheets from the last 2 fiscal years, (iii) an updated financial statement, (iv) the list of the company's creditors and the sums due to them, (v) list of parties who have rights in rem over assets. The term of 60 days may be extended by the court upon request of the commissioner only once and for a period not longer than 60 days.

Within the above term, the commissioner may present to the Minister of Production the admission request of other companies of the group to the New Extraordinary Administration.

After ascertaining that the company is insolvent, the court will:

(a) appoint a judge in charge of the procedure (so-called "*giudice delegato*");

(b) invite the creditors of the company and the parties who have security over global change to "assets" to file their statement of the claims; and

(c) establish the date on which the hearing for the examination of the debts of the company will take place.

The extraordinary commissioner will submit, within 180 days from his/her appointment, the restructuring plan and a report including (i) the reasons which caused the insolvency, (ii) the status of the business, and (iii) the list of creditors, with the sums due to them and their priority rights, to the Minister of Production. The term of 180 days may be extended for a further 90 days.

If the Minister of Production does not authorise the implementation of the restructuring plan and there is no possibility to rescue the company through the sale of developing businesses according to the plan for the continuation of the company's operations (whose duration shall not be longer than one year), the court will declare the company bankrupt.

Within 15 days from the appointment of the extraordinary commissioner, the Minister of Production designates a delegated committee, composed of either 3 or 5 members, one or two of which (subject to the number of the members) is chosen from amongst the unsecured creditors. In practice, it appears that the 15 days term may be extended. The remaining members are experts in the type of business carried out by the insolvent company or experts in the insolvency field. The Minister of Production elects a chairman from the members of the delegated committee.

The delegated committee is a consulting body, whose comments and opinions are not binding. The committee issues comments/opinions on the actions of the extraordinary commissioner.

In addition to these powers, the delegated committee may:

(a) inspect, at any time, any financial document relating to the procedure and ask the extraordinary commissioner and the insolvent company for elucidations;

(b) request the Minister of Production to dismiss the extraordinary commissioner.

After being requested, the delegated committee issues its comments/opinions within 10 days, except when it is invited to respond earlier, for reasons of urgency. In any event, the delegated committee should be granted at least 3 days to submit its response. Its resolutions are passed by a majority vote of its members.

The extraordinary commissioner's restructuring plan may include an arrangement with creditors (the so-called "*concordato*").

The satisfaction of the creditors' claims by means of an arrangement can provide for the repayment of debts in any form, such as a debt to equity swap, or the allocation of ordinary or convertible debt securities. The arrangement can also provide for the incorporation of a NewCo to which the insolvent company will transfer all its assets and the shares of which will be distributed to the creditors of the debtor company in the context of a debt to equity swap. The distribution of shares in the NewCo to the creditors is achieved through a vehicle (so-called "*Assuntore*") to which the creditors have conferred all their claims against the insolvent company. The *Assuntore* confers the claims to the NewCo as an equity contribution and receives shares into the NewCo, which it distributes to the creditors in accordance with the terms of the arrangement.

The arrangement can formulate separate classes of creditors whose legal and financial interest is aligned (i.e. individual investors; bondholders etc.) and provide for a different treatment by class. A different treatment can also be provided for creditors of different corporate entities within the insolvent group. In the event the arrangement provides for a separate treatment, its fairness is subject to the government's scrutiny and must be approved by the Minister.

Once the Minister has approved the proposed arrangement, the extraordinary commissioner files the arrangement with the court, together with a motion to proceed by way of arrangement; in the next ten days the creditors can file their comments on the proposed list of creditors, the proposed list of claims and relevant amounts and ranking. Within the same time, the creditors excluded from the arrangement can file their claim with the court.

Within the following sixty days, the judge, assisted by the extraordinary commissioner, announces a provisional list of creditors and claims with the relevant amounts and ranking and the extraordinary commissioner notifies the creditors. The creditors in the provisional list are admitted to vote on the arrangement. The holders of securities that have been distributed to the public can be admitted as a class and there is no need to identify each security holder.

Those creditors excluded from the provisional list can appeal the relevant order issued by the court. Pending the appeal they are allowed to vote on the arrangement and will participate in the allocation of shares in the Newco. However, the bankruptcy judge may order that any shares issued to such excluded creditors are restricted. In that case the shareholder cannot sell those shares until the court has reached a decision on the appeal.

The arrangement will be finally approved by a vote of creditors representing the majority in the value of claims admitted to the provisional list. Voting takes place by post. A non-vote is considered to be a consent to the arrangement. In case of several classes of creditors, the arrangement must be approved by creditors representing a majority in the value of claims admitted to the provisional list for each class. However, even though the arrangement is approved by a majority of the classes of creditors, the court can still authorise the arrangement if it considers that in comparison with the alternatives, it does not prejudice the dissenting creditors.

If the required majority vote is reached, the court issues a judgment approving the arrangement; if such majority is not reached, the extraordinary commissioner must file all the necessary amendments for the arrangement to be approved. The judgment by means of which the arrangement is approved can also provide for the transfer of all the assets of the insolvency company to the NewCo (Assuntore) formed for the purpose of implementing the arrangement.

The judgment approving the arrangement is enforceable against all creditors whose claims arise prior to the judicial declaration of insolvency and can be appealed by the company, by the creditors and by the extraordinary commissioner within 15 days of being published. If the appeal is successful, the list of creditors and claims is amended accordingly, though such amendment will not affect the vote on the arrangement.

Once the judgment approving the arrangement is *res judicata*, the proceeding comes to an end.

In case the creditors reject the arrangement, the extraordinary administrator can file with the Ministry a divestiture plan which can be extended to a period of time as long as two years. If a divestiture plan is not promptly filed or the Ministry does not approve it, the court will issue an order to convert the extraordinary administration into an ordinary bankruptcy proceeding.

Upon the request of the extraordinary commissioner, the Minister of Production may authorise the transfer, use and lease of assets, real estate, businesses and ongoing concerns of the company with the aim of restructuring the company or its group.

The company may not grant security unless (i) it has been authorised by the bankruptcy judge; and (ii) it has also been authorised by the Minister of Production, if the security is for an undetermined value or for a value exceeding EUR 206,582.76.

When authorisation for the implementation of the restructuring plan has been granted, the extraordinary commissioner may also bring claw-back actions, if such actions benefit the creditors.

The procedure ends when its goals have been achieved, i.e. when the company, after the implementation of the plan, is back in a sound financial situation. Otherwise, the company will be declared bankrupt pursuant to the Italian Bankruptcy Act.

Compulsory Administrative Liquidation

This procedure is only available to public undertakings, insurance companies, banks and certain other regulated entities. The entities which can be subject to this procedure are specifically indicated by the law and generally they cannot be declared bankrupt.

Rescue Procedures

Pre-bankruptcy creditors' composition

The amendments to the Italian Bankruptcy Act have widened the access to the "*Concordato Preventivo*" (Pre-Bankruptcy Creditors' Composition) by eliminating:

(a) subjective requirements (insolvency status of the debtor; the registration in the companies' register for at least two years; no declaration of Bankruptcy in the previous five years); and

(b) objective requirements (grant of guarantee or security in order to secure the payment of at least

40% of the unsecured creditors) that were required under the Bankruptcy Act.

The amendments to the Italian Bankruptcy Act have also reduced the creditors' majority required to uphold a Pre-Bankruptcy Creditors' Composition.

Under the new article 160 of the Bankruptcy Act the proposal may provide that the creditors that hold a preference, a pledge or a mortgage are not satisfied in full on the condition that the plan provides for their satisfaction in an amount not lower than the best possible price which may be obtained from the winding-up taking into consideration the market value of the goods or rights on which there is the preference as estimated by a qualified consultant.

The Public Prosecutor must be informed that a Pre-Bankruptcy Creditors Composition petition has been filed.

Under the new article 177 of the Bankruptcy Act, the Pre-Bankruptcy Creditors' Composition petition must be upheld by the majority of the voting creditors. To the extent that the creditors are divided in different classes, the Pre-Bankruptcy Creditors' Composition petition must be upheld by the majority of the classes of the voting creditors. The creditors that hold a preference, a pledge or a mortgage for which the Pre-Bankruptcy Composition petition provides for their full satisfaction do not have to right to vote if they do not give up their preferential right.

Debt restructuring arrangements under the new article 182-bis of the Bankruptcy Act

The Amendments to the Italian Bankruptcy Act have introduced the so-called "*Accordi di Ristrutturazione dei Debiti*" (Debt Restructuring Arrangements), whereby an entity can enter into a composition with creditors (which is binding on all the creditors of such entity) provided that:

(a) the debt restructuring arrangement is agreed by creditors representing at least 60% of its debts; and

(b) the feasibility of the debt restructuring arrangements and the suitability of such arrangements to ensure repayment of those creditors which did not agree with such Arrangements is confirmed by an independent expert (who must have the requirements provided by article 67 d) of the Bankruptcy Act).

Within 30 days from the issue of the Debt restructuring arrangement the creditors and every other interested person can challenge it. The Court, after deciding on the challenges, homologates the Debt Restructuring Arrangement with a decree.

Pursuant to article 182 *ter* as modified by Legislative Decree 196/2007, it is possible to file a fiscal arrangement not only together with a of a Pre-Bankruptcy Composition with creditors but also together with a Debt restructuring arrangement. The fiscal arrangement enables the debtor to pay his fiscal debts partially and periodically.

Other issues

Directors' responsibilities

Duties imposed on directors apply equally to those who, although not formally appointed to office, carry out managerial activities or are involved in the running of the company.

Civil liability

Directors are jointly and severally liable for breach of their duties. However, a director must be blameworthy to share in this liability. Liability between the directors is divided according to the degree of fault and the damage caused; but where a director can establish his/her lack of blame for the breach, he/she will not be liable at all.

A claim may be brought against a director by the company, by a shareholder or by a creditor who has suffered a loss as a consequence of the director(s)' misbehaviour. If the company is bankrupt or subject to any analogous procedure, the claim may be brought by the receiver.

Where a director has committed an act or omission against the provisions of law or those of the articles of association (e.g. has failed to act with normal diligence in supervising the conduct of the company's affairs, or has failed to do his/her best to prevent the occurrence of prejudicial acts or reduce their harmful effects, or has acted with a conflict of interest), and the company suffers damage as an immediate and direct consequence, directors are personally and jointly liable to the company for the damage suffered. Directors must therefore be wary of simply resigning from a company in financial distress, as this will not be sufficient to discharge their duties.

Directors are liable to the company's creditors for non-observance of their duties concerning the preservation of the company's assets which results in loss to creditors. Shareholders or third parties who suffer damage which directly affects their interests as a result of a director's malicious or intentional act may be entitled to compensation.

Directors are under a duty to call a meeting without delay in the event that the equity capital has decreased by more than one third because of the company's losses. It is unusual for a court to find liability for this breach, due to the difficulty in proving causation. An alternative way to prosecute in this situation is to prove liability for negligent mismanagement in not having acted to prevent losses.

Directors may also be liable for violations which create an over or under valuation of company assets; for falsifying accounts to hide funds from the balance sheet; for failing to make necessary provision for the payment of taxes which causes the liquidation of the company; or failing to make social security payments to employees.

The courts have applied the civil liability regime to the de facto directors of a company, on the basis of a test of actual management of, or intervention in the management of, a company by a person who was not formally empowered to act as administrator of the company. Thus, in the event that a bank representative was found to have caused damage to a company acting as a *de facto* director of the same, the bank representative may be held liable to pay damages to the company.

Criminal liabilities

A director of company may be held criminally liable in respect of actions over the company's assets taken prior the bankruptcy of the company. The most important of these are where a company has:

(a) misused assets in order to prejudice its creditors - article 216 of the Bankruptcy Act;

(b) taken imprudent actions to delay the declaration of bankruptcy - article 217 of the Bankruptcy Act; and

(c) disguised its financial distress or its insolvency state in order to obtain financing (unlawful recourse to lending) - article 218 of the Bankruptcy Act.

The administrators and the liquidators of a company are also subject to these potential liabilities.

Claw-back

Any act of a company, which is subsequently declared bankrupt (including any payments and the granting of security), may be clawed back by the court at the request of the receiver if carried out during a "risk period". The amendments to the Italian Bankruptcy Act have halved all of the claw-back periods, such claw-back periods now amount to:

(a) 1 year, with respect to transactions at an undervalue, or involving unusual means of payment (e.g. payment in kind) or security taken after the creation of the secured obligations, whereby the creditor must prove his lack of knowledge of the state of insolvency of the relevant entity in order to rebut any claw-back action;

(b) 6 months with respect to security granted in order to secure a debt due and payable, whereby the creditor must prove his lack of knowledge of the state of insolvency of the relevant entity in order to rebut any claw-back action; and

(c) 6 months with respect to payments of due and payable obligations, transactions at arms' length or security taken simultaneously to the creation of the secured obligations, whereby the receiver must prove that the creditor was aware of the state of insolvency of the relevant entity in order to enforce any claw-back action.

It is important to underline the difference between situations provided by (a) and (b) above, that, in order to rebut any claw-back actions, the third party must demonstrate that he did not know that the debtor was insolvent whereas in (c) it is the receiver that must prove that the other party knew the debtor was insolvent.

Furthermore, with regard to paragraph (a) above, the amendments to the Italian Bankruptcy Act, expressly set out when a transaction is deemed to be at undervalue, i.e. when the asset or obligation given or undertaken exceeds by 1/4 the value of the consideration received by the debtor. The amendments to the Italian Bankruptcy Act have, therefore, incorporated the "1/4 principle" established by the Italian case law in order to limit any discretion of the Trustee or the courts.

The amendments to the Italian Bankruptcy Law have also established several exemptions to the application of the claw-back regime.

Under the new regime, a claw-back action cannot be filed in relation to:

(a) payments made within the ordinary course of business for assets and services at a market price;

(b) payments made into a bank current account, provided that such payments have not considerably reduced over a period of time the indebtedness of the bankrupt vis-à-vis the account holding bank;

(c) the sale of real estate for residential purposes at arms length, to the extent that such real estate is used as a main house by the buyer or his/her relatives and relatives-in-law;

(d) transactions involving payments as well as security taken over the assets of the debtor, provided that such payments were made or security was taken in order to implement a plan which is deemed "suitable" to redress the indebtedness of the debtor and to readjust its financial situation;

(e) transactions involving payments as well as security taken over the assets of the debtor, provided that such payments were made or security was taken so as to implement a Pre-bankruptcy Creditors' Composition, Controlled Management or the Debt Restructuring Arrangements (see paragraphs above);

(f) payments of the amounts due for the services carried out by the employees and the independent contractors of the debtor entity; and

(g) payments of due and payable obligations in order to obtain services which are auxiliary to the access to the Controlled Management and Pre-bankruptcy Creditors' Composition.

The exemption contemplated under (d) is of particular interest. The reference to the expert's report must be interpreted as a report assessing the reasonableness of the plan which is deemed "suitable" to redress the indebtedness of the debtor and to readjust its financial situation, e.g. in case of a refinancing plan (where there is no leveraged merger buy-out), the said report must assess the reasonableness of the plan as far as the reimbursement of the refinancing is concerned.

Esdebitazione

An important measure introduced by the reform is the discharge of some debts in the case of good conduct. This privilege is available only if the debtor is an individual and where some of the creditors have not been satisfied. The debtor may benefit from this procedure if:

- he has cooperated with the administrative bodies in the proceedings;
- he has not caused delay in the proceedings;
- he has complied with the order to provide the receiver with the correspondence concerning the relationships involved in the bankruptcy;
- he has benefited from the same procedure in the last ten years;
- he has not committed criminal offences such as the misappropriation of assets in order to prejudice creditors or the reporting of non-existent liabilities; causing or worsening the insolvency in order to make difficult the reconstruction of the assets and business, unlawful financing;
- he has not been convicted of fraudulent bankruptcy or offences against the economy, industry or commerce if there has been no rehabilitation for these crimes.

Security

Taking a security interest over an asset does not involve a transfer in ownership. Transferring an asset for the purposes of creating something analogous to a security interest is generally forbidden by law and any agreement to such an end is, in principle, null and void.

Security cannot be taken over leasehold interests, and floating charges are not possible (although a "*privilegio speciale*" – a special type of pledge not requiring delivery - may be analogous in some respects). The concept of a trust is not fully recognised by Italian law.

Security usually ranks in order of creation. Where registration is required, security will rank in order of registration. Certain creditors e.g. tax and social security authorities are preferred by operation of law.

Enforcement of Security – in general and in relation to bankruptcy

Other than in respect of pledges (where the parties can agree on specific

procedures for enforcement), enforcement of security is normally a court-supervised procedure, and is lengthy and bureaucratic.

The enforcement of a mortgage can only be requested on the basis of an enforceable right for a definite, liquidated and matured amount. Enforceable rights include enforceable judgments, bills of exchange and other credit instruments. Notice of the right to enforce must be served on the debtor together with the warning to fulfil its obligation within a term not shorter than ten days. Thereafter the creditor may request the sale of the charged asset. This sale is normally carried out by the court or a notary in accordance with the Italian Code of Civil Procedure.

Pledges can be enforced during bankruptcy proceedings provided that the secured creditor has filed its statement of claim with the court and the court has ascertained its secured creditor status. Thereafter, the secured creditor must request the authorisation of the judge in charge of the bankruptcy, who will establish the manner and timing of the sale. The judge may also authorise the official receiver to keep the pledged assets and to pay the secured creditors.

Security over real estate cannot be enforced independently of the general liquidation of the assets. The sale of the relevant real estate is made by the receiver, although the secured creditor has a priority right over the proceeds from the sale.

Guarantees

Guarantees are available in most circumstances. However, corporate benefit must be established if a company is granting a guarantee. This may take two different forms:

(a) the act must not be ultra vires i.e. must be within the objects of the company as stated in the by-laws; and

(b) any director and any shareholder having an interest in conflict with the interest of the company is not allowed to vote in the meeting on the issue.

These issues must be addressed and can effectively limit the amount that can be guaranteed (e.g. to the net worth of the guarantor). It can be particularly difficult to establish corporate benefit for upstream guarantees. However, some case law has recognised the existence of a "group interest" which goes beyond the interest of the single company. Such "group interest" can justify the granting of upstream guarantees, provided that the grantor obtained some benefit, even if indirectly.

Priorities

In a bankruptcy, the ranking of creditors is regulated by the Bankruptcy Act and the Civil Code. The order is, in summary:

(a) claims associated with the bankruptcy proceedings as set out in a specific legislation;

(b) debts secured by a pledge or mortgage;

(c) debts having a general privilege such as claims for salaries, social contributions, taxes; then

(d) unsecured debts.

The receiver must distribute the available funds to the creditors in accordance with a distribution plan that must be approved by the court. The bankruptcy declaration does not interrupt the increase in interest for claims secured by each kind of preferential right.

Recognition of Foreign Insolvency Proceedings

Within the EU

The Regulation applies; see first part of this note.

An entity that has its principal place of business abroad could be declared bankrupt in Italy even if the declaration of bankruptcy has been pronounced abroad. Although the principal place of business is abroad it may fall within the jurisdiction of the Italian Authority if it is transferred after the request for bankruptcy declaration.

Recognition of foreign insolvency proceedings outside the EU

The recognition in Italy of foreign insolvency proceedings from a non EU member State is subject to the jurisdiction of the Court of Appeal. These proceedings, known as "delibation" proceedings, are however avoided in cases where bilateral or multilateral conventions exists and establish an easier recognition process with less specific formalities.

LUXEMBOURG

Key Elements:

- Considers the two main types of insolvency procedure:
  - – Bankruptcy (*faillite*)
  - – Controlled management and suspension of payments (*gestion contrôlée and sursis de paiement*)
- The effects of insolvency proceedings on the rights of secured creditors
- Guarantees
- Ranking of creditors' claims
- Lender liability issues
- Directors' duties
- Recognition of foreign proceedings outside of the EU

General – insolvency procedures

The standard insolvency procedures for commercial companies are the bankruptcy proceedings (*faillite*). In addition, a controlled management and suspension of payments procedure (*gestion contrôlée et sursis de paiement*) exists.

A third type of proceedings, the pre-insolvency composition arrangements with creditors (*concordat préventif de faillite*) is only rarely used in practice and will not be analysed hereafter.

Specific insolvency procedures (such as for credit institutions, insurance undertakings or investment funds) are not analysed herein.

Controlled management and suspension of payments

These proceedings can be opened only upon the application of a commercial debtor if such person establishes that, its commercial creditworthiness is tainted, or that the integral performance of its obligation is at risk, and if it can show that the suspension of payments or measures of execution and the controlled management may allow it to reorganise its business and to return to a normal activity, or that such procedures will ensure a better realisation of its assets.

These proceedings are excluded (i) after bankruptcy proceedings (*faillite*) have been opened against the applicant, or_(ii)_if the court considers that such measures would not have the purported effect, or (iii) if the court becomes convinced during the proceedings that the applicant has in fact stopped being able to make payments (in which case bankruptcy proceedings may be opened immediately).

The procedure is subject to two different phases. During a first phase, while the management of the company stays in place, the company will in principle not be able to take any measures regarding its assets (in particular any measures of disposal) without the consent of the supervising magistrate appointed by the court. During this phase, the rights of creditors (including secured creditors except where specific laws provide differently) will be frozen. The approval of the appointed supervising judge will be required for all acts to be carried out by the debtor.

During a second phase, and following the nomination of a commissioner (*commissaire*), the approval of the commissioner will be required for either all or certain categories of decisions (as determined by the appointing judgment). The rights of creditors will continue to be frozen (as above). The commissioner draws up a reorganisation plan or a plan for distribution, which is subject to approval by a majority of creditors. It must then be approved by the court before becoming compulsory for the debtor and the creditors.

Bankruptcy proceedings (*faillite*)

Bankruptcy proceedings can be opened upon the application of either the bankrupt company itself, upon application of any creditor, or upon an ex officio decision of the court. The conditions for opening bankruptcy proceedings are the stoppage of payments (*cessation des paiements*) and the loss of commercial creditworthiness (*ébranlement du crédit commercial*). In addition, the failure of controlled management proceedings may also constitute grounds for opening bankruptcy proceedings.

As of the day of the opening judgment, the company's statutory officers (such as the board of directors) are divested of all powers to represent the company. The only legal representative of the company will be the bankruptcy receiver (*curateur*) who will be the only person entitled to take any decisions in relation to the assets.

The *curateur* is appointed by the Luxembourg court. There is no fixed duration for the bankruptcy proceedings, which will in normal circumstances last until such time as all claims have been verified, all assets have been realised, and distributions have been made to the creditors.

Counterparty's ability to exercise rights of termination under a contract with the debtor

The controlled management (*gestion contrôlée*) procedure provides in principle for the freezing of enforcement actions against the debtor during the establishment and until the adoption of the restructuring or liquidation plan or the rejection of the request. Termination clauses, declarations of default and subsequent acceleration are not effective against and do not prevent operation of the restructuring or liquidation plan. The suspension of these execution measures does not prevent creditors from establishing their rights (either by taking conservatory measures or by starting court actions), as long as they do not seek execution of their claims.

Security & proprietary rights

During a controlled management procedure, the rights of secured creditors, privileged or not, are frozen until a final decision has been taken by the court except in limited circumstances where specific laws maintain enforceability.

Furthermore, as soon as a controlled management procedure has been opened, even if the debtor keeps his proprietary rights and the management of its goods and chattels, it needs to be authorised by the supervising magistrate (*juge-commissaire*) and, after his appointment, the commissioner for a vast range of actions relating to its business, like selling goods (chattels and real estate), borrowing or lending monies, paying creditors and granting pledges or assignment of claims (the exact scope of which is determined by the opening judgment).

Specific provisions of Luxembourg (substantive) law on pledges authorise the pledgee to continue enforcement regardless of the state of bankruptcy or liquidation, or any moratorium affecting the pledgor. This provision is however not applicable to controlled management procedures.

The law dated 5 August 2005 on financial collateral arrangements disapplies the provisions of Luxembourg and foreign insolvency proceedings (including controlled management and bankruptcy proceedings), in relation to financial collateral arrangements. This concerns pledges, transfers of ownership for security purpose and repurchase agreements relating to financial instruments (including securities, shares, etc.) and claims (including receivables and bank account balances), regardless of the status of the parties (i.e., none of them needs to be a financial institution).

This applies to Luxembourg financial collateral arrangements but also (subject to certain additional conditions) to equivalent foreign arrangements.

Other rights

During the controlled management procedure (*gestion contrôlée*) all claims and enforcement actions against the debtor are suspended for all creditors, privileged or not except for creditors holding security interests under the 2005 law on financial collateral arrangements. A doubt may arise for contracts containing a reservation of title clause: bankruptcy law (*faillite*) has made such clauses valid and enforceable, but given the special scope and aim of the controlled management and suspension of payments procedure, it is doubtful whether the same rule will apply or if the special claim introduced by that law would be considered an enforcement action which is suspended until the end of the controlled management proceedings. Further analysis would be required with respect to specific types of contracts.

Guarantees

An insolvency receiver may have an interest in challenging guarantees granted by the insolvent company (in particular if the guarantee is secured). The first possible route would be to challenge guarantees entered into during the hardening period (a period preceding the opening of insolvency proceedings by a maximum of six months) if such guarantee was considered to be a gratuitous act or an act at undervalue or if the beneficiary of the guarantee had knowledge of the guarantor's stoppage of payments.

Alternatively, the insolvency receiver might want to challenge a guarantee on (i) the lack of corporate benefit for the guarantor to grant the guarantee, and (ii) that the guarantee was granted for the personal benefit of one of the directors of the guarantor. In such case, the granting of the guarantee may possibly be assimilated to an abuse of corporate assets and, if established, could ultimately lead a court to declare the guarantee unenforceable.

Whether or not an abuse of corporate assets, the corporate benefit problem arises and as a question of fact that needs to be assessed, by the directors of the guarantor, on a case-by-case basis when entering into the agreement. Luxembourg law does not specify when there will be sufficient corporate benefit to permit the granting of a guarantee within one and the same group. In general, a company may grant guarantees to another company belonging to the same group if there is some common economic, social or financial benefit with regard to a common group policy. Even in these circumstances guarantees may not be granted without economic advantage nor if they upset the balance of commitments between the companies concerned. In addition guarantees may not exceed the financial means of the guarantor (often expressed as a percentage of net asset value/funds of the company.)

Very often, downstream guarantees are considered not to give rise to problems. For upstream and cross-stream guarantees, corporate benefit issues may arise. A possible manner to deal with this could be to require the amount guaranteed to be limited but, depending on the circumstances, other solutions might exist and, also, this solution alone may not always be sufficient.

Hardening periods

Security interests may be challenged if they are granted during the hardening period (a period preceding, except in certain circumstances, the actual opening of bankruptcy proceedings by a maximum of six months and ten days) preceding the opening of insolvency proceedings of the grantor (except for security interests governed by the 2005 law on financial collateral arrangements, as stated above). If the security is successfully challenged it is unenforceable. Where security has been enforced, such enforcement may be undone.

If a new pledge or mortgage was granted to secure debt obligations which already existed and that pledge or mortgage was granted during the hardening period, the security will not be enforceable.

Luxembourg law provides for the unwinding of all payments and transactions for consideration where the party to the transaction was aware that the debtor stopped payments, if they took place during the hardening period.

Security will not be enforceable if there was a fraud on the creditors of the company regardless of the date.

Priority

There are complex rules on priority in insolvency. It is generally considered that certain creditors having general rights of preference (such as the preference rights for judiciary fees (including the fees and costs of receiver/liquidator), unpaid salaries, and various tax, excise and social security contributions) may rank ahead of creditors having a security interest over certain assets (in particular if the enforcement is not done by the creditor himself but by a third party such as the insolvency receiver).

In relation to pledges, there is a risk that preferential creditors may, depending on the circumstances, rank ahead of a pledge. This risk does not exist in relation to transfers of ownership for security purposes.

Lender liability

Lenders can be held liable if they have continued to lend in circumstances where the debtor is already in a suspension of payments or its financial position has deteriorated to an irreversible state. The lender is therefore deemed to be adding to the debtor's liabilities and reducing the likelihood of it being rescued (in particular if the lender is considered to have created - or allowed to be created – a false appearance of creditworthiness). In addition, liability may arise where the lender is acting as shadow director.

Directors' duties

Directors are liable towards the company for any wrongdoing or negligence in the management of the company. They are furthermore liable towards third parties as well as towards the company for any losses suffered as a result of a violation of the company's articles or company law.

Directors may be criminally liable for any abuse of corporate interest they may have committed (Article 171-1 of the Company Law). Other criminal offences such as *banqueroute* and *banqueroute frauduleuse* with respect to actions taken in the context of or having lead to the insolvency of a company also exist. In particular, directors are obliged to file for bankruptcy within one month of cessation of payments.

Bankruptcy proceedings may be extended personally to directors having, in particular, made use of the company's assets for their personal purposes or pursued, for personal reasons, the activity of a company that inevitably leads to its insolvency.

Recognition of foreign insolvency proceedings

Within the EU

The Regulation applies, see first part of this note.

Recognition of foreign insolvency proceedings outside of the EU

As a general principle foreign insolvency proceedings regularly opened in another state not being a member state, are recognised directly without any specific formalities except to the extent such recognition would require local enforcement measures, in which case formal recognition needs to be sought from the Luxembourg courts.

BELGIUM

Key Elements:

- Considers the two main types of insolvency procedure:
  - – Bankruptcy
  - – Judicial composition
- Looks at the impact of insolvency on the rights of third parties
- Deals with the challenges that can be made to transactions made within the “suspect period”
- Directors’ duties
- Intra-group transactions
- Recognition of foreign insolvency proceedings outside of the EU

General – insolvency proceedings

There are two types of court-controlled insolvency proceedings under Belgian law, bankruptcy and judicial composition (the Belgian moratorium procedure). An insolvent debtor may also with the agreement of its creditors proceed to a voluntary liquidation.

Bankruptcy

Bankruptcy proceedings facilitate the liquidation of the debtor’s assets and the distribution of the proceeds amongst its creditors. A debtor must (and the creditors and the public prosecutor may) file for bankruptcy when it has consistently stopped paying its debts as they fall due and no longer has credit available to it. A company is declared bankrupt by a judgment of the court. Upon the declaration of bankruptcy, the directors’ powers lapse and a court-appointed liquidator takes control over the company.

Judicial composition

Judicial composition proceedings offer creditor protection and allow a distressed debtor to restructure its business. A composition may be granted to a debtor with temporary payment problems or facing difficulties that could lead to its insolvency, but only if it has reasonable recovery prospects. Only the debtor and the public prosecutor can initiate composition proceedings. The debtor in principle retains its management powers but will be supervised by a court-appointed composition commissioner.

The debtor must devise and, if approved by more than half of the creditors in both number and value, implement a recovery plan, which may include measures to reduce or reschedule liabilities, swap debt into equity or sell all or part of the debtor’s business. An approved recovery plan binds dissenting creditors, including secured creditors, provided that the plan provides for payment of interest on their claims and repayment of their claims is not suspended for more than eighteen months.

Voluntary liquidation

A voluntary liquidation may be used as an alternative to court-controlled insolvency proceedings, provided that it is supported by a sufficient consensus among the creditors. A liquidator is appointed by the shareholders to liquidate the assets of the debtor to satisfy the creditors’ claims. The commercial court must confirm the appointment. Before completion of the liquidation, the liquidator must submit the proposal for distribution of the proceeds to the commercial court for approval.

Counterparty’s ability to exercise rights of termination under a contract with the debtor

Bankruptcy

The existing agreements to which the debtor is a party are not automatically terminated by virtue of the bankruptcy, but:

(a) The counterparty may terminate an agreement with the debtor during a bankruptcy if the agreement gives it the right to do so. An event of default or right of termination triggered by an application for or declaration of bankruptcy is valid and enforceable.

(b) The liquidator has the power to terminate any existing agreement. The counterparty may demand that the liquidator make his decision whether to terminate or continue a contract within fifteen days. If no decision is taken within that time, the agreement is deemed terminated by the liquidator. If the liquidator decides to continue an existing agreement, newly accrued payment obligations of the debtor under the agreement will be accorded a “super-priority” and will be paid first out of the proceeds of the bankrupt’s estate.

Judicial composition

The application for, or grant of judicial composition to a debtor does not by itself terminate existing agreements. In fact, the application for or grant of judicial composition cannot be the reason for the termination. It does, however, remain possible for a counterparty to terminate an agreement if the contract gives it the right to do so, and if the termination is not abusive. A termination will be abusive if, although ostensibly motivated by reasons other than the application for the judicial composition, it is in fact motivated by the application for judicial composition.

Voluntary liquidation

The commencement of liquidation proceedings does not terminate the existing agreements of a debtor. Contractual termination by the parties remains possible, even if the termination is motivated by the liquidation.

Proprietary rights security

Bankruptcy

Upon bankruptcy, all enforcement action against the debtor is suspended, except that notwithstanding the bankruptcy:

(a) Secured creditors (mortgagees, pledgees and holders of floating charges) can enforce their security after completion of the bankruptcy claims verification process (this is the process where the liquidator checks all submitted claims against the books and accounting records of the debtor). This normally implies for these creditors a stay of enforcement of about two months. In addition, the liquidator may ask the court to suspend individual enforcement for a maximum period of one year from the bankruptcy judgment, during which time the liquidator himself may sell the assets which are the subject of the security, if this is in the interest of the bankrupt's estate, and if this course of action is not detrimental to the secured creditors.

(b) Owners can claim repossession of their goods in the debtor's possession. This includes lessors who are thus not subject to a stay of enforcement. Claims for repossession must be filed prior to the completion of the bankruptcy claims verification process, failing which the ownership right may be lost. Special requirements apply to retention of title clauses.

(c) Security over assets in other jurisdictions remains enforceable in accordance with local rules.

(d) Contractual set-off arrangements remain enforceable.

(e) Security over financial instruments and cash accounts remains enforceable.

Rights of enforcement against third party guarantors or security providers are not affected by the suspension.

Judicial composition

Upon grant of a composition, all pre-composition debts are frozen but the debtor must still pay interest and charges on the frozen debts. New liabilities must be paid by the debtor on their due date and, if contracted or accrued by or with the endorsement of the composition commissioner, will be payable ahead of all ordinary and, in special circumstances, secured creditors, if the debtor subsequently becomes bankrupt.

During composition proceedings, all enforcement action against the debtor in respect of pre-composition debts is suspended, except that notwithstanding the composition:

(a) Security over assets in other jurisdictions remains enforceable in accordance with local rules.

(b) Contractual set-off arrangements remain enforceable.

(c) Security over financial instruments and cash accounts remains enforceable.

Rights of enforcement against third party guarantors or security providers are not affected by the suspension. Security may be discharged by reason of a court authorised sale of the debtor's business in the context of a composition, in which case the security will attach to the proceeds of the sale of the relevant assets.

Voluntary liquidation

A liquidation does not trigger any automatic stay of enforcement. Creditors will need to refrain voluntarily from taking action against the debtor in order not to frustrate a successful liquidation.

Voidable transactions

The Belgian bankruptcy law contains voidable preference rules that challenge certain actions made by or with a bankrupt debtor during the pre-bankruptcy suspect period of up to six months. The following actions and payments are caught by the voidable preference rules:

(a) Disposals of assets made without consideration, or at a significant undervalue.

(b) Payments made in respect of liabilities that were not yet due and payable.

(c) Payments in kind, unless the payment in kind is an agreed enforcement method of a financial collateral arrangement.

(d) All transactions with a counterparty who had knowledge of the insolvency of the debtor.

(e) New security granted for pre-existing debts.

Directors

Belgian company law imposes certain duties on the formal directors of a company by virtue of their office. Generally, officers who do not hold a directorship must duly perform and execute their employment contract with the company but the company law does not impose any other specific legal duties on them. Belgian company law does not impose positive duties on shadow directors, but specific liabilities attach to shadow directors who as a matter of fact hold managerial power in a company.

As agents of the company, the directors owe their duties primarily to the company. Yet, the improper execution of their mandate in certain circumstances exposes the directors to liability to third parties for losses suffered as a result. In principle, any person other than the company can be an interested third party, save that a shareholder of the company will often not be able to bring an individual claim as a third party because his interests are, unless proven otherwise, deemed to be identified with the interests of the company.

Under Belgian company law, directors have a duty to act in the best interest of their company and to promote its corporate object. In particular, directors have:

(a) A duty of care as director

Directors are liable to their company for the improper execution of their mandate. The requisite standard of care and skill is that of a reasonably prudent and diligent businessperson. The courts have only limited review powers and may not second-guess business decisions. Only obviously unacceptable behaviour can trigger the directors' personal liability. An action for liability on the basis of a breach of the duty of care can only be brought by the company, or the company's liquidator upon insolvency.

(b) A duty to abide by the company's statutes and the company law

Directors are liable to the company and to third parties on a joint and several basis for breaches of the company's statutes or the company law. Examples include a violation of the publication rules relating to certain corporate information, a breach of the conflicts of interest rules, a failure to comply with the procedures applicable to important losses of shareholder equity etc. An action for liability on the basis of a breach of the statutes or the company law can be brought either by the company or by third parties who have incurred a loss as a result of the breach.

(c) A general duty of care

Like any other person, directors may be liable in tort for wrongful acts which cause damage to someone. An action for liability in tort can be brought by any person who has suffered a loss as a result of the tortious act, but can only in limited circumstances be instituted by a person who also has a contractual relationship with the tortfeasing director (such as, for instance, the company).

(d) Specific liability upon bankruptcy

A specific form of liability applies in the case of bankruptcy of a company with insufficient assets available to meet the liabilities. The directors, former directors or shadow directors of the bankrupt company may, if they were grossly negligent in a way that contributed to the bankruptcy, be held personally liable for all or part of the liabilities of the company up to the insufficiency of the assets.

(e) Liability for failure to prepare and submit proper financial statements upon bankruptcy

The Belgian bankruptcy law provides that the liquidator of a bankrupt company must upon his appointment proceed with the auditing and correction of the financial statements of the company. If no financial statements are available, or if substantial corrections are required, the directors may be held personally liable for the costs of preparing or correcting the financial statements.

General issues

Intra-group transactions

The same duties as set out above must be observed in connection with intra-group transactions. In addition, the directors should ensure that the intra-group transactions are on arm's-length terms and that intra-group services are remunerated at a normal market price. It should be noted that mandatory conflicts of interest procedures apply to situations where a director has a direct or indirect personal financial interest in a proposed transaction with his company (this could for instance be the case of directors holding an equity participation in the counterparty of the intra-group transaction).

Ongoing compliance obligations

Directors must comply with a number of ongoing obligations, such as to hold regular board meetings, to draw up and publish annual accounts and to file tax returns, etc. These obligations give rise to various criminal penalties and possible civil liability. In difficult times or in the period leading up to insolvency, these obligations often tend to be neglected. Irregularities in respect of these obligations may alert the bankruptcy monitoring service of the commercial court which conducts preventative investigations into financially troubled companies.

Obligation to propose liquidation to shareholders meeting

Belgian company law requires the board of directors of a company, when as a result of losses suffered, net equity falls below half of the company's share capital, and again when it falls below a quarter of the share capital, to call a meeting of shareholders which must decide whether to continue the operations of the company or to cease the operations and liquidate the company. Failure to do so in principle triggers the liability of the directors in respect of all liabilities that continue to arise or accrue after the date when the shareholders meeting should have been held. This means in practice that the directors should on a regular basis assess the net equity position of their company.

Recognition of foreign insolvency proceedings

Within the EU

The Regulation applies, see the first part of this note.

Recognition of foreign insolvency proceedings outside of the EU

A judgment obtained in foreign insolvency proceedings that falls outside the scope of the Regulation would be recognised and enforced by the courts of Belgium without review on the merits and subject to certain conditions, which mainly require that the recognition or enforcement of the foreign judgment should not be a manifest violation of public policy, that the foreign courts must have respected the rights of the defendant, that the foreign judgment should be final, and that the assumption of jurisdiction by the foreign court has not breached certain principles of Belgian law.

GERMANY

Key Elements:

- Considers the rules applicable to:
  - – liquidation
  - – reorganisation
- Test for insolvency
- Priority of payment and preferential creditors
- Potential liabilities for directors
- Guarantees
- Lender liability
- Capital maintenance rules
- Set-off issues
- Equity replacement
- Antecedent transactions

Insolvency regimes

The German Insolvency Code (*Insolvenzordnung*), which applies to all types of company, contains rules on the liquidation as well as the reorganisation of a debtor's business. In general, the Insolvency Code provides for uniform insolvency proceedings, which means that the commencement of proceedings does not depend upon the type of proceedings the petitioner intends to initiate. Whether the debtor is to be liquidated or reorganised will be determined by the creditors several weeks after the petition has been lodged.

The Insolvency Code is based on the concept of creditor independence. In the course of the proceedings all major decisions are taken or must at least be approved by the creditors. In some instances, however, the insolvency court may repeal resolutions passed by the creditors.

The insolvent company's business can be reorganised by transferring the valuable assets to a NewCo which can then be sold with the proceeds distributed to the creditors. The Insolvency Code also provides comprehensive rules regarding an "insolvency plan" (*Insolvenzplan*) through which the company as such can be reorganised if this seems feasible.

The Insolvency Code also allows for the management of the distressed company to continue to manage the company (*Eigenverwaltung*) under certain conditions. A specific creditors' trustee is appointed to monitor them in the interest of the creditors. This is comparable to debtor-in-possession proceedings.

German insolvency law does not recognise insolvency proceedings covering groups of companies. In general, insolvency proceedings are commenced for each company separately.

Test for Insolvency

The Insolvency Code lists three trigger points for the commencement of insolvency proceedings: illiquidity, impending illiquidity and over-indebtedness.

Illiquidity is defined as the debtor's inability to honour his payment obligations (now) due. This is generally indicated by the fact that the debtor has ceased to make payments. The debtor's illiquidity cannot be presumed if there is only a temporary delay in payments, for example, when the debtor's gap in liquidity can be closed by expected payments, new loans or the liquidation of assets within a short period of time (usually no more than two weeks). A petition for the commencement of insolvency proceedings on grounds of illiquidity may be made to the appropriate local court (*Amtsgericht*) either by the insolvent person or by a creditor.

Impending illiquidity means that the debtor will not be able to honour existing payment obligations when they become due. Since this is based on a prognosis, the court may require the debtor to submit a "liquidity plan". A petition on the grounds of impending illiquidity may only be filed by the insolvent debtor.

Insolvency proceedings based on over-indebtedness may only be commenced against legal entities. The debtor is over-indebted when its assets no longer cover its liabilities. This is determined by way of a pre-insolvency balance sheet which must value assets at their present liquidation values. These liquidation values may be replaced by going-concern values if, through submission of a continuation forecast, the company demonstrates that the financial strength of the company is sufficient to ensure its economic survival at least for the current and the following business year.

A petition for the commencement of insolvency proceedings on grounds of over-indebtedness may be made either by the insolvent company or by a creditor.

The court will only make an order initiating insolvency proceedings where sufficient assets are available in the estate to cover the costs of the proceedings. These costs include court fees and the estimated fees and expenses of the preliminary administrator, the administrator and the members of the creditors' committee. If the debtor's assets are not sufficient to cover these estimated costs, the court will dismiss the petition unless an adequate advance payment in cash is made.

Insolvency proceedings

There are two distinct periods in the course of insolvency proceedings.

The first begins with the filing of the petition and usually lasts up to three months (so-called "Preliminary Proceedings"). The purpose of Preliminary Proceedings is to allow the court to gather all the information necessary to determine if the prerequisites for commencing insolvency proceedings are met. In general, the filing of a petition, and thus, the beginning of Preliminary Proceedings, does not affect the legal relationship between the creditors and the debtor by, i.e. triggering a moratorium. The insolvency court may - and will in practice - however, take any measures that appear necessary to protect the debtor's estate against any adverse change in the debtor's position until a decision with respect to the petition has been taken. Those measures usually include the appointment of a preliminary administrator (*vorläufiger Insolvenzverwalter*) and an order stipulating that transfers shall only be effective with the consent of the preliminary administrator and/or an order preventing creditors from executing their claims individually into the debtor's assets (unless immovables are concerned). The preliminary administrator is not allowed to begin the liquidation of the debtor's business without the court's prior consent.

Preliminary Proceedings end when a court order initiating the commencement of the actual insolvency proceedings is made. An administrator (*Insolvenzverwalter*) will generally be appointed. The order also leads to a general stay of execution with regard to the claims of all creditors. Creditors may now only pursue their claims according to the provisions governing insolvency proceedings. In addition, any security interest which has been created by execution within one month prior to the filing of the petition will be void.

The administrator is in charge of managing the debtor's business and making all necessary dispositions with respect to the estate. However, before entering into transactions which substantially affect the estate, he must obtain the consent of the creditors. The final decision whether to liquidate or reorganise the debtor's business also remains with the creditors. If the company is wound up, the administrator is then responsible for distributing the proceeds to the creditors.

The Insolvency Code also contains a separate section dealing with self-management, or debtor-in-possession proceedings. If the debtor has applied for self-management and it is considered that this will not result in any disadvantage to the creditors, the court may order that virtually all responsibilities with respect to the estate remain with the debtor. In this event, the powers of the appointed trustee are generally limited to the supervision of the debtor's economic circumstances, the debtor's management and personal expenditures.

Creditors' meetings are summoned by the insolvency court. The court sets a date for a first creditor's meeting, the information hearing (*Berichtstermin*), usually between six weeks and three months after the court order opening insolvency proceedings. At the information hearing, the administrator reports on the debtor's business situation and the causes of insolvency. He also reports on the possibility of reorganising the debtor's business by means of an insolvency plan. The creditors decide whether the debtor's business is to be terminated or provisionally continued. The creditors may also instruct the administrator to prepare an insolvency plan. The creditors may later reverse or amend their initial decisions. To adopt a resolution more than 50% by value of those creditors voting must be in favour. The court will also set a date for the examination hearing (*Prüfungstermin*), at which registered claims are examined to determine their value and rank. This meeting takes place between one week and two months after the date on which the period for registering of claims expires. The court may decide that the examination hearing, and the information hearing will take place together.

Insolvency plan

Under the Insolvency Code there is now a provision for the implementation of an insolvency plan (*Insolvenzplan*). The objective of such a plan is a solution by consent, normally involving the restructuring of the existing company, although such a plan may also be used to liquidate a company.

An insolvency plan can be set up and submitted to the insolvency court by the administrator or the insolvent person. It can be adopted at any stage in the insolvency proceedings. There are few rules regarding the content of the plan (it is effectively a "contract" between the parties) although the Insolvency Code does regulate the formal make-up of such a plan. The Insolvency Code requires the creditors to be divided into groups for the sake of the plan. Such creditor groups or classes can be treated differently by the plan if good grounds exist. Within each group they must be treated equally.

The adoption of the insolvency plan is subject to the agreement of all creditor groups. The majority of creditors in each group must consent and these creditors must hold more than half of the claims within the group. In the event that a creditor group does not consent, the plan may still be adopted if the insolvency court establishes that the creditors of the non-concurring group would not be worse off with the plan than without the plan and the creditors of the non-concurring group have a reasonable share of the economic benefits of the plan. Once agreed, the insolvency plan must be confirmed by the insolvency court in order to come into effect.

The execution and termination of the insolvency plan takes place according to its own provisions and is not part of the statutory insolvency proceedings. After the insolvency proceedings are terminated, the debtor recovers the power to dispose of its assets.

Priority of payment and preferential creditors

Under German insolvency law, there are five different types of creditors. They may be distinguished by their degree of participation in the insolvency proceedings, the extent to which their claims are secured and the rank of their claims within the order of priority.

(a) Creditors with rights to the segregation of an asset (*Aussonderungsrecht*), such as in the case of goods subject to retention of title or (depending on the specific trust agreement) held by the debtor as trustee, can separate these assets from the estate. However, the administrator has powers to prevent a creditor from exercising its right to segregation of goods subject to retention of title by agreement assuming the executory contract.

(b) Creditors of the estate (*Massegläubiger*) do not participate in the actual insolvency proceedings, i.e. their claims will neither be registered nor examined within the proceedings. Claims of creditors of the estate include administrator's costs and liabilities and court costs, liabilities incurred by activities of the administrator, liabilities resulting from executory contracts that have been assumed and liabilities arising from the unjust enrichment of the estate.

(c) Creditors with a right to separate satisfaction (*Recht zur abgesonderten Befriedigung*) are creditors who participate in the insolvency proceedings, but at the same time are secured by collateral that constitutes part of the estate. The right of separation allows such secured creditors to claim the proceeds (in case of the realisation of security over moveable assets in the possession of the insolvency administrator or claims by an insolvency administrator less certain fees of usually some 9% on the proceeds payable to the estate) generated on the realisation of the collateral up to the amount of their secured claim. Any surplus belongs to the estate.

(d) Insolvency creditors (*Insolvenzgläubiger*) are unsecured creditors who have an established claim against the debtor at the time of the opening of the insolvency proceedings. The assets of the estate which remain after the claims of the creditors of the estate have been completely satisfied are distributed pro rata among all insolvency creditors. One of the major reforms of the Insolvency Code was to include employees and tax authorities in this group, who had previously enjoyed preferential status.

(e) The claims of subordinate insolvency creditors (*nachrangige Insolvenzgläubiger*) have the lowest priority among all claims in the proceedings. They are only satisfied after the claims of all insolvency creditors have been completely satisfied. Claims of subordinate insolvency creditors include claims for reimbursement of a shareholder's equity-replacing loan or similar claims, and claims for which subordination in insolvency proceedings has been agreed upon between creditor and debtor.

Directors' liabilities

As soon as the directors of a company have reason to believe that the company is in financial difficulties they are legally required to establish the extent of such difficulties and to continue to keep the company's financial situation under review. In particular, they are obliged to ascertain whether the company has already lost half of its share capital or whether grounds exist for opening insolvency proceedings.

If the company's equity has been reduced to half or less of its share capital, the directors are required to inform all the company's shareholders immediately. Failure to do this may lead to personal civil liability for the directors and constitutes a criminal offence punishable by imprisonment of up to three years.

If a company is illiquid or over-indebted the directors have a duty to file a petition for insolvency without undue delay and within a maximum of three weeks. If attempts to rescue the company during the three week period fail, the directors have to file immediately. Failure to do so can result in criminal sanctions. In addition, they may be personally liable to the company and its creditors for any losses incurred due to the delay in filing. Note that each director is individually responsible for filing the petition.

In the case of impending illiquidity, the directors are entitled, but not obliged, to file a petition for the initiation of insolvency proceedings. However, it should be noted that directors who apply for insolvency proceedings prematurely (before they have explored all other possibilities) risk being personally liable to the company and its shareholders. An application for insolvency proceedings based only on impending illiquidity should not therefore be filed unless the shareholders, by means of a formal shareholders' resolution, have consented to the application or issued instructions to that effect.

Directors who enter into new agreements on behalf of the company which the company is unlikely to be able to fulfil, without informing the other party of the company's financial situation, risk being held personally liable for any damages arising. Entering into any such agreement may also constitute a criminal offence.

In principle, the directors are required to reimburse the company for any payments which they make to third parties out of the company's assets after the company has become over-indebted or illiquid, unless such payments would have been made by a prudent businessman in similar circumstances.

Directors may be liable for payments made to shareholders while the company is in financial crisis or if they make dividend payments in contravention of capital maintenance rules under company law. Supply, service or similar agreements will also be carefully scrutinised to ensure they were made on an "arms length" basis.

Guarantees

Downstream guarantees are available in most circumstances. Upstream and cross-stream guarantees are subject to capital maintenance rules under company law. To avoid liability risks for its directors, a limited company (GmbH) will normally require documentation to be drafted so as to limit its obligations to any amount over and above its statutory capital.

If a public company (AG) grants an upstream or cross-stream guarantee, this may be regarded as a return on capital in breach of maintenance of capital rules even though its statutory capital remains untouched. An AG can usually only enter into a guarantee on the same terms as a third party would enter into such a guarantee (e.g. by being paid a market rate fee). A guarantee by an AG to secure acquisition of its own shares would be generally void under financial assistance provisions.

There is no need for a company to show corporate benefit when entering into a guarantee.

Lenders' liability

Lending to a distressed borrower

German case law and legal literature do not consider the granting of a loan to a company in a crisis to be contrary to public policy, if it can be seen as a restructuring loan granted after a careful and competent assessment of the viability of a restructuring plan. Only under specific circumstances can lenders be held liable for third party damages incurred as a result of a delay in filing for insolvency (*Insolvenzverschleppung*), based on the overriding legal principle of violation of moral principles (*Sittenwidrigkeit*). In order to be held liable the lenders must have acted in a way which is incompatible with good faith. Such incompatibility with good faith may be assumed if new credit is granted which, in the end, does not help to overcome the crisis but only delays the debtor's insolvency. In such a case, there is also a risk of criminal liability through aiding and abetting the directors' delay in filing for insolvency.

If lenders are liable for third party damages under the above principles, creditors who had existing claims against the company before the granting of a new loan can be entitled to compensation equal to the amount by which the dividend they receive in the company's insolvency is reduced as a result of the delay. Creditors whose claims arose after the credit was granted can be entitled to full compensation.

To avoid the risks described above, the lender will have to examine carefully the chances of a reorganisation of the borrower. A plausible business plan (*Sanierungsplan*) together with a work-out opinion will be necessary, which must demonstrate that the company will be able to survive in the medium term if certain measures are met. Furthermore, a binding commitment by the parties involved in these measures will be required.

This business plan is usually drawn up by independent accountants. To avoid a risk of becoming liable for exerting harmful influence (e.g. shadow directorship), it should normally be ensured that the borrower itself appoints the accountant.

As it requires some time to prepare a restructuring plan and obtain an expert opinion on the feasibility of such plan, a bridging loan (*Überbrückungskredit*) to a company in crisis will not generally be considered contrary to public policy. Such a loan will not result in the lender being held liable if it is made in order to prevent illiquidity during the period required for the preparation and examination of the restructuring plan. However, the purpose of such a loan must only be to provide bridging finance during the time required to assess the feasibility of a restructuring of the company. A loan granted only to postpone insolvency and to enable the lender to improve its own position in comparison with other creditors would be considered contrary to public policy and could result in liability for the lender.

Control of borrower

In general a lender will not be liable vis-à-vis the borrower and/or its other creditors, provided that the borrower retains control of its operations.

However liability may arise for the lender if:

(a) the lender deprives the borrower's management of its power to act for the company; or

(b) a person close to the lender (or the lender itself) assumes management powers; or

(c) a person close to the lender (or the lender itself) exerts substantial influence on the borrower.

In order for liability to arise, the lender's influence must be substantial and, ultimately, comparable to the influence of a shareholder.

Equity-replacement and capital maintenance rules

Treatment as equity

A loan by a shareholder (either direct or indirect) to a company may be recharacterised as equity if the loan is made when the company is in crisis. If the loan was made at a time when the company was not in a crisis then, as a general rule, it is only susceptible to recharacterisation if the shareholder fails to make use of any right to call for repayment of the respective loan upon becoming aware of the crisis. The existence of a crisis is established with reference to, *inter alia*, the inability of the company to raise a loan from a third party at market rates.

These rules generally apply to any transaction encompassing the provision of credit by a direct or indirect shareholder.

If a loan is treated as equity, repayment of the principal and interest cannot be claimed if, and to the extent, the nominal share capital would be affected. Furthermore, collateral granted by the debtor cannot be realised.

In the event of a crisis, the shareholder's claim deriving from the re-characterised loan or legal act would be subordinated to claims of creditors of the company by operation of law.

Capital maintenance rules

The nominal share capital for a *Gesellschaft mit beschränkter Haftung*, or abbreviated GmbH, the most common corporate vehicle in Germany, is set out in its articles of association and registered in the Commercial Register of the company. The share capital must be maintained as a fund for creditors. As such, any payment by the company to the shareholder may only be made to the extent that such payment does not impair the company's nominal share capital. Please note that according to recent case law of the German Federal Court, this prohibition applies regardless of whether the company has a valuable repayment claim against its shareholder due to this payment. Payments to the shareholder made in violation of the above rule have to be reimbursed to the company. Similar rules apply to other incorporated German entities. Payments in the above sense are not only cash payments but also any transaction indirectly causing a contribution to the shareholder that would impair the company's nominal capital.

Furthermore, recent case law of the German Federal Supreme Court held that the shareholder of a GmbH has a responsibility not to deprive the company of the liquidity necessary to continue its business. Failing to comply with this obligation may expose the shareholder (besides the acting managing director) to personal liability for damages.

Antecedent transactions

Transactions entered into prior to the filing of insolvency proceedings may be subject to insolvency avoidance rules within certain hardening periods. Within these hardening periods, a transaction may be declared void and unenforceable if it could be considered detrimental to other insolvency creditors. Any of the debtor's assets of which the estate has been deprived by means of a voidable transaction are to be returned to the estate.

For example, the following situations can lead to avoidance, described below with regard to the assignment of security:

(a) Any security given whilst the entity is in a position of illiquidity can be avoided if the beneficiary knew at the time of the taking of the security that the security provider was illiquid or if he had knowledge of circumstances that could lead to this conclusion. In these circumstances, the hardening period is three months prior to the filing of a petition for the commencement of insolvency proceedings.

(b) Security given which the security provider was not legally (e.g. contractually) obliged to assign. The hardening period is a minimum of one month, but an extended hardening period of up to three months prior to the filing of a petition for the commencement of insolvency proceedings applies if the security is given either at a time when the person providing the security is in a condition of illiquidity or if the beneficiary knew that the granting of the security would be detrimental to other creditors.

(c) Gratuitously given security: Third party security may be classified as having been gratuitously given on the grounds that the chargor itself receives no consideration or derives no benefit from the security assignment. The hardening period is four years.

(d) Intentional harming of other creditors: The security can be avoided if the granting of security by the insolvent company was directly detrimental to creditors and was perceived to "intentionally harm creditors" and if the beneficiary had knowledge of such. The hardening period is ten years.

(e) Taking of security by a person (or entity) with a close relationship to the debtor: Such security could be avoided if the granting of security by the insolvent company was directly disadvantageous to creditors, unless the beneficiary is able to show that he was unaware of the debtor's intention to act in a way that was detrimental to other creditors. The hardening period is two years.

Set-off

The general rule is that set-off which was available to a creditor prior to the initiation of insolvency proceedings remains available afterwards.

In the case where the creditor holds a debt which came into existence before the initiation of insolvency proceedings, but which could not be set-off prior to the initiation of insolvency proceedings, set-off may become possible during insolvency proceedings if certain conditions are met.

However, certain exceptions exist to the general rule. For example, a creditor may not use a claim for set-off that has been transferred to him from a third party after the initiation of insolvency proceedings, even if set-off was previously available to that third party. Set-off may also generally not be effected against a claim which has only arisen against the creditor after the initiation of insolvency proceedings.

Further exceptions apply which should be analysed on a case-by-case basis.

Recognition of foreign insolvency proceedings

European Union

Under the Regulation, the opening judgment of one member state of the European Union is automatically recognised in Germany and comes into force without the need for prior recognition judgment of a German court. In general, the law applicable to these insolvency proceedings is that of the member state in which insolvency proceedings were opened.

After the opening of insolvency proceedings in another member state, German courts will only have the jurisdiction to open territorial insolvency proceedings in Germany if the debtor possesses an establishment within Germany, which will have to be liquidation proceedings restricted to the assets situated in Germany. (See the first part of this note for more details on the Regulation.)

Other states

On 20 March 2003, a new German international insolvency law entered into force which applies to states outside of the scope of the Regulation. It is an autonomous legal domain, fundamentally based on the Regulation's basis and system.

The opening of a foreign insolvency proceeding in another state not being a member state of the European Union is, as a general principle, recognised directly in Germany without any specific formality. This is however not the case,

- when the court which opened the proceedings does not have jurisdiction according to German law, or

- recognition would lead to a result which would be manifestly contrary to essential principles of German law, in particular its fundamental rights (*Grundrechte*).

Although the opening order of a foreign court will generally be automatically recognised in Germany, foreign court orders or security measures rendered in the recognised insolvency proceedings of another state may only be executed after being approved by a German court to be enforceable in accordance with the provisions of the German Civil Procedural Code (*Zivilprozessordnung*).

Creditors may file a petition for the commencement of separate domestic insolvency proceedings in Germany, if the debtor possesses an establishment in Germany or owns assets that are located in Germany. However, if the debtor has no establishment in Germany, the application for domestic insolvency proceedings can only be based on a special interest of the creditor to open such separate domestic proceedings, especially if the foreign insolvency proceeding would be clearly disadvantageous to the creditor compared to German insolvency proceedings.

SPAIN

Key Elements:

- New legislation applicable to insolvency proceedings commenced after 1 September 2004
- Introduction of a new procedure which may facilitate either a restructuring or liquidation
- Security enforcement may be delayed for up to one year
- Directors' duty to file for insolvency
- Set-off not available after commencement of insolvency proceedings

The new law on insolvency

A new law on Insolvency (Law 22/2003) was published in Spain on 10 July 2003 ("the Law") and entered into force on 1 September 2004.

The Law regulates court insolvency proceedings, as opposed to out-of-court liquidation, which is only available when the debtor has sufficient assets to meet its liabilities.

General notes on insolvency proceedings

Before analysing the procedural aspects and the effects of insolvency proceedings, the following should be noted.

One procedure for liquidation and restructuring

The same insolvency proceedings, namely "*concurso de acreedores*", are applicable to all persons or entities (excluding public bodies, which may not become insolvent). These proceedings may lead either to the restructuring of the business or to the liquidation of the assets of the debtor.

To date, a group of companies may not initiate joint insolvency proceedings. The Law is based upon the assumption that one company's insolvency does not always result in the insolvency of the whole group. There are, however, certain rules set up to co ordinate various insolvency proceedings being carried out in relation to companies pertaining the same group (whether "*de iure*" or "*de facto*").

Triggering of insolvency proceedings

A debtor is entitled to apply for insolvency proceedings when it is not able to meet its current obligations or when it expects that it will shortly be unable to do so. In this sense, insolvency proceedings are available as a type of legal protection that the debtor may request in order to avoid the attachment of its assets by its creditors.

A debtor (if a company, its directors) is legally obliged to file for insolvency proceedings when it becomes insolvent. A debtor is deemed to be insolvent when it fails to meet its current outstanding obligations on a regular basis. This obligation must be fulfilled within two months as from when the debtor has (or should have) become aware of its insolvency. Failure to comply with this obligation has severe consequences; mainly, the assumption that the insolvency has been carried out in a negligent way (see below).

Procedural aspects

Strictly speaking, insolvency proceedings are initiated when the court formally makes a decision that the debtor is insolvent.

Application

The application for insolvency proceedings may be filed either by the debtor (if a company, by the managing body, but not by the shareholders) or by its creditors. In the first case, they are referred to as "voluntary insolvency proceedings"; in the second case, "compulsory insolvency proceedings".

When the debtor files the application, it must include several documents (among others, a power of attorney, an explanation of the financial situation of the company, a list of assets and a list of liabilities, and the financial statements).

When a creditor files the application, it must provide evidence of its claim in addition to evidence that the debtor is insolvent. The latter may be proven as follows:

- Certain circumstances are generally deemed to be evidence of a debtor's insolvency (such as failure to meet obligations with employees or those due to public bodies for at least three months, among others). In these cases, the debtor may challenge the petition either because the alleged facts are not substantiated, even if they do, because the debtor is not insolvent.

- When enforcement proceedings have been carried out against the debtor and there are insufficient assets to cover the amount claimed. In this case, the debtor would have no grounds to challenge the petition.

Court decision declaring insolvency

When the debtor files the application, the Judge shall immediately (usually in one or two days) issue a decision by virtue of which the insolvency proceedings will be initiated ("*auto de declaración de concurso*"). If it feels that the application does not comply with the legal requirements because the debtor has failed to include the relevant documents, it will grant a term in which the debtor must remedy such deficiency (no longer than five days).

When a creditor files the application, the Judge shall hear the debtor before declaring insolvency by means of the referred court decision; in the meantime, it may adopt interim measures to ensure that the debtor's assets are preserved. If the application is dismissed, the creditor would, in principle, have to pay the corresponding legal costs and fees.

In any event, the following is determined in the initial court decision:

- The scope of the restrictions imposed on the debtor.
- The identity of the receivers appointed by the court (a lawyer, an economist and an unsecured creditor at the Court discretion). For small insolvencies, the court may (at its discretion) appoint only one receiver. Strictly speaking, receivers do not represent the creditors but act as court auxiliaries on behalf of the debtor and are subject to strict liabilities, similar to those affecting directors of a company.

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 receivers of the inventory and the list of creditors, respectively. Below we refer to the initiatives to be adopted by creditors in this regard.

Second stage: arrangement or liquidation

The second stage may lead 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 arrangement in the course of the first stage of the proceedings). The effects of insolvency proceedings are different in each case.

- An arrangement (*convenio*) may be entered into between the debtor and the majority of the ordinary creditors, involving a delay in payment or a partial cancellation of the debts (as a general rule, with the limit of five years or one half of the debts, respectively). As a general rule, the arrangement is approved with the support of half of the ordinary creditors.

  The arrangement is not effective until the court gives its approval: the court may refuse to do so when it feels that the debtor will not be able to fulfil the arrangement in question, or when the creditors oppose it due to the reasons established by law. Once approved, no further appeals against the arrangement are possible.

  Although upon approval of the arrangement most of the effects of insolvency proceedings cease, the proceedings do not terminate until the terms of the arrangement are completely fulfilled.

- In the case of liquidation, the debtor ceases to manage its assets (if a company, its directors would cease). The court receivers liquidate the debtor's assets by selling them, in order to distribute the money obtained among the creditors according to the rules established by the Law (as explained below).

Effects of insolvency proceedings

The initial court decision declaring the insolvency determines the effects of the insolvency proceedings. The varying effects of the insolvency proceedings on other court proceedings, bilateral agreements, obligations and prior transactions shall be distinguished.

Other proceedings

As a general rule, insolvency proceedings are not compatible with other enforcement proceedings. When compatible, in order to protect the interests of the debtor and creditors, the Law extends the jurisdiction of the Judge dealing with insolvency proceedings, who is, in the future, legally authorised to handle any enforcement proceedings or interim measures affecting the debtor's assets (whether based upon civil, employment or administrative law).

Creditors holding security "in rem", that had been traditionally allowed to enforce their claims against the secured asset notwithstanding the initiation of insolvency proceedings, are also subject to certain restrictions regarding the initiation of separate enforcement proceedings (or the continuance of such proceedings already commenced):

- When the secured asset is necessary for the business of the debtor enforcement by the creditor is subject to a delay for a maximum period of one year. It means that, following the declaration of insolvency, enforcement of security will no longer be possible or will be subject to stay until: (i) an arrangement is approved that does not bind such creditor (this is the general rule, except if the creditor gives his approval to the arrangement) or (ii) one year elapses from the date of declaration of insolvency without any initiation of the liquidation stage.
- If the liquidation stage is initiated before the abovementioned one-year term, the creditor loses the opportunity to enforce the asset by means of separate enforcement proceedings. In any case, however, the asset would be sold in order to satisfy the secured creditor.

Bilateral agreements

In this regard, the Law declares the following:

- The declaration of insolvency does not, per se, allow the parties to terminate a bilateral agreement, notwithstanding what has been agreed upon by the parties. In other words, clauses allowing any of the parties to terminate a bilateral agreement due to the insolvency of the contractual counterparty would not be valid.

- In principle, the declaration of insolvency does not alter the general contractual rules on termination. Therefore, following a default (either before or after insolvency is declared), the other party would be entitled to terminate the agreement and to receive compensation for damages caused (depending on when the default was committed, compensation will be, respectively, a pre- or post-insolvency debt - see below).

However, the Law states the following exceptions to the general contractual rules:

- The judge may decide to cure an eventual default of the insolvent party, thus re-stating the agreement (as if the default had never existed). If this is the case, outstanding amounts and further payments under the agreement will be post-insolvency debts, immediately payable.

  This effect, in principle, is favourable for the counterparty, but only if the debtor has sufficient assets to cover such debts. If this is not the case, we understand that a subsequent default would allow the counterparty to terminate the agreement.

- If the court deems it convenient, the insolvent party will be entitled to terminate the agreement at any time. If this is the case, the counterparty will receive compensation for such termination as a post-insolvency debt, to be established by the court dealing with the insolvency.

- There are several specific rules for employment contracts:

- Collective dismissal, suspension or modification proceedings would be under the jurisdiction of the court dealing with insolvency, following a consultation period in which employer and employees would have the opportunity to reach an agreement.

- The judge may dismiss top-level executives, reducing the agreed compensation to be paid by the employer.

Obligations

The following effects should also be noted:

- Following the initiation of insolvency proceedings, interest no longer accrues. Interest already accrued is treated as a subordinated claim (the exception would be secured debts).

- Set-off is applicable, provided that the legal requirements have been met before the company was declared insolvent. Set-off will no longer be possible after insolvency proceedings are initiated.

Prior Transactions

There are no prior transactions that automatically become void as a result of initiation of the insolvency proceedings.

Those transactions which shall be regarded as “ordinary” transactions, in keeping with the business of the debtor, are not subject any further scrutiny.

The receivers may challenge those transactions that could be deemed as having “damaged” the debtor’s interests, provided that they have taken place within two years prior to the declaration of insolvency (transactions taking place earlier than two years before insolvency has been declared are not subject to challenge).

“Damage” does not refer to the intention of the parties, but to the consequences of the transaction on the debtor’s interests. In any case, the Law refers to transactions that are somehow exceptional: in this sense, damage is deemed to exist in case of gifts and payment of obligations before its maturity date. Damage would also be deemed to exist (although the parties could show otherwise) in case of transactions with related entities and rights in rem that have been created in order to protect already existing (non-secured) obligation; in the remaining cases, damage would have to be justified.

The position of the debtor

Following the initiation of insolvency proceedings, the debtor becomes subject to certain restrictions, as established in the initial Court decision:

- As a general rule, insolvency would not affect the continuation of the debtor’s activities. In the case of voluntary insolvency proceedings, the receivers usually supervise the company activities, authorising (or not authorising) any payment or transaction. In the case of compulsory insolvency proceedings, in most of cases the debtor would cease to manage its estate and the receivers would take control of the company, being responsible for all further decisions.

- In any case, the debtor (if a company, its directors) is obliged to co-operate with the receivers and the judge dealing with the insolvency, who may, on an exceptional basis, impose restrictions on certain fundamental rights, in order to facilitate such cooperation.

- These obligations affect, in case of companies, not only the directors (either “*de iure*” or “*de facto*”), but also those who have been directors within the last two years.

Priority of claims

The insolvency order contains an express request for the creditors to notify their claims, within a one-month period (the one-month period begins from the date the insolvency declaration is published) providing original documentation to justify such claims.

Based on the documentation provided by the creditors and that held by the debtor, the receivers shall draw up a list of acknowledged creditors and classify them according to the categories established under law:

- Claims benefiting from special priority, representing attachments on certain assets (basically in rem security). These privileges may entail separate proceedings, though subject to certain restrictions derived from a waiting period that may last up to one year (see above).

  Privileged creditors are not subject to the arrangement, except if they give their express support by voting in favour of the arrangement. In the event of liquidation, they shall be the first to collect payment against the attached assets with absolute priority.

- Claims benefiting from general priority, including employment debts (limited) tax/administrative claims for half their amount, and the claims held by the creditor applying for the corresponding insolvency proceedings, up to a quarter of the amount of such claims.

  The holders of general privileges shall not be affected by the arrangement (if in disagreement) and, in the event of liquidation, they shall be the first to collect payment, in the order established under law.

- Ordinary claims.

- Subordinated debts, thus classified by virtue of an agreement or pursuant to law. Subordinated debts include those debts held by parties in special relationships with the debtor: in the case of an individual, his/her relatives; in the case of a legal entity, the administrators "*de iure*" or "*de facto*", group companies and any shareholders holding more than 5%_(for listed companies) or 10% (for non-listed companies) of the share capital.

  Subordinated creditors are second-level creditors; they may not vote on an arrangement and have very limited chances of collection. When subordination arises from a special relationship with the debtor, the creditor will also lose any security over assets belonging to the debtor.

Insolvency proceedings and priority of claims

In principle, insolvency proceedings affect all claims payable before the initiation of such proceedings, which are subject to the effects explained below.

There are other claims which are not subject to the insolvency proceedings and that are therefore neither acknowledged nor classified. These include obligations assumed by the insolvent party with the approval of the receivers (e.g. those entered into order to continue the activities) as well as other claims prescribed by law, even if such claims begin to accrue earlier (salaries accruing during the last 30 days before the proceedings are initiated, with a limit of twice the official minimum salary). These are immediately payable, although the Law imposes some restrictions on their enforceability.

Costs arising from insolvency proceedings

The debtor must pay all costs arising from insolvency proceedings. The main costs are as follows:

- Attorneys' fees (usually paid at the beginning of the proceedings).

- Court attorney's fees (the court attorney, or "*procurador*", is a mandatory go-between whose duty is to liaise between the court and the parties).

- Receivers' fees that have been established on a fixed basis.

- Court taxes (not higher than €6,000).

- Publications (the most relevant court decisions shall be published at the expense of the debtor).

The position of directors (when the debtor is a company)

Liability arises from various legislative provisions.

Company law

In general (not only in cases of financial distress), directors are liable to the company, the shareholders and the company's creditors for loss caused through breaches of company law or the company's by-laws, or acts undertaken without the necessary diligence. In cases of insolvency, directors have been found liable for loss caused, intentionally or by gross negligence, by making certain decisions (e.g. entering into agreements) knowing that the company would be unable to comply with its obligations.

A different source of liability may arise when the directors become aware that the company's assets have fallen below half of its share capital: unless the inbalance is remedied (e.g. by means of a capital increase), the directors must take all legal steps to initiate the liquidation of the company within a period of two months by calling a general shareholders' meeting for this purpose. If this meeting does not resolve to liquidate the company, the directors must initiate the compulsory liquidation of the company through the courts. The directors of the company will be responsible for the company's debts if they do not observe such obligations when a company is under a compulsory liquidation scenario. The penalty is severe: the directors will be jointly responsible for the company's debts incurred from the point at which they became aware or should have become aware of the insolvency, unless they are able to prove that they took all the necessary steps to liquidate the company.

In the event that the company is subject to compulsory liquidation as a result of the company being insolvent, the directors would be obliged to file for insolvency proceedings (within the referred two months time); otherwise, they would face not only the liability for debts, but also penalties arising from provisions contained in insolvency law.

Insolvency law

The declaration of insolvency usually involves an incidental procedure to examine if civil responsibilities arise that caused or contributed to the insolvency ("insolvency specification proceedings").

The applicable rules may be summarised as follows:

- Incidental proceedings will only be developed when the insolvency leads to liquidation or when creditors accept a severe delay or cancellation of their claims (more than three years' delay or one third cancellation of such claims, respectively).
- Incidental proceedings may lead to the conclusion that insolvency has been either unfortunate or negligent, according to the circumstances established by law (in this regard, the status of the accounts and compliance with the legal duty to apply for insolvency proceedings is essential).
- In the event that the insolvency arises as a result of negligence, the directors or third parties may be obliged to pay damages as a result of their actions.
- In case of negligent insolvency leading to liquidation, directors of the company may be liable for all outstanding company debts. The Law grants Judges a wide range of discretion. The scope of this new provision has yet to be tested by the courts.

Criminal liabilities

Aside from the insolvency proceedings, a criminal claim may be filed against the directors of the company, in order to examine their criminal liabilities (as set forth below). Criminal liabilities would not arise as a result of financial distress except if the directors have committed criminal offences such as the following:

- Culpable insolvency: directors may face criminal liability if they have hidden the assets of the company, if they have intentionally provoked the insolvency or if they have disposed of the companies' assets.
- Unfair or fraudulent management: directors that fraudulently dispose of the company's assets or enter into obligations on account of the company, or intentionally jeopardise the effectiveness of judicial or administrative attachments, may be punished with a prison sentence or a fine.
- False accounting: directors who falsify the annual accounts or other financial documents of the company may also be punished.

Tax liability

Directors may be liable for the tax obligations of the company. Such liability is: (i) joint and several together with the company, if they have committed or co-operated in the commission of tax fraud; (ii) vicarious, when the company has ceased to exist or when the following requirements are met:

- Tax is owed and not paid within the term established for voluntary assessment, and the Tax Authority has found that there are insufficient assets and declares the company insolvent;
- The Tax Authority expressly resolves to direct administrative action against the parties that are vicariously liable, i.e. the directors, to whom due notice must be served; and
- The directors have acted negligently. All those members of the Board committing the act(s) or adopting the resolution(s) in question shall be jointly and severally liable, except for those who did not act or had expressly opposed the resolution(s).

Lender liability

In Spain there has been no case law relating to irresponsible lending. The more general doctrine of "abuse of rights" may exceptionally be applied where acts which manifest surpass the normal limits of the exercise of a right and cause loss to third parties. Under certain circumstances, the lender could be considered as "de facto" director when he had taken control of the activity of the debtor. (In this regard, the enforcement of "step-in" or the instruction to the debtor rights may involve a risk).

New money lending

There appears to be no specific legislation or case law on this matter. As the claim resultant from the lending is accrued after insolvency proceedings are initiated, it is not subject to these insolvency proceedings. New money lending is not frequent, as the lender may fear that there will not be sufficient assets to guarantee the recovery of the loan.

Guarantees

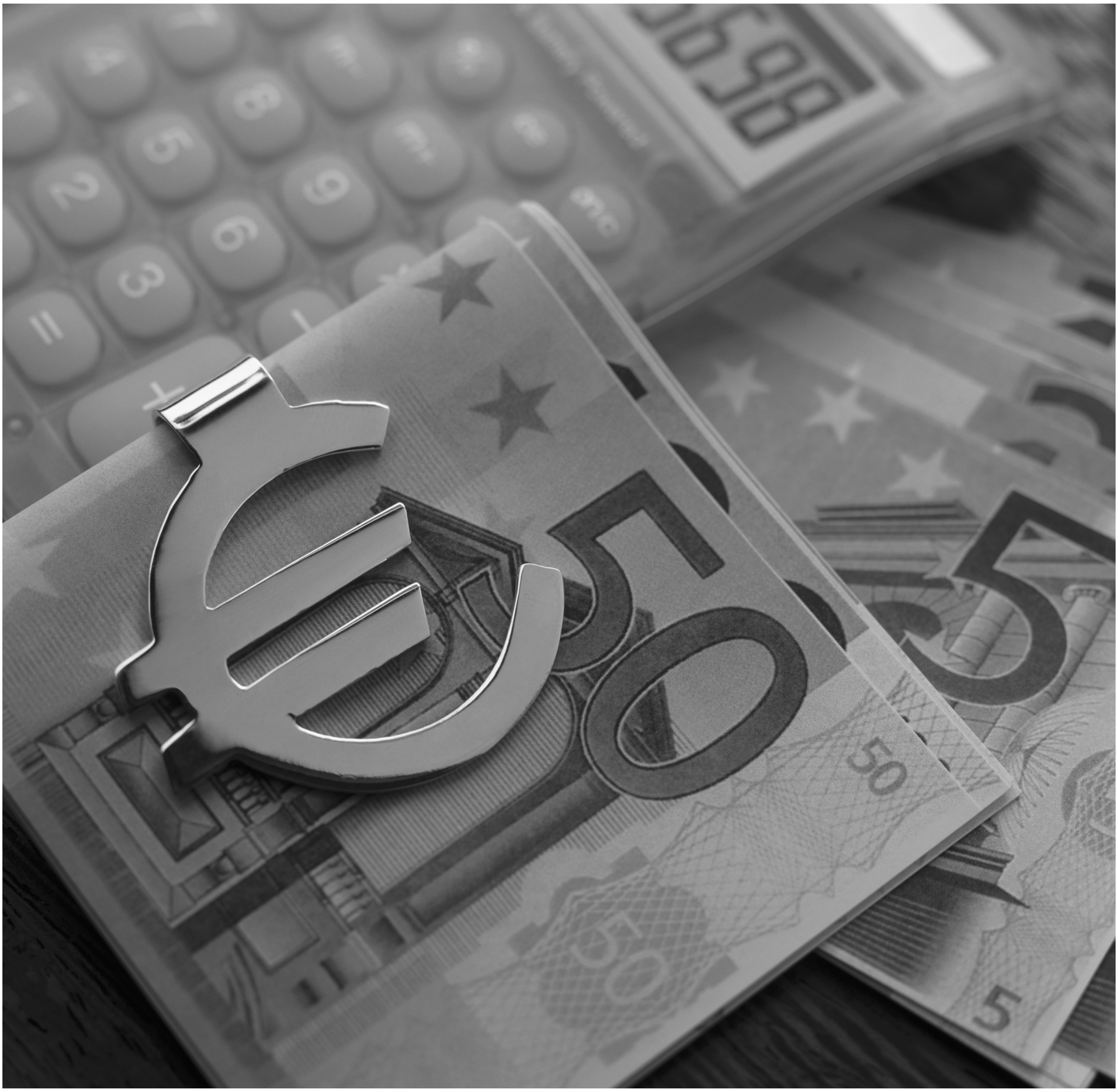
Under Spanish law, guarantees are available in most circumstances, both upstream, downstream and cross-stream. The two most commonly used types of guarantee under Spanish law are: (i) a first demand guarantee (*garantía a primer requerimiento*), where the guarantor is obliged to pay a sum of money at the beneficiary's demand regardless of the fulfilment or existence of the initial obligation; and (ii) a "*fianza*", where the guarantor agrees to pay (or otherwise fulfil) an obligation for a third party in the event that the third party fails to fulfil that obligation.

When the claim is guaranteed, the creditor may collect the due money from the guarantor, who will become subrogated in the insolvency proceedings.

It could be understood that the classification of the claim guaranteed will, take into account the position occupied either by the creditor or by the guarantor. (i.e. if any of them have a "special relationship" with the debtor, the claim would be deemed as subordinated). However, certain case law has stated that the claim has to be classified according to the circumstances of the creditor. In the case of subsequent payment by the related guarantor, the claim would be reclassified, if this were the case, as a subordinated claim.

Cross-border insolvencies
According to the principles established by the Regulation, the court with jurisdiction over the proceedings is determined by the place in which the debtor carries out its main activities (in principle, the registered corporate address). These proceedings are considered the "principal insolvency proceedings".

In addition, insolvency proceedings may be carried out where the debtor has a "permanent place of business". These "territorial insolvency proceedings" have a limited scope, only affecting the assets located in that country.



THE NETHERLANDS

Key Elements:

- Procedures for:
  - Bankruptcy
  - Suspension of payments
- Priority of payment and preferential creditors
- Directors' duties
- Lender liability
- Challenging antecedent transactions
- Set-off

Insolvency regimes

Bankruptcy and suspension of payments

The Dutch Bankruptcy Act ("*Faillissementswet*", the "*Act*") entered into force on 1 September 1896 and has been amended several times since. At present, it contains three types of proceedings:

(a) bankruptcy (*faillissement*);

(b) suspension of payments (*surseance van betaling*); and

(c) debt reorganisation for natural persons (*schuldsaneringsregeling natuurlijke personen*)[10].

Special proceedings and provisions for the insolvency of insurance companies are provided for in the "*Faillissementswet*" in conjunction with the Insurance Industry Supervision Act (*Wet toezicht verzekeringsbedrijf*). For credit institutions, special proceedings and provisions are laid down in the *Faillissementswet* in conjunction with the Credit System Supervision Act (*Wet toezicht kredietwezen*).

A substantial revision of the Act is being prepared by the Insolvency Law Committee (*Commissie Insolventierecht*), installed by the Minister of Justice. A draft for a new Insolvency Act was published in November 2007. The Minister of Justice has granted any interested parties a period of time to provide their comments. The subsequent procedure is to be determined by the Minister of Justice.

Bankruptcy

Bankruptcy is a general attachment on (practically) all of the assets of a debtor, imposed by a judgment of the appropriate District Court (*Rechtbank*) for the benefit of the insolvent debtor's collective creditors. The objective of the bankruptcy is to provide for an equitable liquidation and distribution of (the proceeds of) the debtor's assets among its creditors. In practice, however, bankruptcy proceedings serve as an important instrument for the reorganisation and continuation of businesses in financial distress.

According to the Act, bankruptcy proceedings can be opened in respect of any debtor, natural or legal person, regardless of whether he carries on a business, practises an independent profession or not. The Act also provides for the opening of a bankruptcy proceeding in respect of a commercial partnership (*vennootschap onder firma*). A commercial partnership does not have legal personality, but its partners are jointly and severally liable and its assets form a separate fund available only for recourse by the partnership's creditors. If a bankruptcy proceeding is opened in respect of the partnership, simultaneously bankruptcy proceedings are opened in respect of the partners.

The Act does not provide for the consolidation of bankruptcy proceedings opened in respect of companies belonging to the same group. However, there are some examples of cases in which courts have allowed such consolidation.

If a bankruptcy proceeding is opened, the debtor loses the right to manage and dispose of his assets with retro-active effect to 00.00 hrs. of the day the bankruptcy order is issued. The court appoints a receiver who is charged with the management and realisation of the debtor's assets (including by means of a transfer of (part of) the business as a going concern). The receiver acts under the general supervision of a supervisory judge (*rechter-commissaris*). For certain acts of the receiver the law requires the (prior) authorisation of the supervisory judge, e.g. for conducting legal proceedings and for terminating employment and rental contracts.

10 These proceedings are not dealt with in this briefing.

Suspension of payments

Suspension of payments is a court-ordered general suspension of a debtor's payment obligations; its objective is to provide an instrument for the reorganisation and continuation of viable businesses in financial distress. It is available only at the request of the debtor and only has effect in respect of ordinary (non-secured and non-preferred) creditors. During the period for which the suspension of payments has been granted, creditors with non-preferential claims cannot take recourse in respect of the debtor's assets.

Despite several amendments made over the years to increase the effectiveness of the suspension of payments proceeding (e.g. the liberalisation of the conditions for the granting of a suspension of payments and the introduction of the possibility of a composition) it has in practice never become a satisfactory instrument for the reorganisation of businesses in financial distress. Generally, it is nothing more than a first step towards bankruptcy. Although in recent times there have been examples of successful suspension of payments proceedings, e.g. the recent reorganisations of Versatel, GTS Europe and UPC, as far as reorganisation of businesses in financial distress is concerned, the bankruptcy proceeding in practice proves to be a more effective instrument.

Suspension of payments proceedings can be opened in respect of natural persons carrying on a business or practising an independent profession and juristic persons. The suspension of payments may be granted by the court for a maximum period of one and a half years and may be prolonged at the request of the debtor (if necessary more than once) each time with a maximum of one and a half years.

As a result of the granting of a suspension of payments, the debtor can no longer manage and dispose of its assets without the co-operation or authorisation of a court appointed administrator. Likewise, the administrator cannot act without the co-operation or authorisation of the debtor. The suspension of payments order has retro-active effect to 00.00hrs of the day it has been issued. In a suspension of payments proceeding, the court may appoint a supervisory judge, whose role is limited to regulating certain procedural matters and advising the administrator upon his request.

Obligation to file for insolvency

There is no legal obligation for a debtor to file a bankruptcy petition or to apply for suspension of payments.

The test for insolvency

Bankruptcy

A debtor can be declared bankrupt if it has ceased to pay its debts. The court has relatively wide discretionary powers in assessing whether the debtor has ceased to pay its debts. The court may already come to such a conclusion if there is more than one creditor and at least one matured debt remains unpaid. Bankruptcy proceedings may also be opened in case of the debtor's unwillingness to pay, not only in case of its inability to pay. Balance sheet insolvency is no separate ground for the opening of bankruptcy proceedings.

Suspension of payments

If the debtor, according to its application, anticipates that it will not be able to continue to meet its liabilities as they become due, the court immediately grants a provisional suspension of payments. The court may not grant the definite suspension of payments if (i) a qualified minority of creditors with non preferential claims objects, (ii) if there is well-founded fear that the debtor will prejudice the interests of creditors during the period of suspension of payments or (iii) if there is no prospect of the debtor being able to satisfy its creditors within a certain period of time. That the debtor must be able to satisfy its creditors does not mean that they must be paid in full. It suffices that creditors can be satisfied to some extent, for example by receiving a percentage of their claims within the framework of a composition.

Initiation of insolvency regimes

Bankruptcy

The debtor, its creditor(s) or the Public Prosecutor (for reasons of public interest) may petition for the debtor's bankruptcy by filing a request to the appropriate District Court. Furthermore, in a number of cases the court can open a bankruptcy proceeding following a suspension of payments proceeding.

Suspension of payments

Only the debtor itself can apply for a suspension of payments at the appropriate District Court, on the grounds that the debtor anticipates that it will not be able to continue to meet its liabilities as they become due.

Moratorium

Both in the bankruptcy and the suspension of payments proceedings, the court (and in case of a bankruptcy proceeding: also the supervisory judge) may grant a "cooling down" or "freezing" period (moratorium). During such period, creditors with rights in rem (including rights of pledge and mortgage) cannot repossess or foreclose without prior approval by the court or the supervisory judge. The moratorium does not involve an obligation of financiers to continue to finance the debtor. Furthermore, rights of creditors against third parties are not affected by a moratorium.

A moratorium can be ordered for a maximum of two months, which can be extended once by a maximum of two months.

Rules governing priority of payment and preferential creditors

Bankruptcy

In a bankruptcy, creditors with insolvency claims are entitled to the proceeds of the realisation of the debtor's assets. Costs incurred within the framework of the realisation of the assets give rise to claims against the bankrupt estate; these claims have to be satisfied in priority to insolvency claims. Claims against the estate include the receiver's salary, fixed by the court on the basis of a generally accepted hourly rate, and debts incurred by the receiver in continuing the bankrupt debtor's business and/or during liquidation.

Often the proceeds of the realised assets are insufficient to satisfy all claims against the estate. In that case, the claims against the estate are satisfied in accordance with the same ranking that applies between insolvency claims.

Creditors with a right of pledge or mortgage are, in principle, not affected by claims against the estate. As a general rule, there is no apportionment of the general realisation costs over the proceeds of the assets subject to a right of pledge or mortgage.

Unsecured creditors with insolvency claims can only enforce their claims against the debtor in the manner prescribed by the Act, i.e. by submitting their claims to the receiver within the framework of the claims validation procedure. Creditors with insolvency claims secured by a right of pledge or mortgage, can enforce their rights as if a bankruptcy proceeding had not been opened[11].

The law attaches a priority in the realisation proceeds to certain categories of claims (preferential claims) and determines the ranking of these preferential claims. A claim can have priority in respect of the realisation proceeds of a particular asset (e.g. resulting from a security right or a right of retention) or in respect of the realisation proceeds of all of the debtor's assets (e.g. the claims of tax authorities).

As a general rule, preferential claims in respect of a particular asset have a higher ranking than preferential claims in respect of all assets.

As to the preferential claims in respect of a particular asset, as a general rule, secured claims have a higher ranking than other preferential claims in respect of that particular asset. An important exception to this rule is that, in respect of the proceeds of the realisation of inventory situated on the debtor's premises, the tax authorities' preferential claim (in respect of certain taxes) has a higher ranking than a non-possessory right of pledge vested in such assets. A further exception to the above rule is that a right of retention may, in a particular case, have a higher ranking than a right of pledge or mortgage vested in the asset concerned.

Creditors can agree to a lower ranking of their claims. A contract between the creditor and the debtor may stipulate that the claim of the creditor is subordinated to all or to certain other claims of other creditors.

Shareholders have no right to any distribution of the proceeds within the framework of the proceeding as, under Dutch law, they are not creditors.

Suspension of payments

The suspension of payments only affects non-preferential claims existing at the time of the opening of the proceeding. During the proceeding, these claims cannot be enforced against the debtor's assets and payment of these claims can only be made to all creditors in proportion to their claims.

Preferential claims (including claims secured by a right of pledge or mortgage) are not affected by the proceeding and can, therefore, be enforced against the debtor's assets. This also applies to claims against the estate, i.e. obligations incurred by the debtor with the co-operation or authorisation of the administrator after the opening of the proceeding (e.g. in connection with the continuation of the debtor's business).

Other unsecured creditor actions

The Dutch Code of Civil Proceedings provides for a means of pre-judgment attachment, which is referred to as a "conservatory attachment" (*conservatoir beslag*). With a conservatory attachment a creditor can secure payment by the debtor in anticipation of an enforceable judgment against the debtor. Once the proceedings on the merits result in an enforceable judgment against the debtor, the conservatory attachment becomes an attachment in execution by operation of law, i.e. the attached assets can then be executed.

During the period of attachment the transfer or encumbrance of the attached goods by the debtor has no legal effect vis-à-vis the party that levied the attachment, i.e. the party that levied the attachment can proceed with the attachment as if the attached goods were not transferred or encumbered, unless the purchaser acted in good faith and has acquired possession of the attached goods. Furthermore, the withdrawal of the goods subject to the attachment will constitute an unlawful act and a criminal offence.

The nature of the conservatory attachment can be, amongst others, an attachment by garnishment (i.e. attachment of bank accounts), an attachment of shares or an attachment of assets or real estate.

As a result of the opening of bankruptcy proceedings in respect of the debtor, pre-bankruptcy attachments by creditors are lifted by operation of law and executions of assets included in the bankruptcy proceeding are automatically terminated. As a result of the opening of suspension of payments proceedings, only existing attachments

11 However, during a moratorium, creditors with a right of pledge or mortgage cannot repossess or foreclose without the prior approval of the court or supervisory judge (see paragraph above dealing with moratorium).

levied by non-preferred creditors are lifted by operation of law; executions of assets included in the proceedings are not terminated but suspended.

Scope for majority voting and/or cram down of minority creditors

Bankruptcy

A bankruptcy proceeding does not always lead to the liquidation of the debtor's assets. The proceeding may also result in the reorganisation of debts by means of a composition. A composition can only be proposed by the debtor and, upon approval and confirmation by the court, only binds creditors with non-preferential claims (ordinary, non-secured and non-preferred creditors). Creditors with preferential claims are not bound by a composition.

Only creditors with non-preferential claims have the right to vote on the proposed composition. A composition needs the approval of a normal majority of the (conditionally) admitted creditors with non-preferential claims, representing at least half of the total amount of (conditionally) admitted non-preferential claims.

Upon request by the debtor or the receiver, the supervisory judge can decide to hold the proposed composition as approved, if (i) 3/4 of the (conditionally) admitted creditors approved the composition and (ii) the rejection of the composition is caused by one or more creditors that, taking all circumstances in consideration – especially the percentage of its claim that such creditor would receive in case the estate is liquidated and distributed – reasonably could not have voted against the composition.

Suspension of payments

In a suspension of payments the debtor also has the option of proposing a composition. A composition only binds the creditors with non-preferential claims. The regulation of this composition (*grosso modo*) corresponds with the regulation of the composition in a bankruptcy proceeding.

Courts' responsiveness to creditors

Bankruptcy

The court may appoint a creditors' committee, which in practice, however, is exceptional. If a creditors' committee has been appointed, the receiver is obliged to provide it with all requested information concerning the bankruptcy. In certain cases, the receiver is obliged to seek the advice of the creditors' committee. The receiver, however, is not bound by the committee's advice.

The Act also provides for meetings of creditors to be convened. With regard to certain matters, the law prescribes a meeting of creditors. Decisions concerning the admission of claims must for example be taken in a meeting of creditors, as well as the decision to continue the company's business if a composition has not been offered or has been rejected.

Creditors may submit a petition to the supervisory judge requesting the supervisory judge to order the receiver either to perform certain acts or to refrain from performing certain intended acts. Furthermore, a creditor may request the court to dismiss the receiver.

Suspension of payments

The influence of creditors in the proceeding is limited. The court is obliged to hear their views when deciding whether or not to definitively grant the suspension of payments; when a certain number of creditors objects, the suspension of payments cannot be granted definitively. Any creditor can request the court to dismiss an administrator. Furthermore, any creditor can request the court to take the measures necessary to protect the interests of the creditors. Creditors may also request the court to terminate the suspension of payments.

In contrast with a bankruptcy proceeding, creditors do not have the option to request the supervisory judge to order the administrator to perform or refrain from performing certain acts.

Directors

The law imposes duties on the following persons:

(a) Managing Directors (*bestuurders*); and

(b) Supervisory Directors (*commissarissen*).

Directors' duties

The Managing Directors' duties are owed to the company on the basis of the Dutch Civil Code ("DCC") and the articles of association of such company and, as can be derived from such duties owed to the company, to the shareholders and the employees of such company. Furthermore, duties are, to some extent, owed by the Managing Directors to certain third parties, in particular creditors and counterparties of the company.

The DCC states, in general wording, that "each Managing Director is required properly to execute the tasks entrusted to him". The DCC does not specifically set out which Managing Director's duties exist under Dutch law. Specific tasks include (amongst others) taking decisions to manage the business, reporting and advising the general meeting of shareholders, keeping financial information up to date, filing annual reports and accounts and representing the company in respect of third parties.

Insolvency considerations for directors

The insolvency considerations that exist for Managing (and Supervisory) Directors would relate to any liability that such Directors might incur. Under Dutch law, the following categories of liability of Managing (and Supervisory) Directors can be distinguished:

Director's liability towards the company

This form of liability results from mismanagement (*onbehoorlijk bestuur*). "Mismanagement" is to be defined as a seriously imputable failure to perform the task entrusted to the Managing Director. Such a claim will have to be instigated by the company, or by the receiver in bankruptcy.

The criteria for establishing mismanagement depends to a large extent on specific circumstances. In general, however, the reproach to be made against the Managing Directors needs to be very serious indeed. In order for a Managing Director to be held liable, he must have acted as no sensible Managing Director would have acted under the same circumstances.

For instance, taking substantial financial risks on behalf of a company is not necessarily considered mismanagement. It is taking unnecessary, or unnecessarily large financial risks that might constitute mismanagement. Conversely, it is not taking great business risks in itself, but doing so without proper preparation or research, or engaging in financial transactions that by far exceed the financial capacities of the company that leads to liability.

The liability for mismanagement is in principle a collective liability; it attaches to all Managing Directors regardless of who actually took part in the improper act or omission. If a matter falls within the field of competence of more than one Managing Director, each of them is jointly and severally liable, except any Managing Director who can prove that the act or omission was not attributable to him and that he did not neglect to take measures to avert the consequences of such act or omission.

Managing Directors are only rarely held liable by the company for mismanagement. Usually the Managing Directors are protected against this form of liability by a discharge concerning the management activities of the preceding year granted by the general meeting of shareholders when it adopts the annual accounts for that year. Such discharge, however, only covers facts that are disclosed in the annual accounts or have been reported to the general meeting of shareholders before the annual accounts were adopted. The (board of) Managing Directors may therefore still be held liable for facts they did not disclose in the annual accounts or in the general meeting preceding the adoption of the annual accounts and the granting of the discharge. Moreover, a discharge granted by the general meeting of shareholders does not prevent the commencement of a claim in bankruptcy (see below).

Supervisory Directors may face liability when they fail to initiate steps against Managing Directors of the company, who are mismanaging, or fail to take measures when the (business of the) company is in disarray.

Directors' liability towards third parties

Annual accounts

Managing Directors are jointly and severally liable for loss suffered by third parties as a result of misrepresentation concerning the company's condition in the annual accounts, Managing Directors' report or interim figures published by the company. A Managing Director can exonerate himself by proving that he was not to blame for the relevant misrepresentation.

If the annual accounts misrepresent the financial condition of the company, the Supervisory Directors are jointly and severally liable with the Managing Directors for any damage suffered by third parties as a result thereof. Again, a Supervisory Director who proves that he was not to blame for any failure in his supervisory duties shall not be liable.

Pre-incorporation contracts

Any person or legal entity acting in the name and on behalf of a company which is in the course of being incorporated will be liable for the performance of any obligations undertaken (unless expressly stipulated otherwise) until the company ratifies the act concerned after its incorporation.

The person or entity concerned will be jointly and severally liable with the company for damage if after ratification of the act by the company, the company is unable to perform its obligations pursuant thereto and the person who contracted on behalf of the company could reasonably have known that the company could not perform such obligations. There is a presumption of knowledge if the company is declared bankrupt within one year of its incorporation.

Registration

After incorporation of a company, its Managing Directors are jointly and severally liable for any legal acts by which the company is bound as long as its paid-up capital does not amount to the minimum share capital prescribed by law, the required minimum proportion of its issued share capital has not been paid up or the company has not been duly registered with the Commercial Register.

Tort

Managing Directors acting within the scope of their management activities may in certain exceptional circumstances also be held liable in tort. Normally, a Managing Director is deemed to act in the context of his regular duties and responsibilities, even if financially detrimental to third parties. In other words, the mere fact that a Managing Director takes action that causes financial harm to third parties is insufficient to create personal liability in tort towards these third parties. Only in circumstances where the Managing Director can be seriously reproached, i.e. where he is personally at fault, will he be exposed to liability. This, *inter alia*, is the case where, at the time the company enters into an agreement with a third party, the Managing Director knew (or should have known) that the company would not be able to meet its obligations in due course, and no recourse would be available to compensate for the resulting damages suffered by the other party. Liability in tort could also arise where a Managing Director wilfully prevents the company from performing its obligations towards a third party, when it is otherwise able to do so. Also, financial distributions to shareholders in violation of statutory requirements can lead to liability.

Liability following bankruptcy

General

In the event of a company's bankruptcy, the Managing (and Supervisory) Directors will be jointly and severally liable for all debts remaining unpaid after realisation of the company's assets, if they have manifestly neglected to perform their duties properly and this is an important cause (but not necessarily the only cause) of the company's bankruptcy.

"Manifestly neglecting to perform their duties properly" should be interpreted as the making of a serious mistake which goes well beyond the limits of acceptable risk in the ordinary course of the business concerned.

Manifest improper performance is to be proven by the receiver. If, however, the Managing Directors have not complied with their obligations to keep the company's books or to publish the annual accounts on time, they are deemed (without proof of the contrary being allowed) to have neglected to perform their duties properly. In addition, it is then assumed (but proof to the contrary is allowed in this respect) that such performance constitutes an important cause of the bankruptcy.

The above-mentioned liability is collectively borne by the Managing Directors. The Managing and Supervisory Directors are jointly and severally liable for management and supervision of the company respectively. A discharge granted by the general meeting of shareholders to the Managing and/or Supervisory Directors does not prevent the commencement of a claim as set out above. However, an individual Managing or Supervisory Director may exonerate himself from this liability by proving that the act or omission was not attributable to him and that he did not neglect to take measures to avert the consequences of such act or omission. Finally, a Managing or Supervisory Director can only be held liable for manifest improper performance made in the period of three years prior to the bankruptcy of the company. For the avoidance of doubt, such period of three years does not apply to liability towards the company (see above in the general part of this section) and liability following tort (see above in tort section).

Liability towards tax and social security authorities

Legislation allows for the personal liability of Managing Directors for certain taxes (i.e. wage withholding tax and value added tax), social security premiums and compulsory pension premiums, in the case of "obvious mismanagement". If the Managing Directors have failed to notify the tax authorities that the company is unable to pay its debts on account of these taxes or premiums, immediately after such inability arises, statute provides that mismanagement is deemed to have occurred. In general, the remarks made regarding liability in the case of a company's bankruptcy apply here (see above).

Lender liability

A lender could be held liable as a shadow director under Dutch law if it would have to be deemed to have determined company policy as if it were a director. Whilst this is theoretically possible, there is no case law in which a lender is indeed held liable on this ground. This scenario is generally considered unlikely in relation to a bank or other lender.

Exceptional circumstances could give rise to claims by other creditors or by the receiver in the bankruptcy of the company vis-à-vis the lenders, based on tort. Whether or not the lenders' conduct can be qualified as unlawful depends on all circumstances of the case concerned. Based on case law of the Dutch Supreme Court, the lenders' conduct can be regarded as unlawful especially if the lenders have obtained security over all (or a substantial part) of the debtor's assets, have participated in the keeping up of a semblance of creditworthiness of the debtor and have not sufficiently taken into account the interests of other creditors whose recourse possibilities have been diminished or have become illusive as a result thereof.

If the lenders' conduct would fall within the scope of the statutory provisions on voidable preference (see section below), this also could give rise to a claim in tort of the debtor's creditors whose recourse possibilities have been diminished as a result thereof, or to a claim in tort of the receiver in the bankruptcy of the debtor. A claim in tort can be used as an alternative for an action based on voidable preference.

Voidable preference

Under Netherlands law, if certain requirements are met, the receiver (or, outside bankruptcy, any creditor) has the right to nullify a transaction entered into by the insolvent debtor with a third party on the basis of article 42 of the Act: voidable preference (*actio Pauliana*). The consequences of this are that the receiver can take recourse against the relevant assets as if the voided transaction had not taken place, for at most an amount equivalent to the actual disadvantage to other creditors.

Voluntary transactions

The following requirements have to be met to ensure a successful challenge of a transaction entered into by the debtor on a voluntary basis (i.e. in the absence of a legal or contractual obligation):

(a) the transaction was prejudicial to the recourse possibilities of the debtor's creditors; and

(b) both the debtor and its contracting party knew or ought to have known at the time of the transaction that such prejudicial effect would arise. If the debtor receives no consideration for the transaction, only the knowledge of the debtor itself needs to be proven. The Supreme Court has ruled that it is not sufficient for the receiver (or, outside insolvency, any creditor) bringing the *actio Pauliana* to argue that the contracting parties knew or ought to have known of the possibility that the transaction could be prejudicial to the debtor's creditors.

The burden of proof of the abovementioned elements rests upon the receiver, although a reversal in respect of the "knowledge" requirement is provided in law if the voluntary transaction took place less than one year before the debtor was declared bankrupt in respect of certain categories of "suspect" transactions listed in the Act.

Such suspect transactions include, *inter alia*: (i) transactions by the debtor which are conducted at an "undervalue", (ii) transactions between the debtor and a group company, (iii) transactions between the debtor and a legal entity where the same legal entity holds (directly or indirectly) at least 50% of the issued share capital both in the debtor and the legal entity, and (iv) the paying of or the granting of security for a non-matured debt.

Involuntary transactions (transactions pursuant to a pre-existing statutory or contractual obligation)

On the basis of article 47 of the Act, the receiver also has the power to nullify any transaction performed by the debtor pursuant to a pre-existing statutory or contractual obligation in the event that:

(a) the counterparty knew that a petition for the debtor's bankruptcy had been filed with the court; or

(b) the transaction resulted from concerted action of the debtor and its counterparty aimed at preferring the latter to the detriment of the debtor's other creditors.

"Hardening" period

The power to invoke the *actio Pauliana* as discussed above is not limited to transactions executed within a certain period before the commencement of the bankruptcy proceeding. There is no real "hardening period" for the relevant transactions. Voidable preference has a limitation period of three years from the date on which the receiver discovered the detrimental effect of the transaction.

Recharacterisation/liability for debts at subsidiary level

Recharacterisation

Intra-group loan transactions are, for civil law purposes, generally not susceptible to recharacterisation. However, payments under such loans by the company may be challenged by the receiver (or, outside bankruptcy, any creditor) in the same manner as discussed in the sections above which consider voidable preference and tort.

Liability for the debts of a subsidiary

General

Normally, a shareholder is not liable for debts of the company in which it holds shares, other than through the paid-up share capital (to the extent not yet paid up) in respect of shares held by it. However, there are exceptions to this principle. Many of the issues dealt with below strongly depend upon factual circumstances.

Specific Issues

Assumed unity

In a situation of assumed unity (*vereenzelviging*), the legal distinction between two separate corporate entities (such as the shareholder of a company and the company itself) will be ignored and the corporate entity and its shareholder will be deemed to be one and the same person. This may result in a sharing of liabilities (i.e. both are liable) and making available the joint assets as objects of recourse (i.e. the assets of both are available for recourse).

If such unity is assumed, liability is necessarily shared. This situation is however rarely held to be applicable. The concept of assumed unity is strictly based on case law. In principle, the creditor will have to show that the corporate identity of a company was abused to the detriment of that creditor or creditors in general.

Breakthrough of liability (piercing the corporate veil)

General

Liability of another entity can also occur without the assumption of unity (set out above). The "sharing of liabilities" is then called "breakthrough of liability" (*doorbraak van aansprakelijkheid*) or "piercing the corporate veil".

A shareholder may be held jointly liable with the debtor-company for (part of) a specific claim of a creditor on such debtor company. Such a breakthrough can occur as a consequence of tort (*onrechtmatige daad*) of the parent company, or on limited other grounds as explained below.

The creditor, in this situation, does not have to prove that the distinction of identity of the companies is abused (see above), but instead has to prove that a tort has been committed. This can be based on, among other things, a "duty of care" on the part of the parent company. This duty of care arises when the parent company is actively involved in (in fact: has taken over) the (financial) management of the subsidiary and the parent company knows or should have known that its involvement with the debtor's management would prejudice creditors' rights. If such (active) involvement is established, and a number of additional conditions are met, liability may exist regarding acts detrimental to the subsidiary's creditors. Additional circumstances could be:

- unreasonably substantial distribution(s) of profits/dividends to the sole shareholder;
- selective payment of the shareholder as a creditor; or
- creating comfort on the part of the creditors or business partners of the company, which causes them to continue delivering goods to the company, which remain unpaid, etc.

A claim against a parent company for debts of a subsidiary would therefore normally involve a claim in tort. Any such liability would co-exist with that of the subsidiary company.

Tort: semblance of creditworthiness

Tort may arise because of the creation by the parent company of an unjustified semblance of creditworthiness of the subsidiary. This could for instance be the case when all (or a substantial part of) assets in the subsidiary have been transferred to itself, thereby making the subsidiary insolvent for any claims from new creditors, who entered into transactions with the company on the basis of that (assumed) creditworthiness. In such cases, tort can be established particularly when the parent company has (i) factual control and (ii) knew or should have known that the new creditors would be prejudiced because of an absence of recourse.

Tort: asset-stripping

Tort may be established when the parent company has acquired basically all the assets of a subsidiary. Tort can also arise when a company has made irregular dividend distributions or payments to the parent company, when the parent company, based on factual indications, "should have reckoned with the serious possibility that the subsidiary would experience such a shortage that other creditors would be prejudiced".

Set-off

Set-off outside bankruptcy

Outside bankruptcy, two parties that are each others' mutual creditor and debtor can, by means of a declaration to the other party, in principle set off their mutual claims up to the amount which they have in common. The following requirements will then apply:

(a) the parties have to be mutual creditor and debtor to each other;

(b the claims should correspond to each other (i.e. the debtor should have the right to settle its debt with its claim);

(c) the party invoking set-off is entitled to pay its debt (e.g. the debt has matured or may be prepaid); and

(d) the counter-claim of the party invoking set-off is enforceable.

These requirements, however, are of a non-mandatory nature: parties may agree otherwise.

Set-off in bankruptcy

Under the Act, the creditor of an insolvent debtor may invoke its right of set-off provided that his claim and his debt:

(a) date from before the date of the insolvency; or

(b) result from (one or more) transactions entered into with the insolvent debtor prior to the date of insolvency.

The requirements under (a) or (b) apply to both the claim and the debt. In other words: the cross claims must have pre-insolvency roots. Because the Act presupposes that each creditor of an insolvent debtor may regard his debt as security for the payment of his claim, it may be assumed that all contractual set-off arrangements can be enforced against a receiver, provided that the claim and counter-claim have a pre-insolvency basis. The same applies when the insolvent party is in suspension of payments.

Payments credited to a bank account of the bank's insolvent client after the bankruptcy date do not reduce that client's indebtedness to the bank, unless the bank had a right of pledge over the client's claim vis-à-vis a third party, which was paid into the client's bank account. The same applies if the bank, prior to the client's insolvency, knew that the bankruptcy of its client was to be expected at the time of crediting the bank account.

Neither the court nor the receiver is required by law to apply set-off ex officio, i.e. the creditor of the bankrupt company is required to invoke set-off itself in order for set-off to operate.

Recognition of foreign insolvency proceedings

Within the scope of the EU Insolvency Regulation

Under the Regulation recognition in the Netherlands of foreign insolvency proceedings (listed in the Regulation) would be automatic.

Outside the scope of the EU Insolvency Regulation

To what extent foreign insolvency proceedings of debtors incorporated outside the European Union (or in Denmark) are recognised in The Netherlands, is unclear. It appears from Supreme Court case law, save international treaty provisions to the contrary, that foreign insolvency proceedings, in principle, only have territorial effect.

This means, first of all, that the foreign general attachment of the insolvent debtor's assets (or similar effects, such as the transfer of the estate to a receiver in bankruptcy) does not include the assets of the debtor that are situated in The Netherlands. Furthermore, in principle legal effects of insolvency proceedings under foreign insolvency laws cannot be invoked in The Netherlands.

Although international insolvency law of The Netherlands is based on the territorial effect of foreign insolvency proceedings, this does not mean that these proceedings do not receive any recognition at all. The foreign receiver has *locus standi* in The Netherlands. The powers granted to a liquidator by the foreign *lex concursus* should therefore in principle be recognised in The Netherlands. Also in other respects foreign insolvencies can have legal consequences in The Netherlands. It could be argued that the legal consequences created by the foreign insolvency law can be recognised in The Netherlands, as long as (i) they are not closely connected with the fact that the foreign insolvency must be regarded as a general attachment on the insolvent debtor's assets for the benefit of all his creditors, and (ii) this does not lead to unsatisfied creditors no longer having recourse in respect of assets of the insolvent debtor that are situated in The Netherlands.

One of the main principles of international insolvency law of The Netherlands is that, as far as insolvency proceedings commenced in the Netherlands are concerned, the Netherlands proceedings have "universal effect", which (*inter alia*) means that they aspire to comprise all assets of the insolvent debtor, including those situated abroad.

POLAND

Key Elements:

- Single bankruptcy proceeding
- Separate recovery proceeding
- Ranking of claims
- Directors' duties
- Antecedent transactions

Insolvency regimes

Under the Bankruptcy and Recovery Law dated 28 February 2003 there is a single bankruptcy proceeding (*postepowanie upadlosciowe*) carried out by the court, whereby two insolvency options are available: (i) the liquidation of the bankrupt estate and pro rata distribution of proceeds to the creditors pursuant to the statutory order of priority of claims, or (ii) preserving the debtor's business through a composition arrangement, which is subject to creditors' approval in a vote and final approval by the court.

In addition, there is a separate recovery proceeding (*postepowanie naprawcze*). The procedure is simplified and is basically carried out by the debtor itself (out-of-court, although subject to certain controlling powers of the court). Its aim is to provide a framework for the debtor to reach a composition arrangement with its creditors.

Only an "entrepreneur" (i.e. a natural person, legal person or partnership, which in its own name carries out business activity) can be declared bankrupt. An entrepreneur is obliged to file a petition for the commencement of bankruptcy proceedings within two weeks of the date that a reason for its bankruptcy declaration occurred (i.e., either the solvency test or the balance sheet test was passed). The same duty applies to each representative of a debtor who is a legal person or an entity having legal capacity without being a legal person.

The recovery proceeding is optional, i.e. the debtor who anticipates its insolvency in the future but still remains solvent has the right (but not a duty) to commence the proceedings.

Proposed amendments

The Bankruptcy and Recovery Law is going to be amended, although the exact timing and scope of amendments has not yet been fully determined. Most of the proposed changes are "cleanups" and clarifications but the Parliament is also suppose to deal with some substantive changes as well (e.g. bankruptcy tests, treatment of security assignment, consumers bankruptcy etc.).

Test for Insolvency

Insolvency test

The insolvency test is passed if the debtor does not perform its obligations (whether pecuniary or non-pecuniary) as they fall due.

Balance sheet test

The balance sheet test is passed if the debtor's total obligations exceed the value of total assets (even if the obligations are being performed on a timely basis).

To become "insolvent", a corporate debtor must satisfy either the (i) insolvency test; or (ii) the balance sheet test. With respect to other debtors (especially, sole traders), only the insolvency test applies.

Bankruptcy proceedings

Bankruptcy proceedings are initiated either voluntarily (i.e. through filing by the debtor) or involuntarily (i.e. through filing by any creditor). The court decides after a hearing whether the tests for commencement (described above) have been met. A petitioning debtor must, and a petitioning creditor can, indicate in the bankruptcy petition whether it applies for bankruptcy with a composition option or liquidation.

If it is sufficiently substantiated that through the composition the creditors would be satisfied to a greater extent than in the case of liquidation, the court will declare bankruptcy with a composition option. However, the composition option will not be allowed if, due to the debtor's behaviour to date, there is no certainty that the composition will be achieved (unless the composition proposals provide for a liquidation plan). In addition, if an initial creditors' meeting was convened and adopted a resolution as to the method of conducting the proceedings (i.e. composition or liquidation), the court should respect such resolution unless it is contrary to the law.

During the proceedings the court is able to change its original decision in respect of the applicable bankruptcy option and accordingly switch from the composition option to liquidation or vice versa. Such a decision can only be made if grounds justifying the alternative option have become apparent in the course of the proceedings.

Recovery proceedings

It is the debtor (and not the court) who commences the recovery proceedings by way of notice filed with the court. Therefore, creditors and shareholders do not have the right to apply for the opening of recovery proceedings.

The debtor's notice of commencement of the proceedings should contain administrative details regarding the debtor and should indicate and substantiate circumstances justifying the notice. The notice should be attached with a recovery plan.

The court may prohibit the proceedings from being commenced within fourteen days of the debtor's filing. The court can only prohibit recovery proceedings if the statutory conditions for the commencement are not met, the notice of commencement or attachments do not comply with applicable requirements, or the representations or information set out in the documents filed is not true.

Moratorium

A moratorium applies in relation to each of the aforementioned insolvency regimes. However, the bankruptcy with a composition option and the recovery proceedings do not affect the rights of secured creditors who can enforce their secured claims. The court may temporarily suspend the enforcement, but for not more than three months.

Priorities

Priority of unsecured claims

Unsecured claims to be satisfied out of the proceeds of liquidation are grouped into four categories to be satisfied in the following order:

(i) costs of bankruptcy proceedings; social insurance premiums payable on behalf of the employees; employment claims; farmers' claims under contracts of delivery of products from their own farm for the last two years; pensions due as compensation for causing a disease, inability to work, disability or death; alimony claims; claims originated by the acts of the bankruptcy officer; claims under executory contracts whose performance was demanded by the bankruptcy officer; claims stemming from unjust enrichment of the bankrupt estate; claims generated by the bankrupt's acts carried out with the permission of the court supervisor;

(ii) tax liabilities, other public dues and social insurance premiums not falling into the first category for the year preceding the declaration of bankruptcy, together with interest and costs of execution;

(iii) other claims that do not fall into the fourth category, together with interest for the year preceding the declaration of bankruptcy, together with contractual damages, costs of litigation and execution; and

(iv) interest that does not fall into the higher categories (to be paid out in the order in which the principal sums should be satisfied); fines imposed by the courts and administrative authorities; claims in respect of donations and legacies.

A claim (receivable) against the debtor acquired by way of assignment or endorsement after the declaration of bankruptcy will be satisfied under the third category, unless it is to be satisfied in the fourth category.

Secured creditors

Claims secured in rem, i.e. by way of mortgage, pledge, registered pledge, treasury pledge and maritime mortgage, are dealt with separately from unsecured claims. The Bankruptcy and Recovery Law does not give a secured creditor control over the realisation of the encumbered assets, but it does adopt a clear and sensible approach to realisations. It provides for a separate distribution of proceeds realised from the sale[12] of the encumbered assets[13]. The sale proceeds, after deduction of the costs of sale, are distributed to the secured creditors according to their respective priorities. But, in the case of security over real property or ships (mortgage), the following claims will have priority over the mortgagee's claim: (i) alimony claims; (ii) claims of the employees who performed their work on the real property or ship for the last 3 months preceding the sale (but not more than three times the minimum guaranteed salary); and (iii) pensions due as compensation for causing a disease, injury or death.

Where an asset (a moveable, a receivable or a property right, or a collection thereof) has been encumbered with a registered pledge comprising a contractual option to satisfy the secured claim by taking-over the encumbered asset or by way of its sale, the pledgee will still be able to exercise these contractual options. Accordingly, such assets will be liquidated, at the pledgee's option, through the pledgee taking over title to the assets or through a sale.

As regards security assignment and security transfer of ownership, it has been commonly understood that assets constituting collateral do not constitute part of the bankrupt estate. If such assets are classified as parts of the bankrupt estate, secured creditors (as their owners) can claim their release. The creditors will satisfy their claims pursuant to an agreement establishing security (usually, by way of sale of assets transferred as security or definite assumption of ownership).

12 As a rule, the bankruptcy trustee through a court-supervised, public auction carries out the sale. It is also possible that assets can be sold through an unrestricted sale.

13 If the debtor's business is to be sold as a going concern, it is necessary to value it, presenting in particular the value of security interest and the value of encumbered assets as well as the ratio between the value of security interest and the value of business as a whole.

The remaining portion of their claims (if any) will be satisfied from liquidation of the bankrupt estate.

Creditors who hold claims secured on the debtor's assets located abroad by way of mortgage or entry into a register cannot participate in bankruptcy distributions. Such claims will be allowed only if the creditor submits evidence that security has been de-registered (released).

The unsecured creditors may instigate execution proceedings to enforce their mature receivables. Execution can only be carried out based on a court judgment or other executory document (e.g. an arbitration award or a notarial submission to execution). Before a judgment is issued, the creditor can request the court to issue an interim injunction to "freeze" the debtor's assets until the judgment is issued.

Directors

Under Polish law, fiduciary duties are imposed only on *de jure* directors, i.e. (in the case of companies) members of the management board. *De facto* directors (i.e. those to whom certain management powers are delegated) will be responsible only within the scope of their contract with the company (usually, framed as employment contract). The concept of "shadow directors" is not recognised by Polish law, although one cannot exclude that a person who indeed controls the managers of the company may be held liable for damages it has caused, based on the principle of fault.

In relation to the duty to file a bankruptcy petition, the Bankruptcy and Recovery Law sets out a list of persons obliged to do it, e.g. with regard to legal persons and other organisational entities – it is any person authorised to represent them individually or jointly with other persons; with regard to partnerships – it is any partner; with regard to an entity being subject to non-bankrupt liquidation – it is any liquidator. The duty to file a petition applies to each representative of a debtor who is a legal person or an entity having legal capacity without being a legal person. For companies, this applies to each member of the management board (i.e. *de jure* directors).

Management duties and potential liabilities

Members of the management board owe fiduciary duties to the company itself and can be held liable to it for either breach of law or the company's charter. They can also become liable to the shareholders and third parties (contractors, suppliers, employees etc.) based on the principle of fault (which is present not only if there is an actual intent to cause harm but also in the case of negligence). In certain circumstances, members of the management board can also be subject to criminal liability.

If the members of the management board fail to file the petition for a bankruptcy, contrary to the duty to do so, then they are liable to the creditors for any damages incurred by their failure to file. In limited liability companies, their liability goes even further as they are also liable for all debts of the company if enforcement against the company's assets has proven unsuccessful. Furthermore, they may also be subject to criminal liability (imprisonment for up to 1 year) and be deprived of the right to run a business, act as a representative of entrepreneurs and/or sit on the supervisory boards of companies and co-operatives.

Under Polish law, members of the management board have only statutory duties (stemming from generally applicable laws) and contractual duties (stemming from the relevant contract under which they perform the duties).

Insolvency issues for directors

Wrongful or fraudulent trading triggers civil liability and, in certain circumstances, may also lead to criminal liability. If such facts are established and the tests for composition are substantiated, the court will not allow the management board to keep control over the assets as a "debtor in possession". Following the declaration of bankruptcy, the bankruptcy officer will be able to take an action for compensation against them if, as a result of wrongful or fraudulent trading, the company has suffered damage.

The directors are criminally liable for transactions considered commercially reckless and leading to bankruptcy, as well as for preferential treatment of certain creditors in the event of an upcoming bankruptcy. Notably, for the purposes of the balance sheet test, one should take into account not only mature obligations but also known and/or foreseeable future obligations.

Lender liability

The notion of lenders' liability for the borrower's debts (construed on the basis of "shadow director" or similar concepts) has not been recognised in the legislation, legal doctrine or court practice in Poland. A lender who controls and directs the debtor's business can be found liable for the debtor's debts based on the general principle of fault. To date, the concept of controlling/directing lenders' liability for the borrower's debts has never been successfully claimed in Poland.

Creditor grouping

Voting procedure applies to a number of decisions, but the two most important are the determination of applicable mode of the proceedings (liquidation or composition) and, in the case of composition, the approval of the composition plan. For the purpose of voting on the composition plan, the judge-commissioner will classify the creditors into the groups that follow: (i) employment, (ii) claims secured in rem; (iii) creditors who are shareholders; and (iv) other claims (which may be split into further groups).

Creditors vote in groups. The composition is concluded if the proposals have been accepted in each group by a majority of creditors whose claims in aggregate amount to at least two thirds of the total amount of claims authorised to vote. However, the judge-commissioner will establish that the composition is concluded if there is no required majority in one of the groups of creditors, provided that: (i) a majority of creditors from each of the other groups have accepted the composition, and (ii) the creditors from the dissenting group would be satisfied through the composition to an extent which is not less favourable than in the case of liquidation.

The composition binds all creditors whose claims are subject to composition, save for those whose claims have been deliberately kept undisclosed by the debtor and who have not participated in the proceedings.

Dissenting creditors can appeal against the court decision approving the composition. The appeal can be based on either procedural or substantive grounds; the most significant objection being that the composition is not compliant with the law (but, notably, the law does not limit the scope of available workouts, provided that their terms must be identical in relation to each creditor in the same group) or that its terms are blatantly detrimental to creditors who voted against it and filed pleas.

The aforementioned bankruptcy proceedings aim to enhance the preservation of companies therefore, the courts are quite favourable to the debtors. However, the position of creditors has been significantly improved in comparison to the previous regime. For example, an initial creditors' meeting may choose the method of conducting the proceeding (i.e. composition or bankruptcy) and this choice is binding upon the court. The creditors can also impose their own composition plan (which may even comprise a liquidation plan) on the debtor.

Antecedent transactions

All gratuitous transactions performed by the debtor within one year before the bankruptcy filing are ineffective. The same applies to transactions where a value received by the debtor is considerably less than the value of the debtor's performance i.e. transactions at an undervalue.

The repayment of a debt prior to its maturity date or the establishment of a security interest in order to secure such a debt will not be effective, if made within two months preceding the day of the bankruptcy filing. The creditor may request that the repayment or the provision of security be declared effective on the basis that he had no knowledge about the existence of grounds for the declaration of bankruptcy.

Transactions with related parties (relatives or affiliated companies) are ineffective if made within six months before the bankruptcy filing (even if made at arms length and on fair market terms).

The judge-commissioner may also declare as ineffective the establishment by the debtor of a security interest in rem (including pledge and mortgage) as security for a third party's debt if the debtor has obtained in return no value or inadequate value. Irrespective of the value received, the judge-commissioner will declare ineffective any security interest to secure a debt of a related party. In these cases, the "hardening" period is one year.

The bankruptcy officer may also file an action with the civil court in order to declare any other transaction ineffective if it was made to the creditor's detriment, based on the general "actio Pauliana" (in which case the "hardening" period can be up to five years). A transaction will be declared ineffective on this basis if:

(i) the transaction was detrimental to creditors, i.e. the debtor, as a result of the transaction, became insolvent (or, if it was already insolvent, became insolvent to a greater extent);

(ii) the debtor was aware of the detrimental effect on the position of creditors; and

(iii) the other contracting party was aware of the detrimental effect or, acting diligently, could have become aware of the detrimental effect (awareness is presumed if the contracting party was in a close commercial relationship with the debtor).

In general, all transactions concluded within a hardening period described above are captured by the relevant hardening periods notwithstanding the debtor's intention.

There are two exceptions. Firstly, if the debt was repaid prior to its maturity date, or security was given to secure immature debt, the creditor may rebut the challenge if it proves that at the moment of accepting the repayment or security he was not aware of the existence of the grounds for a declaration of bankruptcy. Secondly, with regard to "actio Pauliana" described above, the creditor may also rebut the challenge if the creditor can prove that they could not have become aware of the detrimental effect.

Recharacterisation

A shareholder's claim in respect of a loan granted to its subsidiary company shall be treated as a contribution to the company's share capital if the company is declared bankrupt within two years of the date the loan agreement being entered into.

All transactions with related parties are ineffective if made within six months before the bankruptcy filing (irrespective of whether any value was provided).

The parent company cannot be liable for the debts of a subsidiary.

Set-off

Set-off is inadmissible if the creditor has acquired its claim by way of assignment or endorsement after the declaration of bankruptcy or within the last year preceding the declaration of bankruptcy if such creditor knew of reasons, which may have led to the eventual bankruptcy.

In the case of bankruptcy with the composition option, as long as the proceedings are not discontinued, completed or switched to the liquidation option, set-off is inadmissible if the creditor has become the bankrupt's debtor after the declaration of bankruptcy, or (while being the bankrupt's debtor) has acquired a claim against the bankrupt by way of assignment or endorsement after the declaration of bankruptcy. However, this limitation does not apply if the creditor has acquired the claim as a result of subrogation i.e. by way of paying off the bankrupt's debt for which it had been personally liable (e.g. as guarantor) or with certain assets (e.g. as pledgee), provided that the liability for the bankrupt's debt originated before an application for bankruptcy was filed. A creditor who wishes to exercise the right of set-off must make a declaration to that effect no later than at the point of filing of its proof of claim and such declaration should be attached thereto.

In the case of bankruptcy with the liquidation option, set-off is possible only if both debts existed at the time of declaration of bankruptcy, even if payment of one of them was not due. The creditor's debt will be fixed at the aggregate amount whereas the bankrupt's debt will be fixed as the principal sum with no interest as from the date of declaration of bankruptcy. If the bankrupt's non-interest-bearing debt did not fall due on the date of declaration of bankruptcy, the amount to be set-off will be the sum reduced by statutory interest (at a rate not exceeding six per cent per annum), running from the date of declaration of bankruptcy until the payment date, but not for more than two years.

Recognition of foreign insolvency proceedings

The comments below do not apply to insolvencies within the EU, which are recognised pursuant to the Regulation.

The Bankruptcy and Recovery Law deals with the recognition of foreign insolvency proceedings in line with the UNCITRAL Model Law on Cross-Border Insolvency.

The recognition of foreign insolvency proceedings does not prevent the Polish court from opening parallel bankruptcy proceedings in Poland (provided that if the foreign insolvency proceedings are recognised as the main proceedings, the proceedings in Poland will have the status of secondary proceedings and can relate only to the debtor's assets located in Poland).

The debtor does not have to run a business in Poland in order to be eligible for bankruptcy proceedings. It is sufficient if the debtor's assets (not necessarily organised as an enterprise) are located in Poland. The debtor must possess bankruptcy capacity, i.e. must be capable of acting in a court proceeding and be an "entrepreneur" within the meaning ascribed to this term by the Bankruptcy and Recovery Law.

Polish Courts will recognise only those foreign proceedings that meet the statutory definition, which covers "any court or administrative proceedings carried out abroad the subject of which is joint enforcement of claims against an insolvent debtor, where the assets and matters of the debtor are surrendered to the control or management of a foreign court for the purpose of their restructuring or liquidation".

Recognition proceedings can only be instigated upon a motion by a foreign administrator. The Polish court will issue an order on the recognition if the Polish courts have no exclusive jurisdiction, the recognition would not conflict with the basic principles of legal order in Poland, and the motion for recognition meets formal requirements. The order on recognition will indicate whether the recognised proceedings are main or secondary proceedings.

The recognition of foreign insolvency proceedings comprises the recognition of decisions relating to the appointment, dismissal and change of an administrator, and decisions relating to the conduct of the foreign proceedings, their suspension or completion. Furthermore, the Polish court can also decide on the enforceability in Poland of foreign executory documents issued in the course of the foreign proceedings (e.g. a list of claims, a composition or similar documents), provided that such executory documents are enforceable in the state where they were issued and relate to a matter that is not subject to the exclusive jurisdiction of the Polish courts, and their enforcement would not conflict with the basic principles of legal order in Poland.

On the day of recognition, by operation of law the court actions relating to the debtor's assets are stayed, and the debtor is deprived of the right to manage and dispose of its assets (unless the recognised proceedings contemplate a composition and the debtor has retained possession of its assets).

The effects of any bankruptcy declaration issued abroad and recognised in Poland as to the assets located in Poland and as to the obligations that have originated or are to be performed in Poland, are subject to Polish law. In addition, the ineffectiveness and avoidance of the debtor's transactions relating to the assets located in Poland will also be subject to Polish law.

THE CZECH REPUBLIC

Key Elements:

- Reorganisation procedures available since January 2008
- Increase in creditor control
- Automatic stay applies
- Set-off is allowed
- Netting arrangements still work

Introduction

As of 1 January 2008, the Czech Republic completely overhauled its insolvency law, replacing its Bankruptcy and Composition Act of 1991 with a new Insolvency Act (Act No. 182/2006 Coll., the "IA"). The legislative process leading to the new codification was long and difficult, but one can say with a reasonable degree of confidence that, quibbles aside, it has resulted in a modern insolvency law regime for corporate debtors. The IA also introduces discharge proceedings available to not-for-profit organisations and individuals but this area of the law, although interesting, is beyond the scope of this publication.

Insolvency and restructuring processes

Under the IA, there are two main types of proceedings available to corporate debtors: liquidation (*konkurs*), i.e. a sale of the estate (piecemeal or as a going-concern) with satisfaction of creditors through distribution of the proceeds, and reorganisation (*reorganizace*), i.e. a non-liquidation reorganisation measure, typically a re-capitalisation, based on a reorganisation plan approved by creditors and the court.

In theory, the proceedings under the Insolvency Act start as unitary with a general phase meant to determine insolvency and the method of its resolution (i.e. liquidation or reorganisation). In actual fact, the majority of corporate debtors will proceed straight into liquidation, upon court determination of their insolvency. This is because reorganisation (unless pre-approved by the majority of secured and unsecured creditors) is available only to debtors who meet a certain threshold, being either minimum annual sales of CZK 100m (approximately €4m) or minimum staff of 100 full-time employees. Based on data on the debtor population under the previous bankruptcy regime in the years 1991 to 2004, this would apply to 8 – 9 per cent of all debtors.

Liquidation

In liquidation, a trustee will displace management, gather the assets, list and verify liabilities (both subject to the possible adjustment via adversary proceedings where ownership of assets or amount or rank of claims is disputed), convert the assets into cash through a sale (piecemeal or going concern) and distribute the cash to creditors in an order of priorities that follows, subject to certain exemptions, the ranking of claims under non-insolvency law.

Reorganisation

The reorganisation provisions were heavily inspired by Chapter 11 of the U.S. Bankruptcy Code, but with significant departures from this model especially as regards the entry into reorganisation (see the "threshold test" above and the creditors' right to determine the type of proceedings, described further below in this section).

In reorganisation, the debtor's management will remain in control, being monitored by a trustee and a creditors' committee and will, upon the court allowing a reorganisation attempt through an initial ruling, propose and negotiate a plan, while the company's business continues. Shareholders will be stripped of their voting control with one exception – they will keep the right to elect the management. Creditors will be able to pre-empt the court's decision on whether a reorganisation attempt should be allowed through a vote, however, such decision must be approved either by a significant majority across classes (90 per cent of all claims present or represented) or by both secured and unsecured creditors voting separately (in each of these groups through a simple majority of claims present or represented). If creditors decide that the debtor's business should be liquidated, the court will convert the proceedings into liquidation, in spite of the debtor meeting the size test, described above. If the creditors agree with the reorganisation plan (or, in relation to a debtor who meets the size test, do not agree but fail to obtain the requisite majority of votes against the debtor's proposal), the court will allow a reorganisation attempt if it is satisfied that reorganisation is proposed in good faith.

This decision will have to be taken within three months of the debtor being declared insolvent by the court. Management will then have an exclusivity period of 120 days (which the court may extend by up to another 120 days) to submit a proposal of a plan to the court, together with a disclosure report. Upon the court's approval of the report, but not earlier than after 15 days from the report being published, a creditors' meeting will vote on the plan. The plan may propose any lawful measure of resolution of the company's insolvency – the IA allows flexibility in this respect. Creditors will vote on the plan by classes; a majority in the number of creditors and by amount of claims in each class is needed for the plan to be approved. Creditors will be placed in classes according to criteria proposed in the plan, however, each secured creditor will always be in a class of its own, as will be the company's shareholders. Creditors whose claims are not affected by the plan will be deemed to have approved the plan. As regards classification of other claims, claims grouped in any one class must be substantially the same as regards their legal rights and their commercial nature. A plan approved by all classes will be confirmed by the court subject to several tests, most importantly legality and good faith, and minimum pay-out test on individual rather than class basis (in U.S. bankruptcy law, this would be called the "best interest" test), being the likely pay-out in a liquidation. The court may also confirm a plan not approved by all classes (the so-called "cram-down") but only if at least one affected class distinct from the shareholders voted in favour of the plan and if the plan (i) leaves the security interests of secured creditors substantially unaltered and pays to secured creditors the net present value of their collateral, as determined by an expert valuer, and (ii) adheres to the "absolute priority rule" with respect to other classes, meaning that the opposing unsecured creditor class must either be paid in full or no class junior to its claims may receive any pay out under the plan, which may entail wiping out the current equity and replacing it with new registered capital. Upon confirmation, the pre-confirmation claims will be extinguished and replaced by new claims as determined in the plan. Also, assets will be freed from pre-confirmation encumbrances. The proceedings will not be terminated upon confirmation. They move into the "performance" phase in which management will remain in control but will still be monitored by the trustee and the creditors' committee. If the plan is performed as confirmed, the court will close the proceedings. If the plan is not performed the court will convert the proceedings into liquidation where creditors claims are at the level previously agreed in the plan.

Impact on third party rights

An insolvency petition will be registered by the insolvency court and published in an on-line publicly accessible insolvency register within two hours of the filing. Upon the publication, the enforcement of creditors claims (secured as well as unsecured) becomes subject to an automatic stay. In liquidation, the stay is de facto limited through a rule that allows the secured creditor to issue instructions to the insolvency trustee as regards the realisation of the collateral. The court may reverse these instructions only where they would prejudice the common interest of all creditors on the highest possible realisation of the estate. In reorganisation, enforcement of creditors claims (including secured creditors claims) will be subject to the stay throughout the reorganisation proceedings. The mitigating factors are the creditors' right to preclude a reorganisation attempt (as explained above) and the debtor's obligation to pay interest to the secured creditors at contract rate from the value of their collateral as determined by an external valuer. A failure to meet these payments would mean a conversion to liquidation.

Unlike in some other jurisdictions, the automatic stay does not extend to shield executory contracts from termination by the debtor's counterparty. These are subject to (rather unclear) rules in liquidation – essentially, the trustee will be able to assume or reject an executory contract but if he does neither within 15 days from the court's decision that the proceedings will be liquidation proceedings, the contract will be deemed to be rejected. The main difficulty with this rule, in addition to the inadequate length of the period given to the trustee, is the fact that the IA effects rejection on a rescission only basis which, under Czech law, puts the parties back in their original position. The counterparty's claim for rescission will rank as an administrative priority claim. This solution is very disruptive (not least to general pre-commencement creditors who will be subordinated to this claim) and seems out of line with rules dealing with executory contracts in other jurisdictions. In reorganisation, executory contracts are arguably not regulated at all, although the IA contains a provision that could possibly be interpreted as a prohibition of ipso facto clauses. The law in relation to executory contracts is arguably the least successful part of the IA and one must hope that the legislator will address these issues in the near future.

Priority ranking of creditors

With certain exceptions, the IA respects the ranking of claims under pre-insolvency law, i.e. it respects both the priority of secured claims and the subordination of junior claims.

With respect to secured claims, the priority is absolute in liquidation, save for capped deductions for the costs of maintenance and sale of the collateral (these should not amount to more than 9 or (depending on the reading of the law) 11 per cent of the gross proceeds of the realisation of the collateral. In a reorganisation, secured creditors may, under certain circumstances, have to suffer a dilution as a consequence of post-commencement finance claims which may rank *pari passu* with pre-commencement secured claims. But this would only be so where (i) the post-commencement financing was provided following the court's approval of the reorganisation attempt and in furtherance of the goals of the reorganisation, and (ii) the secured creditor did not make use of the right of first refusal, granted by the IA, to provide the post-commencement financing itself.

Unsecured claims will be subject to secured pre-commencement claims, administrative (i.e. post-commencement) claims as well as certain preferred pre-commencement claims, most notably unpaid wages and other employee claims going three years back and to personal injury claims.

Subordinated claims will be paid subject to the terms of their contractual subordination. The IA did not introduce equitable subordination of shareholder or other connected party claims.

Directors' duties

These can be grouped into duties relating to the opening of the proceedings and duties that directors have in the proceedings where they remain in control.

The former duties mainly include the directors' duty to file for the commencement of proceedings without delay after the directors have determined, or should have determined, that the company is insolvent. Insolvency is tested both on the cash-flow basis (i.e. the company's ability to meet current debts) and the balance sheet (i.e. the market value of the company's assets against the total amount of its liabilities). This duty is subject to very stringent liability for damages – directors who are in default of the duty will be liable to creditors for damages whose amount will be presumed to be equal to the difference between their proven claims and the insolvency dividend.

The latter duties can be described as the fiduciary duties to the creditors similar to those applicable to the insolvency trustee. The directors who remain in control of the company will have to act diligently and will be obliged to put the creditors' interests first.

Lender liability

As a matter of fact, lender liability law does not exist in the Czech Republic but there are statutory provisions (most notably rules on shadow directorship) which could be used to make a creditor who substantially influences the company's actions liable to the company and indirectly its shareholders. There are, however, no reported higher instance court cases of these rules having been used, let alone used against creditors, so the actual legal position under Czech law is difficult to gauge.

Challenging antecedent transactions

The IA allows the insolvency trustee (but not the debtor's management) to sue in order to avoid antecedent transactions that can be shown to constitute a preference, an undervalue or a transfer with actual fraudulent intent. The trustee may bring the action within one year from the opening of insolvency proceedings. The standard claw-back period is one year for preferences and undervalues and five years for transactions with actual fraudulent intent. For preferences and undervalues, the trustee must show that the debtor was either insolvent or became insolvent as the result of the transaction. For transactions with connected parties, the claw-back period for preferences and undervalues is extended to three years and the debtor's insolvency will be presumed.

Set-off

The IA has substantially liberalised insolvent set-off which was fully precluded under the previous Bankruptcy and Composition Act. Under the IA, a creditor may set off its mutual claims vis-à-vis the debtor provided that the substantive conditions for the set-off were met prior to the date of determination of the type of bankruptcy proceedings. For all practical purposes, this means that a creditor will be entitled to off set pre-commencement claims although a creditor must formally prove its claim and pay any net sums due to the debtor. Also, a creditor will not be entitled to the set-off if he knew of the debtor's insolvency when he acquired his claim.

Guarantees

Guarantees of creditors' claims are not affected by the debtor's insolvency – i.e. the guarantor will pay the creditor outside the insolvency proceedings and will become subrogated into the creditor's procedural position.

The problem with guarantees in Czech law does not come from bankruptcy law but rather from Czech corporate law which contains highly confused rules on intra-group guarantees. In principle, these rules require all intra-group guarantees to be valued by a court-appointed valuer. If the valuation results in a positive number, the beneficiary must pay a fee to the guarantor. Under certain conditions, the guarantee may also need to be approved by the guarantor's general meeting. It is proposed that these rules will be substantially changed in 2008.

Also, another peculiarity with respect to guarantees (and security in general) that one needs to bear in mind is that Czech corporate law prohibits financial assistance not only to joint-stock companies (*akciová společnost*) but also to limited liability companies (*společnost s ručením omezeným*). This is not proposed to change in 2008 when the amendments to European financial assistance rules in the Second Company Law Directive are proposed to be implemented in Czech law, although the prohibition will likely be relaxed, similarly to the relaxation with respect to joint-stock companies as it follows from the amended Second Company Law Directive.

New money lending

New loans made to the insolvency trustee in liquidation will have priority over general creditors but not secured creditors. In a reorganisation, the situation is somewhat more complicated. As was mentioned in the section on "Priority Ranking of Creditors", secured creditors may, under certain circumstances, have to suffer a dilution by new loans made after the commencement of the reorganisation proceedings which may rank *pari passu* with pre-commencement secured claims. But this would only be so where (i) the post-commencement financing was provided following the court's approval of the reorganisation attempt and in furtherance of the goals of the reorganisation, and (ii) the secured creditor did not use the right of first refusal, granted by the IA, to provide the post-commencement financing himself.

Recognition of foreign proceedings

With respect to European Union countries (other than Denmark), the Regulation applies to proceedings opened after 1 May 2004 when the Czech Republic acceded to the EU. Unfortunately, the IA contains no rules on cross-border proceedings outside the EU so there will be significant uncertainty on this point, which is unlikely to be amended before 2009.

SLOVAKIA

Key Elements:

- Single process for bankruptcy and restructuring
- Trustee recommendation required for restructuring
- Automatic stay prevents security enforcement
- Set-off allowed

Introduction

The current insolvency law of the Slovak Republic is based on the Act on Bankruptcy and Restructuring (Act No. 7/2005 Coll., the "**Bankruptcy Act**") which came into effect in the Slovak Republic as of 1 January 2006, replacing the Act on Bankruptcy and Compensation (Act No. 411/2004 Coll.)

The Bankruptcy Act also provides for discharge proceedings available to individuals, but this area of the law is beyond the scope of this publication.

Bankruptcy and restructuring processes

Under the Bankruptcy Act, there are two main types of proceedings available to corporate debtors: bankruptcy (*konkurz*), i.e. a sale of the estate (piecemeal or as a going-concern) with satisfaction of creditors through distribution of the proceeds, and restructuring (*rešntrukturalizácia*), i.e. reconstruction of the debtor's balance sheet, based on a restructuring plan approved by creditors and the court.

Generally, there is a single process under the Bankruptcy Act with a general phase meant to determine insolvency and the method of its resolution (i.e. bankruptcy or restructuring).

In bankruptcy, a trustee will displace existing management, gather the assets, list and verify liabilities (subject to the possible adjustment via adversary proceedings where ownership of assets or amount or rank of claims is disputed), convert the assets in cash through a sale (piecemeal or going concern) and distribute the cash to creditors in an order of priorities that follows, subject to certain exemptions, the ranking of claims under non-insolvency law.

In a restructuring, the debtor's management will remain in control, being monitored by a trustee and the court. Upon the court allowing a reorganisation attempt through an initial ruling based on the restructuring report prepared by the trustee (see below), the debtor or the trustee attempt to propose and negotiate a restructuring plan, while the company's business is being carried on.

If a debtor is threatened by insolvency or is insolvent, the debtor or the creditor/creditors (subject to the debtor's consent) may authorise a trustee to prepare a restructuring report on whether the debtor fulfills conditions for its restructuring. Authorising the preparation of a restructuring report, however, does not obviate a debtor's duty to file for bankruptcy in a timely manner.

Provided that the trustee in its restructuring report recommends the restructuring attempt, the court will allow it. The management (or in the event the restructuring is initiated by the creditor, the trustee) will then have 90 days (which the creditor's meeting may extend up to another 60 days) to submit a proposal of a plan to the creditor's meeting.

The creditors' meeting will vote on the plan within 15 days from the plan being submitted to it. The plan may propose any lawful measure of resolution of the company's insolvency as the Bankruptcy Act allows flexibility in this respect.

Creditors will be placed in classes, according to criteria proposed in the plan. The plan will usually provide for a class of secured and unsecured claims, as well as a class of shareholders' claims. These classes can be also divided into separate classes, in order to group together the claims which are substantially the same as regards their legal rights and their commercial nature.

Creditors will vote on the plan by classes; a majority by number of creditors and by amount of claims in each class combined with the approval of the simple majority of votes (based on the amount of their claims) of the present creditors is needed for the plan to be approved. Creditors whose claims are not impaired by the plan will be deemed to have approved the plan.

If the creditor's meeting approved the plan, the plan is submitted for final confirmation to the court. A plan approved by the creditor's meeting will be confirmed by the court subject to several tests, most importantly, from the point of view of legality, the best interest (being the likely pay out in bankruptcy). The court may also substitute the approval of the plan by a particular class of claims if (i) the relevant plan will not put that class in a worse position, (ii) a majority of the classes voted in favour of the plan by the required majority, and (iii) the present creditors with a simple majority of votes (based on the amount of their claims) voted in favour of plan too.

If the court rejects the plan, it will discontinue the restructuring proceeding and declare bankruptcy over debtor' assets. If the court confirms the plan, it will simultaneously rule on termination of the restructuring. The plan becomes effective upon its publication in the Commercial Gazette.

Unless otherwise provided for in the plan, the plan will not affect the rights of creditors to recover their original claims against co-debtors and guarantors of the debtor, nor will it affect the rights of creditors to satisfy their original secured claims from the assets of third parties.

Impact on third party rights

Bankruptcy

Upon publication of the court resolution on declaration of bankruptcy in the Commercial Gazette, the enforcement and/or execution proceedings of the creditors' claims already existing are stayed. Moreover, no enforcement of the security interest over the assets of the debtor securing the debtor's obligations can be commenced.

Unlike in some other jurisdictions, the automatic stay does not extend to the termination of executory contracts. These are subject to (rather unclear) rules in bankruptcy – essentially, the trustee will be able to assume or reject an executory contract provided that the relevant contract is entered into for indefinite period, the trustee has to do so within 2 months from the court's decision or such shorter period as prescribed by such contract. The main difficulty with this rule is the fact that the Bankruptcy Act effects rejection through the institution of rescission which, under Slovak law, results in the parties being put back into their original position. Although the counterparty's return claim will rank as an administrative priority claim, this solution is still very disruptive (not least to general pre-commencement creditors who will be subordinated to this claim) and seems out of line with rules dealing with executory contracts in other jurisdictions. Whereas in a restructuring, executory contracts are arguably not regulated at all.

In bankruptcy, the stay of the proceedings, as described above, is de facto limited through a rule that allows the secured creditor to issue binding instructions to the bankruptcy trustee as regards the realisation of the collateral. The court may reverse such binding instructions only where they would prejudice the justified claims of the other relevant creditors on or the rules of realisation of the estate prescribed by the Bankruptcy Act.

Upon commencement of the restructuring proceedings, withdrawal of a contractual party from a contract entered into with the debtor for reasons of debtor's delay with fulfilling its obligation under such contract which became due prior to commencement of the restructuring proceeding would be considered invalid. In addition, the contractual arrangements allowing a party to withdraw from a contract for reasons of commencement of restructuring proceeding or bankruptcy are also considered invalid.

Priority ranking of creditors

With certain exceptions, the Bankruptcy Act respects the ranking of claims as it follows from non-insolvency law, i.e. it respects both the priority of secured claims and the juniority of subordinated claims.

With respect to secured claims, the priority is absolute in bankruptcy, save for the costs of maintenance and sale of the collateral.

In bankruptcy, unsecured claims will be subject to secured pre-commencement claims, administrative (i.e. post-commencement) claims as well as certain preferred post-commencement claims, most notably unpaid wages and other employee claims, taxes, and customs. In a restructuring, the post-commencement claims, trustee's wages and non-monetary claims are considered "preferential claims". Preferential claims are not applied in the restructuring proceeding and remain unaffected by commencement of the restructuring proceedings. Should bankruptcy be declared during the restructuring process, the preferential claims which arose in connection with the running of a debtor's business during the restructuring will be satisfied prior to other unsecured claims.

Subordinated claims will be paid subject to the terms of their contractual subordination. The Bankruptcy Act does not provide for equitable subordination of shareholder or other insider debt claims.

Directors' duties

These can be grouped into general duties of directors to avoid insolvency, duties relating to the opening of the proceedings and duties that directors have in the restructuring proceedings where they remain in control.

The former duties include the directors' duty to file for the commencement of bankruptcy proceedings within 30 days after the directors have determined, or should have determined, that the company is insolvent. Insolvency is tested both on the cash-flow basis (i.e. the company's ability to meet current payables) and the balance sheet (i.e. the market value of the company's assets against the total amount of its liabilities). This duty is subject to very stringent liability for damages – directors who are in default of the duty will be liable to creditors for damages whose amount will be presumed to represent the amount of the claim that remained unsatisfied.

The directors who remain in control during the restructuring proceeding, are obliged to act so that they do not diminish the value of the assets of the debtor and do not circumvent the success of the restructuring process.

Challenging antecedent transactions

The Bankruptcy Act allows the insolvency trustee or the creditors to sue to avoid antecedent transactions that can be shown to constitute a preference, an undervalue or a transfer with actual fraudulent intent. The trustee and the creditors may bring the action within 6 months from the declaration of bankruptcy by the court. The standard claw-back period is one year for preferences and undervalues and five years for transactions with actual fraudulent intent. For preferences and undervalues, the trustee and/or the creditor must show that the debtor was either insolvent or became insolvent as the result of the transaction. For transactions with connected parties, the claw-back period for preferences and undervalues is extended to three years and the debtor's insolvency will be presumed.

Set-off
Under the Bankruptcy Act, set off is allowed, except that it is not possible to set off a claim against an entity that arose prior to declaration of bankruptcy of such entity against a claim of such an entity that arose following such a declaration. In addition, a claim not proved for in the bankruptcy as prescribed by law, a claim proved for but acquired by transfer after declaration of bankruptcy, and a claim acquired by an antecedent legal act cannot be set off against the debtor's claims. Set-off of any other claims is allowed.

Guarantees
Guarantees of creditor's claims are not affected by the debtor's insolvency, i.e. the guarantor will pay the creditor outside the insolvency proceeding and will become subrogated to the creditor's procedural position, unless, in case of restructuring, the restructuring plan states otherwise.

New Money lending
The Bankruptcy Act does not specifically deal with new money lending in case of bankruptcy proceedings. The new loans made to the debtor during restructuring proceedings, will have priority over general creditors but not the secured creditors.

Recognition of foreign proceedings
With respect to European Union countries and the signatories of the EEA Agreement[14], the Regulation applies to proceedings opened after 1 May 2004 when the Slovak Republic acceded to the EU.

Cross-border proceedings outside the EU are subject to the rules in the relevant bilateral agreement if in place, or if not in place, the principle of reciprocity with respect to acknowledgement of foreign judgements on bankruptcy and/or restructuring.

14 The agreement on the European Economic Area dated 2 May 1992.

ROMANIA

Key issues

- The effects of insolvency proceedings on the rights of secured creditors
- Guarantees
- Ranking of creditors' claims
- Lender liability issues
- Directors' duties
- Recognition of foreign proceedings

Concept of insolvency under the insolvency law

Pursuant to the provisions of the Romanian law on the insolvency proceedings No. 85/2006 (the "Insolvency Law"), a debtor is "insolvent" if it does not have sufficient available funds for the payment of its outstanding debts. Actual insolvency is presumed where the debtor has not paid a debt within 30 days of its due date. A debtor will also be held to be insolvent if it can be proved that the debtor is unable to pay its debts in the near future from available funds (imminent insolvency).

The Insolvency Law provides for two types of insolvency proceedings:

(i) a general insolvency proceeding applicable to certain categories of debtors which are (or will imminently be) insolvent (e.g. companies, European Economic Interest Groupings ("EEIG") or any other private law entities performing economic activities); and

(ii) a simplified insolvency proceeding applicable to other categories of debtors (e.g. individuals, traders, family associations or certain categories of companies such as companies which do not have any assets or are not able to produce accounting documents).

Commencement of the proceedings

The insolvency proceeding is started by filing a petition with the competent court. The petition can be filed by the debtor, by the creditors, or by certain persons or institutions expressly provided by law (e.g. the National Securities Commission, the National Bank of Romania, the Commission for the Supervision of Insurance).

(i) **The debtor**

The insolvent (or imminently insolvent) debtor is compelled by law to file a petition of insolvency within 30 days from the date it becomes aware that it is or will become insolvent, together with all relevant documents.

(ii) **The creditors**

The petition for opening insolvency proceedings may also be filed by any creditor who has an undisputed claim against the debtor which is quantifiable and has become due, but which has not been paid for more than 30 days.

(iii) **Other persons or institutions**

Other persons or institutions, such as the National Bank of Romania and the Commission for the Supervision of Insurances, may begin the insolvency proceeding in respect of entities under their supervision and control.

Simplified procedure

Under the simplified insolvency proceedings, the debtor will directly enter into liquidation proceedings, either upon the opening of the insolvency proceeding, or after an observation period of no more than 60 days.

Consequences of commencing insolvency proceedings

After considering the insolvency petition, the judge may initiate either (i) general insolvency proceedings (and appoint a judicial administrator) or (ii) simplified insolvency proceedings (and appoint a temporary liquidator).

On the commencement of insolvency proceedings, the debtor loses the right to administer its business (i.e. the right to manage its activity, its assets and to dispose of such assets – including those assets acquired subsequent to the opening of the proceedings), unless the debtor has declared, in certain cases, the intention to reorganise.

The right of management terminates on the date the insolvency proceeding is commenced. Any acts, operations and payments performed by the debtor after the proceeding is commenced are null and void, unless expressly provided by the law or authorised by the judge.

Commencement of insolvency proceeding is notified to all creditors, as well as to the debtor and to the Trade Registry. The decision on commencing the insolvency proceeding will state a term within which creditors should submit claims in the insolvency proceeding. The judicial administrator examines these claims to determine their legitimacy, exact value and priority. The outcome of such examination is recorded in a preliminary table of claims registered with the competent court. The debtor, the creditors and any other interested person may challenge such preliminary table in court. The preliminary table of claims is finalised and registered with the competent court after all such challenges are settled.

The judge will designate a committee of 3-7 creditors from among the largest of the secured claims, the preferential claims due to the state, and general claims. This committee can be replaced by a committee of 3 or 5 creditors designated by the creditors' meeting from those with the largest secured and general claims. The creditors' committee will, amongst other matters, analyse the debtor's situation and make recommendations regarding the continuation of the debtor's activity and the proposed plan of reorganisation, report to the creditors' meeting on the judicial administrator's or the liquidator's activity, solicit the annulment of any fraudulent transactions.

Judicial reorganisation

Following the commencement of insolvency proceedings, any creditors, the debtor or the judicial administrator has the option (upon meeting certain terms and conditions) to request a judicial reorganisation of the insolvent debtor. Judicial reorganisation is a procedure that facilitates the reorganisation of the debtor's business in order to allow payment of its debts according to a plan of reorganisation ("*plan de reorganizare*"), which may provide the following options: (i) the operational and/or financial restructuring of the debtor; and/or (ii) the corporate restructuring by amending the share capital structure; and/or (iii) the rationalisation of the business by liquidating certain assets. The plan is submitted for approval to the creditors and confirmed by the court. Should the judge approve the plan, the reorganisation procedure may not last more than three years.

During the reorganisation, the debtor shall manage its activity under the supervision of the judicial administrator and in accordance with the plan of reorganisation, until the judge decides that either (i) the insolvency proceeding has been concluded as a consequence of the debtor resuming its normal commercial activity, or (ii) the reorganisation has terminated and the debtor has entered into liquidation (i.e. where the reorganisation plan was unsuccessful).

Liquidation

If no plan of reorganisation was proposed or approved or if the plan was unsuccessful, or if the judicial administrator recommends liquidation and the creditors approve it, the judge may order the winding-up of the debtor, the liquidation of its assets and the distribution of the proceeds thereof.

Challenges

Fraudulent transactions

An insolvency official (i.e. the judicial administrator or liquidator) may challenge the following types of transfers performed prior to the opening of the insolvency proceedings:

(i) donations provided during the 3 years preceding the opening of the insolvency proceedings, (except for humanitarian donations);

(ii) transactions at an undervalue, entered into during the 3 years preceding the commencement of insolvency proceedings;

(iii) transactions intended to isolate a specific asset of the debtor from other creditors, executed during the 3 years preceding the commencement of insolvency proceeding;

(iv) the transfer of ownership rights to a specific creditor made in order to discharge a previous debt due to such creditor, if made during the 120 days period preceding the commencement of the proceeding and if the amount that such creditor would have obtained in a liquidation of the debtor would have been lower than the value of such transfer;

(v) the creation or perfection of security in favour of an unsecured claim, during the 120 days period preceding the opening of the proceedings;

(vi) prepayments of debt made within 120 days preceding the commencement of proceedings, if the due date of such debts would have occurred at a date after the commencement of proceedings; and

(vii) transfer or undertaking obligations made by the debtor during the 2 years preceding the opening of the insolvency proceeding with the intention to conceal the insolvency or delay the onset of insolvency proceedings or to defraud persons or entities who were creditors on the date of transfer (in case of transactions with derivative financial instruments, including the close out of a netting contract concluded on the basis of a qualified financial contract), or who became creditors at a subsequent date.

Disadvantageous transactions

The following transactions, concluded within the 3 years period preceding the opening of the insolvency proceeding may also be cancelled if these are detrimental to creditors:

(i) in relation to company's transactions between the debtor and a shareholder holding at least 20% of the capital or 20% of the voting rights;

(ii) in relation to an EEIG, transactions with a member or director;

(iii) transactions with a director, manager or member of the supervisory bodies of the debtor, where the debtor is a joint-stock company or a limited liability company;

(iv) transactions with any party, holding a dominant position over the debtor or its business;

(v) transactions with a co-owner over a common asset.

The insolvency official may challenge the above transactions within one year from the date the report on the debtor's insolvency status has been drafted by the insolvency official, but not later than 18 months from the commencement of the insolvency proceedings. If the insolvency official fails to take action to challenge any of the above-mentioned transactions, the creditors' committee may also challenge these transactions before the court. However, no such claim may be brought against these transactions if performed by the debtor in the ordinary course of its business.

Pending contracts

In order to maximise the value of the debtor's assets, the insolvency official may continue or unilaterally terminate any contract, including any unexpired lease, to the extent that such contract has not been performed in whole, or substantially by all the parties involved. The counterparties of such contracts are entitled to request that the insolvency official confirms in writing whether he is to exercise the option to either continue or terminate such contracts. If the insolvency official fails to reply to such request, he shall not be able to require performance under the respective contracts, and the contracts will be deemed unilaterally terminated.

If a contract is terminated unilaterally, the contractor may file a claim for damages against the debtor.

In addition, but only with the consent of the lenders, an insolvency official may continue to make use of credit facilities or may amend the clauses thereof, so that they ensure the performance of the future undertakings. Such amendments shall be subject to the approval of the creditors' committee, who shall examine whether they are for the benefit of both the debtor and the creditors.

Where a contract provides for periodic payments from the debtor, continuing the contract does not make the insolvency officer liable to pay sums due under the contract which relate to periods prior to the opening of the proceeding.

Security enforcement

As a rule, starting with the opening of the proceeding, all judicial and extrajudicial actions for the recovery of debts from the insolvent debtor are suspended.

In some cases (e.g. when the asset is not material for the success of the proposed reorganisation plan, or the asset belongs to a larger operational system and its independent sale would not affect the value of the system), a secured creditor can make a request that the court cancels such suspension with respect to that asset, provided that (i) the taxes, stamp duties and other expenses determined by the sale of the assets are paid and (ii) the provisions applicable to the realisation of assets are observed.

In liquidation proceedings, the proceeds of a charged asset will be applied directly to reduce the secured debt.

Guarantees

Romanian law allows downstream and upstream guarantees in most circumstances, provided that the corporate benefit of the transaction to the guarantor can be established. Due to the fact that companies are established for the purpose of obtaining profit, corporate benefit has to be established in all situations. Although downstream guarantees are generally valid, in certain situations upstream guarantees could be considered null and void if corporate benefit cannot be established.

According to Romanian Companies' Law no. 31/1990, certain restrictions apply to guarantees provided to directors of companies. For example, a company is prohibited from granting a guarantee in respect of obligations of its directors or his relatives. Also, the prohibitions apply where the beneficiary of the guarantee is a company where the spouse or the relatives of the director of the guarantor is a director or owns more than 20% of the share capital.

Under Romanian Companies' Law no. 31/1990, a company cannot grant any advance of money, lend its own money or charge its own property for the purpose of a third party subscribing or purchasing its shares. A guarantee provided by a company to a third party which uses the guarantee in connection with subscription or purchase of shares of such company is considered to be null and void. It is generally thought that this restriction applies only to joint stock companies (S.A.), but there is a view that such restrictions could be held also to apply to private limited liability companies (S.R.L.).

The Insolvency Law provides for the nullity of any transaction which is prejudicial to other creditors, entered into during the 3 years preceding the commencement of insolvency proceedings with, amongst others, the following persons:

a) an associate or a shareholder holding at least 20% of the social capital or the voting rights of the company;

b) a member or a director, when the debtor is part of a group;

c) a director, a manager or a member of the supervisory bodies of the debtor; and

d) any other person holding a dominant position in respect of the debtor or its business.

Payment priorities

According to the Insolvency Law, the proceeds of realisation of the secured assets are to be distributed to the secured creditors (for the satisfaction of the principal amount, the interest, penalties and any other costs), after payment of the taxes, stamp duties and other expenses determined by the sale of such assets. If the proceeds of enforcement are insufficient for the full repayment of the secured debt, such creditors will be treated as unsecured for the remaining part of the debt and will be satisfied according to the general order applicable for the other types of claim.

A secured creditor is entitled to take part in the distribution of any proceeds made prior to the realisation of the asset securing its claim, provided that any amounts received will be subsequently subtracted from the proceeds of realisation of the secured asset.

In liquidation, the general order of payment of unsecured debts is as follows:

a) taxes, stamp duties and other expenses incurred in connection with the insolvency proceedings;

b) employment claims;

c) post-commencement financing costs;

d) debts owed to the state (including taxes not related to the insolvency proceedings);

e) (where applicable) amounts due pursuant to maintenance obligations, child support or subsistence receivables;

f) (where applicable) certain amounts for the maintenance of the debtor and his family, when the debtor is an individual;

g) claims by certain types of creditors such as banks, landlords, suppliers of goods and services debts;

h) other general debts; and

i) subordinated debts, in the following order:

(i) loans granted by an associate or a shareholder holding at least 10% of the capital or of the voting rights of the debtor, or by a member of the EEIG; and

(ii) gifts.

Payments towards creditors having the same rank will be made proportionally. A debt from a certain class, as listed above, will be paid only after complete payment of the debts in the superior class.

The following amounts will be set aside in case of partial payments:

a) proportional amounts owed to creditors with contingent claims;

b) proportional amounts owed to bond holders who have not presented the originals for payment;

c) claims admitted provisionally; and

d) amounts to cover future expenses in respect of debtor's assets.

Directors' duties

As mentioned above, the insolvent (or imminently insolvent) debtor is compelled by law to file a petition of insolvency within 30 days from the date it becomes insolvent.

At the judicial administrator's request, the court may decide that some of the debts should be paid by the directors personally or by any other party who has contributed to the debtor's insolvency and has been involved in the following activities:

a) using the assets or loans granted to the debtor for their personal use or for that of a third party;

b) performing commercial activities in their personal interest, in the name of the debtor;

c) continuing, in their personal interest, an activity which was clearly leading the debtor to insolvency;

d) false accounting or failing to observe the legal requirements;

e) embezzling the debtor 's assets, or falsely increasing the debtor's debt;

f) using ruinous methods to procure funds in order to postpone the insolvency; or

g) paying or deciding to pay a creditor in preference to and with a detrimental effect on others, in the month prior to the insolvency.

Also the law establishes that certain criminal acts of the directors are punishable with imprisonment.

Lender liability

Although Romanian law does not use the concept of "shadow director" or "de facto director", the Insolvency Law provides that the court may decide that part of the debt be paid by any person who caused the debtor's insolvency through certain actions, as listed above. It could be considered this provision would include a person exerting powers as a de facto director. The Romanian law does not regulate the situation when the lender is in the position of being able to influence the management of the company.

Pursuant to the Insolvency Law, certain types of transaction may be challenged when falling under the definition of fraudulent or disadvantageous transactions, including transactions with any party, holding a dominant position in respect of the debtor or its business.

The Romanian Civil Code provides for a certain type of judicial action to be used by a general creditor in order challenge of a transaction entered into by the debtor which has the effect of prejudicing other creditors (*actiune revocatorie*).

New money lending

Loans granted by credit institutions after the commencement of the insolvency procedure, and other debts incurred by the continuation of the debtor's activity after the commencement of the insolvency procedure have priority over pre-insolvency debts.

Recognition of foreign insolvency proceedings

Law no. 637/2002 on Private International Law Relations in the Context of Insolvency Proceedings (the "Cross Border Insolvency Law") implements in Romania the UNCITRAL Model Law on Cross-Border Insolvency made in 1997 and has been in force since 1 July 2003. Additionally, the Regulation is directly applicable in Romania since Romania's accession to the European Union on 1 January 2007.

Other relevant EU directives have also been implemented through separate legislation, in particular:

a) Law no. 503/ 2004 on financial recovery and bankruptcy of insurance undertakings (the "Insurance Insolvency Law") implements in Romania the provisions of Directive 2001/17/EC of the European Parliament and of the Council of 19 March 2001 on the reorganisation and winding-up of insurance undertakings, and

b) Government Ordinance no. 10/2004 on judicial reorganisation procedure and bankruptcy of credit institutions, as approved and amended, implements the Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions.

INSOLVENCY AND RESTRUCTURING TRENDS IN EUROPE: AUTOMATIC STAY AND RESCUE PROCEDURES

England & Wales	France	Germany	Italy	Spain	The Netherlands
Yes, in administration (initially 10 weeks). Exceptions for secured creditors (who may enforce security with leave or consent).	*Mandat ad hoc* and conciliation procedures do not feature an automatic stay, but deferral of payment may be granted for up to 2 years in respect of individual creditors. Safeguard, rehabilitation and liquidation proceedings feature an automatic stay in respect of payment of debts originating prior to the commencement of the proceedings and commencement of legal actions.	During preliminary proceedings, a provisional stay of execution may be ordered by the insolvency court. After the opening of insolvency proceedings with the exception of claims assigned for security purposes and assets in the possession of the administrator, enforcement of security is possible – unless prohibited by court order (if the assets are required to continue the debtor's business; in such cases interest and compensation for loss in value is to be paid to the secured creditor).	Yes. In "*Concordato Preventivo*" (Composition with Creditors) and "*Accordo di Ristrutturazione*" (Restructuring Agreement), 2 yrs maximum. Security (other than pledges, which can be enforced according to their terms) cannot be enforced.	Enforcement of security suffers a delay up to 1 year.	Initially for 2 months. May be extended for further 2 months, secured creditors may enforce unless enforcement prohibited by court order.
Luxembourg	**Belgium**	**Poland**	**The Czech Republic**	**Slovakia**	**Romania**
Yes, during the controlled management procedure until a final decision is taken by the court.	Yes, during judicial composition, payments are suspended for a period of 6 months for a temporary moratorium (which can be extended to 9 months.). A definitive moratorium can last up to 3 years.	Yes, for up to 3 months. Bankruptcy with a composition option and recovery proceedings do not affect the rights of secured creditors who can enforce their claims.	Yes - stay kicks in upon the filing of the insolvency petition, applies to both unsecured and secured creditors. In reorganisation, the stay is not limited in time but, save for very large debtors, commencement of reorganisation is subject to creditor approval. Also, secured creditors are protected by interest payments on the value of their security throughout reorganisation.	Yes, during restructuring including the enforcement of security.	Yes, during judicial reorganisation, a secured creditor can request that the stay be cancelled if the assets are not crucial to the success of the plan.

INSOLVENCY AND RESTRUCTURING TRENDS IN EUROPE: CRAM DOWN OF CREDITORS

England & Wales	France	Germany	Italy	Spain	The Netherlands
Yes, for a scheme under ss895-901 of Companies Act 2006 require majority in number of creditors, three quarters in value of claims. Yes, for Company Voluntary Arrangements the proposal for restructuring needs to be approved by more than half in value of the shareholders and more than three quarters in value of the creditors.	Yes, as regards members of creditors' committees and bondholders, subject to majority votes by creditors' committees representing not less than two thirds of the debt, and the required majorities in the bondholders' assemblies.	Insolvency plan must be approved by majority of creditors in each class who must hold more than half of the claims in value in each class. Court can override if non-concurring group would be worse off without the plan.	Yes, composition with creditors must be approved by majority of classes of voting creditors in Restructuring Agreement: 60% of creditors by value.	Yes, an arrangement may be entered into with creditors based upon a vote by the majority of creditors.	Yes, a composition needs the approval of a normal majority of creditors representing at least half of the total amount of claims.
Luxembourg	**Belgium**	**Poland**	**The Czech Republic**	**Slovakia**	**Romania**
Yes, controlled management requires adherence of a majority of creditors in number and more than half in value to the restructuring plan or the draft plan relating to the realisation and distribution of assets. Pre insolvency composition arrangements require consent of a majority in number of creditors and three quarters in value.	A recovery plan must be approved by more than half in number and value of all the creditors. It must also be approved by the court.	A composition plan must be accepted by a majority of each group of creditors whose claims amount to two thirds in value of those entitled to vote. The judge-commissioner can in the event of each group not voting in favour, approve the plan if the majority of groups approve it and any dissenting groups are no worse off than in a liquidation.	Yes, in a reorganisation a majority in number and by amount of claims in each class is needed to approve. The Court may also confirm the reorganisation plan without approval of each class subject to specific criteria being met.	Yes, in a restructuring a majority by number and by amount of claims in each class is needed to approve a restructuring plan, the Court may also confirm the plan subject to specific criteria being met.	Yes, in a judicial reorganisation a majority by number and amount of creditors in each class is needed to approve a reorganisation. This is also subject to the approval of the Court.

INSOLVENCY AND RESTRUCTURING TRENDS IN EUROPE: POSITION OF MANAGEMENT

England & Wales	France	Germany	Italy	Spain	The Netherlands
Effectively displaced, unless otherwise agreed by Administrator. Administrator selected by the company or secured creditor.	*Mandat ad hoc* and conciliation procedures: Management stays in possession, assisted by a court-appointed officer in order to facilitate the restructuring of the liabilities. Safeguard Proceedings: management stays in possession. Rehabilitation Proceedings: appointment of a judicial administrator, who either assists or replaces management. Judicial Liquidation: the liquidator replaces the management.	Usually management: (1) continues to manage business during the preliminary proceedings subject to the consent of the preliminary administrator; (2) is displaced by court appointed receiver after the opening of insolvency proceedings However the court may: (1) during preliminary proceedings order the transfer of management to the preliminary administrator; (2) upon the debtor's request, order the opening of debtor-in-possession like proceedings with the management continuing to manage the business under supervision of a specific creditors' trustee.	Effectively displaced by court appointed receiver.	In cases of voluntary insolvency, the receivers supervise the directors' decisions. In case of compulsory insolvency, the management is effectively displaced by receivers.	Effectively displaced by court appointed administrator.
Luxembourg	**Belgium**	**Poland**	**The Czech Republic**	**Slovakia**	**Romania**
During the first phase of controlled management, the directors remain in place, but actions are supervised by magistrate appointed by the court. In the second phase a *"commissaire"* is appointed that supervises management in accordance with the mandate of the court. In bankruptcy proceedings a *"curateur"* displaces management.	Management retain their powers during the observation period of the judicial composition process but receive assistance from court appointed commissioner(s).	In bankruptcy proceedings the management is effectively displaced by a court appointed bankruptcy officer (save for bankruptcy carried out for composition, where "debtor in possession" is optional). In recovery proceedings the management remains (subject to certain controlling powers of the court-appointed supervisor).	In a reorganisation, the debtor's management remains in control, but are monitored by a court appointed trustee and creditors' committee.	In a restructuring, the debtor's management remains in control, but are monitored by a trustee and the court.	In a judicial reorganisation, the debtor's management remains in control under the supervision of the judicial administrator.

INSOLVENCY AND RESTRUCTURING TRENDS IN EUROPE: PERSONAL LIABILITY OF DIRECTORS

England & Wales	France	Germany	Italy	Spain	The Netherlands
Yes, for breaches of fiduciary duties, wrongful trading and fraudulent trading (ss212-214 IA 1986).	Yes, in case of faults of management having contributed to the insufficiency of assets or the company's insolvency; also in case of fraud, etc.	Yes, for failure to file for insolvency, for any payments made to third parties after the company becomes insolvent and for any new agreements which the company is unable to fulfil.	Yes, for breaches of duty and failure to preserve the company's value if that failure results in a loss to creditors. Criminal liability of directors in cases where they have ● distracted, disguised or voluntarily lost the assets ● taken imprudent actions to delay the declaration of bankruptcy ● disguised its financial distress or the insolvency state in order to obtain financing.	When insolvency has been considered as negligent, and provided that they have contributed to provoke the insolvency.	Yes, for mismanagement, fraud or if they have contributed to company's insolvency.
Luxembourg	**Belgium**	**Poland**	**The Czech Republic**	**Slovakia**	**Romania**
Yes, for any wrongdoing or negligence under general corporate law. Criminal liability in respect of certain actions which have lead to the insolvency (including lack of declaration, wrongful or fraudulent trading) other sanctions include extension of liability for some or all debts incurred.	Yes, if grossly negligent in a way that contributes to the bankruptcy.	Yes, for breaches of fiduciary duties, contractual duties or statutory duties. Wrongful or fraudulent trading triggers civil liabilities and may in certain circumstances lead to criminal liability. Directors are criminally liable for preferential treatment of creditors.	Yes, for breaches of fiduciary duties owed to creditors while in office after commencement and for damages caused to creditors by delaying the filing of an insolvency petition.	Yes, for breaches of fiduciary duties, diminishing the value of assets and circumventing the success of the restructuring process.	Yes, for breaches of fiduciary and statutory duties and where directors have contributed to the debtor's insolvency. Criminal sanctions exist for certain acts.

INSOLVENCY AND RESTRUCTURING TRENDS IN EUROPE: TIME LIMITS FOR FILING

England & Wales	France	Germany	Italy	Spain	The Netherlands
No express time limit for filing for insolvency but failure to do so which results in a loss may give rise to action against directors personally.	Obligation to file within 45 days of the company being unable to pay its debt as they fall due.	Obligation to file immediately upon company being unable to pay its debts currently due or over indebtedness occurring; filing may be postponed for up to 21 days if reasonable expectations exist that insolvency can be overcome.	No express time limit for filing for insolvency but failure to do so which results in a loss may give rise to action against directors personally.	Obligation to file within 2 months of when the debtor has or should have become aware of its insolvency. Failure to comply assumes that bankruptcy is carried out negligently.	No express time limit for filing for insolvency but failure to do so which results in a loss may give rise to action against directors personally.
Luxembourg	**Belgium**	**Poland**	**The Czech Republic**	**Slovakia**	**Romania**
Obligation to file within 1 month of company having stopped making payments.	Directors must file within 1 month of it being unable to pay its debts.	Obligation to file within 2 weeks of insolvency (unable to pay debts as they fall due or debts exceed assets).	No express time limit but must file without delay after they have determined the company is insolvent, insolvency is defined objectively, including express time periods of default with payment.	Obligation to file within 30 days after the directors have determined that the company is insolvent.	Obligation to file within 30 days from the date that it is aware that it is or will become insolvent.

INSOLVENCY AND RESTRUCTURING TRENDS IN EUROPE: NEW REFORMS

England & Wales	France	Germany	Italy	Spain	The Netherlands
Last Major reforms: Enterprise Act 2002. Emphasis on rescue culture, curtailed rights of secured creditors to appoint administrative receiver.	New law came into force in January 2006. A further reform is contemplated.	New insolvency laws of 1999 with elements similar to Chapter 11 proceedings. New autonomous international insolvency law rules in force since May 2003 which apply outside the scope of the EU Insolvency Regulation. New revisions currently proposed, including the possibility for the administrator to sell debtor's business prior to the first creditors meeting with the court's consent and a preference for claims of tax authorities.	New insolvency laws introduced in February 2004 to cater for rehabilitation of large businesses. Continuing reforms. Latest amendments: Legislative Decree 5/2006 Legislative Decree 169/2007 which came into force on 1 January 2008.	New laws on insolvency published 10 July 2003 came into effect on 1 September 2004.	Substantial revisions proposed.
Luxembourg	**Belgium**	**Poland**	**The Czech Republic**	**Slovakia**	**Romania**
No substantial revisions proposed.	Substantial revisions to the judicial composition regulations are proposed.	Recent Reforms: Bankruptcy and Recovery Law 2003. Extensive revisions proposed by a legislative commission – early stage of legislative procedure.	Recent Reforms: Insolvency Act No 182/2006 Coll. Effective since 1 January 2008.	Recent Reforms: Bankruptcy and Restructuring Act No 7/2005 Coll. Effective since 1 January 2006.	Recent Reforms: Insolvency Law No 85/2006

CLIFFORD CHANCE CONTACTS

UK

Michael Bray
Tel: +44 20 7006 1291
michael.bray@cliffordchance.com

Adrian Cohen
Tel: +44 20 7006 1627
adrian.cohen@cliffordchance.com

Nicholas Frome
Tel: +44 20 7006 2762
nicholas.frome@cliffordchance.com

Philip Hertz
Tel: +44 20 7006 1666
philip.hertz@cliffordchance.com

Mark Hyde
Tel: +44 20 7006 1616
mark.hyde@cliffordchance.com

David Steinberg
Tel: +44 20 7006 1621
david.steinberg@cliffordchance.com

Gabrielle Ruiz
Tel: +44 20 7006 1615
gabrielle.ruiz@cliffordchance.com

France

Christian Lacheze
Tel: +33 1 44 05 5337
christian.lacheze@cliffordchance.com

Pierre Forget
Tel: +33 1 44 05 2487
pierre.forget@cliffordchance.com

Reinhard Dammann
Tel: +33 1 44 05 5252
reinhard.dammann@cliffordchance.com

Italy

Fabio Guastadisegni
Tel +39 02 80634 353
fabio.guastadisegni@cliffordchance.com

Lia Campione
Tel +39 02 80634 373
lia.campione@cliffordchance.com

Luxembourg

Steve Jacoby
Tel: +35 2 48 50 501
steve.jacoby@cliffordchance.com

Belgium

Yves Herinckx
Tel: +32 2533 5901
yves.herinckx@cliffordchance.com

Germany

Kolja von Bismarck
Tel: +49 30 254 65 7528
kolja.bismarck@cliffordchance.com

Spain

Iñigo Villoria
Tel +34 91 590 9403
inigo.villoria@cliffordchance.com

Alberto Manzanares
Tel: +34 91 590 9490
alberto.manzanares@cliffordchance.com

The Netherlands

Jan ter Haar
Tel: +31 20 711 9200
jan.terhaar@cliffordchance.com

Poland

Jan Zdzienicki
Tel +48 22 429 9451
jan.zdzienicki@cliffordchance.com

The Czech Republic and Slovakia

Vlad Petrus
Tel +420 222 555 207
Vlad.Petrus@cliffordchance.com

Romania

Daniel Badea
Tel +40 21 211 4156
daniel.badea@cliffordchance.com

C L I F F O R D

C H A N C E

Registered office: 10 Upper Bank Street, London, E14 5JJ

www.cliffordchance.com

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