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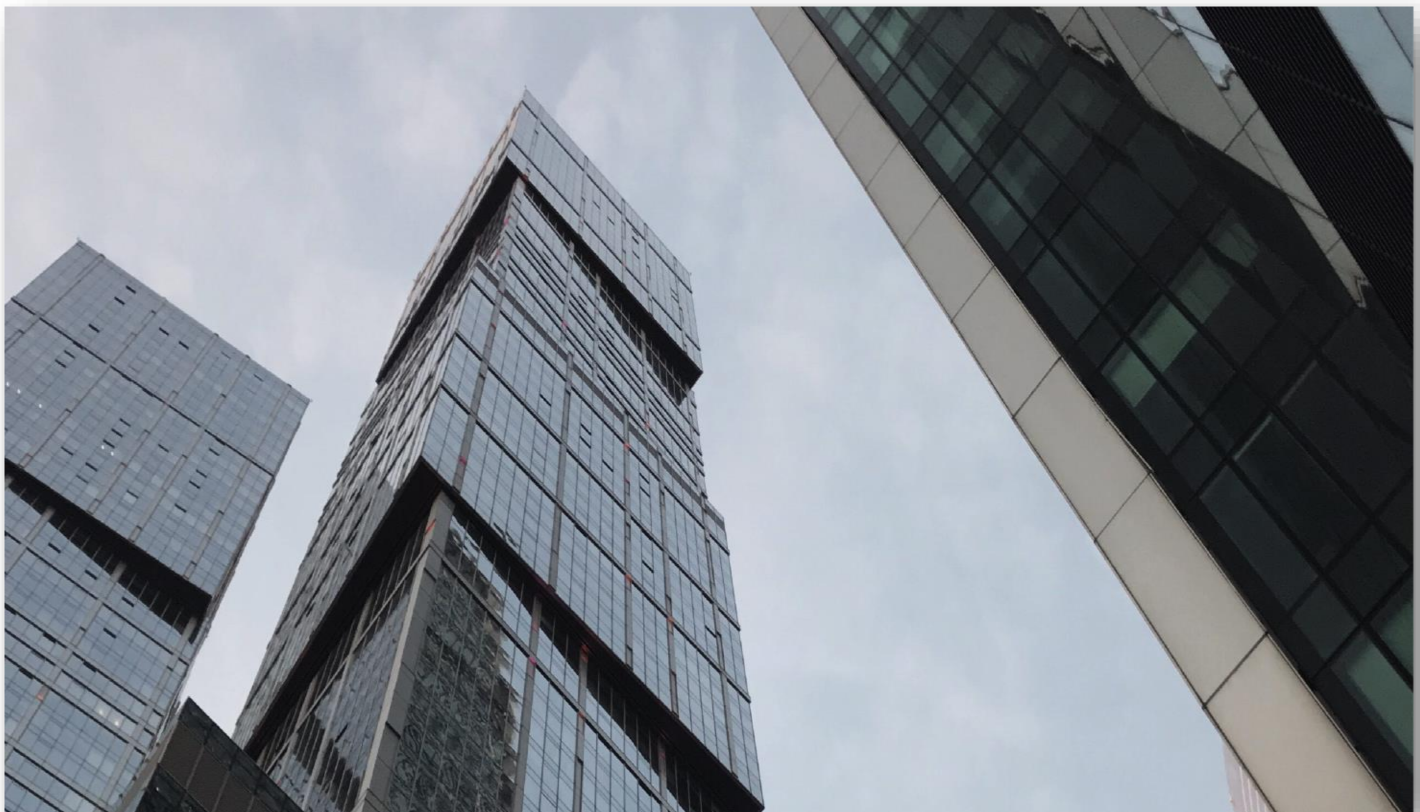

# BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS: AN INTERNATIONAL GUIDE

ILN RESTRUCTURING & INSOLVENCY GROUP

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## Bankruptcy, Insolvency & Rehabilitation Proceedings in Australia

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## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER AUSTRALIAN LAW

**Companies**

Corporate insolvency in Australia mostly involves a company being placed in liquidation or administration.

Companies can be placed in liquidation by:

1. The directors, or
2. A creditor applying to the court, or
3. An oppressed minority shareholder applying to the Court, or
4. The shareholders, or
5. After an administration process, if a scheme of arrangement is not entered into by the company with its creditors.

A liquidator is appointed to control the affairs of the company to recover funds for creditors.

The liquidator will be a private practitioner who will charge fees for his and his firm's work. Those fees are a priority payment before unsecured creditors are paid.

The liquidator needs to be independent. Liquidators that have had a prior association with the company or its directors can be removed.

The voluntary administration process requires the directors to appoint an Administrator to investigate if the company can be saved, most commonly by a sale of assets or a scheme of arrangement with creditors.

When a company is in administration, there is a moratorium that prevents, among other things, the winding-up of the company, secured parties enforcing security interests, landlords taking possession of leased property, and court action cannot commence or proceed.

A scheme of arrangement usually involves shareholders agreeing to provide funds to pay an amount to creditors to avoid the company being placed in liquidation. There is a limited time for a scheme of arrangement to be proposed.

For example, shareholders might advance funds equal to say 50% of amounts owing to creditors.

A scheme of arrangement requires 75% of the value of the creditors, and a majority in number, to agree. Creditors need to be satisfied that the Scheme of arrangement would create a better return than if the company was placed in liquidation.

The Administrator would usually recommend the scheme of arrangement to creditors if that was the case.

Otherwise, the company will go into liquidation.

The Administrator then becomes the Liquidator.

Liquidators will then take such steps as they can to recover funds for creditors. Those steps often include:

- Asking creditors (including the taxation office) who were paid in the 6 months prior to the liquidation to repay the funds to the liquidator;
- Selling assets;
- Collecting debts, including debts owing by directors or shareholders;
- Recovering uncommercial transactions entered into to defeat the interests of the creditors.

**Traps for directors**

Liquidators can pursue bad corporate behaviour by directors.

Directors of a company that goes into liquidation can then have a poor credit rating. Banks may then be reluctant to lend to the director or to

any new company, and creditors may be reluctant to extend credit.

If a person is a director of 2 or more companies that have gone into liquidation, and if the return to creditors was less than 50%, the director can be banned from being a director of a company for 5 years.

If the company was trading and incurring debts when the directors ought to have known the company was insolvent, the directors can be held personally liable for any such debts.

**Individuals**

Personal insolvency is called bankruptcy in Australia.

A person who is unable to pay his or her debts, can declare themselves bankrupt, or a creditor can apply to the Court to bankrupt an individual, if they have a judgment against them for at least $5,000.

Bankruptcy releases a person from unsecured debts and allow them to make a fresh start.

Bankruptcy normally lasts for 3 years and 1 day. It can be extended for up to 8 years most commonly if a person's bankruptcy Trustee has reason to believe that the person has not been truthful about their affairs.

When a person becomes bankrupt a Trustee is appointed. A Trustee is a person who manages your bankruptcy.

A bankrupt person must provide details of their debts, income, and assets to their Trustee.

Your Trustee notifies creditors that you are bankrupt - this prevents unsecured creditors from pursuing the debt.

The trustee can sell certain assets to help pay debts.

A bankrupt may need to make compulsory payments if their income exceeds a set amount.

Bankruptcy is an option, but a person may also try to enter into a personal insolvency agreement, requiring 75% of creditors to agree.

Bankruptcy may have serious consequences and prejudice a person's ability to obtain credit, travel overseas or gain certain employment.

Certain types of professions may be in jeopardy such as a lawyer or a builder.

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## FOGLER RUBINOFF LLP

### Bankruptcy, Insolvency & Rehabilitation Proceedings in Canada

**ILN RESTRUCTURING & INSOLVENCY GROUP**

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER CANADIAN LAW

### 1. Canada's Political and Legal System

Canada has a federal system of government, subject to its Constitution, which was significantly overhauled in the early 1980's, including the creation and implementation of the 1982 Canadian Charter of Rights and Freedoms. Canada places a high value on 'rule of law' concepts in Anglo-American legal traditions. It has both federal and provincial political and legal systems and courts, subject to the common law in various jurisdictions, and civil law in Quebec. The Canadian Parliament is responsible for federal laws, and various provincial legislatures enact local legislation in their jurisdictions. The Province of Quebec implements its Civil Code, largely derived from the French Napoleonic Code in origin and amended over time, in its legislature, called Assemblée nationale du Québec. There are courts with both federal and provincial jurisdiction that make rulings within their jurisdiction, resulting in a general body of common law (with civil law in Quebec), in either official language: English or French, or sometimes in both. Where necessary, the legal principle of 'paramountcy' is applied, whereby federal statutes are intended to prevail over provincial statutes when their terms and application conflict.

### 2. Canadian Insolvency Regime

Insolvency and bankruptcy laws in Canada are generally of the federal domain. Provincial and regional laws are used to implement and interpret issues falling within this domain. There is no single law or statute governing corporate, commercial, or institutional restructuring, bankruptcy or insolvency issues. Insolvency professionals with standing in insolvency proceedings in Canadian courts are usually either licensed lawyers or accounting professionals, with appropriate accreditation.

There are multiple applicable Canadian insolvency and restructuring statutes, listed below. The *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "*BIA*") and the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*"), collectively called the "**Acts**") comprise the "main" statutory framework for individual and corporate insolvencies, restructuring, and bankruptcies in Canada. Stays of proceedings are implemented to allow for re-organisations, restructurings, or liquidations to occur in the best interests of stakeholders and in an orderly fashion. Proceedings under the *BIA* and *CCAA* are monitored and regulated by the federally regulated Office of the Superintendent of Bankruptcy, to whom provincial Official Receivers submit their reports.

**Applicable statutes in Canada**:

i. The *BIA*; This is the main federal statute for personal or 'consumer' bankruptcies. It also has a broader section for both higher net-worth personal bankruptcies and larger corporate and commercial bankruptcy or restructuring opportunities. The *BIA* contains rules for both liquidations or debtor-driven restructurings and reorganisations (generally called 'proposals'), with both creditor remedies (including receiverships), and 'debtor in possession' ("**DIP**") remedies. A statutory priority waterfall for claims against the estate of an insolvent person or entity exists for secured and preferred creditors, thereby implementing rules for dealing with those priority claims in multiple scenarios. DIP proceedings under the *BIA* generally occur in situations in which the debts of the debtor are below CAD5,000,000. The "bankruptcy" provisions of the *BIA* are analogous to Chapter 7 of the U.S.A. *Bankruptcy Code* (the "**Code**") but has many differences beyond the scope covered here. The "proposal"

provisions of the *BIA* are more analogous to Chapter 11 of the Code.

ii. *The CCAA*; This is the principal federal restructuring and recovery insolvency statute for DIP debtors. In comparison with the analogous *BIA* framework, it is generally more flexible in scope and application. The *CCAA* evolved from a largely unused and very brief statute conceived in the 1930s but has been extensively used and adapted since that time. In the present day, it is used mainly for the restructuring of large commercial enterprises with aggregate debt owing in excess of CAD5,000,000. While analogous to Chapter 11 of the Code, the *CCAA* differs in many material respects, not the least of which are the generally increased speed and lower costs in most scenarios. The *CCAA* remains a relatively brief statute, and not all aspects of the law applicable in connection with proceedings there under have been codified. It allows for wide powers of judicial discretion, which is of utility in quickly changing fact scenarios. Cases coming within its wide scope have received a considerable display of jurisprudential flexibility and expediency in many cases, due to the lack of codified rules and procedures.

iii. The Personal Property Security Act/Civil Code in each Province (collectively, "***PPSAs***"); Each province outside Quebec has enacted statutes relating to property rights in assets and security, to partially replace a pre-existing patchwork of common law that preceded them. They also allow for the appointment of receivers both in and out of court. The *PPSAs* contain attachment, perfection, and priority rules in collateral that were initially modelled on the *Uniform Commercial Code* used in US States (collectively, "**UCC**"), but do nevertheless have significant differences. For instance, the *PPSAs* are mainly notice registry systems, and are not title based. There are also differences with UCC Article 9 procedures and accommodation for security interests in cash collateral, and other personal property.

iv. Rules of Court/Rules of Practice ("**Rules**"); These apply in all provinces other than Quebec and have direct and indirect influences on judgements and rulings regarding enforcement and interpretations under applicable statutes. For instance, where it is found to be 'just or convenient', courts may appoint receivers for interests including secured creditors.

v. The *Winding Up and Restructuring Act* ("***WURA***"); This federal statute has been used infrequently and is generally for the restructuring and reorganisation or liquidation of specific entities, mainly banks and insurance or trust companies. In the context of more recent financial upheaval in financial markets and financial institutions in Canada and abroad, this legislation may assume a more prominent role than has unfolded in its recent past.

vi. Business Corporation Statutes; These include multiple statutes in both the federal and provincial domains, such as the *Canada Business Corporations Act* ("***CBCA***") and the various provincial counterparts. These are significant because they allow courts to authorise fundamental changes in corporate structure in distressed scenarios. They contribute to balance sheet refreshments through such arrangements where debt can be converted to equity including through implementation of distress preferred share arrangements as may be approved in Canadian insolvency proceedings. These statutes may also be used to effect liquidations in certain circumstances.

### 3. The Acts: Basics

#### *BIA*

Applications for bankruptcy orders may be filed by the debtor, or by his/her/its creditors. When filed by creditors, there can be proceedings contesting the filing, to be heard by the

bankruptcy courts. Otherwise, liquidations ensue once the trustee in bankruptcy is appointed under a bankruptcy order and that person is usually an accredited accounting professional. That trustee in bankruptcy acts in the estate, effectively on behalf of the general body of creditors. Secured creditors holding perfected security interests take outside of the bankruptcy estate to the extent of the value of their collateral held and will file claims in the estate for unpaid residual amounts of debt not recovered from realization of their specific collateral held.

To avoid bankruptcy, proposals may be filed by debtors under notices of intention ("**NOI**"). These are not initially bankruptcy filings. An accountant is engaged as "Proposal Trustee" to oversee and review the affairs of the debtor, and to report to the court in all proceedings. On filing the NOI, the time "starts ticking". Initially, a 30-day stay is granted, and can be extended up to a maximum of six months by the court, to enable the debtor to file a plan. Time is granted to compose a plan, which is distributed to creditors for a vote. For the proposal to be approved, a 'double majority' vote that occurs with approved creditors will be necessary, in which a majority of both creditors by number and total of outstanding debt thresholds must be met to pass the vote. If the creditors approve the plan, court approval is thereafter required. If timelines are not met, or a plan is neither presented nor approved by creditor vote and court approval, then there is an automatic deemed bankruptcy. At that point, the proposal trustee becomes the trustee in bankruptcy, and liquidation ensues.

All asset bankruptcy estates are subject to a 5% levy, payable to the Superintendent in Bankruptcy.

***CCAA***

Qualified applicants under the *CCAA* are usually applicants being corporate entities who are insolvent, or who have committed an act of bankruptcy under the *BIA*. Total claims against that debtor must exceed CAD5,000,000 before that debtor may commence a *CCAA* filing. Proceedings are initiated by court applications. Filings for 'first day orders' are done by application of the debtor to the applicable court. There may be an initial order implementing a statutory stay of proceedings, but it is granted for a very short period of time and on restricted terms and conditions (colloquially sometimes referred to as the 'skinny order'), in effect for no more than ten days. The applicants must return to court within that time period with another application for the full form of court orders giving broader protections to the Applicant.

Monitors are appointed upon initial orders being granted and are deemed to be officers of the Court, and as such are the "eyes and ears" of the Court in the proceedings. The debtor's auditors are excluded from being appointed as Monitor. Monitors are ideally positioned to act in the 'best interests of the general body of creditors'. Their views and recommendations are submitted to the courts in formal reports, which are generally given a high degree of factual and professional deference. Once appointed to oversee the *CCAA* estate in the first day orders, Monitors coordinate multiple roles. Those include the review of financial information, filing of statutory reports, review of debtor forecasts and plans, implementation of a sale process, and assisting in the drafting of a Plan of Compromise or Arrangement (**"Plans"**). Plans, once approved by creditors in a double majority vote, must also be sanctioned by a Canadian court.

Plans can include sale processes, such as 'stalking horse' bidding procedures for all or part of the business, assets and operations of the debtor, or a broader group of companies and

partnership entities connected to the debtor. They may also include full or partial liquidations of their assets, termination of contracts, key employee retention plans, settlement of debts and charges amounting to a balance sheet restructuring. Monitors interact with officers, directors, and management of the debtor and their counsel. They are also responsible to conducting all statutory proceedings, including any votes of creditors or other stakeholders, outside of the court proceedings.

Assets disposed of in *CCAA* proceedings are not subject to any bankruptcy levies.

**Stays of Proceedings**

Under the *BIA*, statutory stays of proceedings are initiated on issuance and filing an order for bankruptcy, or upon filing a NOI. Under the *CCAA*, statutory stays are initiated by the courts in first day orders and continue under the directions of the court. Stays of proceedings can be implemented for groups of companies domestically, within the ambit of the Canadian courts. For cross-border groups, the continuing cooperation of foreign courts is required, with varying results from case to case.

**Cross Border Proceedings**

Coordination of cross-border proceedings with foreign courts is encouraged and implemented on a regular basis. Canada adopted the UNCITRAL model law on cross border insolvency in 1997, with changes specific to Canada at and after that time. This is incorporated into Canadian law under Part IV of the *CCAA* and Part XIII of the *BIA*, for both recognition of foreign proceedings in Canada, and for recognition of the orders of Canadian courts in foreign proceedings. Canadian courts can exercise jurisdiction over non-Canadian entities and assets if the 'centre of main interest', known as "COMI", is in Canada. These always involve questions of fact and can be hotly contested at the outset of proceedings. *In the Matter of Voyager Digital* recently saw the Ontario Superior Court provide renewed guidance on the determination of COMI in the context of a public company. Cross border cooperation of foreign courts with Canadian courts has occurred in multiple cases, including under Chapter 15 proceedings under the Code.

**Officers and Directors**

Generally, directors and officers of corporations have statutory duties to act honestly and in good faith with a view to the best interests of the corporation (including under the *CBCA*). Directors of an entity entering proceedings under the Acts must continue to generally act in the general best interests of that debtor. They must exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances. Officers have similar duties including remittance obligations to government authorities. While there are duties to 'stakeholders', such as government entities, creditors and employees, there is no specific duty on directors or officers to look after the interests of shareholders. Unlike other jurisdictions, such as Australia, Germany, and France, there are no 'trading while insolvent' liabilities or exposures while the debtor is undergoing a formal restructuring while also operating its business. Remedies sought for breach of such duties, in the absence of fraud, are generally fact-based proceedings, within these general principles.

Additionally, directors should take note that under certain statutory circumstances, directors may be found personally liable for unpaid employee wages and holiday pay, and source deductions for employee income taxes, employment insurance and government pension plan contributions.

## 4. The Acts: Changing Rules and Features and Updates

In recent years, the Acts were amended to achieve better accountability and transparency in Canadian insolvency proceedings.

**Disclosure of Economic Interests**

The *CCAA* was amended to allow interested persons to apply for a court order requiring a person to disclose any "economic interest" in the debtor company. An "economic interest" includes a claim, eligible financial contract, an option, a mortgage, charge, lien, other security interest, the consideration paid for any right or interest, or any other prescribed right or interest. The court must consider whether the information sought would enhance the prospects of a compromise or arrangement for the debtor company and whether any interested person would be materially prejudiced by the disclosure.

The purpose of this may be aimed at leveling the playing field in the administration of estates. Possible scenarios where disclosure might be particularly important are (i) where claims are traded at discount values to purchase blocking votes or (ii) where related parties or parties with undisclosed collateral interests bid on assets of the insolvent estate.

**Pension Funding and Obligations**

To protect the interests of retirees and pensioners, the Acts were amended to require that funds earmarked for registered disability savings plans be added to funds in RRIF plans and RRSPs so that they are exempt from seizure under the *BIA*. The *CBCA* was simultaneously amended to require that directors take into account the financial interests of retirees and pensioners in board deliberations of *CBCA* companies on the eve of insolvency.

Further, in 2023 legislation was passed expanding the super-priority positions afforded to defined benefit pension plans in the course of an employers' insolvency. Importantly, a transition timeframe has been built into this expansion of the super-priority (four years) for defined benefit plans. This will provide existing lenders and employers with some ability to pivot around the new reality, but not much and new employers will not have the same transition period.

**Director and Officer Compensation Clawbacks**

The amendments expose directors to more scrutiny on the eve of insolvency. The courts may "look back" into payments (including termination pay, severance pay, incentive and other benefits) made to directors, officers, and other managing personnel in the year preceding the initial bankruptcy event. If the payments were made when the corporation was insolvent or rendered the corporation insolvent, exceeded the fair market value of the consideration received by the corporation, or were outside the ordinary course of business, the court may issue judgments against the directors personally, as may be appropriate.

**Third Party Releases**

Court-ordered releases within *CCAA* Plans are common in the context of sanction orders. In many cases, it is management and board members who benefit. Directors and officers will usually insist on these in return for avoiding mass resignations during the reorganisation of the insolvent entity.

**Procedural Changes**

Stays of proceedings will be granted in *CCAA* proceedings if "reasonably necessary" for the continued operations of the debtor companies. The initial stay period was reduced from 30 days to 10 days. Also, other initial relief in first day orders will only be granted if "reasonably necessary". These amendments will help ensure that orders granted at the commencement of

insolvency do not over-reach and are fair to other creditor interests. Certain relief like new funding (DIP financing orders) and pre-baked solicitation proceedings for the sale of assets, which may prejudice stakeholders who had no notice of insolvency proceedings, may now be challenged earlier.

**Statutory Duty of Good Faith**

In *Bhasin v Hrynew*, the Supreme Court recognized a general duty of honest performance in contractual dealings which has been broadly applied. Canadian courts must now consider good faith and disclosure of economic interests to enhance their jurisdiction in restructuring matters. Parliamentary debates preceding the amendments suggest that they were intended to protect the public from the effects of high-profile corporate bankruptcies like *Nortel* and *Sears* where many Canadian employees lost their pensions. A statutory duty to act in good faith will now apply to all participants in Canadian insolvency proceedings. Although debtors previously had a duty to act in good faith, the statutory duty now applies to all parties. This amendment is consistent with developments in the common law. In *Century Services Inc v Canada (Attorney General)* the Supreme Court of Canada stated that "the requirements of appropriateness, good faith and due diligence are baseline considerations that a court should always bear in mind when exercising CCAA authority". A statutory duty of good faith is also consistent with British and American insolvency statutes and will therefore be useful in cross-border proceedings.

**No Equitable Subordination in Canada, so Far**

The doctrine of equitable subordination is an American legal doctrine that allows a court to subordinate a creditor's claim and ranking in an insolvency proceeding where that creditor has acted badly, in the determination of the court. Canadian courts have resisted its application over an extended period of time in numerous insolvency proceedings. However, it remains an attractive equitable doctrine to be applied as a potential course of redress. Recent statutory implementation of the duty of good faith in Canada appears to have provided another reason to not apply this doctrine in Canadian proceedings to address the bad behavior of certain creditors. However, this doctrine has not yet been definitively shut off by the highest Canadian courts either, to date.

**Reverse Vesting Orders**

There have been recent developments in the case law regarding the use of reverse vesting orders (**"RVO"**) as a means of providing court approval to certain transactions to be effected in the context of an insolvency proceeding. Through the use of a reverse vesting order, the court may transfer liabilities or undesired assets "out of" the debtor company and "into" a new company or other available existing subsidiary entity. The impact is to "cleanse" the debtor problematic assets or liabilities so as to effect a new state of affairs in assistance of the restructuring. This is a "reverse" to the approach of the traditional approval and vesting order where in the valuable assets are transferred to the court approved buyer with secured interests being vested out.

Of particular in note, in *Harte Gold Corp. Re*, the Ontario Superior Court provided some important new guidance on what questions the court should investigate when asked to approve a RVO: (1) Why is the RVO necessary in this case? (2) Does the RVO structure produce an economic result at least as favourable as any other viable alternative? (3) Is any stakeholder worse off under the RVO structure than they would have been under any other viable alternative? (4) Does the consideration being paid for the debtor's business reflect the importance and value of the licenses and permits (or other intangible assets) being preserved under the

RVO structure? While this test has been set out, the body of law firmly establishing the conditions under which the court might refuse a RVO is in its relative infancy and still developing.

**Environmental Obligations and Priorities**

In 2019 the Supreme Court of Canada released its decision in the case of *Orphan Well Association v. Grant Thornton Ltd.*, which held that certain environmental remediation obligations of an insolvent entity can and should be prioritized over and above the rights of secured creditors in the context of a closed oil and gas operation. More recently, the court in the Province of Alberta has issued several decisions that have potentially expanded the context in which such a super-priority might be found to apply. At the time of this update, however, there are active appeals in this area and so further clarity on the law in this area may be expected in the near future.

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### Bankruptcy, Insolvency & Rehabilitation Proceedings in Cyprus

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## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER CYPRIOT LAW

### 1. The Legal Framework

Insolvency matters in Cyprus are governed by the Bankruptcy Law Cap.5 which deals with the bankruptcy of natural persons, and the Companies Law Cap.113, supplemented by the Companies (Winding Up) Rules and certain provisions of the Bankruptcy Law which regulate the insolvency of legal persons.

In 2015 the Cypriot Insolvency Law has been substantially amended and expanded in order to provide for the possibility of debt restructuring of natural persons through personal repayment plans and debt relief orders by the enactment of the Insolvency of Natural Persons (Personal Repayment Plans and Debt Relief Order) Law of 2015 (L. 65(I)/2015).

In Cyprus, only licensed insolvency practitioners can be appointed and act as trustees in bankruptcy, bankruptcy advisors or liquidators.

Cypriot Insolvency Law is expected to be amended further to align with Directive (EU) 2019/1023 on preventive restructuring frameworks, discharge of debt and disqualifications and measures to increase efficiency (Preventive Restructuring Frameworks Directive).

In this publication, while it is not possible to describe exhaustively all matters of importance, we set out key aspects of the Cypriot insolvency legal framework that we have deemed useful to provide a general understanding.

### 2. Bankruptcy

According to Bankruptcy Law Cap.5, in order for a person to be declared bankrupt, an application must be filed before the Court. The application may be filed either by the debtor's creditors or by the debtor himself, provided that the conditions set by Bankruptcy Law are met.

A creditor may file an application for bankruptcy against the debtor if, *inter alia*, it is proved to the satisfaction of the Court that: (a) the debt owned by the debtor exceeds the amount of €15,000; (b) the debtor has committed an act of bankruptcy within six months before the filing of the petition; and (c) the debt is a liquidated sum payable either immediately or at a certain future time.

A debtor may file a petition for voluntary bankruptcy if the total amount of his debts exceeds the amount of fifteen thousand euros (€15,000) and the debt is not secured.

With the issuance of a bankruptcy order, the debtor's property is vested under the custody and administration of the Official Receiver, or a private insolvency practitioner appointed by the creditors, who will be responsible for realising the debtor's assets and distributing the same proportionally amongst the creditors as per the priority provided by the Bankruptcy Law.

Importantly, three years after the issue of the bankruptcy order, the bankrupt person is automatically discharged from his verifiable debts. If the bankruptcy property has not been distributed in its entirety, it shall remain at the hands of the administrator to the benefit of creditors.

***Protection***

Before the issuance of the bankruptcy order and after filing a bankruptcy application, the Court may at any time, order the stay of any action, execution or other legal processes against the property or the debtor.

After the issuance of the bankruptcy order, creditors are prevented from initiating any legal proceedings against the debtor or his/her property, without first obtaining leave from the Court.

Further, no creditor shall be entitled to register a judgment or mortgage or any other encumbrance on the debtor's property

**3. Winding up (Company Liquidation)**

The Companies Law, Cap.113 provides for two principal forms of winding up a company.

A company may be wound up voluntarily, out of court, by its members or by its creditors, or it may be placed under a compulsory winding up following an application to the court which can be made by the company itself, a member, or a creditor.

***3.1 Voluntary Winding Up by Members***

A company may be wound up *voluntarily by its members* by the passing of a special resolution with at least 75% majority of the members present and entitled to vote.

Within 5 weeks before the members' resolution approving the winding up, the majority of the company's directors must make a statutory *declaration of solvency* under oath, declaring that they have made a full inquiry into the affairs of the company and that they are of the opinion that the company will be in a position to pay in full all of its debts and liabilities within a period not exceeding twelve months from the commencement of the winding up.

The winding up is deemed to commence on the date of passing the special resolution for this purpose. With the commencement of the winding up, all the powers of the directors are shifted to the liquidator, unless the liquidator approves that any of them are to be exercised by the directors.

The liquidator takes possession of the company's assets, liquidates and distributes them amongst the creditors as per the priority provided by the law and any surplus to the members.

To complete the process, the liquidator submits to the Registrar of Companies and Official Receiver the final winding up accounts along with the minutes of the final meeting.

Three months after the final submission to the Registrar, the company is deemed dissolved, and the Registrar issues a certificate of dissolution.

***3.2. Voluntary Winding up by Creditors***

Where the company is insolvent, a voluntary winding up shall be a *voluntary winding up by creditors*.

The procedure initiates with a general meeting of the members and a meeting of the creditors.

At the meetings, the members and creditors nominate the liquidator. Where the person nominated by the creditors differs from the one proposed by the members, the creditors' nomination prevails.

Same as in a voluntary winding up by the members, following the carrying out of the liquidation of assets and payment to creditors, with the expiration of three months as from the submission of the final accounts and minutes of the members' and creditors' meetings to the Registrar of Companies, the company is deemed dissolved, and the Registrar issues a certificate of dissolution.

***3.3 Compulsory Winding up***

The most common grounds on which a company may be placed in a compulsory winding up are when: (a) the company is unable to pay its debts; and/or (b) the Court is of the opinion that it is just and equitable that the company should be wound up.

The date of the commencement of the compulsory winding-up is the date that the petitioner's application is filed with the court.

With the issuance of the winding up order, the Official Receiver is appointed as provisional liquidator and shall act as such unless and until,

the Official Receiver himself or the creditors and contributories in their respective meetings, petition to the court for the appointment of a private insolvency practitioner.

***3.4 Protection***

Following the filing to the court of a winding up application, any court proceedings against the company are stayed and with the issuance of a winding up order, no proceeding may commence or continue against a company without leave of the court.

Any attachment in the hands of a third party, bailment, seizure or execution which commences against the property of the company after the commencement of the winding up is void.

During the winding up, any disposal of property of the company and any transfer of shares or change of status of the members of the company is void, unless the court orders otherwise.

***3.5 Priority of Payments***

A secured creditor may rely on execution of his security in order to satisfy his claim and is not obliged to submit a "proof of debt". Unsecured creditors must submit proof of their debts to the liquidator, in order to participate in the distribution of the liquidated assets of the company.

The order of priority of payments may be summarised as follows:

(i) costs of the winding up;

(ii) preferential debts such as government and local taxes,

(iii) sums due to employees;

(iv) amounts secured by securities;

(v) unsecured ordinary creditors; and

(vi) deferred debts such as dividends declared but unpaid.

***3.6 Transactions subject to challenge***

The liquidator has the right to challenge any questionable transactions entered into by the company or its directors which may have been made at an undervalue, that may be a fraudulent preference, or made to defraud creditors.

**4. Receivership**

Receivership is the process whereby a creditor, by the appointment of a receiver, enforces its security over the company's assets.

The appointment of the receiver may be made out-of-court under the powers contained in any document (e.g., a debenture), or by order of the court after application by a creditor.

The powers of the receiver are determined by the court order by which he is appointed, or by the document under which he is appointed.

With the appointment of the receiver, the powers of the company's directors in connection with the secured assets cease and are shifted to the receiver. Once the receiver disposes of the company's assets covered by the security he was appointed to realise, his powers cease.

The Companies Law does not provide for an automatic moratorium or stay of proceedings against the company in receivership proceedings.

**5. Schemes of Arrangement**

A scheme of arrangement is a procedure provided by the Companies Law, under which a company may enter into a compromise or arrangement with its members and/or creditors.

A scheme of arrangement may be pursued by the company, any member, a creditor or the liquidator of the company.

The scheme must be approved by the members and by the creditors of the company (by a single majority in value of each class of members or creditors voting for the arrangement).

Following approval of the scheme as stated above, the scheme is brought before the court which decides whether it is fair and in the circumstances proper to be sanctioned. Generally, for a scheme to be approved, it must be shown to the satisfaction of the court that with the implementation of the scheme, the members and creditors of the company will not be placed in a worse position than that in which they would be, had the company been liquidated.

Opposing members or creditors have the right to be heard at the court.

Once the court sanctions the scheme, it becomes binding on all the company's members and creditors.

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# INTERNATIONAL LAWYERS NETWORK

## FENNO ATTORNEYS AT LAW

### Bankruptcy, Insolvency & Rehabilitation Proceedings in Finland

**ILN RESTRUCTURING & INSOLVENCY GROUP**

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER FINNISH LAW

**Corporate restructuring in Finland**

Insolvency legislation in Finland provides for two alternative statutory processes: bankruptcy and corporate restructuring, which both have separate proceedings. The purpose of restructuring may be to rehabilitate the viability of the healthy parts of the business or to facilitate their operation, and to make debt adjustment possible. Corporate restructuring in Finland can be done via formal legal proceedings or via out of court proceedings.

As it is common in other countries, also in Finland the voluntary, out of court proceedings are done mostly in big companies. In the SME sector it is popular to do restructuring by formal restructuring proceedings based on law. In this text we are focusing on formal corporate restructuring proceedings in Finland.

**Three steps of process**

Corporate restructuring in Finland divides into three steps: 1) Application 2) Restructuring proceedings 3) Restructuring programme.

1. Application

The Corporate restructuring process in Finland starts when the debtor or a creditor files an application for restructuring to a district court. The decision to start a corporate restructuring process is made by a district court whose jurisdiction the general administration of the debtor is located in. The Court hears the biggest creditors about the application. Negative statement should be justified with arguments which are based on the law.

Under the restructuring proceedings the restructuring debts are defined to the day when application for the proceedings has been filed for the district court. Debts which have arisen before that day are considered as restructuring debts. Once the application has been filed, the company can apply a court order to protect it from the debt collection acts. Starting debt collection after the debtor has filed for restructuring is in most cases pointless and may cause extra costs for the creditor.

Because the corporate restructuring in Finland is based on law, the court appoints almost without exception an administrator for the proceedings. An administrator appointed is almost in every case an attorney.

2. Restructuring proceedings

Administrator´s role is to monitor and supervise the debtor´s activities during the restructuring proceedings. Administrator also audit the debtor´s activities before the proceedings.

Administrator is responsible to react if illegal acts are founded. The administrator is also responsible to react if the company has started to lose money again and it cannot pay the debts which have arisen after the filing of the application. In those cases, administrator will file the application for interruption of the restructuring proceedings to the court.

If it seems that the restructuring proceedings can continue, administrator prepares a report of the debtor´s assets, liabilities and other undertakings and on the circumstances that affect the financial position of the debtor. The report will be sent to all known creditors by the administrator. The report will be done in Finnish, but the administrator can usually give translation or summary of the report also in English if needed.

In the end of the proceedings the administrator will prepare a draft of the restructuring programme. The programme is based on the forecast of the debtor's financial statement. In larger companies the proceedings and programme can be focused on real business turnaround including the changes in company´s strategy.

Under Finnish restructuring proceeding it is common that the haircut is between 50 – 70 percent of the unsecured debts. Secured debts cannot be haircutted. Normal length for the payment programme is between 6 – 8 years.

Restructuring proceedings ends to the voting procedure concerning the proposed restructuring programme. Creditor can accept or reject the programme in the voting. If the programme reaches the majority in each group of creditors participated in voting, the programme shall be approved by the district court.

In Finnish restructuring proceedings it is rare to use debt conversion, so it is very common that the shareholders of the company own the company fully also after the restructuring.

It is important for creditors to understand that in the end only less than 30 percent of the companies reach the approved programme.

3. Restructuring programme

The district court appoints a supervisor to monitor the implementation of the restructuring programme. The Company is responsible to report to the supervisor about the implementation of the programme and company´s financial statement.

When the restructuring programme has been approved, the debtor is responsible to follow the payment programme which has been set out in the programme. If the debtor cannot follow the payment programme, the creditor has a right to request a lapse of the programme from the district court. After the lapse, the creditor has a right to start the collection of the debts again.

It is important for the creditors to understand that only under 10 percent of the companies succeed in implementing the restructuring programme fully. Most of the restructuring proceedings fail in some of the above-mentioned three steps.

## Bankruptcy proceedings in Finland

In Finland the bankruptcy proceedings can be declared if the debtor is unable to fulfill its payments on time and shall be deemed insolvent. Application for bankruptcy can be done debtor by self or the creditor of the company. In Finland the creditor is not responsible to pay the costs of the proceedings if there is no current assets in the bankruptcy estate.

The decision to declare a bankruptcy process is made by a district court whose jurisdiction the general administration of the debtor is located in. The court appoints an administrator/trustee for the bankruptcy. Administrators' role is to control the assets of the debtor and liquidate the assets. In Finland most of debtor's assets is usually sold via internet auction but it is also possible to sell the whole business of debtor.

### Employees

In Finland the employees of the company has a right to have their salaries and other costs related to the employment agreement between the company and employee from Pay security. In bankruptcy the termination period for the employment agreement is 14 days.

Lodgement Letter

If your company has open receivables from debtor which is declared bankrupt in Finland, the most important task to do is to file the lodgement letter of open receivables/claims toward debtor. Lodgement letter must be sent to the administrator no later than the day administrator has ordered as the lodgement date. When the lodgement of claims is done, the administrator will write creditor's lodgement to the disbursement list. The district court approves the disbursement list and in the end of the bankruptcy proceedings the disbursements of the bankruptcy estate's assets will be paid to the creditors whose claims has been taken into account in the approved disbursement list.

Long-lasting proceedings

As in other countries, every bankruptcy is different, but in Finland it is normal that bankruptcy proceedings lasts up to 18 – 36 months. If there is assets which are challenging to sell or there is open court cases pending or arisen during the bankruptcy proceedings, the proceedings may last over 36 months.

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# INTERNATIONAL LAWYERS NETWORK

## A&K METAXOPOULOS AND PARTNERS

### Bankruptcy, Insolvency & Rehabilitation Proceedings in Greece

**ILN RESTRUCTURING & INSOLVENCY GROUP**

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER GREEK LAW

**Introduction**

In the Greek law there are several types of proceedings addressing the inability of a merchant debtor (either a natural person or a legal entity) to pay its debts. On one hand, there is Bankruptcy, which is focused mainly on the payment of its debts to its creditors, mainly by liquidation of the debtor's assets. On the other hand, there are the so-called pre-bankruptcy proceedings whose main purpose is to maintain the debtor's undertaking by a restructuring of its debts. The pre-bankruptcy proceedings are the Rehabilitation Proceedings and the Out of Court Workout.

Before and during the aforementioned bankruptcy and pre-bankruptcy proceedings, protection of the debtor's assets may be provided for the purposes of each procedure. As a result, there are restrictions for the debtor regarding the freedom of administration or transfer of its assets and for the creditors regarding the enforcement of their claims on the debtor's assets.

It must be noted that the law 4738/2020 "Restructuring of debts and provision of a second chance and other provisions" has been issued, which abolishes the Bankruptcy Code and the other relevant legislation.

**I. The Pre-Bankruptcy Proceedings**

**A. Rehabilitation**

**1. The Procedure**

The rehabilitation proceedings of art. 31-64 of the L. 4738/2020 have a different purpose than bankruptcy, which is to reach a settlement/ rehabilitation agreement between the debtor and its creditors, so that the undertaking of the debtor will become viable again. Thus, the target of rehabilitation is not the liquidation of the assets, as it is in bankruptcy (the settlement agreement does not necessarily include liquidation).

The goal of the rehabilitation proceedings is to achieve a rehabilitation agreement between the debtor and a minimum required number of its creditors and to submit it to the competent court, along with a business plan. Subsequently, the rehabilitation agreement is validated by the court. So, there is no formal procedure opening of the negotiations with the creditors, only a "pre-packed" agreement between the creditors and the debtor that is submitted to the court for validation. Also, if the debtor is in a "cessation of payments" (in the meaning of the bankruptcy law), the creditors may also agree a rehabilitation agreement even without the debtor's participation.

**2. The Protection Granted to the Debtor's Assets in Rehabilitation proceedings**

A protection may be granted to the debtor's assets during three different stages: **a)** before concluding the rehabilitation agreement, i.e., during the negotiation between the debtor and its creditors; **b)** at the time that the rehabilitation agreement has been concluded and submitted to the court, but it is not validated yet and **c)** after the validation of the rehabilitation agreement from the court. More specifically:

**2.1 The protection before concluding the rehabilitation agreement**

**2.1.1 The Procedure**

Before concluding the rehabilitation agreement and during the negotiation between the debtor and its creditors, no protection is granted to the debtor automatically by the law. However, the debtor or a creditor may apply, only once, to the competent court for protection of the debtor's assets by ordering Provisional Measures, as an

injunction. Prerequisites for such an application are the written declaration of the creditors who represent at least 20% of the total debts that they participate to the negotiations, that an urgency/imminent danger exists, and that the application has been uploaded to the Electronic Registry of Solvency. The provisional measures cover the period of the negotiations between the debtor and its creditors in order to achieve a rehabilitation agreement and their purpose is, on one hand, to maintain the undertaking in the view of its rehabilitation and, on the other hand, to achieve "serenity" during the negotiations.

In addition, until the hearing and the issuance of the injunction, the above applicant may apply to the court for a Provisional Order (the provisional order is a "fast track" procedure which takes place usually within several days and there is not a formal hearing. The Judge examines the application, and it is at his/her discretion to order provisional measures, until the hearing or until the issuance of the injunctions decision). When the hearing of the injunctions takes place, the court may keep the provisional order valid, or it can modify it, or it may revoke it as well.

The provisional measures are valid until submitting to the court the rehabilitation agreement and cannot exceed 4 months from the decision or the provisional order. After that time limit, the provisional measures are void (under some conditions the above period may be extended, only for the suspension of any enforcement of creditor's claims against the debtor, however the total period must not exceed 6 months).

The competent court may revoke or modify the provisional measures at any time either ex officio or following a relevant application by anyone who has a legitimate interest.

**2.1.2 The Provisional Measures-the Type of the Protection**

The court is not bound by any measures that are mentioned in the application. It has a wide range of options, such as ordering some of the measures asked or even ordering completely different measures at its discretion.

The provisional measures may, indicatively, include the suspension of any enforcement of creditor's claims against the debtor (e.g. by seizure of assets), the prohibition of submitting any civil action against the debtor, the ban of proceeding with injunction against the debtor, the ban of transferring of the real estate property and the business equipment on behalf of the debtor, appointing a sequestrator, banning any termination of contracts, ordering the prolongation of contracts that are to be expired, maintenance of the current jobs in the company etc.

Moreover, for serious reason the court can also decide to apply the protection to the guarantors of the debtor or other co-debtors as well.

The court may also appoint a Special Receiver with the power to undertake the management of the debtor partially or totally (even without the consent of the debtor).

The aforementioned protection may bind all or several of the creditors (depending on the court's decision), including also the State (for taxes etc.). It must be noted that any action on behalf of any person who is bound by the provisional measures (e.g., a creditor), that is in breach of the provisional measures granted, is void.

Furthermore, the provisional measures do not apply regarding some specific types of claims such as the termination of a lease agreement, if the debtor owes at least six-month rents, the financial security agreements of the L. 3301/2004 or when an "important social reason"

occur (e.g., to pay to a creditor an amount which is essential for his and his family survival). The claims of the employees for their wages are not, in principle, affected by the measures, unless the court decides that there is an important reason.

### 2.2 The protection at the time that the rehabilitation agreement has been concluded and submitted to the Court

#### 2.2.1 The Procedure

At the time that the rehabilitation agreement has been submitted to the court for validation, there are two types of provisional protection. First of all, there is a provisional protection granted to the debtor automatically (i.e., the protection is granted directly by the law and no court decision is required) and it is limited to the measures that are listed on article 50 of the law 4738/2020 (see below par. 2.2.2). Secondly, an additional, parallel protection (i.e. additional to the measures that apply automatically) may be granted as an injunction with a court decision (and a provisional order), exactly as the above mentioned protection granted before the conclusion of the rehabilitation agreement (see above paras 2.1.1-2.1.2)

The purpose of the provisional protection at this stage is on the one hand to keep the business of the debtor running and on the other hand to maintain its property.

#### 2.2.2 The Type of the Protection

The automatic provisional protection granted at this stage, according to article 50 of the law 4738/2020, includes the suspension of any enforcement of creditor's claims against the debtor (e.g., by seizure of assets), the ban of proceeding with injunction against the debtor and the ban (in principle) of transferring of the real estate property and the business equipment on behalf of the debtor. Furthermore, any set-off regarding claims born before submission to the court is restricted.

It is noted that the time limits regarding creditors' claims and rights against the debtor and the guarantors/co-debtors are sustained.

The above, automatic protection does not affect, inter alia, the rights of the creditors to file lawsuits against the debtor, the right of the debtor to file an application for bankruptcy, the payments on behalf of the debtor to third parties in order to keep its business running and any enforcement of claims for debts that were born after submitting the rehabilitation agreement to the court.

The aforementioned protection is granted only once and for a 4-month period. After the expiration of the 4-month period it is at the court's discretion to provide further protection according to the procedure and the type of protection above mentioned in paras 2.1.1-2.1.2, or to revoke, modify or prolong the aforementioned protection.

The automatic protection does not apply to co-debtors and the debtor's guarantors. provisional protection may apply to them only by a court decision in the procedures mentioned above (paras 2.1.1-2.1.2) (but it is argued that the letters of guarantee are not affected).

For any additional protection to the debtor that may be ordered by a court, see above, par. 2.1.2.

### 2.3 The protection after the validation of the rehabilitation agreement from the Court

After the validation of the rehabilitation agreement by the court, the agreement binds both the debtor and, in principle, all of its creditors, whose claims are regulated by the agreement, even those who were not part of the agreement or voted for the agreement. However, the creditors whose claims were born

after the validation of the agreement are not bound.

The content of the rehabilitation agreement can be open to the parties, which may include, inter alia, reduction of the debtor's liabilities against its creditors and/or modification of the liabilities of the debtor (such as the time of payment or substitution with an agreement to take part to the debtor's profits) and/or capitalization of liabilities with the issuance of e.g. shares and/or transfer of the debtor's undertaking, and/or transfer of the management of the debtor's undertaking to a third party and/or further funding for the rehabilitation etc.

It must be noted that the claim of a creditor against the co-debtors and the guarantors are in principle limited to the amount that the liability of the debtor has been reduced, according to the validated rehabilitation agreement, unless the creditor does not consent on that (in the latter case, the liabilities of the co-debtors and the guarantors remain intact against the creditor).

**B. The Out of Court Workout**

**1. The Procedure**

The Out of Court Workout is a new procedure, established by the L. 4738/2020 (art. 6 et seq). The law excludes some debtors from the eligibility for these proceedings (e.g., financial institutions, insurance companies, debtors whose debts to financial institutions or the State do not exceed €10,000 etc.).

The Out of Court Workout is a procedure done electronically via a special, public electronic platform. The procedure commences when the debtor or some types of creditors (financial institutions, the State, social security funds) file an on-line application via the above platform to the competent Authority appointed by the law, the Special Secretariat for the Administration of Private Debt. With the application the debtor submits several data and documents including a list of its creditors, its assets etc. Subsequently, the creditors who participate may submit a proposal for the restructuring of the debts.

If a restructuring agreement is not concluded within 2 months from the application, or from the time that the creditors declare that they do not wish to submit a restructuring proposal, the procedure is considered fruitless.

**2. The Protection**

First of all, the filling of the application does not constitute a serious reason for the termination of contracts in force.

Furthermore, from the filling of the application and until the end of the Out of Court Workout, any measure of enforcement of claims on the debtor's movable and immovable assets and claims is sustained automatically by the law. Any relevant action that commences during the above period is void. Any auction scheduled to take place within 3 months from the application and any preparatory action of auction (including the confiscation) by a secured creditor, are not affected.

After the conclusion of the restructuring agreement, the creditors which are bound by it may not proceed with any enforcement proceedings against the debtor and all the pending or not measures of enforcement (either individually or collectively) are sustained during the period of the agreement and under the condition of its performance

**II. Bankruptcy**

The Bankruptcy is focused on the payment of the debtor's debts to the creditors by the debtor's assets, either by liquidation of them by a public auction or by selling the debtor's undertaking as a whole or partially.

When a debtor is in a constant and general inability of payment of its debts, the debtor or a

creditor or, in some instances, the district attorney may apply before the competent court, so that the latter will order the bankruptcy of the debtor. A foreseeable inability of payments can also be sufficient, only when the debtor applies for bankruptcy.

The court examines the case, and it may order for the bankruptcy of the debtor. However, the court may dismiss the application (e.g., when it is submitted in bad faith, e.g., when a creditor submits it for reasons irrelevant with the bankruptcy or when the debtor wants to avoid paying its debts).

If the court accepts the application, it appoints a) a Supervising Judge b) a Bankruptcy Trustee and it orders the debtor's property sealing.

**1. Protection after the application for bankruptcy and until the court decision that orders the bankruptcy**

After the application for bankruptcy has been submitted, whoever has a legitimate interest may submit before the competent court an application for Provisional Measures. The president of the court may order as an injunction whatever provisional measure he/she estimates as adequate for the maintenance of the assets of the debtor. The purpose of these measures is not to avoid the bankruptcy (as in the pre-bankruptcy proceedings) but it is to avoid any reduction of the assets or of their value, so that the claims of the creditors may be satisfied by the bankruptcy proceedings, when and if the bankruptcy will be decided by the court.

Any ordered provisional measure stops automatically, when the decision of the court that orders the bankruptcy (or dismisses the application) is issued and registered in the Electronic Registry of Solvency.

The Provisional Measures may indicatively include the suspension of any enforcement of creditor's claims against the debtor (e.g. by seizure of assets), the prohibition of submitting any civil action against the debtor, the ban of proceeding with injunction against the debtor, the ban of transferring of the real estate property and the business equipment on behalf of the debtor, appointing a sequistrator, banning any termination of contracts, ordering the prolongation of contracts that are to be expired, maintenance of the current jobs in the company etc.

In principle, the aforementioned suspension of any enforcement of creditor's claims against the debtor does not affect in principle the secured creditors from satisfying their claim from the liquidation of the security (e.g., mortgaged or pledged assets), unless there is an admissible proposal for selling the debtor's undertaking (or its sectors) as a whole.

Furthermore, the provisional measures do not apply regarding some specific types of claims such as the termination of a lease agreement, if the debtor owes at least six-month rents, the financial security agreements of the L. 3301/2004 or the rights of the assignee in case of an assignment of a claim.

**2. Protection after the court declares the bankruptcy**

The "protection" mentioned in the present paragraph constitutes consequences of the declaration of bankruptcy for the debtor and the creditors. Some of the consequences are the following:

-After the decision of the court that declares the bankruptcy, the debtor may not in principle administrate or transfer its property/assets-Bankruptcy Estate- (this does not include any property/assets acquired by the debtor, after the bankruptcy is declared, unless it is interest and other periodic benefits, as well as ancillary claims or rights, even if they are born or

developed after the declaration of bankruptcy, if they come from a contract or right existing before the bankruptcy was declared). The administration passes to the Bankruptcy Trustee.

-The creditors may seek to be paid off in principle only through the Bankruptcy Estate. From the declaration of bankruptcy, any measures such as enforcement of creditor's claims against the debtor, any civil action against the debtor, any appeal, are banned to commence or it they already took place they are suspended automatically.

However, the creditors, whose claims are secured by an asset of the debtor (e.g., a mortgage), they are paid by the liquidation of this specific asset (unless they resign from the security, so they may be able to be satisfied by the whole of the bankruptcy estate, with the rest of the creditors). The aforementioned suspension of measures of enforcement, in principle, does not apply to the secured creditors regarding these specific assets for a period of 9 months from the declaration of bankruptcy. There are some exceptions, such as when the asset is important for the debtor's undertaking if the undertaking or a sector of it is to be sold as a whole.

-From the declaration of bankruptcy, the creditors' claims do not produce interest.

-The pending contracts in principle, after the declaration of bankruptcy they are terminated the 60th day from the declaration of bankruptcy. However, the Bankruptcy Trustee may elect to terminate them before the above date or to continue the pending contracts. If the decision that declares the bankruptcy orders to sell the debtor's undertaking (or its sectors) as a whole, the other party of these contracts, within 30 days from the declaration of bankruptcy may impose a reasonable deadline to the Bankruptcy Trustee (which cannot exceed 30 days) in order to elect whether to continue the pending contracts or not. If the Bankruptcy Trustee does not respond in a timely manner or he refuses to perform, the other party is entitled a) to terminate the contract and b) to make a claim for compensation for non-performance, satisfied as a bankruptcy creditor.

-In principle, the declaration of bankruptcy does not affect the right of a creditor to a set off against the debtor, if the prerequisites for a set off were born before the declaration of the bankruptcy.

-Anyone who has a right over an asset, which is not owned by the debtor, may ask from the Bankruptcy Trustee its separation from the bankruptcy estate.

-Anyone who delivered goods to the debtor, under specific circumstances, may ask the Bankruptcy Trustee to return them.

-The Bankruptcy Trustee, under several circumstances, is entitled to revoke acts of the debtor, which took place from the time that the debtor stop making payments and until the declaration of the bankruptcy and they are harmful for the interests of the creditors.

**Conclusion**

As a final remark, the present constitutes only a brief, general outline of the proceedings and the protection of the assets and it is not a legal advice. Obviously, it may not cover all the detailed provisions of the law, as the bankruptcy and pre-bankruptcy proceedings are quite complicated, with many exceptions so, many special exceptions and provisions are not covered. For any specific situation, a creditor must seek specific legal advice from a qualified lawyer.

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# INTERNATIONAL LAWYERS NETWORK

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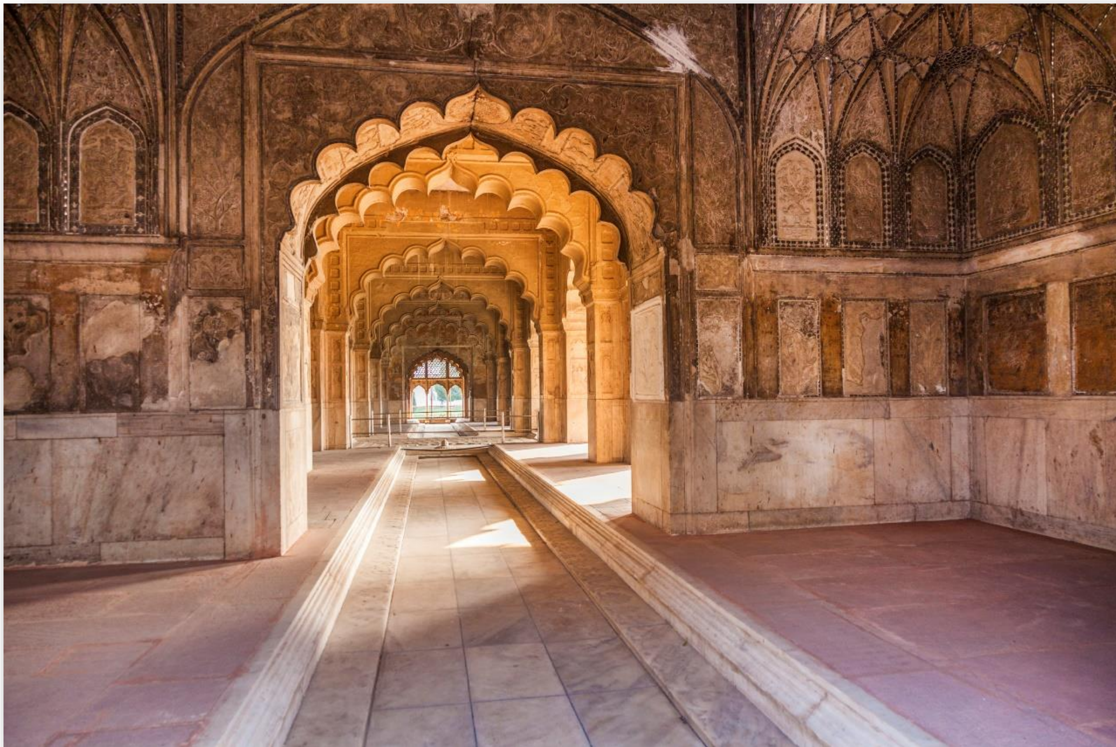

## LEXCOUNSEL LAW OFFICES

### Bankruptcy, Insolvency & Rehabilitation Proceedings in India

ILN RESTRUCTURING & INSOLVENCY GROUP

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER INDIAN LAW

**The Code:**

Introduction of a comprehensive insolvency and bankruptcy law in India is a recent event, with introduction of the Insolvency and Bankruptcy Code, 2016 ("**the Code**") in the year 2016. The Code is oriented to be the umbrella legislation in India for laws relating to insolvency and bankruptcy. At present the Code only governs rehabilitation and liquidation of companies and extends to guarantors.

The Code is administered through the newly formed National Company Law Tribunals ("**NCLT**") across India, with an appellate tribunals based in New Delhi and Chennai, Tamil Nadu, and the Supreme Court of India having the final jurisdiction.

The Code seeks to introduce many fresh legal concepts as also modify the pre-existing ones. Upon admission of a case against a company under the Code, it prescribes for a mandatory Corporate Insolvency Resolution Process ("**CIRP**") for such company (corporate debtor) within which period all efforts are to be made to revive/rehabilitate the corporate debtor. If the revival efforts fail, the corporate debtor can be put into liquidation, where the available assets are distributed against liability claims, as per the priority specified by the Code, with payments being effected to the Insolvency Resolution Professional ("**IRP**"), the secured and unsecured creditors, workmen, Government, shareholders, etc.

The CIRP can be commenced by the NCLT, upon admission by it of any application presented by any applicant (financial or operational creditor) or the corporate debtor itself with evidence of default by the corporate debtor in relation to a debt of INR 10,000,000 (USD 132,000) or above. In addition:

- if an operational creditor approaches the NCLT – it must have already served a 10-day demand notice onto the corporate debtor and the corporate debtor must have failed to either pay the amount or to disclose a pre-existing bona-fide dispute; or
- if a corporate debtor itself approaches the NCLT – its shareholders must have passed a resolution in such regard with 75% majority.

**THE CIRP AND LIQUIDATION**

Once the NCLT is satisfied that a financial default has been committed by the corporate debtor, it directs commencement therewith of the CIRP, i.e., a 180 days' resolution window for revival of the corporate debtor while confirming appointment of an IRP. Within this 180 days' window (extendable by 90 days), the creditors may either with 66% majority decide to revive the company, as per the resolution plan to be subsequently approved by the NCLT or decide to liquidate the corporate debtor. Failure of the creditors to take a decision also leads to liquidation of the corporate debtor.

With commencement of the CIRP, the powers of management of affairs of the corporate debtor moves to the hands of the IRP, who reports to the committee of creditors, and is also entitled to take all steps to ensure that the business of the corporate debtor continues as a going concern. The Code also contains provisions governing penalties and punishments for extortionate and improper transactions, both prior to and during the insolvency process and proceedings.

In the process of liquidation, the timelines would depend upon facts and circumstances of each case such as complexity in sale of assets of the company, finalization of liabilities and any disputes related to rejection of any party's claims by the liquidator, any pending legal

proceedings, tax disputes, appeals, realization of receivables, etc.

**PROTECTION GRANTED TO THE DEBTOR:**

The foremost protection that the Code accords to the corporate debtors is the "moratorium" which commences with commencement of the CIRP. The NCLT, while admitting an application of a creditor against a company or an application by the company itself, declares "moratorium."

The "moratorium" continues through the CIRP and puts an embargo on institution or continuation of suits including execution of any judgment, decree, or order of any court of law, arbitration panel or any other authority. In addition to this, the moratorium also restricts the transfer, alienation or disposal of any assets or legal right or beneficial interest of the corporate debtor. Also, no action can be taken during the moratorium period to foreclose, recover or enforce any security interest created by the corporate debtor.

The moratorium seeks to provide an atmosphere for revival of the corporate debtor.

The protection under moratorium is granted only qua the property, rights, and obligations of the corporate debtor. Irrespective of the moratorium, fresh criminal prosecutions can be lodged, and those lodged earlier can continue, against the corporate debtor as also against its directors/promoters, etc., for any criminal offences.

The benefit of moratorium under the Code is also not available to the guarantors and sureties of the corporate debtor. After the initial conflicts in interpretation, and subsequent observations by the Supreme Court of India, the Code was amended in June 2018 to clarify that no moratorium would apply to the legal actions of recovery against the surety and guarantors of a corporate debtor.

Moratorium also does not apply to the writs as also on the constitutional powers of the Supreme Court and the High Courts. The IRP is expected to appear in, and contest in the best interest of the corporate debtor, all matters which do not fall under moratorium, as also to ensure compliance with all the applicable laws during the CIRP period.

**End to Suspension Period Imposed by the Indian Government due to the Coronavirus:**

The COVID – 19 pandemic had a severe impact on the various industries and different economies around the world. In 2020, the Indian Government after rounds of discussion and deliberations, assessed the adversity that may be caused due to the Coronavirus on Indian economy. Thereafter the Indian Government considered and imposed a suspension on the IBC proceedings to curtail the devastating impact of the Coronavirus and increased the threshold limit of a default to drag a defaulting company to the insolvency tribunal to INR 10 million, from the earlier threshold of INR 0.1 million.

The aforesaid suspension for initiation of IBC cases finally came to an end on March 24, 2021, vide an Ordinance dated April 24, 2021, but the increased threshold is unlikely to be reduced to the original limits.

**Pre-Packaged Insolvency Resolution Process (PPIRCP):**

The Insolvency and Bankruptcy (Amendment) Ordinance, 2021 has introduced a new concept of PPIRCP. PPRICP is a framework provided for resolution of stress of corporate MSMEs (as covered under MSME Act, 2006). Unlike Corporate Insolvency Resolution Process, PPRICP is available to defaults where the default is at least INR 1 million arising between March 25, 2020, to March 24, 2021.

The PRICP is a hybrid process, where pre-initiation phase is largely informal and post-

initiation stage is formal. The informality at pre-initiation stage offers flexibility for the corporate debtors and its creditors to swiftly explore and negotiate the best possible outcome to resolve stress in the business, while the post-initiation is focused on maximization of value and bestows the resolution plan with the statutory protection.

**Bankruptcy for Individuals and Partnership firms:**

The provisions of the Code concerning insolvency and liquidation of individuals and firms are being brought into effect in a phase wise manner. The provisions are still in their infancy and will evolve in due course.

**Conclusion**: The Code has arguably tilted the debtor-creditor balance in favour of the creditor, as one of the consequences of admission of proceedings under the Code is that the erstwhile management of the company is ousted, even if the company is rehabilitated. In cases of small and medium enterprises, the promoters can still lay reclaim the ownership and control of their company, provided they are not declared willful defaulters by the financial institution(s). The pre-packaged insolvency may provide the much-needed respite to the genuine promoters.

Within a short span since its implementation, and despite Coronavirus given business adversities, the Code is proving to be a more effective tool for rehabilitation and liquidation as compared to the winding up provisions of the (Indian) Companies Act and the Sick Industrial Companies Act, 1985, it repealed and replaced.

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# INTERNATIONAL LAWYERS NETWORK

## JST & CO.

## Bankruptcy, Insolvency & Rehabilitation Proceedings in Israel

**ILN RESTRUCTURING & INSOLVENCY GROUP**

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER ISRAELI LAW

The Insolvency and Rehabilitation Law-2018 (the "**Law**") was enacted on 2018 and came into force on September 15, 2019. The Law offers a comprehensive reform and provides Israel with modern insolvency legislation dealing with both corporate and individual insolvency.

The Law has three primary objectives:

1. to promote the debtor's economic rehabilitation;
2. to maximize the debt repayment to creditors and to divide the debtor's pool of assets in a more equitable manner between the secured and unsecured creditors;
3. to increase certainty and stability by streamlining processes and reducing the bureaucratic burden.

The key principles of the Law are as follows:

**1. *A clear and simple definition of insolvency***

An entity shall be deemed insolvent if it cannot actively pay its debts. According to the Law, a creditor is entitled to file an application for a court order to open insolvency proceedings only when a debt has not been paid to a said creditor on time and therefore, creditors cannot file applications preemptively as was the case before 2019.

**2. *Reducing the bureaucratic burden and streamlining the process***

The jurisdiction to conduct insolvency proceedings in relation to corporations is the District Court. However, a significant share of the proceedings being conducted will be decided by administrative authorities and thus will not require court rulings. The Law empowers the Official Receiver or, under its new name, the "Administrator in Charge of Insolvency Proceedings and Economic Rehabilitation" with the administrative powers of insolvency proceedings.

**3. *The bodies before which the procedure is conducted***

If a creditor wishes to initiate proceedings against a debtor (regardless of the amount of the debt), the request must be submitted to the Magistrate's Court and a copy of it submitted to the supervisor of insolvency proceedings (a unit in the Ministry of Justice acting under the Law) (the "**Supervisor**").

If the debtor requests on his own initiative to initiate proceedings, the request must be submitted to the Supervisor.

Insolvency proceedings of an individual who owes up to approximately NIS 161,000 (the amounts are updated every year in line with the price index) will be conducted by the Execution Enforcement and Collection Authority.

Proceedings above this amount will be conducted before the Commissioner of Proceedings insolvency in the Ministry of Justice through an official called the Registrar of Insolvency Proceedings (the "**Registrar**"), under the supervision of the Magistrate's Court.

Insolvency proceedings regarding Corporations will be tried before the District Courts.

**4. *The protection granted to the debtor***

Filing a request to open insolvency proceedings does not "freeze" all proceedings against the debtor automatically. The debtor may apply for a stay of proceedings until an opening order is issued to the legal entity where the proceedings are conducted (court, execution enforcement and collection authority, the fine collection center, etc.) and file a request to order a stay of proceedings.

After checking the correctness of the application at the secretariat, the application will be forwarded for a Registrar's decision. The Registrar will examine the suitability of the application for the procedure. If the Registrar finds that the conditions for opening insolvency proceedings are met, he orders the summoning of a payment settlement meeting between the debtor and the creditors.

The payment settlement meeting will be conducted by the Registrar's representative. The purpose of the meeting is to reach an agreed payment arrangement between the debtor and the creditors already at this point, in order to finish the procedure quickly and efficiently. If an agreed payment arrangement is not drawn up at the settlement meeting the Registrar will issue an order opening proceedings.

With the issuance of the order to open proceedings, all of the debtor's assets and liabilities will be managed in a joint framework of the procedure for the purpose of distributing them to creditors according to law. Accordingly, creditors will not be able to act against the debtor. The order opening proceedings will include all or part of the following instructions at the Registrar's discretion: cancellation of proceedings and foreclosures, restriction on the use of a debit card, restriction on receiving or holding a passport and the extension of its validity, restriction on the establishment or participation in the introduction of a new corporation, and more.

The interim period will begin from the date of issuance of the order opening proceedings and will continue until issuance Economic Rehabilitation order by the Registrar. During the interim period, the trustee appointed by the Registrar will carry out a comprehensive examination of the debtor's finances and the circumstances that led him to his situation. The debtor must cooperate with the trustee, submit income reports to the trustee and expenses as required and reach him for clarification if invited. The trustee will work to collect the debtor's assets and distribute them among the creditors after deciding in the debt claims they filed. Submission of debt claims by creditors is from the day the order opening proceedings was published and within 6 months.

An economic rehabilitation order will include all or part of the following instructions: payment obligation to be imposed on the debtor, the amount of payments and the period of payments, the assets that will be included in the fund, the manner of realization of the assets, restrictions that will apply to the debtor during the payment period, training for proper financial management, debts for which discharge will not be granted etc.

At the end of the payment period set for the debtor in the economic rehabilitation order, the Registrar will examine dismissing the debtor from his obligations. The discharge will be granted if the debtor has met all the conditions of the economic rehabilitation order given to him. The discharge will exempt the debtor from the balance of debts that cannot be paid from his assets.

It is possible to determine in an economic rehabilitation order conditions intended for a later period granting the dismissal.

As a general rule, the discharge will apply to the remaining debts of the debtor that were created before the issuance of a decree initiation of procedures with the exception of exceptions provided by law. Obligations to which the dismissal will not apply punitive payments, such as fines debt created fraudulently or resulting from theft, sexual offense or serious violence, child support debt etc.

**5. *Uniformity in the opening of proceedings***

The Law establishes a uniform and orderly procedure for opening proceedings against a

corporation facing insolvency. The Law prescribes that the court shall decide whether a corporation is insolvent and, only subsequently, determine the most appropriate procedure for handling that corporation on the basis of data submitted to the court. The main procedures for corporations are Liquidation processes and Recovery procedures.

**6. *Creditors' debt repayment order and distribution of funds***

According to the Law, some of the debt repayments will be carved out from the sums owed to the strong secured creditors (i.e., banks and tax authorities). They will then be

distributed among the general unsecured creditors holding no collateral whatsoever. In the majority of cases, these general creditors (usually suppliers, customers, and employees) receive only a tiny portion, if any, of the debtor's pool of assets. To counter this to a degree, the Law prescribes, inter alia, that 25% of the assets pledged under a floating charge (to differentiate from a fixed charge on a specific asset) be carved out in favor of the debtor's general unsecured creditors. It further determines that the volume of assets used to repay the holder of the floating charge be reduced.

The Law also reduces the preferential right given to the tax authorities when dividing up the debtor's assets. Under the former law, the tax authority was entitled to be treated as a preferred creditor in respect of one tax year of its choice. The new Insolvency Law restricts the preference of the tax authority only to debts pursuant to voluntary debt settlements with the debtor regarding tax arrears. The preference for such debts is restricted to a maximum of three tax years.

**7. *Minimizing damages***

The Law imposes an obligation on the board of directors of the debtor corporation to take all reasonable measures to minimize the extent of the insolvency during the period prior to the opening of insolvency proceedings.

**8. *Raising new debt***

Section 65 of the new Insolvency Law provides the ability to raise new debt secured by existing pledged assets or using such assets in another manner, as required for the corporate operation or imposing obligations on certain essential suppliers and third parties to continue providing services, or to abstain from cancelling contracts due to the insolvency even if they are contractually entitled to do so.

**<u>Proceedings for corporations</u>**

A creditor or a debtor wishing to initiate insolvency proceedings must file a standard application to obtain a commencement of insolvency proceedings order. The court will determine whether to channel the corporate entity into a course of rehabilitation or winding up. This decision depends on the economic condition of the entity and is independent of the manner in which the application has been drafted.

Upon issue of the order by the court for the initiation of insolvency proceedings, an automatic stay of proceedings will apply. The court may choose to manage the corporate entity with a view to achieving its economic rehabilitation. In such a case, a stay of proceedings will apply against the secured creditors, subject to adequate protection in order to safeguard the value of their security.

Simultaneously with the issue of the order, the court will appoint a trustee to be entrusted with full control of the corporate assets.

The Law creates a new mechanism of "protective negotiations". This is a temporary provision to be in effect for four years. This mechanism allows a public company to initiate out-of-court protective negotiations with its

creditors while allowing it to remain active and without appointment of a trustee. During the period of the protective negotiations, a complete stay of proceedings shall not apply but the creditors may not file an application for a commencement of insolvency proceedings order against the corporation and may not call for the immediate repayment of debt. If the temporary provision shows positive results in practice, there are good chances it will be prolonged.

Prior to the enactment of the Law, Israeli courts generally did not allow a debtor to terminate agreements simply because a receiver believed that it could receive a better return within an alternative commercial framework. While the prior statutory framework permitted courts in insolvency proceedings to terminate "burdensome" or "unprofitable" executory contracts, courts generally did not allow licensors to terminate agreements that were moderately profitable.

Section 70(d) of the new Insolvency Law provides that a court may allow for the cancellation of all or part of an executory contract if the court determines that such cancellation is either "required for the economic rehabilitation" of the debtor or alternatively will "increase the proportion of the debt that will be repaid to the creditors". The court may approve the cancellation of the contract after giving the other party to the contract the opportunity to voice its position, and may, at the request of the other party, order the cancellation of only part of the contract, if it is found to be sufficient for economic restoration or to reduce such debt rate.

If an existing contract is revoked under this section, all of the corporation's rights and obligations under the contract will cease, but will not be revoked to prejudice another person's rights and obligations but to the extent necessary to release the corporation and its assets.

**Proceedings for individuals**

Under the new Law, a substantial part of the administration of insolvency proceedings related individuals has been moved from the court to administrative authorities.

Insolvency proceedings below NIS150,000 will be administered entirely by the Enforcement and Collection Authority. Insolvency proceedings above NIS150,000 will be conducted before the official receiver (the Insolvency Commissioner) and, if relevant, before the court with respect to further, more specific matters.

At the end of this audit by the Collection Authority/Insolvency Commissioner a payment plan is established, at the end of which the debtor will receive a discharge. The default scenario is a payment period of three years. The court reserves the right to increase or decrease the period depending upon the circumstances of the case.

If the debtor has no proven financial ability to pay the creditors, he may be granted an immediate discharge.

According to the new law a person who is in bankruptcy proceedings, and who owns an apartment registered with the Israel Lands Administration or the Land Registry - may find himself in a particularly problematic situation. This is because the current legislation abolishes the protection afforded by the Tenant Protection Act to the debtor and his family members residing in the property he owns.

Hence in some cases it does not necessarily pay off for debtors to resort to insolvency proceedings, e.g., when the debtor owns a real estate property whose value according to the appraiser's assessment is significantly higher than the debtor's debts. If the value of the

apartment allows a person to repay his debts in full by selling it and leaves him with a sufficient amount to purchase another residential property or pay rent, then there is no point in going into insolvency proceedings, which endanger the debtor in losing the property.

In cases where the value of the property is not significantly higher than the amount of its debts listed in the debtor's execution, and he chooses to go into insolvency proceedings, it is important to know that the court is not necessarily in a hurry to put any residential apartment up for sale, preferring to exhaust all other alternatives. There is still the possibility of receiving the protection of the debtor's residential apartment in certain circumstances.

**Order of Repayment**

Under Israeli law, the order of repayment in insolvency proceedings is as follows:

1. Creditors secured by a fixed charge
2. Expenses of insolvency proceedings
3. Preferred creditors
4. Creditors with a floating charge
5. Ordinary creditors
6. Deferred creditors and shareholders

**Directors' and CEO's liabilities**

The Law allows the court to impose personal liability on a director or general manager that knew, or ought to have known, that the corporate entity was insolvent and did not take reasonable steps to reduce the potential impact of insolvency.

However, the Law creates a presumption that a director or general manager took reasonable steps to reduce the extent of the insolvency, if measures were taken to evaluate the economic position of the corporation and acted to ensure that the corporation take one of the following measures:

1. Receipt of assistance from a corporate rehabilitation specialist
2. Negotiations for debt settlement
3. Commencement of insolvency proceedings
4. Additional measures may be derived from existing case law and practice, such as in cases of distressed companies, the officers of the corporate are required to act in favor of the corporate creditors, and to take all precautionary measures for that purpose.

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# INTERNATIONAL LAWYERS NETWORK

## EXP LEGAL – ITALIAN AND INTERNATIONAL LAW FIRM

### Bankruptcy, Insolvency & Rehabilitation Proceedings in Italy

ILN RESTRUCTURING & INSOLVENCY GROUP

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER ITALIAN LAW

**1. Presentation of the judicial liquidation/ insolvency/ rehabilitation proceedings in Italy and their main characteristics.**

The current legislation for judicial liquidation, insolvency and restructuring proceedings has recently been reformed on February 14, 2019. On this date the New Code of Business Crisis and Insolvency has been published in the Official Gazette (Legislative Decree 12 January 2019 No. 14), replacing the Royal Decree n° 267/1942.

The reform was initially to enter into force in its entirety on August 15, 2020, and then due to the pandemic emergency situation, the Law Decree 23 of April 8, 2020, containing *"Urgent provisions to support companies' liquidity and export"* delayed the entry into force, as stated in article 6, to September 1, 2021, has once again been amended. In fact, in the first place, according to the Law Decree no. 118 - converted into the Law of 21 October 2021 n. 147, - the Company Crisis and Insolvency Code should have entered into force on May 16, 2022. After, according to the Legislative Decree no. 83/2022, the entry into force of the Company Crisis and Insolvency Code was set for July 15, 2022. (Legislative Decree no. 14/2019);

According to the law, the procedures available to debtor and /or to creditors are:

- Judicial liquidation;
- Composition with creditors,
- Restructuring agreements,
- Rescue plans.

The main differences which allow to classify the procedures mentioned above in two macro groups reflect the purpose to which they are directed.

On the one hand, in fact, there are procedures aiming to reorganize the company such as rescue plans, restructuring agreements and composition with creditors where the business continuity is envisaged. They can be used by the entrepreneur in a state of crisis or the phase of a company's business life that puts the prospect of the continuation of the business at risk, if however, the rehabilitation is still possible.

On the other hand, there are procedures aimed at the liquidation of the company's assets such as judicial liquidation and the composition with creditors for liquidation purposes, for the company in a state of insolvency or no longer able to regularly meet its obligations.

Therefore, the procedures respond to different needs depending on the financial condition the debtor intends to use them.

In addition to this difference, it is possible to find others always within the two macro-categories.

In particular, the rescue plan, the restructuring agreements and the composition with creditors with business continuity differ regarding the treatment of creditors. In fact, while an agreement with creditors is not required in the rescue plan, in the restructuring agreements it is foreseen that the non-participating creditors must be paid in full and in the composition with creditors the approval of the proposal submitted by the debtor by so many creditors which are the majority of the credits admitted to the vote is required.

Furthermore, while in the framework of debt restructuring agreements and the composition with creditors there is the possibility of entering into a so-called tax settlement, i.e., an agreement with qualified creditors for the payment, partial or even deferred, of taxes and related accessories. This possibility is excluded in the rescue plan.

Another difference concerns the control of the judicial authority. In fact, while in the rescue

plan there is no provision for judicial review, both in the composition with creditors and in the restructuring agreements, there is the intervention of the judicial authority and in particular , in the restructuring agreements there are minimal procedural aspects and the Court's control but not in the executive phase; in the composition with creditors there is, instead, a keen control of the judicial authority in every phase.

On the other hand, with reference to judicial liquidation and to composition with creditors for liquidation purposes, the most important difference is that while with the composition with creditors, the entrepreneur keeps the administration of his assets and the business under the supervision of the judicial commissioner, with the judicial liquidation the debtor loses the management of the company that is deferred to the insolvency practitioner appointed by the competent Court.

## 2. The protection granted to the debtor against its creditors.

From this point of view, it is possible to carry out a joint analysis of the procedures, since the protections put in favor of the debtor towards the creditors are almost applicable to all the procedures.

### 2.1. Irrevocability of deeds, payments and guarantees.

First of all, the provision for which, in the event of subsequent judicial liquidation, the deeds, payments and guarantees put in place in execution of i) rescue plan, ii) restructuring agreement, iii) composition with creditors cannot be subject to claw back action.

Article 67 letter d) and f) of the Royal Decree, in force until September 2021, in fact establishes that are not subject to the claw back action: *“the deeds, payments and guarantees granted on the debtor's assets if implemented in execution of a plan that appears suitable to allow the reorganization of the debt exposure of the company [...] "and the deeds, payments and guarantees put in place in execution of the composition with creditors [...], as well as the approved agreement pursuant to article 182bis, as well as the deeds, the payments and guarantees legally put in place after the filing of the appeal pursuant to article 161 ”*.

### 2.2. Prohibition to continue or initiate precautionary and executive actions on the debtor's assets.

As a guarantee for the debtor, it is forbidden to continue or to start exercising individual precautionary and executive actions on the debtor's assets.

Preliminarily, it is necessary to clarify what is meant by "*debtor's assets*" and to which creditors the above-mentioned prohibition refers.

With reference to the first aspect, it can be stated that "*debtor's assets*" means the assets and credits of the entrepreneur admitted to the insolvency proceedings acquired to insolvency estate. Otherwise, assets and rights of a strictly personal nature, maintenance payments, salaries, pensions, wages and what the debtor earns with his/her activity within the limits of what is needed for him/her and his/her family, things that cannot by law be foreclosed, etc.

The property owned by third parties, co-affiliated or with guarantors, directed in some way to guarantee the bankrupt's obligations are also excluded from the application of the prohibition.

With regard instead to the individuals to whom this prohibition refers, it is specified by the rules that the recipients are not only creditors who have accrued pre-judicial liquidation credits, but

also creditors who become creditors during the judicial liquidation proceedings and this prohibition does not find the same application in all procedures and does not apply to rescue plans.

In relation to the other proceedings, the effectiveness of this prohibition is regulated differently depending on the procedures and in particular:

i) With reference to restructuring agreements, the suspension of the precautionary and executive actions on the debtor's assets is valid for sixty days from its publication in the Registry of companies;

ii) Regarding composition with creditors, both for liquidation and conservative purposes, this prohibition applies from the date of publication of the appeal in the Registry of companies and until the time the decree approving the composition with creditors becomes final;

iii) Finally, in the event of judicial liquidation, the provision applies from the day of the declaration of judicial liquidation for the entire duration of the judicial liquidation procedure.

**2.3. Contracts pending in the composition with creditors.**

With reference only to the proceeding of the composition with creditors, the legislator for the debtor's protection has provided the possibility for him/her to ask the Court the authorization to terminate contractual relations if they are still in force, (i.e., not yet fully executed nor by one, or by the other contractor) on the date of submission of the appeal for admission to the composition with creditors. This rule also applies against the will of the performing contractor.

The authorization to the Court can be requested and granted when the suspension or winding up appear necessary or perhaps even only convenient to execute the composition with creditors plan.

As an alternative to winding up, the debtor can also request the possibility of suspending the contract for a period of sixty days, which can be extended only once.

This is the current situation, that, as said above, will be modified because of the introduction of the new provisions.

**2.4. The Italian procedure for negotiated settlement.**

With the changes made by the legislative decree n. 83/2022, new measures suitable to promptly detect the presence of a state of crisis have been made more important, first of all, the new provision of the negotiated settlement of the crisis.

This is a new procedure that undoubtedly represents the most significant action in providing a new tool to support companies in difficulties. It is firmly aimed at their recovery and presents the following characteristics. In particular:

i) This procedure can be used by all commercial entrepreneurs, as well as agricultural entrepreneurs – that normally according to previous legislation cannot be adjudicated bankrupt -.

ii) The appointment of an "expert" is required. The presence of this professional aims to facilitate negotiations between the entrepreneur, the creditors, and any other interested parties in order to overcome the condition of equity or economic-financial imbalance.

The expert must be registered in a dedicated professional register and also have previous experience of at least five years in the field of corporate restructuring and business crisis;

Finally, another essential requirement for access to the procedure is the actual perspective of recovery, which is verified by carrying out a test involving a preliminary assessment of the complexity of recovery through the relationship between the entity to the debt to be restructured and the cashflows that could be committed annually to servicing the debt.

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# MARTÍNEZ, ALGABA, DE HARO & CURIEL, S.C.

## Bankruptcy, Insolvency & Rehabilitation Proceedings in Mexico

ILN RESTRUCTURING & INSOLVENCY GROUP

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER MEXICAN LAW

### Preface

On 12 May 2000, the Commercial Insolvency Law (the "**CIL**") was published in the Federal Official Gazette, and it entered into full force and effect the next day. This law replaced the 1943 Law governing the Suspension of Payments and Bankruptcy, and all other legal provisions that opposed the provisions of the new CIL.

Pursuant to its preface, the CIL has the principal purpose of creating a modern regulatory framework that allows the conservation of companies undergoing a financial and economic crisis. To this end, the figure of 'conciliation' was created to make sure that the merchant and its creditors reach an agreement for the payment of the merchant's liabilities over a reasonable period. If reaching a reorganization agreement is unfeasible, the CIL establishes a procedure for the orderly liquidation of the merchant's assets and rights while attempting to maximize the proceeds of the sale, applying the funds obtained therefrom to the payment of the merchant's liabilities, following a fair order and preference regarding the differences between the relevant creditors.

The CIL maintains the federal judge as the central body and rector of the commercial insolvency proceeding; however, as previously stated, it recognizes that she or he must be aided in the performance of his or her functions by specialists in administrative, commercial, industrial, economic and financial aspects, so that the judge may focus efforts on strictly legal tasks. As a result, the CIL created the Federal Institute of Commercial Insolvency Specialists (widely known for its initials in Spanish as "**IFECOM**"). According to the indications of the CIL and the General Rules issued to this effect by this Institute, specialists are appointed by means of a random procedure.

In 2007, the CIL underwent several reforms, most importantly, the addition of a pre-packed reorganization proceeding and once again in 2014, the government issued the Financial Reform, by which, among other legislation, the CIL was reformed.

One of the main purposes of this reform was to eliminate the existing legal gaps in the CIL that permitted the courts to interpret the regulation broadly according to each case. For example, in the bankruptcy proceeding of Compañía Mexicana de Aviación, a pioneer airline in the Mexican aviation industry, the judge illegally determined to extend the conciliatory term for over four years to procure a reorganization agreement, notwithstanding that, by law, this phase has a maximum duration of one year.

Furthermore, this reform also introduced certain provisions that regulate intercompany debts to determine if the merchant is to be declared commercially insolvent or for the approval of the reorganization agreement between the merchant and its creditors.

On August 9, 2019, the CIL was amended to incorporate provisions that would allow majority state-owned companies to request to be declared commercially insolvent or in bankruptcy.

Additionally, on March 4, 2022, an order issued by the Council of the Federal Judicature was published in the Federal Official Gazette, stating the creation of two new Federal Courts specialized in attending insolvency proceedings

governed by the CIL[1].

We consider that there is still a need to reform the CIL, given that there are matters that are not properly regulated, such as: (i) the application and duration of injunctive measures; (ii) protection to creditors´ rights; or (iii) conditions that do not adjust to current market practices. This lack of regulation has led to merchants taking advantage to the detriment of creditors' rights.

Having stated the foregoing, we hereby give a brief presentation of key aspects of the commercial insolvency proceeding, as regulated by the CIL, and the protections granted by the CIL to debtors who are declared insolvent.

**1.- Merchants - Insolvency Conditions.**

Individuals or legal entities that are Merchants pursuant to the provisions of the Commercial Code may be subject to the commercial insolvency proceeding [2] . All commercial insolvency proceedings are conducted before the specialized insolvency Federal District Judges (the "**Insolvency Courts**"), located in Mexico City.

The necessary condition for a Merchant to be declared commercially insolvent is that it can be demonstrated that the Merchant has defaulted in the payment of its obligations in a general manner. In order to prove this condition of general non-performance, a payment default to two or more different creditors should exist, and one of the two following conditions should exist if the insolvency petition is filed by the Merchant, or both conditions if the insolvency petition is filed by the creditors: (i) that of its matured obligations, those that are at least thirty (30) days overdue represent thirty-five percent (35%) or more of all the obligations of the Merchant to the date on which the insolvency petition is filed; and/or (ii) the Merchant has insufficient assets, of those listed below, in order to satisfy at least eighty percent (80%) of its matured obligations on the date the petition is filed. The assets that should be considered for the effects established in this paragraph are: (i) cash on hand and on-sight deposits; (ii) deposits and investments with a term less than ninety (90) calendar days following the date of the petition; (iii) clients and accounts receivable whose maturity does not exceed ninety (90) calendar days following the date of the petition; and (iv) securities for which purchase-sale transactions are regularly conducted in the respective markets, which may be sold in a maximum term of thirty (30) banking days, and whose value is known to the date on which the petition is filed.

**2.- Verification Visit.**

To determine whether a Merchant is found within the premises contemplated by the CIL to be declared commercially insolvent, there is a preliminary stage within the insolvency proceeding named the "Visit", in which an inspection is made of the financial and economic status of the Merchant (the "**Verification Visit**") by a specialist called the "Visitor", who is appointed by the IFECOM.

The CIL stipulates that the Verification Visit will have a duration of 15 calendar days, which, under the request of the Visitor, may be extended by the Insolvency Court to an

[1] The above-mentioned reform has not yet been included in the CIL, which currently states that all commercial insolvency proceedings are conducted before Federal District Judges, located across the Country, and which are appointed based on the domicile of the relevant Merchant.

[2] According to the CIL, the following persons may be subject to a commercial insolvency proceeding: (i) Individuals whose normal occupation is commerce; (ii) Business corporations, including state-owned companies created as corporations and companies with majority state participation, when they initiate processes of disincorporation or extinction; and (iii) branches of foreign companies that perform acts of commerce in Mexico; however, in this case, the declaration of commercial insolvency will only encompass the assets and rights that are located and enforceable in Mexico, and the creditors related to transactions entered into with such branches.

additional 15 days. Based on the opinion submitted by the Visitor and considering the contents of the petition for the declaration of commercial insolvency, the Insolvency Court will determine whether the Merchant is declared commercially insolvent or not, by means of a ruling passed to this effect.

If the Merchant refuses to facilitate the Visitor the financial information needed for the Verification Visit, the Insolvency Court will apply enforcement measures against the Merchant, giving warning that, if the Merchant's reckless conduct continues, the Merchant will be sanctioned by declaring it commercially insolvent.

**3.- Conciliatory Stage.**

If the Merchant is declared commercially insolvent by the Insolvency Court, the conciliatory stage will commence in order for the Merchant and its acknowledged creditors to be in a position to reach an agreement regarding the terms and conditions according to which the Merchant will repay its debts (the "**Reorganization Agreement**"). As indicated by the CIL, the initial term that the parties have to reach a Reorganization Agreement is 185 calendar days, which, under certain circumstances, may be extended by the Insolvency Court up to an additional 180 calendar days.

The task of procuring that the Merchant and its acknowledged creditors agree on the terms of, and execute the Reorganization Agreement, is commissioned to a specialist called the "Conciliator", who is appointed by the IFECOM; however, the CIL stipulates that a majority of creditors, with the Merchant´s consent, can appoint the Conciliator.

During this stage, the Conciliator must prepare the list of creditors of the Merchant, and determine the amount, order, and level of preference of their respective credits. During the conciliatory stage, the Merchant (except in specific cases) will continue to manage its company and business under the supervision and, in some cases, requiring the explicit authorization of the Conciliator.

**4.- Bankruptcy Stage.**

To the extent that the Merchant and its acknowledged creditors are unable to execute the Reorganization Agreement during the maximum conciliatory term of one year established by the CIL or, if the Merchant or its creditors file a bankruptcy petition and it's accepted by the Insolvency Court, the Merchant will be declared in bankruptcy.

At such time, the objective of this stage shall become to sell all the assets and rights of the Merchant, in order to apply the proceeds thereof to the payment of the Merchant's debts, in the order and preference established by the CIL.

In contrast to the conciliatory stage, upon declaration of bankruptcy of the Merchant, management is handed over to a specialist, called the "Receiver", who is also appointed by the IFECOM, whose main objective, as set forth above, is to sell all of the Merchant´s assets to repay its debts, whereas the Conciliator´s objective is to reach a Reorganization Agreement.

**5.- Prepackage Plan.**

Pursuant to article 339 of the CIL, the Merchant and the majority of his creditors may file for a pre-packaged reorganization proceeding, in which a pre-accorded Reorganization Agreement is accompanied with the insolvency petition, so that once the Merchant is declared commercially insolvent, such Reorganization Agreement is submitted for the Court´s approval.

In a pre-packaged proceeding the Insolvency Court decides whether to declare the Merchant as commercially insolvent, based on the

information provided by the Merchant and the majority of his creditors, without the need to perform the Verification Visit. Once the commercial insolvency ruling is issued by the Insolvency Court, the insolvency procedure will be conducted as any other ordinary insolvency procedure.

**6.- Protections during Verification Visit.**

The Merchant, the Visitor or any demanding creditor, if such is the case, may request the Insolvency Court during the visit to adopt, alter or lift injunctive measures for the purposes of protecting the Merchant´s Estate and the rights of the creditors. The determination of the application of the injunctive measures will be left to the discretion of the Insolvency Court, who may also adopt them by operation of law. In any case, the injunctive measures that are issued will be in force until the date on which the Merchant is declared insolvent by the Insolvency Court; however, such measures will be substituted by the injunctive measures set forth in Section 7 below.

These injunctive measures may consist of the following: (i) the prohibition of the Merchant to make payments of obligations due prior to the date of admittance of the petition of commercial insolvency; (ii) the suspension of any enforcement procedure against the assets and rights of the Merchant; (iii) the prohibition of the Merchant to perform sales or transfers or encumbrances of the principal assets of its enterprise; (iv) the prohibition of the any attachment of property; (v) the intervention of the Merchant´s treasury; (vi) the prohibition of the Merchant to perform transfers of funds or securities in favor of third parties; (vii) the placing of a house arrest order on the Merchant, for the sole purpose of not allowing it to leave its place of residence without leaving an attorney-in-fact with sufficient instructions and funds; and (viii) any others of a similar nature.

Notwithstanding the foregoing, it has become a common practice for the Insolvency Courts to extend the beforementioned injunctive measures to the subsidiaries or related companies of the Merchant, no matter whether such entities are subject to a commercial insolvency proceeding. We consider this practice to be against the purposes of the CIL, giving grounds to any affected party to challenge such measures.

**7.- Protections after the Insolvency Ruling.**

The declaration of commercial insolvency of a Merchant by means of a ruling issued by the Insolvency Court (the "**Insolvency Ruling**"), as well as the opening of the conciliatory stage, produces diverse effects, granting the Merchant primarily the following protections:

*(a) Suspension of Payments.* Suspension of payments of the debts contracted prior to the date on which the Insolvency Ruling enters into effect, except for those that are indispensable for the day-to-day operation of the company, regarding which the Merchant should in due time inform the Insolvency Court.

Notwithstanding the foregoing, the declaration of commercial insolvency will not be grounds for interrupting the payment of labor, tax or social security obligations, which should continue to be paid in due course.

*(b) Stay of Attachments and Foreclosures.* From the moment the Commercial Insolvency Ruling is passed and until the end of the conciliatory stage, no enforcement, attachment or foreclosure order may be executed against the assets and rights of the Merchant, except for those practiced securing or pay, as applicable, accrued wages and labor compensation for the period of two (2) years prior to the date of the Insolvency Ruling.

As of the Insolvency Ruling and until the conclusion of the term for the conciliatory stage,

administrative enforcement proceedings of tax credits will also be suspended. Notwithstanding the foregoing, the competent tax authorities may continue the necessary acts for the determination and securing tax credits against the Merchant. We consider that the power given to the tax authorities to "secure" property after the Insolvency Ruling, violates the principles of fairness that should exist between creditors, and that any "securing" performed by the tax authorities to guarantee any credit, cannot give them any privilege over the "secured" asset.

*(c) Property Separation.* The assets in the possession of the Merchant that can be identified, and whose ownership has not been transferred thereto by any definitive and irrevocable legal means, may be separated by their legitimate owners.

In terms of the CIL, the following assets may be separated, as an example: (i) the real-estate sold to the Merchant, but not paid, to the extent the relevant deed has not been duly recorded in the corresponding public registry; (ii) the chattels purchased and payable in cash, if the Merchant has not paid the full price at the moment of the Insolvency Ruling; and (iii) the chattels or real-estate acquired on credit, if a breach of payment resolution clause has been recorded in the corresponding public registry.

*(d) Contracts and Obligations.* With the exceptions established by the CIL, the contracts entered into by the Merchant, and any other obligations assumed thereby, continue to be valid in their terms, except when the Conciliator challenges them for being in the best interests of the Estate.

Anyone who contracted with the Merchant, will be entitled to request that the Conciliator indicates whether he opposes the performance of the relevant contract, and if the Conciliator express that he will not oppose it, the Merchant will have to perform or guarantee its performance, and if the Conciliator manifests that he will oppose it, or does not give a reply within a term of 20 days, the party contracting with the Merchant may at any time terminate the contract, by notice to the Conciliator.

Once the Insolvency Ruling is issued, the injunctive measures ordered by the Insolvency Court during the visit stage are substituted by the protections granted by such Ruling; provided that: (i) once the Reorganization Agreement is approved pursuant to the provisions stated in the CIL, any protection granted by the Insolvency Court is lifted as the Merchant is no longer considered as commercially insolvent; and (ii) if the Merchant is declared in bankruptcy, then injunctive measures subsist until the Court orders their lift.

**8.- <u>Foreign Proceedings</u>.**

The CIL contemplates several provisions that regulate assistance and interaction between Mexican courts and foreign courts in connection with procedures involving insolvency that are brought in respect of a Mexican merchant that has an establishment, place of business or assets abroad, and of a foreign merchant that has an establishment, place of business or assets in Mexico.

Our interpretation of the CIL concludes that there are two classes of foreign procedures in these type of insolvency or bankruptcy procedures: (1) a principal foreign procedure, which is defined as that brought against a merchant, in a foreign state, who has its principal place of business in that foreign state, and (2) a non-principal foreign procedure, defined as one brought against a Merchant that has its principal place of business in Mexico but also has an establishment abroad.

The provisions of the CIL are clear and congruent in the matter of the acknowledgement of a foreign procedure in respect of a Mexican merchant that has an establishment abroad. For

this case, there are provisions that permit the Mexican judge to work in a coordinated manner with the foreign Court to have the proper measures adopted with respect to the assets that the merchant has and the activities that the Mexican merchant performs abroad.

In the case of the acknowledgement of a foreign procedure in respect of a foreign merchant that has an establishment in Mexico, the CIL states that the rules regarding the verification visit have to be observed to determine if the foreign merchant is in effect found to be within the requisite premises of the law to be declared commercially insolvent and that, if such conditions are present, the Mexican judge will issue a ruling to declare such foreign Merchant in commercial insolvency, and the procedure of commercial insolvency will be followed in accordance with the provisions that are stated in the CIL; provided that the effects of this declaration of commercial insolvency are to be limited to the establishment of the foreign merchant in Mexico.

For a foreign procedure to be recognized by the Mexican courts, a petition must be brought before the Insolvency Court for the recognition thereof by the foreign representative, who is the person defined by the CIL as the person or body, including someone designated in a provisional manner, who shall have been empowered in the foreign procedure to manage the reorganization or liquidation of the assets or business of the merchant or to act as the representative of the foreign procedure. The appearance of the foreign representative before the Mexican courts does not imply the submission of the foreign representative nor that of the assets and businesses of the merchant brought to the jurisdiction of the Mexican courts.

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INTERNATIONAL LAWYERS NETWORK

# UDINKSCHEPEL ADVOCATEN

## Bankruptcy, Insolvency & Rehabilitation Proceedings in the Netherlands

ILN RESTRUCTURING & INSOLVENCY GROUP

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER DUTCH LAW

### I. Insolvency proceedings in The Netherlands

There are four law-regulated insolvency proceedings in The Netherlands: bankruptcy (*faillissement* [3] ), suspensions of payment (*surseance van betaling*[4]), debt adjustment for natural persons (*schuldsanering natuurlijke personen*[5]*)* and the confirmation of private plans (*homologatie onderhands akkoord (WHOA)* [6] *)*. Since the scope of this paper focusses on corporate entities, the debt adjustment for natural persons will not be discussed here.

A bankruptcy is generally described as a liquidation of all the debtor's assets whereas a suspension of payments should – theoretically – seek continuation of the activities of the debtor after a period of moratorium. In theory the suspension of payment should be ended after restructuring, after which the debtor can commence his business as usual. In practice a suspension of payments often ends in bankruptcy after which reorganization will proceed under bankruptcy. The reason for this lies with the absence of certain restructuring rules regarding employees (especially with regard to the transfer of a going concern business) in bankruptcy. Obviously it should be noted that under Dutch law pursuing a bankruptcy with the sole object to get rid of employees, results in abuse of (bankruptcy)law.

Both bankruptcy and suspension of payment are proceedings in which the debtor loses its power of disposition and capacity in relation to its assets.

On 1 January 2021 the Act on Confirmation of Private Restructuring Plans (*Wet homologatie onderhands akkoord ("WHOA")*) came into force. The WHOA gives effect to the EU Restructuring Directive (EU 2019/1023). The WHOA is a pre-insolvency procedure and allows a debtor to restructure its debts outside of the above-mentioned formal insolvency procedures. The WHOA is a debtor in possession-procedure. It is similar to the American Chapter 11-procedure and the UK Scheme and is therefore often referred to as the Dutch Scheme.

Both bankruptcy, suspension of payments and the WHOA are opened by a district court. Bankruptcy can be filed either by the debtor itself or requested by a creditor. Suspension of payments can only be filed by the debtor. A WHOA procedure can be filed by the debtor, a creditor, a shareholder, the debtor's work council or the debtor's workplace representation.

### I. Insolvency officers

When opening a bankruptcy, the district court appoints one or more insolvency administrators (*curator*). These administrators are generally speaking attorneys at law, but there is no legal requirement for this capacity. One sees that the district court will sometimes co-appoint a banker, an accountant, or a real estate agent as an administrator with an attorney.

When opening a suspension of payments, the district court appoints one or more insolvency administrators (*bewindvoerder*). Alongside these insolvency administrators, the district court always appoints a supervisory judge (*rechter-commissaris*) who is in charge of supervising the insolvency proceedings and the administrator. The aforementioned insolvency officials in a suspension of payment (*bewindvoerder* and *rechter-commissaris*) almost always serve as an insolvency official in

[3] Article 1 – 213kk Dutch Bankruptcy Code (*Faillissementswet*)

[4] Article 214-283 Dutch Bankruptcy Code

[5] Article 284-362 Dutch Bankruptcy Code

[6] Article 369 – 387 Dutch Bankruptcy Code

bankruptcy (*curator* and *rechter-commissaris)* if a suspension of payments is converted into a bankruptcy.

In a WHOA-procedure, the debtor can propose a private plan to its creditors and shareholders of it can request the appointment of a restructuring expert (*herstructureringsdeskundige*), who can propose such a plan. If the private plan is proposed by the debtor itself, the district court has the possibility to appoint an observer (*observator*) When the WHO-procedure was filed by a creditor, a shareholder, the debtor's work council or the debtor's workplace representation the court will always appoint a restructuring expert who then is entitled to propose the plan to the exclusion of the debtor.

II. Bankruptcy

A bankruptcy can be filed when the debtor is in a situation where he has stopped paying its due and demandable debts.

In bankruptcy the debtor loses its power of disposition and capacity in relation to its assets as of 0:00 hours of the day on which the court opens a bankruptcy procedure. During the course of the bankruptcy this right lies exclusively with the administrator. It is also described as a general attachment on the assets of the debtor in favor of its creditors to be settled by the administrator. As a result, by law creditors can only enforce claims on the debtor by lodging their claim with the administrator and have to await the claim verification procedure. Creditors are prohibited from enforcing actions against the debtor's assets and seizures made prior to opening of the bankruptcy cease to exist.

Excluded from this prohibition are secured creditors who either have a right of pledge or a right of mortgage. They are allowed to act as if the bankruptcy does not exist and can enforce those rights against the debtor's secured assets.

Also excluded are creditors to the bankruptcy estate (*boedelcrediteuren*). They can enforce their rights on the bankrupt estate.

The supervisory judge, however, can issue a stay period (*afkoelingsperiode*) stipulating that for a stay period not exceeding two months, each right of third parties, including secured creditors and creditors to the bankruptcy estate, to enforce against the debtor's assets or to claim assets under the control of the bankruptcy, can only be exercised with his authorization.

Pending lawsuits instituted against the debtor before the opening of the bankruptcy that procure the performance of an obligation from the debtor are suspended by operation of law and will only continue if the obligation is disputed in the verification process.

III. Suspension of payment

The debtor who expects that he will be unable to continue paying its debts, can be granted a suspension of (moratorium on) payment.

During the suspension of payment, only unsecured and non-preferential creditors are prohibited from enforcing their claim against the debtor's assets. Creditors of secured claims (holders of right of pledge of mortgage) or preferential creditors (such as the Dutch Tax Authority, employees or other creditors whose claim is preferential by law) can enforce their rights as if the proceeding has not been opened.

As a result of the granting of suspension of payment, as of 0:00 hours of the day on which the court grants suspension of payment, the debtor can only exercise its power of disposition and capacity in relation to its assets with the cooperation or authorization of the administrator. This is where the suspension of payments differs from a debtor in possession proceeding.

Creditors of unsecured and non-preferential claims are prohibited from enforcing actions

against the debtor's assets and seizures made prior to the opening of the suspension of payments cease to exist. Additionally, the district court (and not the supervisory judge, as in bankruptcy) can issue a written order (*afkoelingsperiode*) stipulating that, for a stay period not exceeding two months, each right of third parties, including secured and preferential creditors and creditors to the suspension of payment estate, to enforce against the debtor's assets or to claim assets under the control of the bankruptcy can only be exercised with his authorization.

In contrast to a bankruptcy proceeding, pending lawsuits are not automatically suspended.

IV. WHOA

The WHOA, also known as the Dutch Scheme, is a fast and informal pre-insolvency procedure meant for companies that are in core profitable but have come into dire straits due to issues of over indebtedness and/or recurring costs. Those companies are enabled by means of debt- and/or cost restructuring to enforce a private plan on their creditors and/or shareholders to prevent the loss in value that occurs in bankruptcy.

The WHOA is quick, flexible, and free of form. It is a debtor-in-possession procedure and has minimum judicial involvement. A WHOA-plan can be enforced on dissenting creditors or shareholders (cram down). Consent of the debtor is required in case of a small or medium enterprise-debtor

The WHOA is applicable for companies that are in a situation where it is to be expected that they cannot continue to pay their debts. The procedure can be filed by the debtor itself or by a creditor, a shareholder, the debtor's work council or the debtor's workplace representation. In the latter case, a restructuring expert is appointed by the District Court. Upon filing one can choose between a public or a confident variant of the procedure. The debtor or – if appointed – the restructuring expert proposes a private restructuring plan to (all or a subset of all) providers of capital, i.e., creditors and shareholders.

During the WHOA-procedure the debtor has access to different supportive measures to enable restructuring, such as a suspension of bankruptcy, a stay period, a protection of security for new funding and the possibility to end or alter contracts. Contrary to bankruptcy, but similarly to suspension of payments, the rights of employees are protected, and employment contracts cannot be effected by the plan. The district court can be asked to lift pre- and post judgement attachments and for any other necessary tailor-made measures. The District Court can also be asked at an early stage for binding decisions regarding legal issues (such as voting rights, class placements, etc.) o avoid uncertainties later on in the procedure.

Creditors (or certain categories of creditors) are put in classes of similarity and vote within this on the acceptance of the plan. The plan is accepted by a class if 2/3rd-majority of the amount of claims or issued capital of the actual voters have voted in favor of the plan.

No dissenting creditor may receive less value then they would have in a bankruptcy situation (best interest of creditors test). The court can be asked for confirmation of the plan if at least one in-the-money class has voted in favour of the plan.

Dissenting classes can be bound (cross class cram down) unless (i) the plan is in breach of the absolute priority rule, (ii) creditors that are small or medium enterprise are not offered an amount in cash that equals 20% of their claim and (iii) the plan lacks a cash exit-possibility for creditors (professional lender excluded).

The voting can take place within a period of eight days and electronic voting is allowed. The restructuring plan becomes binding, after confirmation by the court. A confirmation decision by the court takes place within eight to fourteen days after acceptance of the plan and the confirmation cannot be appealed. In theory, the procedure could be completed within a period of three to five weeks.

In its short existence, The WHOA already has proved to be a quick, flexible and (therefor) very effective tool of reorganization of debts and costs.

V. Asset protection

Both in bankruptcy and suspension of payments the debtor loses (some sort of) power of disposition and capacity in relation to its assets. Either it loses it completely (bankruptcy) or can only exercise it with authorization of the administrator. The debtor’s assets are protected against all unsecured creditors (bankruptcy) or only against non-preferential creditors (suspension of payment). Secured creditors, such as holder of a right of pledge of mortgage, can enforce their right as if no insolvency proceeding (neither bankruptcy nor suspension of payment) has been opened.

In a WHOA procedure, the debtor remains in full possession. Attachments can be lifted during the WHOA in order to realize a restructuring. A restructuring plan cannot be enforced against the will of a small business and entrepreneur-debtor.

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INTERNATIONAL LAWYERS NETWORK

# MGRA & ASSOCIADOS

## Bankruptcy, Insolvency & Rehabilitation Proceedings in Portugal

**ILN RESTRUCTURING & INSOLVENCY GROUP**

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER PORTUGUESE LAW

### I. INTRODUCTION – KEY ASPECTS OF PORTUGUESE LAW - DEFINITION OF INSOLVENCY AND LEGAL FRAMEWORK

Insolvency proceedings consist of a universal enforcement process, with the objective of satisfying creditors in the best possible way in an bankruptcy scenario, either by an insolvency plan based on the recovery of the company via the insolvency assets, or, when this is not possible, by liquidating the debtor's assets and sharing its result among the creditors.

Insolvency proceedings in Portugal are only triggered in the case of a debtor's insolvency, which is defined, in general, as the inability of the debtor to fulfill its obligations as they fall due (cash flow criteria). Aside from this, and in the case of legal entities, the debtor is also considered to be in an insolvency situation when, according to accounting criteria, the liabilities of the debtor clearly exceed its assets (balance sheet criteria).

Under Portuguese Law, the most relevant laws and statutory regimes that apply to the financial restructuring, reorganizations, liquidations, and insolvencies are the following:

- Insolvency and Recovery Code ("*Código da Insolvência e da Recuperação de Empresas*" – hereinafter "CIRE"), approved by the Decree-Law No. 53/2004, dated 18.03.2004 and last amended at 25.08.2022 by the Decree-Law No. 57/2022, on recovery and insolvency judicial proceedings, including the Special Revitalization Proceedings ("*Processo Especial de Revitalização* – hereinafter "PER";
- Civil Code ("*Código Civil*") approved by the Decree-Law No. 47344, dated 25.11.1966 and last amended on 17.08.2023;
- Commercial Companies Code ("*Código das Sociedades Comerciais*"), approved by the Decree-Law No. 262/86, dated 02.09.1986 and last amended on 11.01.2022 on dissolution and liquidation of commercial companies;
- Extra-Judicial Regime for Corporate Recovery ("RERE"), approved by Law no. 8/2018, of March 2nd, providing a specific legal regime for out-of-court recovery agreements;
- Statute of the Insolvency Administrator ("*Estatuto do Administrador de Insolvência*"), approved by the Law No. 22/2013, dated on 26.02.2013 and last amended at 11.01.2022 by the Law No. 9/2022;
- Law of the Companies of Insolvency Administrators ("*Regime Jurídico das Sociedades de Administradores da Insolvência*"), approved by the Decree-Law No. 54/2004, dated 18.03.2004;
- Directive (EU) 2019/1023 of the European Parliament and of the Council, of June 20th, 2019, on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt;
- Law No. 9/2022 was published on 11 January 2022. This new law establishes measures to support and speed up corporate restructuring processes and payment agreements. It is the result of the incorporation into Portuguese law of Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 ("Directive (EU) 2019/1023"). Furthermore, it amends the Insolvency and Corporate Recovery Code ("CIRE"), the Companies Code

(“CSC”), the Commercial Registration Code, and other related legislation.

- Regulation (EU) 2015/848 of the European Parliament and of the Council, of May 20th, 2015, on insolvency proceedings.

The insolvency proceeding governed by the CIRE may be voluntary or involuntary, as it may be commenced on the debtor’s initiative or on any creditor’s initiative. In addition to the insolvency procedure itself, CIRE also provides for two special procedures. The first one is the PER (a voluntary procedure which only applies to companies), considering that only the debtor may submit the request to the court, pursuant to article 17-A of the CIRE. Such request must include a written statement of the debtor and at least one of its creditors, expressing the intention to engage in negotiations leading to its revitalization through the approval of a recovery plan. The second special procedure is the special payment agreement procedure (which may apply to any debtor other than a company). The RERE is also a voluntary proceeding commenced by the debtor’s initiative.

## II. 1.STATUTORY INSOLVENCY AND LIQUIDATION PROCEEDING

A debtor must request a declaration of insolvency within 30 days after the date of becoming aware of such insolvency, or on the date when he should have been aware thereof. The application must contain a series of mandatory elements and meet several requirements.

Natural persons who are not owners of a company on the date of insolvency are exempted from the duty to declare insolvency.

When the debtor is the owner of a company, Portuguese law presumes that awareness of the insolvency occurs three months after the general failure to meet debts regarding taxes and social security payment and contributions; debts arising from an employment contract or from the breach or termination of such contract; or rentals for any type of hire, including financial leases; or instalments of the purchase price or loan repayments secured by a mortgage on the debtor’s business premises, head office or residence.

Moreover, the declaration of insolvency of a debtor may be requested by the person legally responsible for the debts, by any creditor, even if conditional and whatever the nature of the claim, or by the Public Prosecutor's Office, representing the entities whose interests are legally entrusted to it, when any of the following occur:

1. General suspension of payment of due obligations;
2. Non-compliance with one or more obligations which, due to the sum involved or the circumstances of the non-compliance, demonstrate the debtor’s incapacity to promptly satisfy most of its obligations;
3. Abscondment of the owner of the company or the debtor’s directors or desertion of the company’s registered office or place of main business, related to the debtor’s lack of creditworthiness and in the absence of the appointment of a substitute of good standing;
4. Dispersal, abandonment, hurried or destructive liquidation of assets and fictitious constitution of credits;
5. Insufficiency of seizable assets to pay the respective claim in enforcement proceedings brought against the debtor;
6. Non-compliance with obligations set out in an insolvency or payment plan;
7. General non-compliance, in the previous six months, with debts of any of the following

types: **i)** tax; **ii)** social security contributions and dues; **iii)** debts arising from an employment contract, or breach or termination of such contract; **iv)** payments for any type of lease, including financial leases, payments of the purchase price or of a loan guaranteed by a mortgage, with respect to the place where the debtor carries out his activity or has his registered office or residence;

**8.** Should the debtor be a legal person, where it has greater liabilities than assets as shown on the last approved balance sheet or is behind by more than nine months in the approval and filing of accounts, if legally required to do so.

The application submitted by a creditor must include information regarding the nature and amount of the credit, the identification of the debtor's managers (both of fact and law) and its five biggest creditors (not including the applicant), and the debtor's commercial registry certificate. If the applicant is the debtor, then it is important to indicate whether the company's situation of insolvency is current or imminent, and to include documents, such as a list of all known creditors and a clear explanation of the company's activity over the last three years and is also required to include with the initial petition for insolvency, a document identifying the companies with which it is in a control or group relationship under the terms of the CSC or which are considered associated companies, and, if applicable, identifying the processes in which its insolvency is requested or has been declared.

The judicial ruling which then declares the insolvency of the debtor grants creditors – as well as the Public Prosecutor Department – a fixed time limit (maximum 30 days) to claim their credits (including conditional credits) before the Insolvency Administrator (filed online). Creditors must lodge their claim accompanied by various documents and elements that legitimize and ground the claim, such as the origin of the credit and its legal classification (e.g., guaranteed or privileged), and its due date, amount and accrued interest. Creditors who have had their credit acknowledged by a previous judicial decision are not exempt from the duty of claiming it in the insolvency proceeding if they wish to obtain payment within said insolvency proceeding. After said time limited has expired, the Insolvency Administrator will assess whether the credits are to be acknowledged.

The declaration of insolvency is registered in the land, commercial and vehicle register in respect of the assets or rights forming part of the insolvent estate.

Within 15 days of the termination of the time limit for credit claims, the Insolvency Administrator prepares a list of the credits that were legally acknowledged (which is published), as well as the respective terms and conditions of each one (e.g., the identification of the creditor, the nature of the credit, the amount and accrued interests, and the existence of personal or real guarantees, amongst others). In parallel, another list comprising the credits that were not acknowledged, and the respective grounds of justification, must also be drafted and published.

Within ten days of the deadline for the Insolvency Administrator to present these lists, any person with a legal interest can challenge the acknowledged creditors list. The court will then issue a ruling, in which it decides on the existence and correct classification of the credits. The credits whose verification or graduation requires the production of further evidence will now be provisionally verified and graduated in provisional order, instead of relegating the graduation of all credits to the

final judgment when the verification of some of them requires evidentiary steps. The aim is thus to simplify the conduct of the phase of verification of liabilities and graduation of claims.

Despite this, a creditor may still have other claims acknowledged after this period, and may request the separation or restitution of assets, to be considered in the insolvency proceeding, by means of a judicial application against the insolvent estate. The request for the separation or restitution of assets can be filed at any time until the end of the insolvency proceeding. However, the claim for the acknowledgement of credits can only be filed within six months of the judgment declaring the insolvency becoming final.

These credits may be traded amongst creditors and with third parties prior to, or even throughout, the insolvency proceedings, as the only impact that this action has on the claim is the identification of the creditor.

All pending judicial proceedings regarding the insolvency estate assets filed against the debtor or even third parties, which may determine variations in the value of the insolvency estate, and all judicial proceedings with exclusive patrimonial nature filed by the debtor are to be attached to the insolvency proceeding if the Insolvency Administrator so requests. Enforcement proceedings or other measures requested by the insolvency creditors that affect the insolvency estate, as well as arbitration disputes, shall be suspended.

Furthermore, one of the consequences of the declaration of insolvency is the immediate removal of the (debtor) managers' powers of administration over the assets of the insolvency estate and their subsequent transfer to the Insolvency Administrator, who is authorized by law to carry out all transactions in the ordinary course of business of the debtor.

As a rule of thumb, under article 102 of the CIRE, contracts that have been entered between the debtor and a creditor, and that have not yet been completely performed, are suspended until the Insolvency Administrator determines on their performance or non-performance. In these cases, the respective creditor is given the opportunity to set a reasonable date before which the Insolvency Administrator must issue a decision. If no decision is made by said date, then Portuguese law presumes that the Insolvency Administrator has decided not to perform the contract.

### II. 2. AGGRAVATED/CULPABLE INSOLVENCY

Once a court makes a declaration of insolvency, the insolvency may be deemed to be fortuitous or aggravated/culpable (where insolvency is a result of a willful or gross negligence action of the debtor's or of it's in legal directors within the three years prior to the beginning of insolvency proceeding). The law provides for circumstances where **(i)** insolvency is automatically classified as negligent; and **(ii)** where fraud or gross negligence is presumed.

For the purposes of qualifying the insolvency as culpable, Law no. 9/2022, of 11 January, clarified that the presumption of serious fault of the de jure or de facto administrators of the debtor who are not natural persons who fail to comply with the duty to request the declaration of insolvency or the obligation to prepare, submit to supervision or deposit the annual accounts is limited to the existence of seriously culpable behavior.

It is also provided the peremptory nature of the deadline for the opening of the insolvency filing, allowing, however, its extension (which cannot exceed six months from the beginning of the deadline), upon motivated request of the insolvency administrator or of any interested party.

The suspension of the proceedings in the event of death of one of the proponents affected by the classification of the insolvency is established, opening the door to the to the deduction of a habilitation incident in the general terms of the civil procedural law.

**II.3. EFFECTS ON DEBTORS**

A declaration of insolvency transfers the power to run a company from its directors to an Insolvency Administrator, who becomes the representative of the debtor for all purposes. Management bodies of a debtor may continue to operate (when requested by the debtor, if the insolvency is voluntary, or with the agreement of the creditors), but actions that might be carried out by the debtor that breach any required supervision of the Insolvency Administrator may be declared null and void. A declaration of insolvency implies that all debts of the insolvent become immediately due. Any judicial proceedings involving patrimonial matters, where the final result may affect the value of the insolvent company's estate, are attached to the insolvency proceeding provided that the Insolvency Administrator requests it. A declaration of insolvency stays (and may then terminate) any pending enforcement proceedings and creditors cannot initiate new enforcement proceedings against the debtor.

**II.4. EFFECTS ON NATURAL PERSONS**

If the debtor is a natural person, at the debtor's request, he may be granted exoneration from insolvency claims which are not fully paid during the insolvency proceedings or in the three years following closure, as provided for in Articles 235 to 248 of CIRE.

The exoneration of a natural person's liabilities, if allowed, will require the disposable income earned by a debtor to be assigned to a trustee chosen by the court for the five years following the closure of the insolvency proceedings (assignment period). At the end of each year during the assignment period, the trustee uses the sums received: **a)** to pay outstanding costs of the insolvency proceedings; **b)** to reimburse the body responsible for the financial and property management of the Ministry of Justice for the remuneration and expenses of the insolvency practitioner and the trustee as incurred by that body; **c)** to pay his own remuneration and expenses; **d)** to distribute the remainder among the insolvency creditors pursuant to the provisions laid down on payment to creditors in insolvency proceedings.

On the other hand, the judge is allowed to extend the assignment period, up to a maximum of three years, upon the reasoned request of the debtor, a creditor in the insolvency, the insolvency administrator (if still in office) or the trustee who was charged with supervising the debtor's compliance with its obligations. If the judge concludes that there is a serious likelihood of the debtor's compliance with the obligations imposed on him by law, he shall order an extension.

Provision is made for the possibility of a supervening liquidation, once the liquidation of the insolvent's assets has already been completed and the insolvency proceedings are closed. It will now be possible, during the assignment period, for the trustee to seize and sell assets that were also part of the debtor's assets and, subsequently, to allocate the proceeds of the sale to the creditors, in the same manner as the disposable income.

When the assignment period has ended, the exoneration of the debtor may be granted by the court and in such a case, all insolvency claims which still remain at the date exoneration is granted will be cancelled, including those which have not been lodged or verified. However, the exoneration does not include **a)** maintenance claims; **b)** compensation due for unlawful acts by the debtor which have been claimed as such;

**c)** claims for fines and other monetary penalties for crimes or administrative offences; **d)** tax clams.

**II. 5. EFFECTS ON CREDITORS**

Insolvency proceedings are dynamic and, as a result, there is a lot of information that is constantly being analyzed and put forward to all parties involved – the creditors' right to be provided with a report prepared by the Insolvency Administrator should be noted. This report will be presented at the creditors' general meeting, which will focus on discussing and deciding whether to close or maintain the activity of the establishments comprising the insolvency estate and can empower the Insolvency Administrator to prepare an insolvency plan and determine the suspension of liquidation of the insolvency estate.

To a certain extent, CIRE is flexible in allowing creditors to opt for the restructuring and maintenance of the company. If the creditors do not approve an insolvency plan or request the Insolvency Administrator to prepare a plan through which the company is to be maintained and the creditors paid, then the proceeding follows in the view of liquidation and the assets of the insolvency estate will be sold in this framework.

One of the keystones of CIRE is that creditors must receive equal treatment. There are few exceptions to this rule and those permitted by law abide by the rule that "ordinary credits" are considered equal. On this basis, a distinction is made between guaranteed, privileged, ordinary and subordinated credits:

• Guaranteed credits are those secured by a guarantee in rem. They are paid out of the proceeds of the sale of the secured asset once sale expenses and any amount allocated to credits over the insolvency estate are deducted. If the secured assets are insufficient to pay all debts owed to guaranteed creditors, any remaining debt is included in the common credits.

• Privileged credits are those benefiting from general creditor's privilege (e.g., credits arising from an employment contract) over assets comprised in the insolvent estate. Due to their nature, these credits are paid in a pro rata basis with the proceeds of the unsecured assets and according to its inner ranking. In fact, there are several types of privileged creditors that are ranked differently. As a novelty introduced by Law no. 9/2022, of 11 January, the compensatory credits resulting from the termination of the employment contract by the administrator after the declaration of insolvency of the debtor are qualified as automatic insolvency claims.

• Common creditors can only be paid after creditors who rank in priority to them are paid in full. They are paid in a pro rata basis if the proceeds of the insolvency estate are insufficient to fully satisfy the debt.

• Subordinated creditors rank below common creditors. Redefined by Law No. 9/2022 of 11 January as the credits held by persons especially related with the debtor, provided that the special relationship existed already at the time of the credit was born (and not acquired), and by those to whom they may have been assigned in the two years prior to the beginning of the insolvency proceedings.

• In addition, there is another special and prioritized category, known as credits against the insolvency estate, which generally arise after the declaration of insolvency (e.g., court fees, the costs and expenses of administration, and claims resulting from obligations incurred under contracts entered by the Insolvency Administrator after the judgment opening insolvency proceeding or that the administrator chooses to perform). These credits are not subject to ranking or acknowledgement and, in

principle, must be paid by the Insolvency Administrator when they fall due.

Once the judgment declaring the insolvency has become final and the creditors' meeting for the distribution report has been held, the Insolvency Administrator promptly proceeds with the negotiation and sale of the assets. And has the duty to present, within 10 days of that meeting, a liquidation plan for the sale of the assets, containing defined time goals and a list of the concrete steps to be taken. The failure to present or the seriously culpable failure to comply with the liquidation plan constitutes just cause for the dismissal of the insolvency administrator.

The purchasers acquire the assets *f*ree and clear of claims and liabilities. However, the CIRE establishes a set of rights for guaranteed creditors:

• The guaranteed creditor shall be heard regarding the sale's mode and shall also be informed about the initial base value or price of the proposed sale to a certain entity. However, the Insolvency Administrator is not bound to accept the secured creditor's position;

• The guaranteed creditor may propose to purchase the asset, either directly or through a third party, for a price higher than the projected sale price or the initial base value. If such proposal is not accepted by the Insolvency Administrator and the asset is sold at a lower price, the Insolvency Administrator is required to guarantee that the guaranteed creditor is in the situation he would be in if the asset had been sold at the proposed price;

• The proceeds of the sale of assets shall revert immediately to the guaranteed creditors, before any payment is made to any other creditor.

Once insolvency proceedings have commenced, transactions that unfairly favor one creditor over the others or any acts that reduce, make it more difficult or impossible, jeopardize or delay payment to the creditors can be set aside by the insolvency administrator. Two requirements must be fulfilled: the acts must have been carried out in bad faith (with the knowledge of the debtor's insolvency or of the damage that act could cause) and within the two years prior to the initiation of the insolvency proceedings. The insolvency administrator can terminate contracts that fulfil these criteria by means of a registered letter within six months as of the knowledge of their existence. The termination has retroactive effects. The insolvent debtor or the third party which received the communication of termination can challenge it, filing a judicial action within three months after receiving the communication.

One of the biggest novelties of Law 9/2022, of 11 January, is the introduction of compulsory partial distribution of amounts to creditors, whenever, cumulatively:

a) The decision declaring the insolvency has become final and the process has continued for liquidation of assets;

(b) the time limit for contesting the list of recognized creditors has expired without any contestation having been filed, or, if a contestation has been filed, the contestation in question has already been decided, whether for lack of response to the contestation or by a court decision which may not be final;

c) The amounts deposited to the order of the insolvent estate are equal to or greater than EUR 10,000.00 and their ownership is not disputed;

d) The process is not in a condition to prepare the final distribution.

Once these conditions are met, the insolvency administrator shall prepare and publish the partial distribution list, and the creditors and the creditors (if any) shall have 15 days to reply to it. At the end of this period, the process is

concluded with the judge, who decides on the payments that he considers justified.

## III. STATUTORY RESTRUCTING, REHABILITATIONS AND REORGANISATIONS

The PER ("*Processo Especial de Revitalização*") is a special revitalisation proceeding for companies facing a situation of imminent insolvency or economic distress and is not to be used as a substitute for insolvency proceedings. The PER is initiated by a written request subscribed to by the debtor and creditors representing at least 10% of non-subordinated credits (or a lower percentage in certain limited cases), which includes the following:

- A declaration by the company of its ability to recover;
- A joint declaration of the debtor and the abovementioned percentage of creditors expressing the will to engage in negotiations;
- A declaration by a certified accountant attesting that the company is not insolvent;
- Auxiliary documents required in insolvency proceedings (e.g., a list of creditors, pending lawsuits, shareholders, assets and employees; a description of the debtor's activities; and annual accounts, management and audit reports and legal certification for the last three years);
- A proposal of recovery plan, with a description of the company's situation in terms of assets, financing and revenue cash flows, and
- Introduced by the Law No. 9/2022, 11th January, in order to ensure a more equitable treatment of creditors on whom the effective restructuring of companies will depend, companies other than micro, small and medium-sized enterprises will be required to present, with the respective request for submission to the PER, a proposal for the classification of creditors affected by the recovery plan in distinct categories, according to the nature of the respective credits, into guaranteed, privileged, common and subordinated creditors and, among these, reflecting the universe of creditors of the company according to the existence of sufficient common interests, namely:

i. Workers, without distinction of the type of contract;

ii. Shareholders;

iii. Bank entities that have financed the company;

iv. Suppliers of goods and service providers;

v. Public creditors.

Upon the receipt of said request, the judge appoints a provisory judicial administrator ("PA"). The court's order is published, formally initiating the PER. Subsequently, within 20 days of said publication, the creditors make their credit claims to the PA. Within five days, the PA drafts a provisional creditors list, which is published and may be contested in court on the next five business days. Oppositions are decided by the court within the same term, and the definitive list is defined.

Once the definitive list is determined, negotiations between creditors and the debtor shall start and be concluded within a term of two months, which may be extended once for one month.

Being a dejudicialized proceeding, negotiations are organised and supervised by the PA. The court's main role is to decide on the oppositions to the creditors list and to ratify (or refuse to ratify) the recovery plan approved by creditors. Non-ratification occurs if there is any infringement of non-neglectable procedural rules or infringement of material rules (notably, creditors shall be treated equally and creditors' positions shall not, without their consent, be less favourable to the positions they would have in a

non-approval scenario). The recovery plan approved by the creditors and ratified by the court is binding for all parties, including creditors that have not claimed credits and creditors that did not participate in the negotiations or voted against the plan.

The plan's approval requires a vote of creditors through three systems of majority formation:

1. Applicable to cases in which there is classification of creditors in distinct categories (large companies): the rule of the favourable vote, in each of the categories of creditors, of more than 2/3 of the total votes cast (abstentions are not considered as such);
2. Applicable to all other cases (micro, small and medium enterprises): rule of approval of the plan which, being voted by creditors whose credits represent at least 1/3 of the credits related to voting rights (abstentions are not considered), obtains the favourable vote of *(i)* more than 2/3 of the total votes issued and *(ii)* more than 50% of the votes issued corresponding to non-subordinated credits related to voting rights. ;
3. Applicable in all cases (whatever the size of the company): approved the plan that collects cumulatively (without considering abstentions) the favourable vote (i) of creditors whose credits represent more than 50% of the total credits related to voting rights and (ii) of more than 50% of the votes issued corresponding to non-subordinated credits related to voting rights.

The recovery plan must include the following mandatory information:

i. The parties affected by the plan, designated individually and broken down by classes in general terms or, if applicable, by categories, and the amounts of their respective claims or interests covered by the plan;
ii. The parties, designated and apportioned pursuant to the preceding paragraph, that are not affected by the plan, together with a description of the reasons why the proposed plan does not affect them;
iii. The arrangements for informing and consulting employees' representatives, the position of employees within the undertaking and, where appropriate, the general consequences as regards employment, such as dismissals, temporary reduction of normal working hours or suspension of employment contracts;
iv. Any new funding envisaged and the reasons why such new funding is necessary to implement the plan;
v. A statement of reasons containing a description of the causes and extent of the company's difficulties and explaining why there is a reasonable prospect that the recovery plan will prevent the company from becoming insolvent and ensure its viability, including the preconditions necessary for the plan's success.

In the judgment of approval or non-approval of the restructuring plan, the judge must necessarily assess:

i. Whether the recovery plan has been approved (i.e., whether the majorities provided for by law have been respected);
ii. If, in the event of classification of creditors in different categories, creditors in the same category are treated equally and in proportion to their claims;

iii. Whether, in the case of classification of creditors into separate classes, the dissenting voting classes of creditors affected receive treatment at least as favourable as that of any other class of the same rank and more favourable than that of any class of lower rank;

iv. That no class of creditors may, under the plan of reorganisation, receive or retain more than the amount corresponding to the totality of their claims;

v. Whether the situation of the creditors under the plan is more favourable than it would be in a scenario of liquidation of the company, if there are requests for non-approval on these grounds;

vi. If applicable, that the new financing necessary to implement the restructuring plan does not unfairly harm the interests of the creditors;

vii. Whether the rescue plan holds out reasonable prospects of preventing the insolvency of the company or ensuring its viability.

In the absence of approval of a restructuring plan and when the provisional judicial administrator issues an opinion concluding that the company is insolvent, the company shall have a period of five days to oppose it.

Alternatively, the PER may follow a shorter form, being initiated by the presentation of an extrajudicial recovery agreement (signed by the debtor and creditors representing the majority referred to above for the plan's approval), with all ancillary documents. In such cases, following the PA's appointment and the notification of non-subscriber creditors for oppositions to the provisional creditors list, the judge decides on the plan's ratification in the same terms described above. These shorter proceedings may be concluded (upon the final ratification decision) within two to four months on average. Regular proceedings last around six to eight months.

Ratification (or non-ratification) of the recovery plan may be contested through a single appeal to an appeal court (whose decision is final), based on formal or material grounds. Upon the ratification of the recovery plan, the debtor and all creditors (including non-voting, unknown creditors, creditors that have not claimed or have contingent claims regarding facts that occurred on or prior to the PA's appointment) <u>are bound to its terms</u>.

If the recovery plan is not approved, the PA shall communicate the end of negotiations and give an opinion on whether the company is insolvent. If the company is deemed to be insolvent by the PA, the PER is extinguished, and insolvency proceedings are initiated (three business days). If the PER is extinguished the debtor cannot initiate a new PER for the next two years.

These proceedings are not confidential, being available for consultation by interested parties. The main decisions regarding the proceedings are made public.

After the appointment of the PA, any pending enforcement proceedings filed against the debtor shall be suspended, for a period of four months, extendable by one month, and no further proceedings shall be filed for the same purpose after such date (except for claims related to labour credits). The company shall continue to operate its business, under the PA's supervision. The PA's prior written authorization is required for "acts of special importance", without that approval the transactions have no effect.

## IV. OUT OF COURT RESTRUCTURINGS AND CONSENSUAL WORKOUTS

Creditors and debtors favor extrajudicial restructuring proceedings over statutory proceedings because the latter are necessarily prejudicial to the company's image, harming the regular continuation of the business. Moreover, out-of-court proceedings secure greater value for creditors and maximize the recovery of credits. Out of court restructurings may occur within pure informal and dejudicialized negotiations and agreements, or within a proceeding following an Extrajudicial Company's Recovering Regime, set out in Law no. 8/2018 ("RERE"). If the debtor's restructuring inevitably entails the reduction of a debt, then insolvency proceedings or the PER (statutory in-court recovery proceedings) are chosen over out-of-court proceedings.

Simple restructurings are usually concluded within three to four months, and more complex restructurings in eight to 12 months. Creditors do not generally accept any compromise on the suspension or limitation of their rights (e.g., enforcement rights), but, in practice, they refrain from exercising such rights while negotiations are ongoing. Banks generally require full disclosure during negotiations (typically regarding accounts, assets and the business of the debtor). In more complex restructurings, banks sometimes require an audit and a viability plan made by specialized entities. Restructuring agreements typically include solutions such as a restructuring of the payments schedule (periods of grace, extension of repayment dates, decrease of interest rates), a sale of assets, a reduction in activity, and increased compromise by the owners.

Out of court restructuring agreements only bind the signatory parties (they cannot be imposed on non-parties) and cannot modify any rights of non-subscriber creditors or owners. Only PER or insolvency proceedings are binding for all stakeholders, including creditors and owners.

## V. MULTINATIONAL CASES

The effects of restructuring or insolvency proceedings opened in an EU Member State are automatically recognized in all other Member States, according to Regulation (EU) 2015/848 (Recast Insolvency Regulation).

However, the CIRE requires foreign judgments to comply with certain formalities before they can be recognized:

- Insolvency has been declared by a foreign court;
- Foreign court's decision is final and binding;
- Decision is adopted by the court where the debtor's center of main interests is located;
- Decision is not illegal under Portuguese law.

Portuguese courts must normally apply the principle of reciprocity when recognizing foreign insolvency decisions.

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# INTERNATIONAL LAWYERS NETWORK

## PETERKA & PARTNERS

Bankruptcy, Insolvency & Rehabilitation Proceedings in Romania

ILN RESTRUCTURING & INSOLVENCY GROUP

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER ROMANIAN LAW

**1. A brief presentation of the bankruptcy/insolvency/rehabilitation proceedings of the country and their main differences.**

Romanian legislation provides two main categories of such procedures:

I. <u>**Insolvency prevention procedures**</u>

I.1. **Restructuring agreement**

A debtor who faces financial difficulties may propose a restructuring agreement, which can be drawn up either by the restructuring administrator or by the debtor, with the assistance of the restructuring administrator. Among others, the restructuring agreement must contain an analysis on the economic situation of the debtor, a list of the claims which will be and not be affected by the reorganization agreement and the proposed restructuring measures which can be either operational, financial or human resources oriented. The agreement will eventually be voted upon by the affected creditor(s), based on the categories in which they fall. The purpose of the restructuring agreement is for the debtor to restructure its activity and to reach an agreement with its creditor(s) regarding the payment of the due debts.

I.2. **Preventive agreement**

If the debtor faces financial difficulties, it can request the court to open the preventive agreement procedure. The court appoints an administrator contracted by the debtor, who drafts the restructuring plan or assists the debtor in drafting it. The restructuring plan shall include a reorganization plan for the debtor. If the creditors approve the project, the debtor's activity shall be carried on in accordance with such project, for a period of a maximum of 48 months, with the possibility of extending it for another 12 months. During the first year of the implementation of the restructuring plan, the debtor must reimburse a minimum of 10% of the claims affected by the preventive agreement.

II. <u>**Insolvency procedure**</u>

The insolvency procedure may be requested either by the debtor or by any creditor, if debts in the amount of a minimum of RON 50,000 (approximately EUR 10,000) are due for more than 60 days.

If the court approves the request, depending on the debtor's situation, the procedure may be started in one of the following forms:

II.1. **General procedure**

In such case, the debtor enters an observation period, in which the official receiver analyses if there are any chances for the company to be reorganized. Following this first step, the debtor may enter one of the following procedures:

(i) <u>Reorganization</u>, in which the debtor's activity is reorganized in accordance with a reorganization plan, approved by the creditors. The plan may provide various measures, such as reducing the debt or rescheduling one or more

due debts. The execution on the plan is limited to a period of 3 years, with the possibility of extending it. If the debtor is a legal entity, the execution of the plan is limited to a period of 4 years, instead of 3, with the possibility of extending it, if the initial period of execution was less than 4 years. If the plan is successful, the debtor shall be reintegrated in the commercial circuit, and all debt reductions shall remain final. If the plan fails, the debtor enters the bankruptcy procedure (presented in point (ii) below), in which case the reduction of the debts is no longer valid, the creditors being entitled to recover their entire debt.

(ii) Bankruptcy, in which the debtor's assets are sold and all money obtained is distributed to creditors, in accordance with their priority rank, as indicated in the creditors' list (e.g., secured creditors shall recover before unsecured ones).

II.2. **Simplified procedure**

If the conditions are met, the court approves the request and initiates the simplified procedure, in which case the debtor enters the bankruptcy procedure directly, without going through the observation period, as presented in point II.1 above.

**2. (Depending on the type of the proceedings) The protection granted to the debtor against its creditors**.

The following questions should be addressed for each proceeding, provided by the law of the country:

**i) What kind of protection is granted?** (e.g., the creditors may not enforce any court decision against the debtor's assets, etc.)

**Restructuring agreement**

In addition to the measures negotiated with the creditors and expressly provided in the agreement, the law provides that once the restructuring agreement is confirmed by the court, and during its execution, no affected creditor may trigger an insolvency procedure against the debtor.

**Preventive agreement**

If the preventive agreement procedure is initiated, all the enforcement procedures against the debtor are suspended by law for a period of 4 months, which may be extended to 12 months from the moment the preventive agreement has started and until the restructuring plan is homologated. As an exception, wage-claim enforcement procedures shall not be suspended by law, but only upon the debtor's request, if certain requirements are met.

Moreover, during the suspension of the enforcement procedures against the debtor, until the homologation of the restructuring plan, all penalties, interest and other expenses related to the debt will also be suspended.

As of the moment the restructuring plan is homologated, the enforcement procedures regarding the affected claims against the debtor are suspended. The penalties, interest and other expenses related to the debt will be suspended

according to the provisions of the restructuring plan.

As a general rule, for the entire duration of such procedure, an insolvency procedure cannot be started against the debtor. However, for procedures started before July 17, 2022, if the debtor requests an extension of the preventive agreement, the creditors who have voted against the prolongation of the preventive agreement, or the creditors who are not part of the preventive agreement procedure, have the right to submit a request for initiation of an insolvency procedure against the debtor. Moreover, the creditors who voted against the afore-mentioned extension have the right to start enforcement procedures against the debtor.

**Insolvency procedure**

If the insolvency procedure (regardless of the form) is initiated, all the judicial and/or extrajudicial claims, as well as all enforcement procedures against the debtor are suspended. Moreover, creditors cannot start any new such claims or procedures.

Another protection granted to the debtor refers to the suspension of the penalties, interest and other expenses related to the debt.

**ii) What is the extent of the protection?** (e.g., it includes all of the debtor's assets; is it limited to several assets for which the debtor may ask for protection? Is it at the court's discretion to include any asset? Etc.)

**Preventive agreement**

All the enforcement procedures started before the preventive agreement shall be suspended by law, together with the enforceable titles obtained after the start of the preventive agreement, for a period of 4 months – which can be prolonged to 12 months – since the commencement of the preventive agreement, until the homologation of the restructuring plan. After the homologation of the restructuring plan, the enforcement procedures regarding the affected claims against the debtor will be suspended.

The suspension includes all the debtor's assets that are being enforced at the date of the preventive agreement.

**Insolvency procedure**

If the insolvency procedure (regardless of the form) is initiated, all the judicial and/or extrajudicial claims, as well as all enforcement procedures against the debtor are suspended. Moreover, creditors cannot start any new such claims or procedures.

The suspension includes all the debtor's assets that are being enforced and all the judicial/extrajudicial claims filed against the debtor.

In respect to the suspension of the penalties, interest and other expenses related to the debt, from the moment the insolvency procedure is started and until it is finalized, no such expenses are incurred by the debtor.

**iii) By whom it is granted?** (e.g., by a court decision or by injunctions or directly by the law, etc.)

**Preventive agreement**

The suspension is granted *de iure* and is only mentioned in the decision.

**Insolvency procedure**

The suspension is granted *de iure* and it is not necessary to be mentioned in any court decision.

**iv) Does the protection include only the debtor, or may it cover other persons as well** (e.g., guarantors)?

**Preventive agreement**

The suspension includes all the debtor's assets that are being enforced at the date of the preventive agreement. However, such protection is only granted to the debtor and shall not be extended to third parties, such as guarantors.

**Insolvency procedure**

The suspension includes all the debtor's assets that are being enforced and all the judicial/extrajudicial claims filed against the debtor. However, such protection is only granted to the debtor and shall not be extended to third parties, such as guarantors.

**v) When is the protection granted?** (e.g., in the rehabilitation proceeding in Greece, the debtor may apply before a court for protection of its assets before any agreement has been concluded with its creditors. After the agreement is concluded, different protection applies).

**Preventive agreement**

The protection is applicable as of the moment the preventive agreement procedure starts until it is finalized.

**Insolvency procedure**

The protection is applicable from the moment the insolvency procedure is started, until such procedure is finalized.

**vi) For how long is the protection granted?**

**Preventive agreement**

The protection is applicable as of the moment the preventive agreement is started, until such procedure is finalized.

**Insolvency procedure**

The protection is applicable as of the moment the insolvency procedure is started, until such procedure is finalized.

**vii) Which creditors are bound by the protection?**

**Restructuring agreement**

All creditors.

**Preventive agreement**

All creditors.

**Insolvency procedure**

All creditors.

**viii) Any other particularities of the procedures of each country (if any).**

**The Early Warning procedure**

A recent change to the insolvency law is the introduction of the Early Warning procedure through which professionals will receive automatic alerts from the Romanian tax authorities regarding the non-performance of certain fiscal obligations to the state budget, state social security budget and unemployment insurance budget, as well as relevant information regarding the recovery solutions.

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# International Lawyers Network

## PETERKA & PARTNERS

## Bankruptcy, Insolvency & Rehabilitation Proceedings in Slovakia

ILN RESTRUCTURING & INSOLVENCY GROUP

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER SLOVAKIAN LAW

We present here the following answers to the questions mentioned in the ILN Restructuring & Insolvency Collaborative Paper which reflect the regulations in the Slovak Republic. We have dealt with proceedings related to a business company in the position of debtor. We mostly focused on the regulation of preventive restructuring proceedings introduced into Slovak commercial law in 2022.

Should you have any questions, or issues to discuss, please do not hesitate to contact us. We would gladly answer your questions.

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**Presentation of preventive restructuring/bankruptcy/restructuring proceedings in the Slovak Republic and their main differences.**

In Slovakia, there are several ways to avoid the imminent bankruptcy or insolvency of a debtor and ways to proceed.

**(1) Higher creditor's protection under Commercial Code**

A special regime is applied to a business company that is in crisis. A company is "in crisis", if it is technically in bankruptcy or bankruptcy is imminent or if its equity to liabilities ratio is less than 8 to 100.

A company may not return the "performance replacing (the company's) own resources" along with interest and contractual fines, if it is in crisis, or if it would fall into crisis as a result of such performance.

"Performance replacing own resources" includes providing a credit facility (for a period of at least 60 days) or other similar performance with the same economic effect on the company during its crisis (or even before its crisis, if the payment term was postponed or extended during the company's crisis) by *inter alia* a member of the statutory body, proxy, director of the branch, or member of the supervisory board, by a person/entity whose direct or indirect share represents as least 5 percent of the registered capital or on the voting rights or he/she has a similar influence on the company or a person acting on their behalf. Unless otherwise is proven, it is assumed that any performance provided by a person where it is impossible to identify the final beneficiary is considered "performance replacing own resources".

Periods for the return of "performance replacing own resources" are suspended during the periods when it cannot be returned due to the mandatory provisions of Slovak commercial law.

If the "performance replacing own resources" is returned to the creditor despite the statutory prohibition, members of the statutory body (e.g. directors, members of the BoD) who held office at the time the performance was provided and those who held offices as the members of the statutory body in the period in which the company did not claim the return of the performance shall be jointly and severally liable for its return towards the company as well as the company's creditors.

Another aspect of holding company law included in the Slovak Commercial Code is that a controlling person, i.e. a person who holds a majority of the voting rights either by virtue of ownership of a business share or by virtue of a shareholders' agreement, is liable to the creditors of the controlled person for damage caused by the bankruptcy of the controlled person, provided that the controlling person's conduct considerably contributed to the bankruptcy of the controlled person. The

controlling person shall be released from such liability if it proves that it acted in an informed manner and that they were acting in good faith for the benefit of the controlled person. Unless a different amount of damage is proved, it shall be deemed that the creditor incurred damage to the extent to which its receivable was not satisfied from the proceeds after the bankruptcy proceedings held against the controlled person is terminated due to lack of property, cancellation of the bankruptcy declared against the property of the controlled person due to lack of property, termination of execution or similar enforcement proceedings conducted against the controlled person due to lack of property, or the dissolution of the controlled person without a legal successor.

**(2) Preventive restructuring proceeding**

Since July 2022, a new Act No. 111/2022 Coll. *On the Resolution of Impending Bankruptcy* (the "Act"), has been adopted in Slovakia, which provides for a new type of procedure – preventive restructuring and temporary protection of the debtor. This law is a consequence of the transposition of Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

When a debtor (legal entity only) discovers that it is at risk of insolvency in the next 12 calendar months, i.e., the debtor is more than 90 days late in meeting at least two financial liabilities with more than one creditor, it is obliged to monitor its financial situation very closely and to take appropriate measures to avert it without undue delay. To assess whether insolvency is imminent, it is important to calculate the "coverage gap", i.e., if the difference between due cash liabilities[7] and cash assets[8] is more than 1/10 of the debtor's due cash liabilities "*coverage gap*" and it will not be able to reverse this situation within 60 days, the debtor is deemed to have become insolvent. Being registered on the list of debtors for social/health insurance or taxes signals a risk of bankruptcy. In these cases, the debtor should take appropriate precautionary measures, including a preventive restructuring proceeding.

Debtor may initiate preventive restructuring proceeding provided that there is a chance of preserving and recovering its business, it is not yet bankrupt, and no execution or other enforcement proceedings have been

[7] For the purpose of determining the coverage gap, the number of due cash liabilities shall not be taken into account:

- which are linked to a subordinated obligation or would be satisfied in the bankruptcy proceedings in the order of subordinated claims if the creditor has agreed in writing to their temporary non-performance,
- the debtor and the creditor are mutually negotiating to change or modify their maturity and the creditor has an interest in negotiating, which the debtor has confirmed in writing to the creditor at the time of the negotiation.

[8] For the purposes of determining insolvency, cash assets are:

- cash,
- claims on an account, deposit or other form of deposit in a bank or branch of a foreign bank
- monetary claims, securities and financial instruments maturing within 30 days, where, in the exercise of professional diligence, their due and punctual fulfilment can reasonably be expected,
- monetary claims, securities and financial instruments not more than 30 days overdue if, in the exercise of professional diligence, they can reasonably be expected to be duly settled within 30 days of their due date,
- cash receivables, securities and financial instruments that are repayable on demand (sight), if it is reasonable in the exercise of professional diligence to expect that they would be duly and punctually discharged if they were called for repayment on the following day.

commenced against the debtor to enforce a pecuniary claim.

There are two different types of preventive restructuring – public and non-public. Public preventive restructuring in principle deals with all monetary liabilities (except those of "unaffected creditors", e.g., a small creditor with a claim in the amount up to EUR 5,000, persons with an employment claim against the debtor, non-monetary creditor, etc.), while non-public preventive restructuring deals only with the claims of licensed creditors (e.g., banks, leasing companies).

- **Process of Public preventive restructuring**

The application for public preventive restructuring must be submitted by the debtor to the court. The debtor must be registered in the Register of Public Sector Partners (all companies doing business with state, municipalities or state/municipality organisations must be registered in this register. Verifying ownership structures up to UBOs is part of registration process) at the time of the submission of the application.

The application must include a draft restructuring plan with the proposed measures aimed at averting the debtor's insolvency and to ensure the viability of the debtor's business.

A creditors' committee for the debtor is appointed by the court after the authorization of public preventive restructuring. The creditors' committee has the power to determine the debtor's acts, which are subject to the approval of the creditors' committee or a designated consultant, and to approve such acts.

If the court has granted public preventive restructuring, the debtor is entitled to reapply no earlier than two years after the end of the preventive restructuring.

- **Consultant**

The legal and/or economic steps to be taken during preventive restructuring often go beyond the experience of the usual course of business of the debtor and therefore, it is obligatory (with a few legal exceptions) to engage a professional consultant. The debtor may choose one or more consultants, usually lawyers, investment/economic advisors, which can be found *inter alia* on the list published on the website of the Ministry of Economy of the Slovak Republic.

The consultant supports the debtor while preparing the restructuring plan, continuously monitors the debtor's economic situation and development trends and replies to creditors' questions. The consultant is required to act with professional care and is liable for damages towards the debtor and the creditors for which he/she must arrange professional liability insurance.

Once the court approves the public preventive restructuring the consultant(s) is usually replaced by a trustee appointed by a court.

- **Information on bankruptcy**

The debtor's statutory body is obliged to inform the court, the trustee, the creditors' committee, and the creditors who gave their consent to temporary protection, of the debtor's bankruptcy occurring during the public preventive restructuring. Nevertheless, preventive public restructuring is not automatically suspended in such case, provided that it can be reasonably assumed that the debtor will be able to fulfil properly and in a timely manner all new obligations and the restructuring plan will be confirmed by the court, or the debtor will avoid bankruptcy in another way.

Breaching this obligation by a statutory body (directors, members of the BoD) is sanctioned by

a penalty of EUR 12,500 and they are also liable for damages vis-à-vis the debtor and its creditors. Failing to pay the penalty leads to being listed in the Register for Disqualifications causing that the breaching person cannot be appointed as a statutory body or its member, member of a supervisory body, branch director, or a proxy in a Slovak company for a period of three years.

- **Restructuring plan**

Restructuring plan includes one or more legal or economic measures to avert the debtor's insolvency, in particular:

- Restructuring of the debtor's obligations towards the creditors concerned, in particular the postponement or partial remission of their repayment, their security or the modification of their security or their satisfaction otherwise than in cash,
- Restructuring of the debtor's assets, in particular the sale, transfer or encumbrance of the debtor's property, undertaking or part of an undertaking, or the lifting of an encumbrance on the debtor's assets,
- Restructuring of the debtor's capital structure, in particular sale, transfer or issue of new shares, amendment of the memorandum of association, articles of association or other similar documents or the addition to the debtor's capital, or the same measures in the case of a connected person,
- Restructuring of the human resources of the debtor's business, in particular the creation or termination of employments, change of the employment terms,
- Restructuring of the management and control of the debtor, in particular the appointment, removal or replacement of a statutory body or a member thereof or of a supervisory body or a member thereof.

Restructuring plan must also include the expected rate of satisfaction of each of the creditors concerned in the best alternative scenario and the proposed rate of satisfaction of each of the creditors concerned, and a justification of the reasonable prospects of the public plan to avert imminent insolvency and ensure the viability of the debtor's business and an identification of the necessary preconditions for the achievement of that objective, a description of how the debtor's property, business or part of the debtor's business is to be disposed of if it shall be transferred, encumbered or unencumbered, a description of how new shares are to be issued by the debtor or the person involved, and a description of how current shares or new shares are to be disposed of if current shares are to be transferred or unencumbered or new shares are to be issued, name of the entity providing new financing to the debtor or the person involved, the terms and conditions of the new financing, and any other agreed-upon details of the new financing.

A restructuring plan is approved by the concerned creditors, if:

- Each group of the secured creditors has voted in favour of the public plan,
- In each group of the unsecured creditors, at least a 3/4 majority of the voting creditors in that group, calculated on the basis of the number of claims, have voted in favour of the public plan,
- In each group of the unsecured creditors, a majority of creditors with claims exceeding 1 % of the number of claims of the voting creditors in that group, calculated on the basis of the one vote per creditor rule, have voted in favour of the adoption of the public plan,

- In each group of the creditors with related claims and subordinated creditors, a supermajority of the voting creditors in that group, counted according to the number of claims, voted in favour of the adoption of the public plan,
- In each group of the shareholders, a majority of the shareholders voted in favour of the adoption of the public plan.

If any of the groups does not approve the restructuring plan, the debtor is entitled to ask the court to confirm the plan, i.e., to substitute the consent of that group by a court order. The disapproving creditor has the right to comment on the proposal of the restructuring plan.

If the court confirms a restructuring plan it is binding for the debtor and the affected creditors and the debtor's statutory body must exercise the plan and refrain from any action that may frustrate or impede its orderly or timely implementation.

For greater certainty that the debtor will follow the restructuring plan, the plan may establish a supervisory administration by a supervisory trustee to supervise and control the debtor's business activities until the restructuring plan is accomplished.

**(3) Temporary protection**

In addition to the application for public preventive restructuring, the debtor may also apply for *"temporary protection"*, which provides time and material space for effective restructuring. The temporary protection may be granted for a period of 3 months and with the consent of the creditors it may be extended up to 6 months in total.

The temporary protection must be approved by:

- a majority of creditors, calculated as per their outstanding claims; or
- at least 20% of all creditors, calculated as per the amount of their unrelated outstanding claims, and provided that partial remission of the claim or the recognition of its partial unenforceability does not exceed 20% of any creditor's claim in the draft plan and the deferral of repayment of any claim does not exceed one year.

During the temporary protection, the debtor is obliged to limit its activities to those not materially altering composition of its assets, liabilities or obligations; any other activity is subject to the consent of the creditors' committee.

<u>Effects of the temporary protection:</u>

a) **Active bankruptcy immunity –** The debtor is not obliged to file for a bankruptcy proceeding during the temporary protection. This is without prejudice to the information obligation of the debtor's statutory body to inform the court and the creditors on the bankruptcy;

b) **Passive insolvency immunity –** During the period of temporary protection, the debtor cannot be declared bankrupt or restructured and the related proceedings are suspended;

c) **Execution immunity –** No enforcement proceedings can be brought against the debtor (except for the statutory claims);

d) **Priority of the satisfaction of new and unrelated liabilities**;

e) **Temporary impossibility to exercise security rights related to the property of the debtor**, which however does not apply to the claims of the debtor's employees from employment relations;

f) **Prohibition of setting off a related-party claim against the debtor** (related claims of the debtor's statutory body, proxy, a person

who has a qualifying holding in a legal entity – debtor);

g) **Restriction on change of content and termination of the contractual relations –** In case of the debtor's default, which occurred before temporary protection was granted, the creditor may not (over the duration of the temporary protection) terminate the contract, withdraw from the contract, refuse performance under the contract or change the content of the rights or obligations under the contract (the exception is a performance by the other party which is not to be used in connection with the ordinary course of the debtor's business);

h) **Impossibility to terminate the debtor's financing –** The financing agreed between the creditor and the debtor prior to the providing of a temporary protection cannot be terminated during the temporary protection due to the debtor's failure to comply with the terms of the financial ratios. The debtor cannot draw on the financing agreed before the temporary protection was granted without the approval of the creditors' committee;

i) **Suspension of limitation periods for the time-barring of claims.**

The debtor may accept crisis financing during the temporary protection, subject to the consent of the creditors' committee, up to a maximum amount of 6 months of the average debtor's monthly operating costs for the previous year.

**(4) Restructuring and Bankruptcy proceedings**

Act no. 7/2005 Coll. *On Bankruptcy and Restructuring* as amened recognizes two forms of bankruptcy:

- **Insolvency** – a legal entity is insolvent, if it is unable to fulfil at least two monetary obligations to more than one creditor 90 days after their due date. The debtor shall be deemed insolvent, if a monetary obligation cannot be collected through the enforcement;
- **Over indebtedness –** An entrepreneur is overindebted if he/she has more than one creditor and the value of his/her liabilities[9] exceeds the value of his/her assets.

If the debtor finds out that the above criteria are met, so it is bankrupt (contrary to imminent insolvency that may be dealt with within the preventive restructuring proceeding), it may decide for formal **restructuring proceedings** and entrust the restructuring trustee with the preparation of a restructuring opinion to determine whether the restructuring requirements and conditions are fulfilled. If not, they must file for initiation of **bankruptcy proceedings**.

The restructuring administrator may recommend **restructuring** of the debtor, if it is

[9] The sum of the subordinated claims and claims of related parties shall not be included in the calculation.

A related party is:

a) the (member) statutory body, manager, proxy, or a member of the supervisory board of the legal entity,

b) a natural person or some other legal entity that has a qualified participation in the legal entity; qualified participation shall mean a direct or indirect share equal to at least 5% of the registered capital of the legal entity or of the voting rights in the legal entity or an option to exercise the influence on the management of the legal entity that is comparable to the influence corresponding to such share;

c) the statutory body or a member of the statutory body, manager, proxy, or a member of the supervisory board of the legal entity stated in paragraph b),

d) a close person of a natural person stated in paragraphs a) through c),

e) some other legal entity in which the legal entity or any of the parties stated in paragraphs a) through d) has a qualified participation.

reasonable to assume that at least a substantial part of the business of the debtor's business is maintained, and in the case of restructuring proceedings, it is reasonable to assume that the debtor's creditors are more satisfied than in the case of bankruptcy. A restructuring proceeding is a strictly defined process, which is aimed at rescuing a debtor, where the debtor agrees with all creditors to settle their claims and maintains the next operation of the debtor's business including employment, even after the restructuring has ended.

A debtor who is a legal entity is obliged to file for **bankruptcy proceedings** within 30 days from the day it ascertained or, if exerting professional care, could have ascertained its bankruptcy (both in the case of insolvency and over indebtedness).

A person obliged to file for bankruptcy in the debtor's name (e.g., a statutory body or member of the debtor's statutory body, the debtor’s liquidator and the debtor’s statutory representative) failing to comply with such obligation must pay a penalty of EUR 12,500 and is liable for damages towards the debtor and its creditors. Unless a different amount of damage is proved, the creditor shall be presumed to have suffered damage to the extent that the creditor's claim has not been satisfied after the bankruptcy proceedings have been discontinued for lack of the debtor's assets, the bankruptcy declared on the debtor's assets has been annulled for lack of assets, or the execution or similar enforcement proceedings against the debtor have been discontinued for lack of assets. A penalty is enforced by the bankruptcy trustee and its non-payment leads to entering such person into the Register for Disqualifications.

The creditor is also entitled to file a bankruptcy petition, if it can reasonably assume insolvency of its debtor or if the debtor is presumed to be bankrupt due to the publication of a notice in the Commercial Bulletin (e.g., a notice of dissolution of a company, notice of termination of the enforcement proceeding).

Unlike in the case of preventive restructuring proceedings, both restructuring proceedings and bankruptcy proceedings resolve all of a debtor's claims. Both proceedings are very strict, formal and lengthy. Restructuring proceedings in Slovakia last approximately one year and bankruptcy proceedings even several years. It is not uncommon that the restructuring proceedings are unsuccessful, the process does not lead to the debtor's recovery and only extends the time gap between the start of the economic problems and entering into bankruptcy proceedings, and consequently even decreases the creditors' satisfaction rate.

Bankruptcy proceedings always lead to termination of the activity of the legal entity, since the debtor is deleted from the Commercial Register, and it ceases to exist as the legal entity after the scope of the application is fulfilled.

**(5) Bankruptcy trustee**

Apart from “standard” bankruptcy trustees, Act No. 8/2005 Coll. o*n Bankruptcy Trustees* recognizes so-called special bankruptcy trustees who shall be appointed to manage large bankruptcy or restructuring proceedings (with a large number of creditors, with a large number of employees, or with a large volume of assets, etc.) or bankruptcy or restructuring proceedings of special entities (e.g., financial institutions).

*This overview is for information purposes only.*

*Under no account can it be considered as either a legal opinion or advice on how to proceed in particular cases or on how to assess them. Should you need any further information on the issues covered by this overview, please contact Ms. Kristína Ňaňková (nankova@peterkapartners.sk) or Ms. Nicole Šrolová (srolova@peterkapartners.sk).*

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# INTERNATIONAL LAWYERS NETWORK

## LÓPEZ-IBOR ABOGADOS

### Bankruptcy, Insolvency & Rehabilitation Proceedings in Spain

**ILN RESTRUCTURING & INSOLVENCY GROUP**

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER SPANISH LAW

### I. INTRODUCTION -REGULATION OF INSOLVENCY OF COMPANIES AND INDIVIDUALS.

We believe that the opportunity to present this article comes at a perfect time as an important reform of insolvency regulation has recently entered into force in Spain.

This regulation is contained in a single text, Royal Legislative Decree 1/2020, of May 5, which approves the revised text of the Insolvency Law ("**TRLC**") which was recently amended by Law 16/2022, of September 5

The aim, as stated in the preamble, is to preserve business and its underlying employment, for which purpose the law distinguishes between the insolvency proceeding per se, and what it calls pre-bankruptcy proceeding, which allows the insolvency situation to be dealt with without the need to become immersed in the judicial procedures with what is the insolvency proceedings.

Before going into the most relevant aspects of the regulation, we must consider that the last reform referred to above has introduced a specific procedure for the so-called "Micro-companies", which are those companies or individuals that, because they comply with certain parameters, the law understands that they must be subject to a special procedure due to their smaller size, reduced in terms of time and costs.

Having said the above, in the following sections we will first analyze the general procedure, applicable to all individuals and legal entities that are not considered as "Micro-companies", including the so-called pre-bankruptcy law.

We will refer later to the most relevant aspects of this regulation in relation to individuals.

And, finally, we will analyze the special procedure contemplated for "Micro-companies".

### II. OF THE GENERAL INSOLVENCY PROCEEDING.

The insolvency proceeding is regulated by a system of phases, with a first phase called "Common Phase" (Fase Común), and two subsequent phases depending on whether the debtor is viable or not. If the debtor is viable, it will enter the so-called "Agreement Phase" (Fase de Convenio), and if not, the "Liquidation Phase" (Fase de Liquidación).

Likewise, in parallel with the processing of the previous phases, the Law regulates the so-called "qualification of the insolvency proceedings", the purpose of which focuses on analysing whether the insolvency situation has been caused or aggravated as a result of the guilty or negligent actions of the directors.

Regarding pre-bankruptcy law, we will see the so-called "Restructuring Plans".

#### II.1. Commencement of the insolvency proceeding: declaration of insolvency and effects.

II.1.1. Initiation of the procedure.

From a subjective point of view, any legal entity or individual that is not included within the concept of "Micro-companies" may file for insolvency proceeding, with the sole exception of entities belonging to the territorial organization of the State, public bodies and entities.

From an objective point of view, only one condition will be required: that the debtor is

in a "situation of insolvency", understood as the impossibility of regularly complying with its obligations. However, also the debtor may file for an insolvency proceeding not only when such default occurs at the time of filing for an insolvency proceeding (current insolvency), but also when the debtor foresees that the default will occur within the following three months (imminent insolvency).

The insolvency proceeding begins with the filing of a lawsuit for insolvency before the Commercial Court of the province where the debtor has the main centre of management and administration of the company.

The lawsuit may be filed by the debtor itself, in which case we will be dealing with voluntary insolvency proceedings, or by the creditors, in which case we will be dealing with necessary insolvency proceedings. The most relevant consequence between the two cases is that, as a general rule, in the case of voluntary insolvency proceedings, the administrative body will be maintained, whereas if insolvency proceedings are filed by the debtor, they will be dismissed and replaced by the Receiver. However, as we have said, this is not an imperative consequence.

Certain legal and financial documents must be attached to the lawsuit, the most relevant of which are as follows:

- The so-called "Legal and Economic Report" in which the debtor must justify its insolvency situation; describe the legal and economic background; identify the administrative body and partners; express the causes of the insolvency; and whether or not it considers the insolvency to be viable;
- A "List of Creditors" in which the debtor shall duly identify each of its creditors, contact details available to him and the specific debt owed and its status;
- An "Inventory of assets and rights" of which it is the owner with the identification, location and value attributed to each of them.

II.1.2. Declaration of the insolvency proceeding.

The insolvency proceeding shall be declared by means of an order issued by the Commercial Court, which shall contain, among others, the following pronouncements:

- The appointment of a Receiver to manage the proceeding:
- The commencement of the "Common Phase", as well as, in the event that the debtor has requested it in the lawsuit for insolvency proceedings, the simultaneous commencement of the "Liquidation Phase"
- An appeal to creditors to communicate their credits.

II.1.3. Effects of the insolvency proceeding.

The main effects of the declaration of the insolvency are produced by legal imperative, and are the following:

- The paralysis of any judicial or extrajudicial execution against the debtor's assets, except for labor executions, public law credits and secured credits, provided that they are directed against assets or rights that are not necessary for the continuity of the debtor's activity and;
- The suspension of the accrual of any kind of interest, except ordinary interest on mortgage loans and up to the amount of the guarantee

The determination of whether or not the asset or right subject to execution is necessary for the continuity of the debtor's activity is the exclusive competence of the insolvency judge, and only once such declaration of unnecessary nature has been obtained may the execution continue, and only with respect to the three types of credits indicated in the preceding paragraph. For the rest of the credits, the impossibility to initiate executions is absolute.

Having said this, the declaration of insolvency of the principal debtor does not prevent the initiation of claims/enforcement against third party guarantors.

**II.2. Processing of the insolvency proceeding.**

As mentioned in the introduction, the procedure is structured and developed in three phases, the Common Phase, the Agreement Phase, and the Liquidation Phase

Without prejudice to the foregoing, for organisational purposes of the procedure, it should be noted that the insolvency proceeding is divided into six sections within which all the procedures are integrated. Thus, the proceedings pertaining to the common phase are included in Sections 1, 3 and 4, and those relating to the Agreement Phase and Liquidation Phase in Section 5.

Having established the above, in the following points we will first analyze the most relevant aspects of each of the three phases, as it is through them that the bulk of the procedure is carried out, referring finally to section 6, known as "Qualification Section", as this is a very relevant aspect of the procedure whose regulation is outside the three phases mentioned above.

<u>II.2.1. Common Phase</u>: This is the first phase of the insolvency proceeding and its essential objective is to determine the debtor's situation, for which the Receiver must draw up a report containing the following elements:

- An analysis of the "Legal and Economic Report" submitted by the debtor with the lawsuit asking for its insolvency proceeding;
- A statement of the state of the debtor's accounts;
- An explanation of the main decisions and actions taken by the Receiver itself.
- A reasoned statement of the debtor's assets and any other elements that may be relevant to the proceedings.

The report must also be accompanied by an Inventory and a List of Creditors drawn up by the Receiver itself. The List of Creditors will include a classification of the creditors' claims according to their characteristics, which will determine their collection preference and their rights within the Agreement or Liquidation Phase.

Finally, in the case of a company, a valuation must be provided for the company as a whole and for each of the production units that make up the company, both in the hypothesis of continuity of activity and in liquidation.

Once the report has been issued by the Receiver, the creditors and the debtor himself may object to both the Inventory and the List of Creditors if they do not agree with what is reflected in either of these documents.

In the event that no objections are filed or once those filed have been resolved, the Receiver will make the Inventory and the List of Creditors definitive, which may no longer be subject to variations.

II.2.2. Agreement Phase: The purpose of this phase is to process a payment proposal to creditors.

The proposal may be made either by the debtor or by all the creditors representing one fifth of the debtor's assets.

The filing of the proposal may be formalized at any time from the filing of the insolvency lawsuit and up to 15 days after the presentation of its report by the Receiver.

As for the content of the proposed arrangement, it must include proposals for a debt reduction, a waiting period, or both, as well as the conversion of credits into shares in the bankrupt company or the transfer of assets in payment of debts.

Together with the agreement proposal, a Viability Plan must be presented, specifying the resources with which the payments will be met, which must also be reflected in a Payment Plan that will be provided with the agreement proposal.

The proposed arrangement must be evaluated by the Receiver before being submitted to the creditors for approval at the relevant creditors' meeting.

Depending on the content of the proposal, its approval will require the adhesion (by electronic means) of the majority of the credits or up to 65% of the ordinary credits.

Once the creditors have voted in favour of the arrangement proposal, the judge will review compliance with the corresponding formalities and requirements and, if such compliance is verified, will issue a judgement of approval.

The judgement approving the agreement will entail the cessation of the effects of the insolvency proceeding and the dismissal of the Receiver, which will only be authorized to continue with the processing of any incidents that may be pending and to process the section on the qualification of the insolvency proceeding, which we will refer to later.

II.2.3. Liquidation Phase: Although the objective of this phase is to achieve the liquidation of the debtor's assets with the greatest possible degree of satisfaction for creditors, the truth is that the trend in recent years has been to sacrifice this objective in favour of any operation that allows the business activity and employment to be maintained, which is achieved through the creation of viable production units within the insolvent company.

The opening of the Liquidation Phase may be initiated at the same time as the insolvency proceedings are declared, if the debtor so requests in its claim, and it is then processed simultaneously with the Common Phase, or subsequently when an agreement is not approved or the approved agreement is not complied with. In addition, the debtor may request liquidation at any time, and the Receiver may also do so in the event of total or partial cessation of the company´s activity.

The opening of the Liquidation Phase will entail the dismissal of the company directors, who will be replaced by the Receiver.

Liquidation operations shall be subject to the general rules established by the TRLC, unless the Judge in the insolvency proceeding may establish special rules after hearing the Receiver.

The general rules of liquidation give priority to the sale of all establishments and production units as a whole and through electronic auction.

In addition, every three months the Receiver must submit a report on the state of the liquidation.

Once the liquidation has been completed, the Receiver must submit a final report with the result of the liquidation and a rendering account of its actuations, together with a request for the termination of the insolvency proceeding.

If the rendering accounts of the Receiver are approved, the judge will issue an order terminating the insolvency proceedings.

**II.3 Pre-bankruptcy law. The Restructuring Plan.**

The way that the TRLC contemplates to save the insolvency without the need to file for insolvency lawsuit consists of reaching and approving a Debt Restructuring Plan.

This may or may not be preceded by a communication to the Court of the commencement of negotiations with the creditors.

From the moment this communication is made, which may be reserved, two effects will take place:

- The period of three months to try to reach the restructuring plan will begin;
- During the same period, no execution may be initiated or continued on the assets and rights necessary for the continuity of the debtor's activity.

If such an agreement is not reached, the debtor must file for insolvency proceeding within the following month.

Focusing on the Restructuring Plan, its essential notes are the following:

- Its purpose is to modify the composition of the debtor's assets and liabilities or equity;
- It contemplates the possibility of appointing a restructuring expert;
- Extends its affectations to creditors who do not vote in favor of the plan;
- It may affect any type of credit, although with special provisions with respect to public law and secured claims;
- The credits will be grouped by classes according to their insolvency rank and specific characteristics;
- The Plan will be considered approved if more than two thirds of the credits corresponding to each class of credits vote in favor of the Plan;

The Plan must be judicially approved if it is intended to extend its effects to creditors who have not voted in its favor; if it is intended to terminate contracts in the interest of restructuring; or if it is intended to protect any transaction carried out under the Plan (financing granted, etc.) from possible rescission.

**II.4. The qualification section.**

The purpose of the qualification section is to determine whether the insolvency situation was generated or aggravated by the willful or culpable conduct of its directors, ghost directors or general directors

The qualification phase will be opened at the end of the common phase.

For an insolvency to be classified as guilty, the Spanish Insolvency Law (LC) requires that there has been an aggravation of the willful and / or culpable insolvency of the Debtor, establishing two types of factual assumptions: (i) assumptions that, if concur, determine guilt of the bankruptcy without the need to prove that insolvency was caused or aggravated as a result (called “iure et de iure” assumption) where no proof to the contrary is admissible); (ii) and assumptions

that, although they concur, must cause or aggravate the insolvency ("iuris tantum" assumption) and where contrary evidence is permissible. Likewise, the consequences that for the affected persons may derive from the characterization of the contest as guilty are several, from the disqualification to manage assets and rights, to the liability to cover the deficit of assets not satisfied in the insolvency proceeding.

**III.INSOLVENCY PROCEEDING OF NATURAL PERSONS.**

Although there is nothing to prevent natural persons from using the insolvency proceeding referred to in the previous sections, with the necessary differences derived from their status as natural persons (documentation to be provided, shorter processing time, etc.), the fact is that the only reason for individuals to initiate it is that through it they can get their debts discharged.

This is the so-called "Benefit of Exoneration of Unsatisfied Liabilities" ("BEPI"), which is the essential differentiating element in the regulation of the insolvency of natural persons with respect to legal persons, since the latter will not have the option of obtaining such exoneration insofar as, as legal persons, they only are able to approve an agreement and thus continue with their activity, or they are liquidated and extinguished.

Having established the above, in order for a natural person to achieve BEPI the following is required

a) By means of a debt payment plan. This means of exoneration does not require the prior liquidation of the debtor's assets or;

b) When after the liquidation of the debtor's assets there is a continuing insufficiency of assets to satisfy the debts.

In both cases, in order to obtain the BEPI, a series of subjective requirements are established for the personal debtor that focus on his consideration as a debtor in good faith, i.e., not having been declared bankrupt, not having been convicted of crimes against assets, public finances, or against workers in the previous ten years;

In any case, certain credits are not exonerable, among others, those of public law with a limit of up to 10,000€, the credits for alimony, or the expenses and costs for the processing of the bankruptcy.

**IV. SPECIAL PROCEDURE FOR MICRO-COMPANIES.**

This is the first time that a specific and exclusive regulation for a certain type of company, the so-called micro-companies, has been introduced in the insolvency regulations.

The reason for contemplating this special regulation now is twofold, on the one hand, because most companies that go into insolvency proceedings end up in liquidation, and on the other hand, because the Spanish productive composition is made up of a high percentage of companies that meet the parameters of Micro-companies, which makes it necessary to give them a specific treatment with respect to the rest of the insolvency proceedings in order to reduce the costs of the procedure and its duration in view of the smaller size and complexity of these companies.

The aim is that if a company is viable, the agreement can be approved as soon as possible, and if it is not, it can be liquidated as soon as possible.

Having said the above, the defining parameters of a micro-companies are to have less than 10 employees and a turnover of less than Eur. 700,000 euros or liabilities of less than Eur. 350,000, all according to the annual accounts corresponding to the last fiscal year.

Entering the procedure, any company or individual that meets the parameters indicated in the previous paragraph and is in current, imminent (three months) or probable insolvency (forecast of up to two years) may request the insolvency proceeding, which will be processed through this special procedure.

As mentioned above, this procedure is characterized by the streamlining of procedures by providing for appearances to be made by telematic presence (hearings, appearances, declarations) and acts of communication by electronic means and using forms. However, as a counterbalance to this streamlining of formalities, the submission of seriously inaccurate information or documentation is considered as a cause of guilty insolvency.

As with the general procedure, the Micro-company procedure may or may not be preceded by a negotiation period to try to reach an agreement with your creditors. This period will have a maximum and non-extendable duration of three months after which, without having reached an agreement, the insolvency proceeding must be filed provided that you are in actual insolvency (not if it is imminent or probable).

The main effects of the negotiation period are the suspension of judicial or extrajudicial executions of the assets and rights necessary to continue the activity, except with respect to public creditors, and the impossibility for creditors to file for insolvency proceeding.

The special procedure for microenterprises can be processed in two ways:

a) As a continuation procedure, for which it will be necessary to approve a Continuation Plan that must be approved by the creditors, which must be homologated in order to affect public law claims, with certain exceptions.

   In addition, with the application for the Continuation Plan, it is possible to request, among other measures, the suspension of the foreclosure of credits with real or public guarantee on the assets or rights necessary to continue the activity for a maximum period of three months.

b) As a liquidation proceeding, which will be opened at the request of the debtor, when the continuation plan is not approved, homologated, or not complied with and, very importantly, if the debtor is not up to date with its tax or Social Security obligations accrued after the opening of the insolvency proceeding.

   Also in the liquidation proceedings, certain measures may be requested, the most important of which is the suspension of the execution of secured claims on the assets or rights necessary to continue the activity for a maximum period of three months.

   The liquidation will be carried out through the electronic platform system and cannot last more than three months, extendable for an additional month.

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# INTERNATIONAL LAWYERS NETWORK

## DEJ-UDOM & ASSOCIATES LTD.

Bankruptcy, Insolvency & Rehabilitation Proceedings in Thailand

**ILN RESTRUCTURING & INSOLVENCY GROUP**

## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER THAI LAW

### Introduction

The law of Thailand regarding insolvency, bankruptcy and rehabilitation proceeding are stipulated and applied through Thai Bankruptcy Act B.E.2483 (A.D. 1940) ("Bankruptcy Act") and its amendments No.10, B.E.2561 (A.D. 2018).

This paper offers an understanding of the insolvent debtors and their qualification to the protection under Bankruptcy Act and its amendments, as granted by the law and/or by the court's decision or order granted thereunder debtors who initially stated on expressed that they are facing with financial dilemma, bringing them to the point of being insolvent, or they are under the process of negotiation with creditor on an agreement for rehabilitation.

To emphasize the criteria of insolvency in Thailand, Chapter 1 of the Bankruptcy Act prescribes the circumstances in which a debtor can be found insolvent [10], e.g.,

(1) The debtor transfers his property or the right to manage his property to other person for his creditors' benefit.

(2) The debtor fictitiously or fraudulently transfers or delivers his property to another person.

(3) The bankrupted debtor transfers his property or creates any right on his property

(4) The debtor carries out any of the following acts purposedly delaying payment or preventing a creditor from receiving the debt payment:

a. leaving or remaining outside the Kingdom

b. leaving or concealing himself in his residence or absconding by any other means or closing his business site.

c. diverting the property out of the territorial jurisdiction

d. surrendering himself to be subjected to a judgment compelling payment which he ought not to make

By considering the facts presumed to be insolvent under these criteria, it is crucial that such facts exist at the time the lawsuit was filed.

**The Comparison between the bankruptcy and rehabilitation under the Bankruptcy Act and its amendments:**

**1. The Person who is eligible to file the case/ petition with the Court**

<u>**Bankruptcy Case**</u>

- The Creditor (there have 2 types of creditors which are unsecured creditor and secured creditor[11]).
- The Debtor by its Liquidator, if after the completion of liquidation process, the assets of the company are less than the liabilities of the company.

<u>**Rehabilitation Case**</u>

- The Creditor.
- The Debtor.

[10] Section 8 of the Bankruptcy Act B.E.2483.

[11] Section 6 of the Bankruptcy Act B.E.2483 defines secured creditors as creditors who have preferential rights over a debtor's (e.g., a mortgage, a pledge or a right of retention), to receive satisfaction of a claim from the proceeds from disposal of assets. Hence, <u>the secured creditor</u> holds priority on debt collection from the property on which it holds a lien, while <u>the unsecured creditor</u> gets no such protection.

**2. The conditions for filing the petition**

**Bankruptcy Case**

For unsecured creditor

i. The Debtor is insolvent

ii. The Debtor is an individual person or juristic person

iii. The debt amount is not less than THB 1,000,000 (USD 28,485.16) for individual debtor, or not less than THB 2,000,000 (USD 56,970.32) for corporate debtor.

For secured creditor

i. The Debtor is insolvent

ii. The Debtor is an individual person or juristic person

iii. The secured creditor must not be a person who is prohibited from forcing debt repayment against the debtor's property in excess of their security

iv. The secured creditor must refer in the petition that the secured creditor will give up the liens/security[12] for the benefit of all creditors; or

the secured creditor must refer the appraisal of the liens/security in the petition, which when deducted from the amount of the debt, the amount of debt repayment would be lack for individual debtor in the amount of not less than THB 1,000,000 or a corporate debtor in the amount of not less than THB 2,000,000.

**Rehabilitation Case**

i. The Debtor is insolvent

ii. The Debtor is a limited company/public company or any juristic which is specify in ministerial regulations

iii. The debt amount is not less than THB 10,000,000 (USD 284,851.60)

iv. a reasonable cause and prospect for the reorganisation of the debtor's business (debtor must not be placed under absolute receivership)

v. Filing petition in good faith

**3. The effect by the Court Order**

**Bankruptcy Case**

Upon the Court issues an absolute receivership order against the debtor, only the receiver has the authority to manage the business and collect all assets of the debtor for distribution to the eligible creditors who file their claims for repayment of debt within the time frame as specified by the law.

**Rehabilitation Case**

Upon the Court accepting the petition for rehabilitation, the automatic stay of the debtor under Section 90/12 shall be applied.

**4. The operation when entering the process/ the effect by the Court Order**

**Bankruptcy Case**

The debtor shall file proposal for a composition in satisfaction of debts in the creditors meeting

If there is no Proposal or any Approval for a composition in the meetings, the official receiver has to report to the Court and the Court shall have to order that the debtor is bankrupt.

[12] Under Thai law, there are 3 major types of security to be granted over assets, i.e., mortgage, pledge, and business security.

After 3 years from the order's date, the order might be dismissed under some conditions specified by the law, for example, there is no further asset to be seized.

**Rehabilitation Case**

In case of accepting the rehabilitation plan by the Court, the plan administrator shall operate the implementation of the plan which shall not exceed 5 years. The implementation of the plan shall be extended 2 times which shall not exceed 1 year per each extend.

In the Case that, the creditors meeting, and the Court reject the plan, Court will order to dismiss the rehabilitation order, or order the debtor in bankrupt.

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*To summarize, the main differences between the Bankruptcy and Rehabilitation are as follows:*

- *the existence of the business of the debtor;*
- *the repayment of debt to the creditors;*
- *the effect of the court's order; and*
- *the protection granted under the law.*

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**The protection granted to the debtor against its creditors**

***What kind of protection is granted? (e.g., the creditors may not enforce any court decision against the debtor's assets etc.)***

In the bankruptcy case, there is no protection for the debtor upon the Court has the order to place the debtor under absolute receivership. According to the Bankruptcy Act, only the receiver who has the authority to manage business or assets of the debtor for the purpose of collecting all the debtor's asset and sell in the public auction in order to share net amount after deducting expenses and fee to all eligible creditors who file their claim for repayment of debt within the time frame as stipulated in the Bankruptcy Act.

Regarding rehabilitation under the Bankruptcy Act, the business of the debtors shall be existed, the Plan preparer has the duty to prepare the rehabilitation plan while the Plan Administrator has the duty to implement the rehabilitation plan.

In addition, once the Court orders accepting the rehabilitation petition for further inquiry, there are several protections to the debtor under Section 90/12 of the Bankruptcy Act, e.g.,

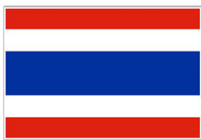
(1) No action or application shall be brought before or filed with the Court for a judgment or an order dissolving the corporate debtor. Should the action or application be brought before or filed with the Court, the Court shall stay the trial of such case. [13]

(2) No civil action shall be instituted against the debtor in connection with the debtor's property and no dispute in which the debtor may be liable or suffer a loss shall be referred to arbitration for a decision. [14] (However, the Creditor could execute a civil action on the joint debtors of his debtor or his debtor's guarantor).

(3) A judgment creditor shall not have any execution undertaken against the debtor's property if the obligation to which the judgment relates arose before

[13] Section 90/12 (1) of the Bankruptcy Act B.E.2483.

[14] Section 90/12 (4) of the Bankruptcy Act B.E.2483.





the date of the Court's order approving the plan. [15]

(4) A secured creditor shall not exercise enforcement for payment of the debt against property given as security unless upon permission by the Court receiving the petition. [16]

(5) A creditor legally entitled to exercise self-help enforcement for payment of the debt shall not seize or sell the debtor's property. [17]

(6) A public utility provider, e.g., electricity, water, or telephone, shall not suspend services supplied to the debtor. (Unless upon permission by the Court accepting petition). [18]

***What is the extent of the protection? (e.g., it includes all of the debtor's assets; Is it limited to several assets for which the debtor may ask for protection? Is it at the court's discretion to include any asset? etc.)***

The extent of all debtors' asset protection is already prescribed by the law. There is no requirement for the debtor to ask the protection from the Court as there is an automatic stay under Section 90/12 as prescribed above, while there is no protection against the debtor's assets granted by the Court if the debtor is already placed under absolute receivership order and/or bankruptcy judgment.

***Does the protection include only the debtor, or may it cover other persons as well (e.g., guarantors)?***

The protection shall be applied only the debtors, it does not cover to the guarantors in accordance with Section 90/60

*" **Section 90/60** The plan approved by the Court binds the creditors who may make applications for repayment of debt in the business reorganization and the creditors who are entitled to repayment of debt in the business reorganization, in accordance with section 90/27.*

*The Court's order approving the plan does not have any effect of varying liabilities of persons who are the debtor's partners or bear joint liability together with the debtor or stand surety for or are in the same position as the surety for the debtor, in respect of the debts existing before the date of the Court's order approving the plan and does not have any effect of rendering such persons to be liable for the debts created under the plan as from the said date unless such persons, with evidence in writing, give consent thereto."*

***For how long is the protection granted?***

Until the Court has the order to dismiss rehabilitation order.

***Which creditors are bound by the protection?***

It is bound to all creditors who are eligible creditors on the date the Court issues the rehabilitation order.

It is worth noting that under the Bankruptcy Act, there are no specific rehabilitation or bankruptcy procedures regarding financial institutions, securities firms, or insurance firms. The Bankruptcy Court applies general corporate insolvency procedures for such entities.

Nevertheless, should the debtor's business be under the supervision of a government agency, i.e., the Office of the Securities and Exchange Commission (SEC) for securities businesses; the Bank of Thailand (BOT) for financial institutions; or the Office of Insurance Commission (OIC) for insurance businesses, it is necessary that the

[15] Section 90/12 (5) of the Bankruptcy Act B.E.2483.

[16] Section 90/12 (6) of the Bankruptcy Act B.E.2483.

[17] Section 90/12 (7) of the Bankruptcy Act B.E.2483.

[18] Section 90/12 (11) of the Bankruptcy Act B.E.2483.

permission from such relevant government agency be obtained before submitting a petition for business rehabilitation proceedings.

In anticipation of the wave of rehabilitation proceedings, in April 2022, the OIC, the regulatory authority which oversees the insurance industry, released a regulation regarding the business rehabilitation of non-life insurance firms to accord with the requirements of the Bankruptcy Act that, before commencing the rehabilitation proceedings, a debtor who operates an insurance firm must obtain written consent from the OIC.

In addition, Thailand insurance firms has been filing for bankruptcy after suffering losses from selling low-cost COVID-19 insurance policies. In May 2022, SET-listed Syn Mun Kong Insurance (SMK) had filed for a rehabilitation petition with the Central Bankruptcy Court and was reported to have sold 1.95 million COVID-19 insurance policies. 16 of 52 Thailand insurance firms had offered COVID-19 insurance with 4 insurers (Asia Insurance, The One Insurance, Southeast Insurance, Thai Insurance) already shut down due to insufficient premiums and capital reserves to pay out the claims.

**SMEs Rehabilitation in Thailand**

To clarify the SME Rehabilitation in Thailand, it is required that the understanding of the characteristics of SME in Thailand [19] be made, i.e.,

| Business Characteristics | Operation Types/ Sectors | Employment rate per year (persons) | Annual revenue |
|---|---|---|---|
| Small enterprise | Manufacturing | < 50 | < THB 100 million |
| | Service providers/ wholesalers/ retailers | < 30 | < THB 50 million |
| Medium enterprise | Manufacturing | 50 < X < 200 | 100 million < X < 500 million |
| | Service providers/ wholesalers/ retailers | 30 < X < 100 | 50 million < X < 300 million |

**Definition of the SMEs Debtor** [20]

i. The Debtor who is individual person, group of persons, unregistered partnership, registered partnership, limited liability partnership, limited company, or other juristic person under the ministerial regulation

ii. Such Debtor operates its business as a SME in accordance with Small and Medium Enterprises Promotion Law.

iii. The SMEs Debtor must have been registered with Office of Small and Medium Enterprises Promotion (OSMEP) or other government agencies.

**The criteria to which SMEs debtor be deemed insolvent** [21]**, e.g.,**

(1) His property is less than his amount of debt.

(2) Failure to pay debts within the deadline.

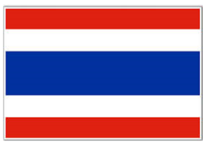
(3) The debtor has defaulted on debt repayment + having the circumstances that they are in default with other creditors as well.

(4) Insufficient cash flow to pay debts.

[19] Ministerial Regulations on the Designation of the Characteristics of Small and Medium Enterprises Promotion Act B.E. 2562, A.D. 2019.

[20] Section 90/91 of the Bankruptcy Act B.E.2483.

[21] Chapter 3/2, Section 90/92 paragraph 2 of the Bankruptcy Act B.E.2483.





By considering the facts presumed to be insolvent under these criteria, it is crucial that such facts exist at the time the petition was filed.

**The person who is eligible to file the SMEs rehabilitation petition with the Court** [22]

- Creditor (unsecured creditor or secured creditor).
- SMEs Debtor.

**The conditions for filing the petition** [23]

i. The SMEs Debtor is insolvent

ii. The SMEs Debtor is an individual person, group of persons, partnership, or juristic person

iii. The debt is caused by business operation of such Debtor

iv. The debt amount is not less than THB 2,000,000 (USD 57,685.94) for individual debtor;

not less than THB 3,000,000 (USD 86,528.91) for the debtor who is a group of persons, unregistered partnership, registered partnership, limited liability partnership, or other juristic person under the ministerial regulation; or

not less than THB 3,000,000 (USD 86,528.91) but not more that 10,000,000 (USD 288,429.70) for limited company debtor.

**The circumstances preventing the eligible person to file the petition** [24]**, e.g.,**

(1) The Court issued an absolute receivership order against the SMEs Debtor.

(2) The Court or the Registrar has issued an order for the dissolution or revocation of the juristic registration of such SMEs Debtor.

(3) The Court had dismissed the rehabilitation of such SMEs Debtor within 6 months prior to the filing of new petition.

Since the beginning of 2020, the Thai economy has faced many challenges from the COVID-19 pandemic. The broader economy is expected to recover gradually, although some sectors are showing the first signs of recovery.

Thailand's economy is expected to gradually recover to its pre-COVID-19 levels. However, the recovery may be uneven, especially for small businesses with limited access to capital. Continued and rising levels of uncertainty have further impacted financial access for affected businesses. Those with outstanding debt also find it more difficult to negotiate a debt restructuring if they have no projections of future income and cash flow.

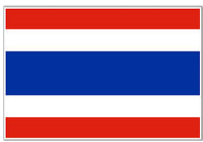
In 2016, the law was amended to make reorganization accessible to SMEs. The debt threshold was reduced, the preparation and approval of plans was simplified, and subject to a shorter implementation period.

In August 2021, the Thai Cabinet approved a set of *proposals for legislative amendments* that could increase the functionality of these procedures, such as increasing the debt threshold up to a maximum of THB 50 million, allowing SMEs not registered as such to use the procedure and to commence reorganization without a prepared plan, and a faster procedure for approval of the reorganization plan. However, such an amendment hasn't yet come into force.

[22] Section 90/93 of the Bankruptcy Act B.E.2483.

[23] Section 90/92 of the Bankruptcy Act B.E.2483.

[24] Section 90/94 of the Bankruptcy Act B.E.2483.





The newly revised Ministerial Regulations issued under the Bankruptcy Act, B.E. 2483 (1940) incorporate new additional pre-requisite for the individual or a corporate entity who desires to apply for a licenses of the rehabilitation planner and/or the rehabilitating administration and shall provide a cash security of THB 500,000 be deposited with the competent authority on the date of filling the application for the licenses. Lastly, the criminal penalties on fines only under this Act have been replaced by the new Act on Regulatory Fines B.E. 2565 (2022) meaning no criminal sanction under these specific provisions effecting from 22 June 2023.

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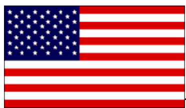
# INTERNATIONAL LAWYERS NETWORK

## CONNOLLY GALLAGHER LLP

### Bankruptcy Proceedings in The United States

**ILN RESTRUCTURING & INSOLVENCY GROUP**





## BANKRUPTCY PROCEEDINGS IN THE UNITED STATES

**General Overview of the Primary Protection Granted to a Debtor Under the United States Bankruptcy Code**

The United States Bankruptcy Code, through its various chapters, governs bankruptcy and reorganization for individuals, corporations, limited liability companies, partnerships, farmers, and municipalities in the United States of America. The Bankruptcy Code is federal law and it applies in all States of the United States. There are no separate "bankruptcy" laws in the individual States. Most States have their own insolvency, receivership, and assignment-for-the-benefit-of-creditors laws, but they are not as widely used.

Upon the filing of a bankruptcy petition by or against a person or entity (the "Debtor"), section 362 of the Bankruptcy Code automatically creates an injunction ("Automatic Stay") that enjoins all creditors and other parties from commencing or continuing any actions against Debtor to enforce claims and obligations that arose prior to the filing of the bankruptcy petition. The Automatic Stay also enjoins action against property of the Debtor's estate.

The reach of the Automatic Stay is very broad, and violations of the Automatic Stay may subject the violator to sanctions by the Bankruptcy Court. However, with limited exceptions, the Automatic Stay does not protect persons or entities related to the Debtors who are not debtors themselves, unless the Bankruptcy Court, upon Motion, extends the Automatic Stay to apply to a specific non-Debtor person or entity. The Automatic Stay applies in all bankruptcy cases, unless modified or lifted by the Bankruptcy Court, upon Motion.