

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

**POLICY DEPARTMENT** **C**  
**CITIZENS' RIGHTS AND CONSTITUTIONAL AFFAIRS**



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# Harmonisation of Insolvency Law at EU Level

NOTE



**DIRECTORATE GENERAL FOR INTERNAL POLICIES**  
**POLICY DEPARTMENT C: CITIZENS' RIGHTS AND CONSTITUTIONAL**  
**AFFAIRS**

**LEGAL AFFAIRS**

**HARMONISATION OF INSOLVENCY LAW**  
**AT EU LEVEL**

**NOTE**

**Abstract:**

This note identifies and outlines disparities between national insolvency laws, which can create obstacles, competitive advantages and/or disadvantages and difficulties for companies having cross-border activities or ownership within the EU. In particular, it provides a list of problems which might occur in the absence of common rules on insolvency, such as problems related to insolvency of corporate groups, liability of shareholders being nationals of different Member States, reference to national laws for the insolvency of 'Community' companies and strategic cross-border movements for insolvency purposes. In addition, the note identifies a number of areas of insolvency law where harmonisation at EU level is worthwhile and achievable. Lastly, it evaluates to what extent harmonisation of insolvency law could facilitate further harmonisation of company law in the EU.

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## SCOPE AND METHODOLOGY

INSOL EUROPE has confined its analysis to insolvency and winding-up proceedings within the meaning of Article 2(a) and (c) of Council Regulation (EC) No 1346/2000, of 29 May 2000, on insolvency proceedings, listed in Annex A and B of this Regulation, leaving aside consumer bankruptcy.

With regard to substantive insolvency law mentioned in this note, INSOL EUROPE has excluded any reference to the specific legislation, which applies to credit institutions, insurance undertakings and investment firms, as these are dealt with in Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding-up of credit institutions and Directive 2001/17/EC of the European Parliament and of the Council of 19 March 2001 on the reorganisation and winding-up of insurance undertakings.

INSOL EUROPE has not addressed the question of security interests as these are dealt with in the Directive 2002/47/EC of the European Parliament and the Council of 6 June 2002 on financial collateral arrangements establishing a specific regime for "*in rem*" security interests over financial instruments or cash, and for netting agreements.

INSOL EUROPE has not taken into account the common law concept of trust when dealing with the bankrupt estate of the debtor or a legal entity.

In its note INSOL EUROPE has based its analysis on country reports from Poland, France, United Kingdom, Germany, Spain, Italy and Sweden. There have also been contributions from the Netherlands and Belgium.

## EXECUTIVE SUMMARY

### Background

Insolvency law represents a balancing of several objectives. It aims at protecting creditors' rights, while safeguarding the interests of shareholders and customers on the one hand and at avoiding liquidation of potentially viable companies on the other hand. Within this context in many Member States insolvency law fosters discipline and honesty in financial management and facilitates the rehabilitation or orderly market exit of companies that are inefficient. The way insolvency law protects the different stakeholders may differ widely from one Member State to another. Therefore, substantial disparities among national insolvency regimes can be identified with regard to their underlying policy considerations, structure and content.

In order to improve and accelerate insolvency proceedings with cross-border implications, the Council adopted Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings<sup>1</sup> (hereafter referred to as the "EC Regulation No 1346/2000"), which lays down common rules on jurisdiction, recognition and applicable law in this field. The EC Regulation No 1346/2000 does not harmonize national substantive laws in the field of insolvency. According to Recital 11 to the Regulation: "This Regulation acknowledges the fact that, as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope in the entire Community. The application without exception of the law of the State of opening of proceedings would, against this background, frequently lead to difficulties. This applies, for example, to the widely differing laws on security interests to be found in the Community. Furthermore, the preferential rights enjoyed by some creditors in the insolvency proceedings are, in some cases, completely different".

Pursuant to Article 3 of the EC Regulation No 1346/2000 main insolvency proceedings can be opened in the Member State where the insolvent debtor has its centre of main interests and territorial proceedings can be opened in the Member State where the insolvent debtor has an establishment. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.

The Court of Justice of the European Union has rendered case law in which it has furthered the possibility of a company with a registered office in one Member State having its centre of main interests in another Member State (Judgment of 9 March 1999, C-212/97, Centros<sup>2</sup> and Judgment of 30 September 2003, C-167/01 Inspire Art<sup>3</sup>) as well as the possibility of moving its registered office to another Member State (Judgment of 16 December 2008, C-210/06 Cartesio<sup>4</sup>). Moreover Council Regulations (EC) No 2137/85<sup>5</sup>, No 2157/2001<sup>6</sup> and No 1435/2003<sup>7</sup> contain rules on transfer of the registered office of a European Economic Interest

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1 OJ L 160, 30.6.2000 p.1.

2 ECJ Case C 212/97 – (reference for a preliminary ruling from the Højesteret (Denmark), Centros Ltd., 9 March 1999).

3 ECJ Case C 167/01 – (reference for a preliminary ruling Kantongerecht Amsterdam, Inspire Art Ltd., 30 September 2003).

4 ECJ Case C 210/06 – Court (Grand Chamber) (reference for a preliminary ruling from the Szegedi Ítélotábla (Hungary)) – 16 December 2009.

5 Council Regulation (EEC) No 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG), OJ L 199, 31.7.1985, p. 1.

6 Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE), OJ L 294, 10.11.2001, p. 1.

7 Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for European Cooperative Society (SCE), OJ L 207, 18.8.2003, p.1.

Grouping (EEIG), a European Company (SE) and a European Cooperative Society (SCE). These implementations of the freedom of establishment entail an increased possibility of moving the actual centre of main interests of a company as well as of moving the registered office, and therefore of changing the applicable insolvency regime with respect to the company concerned. The question of how the differences between insolvency regimes can be reconciled with the ongoing economic integration and thus with the increasing cross-border movement and activities of companies in the EU becomes increasingly important.

## **Aim**

The aim of this note is to assess whether the harmonisation of insolvency law at EU level is necessary or worthwhile. The note further evaluates how the adoption of common rules in the field of insolvency can facilitate the harmonisation of company law within the EU.

## **Summary of the note**

In order to build a crisis management framework for the internal market and for structural measures to be efficient at EU level, it is important to establish the extent to which harmonisation of the insolvency laws within the different EU Member States is required. There are a limited number of areas where harmonisation may be desirable and achievable. These areas are principally the following: a possible common test of insolvency as a requirement of a formal insolvency process; the formal aspects of lodging and dealing with claims in a formal insolvency; certain aspects of the manner in which reorganisation plans are adopted and their contents; the rules regarding so-called detrimental acts and the inter-relationship between contractual rights of termination and insolvency; and finally directors' responsibilities. However, even these areas are affected by non-insolvency law considerations. Therefore, any further consideration of reform in an insolvency law context will have to take into account other important areas that are or may be the subject of European law amendment and reform such as general company law.

## INTRODUCTION

This note identifies and reports situations, without being exhaustive, where disparities between national insolvency and restructuring laws create obstacles, competitive advantages and/or disadvantages or difficulties for companies with cross-border activities or ownership within the EU. Such disparities could lead to the following situations:

- Become obstacles to a successful restructuring of insolvent companies;
- Stand in the way of a level playing field.

Harmonisation of certain aspects of insolvency laws could therefore:

- Protect the value of the assets of the estate, thereby returning greater value to creditors and shareholders;
- Reduce the costs of the administration of the estate;
- Increase predictability on the parts of creditors and shareholders, thereby encouraging the provision of increased working capital;
- Reduce the migration of financially troubled companies to jurisdictions with more workable restructuring provisions; and
- Offer benefits in other respects, such as the preservation of employment.

This note also provides examples of problems, without seeking to be exhaustive, which either do or might occur in the absence of common rules on insolvency, such as problems related to the insolvency of corporate groups, the liability of shareholders being nationals of different Member States, reference to national laws for the insolvency of 'Community' companies (European Company, European Private Company), strategic cross-border movements for insolvency purposes, etc..

The conclusions in this report are based on responses to a questionnaire (attached as Annex I) that INSOL EUROPE sent to a representative sample of members in France, Germany, Italy, Poland, Spain, Sweden and the UK. There has also been input from the authors who are practicing lawyers in Belgium and the Netherlands.

### **1. List of problems that might occur in the absence of common rules on insolvency**

From the point of view of the objectives of insolvency laws, the most important aspects of insolvency law to consider are the following:

- I. The eligibility and criteria for the opening of an insolvency proceeding.
- II. The general stay on the creditors' powers to assert and enforce their rights after the commencement of insolvency and reorganization proceedings.
- III. The rules with respect to the management of the insolvency proceedings.
- IV. The ranking of creditors.
- V. The rules on the process of filing and verification of creditors claims.

- VI. The responsibility for the proposal, verification, adoption, modification and contents of reorganization plans.
- VII. The scope of the insolvency estate.
- VIII. The rules on the annulment of transactions entered into prior to the opening of the insolvency proceeding (avoidance actions).
- IX. The termination of contracts and the rules as to the mandatory continuation of the performance of contracts.
- X. The liability of directors, shadow directors, shareholders, lenders and other parties involved with the debtor.
- XI. The provision of post-commencement finance.
- XII. The practitioner's qualifications and eligibility for the appointment as insolvency representative, different rules regarding licensing, regulation, supervision and professional ethics and conduct.
- XIII. The coordination of insolvency proceedings with respect to companies belonging to a group of companies.
- XIV. The need for an EU database of court orders and judgments.
- XV. The scope of the EC Regulation No 1346/2000.

Following the analysis of the country reports, it is possible to conclude that the current positions of these 15 aspects of insolvency laws in the EU are as follows:

- I. The laws of EU Member States have significantly different criteria for the opening of an insolvency proceeding.
- II. There are differences in the extent of the general stay on the creditors' powers to assert and enforce their rights after the commencement of insolvency and reorganization proceedings.
- III. The laws of EU Member States contain widely different rules with respect to the management of the insolvency proceedings.
- IV. In each EU Member State, there are different ranking of creditors reducing the predictability of the outcome for creditors.
- V. The rules on the process of the filing and verification of claims differ between EU Member States, increasing the inefficiency of proceedings for creditors.
- VI. The laws of EU Member States contain different rules on the responsibility for the proposal, verification, adoption, modification and contents of reorganization plan.
- VII. The rules on the scope of the insolvency estate in EU Member States and the rules on the disposal or sale of assets seem to be similar.

- VIII. The rules on the annulment of transactions entered into prior to the opening of insolvency proceedings (avoidance actions) vary as to the periods and the onus of proof during which such transactions can be liable for consideration for annulment, reducing the predictability of the proceedings.
- IX. The differing rules on the termination of contracts and on the mandatory continuation of performance under contracts reduce predictability and can result in forum shopping.
- X. The laws of EU Member States contain significantly different rules on the liability of directors, shadow directors, shareholders, lenders and other parties involved with the debtor, increasing forum shopping and reducing good corporate governance.
- XI. The laws of EU Member States do not contain adequate provision on the availability and modalities of post-commencement finance.
- XII. The laws of EU Member States have different rules on the qualifications and eligibility for the appointment, licensing, regulation, supervision and professional ethics and conduct of insolvency representatives.
- XIII. At present there are no rules on the coordination of insolvency proceedings with respect to different companies belonging to the same group of companies.
- XIV. Cost effective administration is hindered by the absence of an EU database containing relevant court orders and judgments.
- XV. The EC Regulation No 1346/2000 only applies within the territory of the EU (except for Denmark).

**(I) The laws of EU Member States have significantly different criteria for the opening of an insolvency proceeding**

Pursuant to Article 3 (1) of the EC Regulation No 1346/2000, the courts of the Member State within the territory of which the centre of a debtor's main interests ("COMI") is situated are granted the jurisdiction to open insolvency proceedings. Such proceedings are referred to as main proceedings. Pursuant to Article 3 (2) of the EC Regulation No 1346/2000 the courts of a Member State within the territory of which the debtor has an establishment can subsequently open secondary proceedings. Such proceedings are restricted to the assets of the debtor located in the Member State where the secondary proceedings have been opened (Article 3 (2)). There is a strong interdependence between the main and secondary proceedings: as a result of the opening of secondary proceedings the effects of the main proceedings in the Member State of the secondary proceedings are limited and the powers of the liquidator in the main proceedings are limited as well. EC Regulation No 1346/2000 contains rules on the coordination of main proceedings and secondary proceedings (Articles 31-35). The applicable law to main proceedings is the law of the Member State where these proceedings have been opened. However, if secondary proceedings are opened, the law applicable to those proceedings is the law of the Member State of the secondary proceedings. Pursuant to Article 27 of the same Regulation, the opening of the main proceedings referred to in Article 3 (1) by a court of a Member State shall permit the opening of secondary insolvency proceedings by a court in another Member State with jurisdiction pursuant to Article 3 (2), without the debtor's insolvency being examined in that other State. **In view of the increased mobility of companies and the interdependence between the main and the secondary**

**proceedings, there is a need to define the criteria to be applied for the opening of all insolvency proceedings, as it is further explained below.**

(i) The insolvency laws of the Member States apply different criteria for the opening of insolvency proceedings. Some EU Member States apply the **liquidity tests** (the ability to pay debts as and when they fall due) others the **balance sheet tests** (the surplus of assets over liabilities). Under Polish law, the balance sheet test only applies to certain categories of entities including companies and partnerships. Under Spanish and French laws, only the liquidity test applies. Under Italian law the liquidity test applies subject to some additional criteria: under Italian Law, an entity cannot be adjudicated bankrupt if all of the following three conditions are met: (1) the insolvent entity achieved a gross income, in the three years before the filing of the petition for bankruptcy, in a yearly amount not higher than €200,000; (2) the capital invested by the insolvent entity in the business in the three years before the filing of the petition of bankruptcy did not exceed €300,000; and (3) the total amount of debts of the insolvent entity was not higher than €500,000. Under Swedish law, the liquidity test applies but a creditor is not entitled to have a debtor declared bankrupt if: (1) the creditor has a satisfactory charge or collateral equivalent in value to the property belonging to the debtor; (2) a third party has presented satisfactory collateral for the creditor's claim and the bankruptcy petition conflicts with the conditions for the provision of the collateral; or (3) the creditor's claim is not due and payable and satisfactory collateral is offered by a third party. In German law, overindebtedness and imminent illiquidity can be a reason to file for bankruptcy.

Overall, the liquidity test seems to be the most commonly used test in the EU Member States and is in line with the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law. However, differences exist in defining how much indebtedness must be due for an insolvency or reorganization proceeding to be opened and in reconciling other entry criteria applied by Member States.

Because Member States apply different tests, in some cases companies will not be able to open main proceedings but they may open territorial proceedings, in other cases they may open main proceedings and may, by virtue of Article 27 of Regulation No 1346/2000, open subsequent territorial proceedings in Member States where they do not meet the domestic insolvency test.

(ii) Another problem surrounds the **creditor's ability to commence insolvency proceedings**. Extensive national case law exists as to whether indebtedness only applies to current debts or whether it also includes future debts. Often there are preconditions on the creditor's ability to commence insolvency proceedings or minimum levels of debt involved for the liquidity test to apply.

German and Spanish law provide explicitly that future debts are included. Under English law, a likelihood of insolvency is sufficient for a company to go into administration. Also under English law, a creditor must be owed at least £750 to petition for compulsory winding up proceedings to be commenced. Under Polish law, no minimum statutory threshold exists determining the amount for the liquidity test to apply. It is therefore assumed according to that law that the due date for payment of the second obligation that remains unpaid marks the time when the insolvency commences. Under Spanish law, a creditor is entitled to file for the debtor's insolvency on the basis of the insufficiency of attachable assets when enforcing its claims against the debtor or any one of the following facts: (a) a general default of debtor's payment obligations; (b) general seizure of the debtor's assets; (c) a sale of the debtor's assets at a loss or in a negligent manner; or, (d) the debtor's failure to pay its tax liabilities, social security obligations, or salary and other monetary employment obligations during the 3 month period preceding the filing for necessary insolvency.

(iii) There are **restrictions on the ability of particular entities and persons to invoke the bankruptcy laws**, which have severe consequences on the eventual relief that formal insolvency may be said to represent. Under Italian law, individuals and small entrepreneurs are not subject to the bankruptcy law. French reorganization proceedings only apply to traders, craftsmen, farmers and other natural persons running an independent professional activity, including independent professional persons with a statutory or regulated status or whose designation is protected, as well as to private law entities.

Under Polish law legal persons (e.g. cooperatives, limited liability companies, joint stock companies) and entities without a legal personality (e.g. partnerships regulated by the Polish Commercial Companies Code) carrying on a business activity may be subject to bankruptcy proceedings. Limited liability companies and joint stock companies that do not carry on a business activity and members of partnerships who are liable for the obligations of the partnership without limitation can be declared bankrupt. Bankruptcy may not be declared in respect of, *inter alia*, public health care institutions, individual farmers and academic institutions. Under Swedish law it is unclear whether branch offices of third country companies can be declared bankrupt or to what extent a foreign citizen can be declared bankrupt. Under Italian law, the mere presence of a branch office in Italy could be considered enough to open a bankruptcy proceeding.

(iv) Furthermore, there are **different requirements for the timescales within which the debtor is obliged to commence the bankruptcy**. Under Polish law, the debtor has two weeks after he becomes insolvent in which to file for bankruptcy. Under Spanish law, the debtor must file for insolvency within two months from the date he becomes aware or should have become aware of the insolvency situation. This two months obligation to file can be extended by a further three months if the debtor puts the competent court on notice that he has commenced negotiations towards an anticipated composition agreement. Under French law, the debtor must file for bankruptcy at the latest 45 days following its "cessation de paiements" – a term which is defined by law but which amounts to knowledge of insolvency.

(v) Another issue surrounds the requisite **capacity to commence proceedings against a debtor**. All EU Member States have systems whereby the eligible debtor, creditors and the state (Public Prosecutor) can apply to court to initiate insolvency proceedings against the debtor. In some Member States there are additional bodies that can apply for the insolvency proceedings with respect to the debtor.

Under Polish law certain supervisory authorities and authorities granting public aid in excess of €100,000 may file for bankruptcy. Under French law, it is important to note that in insolvency and restructuring proceedings the works council and the employee delegates may inform the President of the Court or the Public Prosecutor of any relevant factors demonstrating the state of cessation of payments of the debtor.

**In view of the increased mobility of companies and the interdependency between main and secondary proceedings it is desirable that the requirements relating to the opening of insolvency proceedings and the eligibility of the debtor are harmonized.**

Therefore, the following issues should be considered as being suitable candidates for harmonisation:

- Standardisation of the test to be applied for the opening of the insolvency proceeding;

- The entities that are eligible as debtor in insolvency proceedings;
- The entities that may file for bankruptcy; and
- The rules on mandatory filing for bankruptcy by the debtor.

**(II) There are differences in the extent of the general stay on the creditors' powers to assert and enforce their rights after the commencement of insolvency and reorganization proceedings**

Article 5 of EC Regulation No 1346/2000 provides that the opening of insolvency proceedings shall not affect the rights *in rem* of creditors or third parties relating to assets located in another State. According to Article 6 of EC Regulation No 1346/2000, the opening of insolvency proceedings shall not affect the right of creditors to set-off their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim. Pursuant to Article 7 of EC Regulation No 1346/2000, the opening of insolvency proceedings against the purchaser of an asset shall not affect the seller's rights based on a reservation of title where, at the time of the opening of the proceedings, the asset is situated within the territory of a Member State other than the State of the opening of proceedings.

(i) The analysis carried out on the basis of the country reports has found that in most of the EU Member States, there is a **general stay on creditors' rights** to assert and enforce not only any security existing at the time of the opening of the insolvency but also on all other legal proceedings against the insolvent estate. Pursuant to Article 33 of EC Regulation No 1346/2000, the court that opens secondary proceedings must stay the process of liquidation in whole or in part on receipt of a request from the office holder appointed in the main proceedings.

Such a general stay has the following double justification:

- to allow the office holder to treat all the creditors equally; and
- to facilitate the restructuring of the company by preventing the premature dismemberment of essential components of the business entity.

With regard to the latter, a restructuring is only possible presently if the Member State in which secondary proceedings are pending allows these proceedings to be closed without liquidation by "a rescue plan, composition or comparable measure" (see Article 34(1) of the EC Regulation No 1346/2000).

(ii) All Member States determine the appropriate classes of creditors whose claims are given priority or preferential status. However, **some minor but significant exceptions exist, which affect the concept of equal and rateable distribution among all creditors.** This is achieved by amending the status of some creditors' claims - making them effectively pre-preferential.

For example, under Spanish law, claims of an administrative and labour-related nature are not automatically suspended on the date of the declaration of the bankruptcy. Under Polish law, secured creditors with rights *in rem* may enforce their claims against encumbered assets in an arrangement bankruptcy (the claims are not covered by the arrangement proceedings to the extent they are covered by security) and initiate enforcement proceedings. In some EU Member States, the court has the power to lift the stay. Under Swedish law, upon the issuing

of a bankruptcy order, a landlord is entitled to terminate the debtor's lease. If commercial premises are involved and the bankruptcy administrator fails to assume liability for the tenant's obligations during the term of the relevant lease within one month from demand, the landlord may repossess the premises. Under German law, the security interest and ownership interest of creditors with rights to preferential treatment may only be realized after the Creditors' Report Meeting has been held. If after the Creditors' Report Meeting, the insolvency administrator decides to use the property for the insolvency estate, he must pay a rent/interest to those creditors with a security interest in the insolvency estate. In the UK, amounts becoming due under a lease during the period that an administrator is in beneficial occupation are expenses of the estate.

The law of the State of the opening of proceedings determines the conditions under which set-off may be invoked pursuant to Article 4(2) (d) of EC Regulation No 1346/2000. The right of set-off is generally admitted in liquidation and arrangement proceedings in most EU Member States. In certain jurisdictions as, for example, Belgium, the set-off of a claim is only allowed in case of insolvency if the claims concerned arise from the same legal cause. This rule may conflict with Article 4, paragraph 2 (d) of the EC Regulation No 1346/2000 which provides that the law of the Member State of the opening of proceedings shall determine the conditions under which set-offs may be invoked.

No further harmonisation is considered to be necessary with regard to the general stay period. While there are differences in the effect of the stay on creditors' rights, the most important inconsistencies result from different approaches to the rights of creditors holding rights *in rem* and are therefore a result of differences in secured transactions laws.

### **(III) The laws of EU Member States contain widely different rules with respect to the management of the insolvency proceedings**

(i) The management of the insolvency proceeding is either by a court, an insolvency office holder or the debtor.

Under Polish law, there exists a division of powers between the judge commissioner, the bankruptcy court, the receiver (bankruptcy administrator, court supervisor) and the management. Under German law, the power of an insolvency judge is limited. He appoints and supervises the insolvency administrator but he is not involved in the decisions regarding the reorganization or liquidation of the insolvency estate. Under Italian law, the Judge Delegate has a supervisory role and the business management is left to the receiver. Under English law, an administrator or a liquidator once appointed is an officer of the court and an agent of the company with the court being a resource to which the parties may refer disputes or requests for guidance but which has no role in the administration of the proceedings. A liquidation committee is appointed to assist and supervise the liquidator. In case of a UK Corporate Voluntary Arrangement (CVA) a supervisor is appointed and his task is to supervise the arrangement entered into between the debtor and its creditors. Following the making of a bankruptcy order against an individual debtor, an Official Receiver (a civil servant) is appointed. In a case where there are substantial assets, a private sector insolvency practitioner trustee in bankruptcy will generally be appointed. Both will act under the supervision of the court and with the approval of the creditors' committee. Under French law, the court must decide upon the opening of a reorganisation or liquidation proceeding after having heard the debtor, the works council and any other relevant person. The court appoints in its opening order a supervisory judge and one or several trustees/liquidators and for large companies an administrator.

(ii) Depending on the jurisdiction and the actual process chosen, **the management board** may continue to play a leading or limited role in the insolvency or restructuring proceeding. For example, under Spanish law, the receiver has the right to assist and participate in the board and shareholders' meetings of the debtor, although they are not entitled to vote. Under Polish law in liquidation proceedings, the management board is not dismissed, but its role is limited to representing the bankrupt in the course of the bankruptcy proceedings, supporting the bankruptcy receiver as regards information on the business and exercising corporate rights in related companies. However Polish law does not require the bankruptcy receiver to refer his/her decisions regarding the management of the bankrupt's business for consultation with the management board. Under Polish law in an arrangement bankruptcy, the management board supervised by a court supervisor may continue the business: however, the court may revoke the self-administration and appoint a bankruptcy administrator. Under German law, the management of a legal entity remains formally in place until the final liquidation of the legal entity. In addition, the management still represents the legal entity with regard to specific legal rights granted to the legal entity as debtor in the proceedings. Under English Law, whilst the administrator is in office he displaces the board of directors and is responsible solely for the management of the company.

(iii) **The shareholders' rights are not always acknowledged in an insolvency or restructuring proceeding** (see also point (IV) below). Under German law shareholders are generally treated as subordinated creditors and therefore have nearly no influence in the insolvency proceedings. As a consequence of the subordination of any loans they have made to the debtor, they are not even admitted as creditors to any creditors' assembly. In UK liquidation proceedings, the shareholders of the company have little, if any, control or say over or in respect of the actions of the administrator. It is the creditors acting in general meeting or by means of a duly elected committee who control the actions and functions of the administrator.

(iv) **Creditors are often divided into committees or classes or subclasses.** Under Italian law the committee of creditors, appointed by the judge, has a power of authorization and control over the receiver's activity. Under Italian law creditors may be divided into different classes or subclasses. Polish law provides for a creditors' council with a controlling right and a creditors' meeting. Under Polish law, creditors may be divided by the judge commissioner into classes of interests for the purpose of voting on an arrangement. Under French law, the creditors are grouped into two committees of creditors. Creditors who are not members of the committees of creditors are consulted. Controllers, often employees' representatives, are chosen among creditors requesting to be appointed. Bondholders will convene a general meeting of bondholders to decide on their approach to the plan.

It has been established during this research that there are such substantial and structural differences between the roles of the management of the insolvency proceedings in the different EU Member States and in the different proceedings under the general insolvency laws in those States that it is not advisable to attempt to harmonize these rules until there is greater harmony in the underlying proceedings.

#### **(IV) In each EU Member State, there are different rankings of creditors, thereby reducing the predictability of the outcome for creditors**

Whereas in the EU Member States the creditors that are permitted to participate in the proceedings are pretty much the same, they are ranked differently and this could lead to creditors embarking upon forum shopping for jurisdictions.

Among the most surprising differences there needs to be mentioned the fact that under Polish law, claims acquired after a declaration of bankruptcy by way of an assignment or endorsement are subject to special rules and can operate to alter the ranking of debts, which affects the value of the claim for debt trading. Under Italian law, tax and social security claims are sometimes only generally privileged up to 50% of the amount owed. Under Italian law claims of individuals and companies related to the debtor (e.g. group companies, shareholders with a relevant take (10% for unlisted companies) or directors (including shadow directors, liquidators, and other connected parties) are legally subordinated. Under German law, claims for the repayment of a shareholder loan that replaces equity or claims with equal status will also rank as claims in the fourth rank.

Under English law, a 'floating' charge is a very important form of security and is designed to cover all the assets of the company whilst allowing the company to trade in the normal course of business. In the case of a floating charge the realizations will go first to pay the costs of the proceedings, any preferential debts (which are minimal and do not include taxation), and then towards the debt secured by the floating charge. A proportion of the floating charge realizations (the "prescribed part") is diverted in favour of unsecured creditors and the floating charge-holder may not share in this in the event that there is a shortfall as regards their security.

In EU Member States there are significantly different rankings of creditors, in addition to differences in the rules on set-off, retention of title, on creditors with the right of rescission, on the roles of creditors who are connected parties and on administrative expenses such that, at this point, any attempt at harmonisation is destined to fail. It appears that these different rankings are at least partially based on public policy considerations of the different EU Member States.

However, it must be recognized that the differences between the EU Member States, such as in the priority of creditors' claims, liens, mortgage and other guarantees, prevent both the simplification of insolvency and restructuring proceedings and the equal treatment of creditors located in the EU. In addition, contrary to the goal of EC Regulation No 1346/2000, as set out in Recital 4 thereof, these differences will tend to encourage bankruptcy tourism and may also be an obstacle to a successful restructuring of the debtor's business or part thereof.

#### **(V) The rules on the process of filing and verification of claims differ between EU Member States, increasing the inefficiency of proceedings for creditors**

Very often the deadline for filing claims is defined in the bankruptcy judgment, which under Polish law, can be between 1 to 3 months from the moment of publication of the judgment. Under Italian law, the time is usually 30 days before the hearing of the verification of claims. Under French law, foreign creditors have 4 months in which to file their claims compared to French creditors who have significantly less. Under English law there is no statutory time limit fixed until the liquidator is in a position to declare a dividend. German law provides for a period of between 3 weeks and 3 months from the date on which the order commencing the insolvency proceeding is sent to creditors. Under Spanish law, creditors must submit their claims one month after the last placed advertisement of the declaration of insolvency of the debtor in the Spanish Official Gazette. The rules for the verification and filing of claims differ to an even greater extent among the EU Member States, which results in particular in causing a disadvantage to foreign creditors who are less likely to be aware of local requirements. This

may act to reduce suppliers' willingness to advance credit to customers in other EU jurisdictions.

Although Article 40 of EC Regulation No 1346/2000 provides that the court of the Member State that opened the insolvency proceeding or the liquidator appointed by it has a duty to inform immediately all known creditors who have their habitual residences, domiciles or registered office in other Member States, experience suggests that not all creditors are properly informed.

In order to reduce uncertainty and create equal treatment among the creditors in the different EU Member States, there is an urgent need to harmonize the rules with regard to the filing and verification of claims, i.e. the procedures, time limits, penalties and consequences for failure to comply, information to be provided to creditors etc.

In addition, a central data-base containing information regarding all EU insolvency proceedings, time limits for filing etc. should be organized at EU level, and made available to all creditors on the internet (See also Point (xiv) below). As a proviso, it is recognised that the processes for appeal of disputed claims is embedded in the different EU Member States national insolvency and restructuring proceedings and this would be more difficult to harmonize at this stage.

#### **(VI) The laws of the EU Member States contain different rules on the responsibility for proposal, verification, adoption, modification and contents of reorganization plans**

(i) The laws of EU Member States contain **different rules on who can propose a reorganization plan**. For example, under German law the plan can be proposed by the debtor or by the liquidator and, additionally, the creditors' meeting can instruct the liquidator to prepare a plan. Under Polish law the plan may be submitted by the debtor, the court supervisor, the liquidator or the creditor that submitted the initial arrangement proposals. Under French proceedings, only the debtor can draw up the plan. Under German and Polish laws, the creditors are or may be divided into classes and in principle each class has to accept the plan. Under the laws of some of the other Member States, no such division into groups takes place. Under the laws of some of the Member States, secured creditors can be bound by a plan, whereas under the laws of most Member States they cannot.

(ii) The laws of the Member States contain **different rules on the required majorities needed to have a plan accepted**. For example, under English law, the acceptance of a Scheme of Arrangement requires a 75% majority of all creditors whereas a Company Voluntary Arrangement requires a majority in number representing 75% in value of creditors' claims with the general proviso that the claims of connected parties are not included in satisfying the value criteria. Under Polish law a majority of the votes of the creditors representing two thirds of the value of the claims eligible to vote and under Swedish law a majority of 60% of the value of the debts is required. Under Polish law the creditors' meeting which votes on the plan can only be held if the amount of disputed claims does not exceed 15% of the overall value of the claims. The laws of the Member States contain different rules on the parties that can be bound by the plan such as shareholders, secured creditors, preferred creditors and ordinary creditors. In some jurisdictions the creditors are divided up into different classes, in others they are not. Furthermore, the possible contents of the plan differ. The laws of the Member States also contain different rules on the standards applied by

the courts when reviewing the plan and appeal possibilities. Under some laws the courts have wide discretionary powers, under other laws these powers are rather more limited.

**It is suggested that harmonisation measures must be installed in order not to distort the chances of success for companies to restructure their business effectively, regardless of the EU Member State that constitutes their registered seat and in order to reduce forum shopping by debtors. In addition, harmonisation of the rules on reorganisation plans will lead to greater transparency and will therefore result in a better grasp of all parties involved on the available means. Finally, diverging rules on plans constitute an obstacle to the adoption of coherent plans in both main proceedings and territorial proceedings with respect to the same legal entity.**

In conclusion, the following issues should be considered as being suitable candidates for harmonisation:

- The identification of the parties that can act as proponents of the plan;
- The nature and extent of the creditors that can be bound by the plan (ordinary, preferred, secured);
- The way in which shareholders can be affected by the plan (e.g. debt for equity swaps);
- The composition of classes of shareholders and creditors;
- The voting rules;
- The possible contents of the plan;
- The relevant test relating to the approval of the plan to be applied by the supervising court;
- The rules on the possibilities of appeal and the timeframe within which the plan becomes irrevocable; and
- The rules regarding the amendment and rescission of the plan.

#### **(VII) The rules on the scope of the insolvency estate in EU Member States and the rules on the disposal or sale of assets seem to be similar**

Pursuant to Article 4 (2) (b) of the EC Regulation No 1346/2000 the law of the State of the opening of the proceeding determines the assets which form part of the estate.

The rules on the scope of the insolvency estate in the different EU Member States seem to be quite similar as they all include the assets that belong to the debtor on the date of the opening of the insolvency/restructuring proceeding as well as those obtained in the course of the insolvency/restructuring proceeding. All countries provide a minimum level of protection in order to enable an individual debtor and his family to live. Under Polish law excluded from the bankrupt estate are the employee social funds well as assets connected with any sub-participation agreement and certain amounts deposited on a securities account.

The disposal or sale of the assets seems to take place either as part of a business or separately, by public auction or in a private transaction. Under Swedish law the sale of real property may take place through the Swedish Enforcement Authority if the liquidator finds this appropriate but it is also possible to sell it in some other way if the liquidator considers this to be more advantageous for the estate.

Since national rules on the scope of the insolvency estate and the rules on the disposal or sale of assets seem to be quite similar, it is considered that there is no urgent need for harmonisation on these points.

**(VIII) The rules on annulment of transactions entered into prior to the opening of insolvency proceedings (avoidance actions) vary as to the periods and the onus of proof during which such transactions can be liable for consideration for annulment, reducing the predictability of the proceedings**

(i) It follows from the case law of the Court of Justice of the European Union (CJEU) that pursuant to Article 3 (1) of the EC Regulation No 1346/2000 the courts, of the EU Member State within the territory of which insolvency proceedings have been opened, have **jurisdiction to decide to set a transaction aside by virtue of insolvency** that is brought against a person whose registered office is in another EU Member State.

The CJEU concluded this in the Case C-339/07 Frick Teppichboden Supermärkte GmbH v. / Deko Marty Belgium N.V. on 12 February 2009, upon a reference for a preliminary ruling from the Bundesgerichtshof of Germany<sup>8</sup>.

The reference was made in the course of proceedings between Mr. Seagon, in his capacity as liquidator in respect of the assets of Frick Teppichboden Supermärkte GmbH ('Frick'), and Deko Marty Belgium NV (Deko) concerning repayment by the latter of €50,000.

On March 14, 2002, Frick, which has its seat in Germany, transferred €50,000 to an account with the KBC bank in Düsseldorf in the name of Deko, a company with its registered seat in Belgium. Pursuant to an application made by Frick on March 15, 2002, the Amtsgericht Marburg (Local Court, Marburg) (Germany) opened insolvency proceedings on June 1, 2002 in respect of Frick's assets. By application to the Landgericht Marburg (Regional Court, Marburg), Mr Seagon, in his capacity as liquidator in respect to Frick's assets, requested that the court, by way of an action to set a transaction aside by virtue of the debtor's insolvency, ordered Deko to repay the money.

The CJEU followed the opinion given by Advocate General Ruiz-Jarabo Colomer and held that Article 3(1) of EC Regulation No 1346/2000 must be interpreted as meaning that the courts of the Member State, within the territory of which insolvency proceedings have been opened, have jurisdiction to decide an action to set a transaction aside, by virtue of insolvency, that is brought against a person whose registered office is in another Member State.

In addition, the CJEU concluded that "**concentrating all the actions directly related to the insolvency of an undertaking before the courts of a Member State with jurisdiction to**

<sup>8</sup> ECJ Case C-339/07 - Judgment of the Court (First Chamber) - (reference for a preliminary ruling from the Bundesgerichtshof (Germany)) - Christopher Seagon in his capacity as liquidator in respect of the assets of Frick Teppichboden Supermärkte GmbH v Deko Marty Belgium NV - February 12, 2009.

**open the insolvency proceedings”** is “consistent with the objective of improving the effectiveness and efficiency of insolvency proceedings having cross-border effects”.

In other words, the courts of the EU Member State, within the territory of which the insolvency proceedings have been opened, are also competent to entertain and adjudicate upon lawsuits entered into and instituted, which seek to revoke the debtor’s pre-insolvency detrimental transactions against any person living in another EU Member State who has received the benefit. Such lawsuits are deemed to be closely linked with the insolvency proceedings themselves.

(ii) Pursuant to Article 4 (2) (m) of the EC Regulation No 1346/2000 the law of the State of the opening proceedings shall indeed establish the substantial rules which determine the voidness, voidability or unenforceability of legal acts detrimental to all creditors.

An important exception to this rule is found in Article 13 of the EC Regulation No 1346/2000 dealing with **detrimental acts**, which provides that the law of the State of the opening of proceedings shall not apply to determine the rules relating to the ‘voidness’, voidability or unenforceability of legal acts detrimental to all creditors in the case where the person who benefited from an act detrimental to all the creditors provides proof that: (i) the said act is subject to the law of a Member State other than that of the State of the opening of proceedings, and (ii) that law does not allow any means of challenging that act in the relevant case. This provision of the applicability of the law of the contract is said to protect the confidence of the creditors that benefited from the avoided transaction (and is in line with recital 26 of EC Regulation No 1346/2000). It gives creditors the possibility to object that the avoidance action has also to be judged by the law that was applicable to the avoided legal transaction. However, the applicability of the law of the contract in these matters creates great uncertainty among the office holders, especially because these matters must be dealt with by the courts of the Member State within the territory of which insolvency proceedings have been opened under a foreign law. The office holders are generally in favour of abolishing the law of the contract on this point.

(iii) In the EU Member States, it has been noted that **different periods of claw back** exist depending on the type of detrimental acts performed. Under Polish law depending on the legal acts performed the bankruptcy claw back period runs from 1 year to only 2 or 6 months in specific cases. Under Italian law the claw back period runs from 6 months to 1 year, but certain exceptions to this claw back exist. Under German law, the insolvency administrator has the right to contest transactions to the detriment of the creditors over a period from 1 month, 3 months to 1, 4 or 10 years prior to the insolvency petition. Often a showing of bad faith by a third party is required in order for the transaction to be rescinded.

Under UK law, the transaction must have occurred when the debtor was insolvent and within 2 years of the insolvency in case of a transferee or preferred party who was connected with the debtor and within 6 months in the case of non-connected parties. Protection is given to transactions that a company entered into in good faith for legitimate reasons and for value. In the cases of a liquidation or an administration, a floating charge can be challenged within a period of 12 months of the commencement of the insolvency proceeding and within 2 years if the transaction is with a connected party. Any floating charge taken by a creditor within these time limits is therefore invalid except to the extent of the value of further monies advanced, or goods supplied in connection with the charge, subsequent to or at the same time of the granting of the charge. Under Swedish law there do not seem to be strict time limits. Spanish law on the other hand seems to provide a 2 year period whereas France has a 6 months period prior to the bankruptcy declaration during which certain acts can be declared null and void.

(iv) In the Member States a difference exists between who can bring actions on the annulment of a transaction prior to the insolvency proceeding. In Poland only the bankruptcy receiver, the administrator and the court supervisor can bring such an action. In France, the administrator, the liquidator, the plan performance supervisor or the Public Prosecutor may institute an action for nullity.

It is therefore suggested that consideration should be given to the following matters: (1) the abolition of any reference to the law of the contract with respect to the avoidance actions under Article 13 of the EC Regulation No 1346/2000; (2) a distinction must be made where a transaction is with a connected party; (3) the provision of a minimum period of, for example, 90 days for detrimental acts with unconnected parties and one year for connected parties; (4) a minimum list of actions which are subject to possible annulment of the transactions involved; (5) bad faith requirements with respect to the insolvent debtor and/or the other party; (6) the burden of proof with respect to detriment and bad faith and (7) the fact of such actions may only be brought by the office holder on behalf of the estate.

The time period referred to above is simply a suggestion. This minimum list of actions, which are subject to possible annulment of the transactions involved, could be as follows:

- All legal acts including the granting of security only entered into on the basis that the bankrupt has disposed of his or its assets gratuitously or where the value of the bankrupt's performance significantly exceeds the value of the consideration received;
- The repayment of or the establishment of a debt that is not yet due, including a shareholder loan, effected by the bankrupt (e.g. a loan made by the debtor as a shareholder to a company in which he holds shares) prior to the filing of the bankruptcy petition;
- Any deposit and consignment of funds made in contravention of a judicial decision having *res judicata* status; and
- All legal acts concluded with parties who are connected either by personal or corporate ties.

#### **(IX) The differing rules on termination of contracts and mandatory continuation of performance under contracts reduce predictability and can result in forum shopping**

The laws of EU Member States contain different rules on the treatment of contracts with reciprocal obligations. For example, under Spanish law the court may declare such contracts terminated upon the request of the liquidator or the debtor, and in certain cases the trustee may reinstate a finance agreement that was previously terminated. Under German law the liquidator may be asked by the other party to a contract to declare whether he will fulfil the reciprocal contract, failing which he may no longer request fulfilment from the other party. Under English law the liquidator may generally repudiate any contract. Under Polish law any contractual provision for an 'automatic' variation or termination of a contract upon bankruptcy is invalid. Following bankruptcy, the parties may in principle exercise their contractual and statutory termination rights based on other grounds (e.g. failure to perform obligations), but they must respect and give priority to the statutory effects of the bankruptcy. A similar rule

applies under French law. Under French law the other party may not terminate contracts during insolvency proceedings because of the non-performance by the debtor of its pre-insolvency obligations.

Under English law a liquidation or an administration cannot constitute an event of default by itself. Under German law tenancy agreements may always be terminated by the liquidator of the tenant, provided a statutory limitation period is observed. Under Swedish law, the landlord may demand the liquidator to surrender leased premises or provide security for the obligations of the tenant. If the landlord fails to do so the bankrupt estate becomes liable for the tenant's obligations.

Rules on employment agreements differ as well. For example, in Spain employment agreements continue to be in force, except for collective reorganization measures under the supervision of the labour courts. Under Swedish law the liquidator can terminate the employment agreement, but if he does not terminate the employment agreement within one month after the commencement of the bankruptcy, the bankruptcy estate becomes liable for the employee's rights under the agreement.

It is desirable that the rules on agreements are harmonized for the following reasons. First, if the rules on, for example, termination of employment agreements or the mandatory continuation of agreements differ too much, this may elicit "insolvency tourism" (forum shopping, see Recital 4 of the EC Regulation N° 1346/2000) by the attempted shift of the COMI (Centre of Main Interests) of the company or a race to the courts. Secondly, harmonisation of the rules on reorganization plans will lead to greater transparency and will therefore result in increased support by creditors for justifiable schemes. Thirdly, harmonisation will decrease the need for secondary proceedings aimed at seeking a local advantage for a few creditors rather than promoting restructuring and/or efficient distribution to all creditors. Fourthly, harmonisation of these rules will enhance a level playing field. With respect to the leases of real property, there is no compelling need to seek harmonisation, because these agreements are governed by Article 8 of the EC Regulation No 1346/2000. Although Article 10 of the EC Regulation No 1346/2000 contains a choice of law rule with respect to employment agreements, harmonisation of this part of the law is nevertheless desirable, because Article 10 does not extend to the powers of the liquidator under Article 18.

Harmonisation of the rules regarding reorganization plans should take place with respect to the consideration of the following issues:

- General rules on termination of contracts by insolvency office holders;
- General rules on termination of contracts by other parties;
- The assumption of reciprocal contracts;
- The mandatory continuation of contracts;
- The termination of employment agreements; and
- The impact on employment agreements of the transfer of the enterprise.

It is accepted that one or more of these areas (e.g. the final two in particular) may trespass on purely employment law issues.

**(X) The laws of EU Member States contain significantly different rules on the liability of directors, shadow directors, shareholders, lenders and other parties involved with the debtor, increasing forum shopping and reducing good corporate governance**

Most laws contain provisions on the liability not only of directors of a company, but also of *de facto* or shadow directors, that is those in accordance with whose direction the directors are accustomed to act. However, the extent of the liability and the persons who may bring claims against these parties differ from jurisdiction to jurisdiction.

Under English law, only a director (albeit in the expanded sense set out above) may be liable for wrongful trading (i.e. if the directors continued the company's trading and knew or should have known at the time that there was no reasonable prospect that the company would avoid going into liquidation) but both directors and outsiders may be liable for fraudulent trading (trading with the purpose to defraud the company or its creditors).

On the other hand, under Italian law liability for the acts or omissions of directors does not extend to a director who, being without fault, had expressed dissent in the resolutions of the board of directors and has immediately given written notice of this dissent to the chairman of the board of directors. Under the laws of some Member States directors may be liable if they have failed to file in a timely manner for bankruptcy whereas other Member States do not have such provisions. Under Swedish law shareholders may under certain circumstances be liable for the continuation of the business of a company if it has lost more than half of its share capital. The laws of the Member States contain a wide variety of provisions on liability related to such issues as transfers at undervalue, the preparation and adoption of incorrect accounts, the failure to make necessary provisions for the payment of taxes or disguising financial distress. They also contain different rules as to the disqualification of directors. There exist no general rules as to when a director is civilly and criminally liable in the matters mentioned above. The enforcement in practice and the sanctions also differ among the different EU Member States.

It is desirable that the rules on liability are harmonized. First, if the rules on liability of the parties involved differ too much, this may elicit "insolvency tourism" (forum shopping) by the attempted shift of the COMI of the company or a race to the courts. Secondly, harmonisation of these rules will enhance a level playing field.

It is therefore suggested that harmonisation of the rules on liability should take place with respect to the following issues:

- Who can bring claims?
- Who can be liable; and
- Which are the instances in which parties can be liable?
- For what amounts and penalties may they be held liable?

It is again accepted that these issues interconnect with separate domestic law issues, e.g. relating to general duties of care and civil responsibility.

**(XI) The laws of EU Member States do not contain similar provisions on the availability and modalities of post– commencement finance**

Under Polish and German law taking loans or credit facilities, as well as encumbering the bankrupt's assets with rights *in rem* must be approved by the creditors' council or the judge commissioner. In liquidation bankruptcy, claims arising from post commencement financing are to be satisfied in first category.

Under English law provision is usually made at the outset for financing administrations either by way of direct loans from institutional creditors or by having recourse to funds that the company is expected to recover during the administration period. To cope with any lacunae, there are various devices used to swell the funds of an insolvent company or to enable proceedings to be brought against third parties; an administrator or liquidator may transfer the property in relation to which a cause of action is connected and assign the cause of actions, e.g. as a right to litigate, or he can assign the damages or the benefits.

Office holders in Italy, Germany, Spain and France seem to consider post –commencement financing less of a problem because it is considered an administrative expense of the bankruptcy and satisfied in first instance with the approval of the court.

The rules on post-commencement finance seem to depend very much on the extent to which insolvency proceedings can be used for reorganisation purposes and for continuation of the business. In this sense insolvency proceedings in the different Member States are structured quite differently and harmonisation thereof seems to be difficult to achieve. In the absence thereof there is no need for harmonisation of rules on post-commencement finance.

It appears that there is no need for additional harmonisation on this point.

**(XII) The laws of EU Member States have different rules on the qualifications and eligibility for the appointment, licensing, regulation, supervision and professional ethics and conduct of insolvency representatives**

These systems have been described at length in the different country reports. We attach a summary under Annex II of this report. Notwithstanding the different remuneration systems of the office holders, the use of different systems in the EU Member States has not caused any difficulties in practice. The fact that certain functions are reserved to lawyers admitted to the local court, of course, has put a practical restriction on the free provision of services in the EU.

Because of the substantial differences between EU Member States, there is no merit in seeking to harmonise these issues until a further harmonisation of substantive insolvency law and company law has been achieved.

**(XIII) At present there are no rules on the coordination of insolvency proceedings with respect to different companies belonging to the same group of companies**

EC Regulation No 1346/2000 applies only to single companies and the absence of provisions on groups can cause severe problems. In particular, this is the case if the assets of a corporate enterprise are spread over several legal entities or if the businesses of separate legal entities are somehow interlinked. In some instances, courts have tried to resolve this problem by deeming the COMI of all these companies to be situated at the same place, thus enabling joint administration. However, in the absence of a harmonized insolvency law, this is restricted to cases where the COMI of the individual companies is in the same jurisdiction and there are many instances where this is not the case. The main issue that has to be resolved with respect to these group cases is the issue of coordination. The Working Group of UNCITRAL has made a number of recommendations within the last year that will assist in developing practical coordination while protecting the rights of creditors of individual companies. There is a view that the obligation under Article 31 (1) of EC Regulation No 1346/2000 to communicate information should also apply to the relationship between the insolvency proceedings of the parent company and those of any insolvent subsidiary and the same should apply with respect to the obligation to cooperate set out in Article 31(2).

A more contentious issue concerns the obligation under paragraph (3) of this Article to provide an opportunity to submit proposals on the liquidation or the use of assets of the subsidiary by the liquidator in the main proceedings of the ultimate parent company. The liquidator in the ultimate parent's main proceedings should also arguably have a right to request the court that opened the subsidiary's proceedings to:

- stay the process of liquidation in whole or in part, or
- stay the process of reorganization in whole or in part, in the interests of the group as a whole (compare Article 33) subject to appropriate protection of the creditors instead.

Furthermore, the liquidator of the ultimate parent's main proceedings should have a right to:

- propose a plan with respect to a subsidiary and;
- request the court in the subsidiary's main proceedings to suspend any right to propose a plan with respect to that subsidiary on the same basis.

Furthermore, the regulation on group insolvencies should also provide for the possibility of procedural or substantive consolidation in cases where, because of fraud or other exceptional reason, it is not possible to disentangle the assets of the separate estates sufficiently.

It is therefore desirable that rules are adopted at EU level, which further the coordination and efficient administration of international group insolvencies.

**(XIV) Cost effective administration is hindered by the absence of an EU database containing relevant court orders and judgments**

As the publication of bankruptcy judgments is done locally in EU Member States, in the local language, strict deadlines exist for the filing of the claim with the risk of having to incur additional costs when filing a claim or losing out on the distribution. A central database containing relevant court orders and judgments is therefore necessary. This database fits into

the action plan of the EU on the e-Justice portal carried out in the Council Working Party on Legal Data Processing (e-Justice).

This work has been under way in the EU since 2006 and includes, in particular, the creation of a European e-Justice portal on the Internet. The aim is to improve citizens' access to the judicial systems in Europe and to rationalize and simplify legal procedures. The first version of the E-justice portal was inaugurated on December 15-16, 2009 in Stockholm. The portal will contain information, among other things, on the rights of the victims of crime and of suspects, national legal procedures and videoconference facilities. In the long term, it is also intended to develop exchanges of information between EU Member States so that it will be possible to carry out procedural action, such as, for example, European orders to pay, electronically through the portal.

After its inauguration, materials and information relating to other aspects of the laws will be gradually added to the portal. Anticipated users of the portal include both private individuals, for example entrepreneurs and victims of crime, and also practising lawyers. The e-Justice portal is to be a 'one stop shop' where the user can directly access information in his/her own language and be referred to information available elsewhere.

It is suggested that national insolvency judgments and relevant orders could be made available on the E-Justice portal to widespread advantage within the EU.

#### **(XV) The EC Regulation N° 1346/2000 only applies within the territory of the EU (except for Denmark)**

Regarding international insolvency issues between a Member State and non-Member States, different rules apply. Poland has implemented the UNCITRAL Model Law on Cross-Border Insolvency of 1997<sup>9</sup>. The recognition of a foreign law is not automatic in Poland and requires separate recognition proceedings. Also Romania enacted the UNCITRAL Model Law, whilst Spain adopted a system, which partly has been inspired by the same Model Law. In Italy and France however, if no multi or bilateral treaty exists with the third country, an exequatur is required.

In France, exorbitant rules pursuant to the French Civil Code Articles 14 and 15 have permitted the courts to find jurisdiction in insolvency matters in cases with a very limited French element. In Germany, in cases where the EC Insolvency Regulation does not apply, the rules in the Insolvency Code Sec. 335 et seq. based on the EC Insolvency Regulation's body of rules concerning applicable law will apply by way of analogy. A similar situation seems to exist in Sweden.

The UK system seems to be the most flexible and there are three sets of rules that apply to non-EU insolvencies: (i) Section 426 of the Insolvency Act 1986 provides a statutory means by which the English courts recognize and act in aid of insolvency procedures commenced in certain designated Commonwealth or related countries. Court orders may be enforceable throughout the UK even if they originate in another part of the UK; the English court has a discretion to "assist" the "relevant" countries and can apply English or relevant foreign law as

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9 UNCITRAL Model Law: [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html)

appropriate. These relevant countries mainly are the countries of the Commonwealth; (ii) the Cross Border Insolvency Regulations 2006, based on the UNCITRAL Model Law on Cross Border Insolvency, provide a regime for assisting a foreign insolvency representative and for cooperation between a British court and a foreign court; and (iii) In cases where (i) and (ii) do not apply, English common law may recognize a properly authorized and constituted foreign insolvency where proper jurisdictional links are shown to exist between the insolvency and the State where the insolvency is taking place. However, in this last instance the English court will only assist by applying English law and not the foreign law of the insolvency proceeding.

In most jurisdictions, foreign insolvency judgments deemed to be contrary to international public policy rules will not be enforced.

Disparities between the national systems do not create an obstacle in practice to cross border co-operation or a competitive advantage or disadvantage among the EU Member States. In addition, at this point in time there does not seem to be the political will among the EU Member States to adopt a harmonized system for dealing with bankruptcy judgments from third countries. While EC Regulation No 1346/2000 does not apply to Denmark, it would be advantageous if the Regulation applied to cross border insolvencies regarding companies or other debtors located in Denmark.

## **2. Is the harmonisation of substantive insolvency law at EU level worthwhile, necessary and attainable?**

Up to now insolvency proceedings are to a large extent only effective in the EU Member State where they are initiated and mainly apply to those assets that are located within that jurisdiction. Procedural and substantive differences between the national insolvency laws of the EU Member States still exist.

Leaving timing aside, eventual harmonisation of substantive insolvency laws will be worthwhile for the following reasons:

- (i) The present system of different national insolvency regimes may imply that the laws of one Member State could be more beneficial for one stakeholder and the laws of another Member State could be more beneficial for another stakeholder. In addition, it avoids global solutions for global problems such as occur with the insolvency of groups of companies. This may lead to either the management indulging in what is termed 'insolvency tourism' (forum shopping) by the attempted shift of the COMI of a company to a jurisdiction that is more "debtor friendly" or the debtor and the creditors possibly becoming involved in a race to the courts in different jurisdictions.
- (ii) Harmonisation of national insolvency regimes will inevitably lead to greater confidence in the insolvency systems of EU Member States; this increases transparency and therefore leads to a better understanding by the parties involved on the means and methods that are available to address the needs of commercial entities that get into financial difficulty and of the remedies available to the creditors and other stakeholders of those entities;
- (iii) Harmonisation of insolvency regimes will further promote a level playing field; and

- (iv) Harmonisation of the insolvency processes across the Member States of the EU will increase the efficiency of the insolvency and business reorganization processes in the EU and as a consequence, increase the return to creditors where it is decided to liquidate the assets or the prospects of reorganisation by getting a greater number of creditors to support plans for restructuring. These in total will increase the confidence that the commercial and financial sectors have in the efficiency of the financial infrastructure of the EU.

## **2.1. With respect to some insolvency issues the need for harmonisation is greater than for other issues**

There is a need for a balanced and thoughtful approach to harmonisation, which may modify or condition attempts at a wholesale harmonisation of all aspects of insolvency and restructuring law. By its very nature, insolvency law interfaces with many other laws and systems such as land, employment and contract laws and the court systems of each country. Until these are all harmonised, it will not be possible to harmonise all aspects of insolvency law. For example, because of the widely differing structures and roles that the courts play in insolvency proceedings, it will not be possible to harmonise the court's supervision of office holders.

Therefore, at present, there are serious reservations as to whether full harmonisation would be attainable, even if it were deemed possible. However, striving for harmonisation of certain aspects of insolvency law would seem to be very worthwhile. The most appropriate issues for harmonisation would include:

- (i) The roles, responsibilities and procedures for the proposal, verification, adoption, modification and contents of reorganisation plans (see paragraph 1 (VI));
- (ii) Avoidance actions including the provisions relating to connected parties (see paragraph 1 (VIII));
- (iii) Rules on the variation and termination of contracts, in particular labour contracts. Different rules produce market distortion (see paragraph 1 (IX));
- (iv) Rules on the coordination and effective organisation of insolvency proceedings with respect to different economic entities belonging to the same economic group, international holding structures and the organization of financial groups according to business line (see paragraph 1 (XIII));
- (v) In addition, there is no general harmonized provision on the rules governing the effect of lawsuits on insolvency proceedings or lawsuits that are directly or indirectly connected with insolvency proceedings. Article 15 of EC Regulation No 1346/2000 provides that the effects of insolvency proceedings on a lawsuit pending concerning an asset or a right of which the debtor has been divested shall be governed solely by the law of the Member State in which that lawsuit is pending. This will probably also be reviewed on the reform of the EC Regulation No 1346/2000 by 2012;
- (vi) The EU should consider embracing the concepts of the UNCITRAL Model Law on Cross Border Insolvency in its entirety, as it is not in conflict with any existing EU regulation.

As regards the legal basis for any regulatory intervention on the part of the EU depending on the measures suggested in this note, where these relate to the freedom of establishment these should be based on Article 50 (former Article 44 TEC) of the Treaty on the Functioning of the European Union and where these relate to the judicial cooperation in civil matters having

cross– border implications these should be based on Article 81 (former Article 65 TEC) of the Treaty on the Functioning of the European Union.

## **2.2. The harmonisation of the insolvency law could be particularly beneficial for the 'Community' companies**

The importance of the harmonisation of the insolvency and company laws in the different EU Member States has been acknowledged, among others, when having to address the insolvency or restructuring of a SE or a SCE.

Under the relevant Regulations<sup>10</sup>, national law of the registered seat of a SE or SCE is subsidiary law (Article 3 of the EC Regulation No 2157/2001 and Article 8 (1) (c) of the EC Regulation No 1435/2003). This subsidiary law includes rules regarding directors' liability, creditors' protection and the opening of a liquidation proceeding.

In so far as the national laws of the EU Member States, dealing with company and insolvency law matters, are not harmonized the European legislation regarding the 'Community' companies partially misses its goals.

Article 8 (15) of Council Regulation (EC) No 2157/2001 on the Statute for a European company (SE) provides that an SE can no longer transfer its registered office if proceedings for winding up, liquidation, insolvency or suspension of payments or other similar proceedings have been brought against it.

**Therefore, it is important for the purpose of legal certainty and predictability that there is a developed insolvency system in order that, for example, the criteria for opening such proceedings are harmonized in the different EU Member States.**

In the *Cartesio* case (C– 210/06)<sup>11</sup> the CJEU decided that as Community law now stands, Articles 43 and 48 TEC are to be interpreted as not precluding legislation of Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of a Member State of incorporation. The question which arises from this case is whether under Community law, EU Member States enjoy an absolute freedom to determine the life and death of companies constituted under their own domestic law irrespective of the right of freedom of establishment.

The reference was made in the context of proceedings brought by *Cartesio*, a limited partnership established in Baja (Hungary), against a decision rejecting its application for registration in the commercial register of the transfer of its company seat to Italy, while maintaining its status as a company governed by Hungarian law. Under the Hungarian Law on the commercial register, the seat of a company governed by Hungarian law is the place where its central administration is situated. The referring court states that the application filed by *Cartesio* for amendment of the entry in the commercial register regarding the company seat was rejected by the court responsible for maintaining the register on the ground that, under Hungarian law, a company incorporated in Hungary may not transfer its seat, as defined by the Hungarian Law on the commercial register, abroad while continuing to be subject to

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<sup>10</sup> See footnotes 6 and 7.

<sup>11</sup> See footnote 3.

Hungarian law as the law governing its articles of association. Such a transfer would require, first that the company cease to exist and, then, that the company reincorporate itself in compliance with the Law of the country where it wishes to establish its new seat.

In line with Advocate General Maduro's opinion in this case, in principle, the right of freedom of establishment precluded the operation of national rules that otherwise sought to make it impossible for a company constituted under national law to transfer its operational headquarters to another EU Member State.

Whereas in principle, an SE or a SCE are legal entities which are partially regulated by EU law and partially by the national law of the EU Member States, there is a need for harmonisation of company law in order to avoid: (i) national legislation preventing a company from transferring its operational headquarters from one EU Member State to another (where the company wishes to retain its registration in the first State) and (ii) restricting the right of establishment and or the right of liquidation.

### 3. An evaluation on how the harmonisation of insolvency law could facilitate further harmonisation of company law within the EU

It is notable that insolvency law has, to a great extent, been abstracted from the rules of company law as they apply to an insolvent company-debtor. Harmonisation of insolvency law, however, may have some effect on the further harmonisation of company law, in particular if the harmonisation includes:

- (i) **Rules on capital adequacy for the protection of creditor;**
  - (ii) **A clear definition of the corporate interest of the individual company versus the group interest;**
  - (iii) **The "collective" liability of directors and shadow directors;**
  - (iv) **A clear understanding of the liability/or rights of the shareholders** in the event a company goes into a restructuring or insolvency situation; and
  - (v) **Rules on the lifting of the corporate veil**, (which generally addresses the right to ignore the formal corporate structure of a company and attribute liability to the individuals who own or control the company normally only when some fraudulent or similar activity has been perpetrated).
- (i) The **capital maintenance regime** under the Second Company Law Directive<sup>12</sup> requires the approval of the shareholders' general meeting for any reduction in the subscribed capital, and confers pre-emption rights on existing shareholders. The Second Company Law Directive does however **not provide a special provision for the situation where a company enters into insolvency**. The Third Company Law Directive<sup>13</sup> and the Sixth Company Law Directive<sup>14</sup> and Cross Border Mergers Directive<sup>15</sup> do **not**

12 Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with the view of making such safeguards equivalent, OJL 26, 31.1.1977, p.1.

13 Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liabilities companies, OJL 378, 31.12.1982, p.47.

14 Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54(3)(g) of the Treaty concerning the division of public limited liability companies, OJL, 378, 31 12.1982, p. 47–54.

**contain specific rules in a case where a company runs into financial difficulties.** This gap may need to be narrowed or closed when amending these directives in the future.

- (ii) The **corporate interest** of a company can be defined as being the interest, financial, economic or otherwise, which a company has in taking a particular action or entering into a specific transaction. The territorial nature and the substantive differences between separate sets of company laws have in the past represented a stumbling block for asset transfers between companies within a group, in order to solve the liquidity problem of one company within the group, even if this transfer could have been in the corporate interest of the whole group. In addition, within a group of companies cash pooling arrangements are very often in place to provide cheap financing for the whole group. This leads to a discussion concerning the corporate interest of the individual company and the corporate interest of the group at the time of restructuring. The directors of the individual legal entity must justify the fact that the entry into a transaction is in the "corporate interest" of the company in order not to engage their directors' own liabilities

More generally, corporate interest represents the boundary of acceptable corporate behaviour and constitutes an ideal representation and reflection of the management of the collective interests involved.

As a general rule, the existence, and equally the absence of, corporate interest has to be verified on a case by case basis, taking into account the whole structure of which the transactions are part. In our view, it is not relevant whether one or more separate transactions are, individually, contrary to the interests of the company involved, as long as any such disadvantage is compensated by other benefits, of whatsoever nature, that derive from such structure.

In a group context, the interests of the companies within the group taken individually are not entirely eliminated. Although the existence of a corporate interest in the transaction on a group level is important, the mere existence of such a group interest does not compensate for a lack of corporate interest for one or more companies of the group taken individually.

According to French case law as in *Rozenblum and others*<sup>16</sup> which is to a certain extent followed in countries as Belgium and Luxembourg, the following conditions must be met for a particular transaction beneficial to the group not to be considered as a misuse of the corporate interest of the individual entities of the group involved:

- the transaction must be dictated by a common economical, social or financial interest, evaluated with regard to a policy elaborated for the entire group;
- the transaction must not be effected without consideration;
- the transaction must not jeopardize the balance of the respective obligations of the various companies involved;
- the obligations arising out of the transaction must not exceed the financial capabilities of the company concerned; and

15 Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies, OJ L 310, 25.11.2005, p. 1.

16 French *Cour de Cassation*, 4 February 1985, *Rozenblum et autres*, JCP, 1986, II., 20585, and French *Cour de Cassation*, 1 February 2000, *Dr. Sociétés*, 2000, n° 50, p.12.

- the various companies involved must have the same shareholders, the latter being understood as reflecting the fact that the companies must be part of a fully integrated, interlinked group.

It would be advisable to have **the concept of the corporate interest of the individual company versus the group company clearly defined and company law rules harmonized on this point** and applied in all EU Member States **in order to provide legal certainty** to restructuring specialists and company directors when having to decide whether certain transactions are within the corporate interest and in order to limit the liability of those persons involved.

- (iii) Different EU Member States provide different rules regarding the circumstances in which **directors or shadow directors can be held liable** for an infringement of the provisions of the Member State's Companies Code and the articles of association in addition to insolvency laws as for example mentioned under paragraph 1 (X) above. In addition, in certain circumstances directors of a company can be held liable for unfit business decisions. An unfit business decision exists when the director ignores the company interest, which can generally be seen as the interest of all the actual and even future shareholders. A broader interpretation (and possibly one which is too far-reaching) is one which includes even the interests of employees, suppliers, creditors, customers and the region where the company has its main activities. When determining if there is an unfit business decision, the court will most probably not embark on too detailed an examination but will bear in mind all the information, which the director, who has to act as a prudent and reasonable man, had at the moment of the decision. The continuation of a commercial activity that is unmistakably running by way of a deficit can be an example of a mistake committed with regard to management and therefore such as to incur a directors' liability under national company law provisions.

**A harmonized set of rules would avoid insolvency tourism by the directors of a company, especially in the context of a group of companies.** This point is a clear example of where the harmonisation of the national insolvency laws may not differ from the national company laws.

- (iv) **The obligation borne by the shareholders to pay up any outstanding minimum share capital** in case a company goes into insolvency or restructuring must be harmonized in order to avoid different treatment of the shareholders in the different EU Member States. It seems to be the **case in most of the EU Member States**.

With respect to **shareholders' rights**, Article 1, Protocol 1 of the European Convention on Human Rights (ECHR) provides: "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for and by law and by the general principles of international law." The Article acts as a guarantee of the peaceful enjoyment of possessions, including shares. Shareholders have a right not to be deprived of their shares, or suffer a diminution of their value, unless the interference is justified in the public interest and in accordance with the conditions provided in law, and in accordance with international law. Furthermore, Articles 6 and 13 ECHR provide for the shareholders' right to due process and to a legal remedy against unlawful interference with their rights<sup>17</sup>.

<sup>17</sup> Commission staff working document accompanying the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the European Court of Justice and the

Insolvency laws include the principle of equal treatment of creditors who enjoy the same ranking. In the different EU Member States, creditors are involved in various ways in the insolvency and restructuring proceedings and their consent is usually required for any decisions, which may affect their rights and entitlements, such as the sale of assets, the continuation of the business, and the consideration and approval of a reorganisation plan. The shareholders as such are not part of this insolvency or restructuring process unless they are also creditors of the company by way of shareholder loan or convertible bonds. As from the moment the company goes into an insolvency or restructuring proceeding the rights of the shareholders are drastically reduced as in most cases the shareholders are deprived of their right to call a general meeting and to draft the agenda as well as the right to take certain decisions which would normally be reserved for the general meeting.

The question, which arises is whether the existing insolvency and restructuring proceedings sufficiently take into account the shareholders' rights and whether one should not review the company rules in case a legal entity goes into insolvency or restructuring. A restriction of shareholders' rights should only be justified by an overriding public interest and made subject to appropriate safeguards to ensure the interests of shareholders are given proper weight. To date this has never been considered a fundamental problem in a formal insolvency proceeding mainly because the **office holder takes over the power of the corporate bodies of the company in the interest of the company and all the stakeholders concerned.**

**The laws on the subordination of loans of shareholders interrelate with purely financial issues and are strictly outside the context of this document.** The laws of the Member States within the European Union differ as to the way in which such arrangements are regarded. For example, in English law there is a serious question as to whether or not the so called *pari passu* rule is infringed or some other similar principle is infringed by allowing subordination agreements of various sorts to take priority over the strict rights of unsecured creditors or similar ranked creditors in a formal insolvency. In other countries, subordination is only enforceable against third parties if it is registered in a public register. Also this topic deserves to be considered in a more general civil and commercial law context.

- (v) The rules regarding the **lifting of the corporate veil** are difficult and complex and differ substantially from one country to the other. In many jurisdictions an allegation of fraud is almost to be requisite whereas in other jurisdictions nothing so substantial is required. Again, this is an area **that goes beyond the realm of pure insolvency law and will have to be considered in a more general civil and company law context.**

### **3.1. The harmonisation of insolvency and company law will also be greatly beneficial for SMEs**

Similar problems as mentioned above have also been acknowledged for small and medium-sized enterprises (SMEs). Several policies have been introduced to reduce the costs of bureaucracy for entrepreneurs; to help with regard to the educating of entrepreneurship; to ensure fair competition and to support research and development; and to assist SMEs to go

international. These policies do not currently find expression in a harmonised or uniform instrument (e.g. a directive) aiming at getting things right when business is in financial trouble, including an efficient and supervised exit from the market when necessary or an effective method of company rehabilitation. Such an instrument would contain matters of company law (e.g. liability of directors; protection of minority shareholders) and insolvency law. Such an instrument, it is believed, would complete the EU's policies related to SMEs.

#### 4. Conclusions

EC Regulation No 1346/2000 constitutes an important step forward on the path of achieving the proper recognition and coordination of insolvency proceedings. However, the increased mobility of companies and the interdependency of main and secondary proceedings under EC Regulation No 1346/2000 create a need for at least partial harmonisation of the insolvency laws of the Member States.

Topics that are apt for such harmonisation and for which harmonisation is also important are the following:

- **the rules on the opening of insolvency proceedings including the eligibility of the debtor;**
- **the rules on the filing and verification of claims;**
- **the rules on the responsibility for the proposal, verification, adoption, modification and contents of reorganization plans;**
- **the rules on the voidness, voidability and unenforceability of detrimental acts;**
- **the rules on the termination of contracts and rules on the mandatory performance under contracts; and**
- **the rules on the liabilities of directors, shadow directors, shareholders, lenders and other parties involved with the debtor.**

Furthermore, **rules on the insolvency of groups of companies should be developed.** Finally, it is desirable that a **central database** containing relevant court orders and judgements is made available.

## ANNEX I

### QUESTIONNAIRE SENT TO NATIONAL REPRESENTATIVES OF INSOL EUROPE

Members of INSOL EUROPE were asked to report the following information:

- (i) A brief outline of entry criteria (balance sheet test, liquidity test ), entities that are eligible as a debtor and entities that can institute the insolvency proceedings, goal of the proceedings;
- (ii) Rules on the effect of the commencement of proceedings on the suspension of creditor's powers to assert and enforce their rights such creditors to include secured creditors, tax authorities and creditors with retention of title together with possible issues regarding the temporary suspension of rights;
- (iii) Rules on the management of the insolvency proceedings, in particular the division of powers over the liquidator, the management and the court; the question to what extent the management is divested of its powers, the degree of supervision by the court or by a delegated judge, the powers of the creditors with respect to the administration (Can they appoint the liquidator? ; Which decisions require them being heard or their consent ? etc.), the possible influence of the shareholders and the degree of transparency and accountability of the management of the insolvency administration;
- (iv) Rules on the ranking of creditors (including rules on the ranking and the scope of administrative expenses and on the ranking of claims by connected parties such as shareholders), the special powers of secured creditors, special rules on set-off, retention of title, right of rescission;
- (v) Rules on the process of filing and verification of claims (including the issue as to whether there is a bar date and whether claims can be disputed by other creditors or by the debtor);
- (vi) Rules on the responsibility for the proposal of a reorganization plan and the adoption, modification and possible contents of such plan both inside and outside formal insolvency proceedings;
- (vii) Rules on the scope of the insolvency estate (e.g. Does it include assets obtained by the debtor after opening of the proceedings ?) and the rules on the disposal or sale of the assets included in the estate;
- (viii) Rules on detrimental acts (as referred to in Article 13 Insolvency Regulation);
- (ix) Insolvency rules on the termination of contracts and mandatory continuation of performance under contracts;
- (x) Rules on the liability of directors, shadow directors, shareholders, lenders and other parties involved with the debtor;
- (xi) Rules on the availability and modalities of post-commencement finance;
- (xii) Rules on practitioners' qualifications and their eligibility for appointment as liquidator, on supervision and professional ethics and on remuneration;
- (xiii) If there are any rules on insolvencies of groups, we are interested in those as well; and
- (xiv) Rules with respect to insolvency proceedings outside the European Union.

## **ANNEX II:**

# **SUMMARY OF THE RULES ON PRACTITIONER'S QUALIFICATION, ELIGIBILITY FOR THE APPOINTMENT AS LIQUIDATOR, ON SUPERVISION AND PROFESSIONAL ETHICS AND ON REMUNERATION**

	France	Germany	Italy	Poland	Spain	Sweden	U.K
<b>Rules – who may be appointed</b>	<p>The administrators and trustees are both regulated professions. The administrator represents the debtor, administers his property and performs auxiliary or supervisory functions in regard to the management of such property whereas the trustee represents the creditors and liquidates businesses. The two professions are incompatible with one another and with all other professions in order to avoid conflict of interests, with the sole exception that a legal administrator can also be a lawyer.</p> <p>The administrators and trustees are appointed by the commercial court or High Court where insolvency proceedings take place.</p>	<p>There is currently a discussion whether the creditors should be allowed to appoint an insolvency administrator.</p> <p>The remuneration is set out in the insolvency administrator's remuneration code.</p>	<p>After the adjudication of bankruptcy, the judge appoints a receiver who will be a lawyer, a certified accountant or a law firm.</p>	<p>The Bankruptcy Law provides for three kinds of office holders that may be appointed by the court: (i) the bankruptcy receiver (liquidation bankruptcy), (ii) the bankruptcy administrator (arrangement bankruptcy with no self-administration) and (iii) the court supervisor (arrangement bankruptcy with self-administration).</p> <p>The following may be appointed as a bankruptcy receiver, court supervisor or bankruptcy administrator: (i) a natural person with a license to act as bankruptcy receiver (ii) a partnership regulated in the CCC or a company with partners liable without limit for the partnership's obligations or members of the board representing the partnership or company with an appropriate license</p>	<p>The judge is the only one entitled to appoint the receivers' panel: (i) a lawyer; (ii) an auditor or economist; and, (iii) an unsecured ordinary or generally privileged creditor.</p>	<p>A receiver must possess the special knowledge and experience required for the engagement. Liquidators are usually appointed from among members of the Swedish Bar Association</p>	<p>All insolvency practitioners must be properly qualified and licensed under the Insolvency Act. This ensures that they possess suitable professional competence and skill. Most practitioners are members of an accountancy firm. They must be authorized by a recognized professional body (RPB) or hold an authorization granted by the Secretary of State for Business and Enterprise.</p> <p>All practitioners must have in force sufficient security for the proper performance of their functions.</p>
<b>Qualifications</b>	<p>A higher diploma in law, economy or management, a higher studies diploma in accountancy and finance or a diploma of chartered accountant are required. An</p>	<p>A natural person who is qualified for the respective case, experienced in a particular area of business, independent</p>		<p>At least 3 years' experience in managing the bankrupt's assets or a business, pass an examination on economics, law, finance and management</p>			<p>Fulfilment of the requisite professional education and practical training. This includes passing the Joint Insolvency Examination Board examinations in addition to any initial professional qualifications</p>

	entrance exam to a practical training experience, the fulfilment of training period (3–6 years) is also required.	from both creditors and debtors, can be appointed insolvency administrator.					as an accountant or a lawyer.
<b>Eligibility</b>	<p>After the final exam the Court of Appeal must appoint the successful candidate before the candidate can be included on the list of administrators or trustees.</p> <p>The National Commission of Registration and Discipline (<i>Commission Nationale d'Inscription et de Discipline</i>) is responsible for the lists. Only natural persons and private professional companies can be listed.</p> <p>A candidate must have a clean criminal record and subscribe to the professional insurance company (<i>'Caisse de Garantie'</i>).</p>		A receiver will be a lawyer, a certified accountant or a law firm.	The basic prerequisite for the appointment is holding a license, which is issued by the Minister of Justice. The Receiver License Law provide that an eligible candidate will need to possess at least 3 years' experience in managing the bankrupt's assets or a business, pass an examination on economics, law, finance and management before a special commission appointed by the Minister of Justice, and have an impeccable reputation.		Usually members of the Swedish Bar Association	Eligibility for licensing depends on the applicant demonstrating that he or she is a fit and proper person to act as an insolvency practitioner,
<b>Supervision</b>	The official body of administrators and trustees is the National Council of the Administrators and Trustees ( <i>Conseil National des Administrateurs Judiciaires et Mandataires Judiciaires: CNAJMJ</i> ), the council of which comprises an equal number of administrators and			The general supervision of performance of duties by license holders was entrusted to the Minister of Justice. If a person cannot be trusted to duly perform her/his duties, the Minister of Justice shall withdraw the license.			Supervision by the Self Regulating Organisation (of which there are 8) to which the practitioner belongs. All SROs have virtually identical ethical and professional rules although the manner of supervision varies slightly.

	trustees.  The administrators and trustees are also accountable to their accountancy body, the judges in charge of cases and the Public Attorney. The Council sends the Minister of Justice an annual report detailing its activities.						
<b>Professional ethics</b>	Administrators are subject to professional rules and ethics and they give an oath. The National Commission of Registration and Discipline exercises the disciplinary authority.  Strict conflict of interest rules exist.	Several unofficial insolvency administrators' organizations have adopted their own codes of conduct although they have not become law.		There are certain informal initiatives to have professional ethics codified which would operate as "soft law" in the absence of a statutory self-governing body for office holders.			All insolvency practitioners are subject to the ethical rules of their SROs, although these are virtually identical. In the case of professional incompetence or misconduct, the professional bodies as well as the Insolvency Practitioners Tribunal will supervise and control the individual's authorization and removal of authorization in cases of proved unfitness, which the Tribunal may also report to the Secretary of State.
<b>Remuneration</b>	A statutory scale is applied. The fees are calculated as a function of the company's assets, following a defined scale.  The remuneration of a practitioner acting as conciliator or trustee 'ad hoc' is fixed by contract. Having obtained the debtor's approval, the president of the court determines the conditions of	The insolvency administrator is entitled to remuneration for the execution of his office and the reimbursement of reasonable expenses. The ordinary rate shall be calculated on the value of the insolvency estate on the termination of		The remuneration of the receiver, court supervisor or bankruptcy administrator may not exceed 3 % of the bankruptcy estate funds or 140 times the average monthly salary in the enterprise sector (c. EUR 110,000). In certain cases, the remuneration may be increased by 10 % e.g., when the final distribution was made within a year of the deadline for filing claims. If the bankruptcy	The fees of the receivers are determined by law, and are based on the volume of the assets and the complexity of the insolvency proceeding.  Fees incurred by the professionals acting in the insolvency		The Insolvency Rules 1986 provide for the remuneration of insolvency practitioners. There is also a legislative Practice Statement setting out the criteria considered desirable to assess the proper rates and extent of remuneration. The factors listed include the value of the services rendered, what is fair and reasonable, and the professional integrity of the office holder. In an administration,

	remuneration of the trustee 'ad hoc', the conciliator and, if necessary, the expert, at the time of their appointment, on the basis of work entailed in performing their duties. Their remuneration is fixed by order of the president of the court on completion of their duties.	the proceedings. One can derogate from the ordinary rate taking into account the volume and complexity of the administrator's execution office.		receiver or bankruptcy administrator manages the bankrupt's business or in cases justified by extraordinary work input, they may receive additional remuneration not exceeding 10 % of the earned annual profit of the business.  The decision on the remuneration and reimbursement of expenses is issued by the bankruptcy court and subject to an appeal.	proceedings for the benefit of the debtor are considered credits against the debtor's estate and, therefore, are paid prior to any other credit.		remuneration is determined by reference to the time spent by the administrator and his staff, or, more rarely, as a percentage of the value of the debtor's property  If there is a creditors' committee, the committee will determine the basis of the remuneration. If there is no creditors' committee, the remuneration can be fixed by the general body of creditors or by the court. A creditor can challenge the remuneration.
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## **ANNEX III**

### **NATIONAL REPORTS**

## GERMANY

### Question (i):

A) The entry criteria in case of a filing by both creditor and debtor:

a) *Debtor as a natural person:*

Sec. 17 Illiquidity

The debtor is to be deemed illiquid if he is unable to meet his matured payment obligations. As a rule illiquidity is to be presumed if the debtor has ceased to meet his payment obligations

b) *Debtor as a legal entity:*

Sec. 19 Over indebtedness

The over indebtedness of a legal entity is also a reason for the institution of insolvency proceedings. Over indebtedness exists whenever the debtor's property is no longer sufficient to cover in full his liabilities. However, this does not apply in a case where the continuation of the enterprise represents a real probability-

(It should be noted that a filing creditor has in addition to demonstrate a legal interest and has to furnish prima facie evidence in order to make his claim as well as the reasons for institution of proceedings plausible – Sec. 14)

B) Additional entry criteria available for a debtor's own filing only:

Sec. 18 Imminent Illiquidity

If the debtor petitions for the institution of insolvency proceedings, imminent illiquidity shall also constitute a reason for such institution. The debtor is regarded as facing imminent illiquidity if he in all probability is unable to honor his existing payment obligations when due.

### Question (ii):

Once insolvency proceedings have commenced in Germany, the insolvency administrator takes full control of all assets belonging to the insolvency estate (section 148).

During pending insolvency proceedings, judicial execution for individual insolvency creditors are inadmissible both with respect to the insolvency estate as well as with respect to the other assets of the debtor (sec. 89). Generally speaking, secured insolvency creditors are described as creditors with a right to preferential satisfaction. This type of creditor can demand separate satisfaction of his or its claims. This e. g. includes creditors with rights to

satisfaction from immovable property, and creditors to whom the debtor transferred a movable object or a right as a security for a claim. However, the power of such creditors has been limited; they may only assert a claim for preferential satisfaction in accordance with the insolvency legislation to ensure that the assets of the debtor's estate are held together during the initial phase of an insolvency. The possibility of a reorganization should be preserved. Therefore the administrator has the right to continue to use movables, in which a security interest exists and, if necessary, realize them. Nevertheless, the security interest and the ownership interest of creditors with rights to preferential satisfaction are given adequate consideration. Such assets may only be realized after the Creditors' Report Meeting has been held. Should the insolvency administrator decide after this meeting, to use the property for the insolvency estate, he must pay the interest due out to those creditors entitled to satisfaction from the insolvency estate. In case of the sale of any such assets, the administrator has to distribute the proceeds from such sales to the secured creditors; however he is entitled to a statutory fee of about 9 % of the purchase price (sec. 170, 171).

### **Question (iii):**

Under German law the power of an insolvency judge is limited. His most important duty is to choose and to appoint the insolvency administrator. During the insolvency proceeding the insolvency judge can supervise the insolvency administrator in order to avoid misconduct. However the insolvency judge is not at all involved in decisions regarding reorganization or liquidation of the insolvency estate.

However, the insolvency judge may request the insolvency administrator to provide detailed information or a report on the progress of the proceedings and his administration of the estate at any time. If the insolvency administrator does not fulfill his obligations, the insolvency court may set coercive penalty payments upon prior warning being given. In addition the insolvency court may dismiss the insolvency administrator on appropriate grounds. Such dismissals may be ordered ex officio or upon a petition of the administrator, of the creditor's committee or of the creditor's assembly (sec. 58, 59).

At the first creditor's assembly subsequent to the appointment of the insolvency administrator, the creditors may elect another person to replace him (sec. 57 InsO).

The insolvency administrator shall report upon the economic situation of the debtor and the causes thereof at a so-called report meeting, which takes place within weeks after commencement of the proceeding. In this Report Meeting the creditors' assembly shall decide whether the debtor's enterprise is to be closed down or provisionally continued. This assembly may order the administrator to prepare an insolvency plan and may provide him with the objective for such a plan. The assembly may modify the decision at later meetings (sec. 156, 157).

Shareholders are generally treated as subordinated creditors (sec. 39) and therefore have almost no influence upon the insolvency proceeding. As a consequence of the subordination of their loans they are not even admitted as creditors to any creditors meetings.

According to sec. 80 the debtor's right to administer and dispose of the property belonging to the insolvency estate shall be vested in the insolvency administrator only. In case of a legal entity, the management has therefore no power to dispose such property. However,

in formal terms the management is still in place and needs to be maintained until a final liquidation of the legal entity. It may be the case, that the insolvency administrator disposes of worthless assets back to the legal entity. In this case the management has to take care of such assets. In addition the management still represents the legal entity with regard to specific legal rights granted to the legal entity as debtor in the proceedings.

#### **Question (iv):**

##### **A) Ranking of creditors including administrative expenses**

###### *a) First rank:*

The costs of the insolvency proceedings including the court costs, the remuneration earned and the expenses in court by the interim insolvency administrator, the insolvency administrator and by the members of the creditor's committee (sec. 54).

###### *b) Second rank:*

Further insolvency estate liabilities (sec. 55)

1. Liabilities resulting either from the acts of the insolvency administrator or arising in any other way from the administration, the disposition and distribution of the insolvency estate, unless they belong to the cost of insolvency proceedings;
2. Liabilities resulting from mutual contracts in as far as fulfillment is required to the credit of the insolvency estate or which must be fulfilled after the institution of insolvency proceedings;
3. Liabilities resulting from unjust enrichment of the insolvency estate.

###### *c) Third rank:*

Regular insolvency creditors (sec. 38)

###### *d) Fourth rank:*

Insolvency creditors ranking behind (sec. 39)

Ranking behind the other claims of insolvency creditors, the following claims shall be satisfied in the order given as stated below and provided they rank with equal status proportionally to their amounts:

1. The interest accruing on the claims of insolvency creditors since the institution of insolvency proceedings;
2. The costs occurred by each individual insolvency creditor as the result of its participation in such proceedings;
3. Finance and civil – administrative or ancillary – penalties and other such consequences resulting from criminal offences or breaches of regulations, which require the payment of a penalty;

4. Claims for a gratuitous performance by the debtors;
5. Claims for the repayment of a shareholder loan that replaces equity, or claims with equal status.

Claims for which creditors and debtors have agreed that they shall rank in a deferred position in insolvency proceedings, shall, in case of uncertainty regarding their rank, be satisfied after all the claims mentioned above.

B) Special rules on set-off

As a general rule (and according to sec. 94) an insolvency creditor remains entitled to offset at a time of the institution of insolvency proceedings by law or by agreement once the proceeding has been opened.

However, offsetting shall be excluded if the claim against which offsetting is to be effected becomes unconditional and mature prior to the date when offsetting can be effected (sec. 94). Additionally, in the case of sec. 96, offsetting shall be inadmissible if

1. An insolvency creditor has become an obligor to the credit or for the benefit of the insolvency estate only after the institution of insolvency proceedings;
2. An insolvency creditor has only acquired his claims from another creditor after the institution of insolvency proceeding;
3. An insolvency creditor has acquired the opportunity to offset by an avoidable legal action;
4. A creditor with a claim to be satisfied from the debtor's free property is an obligor to the credit or for the benefit of the insolvency estate.

C) Special rules on retention of titles (sec. 107)

1. If, prior to the institution of insolvency proceedings, the debtor has sold movable property under retained ownership and transferred possession to the purchaser, the purchaser may claim fulfillment of the sales contract. The same shall apply if the debtor has assumed additional obligations with respect to the purchaser and such obligations have not been met or not met in full.

2. If, prior to the institution of insolvency proceedings, the debtor has purchased movable property under retained ownership, and possession of such property was transferred to him by the seller, the insolvency administrator who was requested by the seller to exercise his right of choice is not obliged to make the declaration pursuant to Sec. 103 para 2. sentence 2 until immediately after the Report Meeting. This shall not apply if there is expected to be a considerable reduction in the value of the movable property within the time until

the Reporting Meeting, and if the creditor has informed the administrator of such circumstances.

D) Right of rescission

The insolvency administrator has the right to contest several transactions which happen to the detriment of the creditors (sec 129 et seq.) In this respect , the administrator can set aside:

1. Transactions granting security to creditors in the month before an insolvency petition was filed
2. Transactions made in the three months before an insolvency petition was filed if:
  - a third party knew that a company was insolvent;
  - the transaction was disadvantageous to the creditors and the third party was aware of this;
3. gifts that the company has made to a third party in the four years before an insolvency petition was filed;
4. transactions made in the 10 years before an insolvency petition was filed with the intent to prejudice other creditors, and the third party knew of that intention. However, in many cases it is difficult for an administrator to prove such intention.
5. Prepayment on share holder loan in the year before an insolvency petition was filed.

Question (v):

When the order commencing the insolvency proceedings is sent to all known creditors, it will include a notice to those creditors requiring them to submit their claims to the insolvency administrator in a period of between 3 weeks and 3 months from the date of the order. This order also includes a request to creditors to notify the administrator promptly if they claim to have security over the debtor's assets.

Creditors are then obliged to register their claims with the administrator being invited to state the basis and the amount of their claims. Relevant copies of documents supporting or giving evidence to their claim must be attached to the filing of the claim. At a so-called Examination Hearing before the insolvency judge, the registered claims will be examined to determine amount and ranking. Generally, even claims that have been registered after the expiration of the official registration period can still be examined. Claims disputed by the administrator, the debtor or any other creditors are discussed individually. A claim is deemed to have been admitted when no objection has been raised by either the administrator or another creditor. After this examination hearing, the insolvency court will then prepare a so-called table of registered claims, showing which claims have been admitted and setting out the amount and ranking of each claim. Due and formal registration on

this table has the legal effect of a final judgement as far as the administrator and the creditors are concerned. It should be noted, that an objection by the debtor cannot prevent the admission of a claim; it will only prevent the creditor from executing his claim after the termination of the insolvency proceedings on the basis of the entry in the table.

If a creditor's claim is disputed by the administrator or another creditor, each creditor has to issue a complaint in ordinary court proceedings for a decision as to why his claims should be admitted.

### **Question (vi) :**

An insolvency plan can be proposed by the management of a legal entity or by the insolvency administrator of such an entity. In addition the creditor assembly can instruct the administrator to prepare a plan. However, an insolvency plan can only be made once insolvency proceedings have been already commenced. An insolvency plan must be approved by a resolution of the creditors and by the court. For this resolution the creditors are divided into groups by the plan, which is accepted with a majority by number and value in each group voting in favor of it. There are certain provisions available to prevent creditors from obstructing approval. This means, that even in the case, where a creditor is in opposition, the court can overrule this creditor and can enforce the plan if:

- the members of the group of creditors are not placed in a worse position, than they would be during liquidation;
- the majority of the group has accepted the plan, and all creditors obtain some benefit from the distribution of the proceeds. Therefore the acceptance of an insolvency plan is closely connected to an appropriate setting up of the structure of those groups. Generally, the court can take up to 6 months from when a plan is filed to approve it. However, such period can be shorter or substantially longer depending on the circumstances of the case.
- Once the creditors and the court have approved an insolvency plan, it becomes binding to all parties involved and the creditors debts are paid according to the provision of the plan.
- The company's management is responsible for settling the claims set out in the plan. If the company defaults, any suspension created by the plan may no longer be effective.
- Once the insolvency plan has been finalized, the court ends the insolvency proceedings. If required, the administrator has to supervise the fact that the company is following the plan.

Hereby the court can order a supervision to end if either:

- the claims set out in the plan have been settled or guarantee has been given for them; or
- three years have passed since insolvency proceeding ended and a filing has been made for a new insolvency proceeding

### **Question (vii) :**

#### **A) Assets included in the insolvency estate**

According to sec. 35 (definition of the insolvency estate) an insolvency proceeding shall involve the entirety of the property owned by the debtor at the time of the institution of the proceedings and acquired during such proceedings (insolvency estate). In the case of a natural person constituting the debtor, his property, which is not subject to execution (ie protected property which he needs for modest living and working) shall not form part of the insolvency estate, especially property that comprises the debtor's usual household contents and which is used by the debtor in his household and which property shall not form part of the insolvency estate. The sale of such property would in no way generate appropriate returns. However, the debtor's business records shall in any case form part of the insolvency estate. In case of doubts, the insolvency court is competent for decisions as to whether a property is subject to execution.

#### **B) Rules as to the disposal and sale of the assets included in the estate**

Subsequent to the institution of insolvency proceedings, the insolvency administrator shall immediately take possession of and administer all of the assets of the insolvency estate (sec. 48). The insolvency administrator shall draw up a record listing each object of the insolvency estate. The value of each object shall be indicated (sec. 150 and 151). The decision with regard to the disposal of the assets is part of the creditor's assembly decision, whereby this assembly has to decide, that the debtors enterprise shall be closed (liquidation) or optionally continued. In this respect the administrator shall only realize the assets of the insolvency estate after the report meeting, provided such realization does not conflict with any of decisions taken by the creditors' assembly (sec.159). If at the discretion of the creditors' assembly a creditors' committee has not been appointed, the administrator shall obtain the approval of the creditors' assembly if he wants to sell the enterprise or business operation or the entire inventory.

### **Question (vii) :**

Please see comments on point IV

### **Question (viii) :**

If a mutual contract was not completely fulfilled by the debtor and the other party at a time of the institution of insolvency proceedings, the insolvency administrator may fulfill such a contract instead of the debtor and claim a fulfillment or performance from the other party . If the administrator refuses to fulfill or perform such a contract, the other party may assert

a claim by reason of the non fulfillment or non performance only as an insolvency creditor. If the other party requests the insolvency administrator to exercise a right of choice or election, the administrator shall declare without delay whether or not he requests or require a fulfillment or the performance of the contract. If the administrator omits to make such a declaration, he shall no longer be entitled to request fulfillment (sec. 103).

A contract relating to or the tenancy or lease of an immovable property or premises concluded by the debtor as tenant or lessee may be terminated by the insolvency administrator by observing the statutory period irrespective of the agreed contractual term (sec. 109).

In addition a contract for services of which the debtor is the beneficiary may be terminated by the insolvency administrator and by the other party irrespective of any agreed term of such a contract and of any agreed waiver of the right to an ordinary termination. A period of notice shall be three months as per the end of the month unless a shorter period applies. If the administrator terminates such a contract, the other party may, as an insolvency creditor, claim recovery of damages for the premature termination of the contract for services (sec. 113).

Any mandate given by the debtor and referring to the property of the insolvency estate shall expire upon the institution of insolvency proceedings (sec. 115).

### **Question (x):**

Managing directors can be personally held liable in the following cases:

- a. Failing in their duties of supervision and of the prevention of the company from failure. These duties include properly supervision, supervision of the company before it becomes insolvent and taking the necessary steps to implement a restructuring
- b. Making payments that are not necessary to maintain the company as a going concern after the legal entity has become illiquid or over-indebted.
- c. Delay in filing an insolvency petition. This is also persecuted as a criminal offence.
- d. Tax related offences
- e. Misappropriating social security payments, which is also criminal offence
- f. Breach of trust by making payments to the creditors, which constitute unjust transfers of assets, which are also criminal offences
- g. Fraud, in particular, if a Managing Director does not disclose a company's insolvency when entering into a contract with a creditor, which is also a criminal offence
- h. Shareholders mainly are liable in case of repayments of equity made to them while the company is in financial crisis. Generally shareholders can be required either to repay the funds obtained from the company or to continue lease agreements (and similar contracts) with the insolvency administrator.

However, in the latter case, they are entitled to a compensation payment depending on the payment in the last year prior to insolvency.

**Question (xi) :**

Legal rules on the availability and modalities of post-commencement finance are rather lacking in Germany. There is an established practice that creditors grant a loan to the insolvency administrator and according to the general law such loan is a preferred claim in the rank addressed by sec. 55

**Question (xii) :**

The rules on a practitioner's qualification are set out in sec. 56:

A natural person who is qualified for the respective case, and particularly experienced in business matters and who is independent from both creditors and debtors, shall be appointed insolvency administrator.

Currently a big discussion is going on in Germany, whether this clause is appropriate and if a person having such qualification or qualifications similar to those who already get appointed on a regular basis, can claim to become an insolvency administrator. Several unofficial insolvency administrator organizations have in the meantime adopted their own codes of conduct although it has not so far been translated into black letter law . In the recent reform discussions within Germany there has been a discussion whether creditors should have a right to propose a suitable insolvency administrator. Currently the court practice in most of the courts is reject a person as a suitable insolvency administrator being proposed by creditors, because the courts believe, that such a person is conflicted.

The regime as to the remuneration of the insolvency administrator is set out in sec. 63: The insolvency administrator shall be entitled to remuneration for the execution of his office and to reimbursement of reasonable expenses. The ordinary rate of such remuneration shall be calculated on the value of the insolvency estate upon the date of the termination of such proceedings. By derogating from the ordinary rate such remuneration shall account for the volume and complexity of the administrator's execution office. More details are set out in the insolvency administrator's remuneration code (InsVV).

**Question (xiii):**

In Germany there are no rules available or applicable on the insolvency of groups

**Question (xiv):**

In case the EIR does not apply (e.g. outside the EU) sec. 335 et seq., the insolvency code applies. These clauses are modeled in accordance to the EIR and not in accordance with the UNICITRAL-MODEL Law.

## SPAIN

The purpose of this answer-sheet is to provide the addressee with a basic understanding of insolvency proceedings in Spain. The summary disclosed in this answer-sheet focuses exclusively on some of the relevant provisions of the Spanish Insolvency Law<sup>18</sup> (the “**Insolvency Law**”) excluding rules regarding financial guarantees, insurance and other matters subject to special regulation.

### Question (i):

- The Insolvency Law establishes a single insolvency procedure applicable to every debtor in insolvency (“*concurso*”) and is subject to the following *liquidity test*: namely the incapability of the debtor to comply with its obligations regularly when they become due and payable (the “**Actual Insolvency**”). Additionally, the debtor may also apply for insolvency if it foresees such situation in the imminent future.
- This single procedure has a joint phase (the “**Common Phase**”) and two different solutions: (a) a *composition agreement* (the aim is for the debtor and the creditors to reach an agreement on the payment of the latter’s claims in order to enable the debtor to restructure its business); or (b) *liquidation* (the aim is to liquidate the debtor’s assets to pay off its debts).
- The directors of a company have an obligation to file for insolvency (i.e. debtor’s requested insolvency, the “**Voluntary Insolvency**”) within two months from the date they become aware or should have become aware of the insolvency situation. Once the debtor provides evidence to the judge as to its indebtedness and as to its insolvency situation, the judge automatically declares the debtor to be insolvent. The failure of a debtor to file for Voluntary Insolvency, if it is required to do so, subjects the company and its directors to various sanctions (see question (x)).
- Notwithstanding the above, the two-month period obligation to file for Voluntary Insolvency may be extended: if the debtor puts the competent court on notice that it has commenced negotiations towards an anticipated composition agreement (see question (vi)) within the referred two month-period, it will have three additional months to negotiate its creditors’ adherence to such a proposal without (a) the obligation to file for insolvency within such negotiation period; and, (b) the risk that a creditor files for insolvency (i.e. creditor’s requested insolvency). Such pre-filing period may only be exercised by the debtor (provided it is in Actual Insolvency) and it is optional (if not exercised, the debtor can directly file for Voluntary Insolvency).

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18 “*Ley 22/2003, de 9 de julio, Concursal*”; this answer-sheet includes the recent amendments introduced by Royal Decree-Law 3/2009 dated 27 March, on urgent measures on taxation, financial and insolvency matters to the Insolvency Law.

- Likewise, any creditor is entitled to file for the debtor's insolvency (i.e. a creditor's requested insolvency, the "**Necessary Insolvency**"), basing its claim on the insufficiency of attachable assets when enforcing its credits against the debtor, or otherwise by providing evidence of any of the following facts: (a) general default of the debtor's payment obligations; (b) general seizure of the debtor's assets; (c) sale of the debtor's assets at a loss or in a negligent manner; or, (d) the debtor's failure to pay during the three-month period preceding the filing for Necessary Insolvency its tax liabilities, social security obligations, or salary and other monetary employment obligations. Such a creditor, being an ordinary creditor, will be privileged as to an amount equal to 25% of its claim. The debtor is entitled to give evidence in a hearing to be held in this respect to the effect that, notwithstanding the concurrence of any of such facts, no insolvency arises.

#### **Question (ii) :**

- Enforcement of claims initiated before the declaration of insolvency will be suspended on the date of the declaration of insolvency, except for those of an administrative and labour-related nature, to the extent that they are enforced on assets which are not necessary to carry out the business of the debtor.
- Until (a) the approval of any composition agreement or (b) the expiry of one year from the date of any declaration of insolvency provided that the liquidation phase is not opened (whichever is earlier), no enforcement of a security can be commenced or continued if the enforcement relates to assets assigned to the debtor's business activity (unless, (1) advertisements on the collateral's auctions would have been published by the time of the declaration of the insolvency; and, (2) the assets, although assigned to, were not necessary as to run the debtor's business). Other creditors (e.g. financial lessors, or sellers of real estate with deferred payment subject to termination conditions registered with the Commercial Registry) are subject to the same regime.
- The owners whose goods are in the possession of the insolvent debtor have a right of separation, provided that the debtor has neither a right of use, nor a guarantee nor a retention right over said goods. If this condition is fulfilled, at the owner's request, the receivers will hand over those goods over which the former has exercised said right of separation and, in case the receivers deny said demand, the judge will have to rule there over.

#### **Question (iii):**

- During the Common Phase, the judge will appoint the members of the receivers' panel, whose main function is to determine the debtor's estate and existing debts, and to control the management of the debtor's business. The receivers will issue a report drafted on the causes of the insolvency as alleged by the debtor and setting out its net worth and accounting situation, as well as setting out the inventory of the debtor's estate and the list of creditors.
- As a general rule, during the Common Phase:

- (a) in case of a Voluntary Insolvency, the debtor will remain in possession of its management and disposal faculties and rights, but the exercise of these faculties will be subject to the receivers authorisation or approval; or,
- (b) in case of a Necessary Insolvency, the receivers will replace and take over the debtor's existing management and disposal faculties.

Notwithstanding the above, the judge is entitled to reverse this regime at the beginning of or during the insolvency proceeding. As and when the liquidation phase starts, the debtor's directors will cease with regard to their functions, which shall be performed during the liquidation by the receivers.

- Receivers have the right to assist and participate in the board and shareholder's meetings of the debtor, although they are not entitled to vote.

#### **Question (iv) :**

- Once the insolvency has been declared by the judge, the following ranking will apply to the creditors' claims:

(1<sup>st</sup>) Claims against the debtor's estate: Certain debts incurred by the debtor following the declaration of insolvency will be payable when they are due according to their own terms. These include, *inter alia*: (1) salary claims for 30-days prior to the declaration of the insolvency (subject to a limit of twice the minimum legal salary); (2) legal costs, expenses of the insolvency or for filing the insolvency proceedings (with certain limits); (3) receivers' fees; (4) debts incurred during the insolvency proceedings in the ordinary course of the business or any other obligations with the approval of the receivers; (5) claims due as a consequence of reinstatement of claims; and, (6) claims for claw-back actions due to third parties who acted in good faith.

(2<sup>nd</sup>) Special privileged claims: Claims secured with or by the assets of the debtor and which are paid on account of the said assets in preference to any other creditor. For instance: (1) claims granted with *in rem* security interests; (2) salary claims arising from assets manufactured, restored or repaired by employees while such assets are owned by or are in the possession of the debtor; (3) financial leases and purchase agreements with deferred payments which imply a retention of title, and claims based on or involving a prohibition of disposal or a termination condition; (4) claims secured with securities; and, (5) pledge over claims.

(3<sup>rd</sup>) Generally privileged claims: Claims that are paid by way of preference to those of other creditors other than those referred above, including *inter alia*: (1) other salary claims and redundancy payments up to a certain threshold; (2) tax and social security liabilities (for certain claims up to 50% of the amount owed); (3) non-contractual civil liabilities; and, (4) in case of Necessary Insolvency, 25% of the amount of the claim of the creditor that filed for insolvency.

(4<sup>th</sup>) Ordinary claims: Claims that are not classified as privileged (either specially or generally) or subordinated.

(5<sup>th</sup>) Subordinated claims: Claims that will only be paid out once all other claims (privileged and ordinary) have been satisfied in full, including: (1) claims for which timely notice has not been provided to the receivers (see question (v)); (2) contractual subordination claims; (3) claims of individuals and companies related to the debtor (e.g. group companies, shareholders with a relevant stake (10% for

non-listed companies) or directors (including shadow directors, liquidators, relatives); (4) claims for interest and penalty payments; (5) claims for claw-back actions due to third parties who acted in bad faith (see question (viii)); and, (6) claims arising from contracts with reciprocal obligations if the creditor repeatedly breaches said contract during the insolvency process.

- Such ranking also has some effect in relation to composition agreements, basically: (a) claims under 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> are not subject to the composition agreement, unless such creditors wish to be included; and, (b) claims under 5<sup>th</sup> are paid once all other claims (privileged and ordinary) have been satisfied in full and applying their own terms.
- No set-off can be carried out after the declaration of insolvency, unless the requirements for such set-off pursuant to the Spanish Civil Code ("*Código Civil*") are met prior to the declaration of insolvency. Notwithstanding any possible claw-back actions, the opening of insolvency proceedings will not affect the right of the creditor to set-off if the Law that governs the reciprocal debtor's claim allows set-off in cases of insolvency.
- Interest on unsecured claims ceases to accrue, whilst interest on secured claims continues to accrue up to the value of the collateral.
- There are no particularities on tax liabilities or on the tax regime for trading whilst the company is in insolvency, except for certain rules on VAT recovery for unpaid claims.

#### **Question (v) :**

- Creditors must submit their claims to the receivers one month after the last placed advertisement of the declaration of insolvency of the debtor in the Spanish Official Gazette. Late notice by creditors can lead to having their claim classified as subordinated.
- Any interested party may bring a claim against the creditors' list and/or inventory drafted by the receivers within 10 days since the latter have submitted their report to the judge.

#### **Question (vi) :**

- Reorganization plans are carried out by means of in-court composition arrangements: (a) anticipated composition agreement ("*convenio anticipado*") or ordinary composition agreement ("*convenio ordinario*").
- An anticipated composition agreement may only be filed by the debtor with the support of any type of creditors representing at least 20% of the total debt and, if such agreement is filed at the same time and together with the debtor's request for insolvency, the threshold hereto is reduced to 10% of the total of the debtor's liabilities.
- As a general rule, an ordinary composition agreement may be proposed by both the debtor and the creditors (however, the debtor can turn down those ordinary composition agreements proposed by its creditors) and is approved by a majority

of 50% ordinary claims, including with this respect privileged and secured creditors. Nevertheless, if the ordinary composition agreement contemplates either full payment of ordinary claims within a term not higher than three years or the immediate payment of outstanding claims with a discount of not more than 20%, such creditors' composition may be approved by simple majority. Subordinated creditors and assignees of credits who have acquired the credit after the declaration of insolvency have no right to vote.

- Once approved by creditors, both anticipated and ordinary composition agreements need to be also approved by the judge.
- A composition agreement (anticipated or ordinary) may provide for reorganisation measures as: (a) stays and/or debt reductions; (b) mergers or other corporate measures; (c) debt to equity swaps if the creditors to become shareholders as well as the former debtor's shareholders agree as much; (d) new money to be granted by third parties and/or creditors if they accept so by signing the proposal of the composition agreement; and, (e) sale of the debtor's business (see question (vii)).
- A composition agreement (anticipated or ordinary) may not provide for: (a) a change in the creditors ranking; (b) a moratorium for more than 5 years (with legal exceptions); (c) a debt reduction for more than 50% of the debts (with legal exceptions); (d) a "hidden" liquidation by assignments of debts and assets; or, (e) a condition precedent as to be effective (unless such condition is the approval of a composition agreement in the insolvency of a company of the same group of the debtor).

#### **Question (vii) :**

- As a general rule, unless the debtor requests its liquidation, the declaration of insolvency does not affect the continuation of the debtor's ability to continue trading and, until the acceptance of the receivers, the debtor may carry out all those commercial transactions in its ordinary course of business given that these are carried out under standard market conditions:
  - (a) In the case of Voluntary Insolvency, where the debtor's management and disposal faculties are subject to the prior receivers' authorisation, the latter may determine those acts and operations which are an inherent part of the debtor's business activity which, due to their nature or quantity, may be authorised by way of a general extension; and,
  - (b) In the case of Necessary Insolvency, being a case in which the debtor's management and disposal faculties are suspended, it will be up to the sole discretion of the receivers to adopt those measures which are necessary for the continuation of the debtor's activity.
- Notwithstanding the above, upon a request by the receivers, the judge may decide to shut down the debtor's operations totally or partially.
- A sale of the debtor's business may be carried out as a part of a composition agreement (including anticipated composition agreements as part of a pre-

packaged deal) if: (a) the purchaser commits to continue running the debtor's business as well as to paying the creditors, in the terms stated in the composition agreement, by means of the funds raised from such business; and, (b) a viability planning is filed with this respect.

- If no anticipated composition agreement is filed or approved, it remains arguable as to whether the sale of the debtor's business during the Common Phase is allowed; otherwise it is necessary to wait until the liquidation phase is opened. In any case, such sale during the Common Phase should be authorised by the receivers as well as by the judge.
- In the liquidation phase, it is intended that debtor's business (or part of it) is sold as a going concern.

#### **Question (viii):**

- The transactions executed by the debtor during a two-year period prior to the initiation of insolvency proceedings and that are detrimental to the debtor's estate may be challenged and annulled, even in the absence of fraud. In particular:
  - (a) acts for no consideration and the pre-payment of obligations maturing after the date of declaration of insolvency are presumed, in any event, to be detrimental;
  - (b) transfer of assets to any of the persons that are "specially linked with the debtor" (e.g. inter-group transactions) and security granted for securing existing non-secured obligations or new obligations replacing non-secured obligations, are also impeachable unless evidence on the contrary is provided; and,
  - (c) for the rest of cases, the prejudice must be evidenced by the party who applies for claw back actions.
- The general effect of the claw-back is the annulment and simultaneous restitution of whatever they may have already received from the other. The consideration to be returned to the creditor will be classified as a claim against the debtor's estate; except in cases of bad faith, when the said claim will be classified as subordinated, to be paid once all other claims (privileged and ordinary) have been paid in full (see question (iv)).
- Payment and settlement transactions in the securities and financial markets and those entered into by the debtor in the ordinary course of business on an arms length basis are not subject to claw-back as well as any security granted in favour of or in respect of Public law claims and of the Salary Guarantee Fund ("*Fondo de Garantía Salarial*") in those types of recovery agreements or settlements foreseen in those parties' specific rules.
- Refinancing agreements by which there is, at least, a significant increase of credit or amendment of its obligations, either through the extension of its maturity, either through the establishment of other obligations in lieu thereof (the

**"Refinancing Agreement"**) are not subject to claw back (neither such Refinancing Agreement nor agreements, payments or security or guarantees arising from the said Refinancing Agreements are impeachable) provided that:

- (1) the same must be approved by creditors representing at least 60% of the liabilities of the debtor;
  - (2) it is under the umbrella of a viability plan to allow the continued operation of the debtor in the short and medium term. The said viability plan shall be the subject of a report by an independent expert (appointed by the Mercantile Registrar) containing a technical judgement concerning: (1) the sufficiency of the information provided by the debtor; (2) the reasonableness and feasibility of the viability plan; and, (3) the proportionality of the guarantees granted under the Refinancing Agreement in accordance with the normal market conditions at the relevant time ; and,
  - (3) the same is formalised in a public deed.
- Claims against Refinancing Agreements may be only brought by the receivers. Thus, the rest of general rescission actions under the Spanish Civil Code still apply (articles 1,111 and 1,291).

**Question (ix):**

- Contracts with reciprocal obligations for both parties pending to be performed at the time of the insolvency declaration:
  - (a) will remain in force and with effect, and will be funded by the debtor's estate;
  - (b) as a matter of principle, early termination clauses triggered by the insolvency declaration are void and unenforceable;
  - (c) the judge may declare, if appropriate for the insolvency, the termination of such contracts upon the request of the receivers or the debtor, even if no specific termination provision or default exists (in the absence of an agreement on the termination terms, the judge will determine them, and the creditor's indemnity will be paid from the debtor's estate);
  - (d) any non-compliance by any of the parties that takes place after the insolvency declaration may enable the non-defaulting party to request the judge that the agreement be terminated (the termination cannot take place out-of-court);
  - (e) the judge may decide not to terminate the agreement if it considers that this is appropriate for the insolvency (any obligation arising from such agreement will be satisfied from the debtor's estate);
  - (f) the receivers may decide upon the reinstatement of a financing agreement, provided that (1) it was terminated prematurely due to a payment default

during the three months prior to the insolvency declaration; and (2) the creditor does not oppose and has not started collection actions; and,

- (g) in some cases (e.g. lease and supply agreements), the termination may also be based on defaults arising prior to the insolvency declaration.
- Regarding reinstatement of terminated agreements:
  - (a) the receivers shall pay or deposit all the amounts owed until the reinstatement of the agreement and undertake to pay all future amounts on account of the debtor's estate (if a breach of the reinstated agreement occurs, the creditor is entitled to terminate the contract and no further reinstatement can be exercised); and,
  - (b) reinstatement of an asset acquisition agreement with a deferred payment is also stipulated in the Insolvency Law, with a similar regime.
- Employment contracts continue to be binding and in force, although such contracts may become subject to collective reorganisation measures such as amendment, suspension or termination (including those relating to severance payments or golden parachutes of high-ranked employees), as ruled upon by the judge; in particular, the judge has jurisdiction to rule on the labour-related claims of the debtor's employees, as well as the right to (a) dismiss, under certain circumstances, senior employees of the debtor; and (b) decide on the compensation of such employees.

#### **Question (x) :**

- In some cases, sub-proceedings are begun (in practice this starts at the end of the insolvency procedure) to determine whether the insolvency has been caused or aggravated by registered, *de facto* or shadow directors. The outcome of the sub-proceedings will be the judge making a ruling as to either:
  - (a) there being no liability on the part of directors on the cause or aggravation of the insolvency; or
  - (b) a director's or directors' liability with the following consequences for them (and any of the persons who have fulfilled management functions within the two years prior to the insolvency declaration): (1) the directors' inability to represent third parties as directors or attorneys for a minimum period of two years and a maximum of fifteen years; (2) losing any claims held against the debtor; (3) being subject to an obligation to indemnify as to damages; and, (4) the judge may decide to impose an obligation on the directors to provide other indemnities as to any damages caused and (in the event that the insolvency proceedings lead to liquidation) pay the amount of the loans that remain unpaid after the liquidation of the debtor.
- If the insolvency proceedings lead to the liquidation of the company, or to a creditors' agreement which provides for a reduction higher than 1/3 of the liabilities of the company or for a stay of more than three years, the judge shall

analyse the question as to whether the insolvency should be declared 'guilty' or not. The following criteria will apply:

- (a) The insolvency would be qualified as 'guilty' if it has been caused or aggravated due to the debtor's and/or its directors' (including shadow and *de facto* directors) wilful misconduct or gross negligence (absent evidence to the contrary, the said wilful misconduct or gross negligence will be presumed, among others, in the following cases: where directors fail to file an application for insolvency within two months from the date when they knew or should have known the insolvency situation of the company<sup>19</sup>); and,
- (b) where the annual accounts related to the three fiscal years preceding the declaration of insolvency have not been issued, or audited or, once approved, have not been deposited within the Commercial Registry.

Additionally, it must be highlighted that, among other cases, the Insolvency Law provides that the insolvency will be determined, in any case, as being 'guilty' if:

- (a) the debtor has not complied with its accounting obligations or has engaged in double accounting or has been responsible for a relevant irregularity that may affect the understanding of its net worth or financing situation;
  - (b) the debtor's assets are fraudulently transferred out from the debtor's estate during the two years prior to the declaration of insolvency; or,
  - (c) the debtor has carried out acts with the intention to simulate a fictitious net worth position.
- In the event of insolvency proceedings ending in liquidation, such directors can be sanctioned to pay the amount of credits that remain unpaid after the liquidation of the debtor.
  - It is also possible that, at any stage, the judge may order the seizure of goods owned by directors (including shadow and *de facto* directors during the above referred period of time) when it is foreseeable that the insolvency will be declared as 'guilty' and that there will not be enough assets to pay all debts.
  - Notwithstanding the above, directors may also face criminal as well as corporate law liability and, in particular regarding the latter, the most important case in this respect is the mandatory dissolution of the company imposed upon the directors by corporate law if the company's net worth falls below half of its share capital (capital impairment situation).

### **Question (xi):**

Claims arising from any post-commencement finance will be classified as claims against the debtor's estate since these are debts incurred after the declaration of the insolvency in the

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19 It is presumed, absent evidence to the contrary, that the debtor was aware of its insolvency situation if any of the acts enabling creditors to file for insolvency (i.e. Necessary Insolvency) exist (see question (i)).

ordinary course of the business with the approval of the judge which would be payable when it is due according to its own terms (see question (iv)).

**Question (xii):**

The judge is the only one entitled to appoint to the receivers' panel: (i) a lawyer; (ii) an auditor or economist; and, (iii) an unsecured ordinary or generally privileged creditor.

- Fees incurred by the professionals acting in the insolvency proceedings for the benefit of the debtor are considered credits against the debtor's estate and, therefore, are paid prior to any other credit.
- The fees of the receivers are determined by law, and are determined based on the volume of the assets and the complexity of the insolvency proceeding.

**Question (xiii):**

- The Insolvency Law does not provide for group insolvency proceedings and, thus, each company belonging to a group shall be subject to individual insolvency proceedings. However, the law does provide that, under certain conditions, each of the individual insolvency proceedings may fall under the jurisdiction of the same judge and, in practice, have the same receivers.

**Question (xiv) :**

Any cross border insolvency regarding EU jurisdictions shall be governed by EC Regulation No 1346/2000 of 29 May 2000 on insolvency proceedings and regarding non-EU jurisdictions, Spanish law provides for specific rules which, in general, are similar to those established by the EC Regulation.

## FRANCE

### INTRODUCTION

The law applicable in France regarding insolvency matters is now contained in **Act No 2005-845 of 26 July 2005** (Official Journal of 27 July 2005 in force on 1 January 2006) most recently modified by the **Ordinance No 2008-1345 of December 18, 2008** (ratified by Act No 2009-526 of 12 May 2009, OJ 13 May 2009) completed by:

- **Ordinance No 2009-112 of 30 January 2009** (OJ of 31 January 2009)
- **Decree No 2009-160 of February 12, 2009** (OJ of 13 February 2009)
- **Act No 2009-526 of 12 May 2009** (OJ of 13 May 2009)

### Question (i):

- **French test of insolvency:**

French insolvency law provides for three proceedings supervised by the commercial courts (« *Tribunal de Commerce* ») if the debtor has a commercial activity and by civil courts (« *Tribunal de grande instance* ») in all other cases.

**Reorganisation** (« *Redressement judiciaire* ») **and trustees** (« *Liquidation judiciaire* ») **proceedings** are procedures applicable to insolvent debtors whereas **safeguard proceedings** (« *Procédure de sauvegarde* ») are preventive proceedings under the supervision of the Court and are relevant in the case of debtors facing difficulties that they cannot overcome<sup>20</sup> (i.e where the debtor is not insolvent!).

French proceedings in respect of insolvent debtors (**reorganisation and liquidation** proceedings) apply only if the formal requirement has been met as to the debtor's *cessation of payments* (« **état de cessation des paiements** »). This describes situations where the current liabilities that are due exceed the available assets (**liquidity test**).<sup>21</sup>

- **Debtors subject to insolvency proceedings (both reorganisation and liquidation proceedings):**

French reorganisation proceedings apply to **traders, craftsmen, farmers** and other natural persons running an **independent professional activity** including independent professional persons with a **statutory or regulated status** or whose designation is

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<sup>20</sup> From February 15, 2009, the condition for access to the « *procédure de sauvegarde* » no longer requires the debtor to demonstrate insurmountable financial difficulties leading to the state of cessation of payments. Commercial Code, Art. L. 620-1: « *This article institutes a safeguard procedure to be commenced on the petition of the debtor (...) that, without being in a state of cessation of payments, shows difficulties that it is unable to overcome on its own.* »

<sup>21</sup> The notion of « *available assets* » includes reserve credit and moratoriums (details added by the Ordinance No 2008-1345 of December 18, 2008).

protected, as well as to **private law entities**. By contrast, individuals and public entities are regulated by specific rules.

- **Persons allowed to file for insolvency proceedings (both reorganisation and liquidation proceedings):**

The **debtor** must apply for the commencement of reorganisation proceedings at the latest within 45 (forty-five) days following its cessation of payments<sup>22</sup>. The **Court** may also initiate reorganisation proceedings of its own motion or upon request of the **Public prosecutor** or by writ of summons by the **creditors**.

It is important to note that in both proceedings the works council (« le comité d'entreprise ») (or, in the absence of a works council, the employee delegates (« les délégués du personnel »)) may inform the President of the Court or the Public prosecutor of any relevant factors demonstrating the state of cessation of payments of the debtor.

- **Goals of French insolvency proceedings:**

The purpose of **reorganisation** proceedings is to allow the continuation of the business's operations, the maintenance of employment and the settlement of its liabilities while **liquidation** proceedings tend to end the business activity or to result in the sale of the debtor's assets through a general or separate sale of its interests and property in the light of the fact that the reorganisation of the business is clearly impossible.

#### **Question (ii):**

- **Rules on the effect of the commencement of proceedings on the suspension of creditor's powers to assert and enforce their rights:**

##### **1. Suspension of creditor's legal actions and proceedings for enforcement with regard to the debtor**

The order of the court opening the insolvency proceedings (safeguard, reorganisation or liquidation proceedings) stays or prohibits legal actions of **all creditors** (even secured creditors, tax authorities, etc.) whose claims arise **prior** to the order opening the proceedings aimed at obtaining an order against the debtor to pay a sum of money and the rescission of a contract on the grounds of non-payment of a sum of money.

In addition, the order opening the insolvency proceedings stays or prohibits all proceedings for enforcement filed by the creditors in respect of movable and immovable properties and all distribution proceedings without legal effect **prior** to the order opening the insolvency proceedings.

<sup>22</sup> Commercial Code, Art. L. 631-4: « The commencement of reorganisation proceedings must be requested by the debtor at the latest within the forty-five days following the cessation of payments if the debtor has not, within this time limit, requested the commencement of conciliation proceedings. If the conciliation proceedings fail, the court will initiate a case of its own motion in order to rule upon the commencement of reorganisation proceedings if it appears from the conciliator's report that the debtor is in a state of cessation of payments.»

The order opening the insolvency proceedings also stays or prohibits legal actions and proceedings for enforcement of all creditors and whose unsecured claims arise **after** the order opening the proceedings, other than maintenance claims.

This suspension of creditor's legal actions and proceedings for enforcement with regard to the debtor is a public policy principle inherent to all insolvency proceedings.

In consequence, creditor's legal actions and proceedings for enforcement with regard to a third party are admissible.

In compensation, all time limits, to be observed under the penalty of loss or rescission of rights, shall be stayed.

This suspension of creditor's legal actions and proceedings for enforcement with regard to the debtor are stayed until the creditor has proceeded to the statement of his claim. Hence, the claim will be established, its amount will be fixed and the claim will be notified as to the position regarding claims. Otherwise, the claim will be declared to be void.

## **2. Prohibition on the payment of claims**

The order opening the insolvency proceedings automatically prohibits payment of claims arising **prior** to the order opening the proceedings, except set-off payments of connected claims.

It also automatically prohibits the payment of unsecured claims arising **after** the order opening the proceedings, other than maintenance claims, and bills of exchange.

## **3. Suspension of creditor's rights**

Some securities are paralyzed with the opening of the safeguard proceedings and the reorganisation proceedings as the lien during the observation period and the implementation of the plan, unless the property, subjected to pledge, is included in a transfer of activities.

The trust is also paralyzed with the opening of the safeguard proceedings and the reorganisation proceedings in case the debtor retains the use of the property.

The order opening the insolvency proceedings also forbids the conclusion and performance of a *commisoria lex*.

### **Question (iii):**

- **Rules on the management of the insolvency proceedings:**

#### **I. Reorganisation proceedings**

- **Degree of supervision of the reorganization proceedings by the Court:**

The Court must decide upon the opening of a reorganisation proceeding after having heard the debtor, the works council (« *comité d'entreprise* ») and any other relevant

person. The Court has also the power to appoint a judge in order to evaluate, with the potential assistance of an expert, the business's financial, economic and employment position before delivering its decision to open the reorganisation proceeding.

The opening order of the Court shall determine an observation period (« *période d'observation* ») for two months that may be renewed. The Court can also appoint a **supervisory judge** (« *juge-commissaire* »). In the same order, the Court can appoint one or several **trustees** (« *mandataires judiciaires* ») and **administrators** (« *administrateurs judiciaires* »).

Within the two-month observation period, the Court can order, on the basis of the report of the administrator, the continuation of the business provided there are sufficient financial resources. The Court makes its own decision based on the administrator's report, after having received the opinion of the Public Prosecutor and after having heard or duly summoned any interested party within the reorganisation proceeding. Where the administrator is required to carry out the entire management of the business alone, the Court will appoint one or more experts to assist him in carrying out their management tasks. The President of the court determines the remuneration of the experts, which shall be covered by the insolvency estate.

If during the observation period, the debtor has enough money to pay off the creditors and the fees and related costs of the proceedings, the court terminates the proceedings upon request of the debtor. By contrast, where the court pronounces the liquidation of the debtor, it terminates the observation period and the duties of the administrator.

The court will fix the duration of the reorganisation plan. In the order confirming or modifying the plan, the court may decide which assets, if any, are indispensable for the continuation of the business and which may not be disposed of without its permission. The period of this inalienability may not exceed that of the plan. It is up to the court to charge the administrator with carrying out acts necessary to implement the plan. The court can appoint the administrator or the trustee as **plan performance supervisor** (« *commissaire à l'exécution du plan* ») who may initiate an action in the collective interest of creditors and may obtain all documents and information useful for his duties. The plan performance supervisor informs the President of the court and the Public Prosecutor of any failure in the implementation of the plan. Substantial modifications of the goals or means of the plan may be made only by the court, upon request of the debtor and based on the report of the plan performance supervisor. It is for the court, which confirmed the plan, to order, after the Public prosecutor has given his opinion, the rescission of the plan if the debtor does not fulfill its commitments within the time limits provided for in the plan. By contrast, where it is established that the commitments stated in the plan or ordered by the court have been performed, the court, upon the request of the plan performance supervisor, the debtor or any interested party, will record that the plan has been implemented.

Importantly, if the reorganisation of the business required so, the court may order the implementation of the plan provided there occurs the removal of the head of the business or the non-transferability of the shares. Moreover, where the committees of creditors have adopted the draft plan, the court will ensure that the interests of all of the creditors are sufficiently protected. In this case, the court confirms the plan with respect to the adopted draft. Its decision makes binding the proposals accepted by each committee to all their members. Substantial modifications in the goals or means of the plan confirmed by the Court may occur but in a very limited way.

Finally, if the state of cessation of payments appears during the application of the reorganisation plan, the court can decide to stop the plan and to open a liquidation

proceeding. At the other extreme, if the court evaluates that the partial or total assignment of the business is possible or if the debtor is unable to continue the business as a going concern, the court will order the total or partial cessation of the business and an administrator will be appointed to realize the assets in that way. However, if the assignment is not sufficient to redress the situation, the procedure is closed and a liquidation proceeding is opened at the discretion of the court.

The main function of the **supervisory judge** is to supervise the progress of the proceedings and to ensure the protection of the interests of parties involved in the process. The supervisory judge is also competent to appoint five controllers among creditors requesting to be appointed (« *les contrôleurs* »). The supervisory judge may allow the debtor or the administrator to carry out acts of disposition not included in the ordinary management of the business (for instance to grant mortgages). Additionally, the supervisory judge may also allow them to pay debts arising prior to the opening of the reorganisation proceeding where the continuation of business operations required so. The supervisory judge may in addition order provisional payment of the whole or part of the secured creditors' claims or the substitution of equivalent guarantees. On the proposals submitted by the trustee, the supervisory judge will decide on the admission or rejection of the claims and particularly the statements of claims resulting from employment contracts.

- **Powers of the insolvency office holders**

In the judgment opening a reorganisation proceeding, the court appoints insolvency practitioners namely a trustee (« *mandataire judiciaire* ») and an administrator (« *administrateur judiciaire* »). Upon the request of the Public Prosecutor, the court may appoint several trustees or administrators.

Only **the trustee** appointed by the Court may act on behalf and in the general interest of the creditors.

He has the duty to inform the *supervisory judge* (« *juge-commissaire* ») and the *Public prosecutor* (« *ministère public* ») of the progress of the reorganisation proceeding. The trustee may be assisted by controllers chosen amongst the creditors. The trustee shall also draw up the list of the lodged claims with his proposals for their admission, rejection or their transfer to the competent Court.

During the observation period, the Public prosecutor will suggest the name of a trustee to the Court.

With regard to the reorganisation plan, the trustee must obtain the individual or the collective assent of the creditors who have submitted their claims in order to valid moratoriums and reductions proposed to them. The trustee will record the creditors' replies. This statement is to be sent to the debtor and to the administrator as well as to the controllers.

As an administrator is not compulsory appointed by the Court for the insolvency of small companies (less than 20 employees and less than 3.000.000 Euros turnover net of tax), it is for the trustee to perform the powers granted to the administrator with regard to the reorganisation plan.

For large companies, the court appoints an **administrator** (« *administrateur judiciaire* ») and determines his duties.

He has the duty either to assist the debtor's management operations or to carry out the entire management of the business. In any case, the administrator must comply with

the legal and contractual obligations under which the debtor is liable. However, at any time, the court may modify the administrator's duties on its own motion or upon the request of the trustee or of the Public Prosecutor. The administrator must carry out all acts necessary for the preservation of the business's interests and to maintain production. The administrator may receive information enabling him to know the exact position of the debtor's estate from public authorities and related bodies, provident institutions and social security, credit institutions and bodies responsible for the centralization of information on banking risks and payment incidents.

During the observation period, the administrator may be allowed by the supervisory judge to implement redundancies for proper economic reasons. The administrator, with the consent of the debtor, may approve the recovery or restitution of assets. In the absence of consent or in the event of a dispute, the request will be filed before the supervisory judge. Besides, the court, on request of the administrator may order the partial cessation of the activity or will pronounce its liquidation, if legal requirements are fulfilled, at any time of the observation period.

With regard to the reorganisation plan, the administrator must send the proposals for the settlement of debts to the trustee, to the controllers as well as to the works council (« comité d'entreprise »). Besides, the court may charge the administrator with carrying out acts necessary to implement the plan. Furthermore, it is the responsibility of the administrator to draft with the debtor the reorganisation plan and to submit it to the committees of creditors.

Both of these insolvency practitioners have the duty to inform the supervisory judge and the Public prosecutor of the progress of the reorganisation proceeding.

- **Divestment of the debtor or the management of the debtor in the reorganisation proceeding**

In reorganisation proceedings, the business's activity is continued. The debtor continues to carry out acts of disposal and management over his personal estate as well as to exercise rights and actions not included within the administrator's duties. If the debtor has enough money to pay off the creditors and the fees and related costs of the proceedings, the court may terminate the reorganisation proceeding upon the request of the debtor. By contrast, the court may order the partial cessation of the business's operations at any time during the observation period upon the request of the debtor.

With regard to the reorganisation plan, the debtor, with the support of the administrator, presents its proposals for the drawing up of the draft plan to the committees of creditors.

In the reorganisation proceeding, the debtor which has fewer than 20 employees and less than 3.000.000 Euros regarding its turnover net of tax, can with the consent of the trustee exercise the functions of an administrator. The debtor can, during the observation period, prepare a draft plan and can be potentially be assisted by an expert appointed by the Court. The debtor will send his proposals for the payment of its liabilities to the trustee and the supervisory judge who exercises an indirect control over the debtor's activities. During the observation period, the business operations shall be carried on by the debtor, which exercises the powers granted to the administrator. The debtor shall, with the consent of the trustee, exercise the power given to the administrator to assume executory contracts. In the event of disagreement, the supervisory judge will hear the petition of any interested party.

- **Influence of the *creditors* on the reorganisation administration**

A creditor can apply to the court to appeal against the decisions of the supervisory judge.

With regard to the reorganisation plan, credit institutions and main suppliers of goods or services are grouped into two committees of creditors by the administrator within thirty days from the decision opening the reorganisation proceeding<sup>23</sup>. Each supplier of goods or services shall be a member ipso jure of the committee of the main suppliers where its claims account for more than 3% (Ordinance of 2008) of the total claims of suppliers. The other suppliers may be members of this committee on invitation by the administrator. After discussions with the debtor and the administrator, the committees will vote on the draft plan, modified if necessary, at the latest within thirty days after the proposals have been sent by the debtor. The decision shall be made by each committee by a majority vote of its members, representing at least two-thirds of the total amount of the claims of all the members of the committee of creditors as indicated by the debtor. Creditors who are not members of the committees of creditors are consulted and the provisions of the plan regarding the creditors who are not members of the committees of creditors are confirmed.

Controllers (« *les contrôleurs* ») are chosen among creditors requesting to be appointed. Creditors as controllers assist the trustee in his functions and the supervisory judge in his duty of supervising the management of the business.

At any time during the observation period, the Court, upon request of one of the controllers may order the partial cessation of the activity or will pronounce its liquidation.

- **Influence, if any, of the *shareholders* on the insolvency administration**

With regard to the reorganization plan, where there are bondholders, the administrator will summon representatives of the body of bondholders, if any, within fifteen days from the date the draft plan is sent to the committees of creditors in order to outline it to them.

Representatives of the bondholders subsequently convene a general meeting of bondholders within fifteen days in order to decide on the reorganisation draft. The decision may relate to the total or partial abandonment of the bondholders' claims.

However, the failure to act or the absence of any representative of the bondholders will be properly recorded by the supervisory judge and the administrator will convene the general meeting of bondholders.

## **II. Liquidation proceedings**

- **Degree of supervision of the liquidation proceedings by the Court:**

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<sup>23</sup> The provisions regarding the committees of creditors are relevant in respect of companies which have more than 150 employees and an annual turnover in excess of 20.000.000 Euros.

The court will decide upon the opening of a liquidation proceeding after having heard the debtor, the representatives of the works council and any other relevant person. The court has also the power to appoint a judge in order to evaluate, with the potential assistance of an expert, the business's financial, economic and employment situation before delivering its decision to open the liquidation proceeding.

The decision to open a liquidation proceeding in respect of the debtor will mention the appointment of a **supervisory judge** (« *juge-commissaire* »), a **liquidator** (« *liquidateur* »)<sup>24</sup> who is a trustee (« *mandataire judiciaire* »). An **employees' representative** (« *représentant des salariés* ») will also be appointed as well as **controllers** (« *les contrôleurs* »). For the purposes of drawing up the inventory and of valuating the assets, the court will appoint an **auctioneer, a bailiff, a notary or an accredited goods broker**. It is then for the court to decide to open or not a liquidation proceeding on the basis of the report of the appointed liquidator.

Where the debtor's assets do include real property and the number of persons employed by the business or the sales turnover net of tax exceeds 1 employee or 300.000 Euros, or where necessary, the court will appoint an **administrator** to manage the business<sup>25</sup>. In this case, the administrator prepares the plan, carry out the acts necessary to implement the plan and he may dismiss employees. On the contrary it may decide to open a simplified liquidation procedure.

At any time during the proceeding, the court may terminate the business. In any event, only the court may grant substantial modifications to the aims or means of the approved plan (except the price) on the request of the author of the offer. The court will also determine the contracts necessary to maintain the activity of the debtor and the order confirming the plan will result in the assignment of these contracts. Furthermore, the court may attach a clause to the assignment plan providing that all or part of the assets assigned may not be alienated for a limited time.

In the decision opening the liquidation proceeding, the court will determine the deadline before which the closing of the case will be examined. In the event of an assignment plan, the court will pronounce the closing of the case only after having established that the author of a plan has performed his obligations.

In the event of fraud affecting one or more creditors, the court will allow their resumption of individual right of action against the debtor. The Court may take this decision after the closing of the proceedings, upon the request of any interested party.

The **supervisory judge** supervises the progress of the proceeding and ensures the protection of the interests of parties involved in the process, especially in case of the termination of contracts. When a formal notice has been sent to the liquidator that has remained unanswered for a month, the contracting party can request that the contract be automatically terminated. However, the supervisory judge may grant the liquidator reduced or additional time to adopt a position. The supervisory judge has the power to authorize the

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24 The Public Prosecutor may deliver his opinion on the appointment of the liquidator.

25 Where the debtor's assets do not include real property and the number of persons employed by the business or the sales turnover net of tax exceeds 1 employee or 300.000 Euros (the compulsory simplified procedure) but do not exceed 5 employees and 750.000 Euros of sales turnover net of tax, the court have (only) the faculty to grant a voluntary simplified procedure.

liquidator or the administrator to pay debts incurred before the decision opening the insolvency proceedings regarding, among others, the execution of a pledge or of a retention title.

- **Powers of the *insolvency office holders***

Where the liquidation proceeding is opened during the observation period of a safeguard or a reorganisation proceeding, it is generally for the trustee appointed in these proceedings to act as **a liquidator** in the absence of a decision to the contrary by the court.

The liquidator's main function is to carry out liquidation operations at the same time as the verification of the claims unless the proceeds of the asset sales are totally absorbed by legal fees and secured claims. He determines the priority order of the creditors and has the power to break employment contracts. He has the duty to inform on a quarterly basis the supervisory judge, the debtor and the Public Prosecutor of the progress of the procedure.

The liquidator will manage the business to maintain the activity and may, where appropriate, prepare the sale of the business as a going concern and receive and distribute the price resulting from the plan. However, where the number of persons employed by the business or the sales turnover exceeds respectively 1 employee and 300.000 Euros sales turnover net of tax, or, where necessary, an **administrator** can be appointed by the court to manage the business. In this case, the administrator will prepare the plan, carry out the acts necessary to implement the plan and he may dismiss employees.

Only the liquidator has the right to require a party contracting with a debtor to perform executory contracts in exchange of the performance of the debtor's obligations.

Where the performance concerns the payment of a sum of money, it must be paid promptly, except where the liquidator requests a moratorium.

As far as an assignment of the business of the debtor is concerned, the liquidator will inform the debtor, the employees' representative and the controllers of the content of the offers received. He will file them before the court clerk's office where any interested party may consult them.

It is the responsibility of the liquidator to examine carefully and to provide to the Court all the materials that will help it examine the seriousness of the offers.

- **Divestment of the debtor or the management of the *debtor***

The debtor has the power to request the court opening the liquidation proceeding, the appointment of another liquidator, expert or administrator. He has also the power to request the supervisory judge to replace the expert.

The liquidation order will organize and order the divestment and separation of the debtor from the management and its right to dispose of its assets until the end of the liquidation proceeding. The debtor's rights regarding its estate shall be exclusively exercised by the liquidator excluding those rights that are not included within the duties of the liquidator.

The debtor will be informed by the liquidator of the content of the offers received as far as the assignment of its business as a going concern is concerned.

- **Influence of the *creditors* on the liquidation administration**

The creditors have the power to request the Court opening the liquidation proceeding the appointment of another liquidator, expert or administrator or to appoint one or several other liquidators or administrators. They have also the right to submit their claims to the liquidator. In addition, if the liquidator does not make use of his right to continue a contract, the non-performance of the contract by the debtor may give rise to damages that must be claimed by creditors as liabilities. Creditors have to submit these claims to the liquidator.

Secured creditors (lien, pledge or mortgage holders) may, once they have submitted their claims even if these have not yet been admitted, exercise their right to bring separate actions if the liquidator has not begun to sell the encumbered property within three months from the decision opening the liquidation proceeding. Further, where the court has fixed a deadline prior to which purchase offers must be sent to the liquidator, these creditors may exercise their right to bring separate action if no offer including this asset has been presented at the end of the deadline. Furthermore, a creditor may apply to the supervisory judge in order to obtain an order for the payment, on a provisional basis, of a portion of a claim that has definitively been admitted.

In principle, the judicial decision closing the liquidation proceeding due to an excess of liabilities over assets will not allow creditors to recover their separate right of action against the debtor. However, the French commercial code provides several exceptions if their claims result, among others, from a criminal conviction of the debtor or the personal disqualification of the debtor. In addition, in the event of fraud affecting one or more creditors, they will apply to the court in order to obtain the resumption of their individual right of action against the debtor. Besides, if assets have not been sold or if the relevant litigation in the interest of creditors has not been initiated during the proceeding after its closing due to an excess of liabilities over assets, any interested creditor may apply to the court to reopen the latter proceeding.

As controllers, creditors shall be informed by the liquidator of the content of the offers received as far as the assignment of the business of the debtor is concerned. Other creditors can consult the offers at the court clerk's office.

- **Degree of transparency and accountability of the management of the liquidation administration;**

Any assignment of the business as a going concern and any sale of assets must be preceded by a specific publication according to the size of the business and the nature of the assets to be sold. The liquidator must also inform the debtor, the employees' representative and the controllers of the content of the offers received. He must file them with the court clerk's office where any interested party can consult them. It is the duty of the liquidator to examine carefully and to provide to the Court all materials that will help it to examine the seriousness of the offers.

Before any sale or destruction of the debtor's archives, the liquidator will inform the competent public authority for the conservation of archives. The authority has a pre-emptive right.

Regarding the simplified liquidation procedure (which is applicable if the debtor's assets include no real estate and where the number of its employees during the six months prior to the decision opening the proceeding and its sales turnover excluding tax are equal to or less than the thresholds fixed by a *Conseil d'État* decree<sup>26</sup>), one year at the latest after the decision opening the proceeding, the court will pronounce the closing of the liquidation procedure. However the Court may decide at any time during the simplified procedure to apply rules applicable to any liquidation procedures.

#### **Question (iv):**

- **Rules on the ranking of creditors**
- **Rules on the ranking of claims in case of safeguard proceedings or reorganisation proceedings**

In case of **safeguard proceedings** or **reorganisation proceedings**, claims shall be paid in the following order:

1. Claims of wages and salaries;
2. Legal fees regularly arising **after** the order opening the proceedings;
3. Claims included in the agreement confirmed by the court in the conciliation proceedings (extrajudicial proceedings) according to their preferential of "new money" (creditors who have made a contribution of fresh funds to the debtor in order to ensure the continuation and long-term future of the business's activity or who, in the approved agreement, supply new assets or services in order to ensure the continuation and long-term future of the business. This provision shall not apply to contributions made by shareholders or partners in the form of a capital increase. Creditors that are signatories to the agreement may not benefit directly or indirectly from this provision in respect of their contributions prior to the commencement of the conciliation proceedings);
4. Claims arising **after** the order opening the proceedings;
5. Claims arise **prior** to the order opening the proceedings (even for the secured claims).

- **Rules on the ranking of claims in case of liquidation proceedings**

In case of a **liquidation proceeding**, claims shall be paid in the following order:

1. Claims of wages and salaries;
2. Legal fees arising **after** the order opening the proceedings;
3. Claims included in the agreement confirmed by the court in a conciliation proceeding according to their preferential of "new money";
4. Charge secured on movable or immovable property;
5. Charge secured on special personal property subject to lien and pledges on tool outfit and equipment;
6. Claims arising **after** the order opening the proceedings;

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<sup>26</sup> Decree No 2009-160 of 12 February 2009, new article D. 641-10 of the French commercial code.

7. Claims arise **prior** to the order opening the proceedings (even for the secured claims).

- **Rules on the ranking of claims arising after the decision opening the insolvency proceedings**

Creditors whose claims arise **after** the order opening the insolvency proceedings shall be paid in the following order:

1. Claims of wages and salaries for which funds have not been advanced by the Guarantee Fund of Wages and Salaries (*Association pour la Gestion du régime de garantie des créances des Salariés: AGS*).
2. Loans and claims arising from the performance of continued contracts and where the other party accepts deferred payments. These loans and the moratorium shall be allowed by the supervisory judge within the limits necessary for the continuation of business operations during the observation period and shall be published. In the event of termination of a contract that had been continued in a proper manner, compensation and penalties will be excluded.
3. Other claims, according to their priority.

### **Question (v):**

- **Rules on the process of filing and verification of claims:**

#### **I. Reorganisation proceedings**

As soon as the reorganisation order is published, all creditors other than employees, whose claims arose prior to the decision opening the reorganisation proceeding, have two months to submit their claims to the trustee. All foreign creditors have four months to submit their claims to the French trustee. Secured creditors are informed personally and the period provided to submit their claims will run from the receipt of the notice of this personal information delivered to them.

All claims subject to pending civil, administrative or criminal proceedings whose amount is not yet definitively determined are to be submitted based on an assessment and within the time limit provided by the court under penalty of debarment.

Regarding claims arising after the decision to open the reorganisation proceeding, these are to be successively submitted with regard to the maturity date of the claim. Creditors whose claims arise from a contract involving successive performance must submit the total amount of their claim.

The submitted claims will be certified as genuine by each creditor unless if the claim results from a judgment. However the supervisory judge may request the statutory auditor's stamp or the stamp of a public accountant to be affixed to the submission of claims.

If creditors fail to submit their claims on time, they will not participate in the allocation of funds and distribution of dividends. However the supervisory judge has the power to set aside the debarment of their claims if they are able to prove that they are not liable for the absence of submission of claims. In this case, they may then participate only in the distributions of dividends made after the date of their request.

Besides, the creditor cannot invoke claims not submitted on time during the execution of the plan. However, any creditor can apply to the court to set aside a debarment but only within a six-month period. This period will run from the date of publication of the decision to open the reorganisation proceeding. With respect to secured creditors, the period runs from the receipt of the notice delivered to them. As an exception, the period is to be extended to one year with regard to creditors who were unable to know the existence of their claim before the end of the six months period.

In the event of a dispute over the whole or part of a claim, the trustee will inform the interested creditor and he must request him to give its explanations. A failure to reply within thirty days shall bar any later dispute over the trustee proposals.

During the observation period, the statement of creditors' claims (i.e the list of creditors and the amount of the debts) is submitted to the administrator and to the trustee. The trustee shall draw up the list of the lodged claims with his proposals for their admission, rejection or their transfer to the competent court. The list will be submitted to the supervisory judge. Based on the proposals submitted by the trustee, the supervisory judge decides on the admission or rejection of the claims. He must also mention the existence of a pending legal action or his lack of jurisdiction in respect of the dispute. An appeal against the decisions of the supervisory judge can be available to the creditor, the debtor or to the trustee.

## **II. Liquidation proceedings**

As soon as the liquidation order is published, all creditors other than employees, whose claims arose prior to the decision to open the liquidation proceeding, have two months to submit their claims to the trustee. All foreign creditors have four months to submit their claims to the French trustee. Secured creditors are to be informed personally and the period to submit their claims will run from the receipt of the notice of this personal information delivered to them.

All claims subject to pending civil, administrative or criminal proceedings whose amount is not yet definitively determined are to be submitted based on an assessment and within the time limit provided by the Court under penalty of debarment.

Regarding claims arising after the decision to open the liquidation proceeding, they are to be successively submitted with regard to the maturity date of the claim. Creditors whose claims arise from a successive performance contract shall submit the total amount of their claim.

The submitted claim must be certified as genuine by the creditor unless if the claim results from a judgment. However the supervisory judge may request the statutory auditor's stamp or the stamp of a public accountant to be affixed to the submission of claims. Any refusal to affix the stamp must be motivated by the Court.

If creditors fail to submit their claims on time, they will not be able to participate in the allocation of funds and distribution of dividends. However the supervisory judge has the power to set aside the debarment of their claims if they are able to prove that they are not liable for the absence of submission of claims. In this case, they may then participate only in the distributions of dividends made after their request. Further, claims not submitted on time cannot be invoked by the creditor during the execution of the plan or if all the duties

of the debtor have been fulfilled. However, any creditor can apply to the court to set aside a debarment but only within a six-month period. This period will run from the date of publication of the decision to open the proceeding. With respect to secured creditors, the period will run from the receipt of the notice delivered to them. As an exception, the period is to be extended to one year with regard to creditors who were unable to know the existence of their claim before the end of the six months period.

In the event of a dispute over the whole or part of a claim, the trustee will inform the interested creditor and he must request him to give its explanations. A failure to reply within thirty days shall bar any later dispute over the trustee proposals.

Regarding the simplified liquidation procedure (applicable if the debtor's assets include no real estate and the number of its employees during the six months prior to the decision opening the proceeding and its sales turnover excluding tax are equal to or less than the thresholds fixed by a *Conseil D'État* decree), the verification of claims will be limited to those claims of which the ranking could enable payment in the distribution and to claims arising out of a contract of employment.

#### **Question (vi):**

- **Rules on the responsibility for the proposal of a reorganisation and the adoption, modification and possible contents of such plan both inside and outside formal insolvency proceedings.**

#### **1. Extrajudicial proceedings**

##### **a. Mandat *ad hoc* proceedings**

The debtor shall file its case with the president of the court, stating therein its economic, employment and financial situation, financing needs.

The *Tribunal de commerce* (Commercial court) shall have jurisdiction for the debtor who carry out a commercial or craftsman's activity and farmers. The *Tribunal de grande instance* (High court) shall have jurisdiction for private law entities and to natural persons running an independent professional activity, including independent professional persons with a statutory or regulated status or whose designation is protected.

The president of the *Tribunal de commerce* (Commercial court) or the president of the *Tribunal de grande instance* (High court) may, at the request of the debtor, appoint a trustee *ad hoc* (*mandataire ad hoc*) whose duties he shall set out for a period in the discretion of the court. The debtor may propose a trustee *ad hoc* to be appointed by the president of the court.

The debtor continues to manage his business without being divested. The trustee *ad hoc* only supervises the administration of the debtor's affairs.

The trustee *ad hoc*'s duty is to promote negotiation and a compromise solution and to obtain concessions from the creditors.

The trustee *ad hoc* and the president of the court shall be bound by a duty of confidentiality.

The mandat *ad hoc* will be a success if the trustee *ad hoc* reaches an amicable agreement between the debtor and its main creditors.

But the mandat *ad hoc* can also be a flop leading to the opening of a reorganisation proceedings or a liquidation proceedings if the president of the court establishes a state of cessation of payments (the current liabilities that are due exceed the available assets).

#### **b. Conciliation proceedings**

A conciliation proceedings is instituted before the *Tribunal de commerce* (Commercial court) for the persons who carry out a commercial or craftsman's activity, who encounter an actual, or a foreseeable legal, economic or financial difficulty, **and who have not been in a state of cessation of payments for more than forty-five days.**

The conciliation proceedings shall be applicable, under the same conditions, to private law entities and to natural persons running an independent professional activity, including independent professional persons with a statutory or regulated status or whose designation is protected. The *Tribunal de grande instance* (High court) shall have jurisdiction and its president shall have the same powers as those attributed to the president of the *Tribunal de commerce* (Commercial court).

The conciliation proceedings shall not apply to farmers as they are subject to the procedure provided for in Articles L351-1 to L351-7 of the Rural Code (*règlement amiable* proceedings).

The debtor shall file its case with the president of the court, stating therein its economic, employment and financial situation, financing needs and, if necessary, the means to tackle them. The debtor may propose a conciliator to be appointed by the president of the court.

The conciliation proceedings shall be commenced by the president of the court who shall appoint a conciliator for a period not exceeding four months but that he may, through a reasoned ruling, extend by one month at the most when so requested by the conciliator. However, if an application for an **approval agreement** is submitted to the court before the end of this period, the conciliator's duties and the proceedings are extended until the decision of the court.

Where it is impossible to reach an agreement, the conciliator's duties and the proceedings shall come automatically to an end.

The decision opening the conciliation proceedings shall be notified to the Public prosecutor. Where the debtor runs an independent professional activity with a statutory or regulated status or whose designation is protected, the decision will also be notified to the relevant supervisory body or authority, if any.

After the opening of the conciliation proceedings, the president of the court may appoint an expert of his choice to draw up a report on the debtor's economic, employment and financial situation and, notwithstanding any statutory or regulatory provision to the contrary, obtain all information enabling him to know the debtor's accurate economic and financial situation from banking and financial institutions.

Any person who has taken part in the conciliation proceedings or who, by virtue of his duties, knows about these shall be bound by a duty of confidentiality.

The conciliator's duty is to promote the conclusion of an amicable agreement between the debtor and its main creditors as well as, if applicable, its usual contracting partners, which is intended to put an end to the business's difficulties. He may also make any proposals for the safeguarding of the business, the continuation of the economic activity and the maintenance of employment.

For this purpose, the conciliator may obtain all useful information from the debtor. The president of the court shall transmit to the conciliator all information in his possession and, if applicable, the results of the investigation if the court has appointed an expert to draw up a report on the debtor's economic, employment and financial situation.

The conciliator shall inform the president of the court of the progress of his duties and state all relevant comments on the debtor's performance.

Where it is impossible to reach an agreement, the conciliator will promptly present a report to the president of the court, who shall terminate the conciliator's duties and the conciliation proceedings. The president's decision shall be notified to the debtor.

The conciliator is liable for all negligence in performing his duties. But in practice, it is difficult to offer proof of negligence because the conciliator is not obliged to reach an agreement.

Financial authorities, social security bodies, institutions managing the unemployment insurance system may consent to a cancellation of debt as well as assignments of preferential lien or mortgage or renunciation of securities.

If, during the proceedings, the debtor is sued by a creditor, the judge who has commenced the proceedings may, at the debtor's request and after having been informed regarding the situation by the conciliator, apply Articles 1244-1 to 1244-3 of the Civil Code.

Following these articles, taking into account the debtor's position and in consideration of the creditor's needs, a judge may, within a two-year limit, defer or spread out the payment of sums due. By a special judgment, setting out the grounds on which it is based, the judge may order that the sums corresponding to the deferred due dates carry interest at a reduced rate which may not be lower than the statutory rate or that the payments be appropriated first to the capital. Furthermore, he may subordinate those measures to the performance, by the debtor, of acts appropriate for facilitating or guaranteeing the payment of the debt. The provisions of these Articles shall not apply to debts for maintenance.

- **The agreement recorded by the court (*accord constaté*)**

Upon the joint petition of the parties, the president of the court shall **record** their agreement and make it enforceable. He shall rule upon the case based on the debtor's certified statement attesting that he was not in a state of cessation of payments at the time the agreement was entered into or that the agreement has put an end to the state of cessation of payments. The decision recording the agreement shall not be subject to publication formalities and shall not be appealed against. The agreement shall terminate the conciliation proceedings.

- **The agreement approved by the court (*accord homologué*)**

However, at the debtor's request, the court shall **approve** the agreement obtained if the following conditions are met:

1. The debtor is not in a state of cessation of payments or the agreement puts an end to it;
2. The terms of the agreement should normally ensure the continuity of the business's activity;
3. The agreement does not harm the interests of non-signatory creditors.

The court shall rule upon the approval of the agreement after having heard or duly summoned to the judge's chambers, the debtor, the creditors who are party to the agreement, the representatives of the works council or, in the absence of a works council, the employee delegates, the conciliator and the Public prosecutor. The supervisory body or, if any, relevant authority of a debtor who runs an independent profession with a statutory or regulated status or whose designation is protected, shall be heard or summoned under the same conditions. The court may hear any other person whose hearing that it deems useful.

The approval of the agreement shall terminate the conciliation proceedings.

Where the debtor is subject to a statutory audit of its accounts, the **approved agreement** will be transmitted to the statutory auditor. The approval decision shall be filed with the clerk's office, where any interested party may consult it, and be published. The approval decision shall be subject to appeal by the Public prosecutor. The approval decision shall be subject to appeal by the parties arising out of their preferential of "new money". The approval decision shall be subject to third-party proceedings. A decision to refuse to approve the agreement shall not be published. It shall be subject to appeal.

The **recorded agreement** or the **approved agreement** shall stay or prohibit, during its performance period, all suits and shall quash or prohibit all actions filed by creditors individually relating to movable property as well as immovable property of the debtor for the payment of claims referred to in the agreement. It shall interrupt, for the same period, the time limits given to creditors that are parties to the agreement, under the penalty of loss or termination of rights attached to the claims stipulated in the agreement. Co-obligors and persons who are bound by a surety bond or an independent guarantee may avail themselves of the provisions of the approved agreement.

Co-obligors and persons who are bound by a personal guarantee or affect or subject an asset in guarantee may avail themselves of the provisions of the **recorded agreement** or the **approved agreement**.

The **approved agreement** shall lead to the automatic removal of any prohibition from issuing cheques, imposed in compliance with Article L131-73 of the Monetary and Financial Code after rejection of a cheque issued prior to the commencement of the conciliation proceedings.

Upon a petition by one of the parties to the **recorded agreement** or the **approved agreement**, the court, if it observes non-performance of the obligations emanating from the agreement, shall pronounce the rescission of the latter as well as the loss of any grace period granted applying Articles 1244-1 to 1244-3 of the Civil Code.

If safeguard proceedings, reorganisation proceedings or liquidation proceedings are commenced, those persons who, under the **approved agreement**, have made a

contribution of fresh funds to the debtor in order to ensure the continuation and long-term future of the business's activity will be paid, up to the amount of this sum, according to their preferential lien before all other claims after and prior to the commencement of the conciliation proceedings.

Those persons who, in the **approved agreement**, supply new assets or services in order to ensure the continuation and long-term future of the business will be paid, for the amount of the price of the assets or services, according to their preferential lien before all claims born after and prior to the commencement of the conciliation proceedings.

This provision shall not apply to contributions made by shareholders or partners in the form of a capital increase.

Creditors that are signatories to the agreement may not benefit directly or indirectly from this provision in respect of their contributions prior to the commencement of the conciliation proceedings.

The commencement of safeguard, reorganisation or liquidation proceedings shall automatically terminate the agreement **recognised** or **approved**. In this case, the creditors will recover all their claims and guarantees, after deduction of sums received.

## **2. Formal proceedings**

### **a. Safeguard proceedings and reorganisation proceedings**

The **safeguard** proceedings is opened on the petition of the debtor that shows difficulties that it is unable to overcome on its own but that is not in a cessation of payments.

The purpose of these proceedings is to facilitate the reorganisation of the business in order to allow the continuation of the economic activity, the maintenance of employment and the settlement of liabilities.

The **reorganisation** proceedings are available to the debtor which, being unable to pay its accrued liabilities with its quick assets, is in a state of cessation of payments.

The commencement of these proceedings must be requested by the debtor at the latest within the forty-five days following the cessation of payments if the debtor has not, within this time limit, requested the commencement of conciliation proceedings. If the conciliation proceedings fail, the court will initiate a case of its own motion in order to rule upon the commencement of reorganisation proceedings if it appears from the conciliator's report that the debtor is in a state of cessation of payments.

The purpose of the reorganisation procedure is to allow the continuation of the business's operations, the maintenance of employment and the settlement of its liabilities.

The **safeguard** proceedings and the **reorganisation** proceedings shall apply to debtors carrying out a commercial or craftsman's activity, farmers, other persons running an independent professional activity, including an independent professional person with a statutory or regulated status or whose designation is protected, as well as private-law entities.

The **safeguard** proceedings and the **reorganisation** proceedings shall give rise to a plan to be confirmed by a court order at the end of an observation period and, where appropriate, to the formation of two committees of creditors.

- **The opening of the safeguard proceedings and the reorganisation proceedings**

In the **reorganisation** proceedings, the court shall determine the date of the cessation of payments. If a date is not being determined, the date of the cessation of payments shall be deemed to be that of the issuance of the order recognizing it.

The date of the cessation of payments may be moved once or more times, without however going back more than eighteen months before the date of issuance of the order recognizing the cessation of payments. Except in cases of fraud, it may not be moved to a date prior to the final decision endorsing an amicable agreement. An action may be filed with the court by the administrator, the trustee or the Public prosecutor to that effect. The court shall judge the case after hearing or duly summoning the debtor. The petition for modifying this date must be filed with the court within a year following the issuance of the commencement order.

In the **safeguard** proceedings and in the **reorganisation** proceedings, the court shall issue an order on the commencement of the proceedings after having heard in or duly summoned to the judge's chambers, the debtor, and representatives of the works council or, in the absence of a works council, the employee delegates. The court may hear any other person whose testimony it deems useful.

The court may, before making a ruling, appoint a judge who will gather information regarding the business's financial, economic and employment situation. He may be advised by any expert of his choice.

The hearing for the commencement of proceedings with respect to a debtor who benefits or has benefited from a mandat *ad hoc* or from conciliation proceedings during the preceding eighteen months must be held in the presence of the Public prosecutor.

The judgment shall open an observation period not exceeding six months, which may be renewed once by a reasoned ruling on motion of the administrator, the debtor or the Public prosecutor. It may also be extended exceptionally, on motion of the Public prosecutor, by a reasoned ruling of the court.

The court shall appoint the supervisory judge, has the possibility of appointing one or more experts for duties that it shall determine and shall appoint one or more judicial trustees and one or more judicial administrators.

The supervisory judge shall supervise the speedy progress of the proceedings and the protection of the parties' interests.

The administrator and the trustee shall inform the supervisory judge and the Public prosecutor of the progress of the proceedings on regular basis. The supervisory judge and the Public prosecutor may request the disclosure of all deeds and documents relating to the proceedings at any time. The Public prosecutor shall give to the supervisory judge, on the latter's request or of his own motion, notwithstanding any legal provision to the contrary, any information he holds and which may be useful for the proceedings.

The supervisory judge shall appoint up to five controllers from among those creditors requesting to be appointed. Where he appoints several controllers, he must ensure that at least one of them is chosen from among the secured creditors and one from among the unsecured creditors.

The controllers shall assist the trustee in his functions and the supervisory judge in his duty of supervising the management of the business.

- **The business during the observation period**

In the **safeguard** proceedings, the management of the business shall be carried out by its manager. The administrator(s), supervise(s) the debtor's management operations or to assist the debtor in all or some of the management.

From the opening of the **safeguard** proceedings and the **reorganisation**, an inventory and a valuation of the debtor's estate and the guarantees encumbering it shall be made. The debtor shall add to the inventory to be given to the administrator and the trustee a statement with respect to assets he holds that may be claimed by a third party.

The business's activity shall be continued during the observation period.

The court may order the partial cessation of the business's operations at any time during the observation period, on motion of the debtor.

Under the same conditions, the court will convert the safeguard proceedings into reorganisation proceedings or liquidation proceedings, on motion of the debtor, administrator, trustee, one of the controllers, the Public prosecutor or, of its own motion.

The court will also convert the safeguard proceedings into reorganisation proceedings if the adoption of a safeguard plan is manifestly impossible and if the end of the proceedings would most probably and in a short period lead to the cessation of payments.

In the **reorganisation** proceedings, at any time during the observation period, the court, on motion of the debtor, the administrator, the trustee, one of the controllers, the Public prosecutor or of its own motion may order the partial cessation of the activity or will pronounce its liquidation.

In the **reorganisation** proceedings, where dismissals for economic reasons are urgent, inevitable and indispensable during the observation period, the administrator may be allowed by the supervisory judge to implement these dismissals.

- **Report on the business's economic and employment situation:**

The administrator, in cooperation with the debtor and possibly assisted by one or more experts, shall be required to draw up a report on the business's economic and employment situation.

The report on the economic and employment situation shall state the origin, extent and nature of the business's difficulties.

The supervisory judge may, notwithstanding any statutory or regulatory rule to the contrary, obtain information enabling him to know the debtor's exact economic, financial, employment and net asset situation from statutory auditors, public accountants, employees or employees' representatives, public authorities and bodies, social security and provident institutions, credit institutions as well as from bodies responsible for the centralisation of information on banking risks and payment incidents.

The administrator shall obtain from the supervisory judge all information and documents useful for the implementation of his duties and those of any experts.

Where the proceedings are commenced with respect to a business that benefits from an approved amicable agreement (conciliation proceedings), the administrator will receive the expert's report.

The administrator shall consult the trustee and hear any person capable of informing him about the business's position and the possibilities for its recovery, the conditions for settling its debts and the employment conditions under which the activity may be continued. He shall inform the debtor of this and consider the debtor's views.

He shall inform the trustee as well as the works council or, in the absence of a works council, the employee delegates, of the progress of his duties. In the reorganisation proceedings, the administrator shall also inform the debtor.

Where the debtor is an independent professional person with a statutory or regulated status or whose designation is protected, the administrator will consult the debtor's supervisory body or relevant authority, if any.

Where there is a serious likelihood of saving the business, the court will draw up a plan, terminating the observation period in so doing.

The plan shall include, if necessary, the cessation, the addition or the assignment of one or more activities.

- **Drawing-up a draft plan**

The draft plan shall state the prospects for turning the business around on the basis of the operational possibilities and methods, market conditions and the means of finance available.

It shall define the terms and conditions for settlement of the liabilities and any performance guarantees that the head of the business must provide.

The draft shall state and explain the level of and prospects for employment as well as the employment conditions for continuation of the business's operations.

Where the draft provides for dismissals for economic reasons, it will review steps already taken and define the actions to be carried out to facilitate the re-employment and the compensation of employees whose jobs are under threat. The draft shall take into consideration any work documented in the environmental report.

It shall document, attach and analyse the purchase offers from third parties with regard to one or more activities. It shall state the activity or activities to be closed or added.

The administrator shall send the proposals for the settlement of debts, as they are being drafted and under the supervision of the supervisory judge, to the trustee, the controllers as well as to the works council or, in the absence of a works council, to the employee delegates.

The trustee must obtain the individual collective assent of the creditors who have properly submitted claim in to the moratoriums and reductions proposed to them.

The trustee shall record the creditors' replies. This statement shall be sent to the debtor and to the administrator, as well as to the controllers.

- **Order confirming the plan and implementation of the plan**

After having heard or duly summoned the debtor, the administrator, the trustee, the controllers as well as the representatives of the works council or, in the absence of a works council, the employee delegates, the court shall make its decision based on the debtor's draft plan and on the report on the business's economic and employment situation, after having received the opinion of the Public prosecutor.

The plan shall state the persons bound to implement it and all of their commitments necessary for the safeguard of the business. These commitments shall relate to the future of the business's activity, the terms and conditions for maintaining and financing the business, the settlement of liabilities as well as any guarantees given to ensure implementation of the plan.

The plan shall state and explain the level of and prospects for employment as well as the employment conditions for continuation of the business's operations.

The order confirming the plan shall make its provisions binding on anyone.

The duration of the plan shall be fixed by the court. It may not exceed ten years. Where the debtor is a farmer, this period may not exceed fifteen years.

The confirmation of the plan by the court shall lead to the automatic lifting of the prohibition to issue cheques, ordered on rejection of a cheque issued prior to the issuance of the commencement order, in compliance with Article L131-73 of the Monetary and Financial Code.

In the order confirming or modifying the plan, the court may decide that assets that it deems indispensable for the continuation of the business may not be alienated, for a period fixed by it, without its permission after having received the opinion of the Public prosecutor. The period of inalienability may not exceed that of the plan.

The plan shall state the modification of the articles of association necessary for the reorganisation of the company.

Where necessary, the order confirming the plan shall give a power of attorney to the administrator to convene the competent meeting to put into effect the modifications provided for in the plan.

The partners or shareholders must pay the capital contribution they have subscribed to within the time limit determined by the court. In the event of immediate payment, they may benefit from set off up to the amount of their admitted claims and within the limit of the debt reduction included the plan in the form of debt cancellation or moratoriums.

The court shall take cognizance of the moratoriums and cancellations accepted by the creditors. These moratoriums and cancellations may, if necessary, be reduced by the court. For other creditors, the court shall impose uniform payment terms, subject to, regarding claims for future settlement, longer payment terms than those stipulated by the parties prior to the commencement of the proceedings, which may exceed the period of the plan.

The first payment may not be scheduled more than one year hence.

After the second year, the amount of each annuity stipulated by the plan may not, except in the case of an agricultural activity, be less than 5% of the admitted liabilities.

For finance lease contracts, these payment terms will come to an end if, before their expiry, the finance lessee exercises its purchase option. This may not be exercised if, subject to the deduction of accepted cancellation, all sums contractually due have not been paid.

The court may charge the administrator with carrying out acts necessary to implement the plan to be determined by him. The trustee shall remain in office during the time necessary for the verification and drawing up of the definitive list of claims.

The court shall appoint the administrator or the trustee as plan performance supervisor. The court may appoint several supervisors, if necessary.

The plan performance supervisor may initiate action in the collective interest of creditors and obtain all documents and information useful for his duties. He shall inform the president of the court and the Public prosecutor of any failure in the implementation of the plan. He shall also inform the works council or, in the absence of a works council, the employee delegates.

Substantial modifications of the goals or means of the plan may be made only by the court, on motion of the debtor and based on the report of the plan performance supervisor.

The court shall rule upon the case after having received the opinion of the Public prosecutor and after hearing or duly summoning the debtor, the plan performance supervisor, the controllers and representatives of the works council or, in the absence of a works council, the employee delegates and any interested party.

The court that confirmed the plan may, after the Public prosecutor has given his opinion, order the rescission of the plan if the debtor does not fulfil its commitments within the time limits provided for in the plan. When the debtor doesn't pay dividends, the plan performance supervisor shall recover these dividends in accordance with the provisions of the plan.

Where the debtor's cessation of payments is established during the performance of the plan, the court which has confirmed the plan shall, after the Public prosecutor has given his opinion, order its rescission and pronounce the judicial liquidation.

The order pronouncing the rescission of the plan shall stay its implementation and the proceedings and lapse all moratoriums granted.

Where it is established that the commitments stated in the plan or ordered by the court have been performed, the court, on motion of the plan performance supervisor, the debtor or any interested party, will record that the plan has been implemented.

#### - **Committees of creditors**

Both in safeguard proceedings and reorganisation proceedings, debtors whose accounts are certified by a statutory auditor or prepared by a public accountant and whose number of employees exceeds 150 or sales turnover excluding tax exceeds the thresholds of 20 million Euros (fixed by a Conseil d'Etat decree) shall constitute committees of creditors.

On motion of the debtor or the administrator, the supervisory judge may constitute committees of creditors where this threshold is not reached.

Credit institutions and main suppliers of goods or services are grouped into two committees of creditors by the administrator within thirty days from the decision opening the reorganisation proceeding.

Each supplier of goods or services shall be a member ipso jure of the committee of the main suppliers where its claims account for more than 3% of the total claims of suppliers.

The other suppliers may be members of this committee on invitation by the administrator.

After discussions with the debtor and the administrator, the committees will vote on the draft plan, modified if necessary, at the latest within thirty days after the proposals have been sent by the debtor.

The decision shall be made by each committee by a majority vote of its members, representing at least two-thirds of the total amount of the claims of all the members of the committee of creditors as indicated by the debtor.

Creditors who are not members of the committees of creditors are consulted and the provisions of the plan regarding the creditors who are not members of the committees of creditors are confirmed.

#### **Question (vii):**

- **Rules on the establishment of the insolvency estate:**
- **Scope of insolvency proceedings with respect to assets (for both proceedings):**

From the decision opening the reorganisation/liquidation proceeding, an inventory and a valuation of the debtor's estate and the guarantees encumbering it is to be made. The inventory must be submitted to the administrator and to the trustee/liquidator. The debtor must add a statement with respect to the assets he holds that may be claimed by a third party. The debtor must give to the administrator and to the trustee/liquidator a list of its creditors, the amount of its debts and the main executory contracts. The debtor must also inform them of any pending proceedings.

The administrator (or the trustee/liquidator if no administrator has been appointed) can receive information enabling him to know the exact position of the debtor's estate from public authorities and bodies, provident institutions and social security, credit institutions and bodies responsible for the centralization of information on banking risks and payment incidents.

The sums recovered following actions initiated by the trustee/liquidator become part of the debtor's estate and are to be used to pay the debtor's liabilities according to the terms provided for paying liabilities if the continuation of the business is decided upon. In this connection, the spouse of a debtor subject to insolvency proceedings must specify the content of his/her personal property in compliance with the rules of the matrimonial regime. However, in case of doubt, the trustee/liquidator or the administrator may prove by all means that the assets acquired by the debtor's spouse have been paid by money

provided by the debtor, and shall request the inclusion of these acquisitions in the debtor's assets.

Recovery claims against movable properties may be filed from the date of publication of the order commencing the proceedings within a three-month period. Goods may be claimed in cases where the sale contract was rescinded prior to the decision opening the insolvency proceeding, either pursuant to a court decision or pursuant to a condition subsequent, and if the goods still exist in kind, wholly or partially. The recovery claim must also be admitted even if the rescission of the sale had been ordered or referred to by a court decision after decision opening the insolvency proceeding where the action for recovery or for rescission of a contract was initiated by the seller, for a reason other than non-payment of the sales price, prior to the decision opening the insolvency proceeding.

The administrator with the consent of the debtor (or in the absence of an administrator, the debtor with the consent of the trustee/liquidator) may approve the recovery claim or restitution claim of assets. In the absence of consent or in the event of dispute, the request will be filed before the supervisory judge.

- **Rules on the disposal or sale of the assets included in the estate:**

### **I. Reorganization proceeding**

The court will determine and modify at any time the duties of the administrator. The court may modify the duties of the administrator at any time. The court may require the administrator, jointly or separately if several administrators have been appointed by the court, to assist the debtor in all or certain management operations, or to carry out the entire management of the business, or part of it, alone. In performing his duties, the administrator must comply with the debtor's legal and contractual obligations.

Third parties are allowed to submit offers to the administrator in order to maintain the activity of the business through a partial or complete assignment of the business's assets from the decision opening the reorganisation proceeding. The court will order that the observation period be continued if the business has sufficient financial resources. By contrast, the court may order the partial cessation of the activity or will pronounce its liquidation at any time during the observation period. However, if, during the observation period, the debtor has enough money to pay off the creditors and the fees and related costs of the proceedings, the Court may, on the motion of the debtor, terminate the proceeding.

### **II. Liquidation proceeding**

The assignment of the business involving all or some of the assets of the debtor is aimed at maintaining those activities capable of being operated autonomously, maintaining all or part of the related employment contracts and settling the liabilities.

Where the court is of the view that the total or partial assignment of the business as a going concern may be considered, it will allow the continuation of operations and determine a deadline before which purchase offers must be sent to the liquidator. Claims arising regularly after the decision opening the liquidation proceeding for the needs of the proceedings or because of goods or services provided to the activity debtor shall be paid as

they fall due. The court may also attach a clause to the assignment plan providing that all or part of the assets assigned may not be disposed of for a limited time.

The liquidator must inform the debtor, the employees' representative and the controllers of the content of the offers received. He must file them before the court clerk's office where any interested party may consult them.

Regarding the assignment of the real estate, the supervisory judge must determine the opening bid and the main terms of the sale. Then the liquidator must distribute the proceeds of the sale and settle the priority among the creditors. Any disputes may be filed before the enforcement judge (« *juge de l'exécution* »).

In any event, the supervisory judge can either order the sale at a public auction or allow a private sale of the debtor's other assets. The supervisory judge may require that the draft for an amicable sale be submitted to him to ascertain whether the terms he has provided for have been complied with.

Regarding the simplified liquidation procedure (applicable if the debtor's assets include no real estate and that the number of its employees during the six months prior to the decision opening the proceeding and its sales turnover excluding tax are equal to or less than the thresholds fixed by a *Conseil d'État* decree), the court will determine the assets of the debtor that may be sold in a private sale which will be implemented by the liquidator within three months following the decision opening the liquidation procedure.

#### **Question (viii):**

- **Rules on detrimental acts (as referred to in Article 13 Insolvency Regulation).**

The following acts are null and void if performed by the debtor after the date on which insolvency was declared (cessation of payments):

1. All free transfers of moveable or immoveable property;
2. Any commutative contract in which the debtor's obligations substantially exceed those of the other party;
3. Any payment, howsoever effected, of debts not due on the date of payment;
4. Any payment for debts due made other than in cash, negotiable instruments, bank transfers, the transfer vouchers referred to in Law No. 81-1 of 2 January 1981 facilitating corporate credit, or any other method of payment generally accepted in business dealings;
5. Any depositing and any consignment of funds made pursuant to Article 2350 of the Civil Code<sup>27</sup>, failing a judicial decision having *res judicata* status;

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<sup>27</sup> Article 2350: "The deposit of sums, effects or securities, judicially ordered for guarantee or as a provisional measure, involves the special lien and the prior charge of Article 2333".

Article 2333 of the Civil Code: "A pledge is an agreement by which the pledgor gives to a creditor the right to be paid in preference to his other creditors out of a corporeal movable or a set of corporeal movables, actual or future. The debts secured may be actual or future; in the latter case, they must be determinable".

6. Any contractual mortgage, any mortgage ordered by the court, or any statutory mortgage between spouses, and any hypothecation right or pledge registered on the debtor's property for debts previously contracted;

7. Any protective measure, unless the registration or the distraining order predates the declaration of insolvency (cessation of payment);

8. Any authorisation and purchase option;

9. Any transfer of property or any transfer of rights in a trust estate unless this transfer has taken place by way of a guarantee of a debt simultaneously contracted;

10. Any amendment to a trust contract affecting rights or property already transferred in a trust estate place by way of a guarantee of a debt contracted prior to the amendment.

The court may also cancel any free transfers of property of moveable or immoveable property, made during the six months preceding the declaration of insolvency (cessation of payment).

Payments made against matured debts from the date of the declaration of insolvency (cessation of payment) and instruments for money consideration concluded from the said date may be annulled if the parties transacting with the debtor aware of the cessation of payment.

Any notice to a third holder (*avis à tiers détenteur*), any attachment (*saisie attribution*) or any appeal (*opposition*) may be annulled if issued or seized by a creditor from the date of cessation of payment and if the creditor is aware of the cessation of payment.

All these provisions shall not invalidate payment of a bill of exchange, a promissory note or a cheque.

However, the administrator or the liquidator may institute restoration proceedings against the person who drew the bill of exchange or, if it is drawn on account, against the principal or against the payee of a cheque and the first endorser of a promissory note if it is ascertained that they were aware of the cessation of payments.

Actions for nullity may be instituted by the administrator, the liquidator, the plan performance supervisor or the Public prosecutor, i-e in reorganisation and liquidation proceedings. These proceedings shall restore the debtor's assets.

### **Question (ix):**

- **Rules on termination of contracts and mandatory continuation of performance under contracts:**

#### **I. Reorganisation proceeding**

The French Commercial Code provides that « *notwithstanding any legal rule or contractual term to the contrary, the indivisibility, termination or rescission of the contract may not result from the sole decision opening a reorganization proceeding* ». Thus, it implies that the other party must perform its obligations despite the non-performance by the debtor of the obligations entered into prior to the decision opening the reorganisation proceeding. The non-performance of these obligations will only give creditors a right to a submission of their claims.

During the observation period, only the administrator has the right to require the debtor's contracting party to perform executory contracts in exchange of the performance of the debtor's obligations but only if the administrator has enough money to ensure it.

In the absence of payment or if the other contracting party does not agree to continue the contractual relationship, the contract will automatically be terminated. The same also applies when a formal notice has been sent from the other contracting party to the administrator that has remained unanswered within a month. However, the supervisory judge may grant the administrator reduced or additional time, which may not exceed two months, to adopt a position.

The contract will also be automatically terminated when the administrator informs the contracting party of its decision not to continue the contract. In consequence, the administrator will request to the supervisory judge to terminate any contract, which would not be necessary to reorganisation operations all in preserving rights and interests of the contracting party. Moreover, if the administrator does not make use of his right to continue the contract, this non-performance may give rise to damages that must be claimed as liabilities due to the other party.

The termination of the debtor's lease rights over immovable property used in the business's operations will be ordered either if the administrator decides not to continue the lease (this non-performance may give rise to damages that must be claimed as liabilities due to the other party) or if the debtor has not fulfilled its duties after the decision opening the reorganisation proceeding. Where the lease is assigned, any clause imposing a solidary liability with the assignee on the assignor shall be deemed void. If the lease is terminated, the lessor will have a preferential lien in respect of performance of the lease in the current year and damages that may be awarded by Court.

The supervisory judge may allow the debtor or the administrator, as the case may be, to sell movable assets furnishing the leased premises susceptible to be easily deteriorated, depreciated, or to be costly preserved.

## **II. Liquidation proceeding**

The French Commercial Code applies the same principle to liquidation processes as it does for reorganisation proceedings. Notwithstanding any legal rule or contractual term to the contrary, the indivisibility, termination or rescission of the contract may not result from the sole decision opening a liquidation proceeding. The other party must perform its obligations despite the non-performance by the debtor of the obligations entered into prior to the decision opening the liquidation proceeding. The non-performance of these obligations shall only give creditors a right to submission of claims. This new provisions aim at preserving the value of the assets regardless of the continuation of the business<sup>28</sup>. Additionally, the court will determine the contracts necessary to maintain the activity of the debtor. As a result, the order confirming the plan shall result in the assignment of these contracts.

Only the liquidator has the right to require the debtor's contracting party to perform executory contracts in exchange for the performance of the debtor's obligations but only if the liquidator has enough money to ensure it. In the absence of payment or if the other

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<sup>28</sup> Cass. com., 15 févr. 2005 and New Article L641-11-1 of French Commercial Code

contracting party does not agree to continue the contractual relationship, the contract will automatically be terminated. The same also applies when a formal notice from the other contracting party has been sent to the liquidator that has remained unanswered within a month. However, the supervisory judge may grant the liquidator reduced or additional time, which may not exceed two months, to adopt a position.

The contract is also automatically be terminated when the liquidator informs the contracting party of its decision not to continue the contract. In consequence, the liquidator will request to the supervisory judge to terminate any contract, which would not be necessary to the liquidation operations. However he must pay attention to preserve the rights and interests of the contracting party. Furthermore, if the liquidator does not make use of his right to continue the contract, this non-performance may give rise to damages that must be claimed as liabilities due to the other party.

NB: it is important to note that the French Commercial Code contain specific provisions dealing with employment, leasing and trust contracts. If the decision opening the liquidation proceeding does not automatically terminate the leasing contract, the trust contract is automatically be terminated to ensure the debtor's assets to go back within the estate of the debtor.

### **Question(x): Rules on the liability of directors, shadow directors, shareholders, lenders and other parties involved with the debtor.**

- **Rules on liability of creditors**

When safeguard, reorganisation or liquidation proceedings is opened, creditors may not be held liable for harm in relation to credits granted, except in cases of fraud, indisputable interference in the management of the debtor or if the guarantees obtained for the loans or credits are disproportionate.

If the liability of a creditor is established, the guarantees obtained for the loans may be annulled or reduced by the court.

- **Liability for excess of liabilities over assets**

Rules on liability for excess of liabilities over assets shall apply to the managers of private law entities submitted to insolvency proceedings as well as to individuals who serve as permanent representatives of managing legal entities.

Where the liquidation of a legal entity reveals an excess of liabilities over assets, the liquidator, the Public prosecutor or a majority of creditors appointed as controllers may apply to the court in the collective interest of creditors.

Then, the court may, in instances where management fault has contributed to the excess of liabilities over assets, decide that the amount of the excess of liabilities over assets will be borne, in whole or in part, by all or some of the *de jure* or *de facto* managers, who have contributed to the management fault. If there are several managers, the court may, by way of a reasoned ruling, declare them jointly and severally liable.

The right of action shall be barred after three years from the date of issuance of the order pronouncing the liquidation proceedings.

Sums paid by the managers shall form part of the debtor's assets. These sums shall be distributed to all creditors on a pro rata basis. Managers can't take part in the apportionment to the amount of sums which they have been ordered to pay.

Legal fees that the managers are ordered to pay shall be paid in priority out of the sums that are paid to make up for liabilities.

- **Personal disqualification and other prohibitions**

Where reorganisation or liquidation proceedings are opened, personal disqualification shall apply to:

1. natural persons carrying out a commercial or craftsman's activity, farmers, and to any other natural person running an independent professional activity, including an independent professional person with a statutory or regulated status or whose designation is protected;
2. natural persons who are *de facto* or *de jure* managers of legal entities;
3. natural persons, who serve as permanent representatives of legal entities, managers of legal entities.

These same provisions shall not apply to natural persons or managers of a legal entity running an independent professional activity and, for that reason, subject to disciplinary rules.

The rights of action shall be barred after three years from the issuance of the order pronouncing the commencement of the reorganisation or liquidation proceedings.

A court may pronounce the personal disqualification of those persons whom any of the following facts has been proved:

- 1°. running a commercial, craftsman's or agricultural activity or holding a management or administrative position in a legal entity in violation of a prohibition provided for by law;
- 2°. purchasing goods for services for resale at below market prices or using ruinous means to procure funds, with the intention of avoiding or delaying the commencement of reorganisation or liquidation proceedings.
- 3°. entering into, on behalf of another, without consideration, commitments deemed to be disproportionate when they were entered into, given the situation of the business or the legal entity;
- 4°. paying or causing someone else to pay a creditor, after cessation of payments and while being aware of this, to the prejudice of other creditors;
- 5°. hampering the good progress of the insolvency proceedings by voluntarily abstaining from co-operating with the persons (authorities) in charge of the proceedings;
- 6°. destroying accounting documents, not keeping accounts where applicable texts made this an obligation or keeping accounts that are fictitious, manifestly incomplete or irregular with respect to the applicable provisions.

The court may pronounce the personal disqualification of any natural persons carrying out a commercial or craftsman's activity, farmers, and any other natural person running an independent professional activity, including an independent professional person with a statutory or regulated status or whose designation is protected (except natural persons or managers of a legal entity running an independent professional activity), against whom any of the following facts has been proved:

1. abusively operating an unprofitable business activity that would necessarily lead to cessation of payments;
2. embezzling or concealing all or part of his assets or fraudulently increasing his liabilities.

The court may pronounce the personal disqualification of any *de jure* or *de facto* manager of a legal entity who has committed one of the following faults:

1. selling property belonging to the legal entity as his own;
2. carrying out company transactions to further his personal interests, using the legal entity as a cover for his schemes;
3. using property or credit of the legal entity, against that entity's interests, for personal purposes or in favour of another legal entity or business in which he had a direct or indirect interest;
4. abusively, for his personal interest, an unprofitable business activity that would necessarily lead to the legal entity's insolvency;
5. embezzling or concealing all or part of the assets of the legal entity or fraudulently increasing its debts.

The court may pronounce the personal disqualification of the manager of a legal entity who has not paid the latter's debts put at his expense.

Personal disqualification shall entail a prohibition from running, managing, administering or controlling, directly or indirectly, any commercial or craftsman's business, any agricultural activity or any business operating any other independent activity and any legal entity.

A court may pronounce, instead of personal disqualification, a prohibition from managing, running, administering or controlling, directly or indirectly, any commercial or craftsman's business, any agricultural activity or any legal entity or one or more of these.

The prohibition may also be pronounced against any person who, in bad faith, has not given to the administrator or the liquidator, information he is bound to disclose to them within the month following the date of issuance of the commencement order.

The same prohibition may also be pronounced against any person who has omitted to file the opening of a reorganisation or liquidation proceedings, within the time limit of forty-five days from the date of the cessation of payments, without having otherwise filed for the commencement of conciliation proceedings.

The liquidator or the Public prosecutor may apply to the court in these cases.

Where the liquidator entitled to bring them has not applied for the actions provided for in these articles and has not answered to default notice delivered to him within the time limit and under conditions to be determined by a Conseil d'Etat decree, a majority of creditors appointed as controllers may also apply to the court in the collective interest of creditors at any time during the proceedings.

The supervisory judge may not sit in judgement nor participate in consideration of the same cases.

The voting rights of managers under personal disqualification or under a prohibition shall be exercised in the meetings of legal entities submitted to safeguard, reorganisation or liquidation proceedings by a liquidator appointed by the court for this purpose on motion of the administrator, the liquidator or the plan performance supervisor.

The court may order these managers or some of them to sell shares or share capital in the capital of legal entities or order a forced sale through a liquidator, if necessary after an expert's report. The proceeds of the sale shall be used to pay the debts of the entity borne by the managers.

The court that pronounces the personal disqualification may pronounce the ineligibility to occupy a public office. The ineligibility shall last the period of the personal disqualification, without exceeding a five-year period. Where the decision becomes

definitive, the Public prosecutor will inform the interested party of his ineligibility, which shall take effect on the date of notice.

Where a court pronounces the personal disqualification or the prohibition, it will fix the duration for the prohibition, which may not exceed fifteen years. It may order the provisional enforcement of its decision. The loss of rights, prohibitions and ineligibility to occupy a public office shall automatically cease at the end of the fixed term, without any need for a court decision.

The final decree closing the proceedings on the grounds of extinguishment of liabilities shall, even after an order to pay for liability for excess of liabilities over assets, return all rights to the debtor natural person or managers of the legal entity. It shall exempt or relieve them from any loss of rights, prohibition and ineligibility to occupy a public office.

The debtor natural person or manager concerned may request the court to relieve him from, in whole or in part, any loss of rights, prohibition and ineligibility to occupy a public office if he has made a sufficient contribution to the payment of liabilities.

Where he is subject to the prohibition, he may be relieved of it if he presents guarantees showing his capacity to manage or control one or more businesses or legal entities.

Where a complete relief from any loss of rights, prohibition and ineligibility is pronounced, the court's decision will entail rehabilitation.

- **Criminal Bankruptcy**

Criminal bankruptcy shall apply to:

- 1°. traders, farmers, natural persons registered with the craftsmen's register and natural persons running an independent professional activity, including an independent professional person with a statutory or regulated status or whose designation is protected;
- 2°. persons who, directly or indirectly, de jure or de facto, have managed or liquidated a private law entity;
- 3°. natural persons, who serve as permanent representatives of the managing legal entities.

Where reorganisation or liquidation proceedings are commenced, these persons shall be guilty of criminal bankruptcy where any of the following offences is proved against them:

- 1°. purchasing for resale at below market prices or using ruinous means to obtain funds with the intention of avoiding or delaying the commencement of the reorganisation proceedings;
- 2°. embezzling or concealing all or part of the debtor's assets;
- 3°. fraudulently increasing the debtor's liabilities;
- 4°. keeping fictitious accounts or destroying accounting documents belonging to the business or legal entity or failing to keep any accounts where the applicable texts impose an obligation so to do;
- 5°. keeping accounts that are manifestly incomplete or irregular with regard to legal provisions.

Criminal bankruptcy shall be punishable by five years' imprisonment and a fine of €75,000. The same penalties shall be incurred by the accomplices of the criminal bankrupt,

even if they are not traders, farmers or craftsmen and do not manage a private law entity, directly or indirectly, de jure or de facto.

Where the culprit of or accomplice to criminal bankruptcy is a manager of a business that provides investment services, the penalties will be increased to seven years' imprisonment and a fine of €100, 000.

Natural persons found guilty of those offences shall also incur the following additional penalties:

- 1°. prohibition from exercising civic, civil and family rights;
- 2°. prohibition, from occupying a public office, from running the professional or corporate activity in the exercise of which, or while being exercised, the offence was committed, from occupying a commercial or industrial activity, from running, managing, administering or controlling, directly or indirectly a law entity;
- 3°. ineligibility for public procurement contracts for a maximum period of five years;
- 4°. prohibition, for a maximum period of five years, from issuing cheques other than those allowing for the withdrawal of funds by the drawer from the issuing bank or from issuing certified cheques;
- 5°. display or publication of the court order.

The Criminal court that finds one of these persons guilty of criminal bankruptcy may, in addition, pronounce the latter's personal disqualification or the prohibition unless a Civil or High court has already imposed such a sanction by a decision that has become final.

#### **Question (xi):**

- **Rules on the availability and modalities of post-commencement finance (for both proceedings):**

The order commencing the insolvency proceeding will automatically prohibit payment of claims arising prior to the decision opening the procedure, except set-off payments of connected claims. It will also automatically prohibit payment of claims arising after the decision opening the insolvency proceeding.

However, the supervisory judge may allow the debtor to carry out acts of disposition not included in the ordinary management of the business (for example to grant mortgages). The supervisory judge may also allow the debtor to pay debts arising prior to the decision opening the procedure to withdraw a pledge or possession of a thing held lawfully or to obtain the return of goods or rights involved in a trust, where it is justified by the continuation of business operations.

Claims arising in a proper manner after the decision opening the proceeding and for the benefit of the proceeding or as consideration for goods and services provided to the debtor with respect to its professional activity are to be paid as they fall due.

Any sum received by the administrator or court nominee, that has not been deposited on the debtor's bank or Post Office accounts in order to continue business operations, must immediately be deposited in a deposit account with the Caisse des dépôts et consignations.

**Question (xii):**

- **Rules on practitioner's qualification and eligibility for the appointment as liquidator, on supervision and professional ethics and on remuneration.**

France has created two exclusive regulated professions: administrators and trustees. Both have a monopoly on all proceedings, representing a sort of public service of justice. The administrator represents the debtor, administers his property and performs auxiliary or supervisory functions in regard to the management of such property whereas the trustee represents the creditors and liquidates businesses.

The two professions are incompatible with one another and with all other professions in order to avoid conflict of interests, with the sole exception being that a legal administrator can also practise the profession of lawyer.

- **Qualification**

The access to the insolvency profession is strictly regulated in France: a higher studies diploma in law, economy or management, a higher studies diploma in accountancy and finance (4 years) or a diploma of chartered accountant are required.

An entrance exam to a practical training experience, the fulfilment of the training period (3-6 years) and an entrance exam are also required.

- **Eligibility for the appointment**

After having successfully passed the final exam a candidate tries to be appointed to a Court of Appeal. Only after obtaining this appointment the candidate will be included in the national professional lists. There are two lists: one for administrators and one for trustees. The two lists are established by the National Commission of Registration and Discipline (Commission Nationale d'Inscription et de Discipline).

Only a natural person and a private professional company can be on the list.

Strict rules dictate that the appointment of practitioners who may have private interests in the proceedings is not allowed.

The duties of a trustee *ad hoc* (mandataire *ad hoc*) or those of the conciliator may not be carried out by any person who has received during the last twenty-four months remuneration or payment from the debtor, from any of the debtor's creditors or from a person who controls or is controlled by the debtor within, for whatever reason, directly or indirectly, other than remuneration or payment for a mandat *ad hoc* or duties in connection with an amicable settlement or a conciliation carried out in favour of the same debtor or the same creditor. The person thus appointed must attest on his honour, at the moment of acceptance of his duties that he complies with these prohibitions.

The duties of the trustee or those of the conciliator may not be entrusted to any Tribunal de commerce (Commercial court) judge who is either in office or who has left office within the previous five years.

A clean criminal record is required and subscription to the professional insurance company ('*Caisse de Garantie*') is required, to cover any damage caused to third persons.

Administrators and trustees are appointed by a commercial court or a High court, where insolvency proceedings take place.

- **Supervision**

The official body of administrators and trustees is The National Council of the Administrators and Trustees (*Conseil National des Administrateurs Judiciaires et Mandataires Judiciaires: CNAJMJ*). The CNAJMJ, which was set up to oversee insolvency practitioners responsibility for managing funds belonging to others, has a council made up equally of administrators and trustees.

Administrators and trustees are also accountable to their chartered accountant, the judges in charge of cases and the Public Attorney.

The CNAJMJ defends the interests of the two professions. It also checks if practitioners honour all their obligations, organises professional training and exams and arranges the control of professional's practices by their peers, every two years. The council also must send the Minister of Justice an annual report detailing its accomplishments.

- **Professional ethics**

Independence, integrity, honour, honesty, dignity, conscientiousness, humanity, disinterestedness, scrupulousness, moderation, courtesy, fraternity and tact are imperious duties of the administrators and trustees.

They are submitted to professional rules and ethics very strict and they take oath.

The National Commission of Registration and Discipline (*Commission Nationale d'Inscription et de Discipline*) exercises the disciplinary authority.

- **Remuneration**

A statutory scale is applied in France. The administrator and trustee's remuneration is calculated by the function of the company's assets, following a defined scale, as follows containing a fixed amount per case; an amount calculated on the basis of the number of employees treated; an amount calculated on the basis of the assets realised (decreasing in layers – of not much interest for the administrators and trustees implied in large or medium-sized insolvencies) and an amount calculated on the basis of the number of claims checked.

As the remuneration is decreasing in layers, the practitioner who will work hard to sell the assets at a better price will not see his remuneration improve. There is no notion of "success fee" in France. If a practitioner acts as conciliator or trustee "ad-hoc" this is different, because remuneration is fixed by contract.

Having obtained the debtor's approval, the president of the court shall determine the conditions of remuneration of the trustee *ad hoc*, the conciliator and, if necessary, the expert, at the time of their appointment, on the basis of the work entailed in performing their duties. Their remuneration shall be fixed by order of the president of the court on completion of their duties.

Before the decree of June, 10 2004, if the insolvent company had no assets, the trustee was not remunerated. Now trustees are remunerated to close such proceedings (€1,500 per case).

The money comes from a Financing Fund at the (*Caisse des Dépôts et Consignations*: CDC). This special 'deposit and consignment' bank has the monopoly to manage all the accounts of companies under insolvency proceedings. A part of the proceeds obtained from these accounts form the Financing Fund.

### **Question (xiii):**

- **Rules on the coordination of insolvency proceedings with respect to different companies belonging to the same group of companies**

At present there are no rules.

However Article L621-2 of the Commercial Code provides that "*the commenced proceedings may be extended to one or more other persons where their assets are intermingled with those of the debtor or where the legal entity is a sham. The court that has commenced the initial proceedings shall remain competent for this purpose*".

### **Question (xv):**

- **Rules with respect to insolvency proceedings outside the European Union**

French decisions are automatically recognized abroad under special provisions as bilateral treaties or multilateral treaties.

In all other situations, the French Commercial Code provides that French courts have territorial jurisdiction to apply French insolvency rules<sup>29</sup> in respect of a company whether its seat (« *siège statutaire* ») or if its main interests (« *centre principal de ses intérêts* ») are located within the French territory. This includes companies whose (legal) seats are located outside French territory but where their principal interests are in France. French judges have also considered that insolvency proceedings with universal effects may be opened in France against entities without legal personality (establishment (« *établissements* ») or branch office (« *succursales* »)).

Exorbitant jurisdiction rules pursuant to Articles 1430 and 15 of the French Civil Code has permitted also to attract jurisdiction<sup>31</sup> in insolvency matters in any case with a (very limited) French element<sup>32</sup>.

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### 29 Book VI of the Commercial Code.

30 French Civil Code, Article 14 : "An alien, even if not residing in France, may be cited before French courts for the performance of obligations contracted by him in France with a French person; he may be called before the courts of France for obligations contracted by him in a foreign country towards French persons".

French Civil Code, Article 15 : "French persons may be called before a court of France for obligations contracted by them in a foreign country, even with an alien".

See the last judgment regarding the application of Article 14 of the French Civil Code: Judgment n° 771 of 1st July 2009 (N°08-15.955) of the French Civil Supreme Court available in French only at :

[http://www.courdecassation.fr/jurisprudence\\_2/premiere\\_chambre\\_civile\\_568/771\\_1er\\_13158.html](http://www.courdecassation.fr/jurisprudence_2/premiere_chambre_civile_568/771_1er_13158.html))).

31 See Cass. com., 19 November. 2002, Bull. civ. I, n°275 (Banque Worms case) which devoted the principle of universality of insolvency proceedings opened by French Courts which have jurisdiction.

32 See for example :

Nancy, 29 April 1911, JDI 1913 p.1240

Req., 5 July 1897, D. 1897, I, 524

However, the present trend is to set aside the extensive French interpretation of rules regarding French jurisdiction since the *Prieur* case has been delivered by the *Cour de cassation* (the French Supreme Civil court) on May 23, 2006<sup>33</sup>. In fact, a lack of legitimacy was regularly levelled against French judgments opening insolvency proceedings for instance when the only link was the sole presence of an establishment without legal personality in France. Without mutual and automatic recognition, the consequence was that French decisions were not recognized abroad whereas concurrent proceedings were regularly initiated in other countries against the same debtor paralysing any chance of reducing additional costs<sup>34</sup>. Now, French judges, since May 31, 2002, have been under an obligation to identify the “*debtor’s centre of main interests*” pursuant to Article 3(1) of the EC Regulation in order to have jurisdiction to open insolvency proceedings with cross-border effects within the European Union<sup>35</sup>.

By contrast, there were few cases exhibiting any tendency in the French Courts to recognize the effects of foreign insolvency proceedings on French territory and sometimes before the ‘*exequatur*’ procedure<sup>36</sup>. Article 16 of the EC Regulation changed the traditional control scrupulously exercised by French judges to recognize foreign insolvency proceedings in France via the ‘*exequatur*’ procedure, which renders the foreign decision capable of being applied within the French territory.

Actually, in the absence of specific International or European texts or bilateral treaties on recognition regarding insolvency proceedings, foreign judgments are only enforceable in France once they have been subject to a limited review (*exequatur*) procedure. This essentially verifies<sup>37</sup> (1) the proper jurisdiction of the foreign court; (2) the application of the proper law; (3) due process and adversarial procedure; (4) compliance with international public policy and (5) the absence of fraud<sup>38</sup>.

The main usefulness of the ‘*exequatur*’ procedure is to prevent the opening of a parallel and useless insolvency proceeding in France on the initiative of a small number of creditors. Besides, the foreign insolvency judgment will not be enforced if it might be contrary to French international public policy rules (“*conception française de l’ordre public international*”).

In the meantime, the ‘*exequatur*’ procedure justified the reciprocal effectiveness of French insolvency proceedings abroad although limited to formal recognition by the foreign

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Cass. com., 26 October 1999, unpublished, N° 96-12946 available at: <http://www.legifrance.gouv.fr>

Cass. com., 1 October 2002, CRCAM Quercy-Rouergue c. Société European Estates France, RJDA 02/2003, n°152. 33 unanimously accepted by a majority of French commentators D. 2006, p.1880. See also B. Audit, La fin attendue d’une anomalie jurisprudentielle: retour à la lettre de l’article 15 du code civil, D. 2006, chron. p. 1846.

34 See Cass. com., 21 march 2006, Bull. civ IV, No 74, p.73

35 See Cass. com., 8 July 2008, No 07-15010 available at : <http://www.legifrance.gouv.fr> where the French Supreme Court rejected the application of the EC Regulation as insolvency proceedings were opened before May 31, 2002.

36 See Cass. 1re civ., 25 February 1986, Bull. civ. I, n°38 (Kléber case) and CA Metz, 25 June 2003 J.D.I. I, 2004, p. 188-192.

The Kléber case showed that prior to the *exequatur* decision, it is possible for French judges to take into account substantive provisions of the foreign legislation to prevent some creditors from suing in France with the main idea to neutralize the foreign insolvency proceeding effects on main debtor’s assets located in France. Similarly, French case-law considers that insolvency proceedings opened in France produce their effects wherever the debtor has assets but with the exception of reciprocity from the country which would be applicable.

37 Cass. 1re civ., 7 January 1964 ( Munzer case) ; Cass. 1re civ., 4 October 1967 (Bachir case) and Cass. civ. I, 6 February 1985 (Simitch case).

38 See Cass. 1re civ. 20 February 2007 where condition of the application of the proper law (N°2 in this paper) is not any more required as it was a kind of indirect control of the jurisdiction of the foreign state.

jurisdiction. However, the *Cornelissen* case on February 20, 2007<sup>39</sup> facilitated the recognition by French courts of foreign judgments via the 'exequatur' procedure.

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39 Cass. 1re civ., 20 February 2007, D. 2007, p. 324

## ITALY

Italian bankruptcy, liquidation and crisis resolution law is primarily contained in:

- articles 2272-2283, 2308-2312 and 2484-2496 of the Civil Code, as regards the liquidation of partnerships and companies;
- the bankruptcy Law of 1942 (Royal Decree no 267 of 16 March 1942), concerns bankruptcy procedures and other arrangements. Many articles of this Law were revised by Law Decree no 35 of 14 March 2005, Law no 80 of 14 May 2005 and Legislative Decree no 5 of 9 January 2006 and, finally with Legislative Decree no 169 of 12 September 2007).
- the extensive insolvent companies Law, known as the "Prodi Law", as regards the extraordinary controlled management of large insolvent companies, as revised by the "Prodi-bis Law" of 1999) and integrated, in the case of very large companies, by the "Parmalat Decree" of 2003 and subsequent amendments.

At this point, it is also important to mention that the international financial and economic crisis has produced in Italy remarkable effects on the productive system and on jobs; in this context, the project of law 2364, approved April 1, 2009 by the Senate, now under examination at the Chamber, has originated from the demand to take into consideration parties whose interest are thought worthy of special protection

The second section of the project of law is entirely devoted to the procedure for the composition of the claims of creditors of companies facing critical difficulties and proposals to find a solution to apply to the individuals, which are excluded by the Italian bankruptcy law.

The peculiarity of the procedure consists in the fact that it is directly activated by the debtor in "over indebtedness", a term indicating a situation of persisting economic imbalance given the impact of its obligations and the available funds.

The debtor drafts an agreement for the restructuring of its debts containing a reimbursement plan to submit to the creditors and, subsequently, the agreement is filed in Court with the list of all the creditors and the sums due to them; it is foreseen that the debtor can get the validity of the agreement with the approval of the majority of his/her creditors and granting the regular payment of the creditors non signatory of the agreement.

The proposal is filed before the Court of the place of residence of the debtor and the Judge immediately fixes a hearing, informing the creditors as to when in relation to the activity of a company, the plan will proceed to the publication of the same in the Register of Companies Register

Together with the proposal, the debtor must file the list of all the creditors, with the indication of the amounts due and the attestation on the feasibility of the plan.

In this memo, only the bankruptcy law provisions will be described, while liquidation and the Large Insolvent Companies Law are excluded by the perimeter of the present discussion as well as financial guarantees, insurance and other matters subject to special regulation.

### **Question (i) :**

The laws of Italy foresee that the goal of the insolvency and bankruptcy proceedings is to verify whether the rescue of a troubled business is possible and, if the answer is in the negative, to dispose of the debtor's assets in the most effective way on behalf of the creditors.

The bankruptcy proceedings can be started by the debtor, by one of the creditors or by the Public Prosecutor.

The condition for opening any proceedings is that the company must be insolvent, i.e. unable regularly to fulfill its obligations when they fall due.

All the entrepreneurs who engage in commercial business, except for individuals, public bodies and small entrepreneurs are subject to the bankruptcy provisions.

However, no bankruptcy can be adjudicated upon unless the three requisites hereinafter set out are met:

- gross income of the insolvent entity, in the three years before the filing of the petition for bankruptcy, in an yearly amount not higher than € 200.000,00;
- capital invested by the insolvent entity in the business in the three years before the filing of the petition of bankruptcy not exceeding € 300.000,00;
- an amount of debts of the insolvent entity not higher to € 500.000,00.

Jurisdiction lies with the Bankruptcy Court competent for the area where the company's main office is located; also the mere presence in Italy of a branch could be considered enough to declare bankruptcy in Italy, according to article 9, paragraph 2, of the bankruptcy Law.

### **Question (ii):**

After the adjudication of bankruptcy, any action by the creditors cannot be started while the enforcement of claims initiated before is suspended.

on the date of the adjudication of bankruptcy.

Any credit, supported by the necessary evidence, must be filed in the procedure.

### **Question (iii) :**

The entrepreneurs or the company's directors, once the bankruptcy is adjudicated, lose their right to manage the business or to sell any assets and the receiver disposes of all of

the entrepreneur's assets, where possible preserving any business unit and goodwill, verify the existence and the evidence of all the creditors' claims.

Continuation of operations may, however, be authorized if an interruption would cause greater damage to the company, but only if the continuation of the company's operations does not cause damage to the creditors.

The bankruptcy assets include not only those assets owned by the debtor when the bankruptcy is adjudicated but also those which are not in his or its possession at that time, but which are included by law among the assets subject to the bankruptcy procedure.

The receiver must issue a report indicating the causes of the insolvency together with the accounting situation and in addition he must set out the inventory of the debtor's assets and the list of creditors.

Reforms have modified the Judge Delegate's role in the insolvency procedures, assigning to the latter tasks of protection and supervision, a responsibility as regards the legitimacy and fairness control of the procedure; the business management is, instead, granted to the receiver and to the committee of the creditors

The receiver is the executive body of the bankruptcy procedure, having tasks of administration of properties of the bankrupt company; he/she is appointed by the judgement relating to the adjudication of bankruptcy, or in case of substitution or revocation, by a Court decree.

The judge also appoints a committee of three to five individuals, chosen among the creditors in such a way that they could represent, equally, the quality and quantity of credits; this committee has supervisory powers over the receiver's activity.

The role of the committee of creditors has been greatly modified and such a body also possesses powers of authorization and control over the receiver's activity in addition to its advisory functions.

Certain acts must be authorized by the bankruptcy judge who has fewer powers than in the past, as he no longer has any managerial powers, but only supervisory and control functions.

The supervisory functions have been improved in order to avoid uncontrolled management by the receiver, who now has more duties and who now administers the debtor's assets and is responsible for the procedure.

#### **Question (iv) :**

The claims of Italian and foreign creditors rank *pari passu* (equally) and the rights to preferential payment provided are several. Such preferential claims are normally secured by pledges, mortgages or other liens of the debtor.

However, the law provides for additional privileges and liens. Creditors who believe their claims to be secured by mortgages, liens or other privileges must advise the receiver accordingly.

The order of the creditors to the end of the distribution of assets is as follows:

- ✓ claims due for the management of the procedure and for the continuation of the business, if authorized;
- ✓ Tax and social security claims;
- ✓ employees claims;
- ✓ claims secured by a pledge or mortgage;
- ✓ claims having a general privilege, such as claims for salaries, professional fees, social security contributions and taxes;
- ✓ unsecured claims.

The creditors are divided in different classes, in some cases also into sub – classes and the law foresees the same treatment for the privileged creditors; the payment of the credit may be on a pro rata basis.

The creditors may set-off their debts with credits concerning the period before the adjudication of insolvency.

**Question (v) :**

The receiver gives notice of the adjudication of bankruptcy to all creditors, indicating the time to file their claims and the Bankruptcy Court where the proceeding is pending, usually at least thirty days before the date of the hearing for the verification of the credits; in specific situations, late claims are admitted.

In any event, the filing of a claim is deemed to be the responsibility of the creditor.

The state of liabilities is made up and enforced through a procedure that usually consists of several phases: the receiver drafting the state of liabilities, the Judge Delegate adopting the relevant resolutions and declaring the enforcement of the state of liabilities.

The phase regarding the liquidation of the assets consists in the sale of movables and immovables of the bankrupt, followed by the phase of allocation of the assets, during which money deriving from the sale is distributed among the creditors in order to satisfy their credits.

In order to proceed to the liquidation, the receiver prepares, within sixty days from the drawing up of the inventory, a liquidation plan to be submitted to the approval of the Judge Delegate, upon favorable opinion of the committee of the creditors.

Claims must be filed in writing, in the Italian language and clearly indicating the name and address of the creditor, the amount claimed, together with any security backing the claim for which supporting documents must be produced.

The Bankruptcy Court then sets a date for the hearing at which the receiver's report on the claims filed will be discussed.

In the event that the receiver rejects a claim, the creditor may file an appeal with the Court setting forth the reasons why he believes his claim should be admitted.

**Question (vi):**

The recent reform of Italian Bankruptcy law has introduced the so-called *accordi di ristrutturazione dei debiti* ("debt restructuring arrangements"), whereby an entity can enter into a composition with creditors which is binding on all the creditors of such entity provided that:

- the debt restructuring arrangement is agreed by creditors representing at least 60% of its debts; and
- the feasibility of the debt restructuring arrangements and the suitability of such arrangements to ensure repayment of those creditors which did not agree with such Arrangements is confirmed by an independent expert .

The debt restructuring agreements are divided into two phases: the extrajudicial one, in which the debtor negotiates his/her indebtedness with the creditors; the judicial one, in which the agreement must be approved by the Court before producing further legal effects.

The debtor must also specify the value of assets and the personal creditors of any shareholders who may be liable on an unlimited basis; he/she must also file the report of an expert on the feasibility of the agreement, and in particular on its suitability for the granting of regular payments to creditors who are not signatories to the agreement

The arrangement is submitted to the Court, together with the accounting records and the publication on the Companies Register suspends for sixty days any executive claim carried forward by the creditors.

The Court then issues a decree approving or rejecting the agreement, which is exempt from the claw back action.

Any party concerned has fifteen days in which to ask the Court of Appeal to re-examine the plan.

**Question (vii) :**

The Bankruptcy estate includes any assets owned by the debtor at the time of the bankruptcy declaration as well as any assets which the debtor may have disposed of prior to the bankruptcy in favor of some creditors and to the detriment of all other creditors.

The assets from the bankruptcy estate are liquidated by the receiver who submits a plan indicating the proposed methods of liquidation and the time schedule.

The business can be sold as a whole or by means of its separated parts, taking into account the various elements ( immovable and movable property, enforcement of receivables,

The conditions of the sale including the minimum price are determined by the Judge, whether in public auction or a private transaction, at any rate securing the adequate publicity to the operations.

The sale is followed by a phase which addresses the allocation of the assets, during which money deriving from the sale is distributed among the creditors in order to satisfy their credits.

In order to proceed to the liquidation, the receiver prepares, within sixty days from the drawing up of the inventory, a liquidation plan to be submitted to the approval of the Judge Delegate, based upon the favorable opinion of the committee of creditors.

Once the liquidation of the assets has been completed and prior to the final allocation, the receiver files the statement of account with the Judge Delegate and, once it has been approved and the receiver's fees have been paid, the Judge Delegate provides the final allocation.

### **Question (viii):**

The acts of a company which is subsequently adjudicated bankrupt may be clawed back by the Bankruptcy Court, at the request of the receiver if carried out during a "suspect period", with the goal to annul the act and to grant simultaneous restitution.

The amendments to the Italian bankruptcy law have halved the claw-back period which runs from the bankruptcy order: where the above period was two years under old regime, it is now one year; where it was one year, it is now six months.

The above applies to transactions at an undervalue, or those involving unusual means of payment or security taken after the creation of the secured obligations, whereby the creditor must prove his lack of knowledge of the state of insolvency of the bankrupt.

With respect to security granted in order to secure a debt due and payable, the creditor must prove his lack of knowledge of the state of insolvency of the relevant entity.

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

The Italian Bankruptcy Law has also established several exemptions to the application of the claw-back regime in relation to:

- ✓ payments made within the ordinary course of business for assets and services at a market price;
- ✓ payments made into a bank current account, provided that such payments have not considerably reduced over a period of time the indebtedness of the bankrupt vis-à-vis the account holding bank;
- ✓ the sales of real estate for residential purposes at arms length, to the extent that such real estate is used as a main house or residence by the buyer or his/her relatives and relatives-in-law;
- ✓ transactions involving payments as well as security taken over the assets of the debtor, provided that such payments were made or security was taken in order to implement a plan which is deemed "suitable" to redress the indebtedness of the debtor and to readjust its financial situation;
- ✓ transactions involving payments as well as security taken over the assets of the debtor, provided that such payments were made or security was taken so as to

implement a Pre-bankruptcy Creditors' Composition, or the Debt Restructuring Arrangements.

**Question (ix) :**

The contracts with obligations for both parties pending to be performed at the time of the adjudication of bankruptcy will remain suspended until the receiver with the consent of the committee of creditors declares that he will replace the bankrupt in the contract or that he will terminate it, if this is considered in the interest of the procedure.

**Question (x) :**

The directors must fulfill the duties imposed on them by law with the proper necessary care and they are liable "*in solido*" to the company for damages originating from the non-observance of such duties if they fail to supervise the general conduct of company affairs or if, being aware of prejudicial acts, they did not do what they could to prevent or to eliminate or to reduce their harmful consequences.

Liability for acts or omissions of directors does not extend to a director who, being without fault, had expressed his dissent in the book of the resolutions of the board of directors and has immediately given written notice to the chairman of the board of auditors.

The directors are liable to company creditors for non-observance of their duties concerning preservation of the company's assets and such an action can be promoted by the creditors when company assets prove insufficient for the satisfaction of their claims.

Liability between the directors is divided according to the degree of fault and the damage caused but where a director can establish his/her lack of blame for the breach, he/she will not be liable at all.

A claim may be brought against a director by the company, by the receiver or by a shareholder or by a creditor who has suffered a loss as a consequence of the director(s)' misbehavior.

Directors are liable to the company's creditors for non-observance of their duties concerning the preservation of the company's assets which loss results in loss to creditors.

Shareholders or third parties who suffer damage which directly affects their interests as a result of a director's malicious or intentional act may be entitled to compensation.

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

A director of company may be held criminally liable in respect of actions carried out with regard to the company's assets and taken prior the bankruptcy of the company as a result of which actions the company has :

- ✓ distracted, disguised or voluntarily lost its assets in order to prejudice its creditors;
- ✓ taken imprudent actions to delay the declaration of bankruptcy;

- ✓ disguised its financial distress or its insolvency state in order to obtain financing.

**Question (xi) :**

Any claim arising from any post-commencement finance must be treated as executed for the continuation of the business with the approval of the judge and will be paid as due for the management of the procedure and for the continuation of the business.

**Question (xii):**

After the adjudication of bankruptcy, any receiver must be a lawyer or a certified accountant, or a law firm as appointed by the judge and the company cannot run its business independently.

**Question (xiii) :**

Generally speaking, Italian legislation does not foresee the concept of group insolvency, this meaning that each company has to be separately adjudicated bankrupt.

Only in the special law for extraordinary administration of large insolvent companies and for forced administrative liquidation are such specific provisions present.

**Question (xv):**

In Italy, except for the EU Regulation 1346/2000 and few bilateral and multilateral Treaties, no specific rules concerning the recognition of foreign bankruptcies are envisaged.

The recognition in Italy of foreign insolvency proceedings of another Country which is not a member State is subject to the ascertainment of specific requirements by the Court of Appeal, in whose area of jurisdiction the enforcement of the foreign decision must take place.

These proceedings, known as "exequatur" proceedings, are however avoided in cases where bilateral or multilateral conventions establish easier and less specific formalities.

## POLAND

### APPLICABLE REGULATIONS

The following regulations (defined below) are relevant for the purposes of this memorandum:

"Bankruptcy Law"	means the Polish Act on bankruptcy and rehabilitation proceedings dated February 28, 2003 (as amended)
"CC"	means the Polish Civil Code dated April 23, 1964 (as amended)
"CCC"	means the Polish Commercial Companies Code dated September 15, 2000 (as amended)
"CCP"	means the Polish Code of Civil Procedure dated November 17, 1964 (as amended)
"Receiver License Law"	means the Polish Act on a Receiver License dated June 15, 2007 (as amended)

### Question (i) :

#### Entry criteria

A debtor may be declared bankrupt if it is insolvent, i.e., at least *one* of the relevant substantive insolvency tests is met (*Article 10 of the Bankruptcy Law*).

There are two insolvency tests:

- the **liquidity test** – the debtor fails to satisfy its due (monetary) debts;
- the **balance sheet test** – the liabilities of a debtor exceed its assets (this test is confined to certain categories of entities including companies and partnerships regulated by the CCC) (*Article 11 of the Bankruptcy Law*).

In applying the **liquidity test**, there are no minimum statutory thresholds determining what amount or percentage of debt must remain outstanding beyond the due date for the debtor to become insolvent. It is therefore assumed in the doctrine is the decided case law (hereafter referred to as doctrine) that the due date for the second obligation that remains unpaid marks the time when insolvency occurs.

With respect to the **balance sheet test**, the Bankruptcy Law does not determine how – with reference to what criteria – the value of assets / liabilities should be determined. In doctrine, however, it is submitted that the balance sheet value of assets should not be decisive, as often it does not reflect their real market value (e.g. due to depreciation). Rather, it is the market value which should be taken into account when considering whether bankruptcy should be declared in order to protect the creditors of a debtor with excessive liabilities. Hence, while in applying this test bankruptcy courts usually start from analyzing a debtor's balance sheet (i.e. balance-sheet value of assets and liabilities), eventually they usually seek expert opinion on the market value of a debtor's assets as more appropriate.

**Eligibility for debtor status**

The following entities are eligible as debtors (*Article 1 and 5 of the Bankruptcy Law*):

- natural and legal persons (e.g., cooperatives, limited liability companies, joint-stock companies) and entities without legal personality (e.g. partnerships regulated in the CCC) which carry on business activity;
- limited liability companies and joint-stock companies that do not carry on any business activity;
- members of partnerships (partners) who are liable for the obligations of the partnership without limitation;
- natural persons that do not carry on business activity who became insolvent as a result of extraordinary circumstances not dependent on them.

Bankruptcy may not be declared in respect of the State Treasury, local self-government units, public health care institutions, institutions and legal persons created by statute, farmers and academic institutions (*Article 6 of the Bankruptcy Law*).

**Entities that can institute insolvency proceedings**

The proceedings to declare a debtor bankrupt are initiated by a petition submitted to the court by (*Article 20 of the Bankruptcy Law*):

- a debtor is required to file a bankruptcy petition within two weeks from the moment it becomes insolvent;
- any of its creditors;
- in relation to certain debtors only: selected public authorities supervising the debtor, curators or liquidators, authorities granting public aid in excess of EUR 100,000.

**Goal of the proceedings**

The goal of the proceedings (regardless of whether they are conducted as liquidation bankruptcy or arrangement bankruptcy) is primarily to provide for the maximum satisfaction of the creditors' claims, and – if reasonable – to preserve the debtor's business. In arrangement bankruptcy a more specific goal is to enable a company in financial difficulties to reach a binding arrangement with its creditors to avoid liquidation and provide creditors with a better chance for recovery from debtor's assets rather than through winding up the company (*Article 14 of the Bankruptcy Law*).

**Question (ii) :**

The effects of the commencement of proceedings are different depending on the phase of proceedings (ie whether the proceedings are to declare a debtor bankrupt or "core" bankruptcy proceedings) and on the type of "core" bankruptcy proceedings commenced in a specific case (liquidation or arrangement bankruptcy).

**Interim measures in the course of proceedings to declare a debtor bankrupt:**

- upon the motion of the debtor, the court may stay enforcement proceedings against the debtor for a claim that would be covered by the arrangement if the enforcement could jeopardize the possibility to conclude an arrangement; the court may also lift an attachment of a debtor's bank account (*Article 39 of the Bankruptcy Law*).

**In case of liquidation bankruptcy:**

- in general, creditors (including secured creditors and tax authorities) may not assert or enforce their rights other than by submitting their claims in the bankruptcy proceedings;
- pending court and administrative proceedings regarding claims against a debtor which are to be satisfied from the bankruptcy estate are terminated, and may be re-commenced against the bankruptcy receiver only after a creditor's submission of claim has been finally refused recognition in the bankruptcy proceedings (*Article 145 of the Bankruptcy Law, Article 182<sup>1</sup> of the CCP*);
- other pending proceedings concerning the bankruptcy estate are stayed and may be resumed against a bankruptcy receiver (*Article 174 of the CCP*);
- no new proceedings in which creditors seek payment of claims that arose prior to bankruptcy may be commenced for the duration of the bankruptcy proceedings;
- enforcement proceedings are stayed upon declaration of bankruptcy, and terminated when the decision on declaration of bankruptcy becomes final (the bankruptcy declaration is subject to appeal) (*Article 146 of the Bankruptcy Law*). No new enforcement proceedings concerning monetary claims against the bankruptcy estate may be initiated;
- interim measures to secure claims against the debtor granted prior to bankruptcy may not be enforced after the declaration of bankruptcy. (*Article 146 of the Bankruptcy Law*);
- secured creditors may not enforce their security outside the bankruptcy proceedings, their claims are satisfied from the asset subject to security (i.e., from the proceeds of liquidation thereof) with priority before other creditors (with minor exceptions related to registered pledges);
- after the bankruptcy declaration no new security resulting from transactions entered into by a debtor may be established (*Article 81 of the Bankruptcy Law*).

**In case of arrangement bankruptcy:**

- pending court and administrative proceedings against the bankrupt may be continued, and new proceedings may be commenced by a debtor's creditors (*Article 137<sup>1</sup> of the Bankruptcy Law*);
- if the administration of a bankrupt's assets was established, pending proceedings concerning the bankruptcy estate are stayed to enable the court appointed bankruptcy administrator to replace the bankrupt's representatives

in those proceedings (*Article 174 of the CCP*). New proceedings concerning the bankruptcy estate must be commenced against the bankruptcy administrator. (*Article 139 of the Bankruptcy Law*);

- in case of self-administration and the appointment of a court supervisor, the court supervisor joins court and administrative proceedings concerning the bankruptcy estate with the powers of an independent side intervener on the bankrupt's side (*Article 138 of the Bankruptcy Law*);
- enforcement proceedings commenced before a bankruptcy declaration and concerning claims covered by the arrangement are stayed upon bankruptcy declaration (*Article 140 of the Bankruptcy Law*);
- interim measures to secure claims covered by the arrangement granted prior to bankruptcy may not be enforced after the declaration of bankruptcy (*Article 140 of the Bankruptcy Law*);
- the bankruptcy judge (the so-called judge-commissioner) may, upon a motion filed by the bankrupt or the bankruptcy administrator, lift attachments made in order to secure or enforce a claim covered by the arrangement if it is necessary to continue operating the bankrupt's business;
- secured creditors may enforce their claims against assets which are subject to security (in the part in which they are covered by security, the claims are not covered by the arrangement proceedings), and initiate enforcement proceedings;
- after the bankruptcy declaration no new security resulting from transactions entered into by a debtor may be established (*Article 81 of the Bankruptcy Law*).

### **Retention of title**

- retention of title is effective in liquidation bankruptcy if the provision stipulating such retention of title by a seller was made with a certified date (*Article 101 of the Bankruptcy Law and Article 590 of the CC*).
- arrangement bankruptcy does not affect retention of title.

### **Question (iii) :**

### **Management of a debtor's business – general principles**

#### **In liquidation**

The management of a debtor's business is taken over by a court-appointed bankruptcy receiver. The management board is not dismissed, but its role is in practice limited to representing the bankrupt in the course of bankruptcy proceedings, supporting the bankruptcy receiver as regards information on the business and exercising corporate rights in related companies (*Articles 75, 156, 173 of the Bankruptcy Law*).

The law does not require the bankruptcy receiver to consult his/her decisions regarding the management of the bankrupt's business with the management board.

**In arrangement bankruptcy**

The business of the debtor is continued, managed by either a bankruptcy administrator or the debtor's management board supervised by a court supervisor (self-administration / debtor-in-possession). In both cases the management board is more or less limited in its actions concerning the administration and disposition of the assets belonging to the bankruptcy estate (*Article 76 of the Bankruptcy Law*). The appointment of the court supervisor allows the debtor's management board to retain most of its powers over the bankrupt's assets. The debtor may carry out transactions within the scope of ordinary business. However, any actions by the debtor going beyond this scope (e.g. the sale of valuable assets) have to be approved by the court supervisor or by the creditors' council, if the law so stipulates. Additionally the court supervisor may at any time control debtor's actions and its business.

The court may revoke self-administration and appoint a bankruptcy administrator. The bankruptcy administrator, if appointed, replaces the debtor's management board in performing acts of regular administration. The position of the management board is roughly comparable to that of a receiver in case of liquidation bankruptcy.

**The division of powers between judge-commissioner, court, receiver (bankruptcy administrator, court supervisor), and the management****Judge-commissioner**

After bankruptcy is declared, bankruptcy proceedings are conducted by the judge-commissioner, and only in specific cases decisions in the course of proceedings are taken by the bankruptcy court. The judge-commissioner supervises the bankruptcy receiver (or depending on the type of proceedings and the decision regarding the management of the bankrupt's business, the bankruptcy administrator or the court supervisor). The judge-commissioner is not directly involved in the day-to-day management of the bankruptcy estate. He / she may specify acts which may not be undertaken by the bankruptcy receiver (the bankruptcy administrator or the court supervisor) without his / her consent, and is entitled to grant his / her consent for issues requiring the consent of the creditors council if the council was not appointed in a given proceeding (*Article 151 of the Bankruptcy Law*).

**The bankruptcy court**

As noted, the bankruptcy court's role in the proceedings is limited to specific issues, *inter alia*: it recognizes complaints against appealable decisions of the judge-commissioner, decides on changing the bankruptcy proceedings from liquidation bankruptcy to arrangement bankruptcy and *vice versa* in situations specified by the Bankruptcy Law, decides on the remuneration of the receiver, court supervisor and the bankruptcy administrator, dismisses the receiver, court supervisor and the bankruptcy administrator if they do not perform their duties properly or are otherwise prevented from performing such duties (*Articles 16, 17, 151, 164, 170, 222 of the Bankruptcy Law*).

**The bankruptcy receiver**

The bankruptcy receiver is appointed in liquidation bankruptcy exclusively to represent and manage the bankruptcy estate. The receiver has to take possession of

the bankrupt's assets, administer them, secure them against destruction, deterioration or appropriation by third parties, and initiate the process of liquidation of the assets.

The bankruptcy receiver is appointed by the court in the bankruptcy declaration (or subsequently if there was a change from arrangement proceedings to liquidation proceedings) among persons who hold a professional license of a bankruptcy receiver (*Article 173 of the Bankruptcy Law*).

### **The court supervisor**

The court supervisor is appointed when arrangement bankruptcy is declared and self-administration is established over a bankrupt's assets. All actions of the bankrupt which are outside its ordinary scope of business require the court supervisor's consent, otherwise they are invalid. The court supervisor may, at any time, control the bankrupt's activities and inspect the bankrupt's business (*Article 180 of the Bankruptcy Law*).

The court supervisor is appointed by the court in the bankruptcy declaration (or subsequently if there was a change from liquidation proceedings to arrangement proceedings) among persons who hold a professional license of a bankruptcy receiver.

### **The bankruptcy administrator**

The bankruptcy administrator is appointed if arrangement bankruptcy is declared and the bankrupt is deprived of the administration of the bankruptcy estate. He is exclusively authorized to manage the bankruptcy estate. He is obliged to perform all the activities concerning related to the on-going operation of the bankrupt's business and to the preservation of the bankruptcy estate in unimpaired condition (*Article 182 of the Bankruptcy Law*).

The bankruptcy administrator is appointed by the court in the bankruptcy declaration (or subsequently if there was a change from liquidation proceedings to arrangement proceedings) among persons who hold a professional license of a bankruptcy receiver.

### **Powers of the creditors**

#### **General remarks**

Generally, individual creditors have very limited direct influence on the proceedings. Bankruptcy law provides for two bodies intended to represent the collective interests of creditors:

- the creditors' council (composed of three to five creditors and one or two deputies), which the judge-commissioner may appoint if he or she finds it necessary (the judge-commissioner is under no obligation to appoint the creditors' council, unless such an appointment is requested by creditors jointly owning no less than 1/5 of the total sum of the claims recognized or substantiated on the list of claims) (*Article 202 of the Bankruptcy Law*);
- the creditors' meeting (composed of the creditors included on the list of claims, which participate in the meeting and have the right to vote); the judge-commissioner is obliged to appoint the meeting in cases provided for by statute and, in other cases, s/he may appoint it if s/he considers it necessary (*Articles 191, 195 of the Bankruptcy Law*).

Importantly, creditors do not appoint the bankruptcy receiver / administrator / court supervisor, and they cannot give them binding instructions.

### **Creditors' Council**

Generally, it is the council's task, *inter alia*, to control the activities of the bankruptcy receiver / administrator / court supervisor, examine the condition of the bankruptcy estate funds and express an opinion on matters submitted to the consideration of the creditors' council by the judge-commissioner or the bankruptcy receiver / administrator / court supervisor. Specific powers include, *inter alia*:

- the right to demand explanations from the bankruptcy receiver / administrator / court supervisor;
- the right to audit books and documents regarding the bankruptcy;
- the right (vested also individually in each member of the creditors' council) to file a motion to dismiss the bankruptcy trustee with the bankruptcy court;
- to grant a permit for the indicated activities of the bankruptcy receiver / administrator, *inter alia* to withdraw from the sale of a business in whole, to recognize disputed claims or to conclude a settlement regarding such claims or to encumber the bankrupt's assets (*Article 205 of the Bankruptcy Law*);
- to grant consent to an "open sale" of a business or real estate by specifying the conditions for such sale, including the minimum price.

The following specific acts require the permission of the creditors' council depending on the type of bankruptcy:

- **in liquidation bankruptcy:**
  - further operation of the business by the receiver, if the business is to be operated for more than three months from the date bankruptcy is declared;
  - resignation from the sale of the bankrupt's business as a whole;
  - the sale of rights and claims;
  - taking loans and bank credits and encumbering the bankrupt's assets with rights *in rem*;
  - the performance of a reciprocal agreement entered into by the bankrupt or the rescission of such agreement, as well as the performance or rescission of an agreement entered into by the bankrupt;
  - the acknowledgement, waiver and conclusion of a settlement, concerning challenged claims, as well as submitting a dispute to an arbitration for settlement (*Article 206 of the Bankruptcy Law*).
- **in arrangement bankruptcy:**
  - encumbering the assets of the bankruptcy estate with a mortgage, pledge, registered pledge, tax lien, maritime mortgage in order to secure claims not included in the arrangement with creditors by the bankrupt or bankruptcy administrator;

- encumbering the assets of the bankruptcy estate with other rights by the bankruptcy administrator;
- taking loans and bank credits by the bankruptcy administrator (*Article 206 of the Bankruptcy Law*).

### **Meeting of Creditors**

The creditors' meeting does not possess any controlling rights similar to those of the creditors' council. Convening the meeting is obligatory if it is demanded by at least two creditors jointly holding at least one-third of the sum total of the claims recognized on the list of creditors, as well as in several special situations if the Bankruptcy Law so requires (e.g., in order to vote on arrangement proposal) (*Article 191 of the Bankruptcy Law*). However, in liquidation bankruptcy, the creditors' meeting is rarely convened in practice. Moreover, due to its general nature (i.e. participation of potentially all recognized creditors) and the resolution of only those issues that have been submitted for resolution, the creditors' meeting does not constitute a body that might exercise ongoing control of the proceedings.

### **Influence of the shareholders on the on the insolvency administration**

#### **In liquidation**

Because a bankruptcy receiver is appointed to manage the bankrupt's business, the shareholders of the bankrupt company may no longer (through the management board they appointed)<sup>40</sup> influence the management of the bankrupt company's business. The law does not require any decisions of the bankruptcy receiver to be the subject of consultation with the shareholders.

#### **In arrangement bankruptcy**

The influence of the shareholders on the management of a bankrupt's business (through the management board they appointed) varies depending on the court's decision regarding such management. If self-administration is established, such influence may be greater, whereas if a bankruptcy administrator is appointed the situation will be similar to that in the case of liquidation bankruptcy, i.e., the management board itself will have a very limited role. Shareholders have limited control over the terms of the future arrangement. Through the bankrupt's management board they may influence the arrangement proposal that will be submitted to a vote. However, arrangement proposals may also be submitted by other parties to the proceedings and they are submitted to a vote in the order determined by the judge-commissioner. As shareholders (with regard to their contributions towards shares, and certain loans) are not treated as creditors, they do not vote on the arrangement proposals. Shareholders who control more than 20% of shares or votes at the shareholders' meeting of the bankrupt company are also excluded from voting on arrangement proposals even if they have other types of claims against the bankrupt, e.g., trade claims.

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<sup>40</sup> Here, one caveat must be made: under Polish law board members in the first place owe fiduciary duties to – and must act in the best interest of – the company rather than its shareholders.

## Transparency / accountability of bankruptcy management

The bankruptcy receiver / administrator / court supervisor must submit the following documents to the court files of the bankruptcy proceedings (the files may be inspected by creditors):

- periodic reports regarding his/her activities and accounting report (with a frequency determined by the judge-commissioner, at least once every three months), the specific scope of such reports is determined by the judge-commissioner;
- inventory of the bankruptcy estate (*Article 168 of the Bankruptcy Law*);
- motions to the judge-commissioner for consent to specified measures, where such consent is required;
- motions for payment of advances for his/her remuneration.

The creditors' council, if appointed, has a right to inspect documents of the bankrupt, control his/her activities and demand explanations (see comments above) (*Article 205 of the Bankruptcy Law*). Individual creditors have access to the court files of bankruptcy proceedings.

### Question (iv) :

#### Rules on ranking creditors

In liquidation bankruptcy, creditors are ranked in five categories:

- **category one** includes, *inter alia*, the creditors who claim for: the costs of bankruptcy proceedings; alimonies, pensions for illness, incapacity to work, disability or death due for the period after the bankruptcy is declared; amounts resulting from the acts of the bankruptcy administrator or receiver, amounts resulting from reciprocal agreements concluded by the bankrupt before the declaration of bankruptcy the performance of which has been requested by the bankruptcy administrator; amounts resulting from the acts of the bankrupt performed upon the consent of the court supervisor or not demanding the supervisor's consent;
- **category two** includes, *inter alia*, the creditors who claim for: amounts resulting from employment agreements, alimonies, pensions for illness, incapacity to work, disability or death due for the period before the bankruptcy is declared; social security contributions together with due interest and execution costs due for the period of two years before the bankruptcy is declared;
- **category three** includes the creditors who claim for: taxes, other public levies, social security contributions not included in category two together with due interest and execution costs;
- **category four** includes creditors who claim for other amounts when not included in category five, together with all interest due for the period of one year before the bankruptcy is declared with contractual damages, court proceeding costs and execution costs;

- **category five** includes creditors who claim for interest not included in the categories of higher priority, to be satisfied in the order in which the principal amount is to be satisfied, as well as court and administrative fines and amounts resulting from donations and legacies (*Article 342 of the Bankruptcy Law*).

Notwithstanding the classification above there are specific rules applying to the creditors who possess:

- **claims acquired after the declaration of bankruptcy by way of an assignment or endorsement** – which are subject to satisfaction within category four, provided that they are not subject to satisfaction within category five. However, this does not apply to claims that result from the acts of the bankruptcy administrator or receiver, or the acts of the bankrupt performed upon and with the consent of the court supervisor (*Article 342 of the Bankruptcy Law*);
- **claims secured by a mortgage, pledge, registered pledge, tax lien, maritime mortgage, personal rights and claims encumbering the real property** – which are satisfied from the proceeds of the sale of the encumbered asset, in an amount reduced by the costs connected with the sale and other cost of insolvency proceedings but not more than by 10% of the proceeds of sale (*Article 345 of the Bankruptcy Law*);
- **claims of shareholders** – shareholders “claims” for the return of contributions are not satisfied alongside other creditors’ claims in the distribution of liquidation proceeds. In fact, in liquidation bankruptcy the shareholders do not receive any compensation for their shares in the company. Upon conclusion of the proceedings, when the bankrupt company is deleted from the commercial register, the shareholder rights (embodied in shares) also cease to exist<sup>41</sup>.

### Special rules on set-off

#### In liquidation:

- set-off of the bankrupt's claim against the creditor's claim is admissible if both claims existed on the date bankruptcy was declared, even if one of them was not yet due;
- set-off is inadmissible if the debtor of the bankrupt has acquired the claim through an assignment or endorsement after the declaration of bankruptcy or if it has acquired the claim within the last year prior to the date bankruptcy is declared, knowing that the relevant basis existed for declaring bankruptcy. However, set-off is admissible if the acquirer of the claim has become a creditor of the bankrupt as a result of paying off the debt owed by the bankrupt, for which the acquirer was liable personally or with or upon

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<sup>41</sup> As regards other claims against the bankrupt that the shareholders may have, they are in principle treated in the same manner as other creditors with one important exception. Any loans granted to the bankrupt company within 2 years prior to the bankruptcy declaration are treated in the same manner as their contributions towards shares.

certain proprietary items, and if the acquirer, at the time of assuming the liability for the bankrupt's obligation, did not know that a basis existed for declaring bankruptcy. A set-off is always admissible if the assumption of liability was effected at least one year prior to the declaration of bankruptcy;

- set-off is inadmissible if the creditor has become a debtor of the bankrupt after the date bankruptcy is declared (*Articles 93,94,95 of the Bankruptcy Law*).

#### **In arrangement bankruptcy:**

- the set-off of reciprocal claims between the bankrupt and the creditor is generally admissible. It is excluded only if the creditor:
  - has become a debtor to the bankrupt after the declaration of bankruptcy;
  - being a debtor to the bankrupt, has become a creditor to the bankrupt after the declaration of bankruptcy, by acquiring, through an assignment or endorsement, a claim which arose prior to the declaration of bankruptcy. However, the set-off of reciprocal claims shall be admissible if the acquisition of the claim has been effected as a result of paying the debt, for which the acquirer was liable personally or with certain proprietary items and if the acquirer's liability for the debt had arisen before the day the petition to declare bankruptcy was filed (*Article 89 of the Bankruptcy Law*).

#### **Retention of title / right of rescission**

On retention of title, please refer to point II.4 above.

In liquidation bankruptcy, the bankruptcy receiver has a special right to rescind a reciprocal contract (i.e., a contract in which both parties have mutual obligations), if neither of the parties has yet performed its or his obligation under the contract in full. Arrangement bankruptcy gives no special right to rescind contracts.

#### **Question (V) :**

#### **Rules on the process of filing claims**

A creditor must generally file a submission of claim in order to participate in the proceedings; only certain claims are recorded on the list of claims ex officio (e.g., secured claims, claims under labour contracts) (*Article 236 of the Bankruptcy Law*). A submission should be filed with the judge commissioner by the deadline set out in the declaration of bankruptcy, which takes one to three months from the date of publication of the announcement of the decision in the Court and Business Monitor (official gazette); however late filings are admissible. The creditor which filed its claim after the deadline participates in further proceedings but may not demand the proceedings to be repeated or claim the recovery of his part in whatever was distributed earlier among creditors. He may also be obliged to pay costs triggered by such late filing (*Articles 252, 253 of the Bankruptcy Law*).

Claims submitted by creditors are initially considered by the bankruptcy receiver, the court administrator or the court supervisor, who makes a decision whether they should or should not be recognized in a list of claims (and to what extent). The list is subsequently submitted to the judge-commissioner, and a public announcement is

made that the list may be inspected at the court (*Article 243 of the Bankruptcy Law*).

### **Rules on verification of claims**

Within two weeks of the announcement in the Court and Business Monitor, each creditor recorded on the list may file an objection to the judge-commissioner against the recognition of a claim of another creditor. Additionally, any creditor whose claim has not been recognized in the list may file an objection against the refusal to recognize its claim.

The debtor may file an objection to a claim only if the debtor's position regarding the claim presented to the bankruptcy receiver / administrator / court supervisor was not reflected in the list of claims submitted to the judge-commissioner (*Article 256 of the Bankruptcy Law*).

Objections are recognized by judge-commissioners, whose decisions are subject to appeal (complaint to the bankruptcy court). The bankruptcy court makes the final and non appealable decision (*Article 259 of the Bankruptcy Law*).

Once all objections are recognized, a final list of claims is approved by the judge commissioner (*Article 260 of the Bankruptcy Law*).

### **Question (vi) :**

### **Rules on the responsibility for the proposal of a reorganization plan**

#### **In arrangement bankruptcy**

Arrangement proposals may be submitted by:

- the bankrupt (if self-administration was established, and the bankruptcy does not submit such proposals within a specified deadline, the self-administration is revoked and a bankruptcy administrator is appointed to manage the bankruptcy estate instead of the bankrupt);
- the court supervisor or the bankruptcy administrator;
- the creditor which moved for bankruptcy and submitted initial arrangement proposals (*Article 267 of the Bankruptcy Law*).

#### **In liquidation**

Arrangement proposals may also be submitted in liquidation bankruptcy, even though proceedings of this type are not aimed at concluding a debt restructuring arrangement. However, as noted, there exists the possibility of changing the type of bankruptcy. The arrangement proposals may be submitted by:

- the bankrupt;
- the bankruptcy receiver;
- the creditors' council (*Article 268 of the Bankruptcy Law*).

## Contents of arrangement proposals

The arrangement proposals should include a reasoned description of the methods of restructuring the bankrupt's obligations.

There is no closed catalogue of the possible methods of restructuring the bankrupt's debts. The law only provides some examples of such methods including:

- deferment of the performance of the bankrupt's obligations;
- payment of debts in instalments;
- reduction of debts;
- debt-to-equity swap.

The arrangement may indicate more than one method of restructuring the bankrupt's obligations (*Article 270 of the Bankruptcy Law*).

The creditors may also agree in the arrangement on the liquidation of a debtor's assets (such as by agreeing to sale to a selected buyer or in a public auction, or to a takeover of assets) and the distribution of proceedings of sale to creditors.

Generally, the provisions of the arrangement should be identical for all the creditors within the same group of interests (constructed for the purpose of voting on such an arrangement), with two exceptions, that is:

- **less favorable** conditions may be granted to creditors only if they so consent;
- **more favorable** conditions, on the other hand, may be granted to creditors if:
  - their claims are small; or
  - they, after the declaration of bankruptcy, have extended to a debtor financing that is indispensable for the performance of the arrangement (*Article 279 of the Bankruptcy Law*).

## Rules on adoption of arrangement

The arrangement with the creditors is adopted in voting during a meeting of creditors convened within a month of the date the list of claims is approved. The judge - commissioner may proceed with convening the meeting if the amount of claims which are still disputed does not exceed 15% of the overall value of claims (*Article 282 of the Bankruptcy Law*).

Creditors whose claims have been acknowledged in the bankruptcy proceedings or in a final judgement or administrative decision are entitled to attend such a meeting with the right to vote.

Creditors vote with the sum of claims recognized on the list of claims or acknowledged in a final judgement or decision. However, in matters concerning the arrangement with creditors, creditors who are the bankrupt's affiliates or dominant companies (subsidiaries), as well as persons authorized to represent such companies, exercise no voting rights.

For the purpose of voting on such an arrangement creditors may be divided by the judge-commissioner into groups of specific and/or similar interests, that is:

- creditors entitled to claims arising under employment relationships (employees);
- creditors whose claims are secured by rights in rem (such as a pledge or mortgage);
- farmers with claims for payment for commodities from their farms;
- creditors who are shareholders of the bankrupt;
- other creditors. This group may be further divided taking into consideration inter alia the character of the debt, the amount of the claim and its maturity date (*Article 279 of the Bankruptcy Law*).

The arrangement is adopted if it attracted a majority of the votes of creditors representing on aggregate 2/3 of the overall value of claims eligible to vote. If creditors were divided into groups: the arrangement is adopted if in each group it attracted a majority of the votes of creditors representing on aggregate of 2/3 of the overall value of claims eligible to vote in a given group.

A cram-down is available and allows the judge - commissioner to conclude that the arrangement was adopted even though it was not adopted in certain groups, provided that a majority of creditors from the remaining groups representing on aggregate 2/3 of the overall value of claims eligible to vote was in favour of its adoption and if under such an arrangement the claims of creditors from dissenting groups are satisfied to an extent no less favourable than in the event of liquidation bankruptcy (*Article 285 of the Bankruptcy Law*).

The arrangement adopted by the meeting of creditors has to be approved by the court. The court refuses to approve the arrangement if it contravenes the law, or if it is evident that the arrangement will not be performed. The court may also refuse to approve the arrangement if its terms and conditions are grossly detrimental to the creditors who voted against it and such creditors have filed objections (*Articles 287, 288 of the Bankruptcy Law*).

If the meeting fails to adopt the arrangement the court immediately converts the decision declaring bankruptcy with the possibility to make an arrangement into a decision declaring liquidation bankruptcy and there is no further possibility to make an arrangement with creditors (*Article 286 of the Bankruptcy Law*).

### **Rules on modification of the reorganization plan**

Changes to arrangement proposals may be submitted by the bankrupt during the meeting of creditors, unless he lost the right to submit the initial proposals.

An already approved arrangement may be modified only if an extraordinary change of the economic situation significantly affecting the continuous increase or decrease of the income of the bankrupt's business occurs, upon a motion of a bankrupt or each of the creditors. Modification of the arrangement also has to be accepted in voting and approved by the court (*Article 298 – 300 of the Bankruptcy Law*).

**Question (vii) :****Rules on the scope of the insolvency estate**

According to the Bankruptcy Law the insolvency estate comprises assets which belong to the bankrupt on the date the bankruptcy is declared as well as those obtained by the bankrupt in the course of insolvency proceeding (*Article 62 of the Bankruptcy Law*).

Importantly, the bankruptcy estate also includes property in respect of which ownership was transferred by the bankrupt as security for a creditor (such creditors are treated as secured creditors in relation to those assets, i.e., they enjoy a priority in satisfaction from the proceeds obtained from such assets).

The Bankruptcy Law provides for the exclusion from the bankruptcy estate of certain special assets, such as assets generally exempt from enforcement proceedings, the employee social fund, assets connected with sub-participation agreements and certain amounts deposited on a securities account (*Article 63 of the Bankruptcy Law*).

**Rules on the management, disposal or sale of the assets included in the insolvency estate**

Regarding the management of the bankruptcy estate, please refer to point III above.

Rules on the disposal / sale of assets forming part of the bankruptcy estate are set forth below.

**In liquidation**

The assets from the bankruptcy estate are liquidated by the bankruptcy receiver. The bankruptcy receiver submits a plan of liquidation that describes the proposed methods of liquidation and the time schedule. Liquidation is commenced after the inventory of the bankruptcy estate and financial statement of the bankrupt have been made (*Articles 306, 307, 308 of the Bankruptcy Law*).

The bankruptcy administrator liquidates the insolvency estate by selling the business as a whole (which is preferred) or its separated parts, sale of real property and movables, enforcement of bankrupt's receivables, enforcement or sale of bankrupt's property rights (such as, e.g., shares in other companies) (*Article 311 of the Bankruptcy Law*).

The business should be sold as a whole unless the same is not possible. The creditors' council's (or the judge-commissioner's – if the council was not appointed) permission is required if the business is not to be sold as a whole (*Articles 316, 206 of the Bankruptcy Law*).

The business or its parts, as well as real property, should be sold by public auction (*Article 320 of the Bankruptcy Law*). The creditors' council (or the judge-commissioner – if the council was not appointed) may grant consent to an "open sale" (e.g. in a "privately negotiated" transaction) of a business or real estate by specifying the conditions for such a sale, including the minimum price.

**In arrangement bankruptcy**

In arrangement bankruptcy the bankrupt's assets are not generally liquidated (unless the accepted terms of arrangement provide for liquidation in order to satisfy the creditors).

Because the bankrupt's business operations are continued, the assets of the bankruptcy estate which are normally traded by the bankrupt may be sold.

### **Question (viii):**

#### **According to the Bankruptcy Law, i. a.:**

- all legal acts performed by the bankrupt within one year prior to the filing of the petition to declare bankruptcy, on the basis of which the bankrupt has disposed of its assets, are ineffective towards the bankruptcy estate if such acts were performed gratuitously or for consideration, but where the value of the bankrupt's performance significantly exceeds the value of the consideration received by the bankrupt or reserved for the bankrupt or a third party (significant disparity of performance). The Bankruptcy Law does not clarify the term 'significant disparity of performance' – this has to be determined by the court in each particular case;
- repayment of or establishing a security interest for the payment of debt that is not yet due, effected by the bankrupt within two months prior to the filing of the bankruptcy petition, are also ineffective towards the bankruptcy estate (*Article 130 of the Bankruptcy Law*);
- legal acts for consideration (i.e., acts that are not gratuitous ), performed by the bankrupt within six months prior to the filing of the bankruptcy petition are ineffective as against the bankruptcy estate if concluded with certain entities related to the bankrupt. As far as companies go, these entities include affiliated companies and companies in relation to which the bankrupt was a dominant or a subsidiary party (*Article 128 of the Bankruptcy Law*).

All the acts mentioned above are ineffective as against the bankruptcy estate by operation of law (*ex lege*). The bankruptcy receiver, court supervisor or bankruptcy administrator may demand that a civil court issue a declaratory award confirming that a particular act is ineffective as against the bankruptcy estate.

When a disposal of assets is found to be ineffective vis-à-vis the bankruptcy estate, the bankrupt does not 'again' become the owner of the object that was disposed of. What happens is that the object becomes part of the bankruptcy estate (while continuing to be owned by the purchaser), one consequence of which is that it can now be disposed of during the liquidation of the bankruptcy estate to satisfy the claims of the bankrupt's creditors. In principle, such assets should be returned in kind but if this should prove impossible, an equal amount of money should be paid to the bankruptcy estate (*Article 134 of the Bankruptcy Law*).

#### **According to the CC**

Pursuant to Article 527 et seq. CC, the bankruptcy receiver/ bankruptcy administrator/court supervisor may demand that an act of the bankrupt is declared ineffective if:

- the act resulted in any detriment to the creditors, whereas a party to the transaction gained a material benefit;
- the bankrupt deliberately entered into the transaction, and (unless there was a gratuitous transfer) the other party was aware of that.

**Question (ix) :**

The effects of bankruptcy on contracts concluded with the debtor will vary depending on the type of bankruptcy proceedings.

Any contractual provision for an 'automatic' variation or termination of a contract upon bankruptcy is invalid. Following bankruptcy, the parties may in principle exercise their contractual and statutory termination rights based on other grounds (e.g. failure to perform obligations), but they must respect and give priority to the statutory effects of bankruptcy. Those effects are separately regulated in relation to liquidation and arrangement (*Article 83 of the Bankruptcy Law*).

**In liquidation**

- first, all claims for non-monetary performance (such as a claim for delivery of products) owing from the bankrupt company are transformed (*ex lege*) into monetary claims (with exceptions applicable to *inter alia* reciprocal contracts which may be rescinded or performed as contracted for, see below). Secondly, all claims become immediately due and payable (*Article 91 of the Bankruptcy Law*). Thirdly, no payments (which arose prior to bankruptcy) may be made to creditors otherwise than during the distribution of the liquidation proceeds by the bankruptcy receiver (i.e. following sale of the assets of the bankruptcy estate);
- reciprocal agreements – as noted in point IV the receiver may wholly or partially rescind a reciprocal contract (such as a sale or delivery contract) that has not yet been fully performed by either of the parties. The receiver may also demand the full performance of obligations under such a reciprocal contract. A bankrupt's counterparty under such a reciprocal contract may seek a decision from the receiver on whether he rescinds or performs the contract (decision to be taken within three months). A failure to respond means that the contract is rescinded.

There are also specific rules applying to particular sorts of agreement, e.g.:

- mandates and commission agreements granted by the bankrupt, as well as management and agency agreements expire upon the declaration of bankruptcy (*Articles 102, 103 of the Bankruptcy Law*);
- agreements for the lease or tenancy of the bankrupt's real property – can be terminated by the bankruptcy receiver with the judge-commissioner's consent (even if no termination right could be exercised by the bankrupt) (*Articles 107, 109, 110 of the Bankruptcy Law*);
- securities account agreements and agreements on providing safe-deposit boxes and on safe-keeping with a bank – expire on the date bankruptcy is declared (*Article 113 of the Bankruptcy Law*);
- leasing agreements – upon the consent of the judge-commissioner the receiver may terminate the leasing agreement with immediate effect.

**In arrangement bankruptcy:**

- contracts generally remain binding and may be terminated as indicated above. However, due to a statutory moratorium, no obligations existing on the date of the bankruptcy declaration may be performed by the bankrupt (before the arrangement is adopted by creditors and accepted by the court).

- in relation to certain agreements, a bankrupt's counterparty is prevented from terminating them without the permission of a creditors' council resolution (or that of the judge-commissioner – if the council was not appointed) for the duration of the proceedings or until an arrangement is concluded, or until liquidation bankruptcy opened. The terms of arrangement may also provide that the contracts may not be terminated until the arrangement is performed. Those provisions apply to agreements for the lease or tenancy of the premises or real property where the bankrupt operates his business, financial and/or lease agreements, property insurance agreements, bank account agreements, surety and bank guarantee agreements, letters of credit, as well as license agreements under which licenses have been granted to a bankrupt (*Article 90 of the Bankruptcy Law*).

### **Question (x) :**

#### **General rules**

For the purpose of this section, we have disregarded situations where a certain third party (including, e.g. a shareholder or a director) is contractually liable for the bankrupt's debts as a person who provided security for its obligation or acceded to its debts.

We only deal with liability connected with the debtor's bankruptcy.

#### **Directors**

Each person entitled to represent the debtor (e.g. a member of the management board) has an obligation to file a bankruptcy petition on the debtor's behalf within two weeks of the company becoming insolvent. The obligation exists irrespective of whether the authority to act as a representative was joint or not, or of actual knowledge of insolvency if any grounds exist to justify the finding that the member should have known about it, or whether the member failed to submit the petition at all or it was only delayed.

The liability covers damage suffered by third parties as a result of their omission to file a bankruptcy petition within the mandatory term. In practice the liability would be owed to the debtor's creditors, since they are the parties most likely to sustain damage resulting from the failure to file for bankruptcy in a timely fashion (e.g. because the company's liabilities increased or assets diminished, the creditor's claim may only be satisfied in a smaller degree).

In addition, persons authorized to represent a debtor (also shadow directors) may be exposed to criminal liability for certain actions detrimental to the creditors or to liability in tort if their unlawful behaviour triggered damage for creditors.

#### **Liability for company's civil law debts, tax arrears and social security payments**

Under certain circumstances the directors of commercial companies can be held liable for certain debts of the company if they fail to file for the company's bankruptcy within the statutory term, i.e.:

- directors of commercial companies may be liable for the company's tax arrears and social security payments;
- directors of limited liability companies may also be liable for its civil-law debts.

**Penal liability**

Failure to file a bankruptcy petition is also subject to penal liability, which is borne by the members of the management board ( eg a fine, restriction of liberty, or imprisonment of up to one year).

As indicated above acts which are detrimental to creditors (e.g. asset-stripping, selective repayment of creditors) are criminal offences and may be prosecuted.

**Ban on conduct of business activity or board membership**

The bankruptcy court may also place a special ban on a member of the management board who is liable for failure to file a bankruptcy petition in a timely manner . The ban, of between three and ten years, may cover: the carrying on of a business activity on his own account, serving as a representative (including as a management board member), or as a member of the supervisory board or as an attorney of a commercial company, state enterprise, cooperative, foundation or association.

**Shareholders / lenders**

The Bankruptcy Law does not provide for any special liability of a bankrupt's lenders or shareholders . Under certain specific circumstances, e.g. if shareholders or lenders (or their representatives) were engaged in asset-stripping transactions, they may be exposed to criminal liability. Unlawful behaviour may also fall within the ambit of civil law torts and, as such, give rise to claims for damages against them.

**Question (xi) :**

The cost of proceedings and of operating a bankrupt's business should generally be financed from and out of the bankruptcy estate (in specific instances, creditors may be obliged to make an advance payments towards the costs, *Art. 361 of the Bankruptcy Law*).

The taking of loans or credit facilities, as well as encumbering the bankrupt's assets with limited rights *in rem* needs to be approved by the creditors council (*Article 206 of the Bankruptcy Law*) or the judge-commissioner if the creditor's council was not appointed (*Art. 213 of the Bankruptcy Law*).

In liquidation bankruptcy, claims arising from post-commencement financing are to be satisfied as part of a first category of claims (they constitute so-called obligations of the bankruptcy estate, as opposed to obligations of the debtor).

In arrangement bankruptcy claims against the bankrupt which arise after the date the bankruptcy is declared are not included in the arrangement (i.e., they are not subject to a moratorium on payments, and are not subject to the terms of arrangement). Those creditors who participate in the arrangement and after the declaration of bankruptcy agree to grant to a bankrupt a loan necessary to perform the arrangement may be granted – in the arrangement - more favourable terms of restructuring (*Art. 279 of the Bankruptcy Law*).

**Question (xii) :****Rules on a practitioner's qualification and eligibility for appointment**

As described in point III above, the Bankruptcy Law provides for three kinds of office holders that may be appointed by the court in bankruptcy proceedings: the bankruptcy receiver (liquidation bankruptcy), the bankruptcy administrator (arrangement bankruptcy with no self-administration) and the court supervisor (arrangement bankruptcy, with self-administration).

The following persons may be appointed as a bankruptcy receiver, court supervisor or bankruptcy administrator:

- a natural person with an appropriate professional license of a bankruptcy receiver (applicable in relation to all three officers);
- a partnership regulated in the CCC or a company – when partners are liable without limitation for the partnership's obligations or members of the board representing the partnership or company have an appropriate professional license (*Article 157 of the Bankruptcy Law*).

As can be seen from the above, the basic prerequisite for the appointment is the holding of a license which is issued by the Minister of Justice<sup>42</sup>. The Receiver License Law sets high substantive and moral standards which must be met by a candidate trustee, i.e., an eligible candidate will need to possess at least 3 years' experience in managing the bankrupt's assets or a business, pass an examination on economics, law, finance and management before a special commission appointed by the Minister of Justice, and have an impeccable reputation (*Article 3 of the Receiver License Law*).

In relation to specific bankruptcy proceedings, the following persons are excluded:

- creditors and debtors of the bankrupt, the bankrupt's relatives and their partners without marital status;
- present or ex-employees, members of corporate bodies, shareholders (*Article 157a of the Bankruptcy Law*).

**Rules on supervision**

**In given proceedings**, the bankruptcy receiver (court supervisor or administrator) is supervised by the judge-commissioner, and also by the creditors council (if appointed).

With a frequency specified by the judge-commissioner, the bankruptcy receiver (court supervisor or bankruptcy administrator) has to submit reports to the judge-

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<sup>42</sup> The license requirement was introduced by the Receiver License Law. As it was a constitutional requirement to protect rights previously acquired by individuals (and there was a clear need to ensure there are enough license holders in Poland), persons eligible on the basis of previous regulations could have preserved their right to be appointed to act as a trustee, court supervisor or receiver. This "grace period" was limited in time and will expire after three years from the effective date of the Receiver License Law (in October 2010).

commissioner (at least every three months). After the termination of their activities they have to submit a final report on their activities and a financial report.

The judge-commissioner may also specify the acts which the bankruptcy receiver (court supervisor or bankruptcy administrator) may not perform without his approval or without the consent of the creditors' council.

The Bankruptcy Law provides several sanctions in case the bankruptcy receiver (court supervisor or bankruptcy administrator) neglects his/her duties. The judge-commissioner, within his supervisory powers, may reprimand a bankruptcy administrator, and if his/her dereliction of duty does not cease, the judge-commissioner may impose a fine on a bankruptcy administrator of a maximum of PLN 30.000; c. EUR 7.500 (*Article 169a of the Bankruptcy Law*). Decisions of the judge-commissioner are subject to appeal to the bankruptcy court.

The bankruptcy receiver (court supervisor or bankruptcy administrator) with respect to the duties performed is subject to liability for the improper performance of duties (*Article 160 of the Bankruptcy Law*).

If a bankruptcy receiver (court supervisor or bankruptcy administrator) does not perform his duties properly he may be dismissed by a bankruptcy court (*Article 170 of the Bankruptcy Law*). The court acts upon a motion of the creditors' council or on that of a member of the creditors' council (*Art. 205 of the Bankruptcy Law*).

Nevertheless, the court may also dismiss a bankruptcy receiver (court supervisor or bankruptcy administrator) *ex officio* (i.e. no motion of an authorized person is required; the court may base such a decision on information about the negligence of a bankruptcy administrator and support it with evidence which is known to the court *ex officio* or submitted by a creditor). A decision of a bankruptcy court is subject to appeal to a district court.

The **general supervision** of the performance of duties by license holders (bankruptcy receivers, court supervisors or bankruptcy administrators) was entrusted to the Minister of Justice. If a given person cannot be trusted duly or properly to perform her/his duties, the Minister of Justice shall withdraw the license. This may be the case if the license holder:

- was dismissed, pursuant to a final and non-appealable ruling, on two occasions, as a result of the improper fulfilment of his/her duties in the course of bankruptcy proceedings;
- committed a gross breach of duty, which was disclosed after this person ceased to perform his/her function in proceedings;
- was convicted of a premeditated crime or a tax offense pursuant to a final and non-appealable court judgment (*Article 18 of the Receiver License Law*).

## Rules on remuneration

The receiver, court supervisor and bankruptcy administrator are entitled to remuneration for the performance of their duties corresponding to the work performed by them. The total amount of remuneration the receiver, court supervisor or bankruptcy administrator may not exceed 3 percent of the bankruptcy estate funds and is to be fixed at a level not exceeding 140 times the average monthly salary in the enterprise sector (c. EUR 110.000). In certain cases the remuneration may be increased by 10%, e.g., when the final distribution was made within one year since the deadline for filing claims (*Art. 162 of the Bankruptcy Law*). If the

bankruptcy receiver or bankruptcy administrator manages the bankrupt's business or in cases justified by extraordinary work input, they may receive additional remuneration not exceeding 10 percent of the earned annual profit of the business (*Art. 163 of the Bankruptcy Law*).

The decision on the remuneration and reimbursement of expenses of a bankruptcy receiver, court supervisor and a bankruptcy administrator is issued by the bankruptcy court (*Art. 164 of the Bankruptcy Law*). The decision is subject to an appeal (*Art. 165 of the Bankruptcy Law*).

### **Professional ethics**

The Bankruptcy Law does not provide for any detailed rules of professional conduct regarding the bankruptcy receiver (bankruptcy administrators or court supervisors), except for rules regarding the exclusion from appointment, the obligation to exercise diligence, and the prohibition to acquire any assets from the liquidation of the bankruptcy estate by the bankruptcy receiver (bankruptcy administrator or court supervisor), his/her relatives or partner (*Article 157a of the Bankruptcy Law*).

To our knowledge, there are certain (still informal) initiatives to have professional ethics codified. However, in the current legal framework where there is no statutory self-governing body of office holders (similar to a bar for attorneys), the code of ethics would operate as "soft law" rather than strict rules the observance of which may be scrutinized and/or enforced.

### **Question (xiii):**

Polish law does not include any specific rules relating to insolvencies of groups.

### **Question (xiv) :**

Polish courts may recognize foreign insolvency proceedings under provisions of the Bankruptcy Law (*Articles 378-424 of the Bankruptcy Law*) which constitute an implementation of the UNCITRAL Model Law on Cross-Border Insolvency of 1997. The Bankruptcy Law regulates the following issues related to cross-border insolvency cases:

- jurisdiction of Polish courts;
- rules on the recognition of foreign insolvency proceedings in Poland – under the Bankruptcy Law, recognition of foreign insolvency proceedings is not automatic and requires the initiation of separate (recognition) proceedings. As a result of recognition, the effects of a foreign insolvency proceeding extend to Poland, and:
  - any person who, in the course of the recognized proceedings, performs functions equal to those of a receiver, a court supervisor or a bankruptcy administrator under Polish law (foreign representative) may perform the same functions in Poland;
  - litigation in respect of a debtor's assets and enforcement proceedings in relation to these assets is stayed;
  - the debtor loses the right to manage its assets – unless proceedings leading to an arrangement with creditors were initiated and the foreign representatives takes over the management and liquidation;

- rules on the co-operation of Polish courts (judge-commissioner, bankruptcy receiver/ administrator/court supervisor) with foreign courts and bankruptcy administrators in order to increase the efficiency of actions taken in insolvency cases in Poland and abroad (referring in particular to the exchange of information regarding debtor's assets, the satisfaction of creditors and the manner in which the bankrupt's assets are secured and/or liquidated;
- relations between local and foreign (main) insolvency proceedings conducted at the same time (concurrent proceedings).

## **SWEDEN**

### **Question (i) :**

#### **Entry criteria**

Pursuant to Chapter 1, section 2 of the Bankruptcy Act ("BA"), a debtor who is insolvent shall be declared bankrupt following his own or a creditor's petition. "Insolvent" means that the debtor cannot pay his debts when due and that this incapacity is not merely temporary.

#### **Eligible as debtor**

A legal person can be declared bankrupt. In other words, both natural persons and legal entities can be declared bankrupt. On the other hand, the State and municipalities cannot be declared bankrupt. It is also unclear whether branch offices of foreign companies can be declared bankrupt in Sweden and to what extent a foreign citizen can be declared bankrupt in Sweden.

#### **Entities that can institute the insolvency proceedings**

Creditors (legal entities and natural persons as well as the State and municipalities) can petition the court for a debtor to be declared bankrupt.

Chapter 2, section 10 of the Bankruptcy Act provides that a creditor is not entitled to have a debtor declared bankrupt if:

1. the creditor has a satisfactory charge or collateral equivalent thereto in property belonging to the debtor;
2. a third party has presented satisfactory collateral for the creditor's claim and the bankruptcy petition conflicts with the conditions for the provision of the collateral; or
3. the creditor's claim is not due and payable and satisfactory collateral is offered by a third party.

#### **Goals of the proceedings**

Pursuant to Chapter 1, section 1 of the BA, the goal of the proceedings is to have compulsory recourse to the total assets of a debtor for payment of the debtor's debts.

**Question (ii) :**

Chapter 3, section 1 of the BA provides that following the issuing of a bankruptcy order, the debtor may not control property belonging to the debtor. Nor can he assume such obligations as may be asserted in the bankruptcy.

Unless otherwise provided in Chapter 3, section 2 of the BA, a bankruptcy estate includes all property belonging to the debtor when the bankruptcy order was issued or which accrues to the debtor during the bankruptcy and constitutes such property that it may be attached (Chapter 3, section 3 of the BA).

When the bankruptcy order has been issued, creditors may no longer have their claims enforced through distress. They must wait for a dividend on their claims until such time as there is any dividend in the bankruptcy. Creditors with security may receive advance payment on their claims in the bankruptcy. Where the debtor holds property which is covered by a retention of title clause or where any person has a right of reclamation in respect of property located at the debtor, the party entitled to the property is permitted to receive his property from the bankruptcy estate without being required to wait until the conclusion of the bankruptcy.

Upon the issuing of a bankruptcy order, landlords become entitled to terminate the debtor's lease, though if the premises are apartments where people live the tenant must agree to the termination of the contract. If commercial premises are involved and the bankruptcy estate fails to assume liability for the tenant's obligations during the lease term within one month from a demand therefore, the landlord may repossess the premises. This can be regarded as an additional right of landlords due to the tenant having been declared bankrupt.

**Question (iii) :**

A petition to have a company declared bankrupt may state that the company or the creditor petitioning to have a debtor declared bankrupt wishes to have a specific person appointed as receiver in bankruptcy. A liquidator must possess the special knowledge and experience required for the engagement and otherwise be suitable for the engagement. The liquidator is subsequently appointed by the court. The court also determines the number of liquidators. Several liquidators may be appointed if, in light of the scope and nature of the estate, it is necessary for the administration to be divided or to be managed undivided by several liquidators.

The liquidator is charged with the task of protecting the common rights and interests of the creditors and taking all measures which promote a beneficial and speedy liquidation of the estate. Issues concerning the administration are determined independently by the liquidator without it being possible for the issues to be determined by the court, e.g. a question whether certain property should be sold to a particular person and what price may be accepted. Instead, on more important issues the liquidator is required to consult with the supervisory authority for bankruptcies and specifically affected creditors, in the absence of any impediments to doing so. The liquidator must also consult with the debtor where this can suitably take place.

The court must be notified immediately upon conclusion of the engagement. At the same time, a report shall be presented regarding the work resulting from the engagement.

**Question (iv) :**

In so far as funds are not used for payment of the bankruptcy costs and other debts incurred by the estate, the remaining funds shall be distributed to the creditors in the order set forth in Chapter 11 of the Bankruptcy Act. Dividends shall be distributed in accordance with the right to payment which vests in the creditors by virtue of the provisions of the Rights of Priority Act.

A creditor's right of priority is considered to be either specific or general. Rights to payment which are not pursuant to rights of priority are to be considered non-preferential claims in the bankruptcy and are entitled to a dividend after claims with specific or general rights of priority have received full payment. Section 18 of the Rights of Priority Act prescribes that non-preferential claims are entitled to payment *pari passu*, entailing that each creditor receives payment *pro rata* to his claim.

**Claims with specific rights of priority**

Specific rights of priority apply *inter se* as ranked in the sections of the Rights of Priority Act and in accordance with the enumeration set forth in sections 3a – 7. The list presented below is in accordance with the ranking *inter se* of the specific rights of priority, taking into consideration their placement in the Rights of Priority Act:

1. claims against an issuing house as holder of debt instruments issued pursuant to the Secured Bonds (Issuing) Act;
2. maritime liens and aircraft liens;
3. pledges and rights to retain possession of property as security for a debt;
4. security interests based upon mortgages granted in ships or shipbuilding or aircraft and spare parts for aircraft;
5. registration of advances for the construction of boats made pursuant to the Boat (Registration of Advance Payments) Act;
6. rights of priority attach to the claims of policy-holders and other parties entitled to indemnification from an insurer in such property and to such extent as set forth in Chapter 7, section 11a of the Insurance Business Act and Chapter 5, section 11 of the Foreign Insurers (Operations in Sweden) Act;
7. rights of priority in personal property owned by undertakings attach to floating charges;
8. rights of priority in real property attach to claims which, pursuant to law, possess a right of priority and mortgages in the property; and
9. rights of priority in site-leasehold interests in land attach to claims for ground rent under a lease which is not due for payment earlier than one year prior to the filing with the court of a petition for bankruptcy; claims which possess a right of priority pursuant to law, as well as mortgages in site-leasehold interests in land.

**Claims with a general right of priority shall be entitled to a dividend after the specific rights of priority and in the ranking stated below:**

Claims with a general right of priority in accordance with the subsections below rank *pari passu*.

1. a creditor's costs incurred in having the debtor declared bankrupt and for obtaining an order that the property of the estate of a deceased be placed into the hands of an estate administrator, as well as costs for burial and for preparation of the inventory for the estate of a deceased, where the debtor has died prior to the issuing of the bankruptcy order;
2. fees and reimbursement for costs due to an administrator pursuant to the Company Reorganisation Act, supervisors appointed pursuant to that Act or pursuant to the Bankruptcy Act, or estate administrators if the debt relates to a period within six months prior to the date on which the bankruptcy petition was filed and thereafter;
3. costs for specific measures which, during the period referred to in subsection 2, have been adopted with the approval of the administrator in a company reorganisation or supervisor or estate administrator and which have clearly been in the best interests of the creditors;
4. other claims based on agreements entered into by the debtor with the administrator's consent during a company reorganisation;
5. compensation for an engagement to perform such audit as prescribed in law or any other statutory instrument and for engagements involving the preparation of accounting records in the performance of bookkeeping obligations prescribed in such instruments, to the extent that the compensation relates to work undertaken in the six months prior to the date on which the bankruptcy petition was filed with the District Court;
6. employees' claims for wages or other compensation arising from the employment to the extent the claim relates to a period of three months prior to the issuing of the bankruptcy order and one month thereafter; rights of priority attach to claims for severance pay relating only to a period not exceeding the notice of termination period calculated in accordance with section 11 of the Employment Protection Act, subject to certain exceptions as set forth in section 12, paragraph 2 of the Rights of Priority Act. Where a claim for wages which has accrued earlier than three months prior to the filing of a bankruptcy petition has been disputed, a right of priority attaches to the claim provided that proceedings were commenced, or a request for negotiations as referred to in a collective bargaining agreement or in the Co-Determination in the Workplace Act was submitted, within four months; a right of priority attaches to holidays and holiday remuneration which have accrued prior to the filing of the bankruptcy petition to the extent they have accrued during the current and immediately preceding year of vesting; a right of priority attaches to pension benefits to which the employee or his survivors become entitled during a period of not more than six months prior to the filing of the bankruptcy petition and six months thereafter; and
7. claims for future pensions for employees born 1907 or earlier.

Fines, conditional fines and claims based on forfeiture or other special legal consequences of a crime shall, in the event of bankruptcy, receive a dividend after other claims.

**Question (v) :**

In those cases where the liquidator has to arrange a coverage procedure, non-preferential creditors may register their claims with the District Court. Creditors holding a security interest in real or moveable property do not need to coverage their claims in order to be entitled to payment from the pawn property. The creditor has to state the amount of the claim in the submitted coverage which the creditor has to hand in to the District Court. The basis for the claim must be clearly stated. If a right of priority is claimed, the creditor must also clearly state the grounds there for. The coverage period is fixed by the District Court at not less than four and not more than ten weeks from the date of the decision to arrange the coverage procedure. Thereafter, an objections period of not less than two and not more than four weeks is commenced calculated from the expiry of the proof of claim period. A settlement meeting shall be held after two weeks but within four weeks from the expiry of the objections period. During the objections period, the liquidator, a creditor who has covered a claim in the coverage procedure and the debtor has a right to raise objections to the coverage.. The settlement meeting shall address any disputed issue which has arisen through presented objections and which has not been settled. Those disputed issues, which cannot be settled at the settlement meeting, shall be judged by the court at a hearing which, if possible, shall be held immediately after the settlement meeting and otherwise within four weeks of the settlement meeting. There creditors also have a possibility to cover their claims after the expiry date of the coverage procedure.

**Question (vi) :**

There are no specific rules regarding such liability. General tort law rules may be used in order to determine whether liability in tort may be relevant.

**Question (vii) :**

The bankruptcy estate includes all property which belonged to the debtor when the bankruptcy order was issued or which accrues to him during the bankruptcy and is such that it may be attached. Property which cannot be attached comprises the personal effects of a natural person such as clothes, furniture, work tools, etc. to a reasonable value.

The sale of the estate's property is regulated by law. The estate's property shall be sold as soon as practically possible. Sale of real property may take place through the Swedish Enforcement Authority if the liquidator finds it appropriate but it is also possible to sell it in some other way if the liquidator considers this to be more advantageous for the estate. The sale of moveable property which does not take place through continuation of the debtor's business shall take place at auction or in another manner based on what the liquidator considers to be most advantageous for the estate.

**Question (viii) :**

Presented below is a brief description of the various statutory rules in Swedish law which govern the consequences of a legal act undertaken in violation of the statutory rules which are established to protect the interests of creditors or shareholders.

In order to be able to maintain the principle of equal treatment of the creditors in a bankruptcy a possibility has been incorporated in the Bankruptcy Act, for the liquidator to intervene against actions which are normally valid as regards rights *in rem*. Acts which were undertaken by the debtor prior to a bankruptcy for an unwarranted purpose, e.g. to

benefit a closely-related party or a creditor over other creditors. Furthermore, it has been considered important to prevent the debtor from concealing property from the creditors, e.g. through the gratuitous legal acts. The rules regarding avoidance of transactions counteract unwarranted transactions by the debtors or a creditor.

In order primarily to protect creditors, the Swedish Companies Act ("**CA**") has also introduced two prohibitions on limited companies providing loans. The first prohibits a limited company from providing money loans to certain closely-related companies or persons. The second prohibition limits the company's possibilities to grant loans to enable the borrower to acquire shares in the company or in a parent company in the same group, referred to as a prohibition on acquisition loans. EU company law contains a corresponding prohibition, but that is not the case as regards the prohibition on loans to closely-related parties referred to in the second sentence of this paragraph.

Chapter 17 of the CA also regulates the legal consequences of unlawful transfers of value, i.e. where a transaction does not take place in accordance with the provisions in Chapters 17, 18 or 19 of the CA regarding permitted value transfers. The consequence of a transfer of value taking place in accordance with the above-mentioned Chapter is that the recipient must return the value that he or she has received. One criterion which has to be proven is that the person which received the unlawful transfer of value realised or should have realised that the transfer of value took place in violation of the CA. If a deficiency arises in conjunction with the repayment, those persons who participated in the decision regarding the transfer of value are liable to make up the deficit. The aforesaid applies to those persons who participated in the execution of the decision or in the preparation or adoption of an incorrect balance sheet on which the decision regarding the value transfer was based.

The Companies Act also contains special damages rules regarding the founders of companies, directors and managing directors. The rules are aimed at fostering a functioning business community by providing effective incentives for the executive management of a company to perform their obligations. The general law of tort constitutes, however, the basis for the assessment of liability.

In addition, Chapter 25 of the CA also contains rules whereby a shareholder who participates in a decision to continue the company's operations while being aware that the company is obliged to go into liquidation or that it has consumed more than one-half of its share capital and has failed to restore such share capital within the prescribed deadlines, shall be jointly and severally liable for the company's obligations together with the company's representatives.

Chapter 7, section 16 of the Bankruptcy Act provides that if the liquidator considers that a debtor may be suspected of an offence as referred to in Chapter 11 of the Penal Code, which governs crimes against creditors, he must notify the Public Prosecutor thereof and state the grounds for the suspicion. The Prosecutor must then pursue the issue of any penal liability. In addition, a debtor who conducts business operations during the bankruptcy in violation of a disqualification from trading may be punished therefor.

### **Question (ix) :**

The bankruptcy estate may choose to accede as a party to the debtor's contracts and assume the debtor's obligations for performance of the contract. In the situation which arises, the bankruptcy estate can demand performance of the other party's obligations in accordance with the contract. Employment contracts remain in force unless the liquidator

terminates the employment agreement or the employee himself terminated his or her employment agreement. If the liquidator does not terminate the employment agreement, within one month from the date of the bankruptcy, the bankruptcy estate will become a part of the employment agreement and therefore liable in relation to the employee's rights under the contract.

A landlord may, after being notified about the bankruptcy, demand the liquidator to surrender the leased premises to the landlord or provide security for the obligations of the tenant (the debtor) during the rest of the tenancy. If the liquidator fails to surrender the premises to the landlord within such time or fails to provide security for the tenant's obligations, the bankruptcy estate will be liable for the tenant's obligations under the lease contract from the date of the bankruptcy.

**Question (x) :**

See above under (viii).

**Question (xi) :**

The Swedish Bankruptcy Act contains no special rules thereon.

**Question (xii):**

Pursuant to Chapter 7, section 1 of the Bankruptcy Act, a receiver must possess the special knowledge and experience required for the engagement and must also otherwise be suitable for the engagement. A person who is employed by a court may not be appointed as a liquidator. A person who has such a relationship with the debtor, a creditor or any other person that it is likely to undermine confidence in his impartiality in the bankruptcy may not be appointed as a liquidator. Liquidators are usually appointed from among lawyers who are member of the Swedish Bar Association.

**Question (xiii) :**

The Swedish Bankruptcy Act contains no special rules thereon.

**Question (xiv) :**

In addition to the Insolvency Ordinance, which applies to bankruptcy proceedings within the European Union, there is special legislation regarding bankruptcies which cover property in another Nordic country.

## UNITED KINGDOM

### **1     Question (i) : The entry criteria and procedural considerations**

- 1.1 In the case of companies there are two principal forms of insolvency, namely administration and winding up. In addition there is an out of court procedure called a company voluntary arrangement. That has a minimal court involvement. Finally, there is a process called a scheme of arrangement which will be dealt with below in more detail at (6) where insolvency is not necessarily a pre-requisite to the procedure.
- 1.2 In the case of corporate debtors the company must be unable to pay its debts which covers both a want of liquidity, ie a cash flow insolvency and a balance sheet insolvency. The court must be satisfied that the company is likely to become insolvent. This means that a presently solvent company can apply for administration. It is virtually impossible for a solvent company in practical terms to go into winding up.
- 1.3 The present administration regime requires a need to demonstrate that one or more objectives can be achieved, namely:
  - (i) the rescue of the company as a going concern;
  - (ii) the achievement of a better result for the company's creditors as a whole than would be likely if the company were wound up; and/or
  - (iii) the realisation of property in order to make a distribution to one or more of the secured or preferential creditors. Secured and preferential creditors will be dealt with in more detail in various other questions following below.
- 1.4 In the case of winding up this can be instituted both by the company in the form of a voluntary winding up and by a court process called compulsory winding up. This second process is normally on the basis of a petition presented by a creditor based on an unpaid debt amounting to at least £750.  
  
In the case of a voluntary winding up liquidation will occur both when there is a balance sheet deficiency and/or where there is a cash flow insolvency.
- 1.5 There are a number of additional grounds which justify a compulsory winding up such as a failure by the company to carry out its main corporate objects or where the business cannot properly be carried out whether on the basis of fraud or otherwise frequently in the case of small companies which are commonly called in English law quasi partnerships.
- 1.6 A company voluntary arrangement (CVA), which is a compromise or arrangement between the company's creditors and the company, does not depend on a showing of insolvency in the sense of either of the two tests mentioned above.
- 1.7 It is enough if at least 75% of the creditors agree to such an arrangement which originally takes the form of a proposal put forward either by the directors or by the

members of the company which when approved is administered by a supervisor. That supervisor before his appointment is described as a nominee and he will take part in the formulation of the proposal.

- 1.8 The proposal must explain why in the directors' opinion a voluntary arrangement is desirable. Invariably a company which seeks to go into a voluntary arrangement will be insolvent in one or both of the senses mentioned above. The proposal will list the nature and extent of the company's liabilities together with all other information which is relevant to the proposal and the carrying out of the proposal when approved. In practical terms the company is able to carry on business while providing funds to satisfy the amounts agreed to be paid under the proposal with the whole arrangement being administered by the supervisor.
- 1.9 The insolvency of an individual debtor is called bankruptcy. Bankruptcy can be instigated by a creditor which is the usual procedure. Alternatively, a debtor can present his own petition for bankruptcy, a process which is increasingly common in the depressed economic present climate. In the case of the former process reliance can be placed on the liability of the debtor to pay or secure a debt which is treated as evidence of insolvency. That evidence usually consists of failure by the debtor to satisfy what is called a statutory demand which requests the debtor to pay a sum in excess of a minimal amount, namely £750, within 3 weeks or else face the prospect of having a petition presented against him.
- 1.10 The debtor can seek to satisfy the statutory demand on a number of grounds principally on the basis that there is an arguable defence or a cross claim. If he fails to do this then the petition will proceed and the court must be satisfied on the basis of the unpaid statutory demand that the debtor is unable to pay his debtors as they fall due.
- 1.11 A debtor will present its own petition when he demonstrates that he is unable to pay his debts either on a cash flow basis or on the basis of a balance sheet insolvency.

#### The aims of the various processes

- 1.12 An administration seeks to promote what is often called the rescue culture. An analogy is often drawn between UK administrations and US Chapter 11 proceedings. Sometimes a company in administration is subsequently the subject of a CVA. Equally if the rescue is not achieved the company will be placed into liquidation.
- 1.13 Liquidation is therefore a procedure which effectively indicates the commercial end of the company's trading existence. It is a process which has many common features with civil law of liquidation. A liquidator both in a voluntary winding up and in a compulsory liquidation will be appointed who will collect in assets and make distributions to creditors as and when appropriate.
- 1.14 The above is to be compared with the aim of a company voluntary arrangement as CVA which seeks to preserve the business of the company and to ensure that the company's board of directors remains in place. The supervisor will collect in the assets and distribute them in a manner prescribed by the terms of the arrangement. When approved the proposal and the arrangement will bind all the creditors of the company.

- 1.15 Bankruptcy is equivalent to liquidation. In cases where a bankruptcy order is made a Government official called the Official Receiver will initially be appointed to administer the estate. If there are assets and/or claims which need to be pursued almost invariably a trustee in bankruptcy will be appointed. Both those appointees will collect in assets and make distribution to creditors if applicable.
- 1.16 In most cases a bankrupt will be discharged after 1 year but in a serious case the period, at the end of which he gets his discharge, may be longer.
- 1.17 An insolvent individual, however, may wish to avoid bankruptcy and enter into an arrangement with creditors. This is called an individual voluntary arrangement (IVA). Its aim is to ensure that the debtor does not suffer any of the handicaps of bankruptcy such as the inability to get credit. Its operation reflects that of a CVA.

## **2      Question (ii) : Suspension of rights**

- 2.1 In an administration the suspension of rights against the company is called a moratorium. It is at the heart of the administration process. Once an administration order is made (and even before that date namely when an application is made for an administration usually by a third party, namely the holder of security called a qualifying floating charge holder or sometimes by a creditor) there will be a stay on pending or contemplated liquidation proceedings, as well as an order that any receiver appointed by creditors who hold any appropriate form of security (invariably a floating charge) be dismissed. The moratorium extends to all other insolvency proceedings and all other processes.
- 2.2 The moratorium is imposed in order to enable the administrator to be able to continue the business of the company with a view to its eventual rescue and rehabilitation. The administrator displaces the company's board of directors and acquires and can exercise full powers of management. He is expected to take all management decisions in order to promote the purpose or purposes of the administration. In case of doubt he must apply to the court for directions but he is generally encouraged to take business decisions on his own account without the need to seek court approval. Court directions are now common in the case where there is a clear dispute involving legal issues between various parties.
- 2.3 One major disadvantage of the moratorium especially from the point of view of secured creditors, is that those creditors lose the power and the ability, at least temporarily, to exercise their secured rights. Another disadvantage is that an administrator unlike a liquidator cannot exercise certain insolvency related proceedings against directors such as wrongful trading in respect of business improperly carried out prior to the insolvency nor can he take proceedings in respect of breaches of duty by the directors, commonly called misfeasance. These are procedures only open to a liquidator.
- 2.4 In a liquidation the effect of a winding up order being made against the company again is to impose an automatic stay on any "action or proceeding" in which the company is a defendant. Such proceedings may not be continued except with the permission of the court and on such terms as the court thinks fit. There is no automatic stay until the winding up order is made by the court or until in the case of

a voluntary liquidation the company passes the appropriate resolutions to place itself into voluntary liquidation.

- 2.5 In the case of liquidation, a secured creditor (defined as one who holds any mortgage, charge, lien or other security over the company's property) can choose not to file a proof for his debt in the liquidation and can rely entirely upon his security. In the alternative he can realise or value the security and can prove for the balance or surrender the security for the benefit of the estate generally and then prove for the entire debt as if it were unsecured. The liquidator can in an appropriate case require the security to be offered for sale.
- 2.6 As indicated in reply (I) above, the approval of a proposal for a CVA binds all creditors whether they vote in favour of the proposal or not. However, approval of the voluntary arrangement has no effect on persons who are not parties to it. Dependant on the terms of the arrangement the compromise or discharge of a debt agreed with a company under the arrangement may discharge a third party liable for the same debt. However, in general terms third parties can proceed with existing claims against the company and can issue fresh proceedings during the duration of the arrangement.
- 2.7 In the case of bankruptcy, the rules regarding suspension of rights are the same as those which exist for liquidations including the rules regarding the valuation and surrender of security.

#### Preferential creditors

- 2.8 Following statutory reforms in 2002, the Crown which is the party representing the taxation authorities in the United Kingdom is no longer to all intents and purposes a preferential creditor. In practice the beneficiary of this loss of status will be the holder of that form of security which is called a floating charge in UK law. That form of secured creditor will generally benefit from the amount which otherwise would have gone to the Crown.
- 2.9 However, by way of compensation the general body of creditors will be granted a share of those particular assets which otherwise would go to the floating charge holder and there are detailed rules regarding the percentages available dependent upon the sums involved.
- 2.10 Retention of title claimants in the case of administrations are treated in the same way as secured creditors and are subject to the overall moratorium. In a liquidation all rights enjoyed by retention of title claimants are stayed since in the case of a liquidation in general terms the retention of title claimant will not qualify as a secured creditor given the definition referred to above.
- 2.11 Whether or not a retention of title claimant can exercise rights against the company which is the subject of a company voluntary arrangement will depend on the terms of the arrangement.
- 2.12 The position of a retention of title claimant in a bankruptcy is similar to that which applies in a liquidation.

- 2.13 In none of the insolvency processes referred to above does there exist any temporary suspension of rights. However, in the case of an administration, as well as in a compulsory liquidation and in bankruptcy, there will be a suspension of rights of some sort equivalent to the final forms of stay once the original processes have been initiated, eg by the presentation of the relevant petitions.

### **3 Question (iii) : Management of the insolvency proceedings**

#### General

- 3.1 Some of the matters set out below have already briefly been referred to in relation to the first two replies.

#### Administration

- 3.2 An administrator once appointed is an officer of the court. This means that he owes various duties and responsibilities to the court including duties of honesty and impartiality. In particular he is subject to a principle which prevents him from taking any unfair advantage in dealing with a third party and which may result in any form of unjust enrichment to the company or the estate. If he infringes this principle or acts in a way which causes loss to the company or to the estate he can be subject to a claim in misfeasance or breach of duty which can be brought against him by a creditor or more usually a liquidator appointed after the end of the administration.
- 3.3 The administrator is the agent of the company. As indicated in the preceding paragraph he occupies a fiduciary position as regards the company and its creditors as a whole and must not put himself in a position where his personal interests conflict with those of his duties. These principles are reflected in his professional obligations which will be touched on in answer to question 12.
- 3.4 Whilst the administrator is in office he displaces the board of directors and is responsible solely for the management of the company although he may well reappoint the board in that respect. He is, therefore, expected to take all management decisions in the light of the purpose or purposes which underlie the administration generally. These purposes are all designed to promote the rescue of the company and its business in whole or in part. As indicated above he should only seek the directions of the court where absolutely necessary or where there is a serious issue to be decided involving other parties.
- 3.5 In the case of death or resignation the administrator can be replaced either by a creditors' committee's decision to that effect (if there is one) or by the company or by the directors by one or more creditors of the company. Usually there will be a creditors' committee which will make this decision. If none of the above parties is able to come to a decision in this respect then an application can be made to court by an interest party.
- 3.6 In many cases an administration order is obtained out of court by a particular kind of secured creditor called the holder of a qualifying floating charge, ie the qualifying floating charge holder referred to in the earlier answers. In such cases that form of

secured creditor can replace the administrator or the court can do so at the request of another interested party.

- 3.7 The court can remove an administrator on the application of the creditors' committee or on the application of the directors or the company but only when the administrator has been guilty of some form of improper conduct. The court has a broad discretion in that regard.
- 3.8 The administrator enjoys a broad range of powers. He must abide by the company's constitution and gather in all the company's property and assets. Initially his duty is to prepare a proposal for the creditors' approval suggesting how the purpose or purposes of the administration can be achieved. He can call meetings of shareholders and creditors. He must consider when and how the moratorium imposed on all creditors including any secured creditors should be lifted. It may well be that it is advantageous to the purpose or purposes of the administration that the moratorium be lifted in specific instances.
- 3.9 The Insolvency Act 1986 (which basically regulates the administration regime) sets out specific powers which an administrator can exercise without the creditors' approval including but not limited to the taking of proceedings to protect or collect in company property.
- 3.10 In certain cases he can make distributions to creditors provided such distributions are in the best interests of the company's creditors. The guiding principle underlying the basis for such distributions can again be said to reflect whether the purpose or purposes of the administration are being furthered.
- 3.11 The administrator also enjoys extensive powers of investigation similar to those enjoyed in a liquidation. He can apply for immediate recovery of the property of the company in certain cases. He can also obtain the books and records of the company from company officers as well as from third parties. Company officers and employees have a statutory duty to co-operate with him along with others who may be regarded as holding important information about the company's affairs. All these persons can be cross-examined by the administrator under the control of the court.
- 3.12 The administrator can also issue proceedings with regard to antecedent or anterior transactions but his powers are not as extensive as those of a liquidator as indicated above. In particular he can attack what are called transactions at an undervalue ie, so-called detrimental acts which are dealt with in answer to question 8. Transactions at an undervalue occur whenever a company makes a gift to a person or enters into a transaction with a person under which the company receives significantly less in value than the consideration provided by it. In addition he can attack a preference, ie a payment or other disposal made to a creditor in preference or in priority to other creditors. He can also impeach certain forms of security called a floating charge: again see 8 below.
- 3.13 However, in general an administrator must respect pre-administration contracts, a matter reviewed again in answer to question 9. In particular the administrator cannot disclaim, ie formally disregard contracts which contain or impose onerous or extensive obligations on the company. This power is only enjoyed by a liquidator or by a trustee in bankruptcy.

- 3.14 As referred to above, and on account of the moratorium which accompanies an administration, an administrator has wide powers which enable him to dispose of secured assets and/or third party property, eg property subject to retention of title claim. This is to enable a better price to be achieved than might otherwise be achieved were a disposal not to take place, in particular if the disposal is made in conjunction with the sale of other assets.
- 3.15 In exercising his powers and duties the administrator is subject to a duty of care and in most cases to a fiduciary obligation as the company's agent as well as being an officer of the court as indicated above.
- 3.16 He must obtain a formal statement of affairs from the company's directors. That statement represents one of the principal bases of the proposals which he is under a duty to prepare within an 8 week period following the start of the administration. That proposal is designed to be considered properly and fully by the creditors to see whether they believe the proposal could be achieved. The proposal must contain as much detail as possible as to the way in which the company in administration will be run and as to the manner in which the purposes behind the administration will be implemented.
- 3.17 The proposals must be considered by a properly convened creditors' meeting chaired by the administrator. The proposal can then be voted on by the creditors and either accepted in whole or in part or rejected. Voting approval is then conducted according to the majority in value of those present in person or by proxy.
- 3.18 After approval the administrator must provide periodic reports as to the progress of the administration relating how the administration is progressing. The general rule is that the administrator should seek to achieve completion of the administration within 12 months. There is a power to extend but it is not commonly employed save perhaps in the most complicated administrations.
- 3.19 In reality the shareholders of the company have little, if any, control or say over or in respect of the actions of the administrator. It is the creditors acting as a whole or by means of a duly elected committee who control the actions and functions of the administrator.

#### Liquidations

- 3.20 As in the case of liquidations the function of a liquidator are dictated by the English Insolvency Act 1986 where his duties and obligations are set out. This is almost entirely a statutory process. In certain cases he will be assisted by a liquidation committee but his overall responsibility is to collect in the assets, pay the company's debts and return any surplus to the members or shareholders.
- 3.21 Again, as in the case of an administration, he can in appropriate cases seek the assistance of the court in the form of directions but will only do so when there is a real issue to be determined.
- 3.22 As in the case of an administrator he too will act in a fiduciary capacity in his dealings with the company and with its creditors. In the case of a compulsory liquidation he is an officer of the court. In the case of a voluntary liquidation he

occupies a similar position owing the same fiduciary duties to the company and to the creditors.

- 3.23 Yet again as in the case of an administration, a liquidator can be regarded as the agent of the company. In that capacity and when fulfilling his duties and responsibilities as such he does not undertake any personal liability. However, he frequently has the choice of litigating in the company's name or in his own name.
- 3.24 If the cause of action is one held by or vested in the company, litigation will take place in the company's name. In such a case the defending party has the right to seek security for its costs should proceedings be issued. Security is sought on the basis of the insolvency of the claimant, namely the company.
- 3.25 However, when he claims that there are transactions at an undervalue or preferences or when he claims that the directors have acted in breach of duty so as to constitute misfeasance as well as for any claims he makes that the directors have committed wrongful trading, ie trading whilst the company was insolvent, such proceedings can be taken in his own name. In such a case he litigates at his risk but in most cases he will be allowed to seek an indemnity out of the company's assets when such assets are sufficient. Otherwise he will need to make suitable insurance and funding arrangements for his costs, a matter which will be touched on again in answer to question 12.
- 3.26 The property of the company does not vest in the liquidator as it does in the case of a trustee in bankruptcy in the case of the bankrupt's estate. However, there are the occasionally rare cases where a vesting order can be sought by a liquidator but in practical cases this hardly ever arises.
- 3.27 Many of the liquidator's powers are set out in the Insolvency Act 1986. The Act draws a distinction between powers which can be exercised without the sanction either of the court or of the creditors and those powers which can be exercised without such sanction. The latter include the power of sale, the power to raise money on the security of the company's assets and the power to appoint sub agents. Powers which require sanction include the power to bring or defend legal proceedings and the power to carry on business insofar as the same is beneficial to the winding up as well as the power to pay or make compromises with creditors.
- 3.28 Although a liquidator owes no duty to individual creditors he must act in the interests of all creditors and contributories, ie shareholders generally. He must avoid actual or potential conflicts of interest but as a matter of general law and as a matter of ethical or correctness in accordance with the professional duties.
- 3.29 Many specific duties imposed on a liquidator are straightforward and include the following, namely a duty to call meetings (though not subject to the same periodic regime as in the case of an administration), the duty to provide information and the duty to collect in assets.
- 3.30 A liquidator enjoys the same range of investigative powers as an administrator. To fulfil his duty to realise assets and discharge liabilities he can sell the assets in a variety of ways in conjunction with his duty to discover who the creditors of the company are and to ascertain the amount of their claims.

- 3.31 The rules regarding the resignation, removal and vacation from office reflect those applicable to administrations. The powers of the court to remove a liquidator are very broad and again are the same as those which apply in an administration.
- 3.32 A liquidator can in addition obtain his release from liability when he has fulfilled his duties and functions and duly notifies the creditors.
- 3.33 A liquidation committee is invariably appointed to assist and supervise in the orderly administration of the assets in the liquidation particularly in large and complicated liquidations. The committee can often influence a liquidator in a manner in which he conducts the liquidation. The liquidator will normally convene a first meeting not more than 4 months after the commencement of the winding up and frequently well before. After that and prior to a final meeting it is entirely in the hands of the liquidator whether and if so when he should convene further meetings. The creditors can themselves requisition such meetings if they think it appropriate. Resolutions are normally passed by a majority in value of those present and voting.

#### CVAs

- 3.34 After a company by its creditors or members has made a proposal for such an arrangement, a nominee must be appointed. His duty is to report to the court and to the creditors on the merits of the proposal. The court's role however is purely formal.
- 3.35 Once a proposal is approved, the nominee will become the supervisor of the arrangement. Although the nominee has powers to investigate the debtor's proposals and the company's statement of affairs there is no duty imposed on him by a statute to do so. Unlike an administrator or a liquidator in a compulsory liquidation he is not an officer of the court. He must convene the necessary meetings to consider the approval of the proposal and he must ensure that he chairs the relevant meetings. As supervisor his powers will be set out and explained in the proposal as approved.
- 3.36 If any creditor, director or member is aggrieved by any act, omission or decision of the nominee an application can be made to the court. The court can then confirm, reverse or modify such act or decision or make any other order it thinks fit.
- 3.37 The nominee has no statutory protection with regard to the performance of his duties in connection with the arrangement. His powers and duties are entirely circumscribed and provided for by the terms of the arrangement.
- 3.38 The court can, however, direct that a supervisor be replaced by another qualified person to act as supervisor usually on the application of the creditors.
- 3.39 In some cases a committee can be formed and resolve that the moratorium created by the proposal be extended if necessary provided the supervisor agrees.
- 3.40 Once a proposal has been approved, the supervisor must prepare a formal report containing all relevant matters, to be filed with the court although the court has no pro-active role in this respect.

- 3.41 Any creditor can after approval claim that his or its interests have been unfairly prejudiced by the arrangement. Alternatively, he or it can claim that there has been some material irregularity which has occurred with regard to the approval. The court then has a wide range of powers and orders to be able to make any suitable order including an order that a further meeting or meetings be held.
- 3.42 In the case of small companies which seek to go into CVA a moratorium regime has been introduced since 2002. There is no need for a formal application or a court hearing. The main conditions with regard to these small companies are that the turnover be not more than £5.6 million with a balance sheet total of £2.8 million and with the number of employees not to exceed 50. The moratorium is equivalent to the moratorium which applies in an administration and is designed to ensure that there is a fair chance of the proposal being workable and implemented.
- 3.43 After approval, the role, functions and duties of the supervisor will be determined by the terms of the proposal including any provisions as to resignation or replacement. The court, however, does have an overriding power to control his actions and, if necessary, remove him. The supervisor will have such powers as is given to him by the proposal.
- 3.44 A supervisor's conduct is generally regulated by rules set out by the governing body for all insolvency practitioners, a matter dealt with in further detail in 12. The main professional body governing insolvency practitioners is known as the Association of Business Recovery Professionals, commonly known as R3. If any creditor or any other interested party is dissatisfied by any act, omission or decision of the supervisor the court can confirm, reverse or modify any such decision and make any order as it thinks fit. In general terms it is unlikely that the court would interfere with commercial decisions made in good faith by a supervisor in implementing the arrangement.
- 3.45 As indicated above, however, the supervisor's primary obligation is to ensure that funds are passed to creditors and not to engage in the management of the company.
- 3.46 Once the arrangement has been terminated according to its terms the supervisor may notify all creditors of the fact following which he will be at liberty to vacate his office.

### Bankruptcy

- 3.47 Following the making of a bankruptcy order a Government official known as a Official Receiver is appointed. In cases where there are substantial assets or the possibility of such assets whether in the wake of claims or otherwise, a formal trustee in bankruptcy will be appointed who will be a qualified professional and usually a chartered accountant. He will enjoy the same wide range of powers as are enjoyed by a liquidator. He will also benefit from certain additional specific powers which address certain important bankruptcy considerations. These include the power to claw back pre insolvency transactions as well as to claim after acquired property.

- 3.48 In many cases he will require the sanction of the creditors' committee or of the court before he can exercise such powers. As in the case of liquidators and administrators, his actions are subject to challenge by the bankrupt or by the bankrupt's creditors or any other interested party who may be dissatisfied with his decision.
- 3.49 Generally, the trustee should obtain the requisite permission before he exercises the powers in question. If he exercises any power without permission any transaction which he has entered into remains voidable but not void.
- 3.50 As in the case of liquidations and administrations, the administration of the estate in bankruptcy is conducted by the trustee but subject to the control of any creditors' committee or of the creditors generally. The first meeting will be called by the Official Receiver in order to appoint a trustee if thought appropriate. It is the trustee's duty to report to the creditors' committee as to anything which appears to him to be of concern to the creditors. However, meetings can be held as and when determined by the trustee.
- 3.51 Once appointed the trustee must provide information records and assistance to the Official Receiver and must keep proper records and make accounts with regard to his administration.

#### IVAs

- 3.52 The position and the rights and duties of a nominee after the approval of a proposed IVA and those of a supervisor after approval are in effect the same as those which apply to a nominee and supervisor in a CVA.

### **4 Question (iv) : Ranking of creditors**

#### Administration

- 4.1 As mentioned above, an administration is not designed to implement payment to creditors although distributions can be made only when they are regarded as being of benefit to the purpose or purposes of the administration.

#### Liquidations

- 4.2 An important consideration in a liquidation is whether the assets which form part of the estate can be claimed to be subject to a fixed charge or a floating charge. A fixed charge is straightforward and normally reflects a standard mortgage, eg a mortgage on real property. A floating charge is a very important form of security and is designed to cover all the assets of the company whilst allowing the company to trade in the normal course of business.
- 4.3 In the case of a floating charge the realisations will go first towards the costs of realisation, any preferential debts (which are presently minimal and do not include taxation), and then towards the principal among and interest secured by the floating charge.

- 4.4 In the case of a fixed charge, eg a mortgage of real property, the mortgagee can recover the amount secured by his fixed charge and any remaining assets are then called free assets. The fixed charge will take priority over the floating charge depending in part on the order of registration.
- 4.5 The free assets will be distributed first in respect of the costs of realisation, then towards the liquidator's remuneration and his proper costs and expenses, followed by any preferential debts and, finally, they will go to the general body of creditors, ie the unsecured creditors.
- 4.6 This means that the liquidator's costs cannot be paid out of floating charge realisations but since 2006, that principle has been amended so that the expenses of the winding up can now be paid before payment to the floating charge holder.
- 4.7 If there is any surplus after payment of all of the above items, it will be paid to the contributories, ie the shareholders in accordance with their share entitlement.
- 4.8 To be entitled to share in any distribution, a creditor must submit a proof of debt.
- 4.9 Sometimes the liquidator administers assets held by a company but which are held on trust for another party. This means that they are outside the immediate scope of the liquidation and do not form part of the estate. However, there remains a jurisdiction in the court to permit the liquidator to have access to those assets in order to pay the costs in relation to the administration in realisation of such assets even though they are held on trust.
- 4.10 There do remain, despite the abolition of taxation of preferential debt, a few preferential debts principally in relation to employment. There is a limited entitlement to unpaid remuneration (in general for about four months prior to any liquidation) and an entitlement to accrued holiday pay.
- 4.11 All other debts, apart from preferential debts and a very limited number of postponed debts, rank equally amongst themselves in the liquidation.
- 4.12 The shareholders, should they receive any distribution, are bound by any limitations on the shares set out in the company's constitution.

#### Administration

- 4.13 Even though it is not common for an administrator to make distributions, he can claim his expenses out of the assets available to him, if necessary out of assets which otherwise would go to the floating charge holder.
- 4.14 As explained above, a small proportion of the floating charge realisations should be diverted in favour of unsecured creditors to compensate them for their ranking below any floating charge holder in a case where the floating charge holder would otherwise benefit from the abolition of Crown preference. This so-called prescribed part was introduced in 2002.

#### Set-off: in administration

- 4.15 If an administrator makes a distribution to creditors, he must allow set-off to apply. In that case the general rules applicable to set-off in liquidation and bankruptcy will apply.

Set-off: liquidation and bankruptcy

- 4.16 Set-off applies to "mutual credits, mutual debts or other mutual dealings". Future liabilities are allowed provided they will mature into debts. In addition, obligations where the payment is certain or contingent will be allowed for set-off.

Set-off generally

- 4.17 Set-off will also be allowed if the amount or amounts in questions are fixed or liquidated or are capable of being ascertained by fixed means. In general, all obligations are covered whether arising under an agreement, by rule of law or otherwise.
- 4.18 Mutual debts cover actual, as well as contingent and prospective debts, and include interest.
- 4.19 However, if an obligation is incurred at a time when the insolvent party was on notice of the insolvency, set-off will generally be prohibited.
- 4.20 Mutual dealings is a wide concept and will cover tortious and/ or delictual liabilities. However, if monies are handed over for a specific purpose, they will not in general be regarded as forming part of any mutual dealings.
- 4.21 All insolvency set-off rules which are prescribed by the Insolvency Act and the underlying Insolvency Rules are self-executing and may not be excluded by agreement.
- 4.22 The date to determine and establish a set-off is the date on which a company went into liquidation or on which a bankruptcy order was made. In the case of administration, the relevant date is the date the administrator declares that it proposed to make a distribution to creditors.

Secured creditors

- 4.23 In the case of liquidations and bankruptcies, this has been dealt with above.
- 4.24 In the case of voluntary arrangements, unless the proposal alters his or its rights and does so with his or its consent, the secured creditor retains all his or its rights to enforce his or its security against the company.

## **5 Question (iv) :Processing and Verification of Claims**

- 5.1 As indicated in various points above, the finding of claims or the proving of debts occurs principally in liquidations and in bankruptcy.
- 5.2 A debt which is barred by limitation of time at the commencement of either form of insolvency is not provable.

- 5.3 Generally, a proof may be in any form, except in compulsory liquidations when a statutorily prescribed form is required. Otherwise it must take the form of a claim in writing. Although no time for proving is specified in the legislation, the court may fix a time within which creditors must file a proof in the absence of which they may be excluded from any distribution.
- 5.4 A liquidator and a trustee in bankruptcy have a duty to investigate each proof of debt and to determine whether it should be admitted in the insolvency. In particular, if it is appropriate, the liquidator and the trustee in bankruptcy can examine and go behind any judgment on which the claim may be based.
- 5.5 If a liquidator or trustee in bankruptcy rejects the proof, the creditor may apply to the court and the court will determine the issue. A creditor wishing to challenge another creditor's proof may request a liquidator or trustee to reject the proof. If necessary, the creditor making the challenge can apply to the court directly.
- 5.6 In a compulsory liquidation, as said above, the contents of the proof are prescribed by the legislation. Each creditor must bear the cost of proving his or its debt. Once the liquidator has collected proofs, they are open to inspection principally by other creditors and contributories.
- 5.7 If a creditor is dissatisfied by the liquidator's or the trustee's decision about his proof, he may apply to the court and the court can make any order it thinks appropriate.

## **6 Question (vi) : Reorganisation plans inside and outside formal insolvency proceedings**

- 6.1 There are two forms of reorganisations possible under English law.
- 6.2 First, there is a CVA which has been dealt with at length above. This has been extended to cover individual arrangements known as IVAs, again mentioned above. In the case of a CVA, it can be entered into independently or in consequence of an administration as a means of effecting a rescue or restructuring of the business concerned.
- 6.3 Second, there is a procedure which ultimately involves court approval, called a scheme of arrangement. This may take the form of a compromise or rearrangement which is acceptable to 75% of all creditors. Such schemes are regulated by the Companies Act 2006 and not by the Insolvency Act 1986. In any compromise or arrangement as proposed between the company and its creditors or any class of creditors, or between the company and its members or any class of members, the court may on the application of the company, or of any creditor or member, order a meeting of creditors or class of creditors, or of the members or class of members to be called. If 75% in value of the creditors or class of creditors, etc agree to the composition or arrangements, and provided it is sanctioned and approved by the court, it will be binding on all the creditors, or the class of creditor or on the members or class of members. In particular, a liquidator may propose a scheme and if he does so and it is approved by the court, he too will be bound.

- 6.4 In large liquidations, it is not uncommon to find schemes of arrangement proposed by a liquidator, and in the present climate, this is perhaps increasingly common.
- 6.5 It is important to ensure that each class of creditor fairly represents creditors with similar rights and interests. However, the power of the court to sanction a scheme is discretionary, although the court has an obligation to fulfil two principal duties. First it must ensure that all appropriate resolutions have been passed by the requisite majorities, and secondly, it must verify whether the proposal is one that an intelligent and honest man being a member of the class concerned and acting reasonably in defence of his own interest might reasonably approve.
- 6.6 In addition, the scheme must constitute a compromise or arrangement within the meaning of the legislation. A compromise generally suggests some form of accommodation on each side. An arrangement generally indicates some element of "give and take".
- 6.7 Although schemes of arrangement which are sanctioned by the court bind all creditors, they do not bind creditors in respect of debts governed by foreign law. Such creditors can therefore take proceedings in their own courts to enforce their claims. It is possible, on occasion, for the scheme to be put forward both before the English court as well as before the foreign court, but that is not usual.
- 6.8 Third parties will however not generally be bound by an approved scheme. The court, however, may wish to be satisfied that there is some means by which the members and/or the company can legally maintain their rights against third parties. A person who is not a party to the scheme has no right or challenge.
- 6.9 If the liquidator promotes a scheme, it is possible that, on approval, the court will impose terms which differ from those which apply in an orthodox liquidation.

## **7 Question (vii) : The scope of the insolvency estate**

### Company insolvencies : void dispositions

- 7.1 In both administrations and liquidations, it is the duty of the administrator, or the liquidator, as the case may be, to collect in all assets which the company owns at the commencement of the process. Administrators and liquidators must also do so in respect of assets and rights acquired during the liquidation or the administration. The latter form of assets will still belong to the company. In rare cases, a liquidator can request the courts that such assets be vested in him.

### Avoidance of dispositions after winding up

- 7.2 Since the primary aim of English insolvency law is to ensure that all creditors in the class are treated equally in an insolvency of a company, any disposition of the company's property which is made after the commencement of the liquidation is void unless the court validates the disposition. The court will only do so if by doing so it ensures that there is a rateable division of the assets between the creditors.
- 7.3 These principles address particularly the circumstances which exist between the time the originating process, ie a petition, is presented to place the company into

liquidation in a compulsory liquidation and the time when the company formally goes into liquidation but it is also of general application throughout the currency of the winding up.

- 7.4 Similarly, any transfer of shares or alterations in the status of the company's members after the commencement of the winding up will be void.
- 7.5 This means that all such dispositions are of no effect. On the other hand, if the court validates any disposition, the court enjoys a very wide discretion. In the period prior to a winding up, the court will generally need to be satisfied that the company is solvent, either on a cash flow or on a balance sheet basis. Secondly, it will need to be satisfied that the transaction in question is beneficial to creditors. This second principle will be critical in respect of any validation sought after the winding up has started.
- 7.6 Any disposition which remains void can generally be recovered by the liquidator, but usually on restitutionary principles or on general trust law principles.

#### Administrations

- 7.7 There is no comparable provision to that described above with regard to voidable transactions in the case of company liquidations which applies in the case of administrations. This is partly because it is usually the company itself which seeks to place itself into administration. Even if administration is sought by a third party, eg the holder of a qualifying floating charge, a subsequent administrator will be able to reclaim the assets which have disposed of either by virtue of insolvency related claw back procedures or under the general law.

#### Sales in administrations and in liquidations

- 7.8 Both administrations and liquidations give the administrators and liquidators extensive statutory powers which they can exercise with regard to sale and disposal generally without the sanction of the creditors or of the court.

#### Voluntary arrangements

- 7.9 In both kinds of voluntary arrangements, all the relevant powers are usually set out in the proposal which will determine the extent and nature of the supervisor's powers and functions.

#### Bankruptcy: void dispositions

- 7.10 The principles and rules regarding void dispositions are the same as those which apply in company liquidations: see above.
- 7.11 However, unlike the normal position in a liquidation, all the property which belongs to the bankrupt at the commencement of the bankruptcy, vests in the trustee in bankruptcy as from the date in which the bankruptcy order is made. This excludes any property which the bankrupt holds on trust for another party.

- 7.12 In the case of property which is acquired, or which devolves upon a bankrupt after the commencement of his bankruptcy, the trustee in bankruptcy can in general, and by notice in writing, claim such property for the estate. He may, however only do so within a 42 day period following the time notice of the existence of such property came to be known by him.

## **8 Question (viii) : Detrimental acts**

- 8.1 In English law, the principal examples of legal acts which are detrimental to creditors are transactions at an undervalue, voidable preferences and void floating charges. The last of these three claims arises only in the case of corporate insolvency. However, transactions at an undervalue and preferences are also very important in bankruptcy.

### Transactions at an undervalue and preferences

- 8.2 In such proceedings, only the officeholder, ie the liquidator, the administrator or the trustee in bankruptcy can issue proceedings. If the application is successful, recovery is made for the benefit of the whole estate.
- 8.3 In a case of both claims, the transaction must have occurred if the company or the individual was insolvent at the relevant time and within two years of the insolvency in a case of a transferee or preferred party who was connected with the company or individual and within six months in the case of non-connected parties. A connected party is normally a director or an associate of a director or a relative of the bankrupt.
- 8.4 Insolvency usually means a balance sheet insolvency.
- 8.5 In the case of a transaction at an undervalue, the officeholder can apply to the court for an order to restore the position to what it would have been if the company had not entered into the transaction.
- 8.6 A transaction at an undervalue usually takes the form of a gift or of a transaction with a party for a consideration of value for which money or moneys' worth is "significantly less" than the value in money or moneys' worth than the consideration provided by the company. The term "transaction" is a wide one and covers all forms of agreements and arrangements.
- 8.7 However, the giving of security by the company over its assets is not of itself a transaction at an undervalue. This is because the creation of a security does not diminish the value of a company's assets.
- 8.8 Protection is given to a transaction which a company enters into in good faith for legitimate business reasons. The court must not make any order unless it is satisfied that it entered into the relevant transaction in good faith for the purpose of carrying on its business and that at the time the transaction was entered into, there were reasonable grounds for believing the transaction would benefit the company. The same principles apply in the case of a bankruptcy.

- 8.9 A company or an individual gives a preference to a person where the person is a creditor or guarantor of the company's or individual's debt. It or he does so when it or he does anything or suffers anything to be done which in either case has the effect of putting that person into a position which in the event of the company going into insolvent liquidation or the debtor going into bankruptcy will be better than the position that would have applied had the insolvency not occurred. Finally, in giving the preference, the company or the individual must have been influenced in deciding to give it by desire to put that person into a better position on an insolvent liquidation than it would have been in had the preference not been given.
- 8.10 Whether a preference has been given is to be determined objectively. It must be shown that the company or the individual granting the preference intended to do so and acted voluntarily. The notion of "desire" imports a subjective element into the test for a preference. If the company or the individual is influenced by proper commercial considerations there will generally be no preference.
- 8.11 If the alleged preference is made in favour of a connected party, it will be presumed unless the contrary is shown, that the company or the individual debtor was influenced to give the preference by the requisite desire.
- 8.12 The court has the power to set aside the transaction and can make further orders aimed at restoring the pre-preference position, eg an order for sale.
- 8.13 However, both in the case of transactions at an undervalue and preferences, any order must not prejudice any interest in property which was acquired by a third party in good faith and for value except where that party was implicated in the transaction or in the preference. Usually such implication will arise when the third party not only knew that a transaction and preference was involved, but also knew of the insolvent state of the company or of the debtor's financial position.

#### Avoidance of floating charges

- 8.14 These provisions apply both in the case of liquidations and administrations. Their aim is to prevent a creditor from obtaining an advantage over other creditors when the company's ability to repay its debts is in doubt by taking some form of security to secure further advances. A challenge can be made within 12 months of the commencement of the insolvency and within two years if the transaction is with a connected party: see above.
- 8.15 The transaction in question is one in which a floating charge is granted to a creditor. A floating charge is a form of security which is over a class of assets which are presently owned as well as over a class of assets which may arise in the future. That class, or those classes, must be one or ones which, in the ordinary course of the company's business, will be changing from time-to-time. An example would be stock, or more particularly, receivables. The charge should contemplate that until some step by way of intervention is made by the holder of the charge, the company remains free to deal with its assets. When that step is taken, the charge is said to crystallise.
- 8.16 Any floating charge taken by a creditor within the above time limits is therefore invalid except to the extent of the value of further monies advanced, or goods

supplied in connection with the charge, at, or the same time of the granting of the charge.

## **9 Question (ix) : Rules on contracts**

### Administrations

- 9.1 In the case of contracts entered into prior to an administration, the administrator will generally have a free choice whether and for how long the company should give effect to them. He may decide that the contract should continue or remain in force as long as the company fulfils its obligations under those contracts, or at any time he may decide to repudiate the contract and bring the contract to an end. The primary consideration will be whether, and if so, to what extent, termination or continuation of the contract would be beneficial for the purpose or purposes of the administration. The availability of suitable financing will often be critical if not conclusive.
- 9.2 An administrator has the power to enter into new contracts. If he does so in his capacity as administrator, he will generally incur no personal liability. However, any liabilities under such contracts will be expenses within the administration and will rank over the administrator's own remuneration.
- 9.3 In particular, an administrator will not personally be liable in respect of adopted employee contracts. Again, in general, the liabilities under such contracts will be regarded as proper expenses arising in the administration.
- 9.4 It follows that if an administrator terminates a pre-administration contract, the innocent party will be left to his remedy in damages and can only claim as an unsecured creditor except in the case of employee related contracts, or certain specific contracts which are ratified and which qualify for expense status.

### Liquidations

- 9.5 A winding up does not of itself constitute a breach of executory obligations under contracts made by the company. The commencement of a winding up does not automatically bring a company's business to an end so that dealings with third parties may continue depending on whether the liquidator wishes to carry on a business.
- 9.6 If the liquidator announces that he is unable to perform the company's contracts, the other party can treat the commencement of the winding up as an immediate breach and claim damages as an unsecured creditor.
- 9.7 Many contracts provide that a party can treat a contract as terminated by reason of the other party's insolvency.
- 9.8 The Insolvency Act provides that on the application of a person who is entitled to the benefit of, or subject to the burden of a contract with the company, the court may make an order rescinding the contract on such terms as to payment by or to either party of damages for non-performance as the court thinks fit. Damages payable to the third party are provable as a debt. The liquidator can object only on

the basis that the company's obligations under the contract will be carried out in full.

- 9.9 In the case of employee contracts, a winding up which leads to a cessation of business will constitute a discharge of all employees enabling them to prove for damages.
- 9.10 If business is not interrupted, the employment may probably continue. A contract which contains an onerous obligation on the company can be disclaimed on notice by the liquidator without incurring any further liability on the part of the company.

#### Bankruptcy

- 9.11 The basic principles which apply to a liquidation apply in the case of a bankruptcy. If a contract involves the personal skill of the bankrupt, the right to enforce an executory contract will not pass to the trustee in bankruptcy.
- 9.12 If the bankrupt induced the other party to enter into the contract by means of a misrepresentation, the other party may rescind the contract and may rely upon the right to rescind as against the trustee.
- 9.13 If the further party is entitled to a specific performance of the contract, eg the contract is one which involves a proprietary or equitable right such as the sale of property by the bankrupt, that remedy will be available to the non-bankrupt party against the trustee.
- 9.14 A trustee in the same way as a liquidator can disclaim all onerous contracts.
- 9.15 If a contract has been made with a person who is subsequently adjudicated bankrupt, the court may on the application of the other party rescind the contract and order either party to pay damages. If damages are payable by the bankrupt, they will constitute a provable debt in the bankruptcy.

### **10 Question (x) : Liability of directors, shadow directors, shareholders and lenders, etc.**

- 10.1 For obvious reasons, this response does not deal with anything other than corporate insolvency and, in particular with liquidations and administrations.
- 10.2 Under general principles of English law, directors are those who occupy the position either as *de facto* directors or as *de jure* directors. In those positions, directors owe duties of care at common law, both in tort and in contract, when the latter is applicable. Those duties may be affected by the company's constitutional.
- 10.3 In addition, under the Companies Act 2006 and under general equitable principles in English law, the directors owes fiduciary duties, ie a duty of trust and loyalty such as a duty to act *bona fide* in the interest of a company and/or to promote the company's interest, a duty not to place themselves in positions where there is a conflict of interest and/or a duty to exercise independent judgment and/or a duty to use their powers for a proper purpose. If any of those duties are broken, a liquidator as distinct from an administrator can allege that there has been a

misfeasance on their part and the liquidator can seek relief by way of compensation, restitution, etc.

- 10.4 A director or a person occupying a similar position can also be liable for fraudulent trading. This deals with the carrying on the company's business with an intent to defraud the company or its creditors and/or for any fraudulent purpose. This again is a procedure available only to a liquidator who may join other parties who he alleges are knowingly parties to the carrying on of the business. He can claim that such parties should contribute to the assets of the company in such ways as the court thinks fit. This cause of action means that it can address and cover any party who was involved in steps or circumstances designed to defraud the company or who otherwise acted for a fraudulent purpose with regard to the company's affairs.
- 10.5 Furthermore, a liquidator (again as distinct from an administrator), can allege that directors and shadow directors who have conducted trading at a time prior to the insolvency on a reckless basis should be guilty of wrongful trading.
- 10.6 The essence of wrongful trading is that if there is an insolvent liquidation, and at some time before the commencement of the liquidation, such a person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation and he was a director or shadow director at that time, then unless he can satisfy the court that he took every step he ought to have taken to avoid loss to the creditors, that person can be made to contribute to the assets of the company. There is no liability for wrongful trading if no increased deficiency is shown for the period in which wrongful trading is said to have occurred.
- 10.7 The burden of proof is therefore lower than in the case of fraudulent trading. Fraudulent trading can apply to outsiders as indicated above. Wrongful trading applies only to directors or shadow directors. A shadow director is one who is not a *de jure* or a *de facto* director, but is one who controls those who are in charge of the company, ie he is a person in accordance with whose directions the directors are accustomed to act. This would exclude in most cases professional advisers and lenders.
- 10.8 It follows that apart from the procedures described briefly above, lenders and shareholders and other parties will be liable only if they are parties to fraudulent trading. They can of course be liable under the general law outside insolvency related principles, eg in contract, tort, breach of trust or any restitution.

#### Disqualification

- 10.9 There is a separate statutory regime which deals with the disqualification of directors or *de facto* directors who are shown to have acted in a manner which the court regards as making them unfit to act as directors for any future period. In serious cases, the period of disqualification can be up to 15 years. The application is conducted by the Secretary of State for Business and Enterprise and usually, it is granted where it is shown to the satisfaction of the court that the person's conduct as a director in connection with one or more insolvent companies fell below the standard of proper and/or reasonable management.

## **11    Question (xi) : Post-commencement finance**

- 11.1 There exists a variety of techniques whereby all forms of insolvency processes can be funded.
- 11.2 In the case of voluntary arrangements, invariably, the arrangement will be self-financing although this is not always the case. Nothing further therefore will be said about this.
- 11.3 In the case of an administration, provision is usually made at the outset for financing either by way of direct funding from institutional creditors, eg banks, or by having recourse to such funds as the company is expected to recover during the administration period and/or to other third party funds.
- 11.4 Most importantly perhaps in order to raise funds, whether to swell funds of an insolvent company or to enable proceedings to be brought against third parties, an administrator and a liquidator may wish to assign rights of action or so-called proceeds sometimes called the fruits of contemplated litigation.
- 11.5 There are at least three ways that this can be done. First, the officeholder can transfer the property in relation to which a cause of action is connected, eg a debt. Second, he can assign the cause of actions, eg as a right to litigate. Third, he may assign the fruits in the sense put above, ie the damages or the benefits.
- 11.6 There are more detailed requirements which accompany each of the above possibilities and there are other forms of funding, eg insurance. It is important however that a liquidator or administrator does not surrender his rights to control the relevant litigation in relation of insolvency-related claims, eg claw back claims.
- 11.7 The other principles apply equally in the case of claims made, or to be made, by a trustee in bankruptcy.

## **12    Question (xii) : Practitioners' qualifications**

- 12.1 There exists a statutory scheme under the Insolvency Act to ensure that all insolvency practitioners are properly qualified and licensed. This in turn ensures that they possess a suitable professional competence and skill.
- 12.2 An individual practitioner is normally a member of an accountancy firm. He must be authorised by a so-called recognised professional body (RPB) or he must hold an authorisation granted by a competent authority. The only competent authority at the moment is the Secretary of State for Business and Enterprise. All these matters will involve professional education and practical training.
- 12.3 A person acts as an insolvency practitioner in relation to a company by acting as a liquidator, administrator or as nominee/supervisor of a CVA. In the case of bankruptcy, the relevant positions are those of a trustee in bankruptcy and of a nominee/supervisor of an IVA.

- 12.4 All practitioners must be individuals who are authorised in each of the ways indicated above and they must also have in force sufficient security for the proper performance of their functions.
- 12.5 Eligibility in all of the above ways depends on the applicant demonstrating that he or she is a fit and proper person to act as an insolvency practitioner, coupled with fulfilment of the requisite education and training.
- 12.6 All insolvency practitioners are subject to the ethical rules of their individual professional bodies. Most practitioners are chartered accountants and are therefore subject to the rules and regulations of the UK Institute of Chartered Accountants. In the case of professional incompetence or misconduct, all those professional bodies as well as the Insolvency Practitioners Tribunal will supervise and control the individual's authorisation and removal of authorisation in cases of proved unfitness. In cases of proved unfitness, the Tribunal may make a report to the competent authority, eg the Secretary of State. The Secretary of State will then revoke the individual's authorisation.
- 12.7 The Insolvency Rules 1986 provide for the remuneration of insolvency practitioners in where there is an insolvency, corporate and personal in which they may become officeholders. There is in addition a legislative Practice Statement which sets out the relevant criteria considered desirable to assess the proper rates and extent of remuneration in each of those cases.
- 12.8 In the case of a voluntary arrangement, the creditors' meeting will normally fix the amount and rates of remuneration expenses of the nominee and supervisor.
- 12.9 In an administration, remuneration is fixed either as a percentage of the value of the property which the administrator has to deal with or by reference to the nature and extent of the property controlled by the administrator and his staff in dealing with the matters in the administration. Outsiders can be employed as and when necessary. If there is a creditors' committee, the committee will determine the basis of the remuneration and will take into account such matters as the complexity of the case, the effectiveness of the administration and the value and nature of the property involved. If there is no creditors' committee, the remuneration can be fixed by the general body of creditors or by the court.
- 12.10 The remuneration can be challenged by a creditor. The factors listed in the Practice Statement can be taken into account, eg the value of the services rendered, what is fair and reasonable, the professional integrity of the officeholder, etc, etc.

### **13 Question (xiii) : Rules as to group insolvencies**

- 13.1 There are no specific rules or provisions in English law which address and/or regulate group insolvencies as distinct from the insolvency of individual companies and individual debtors.

### **15 Question (xiv) : Non-European Union insolvency proceedings**

- 15.1 There are three main sets of principles of rules which apply to non-EU insolvencies.

- 15.2 First, section 426 of the English Insolvency Act provides a statutory means by which the English courts can recognise and act in aid of certain foreign insolvency procedures. However, this provision is limited to procedures which take place only in certain designated countries, mainly former Commonwealth countries or existing Commonwealth or related countries which have similar systems and traditions to English law. The effect of this provision is that court orders in insolvency matters may be made which are enforceable throughout the United Kingdom, even if they have their origins in another part of the United Kingdom other than England and Wales, eg Scotland and Northern Ireland. The English court is also given a discretion to "assist" the "relevant" countries. The English court can also apply English law or the relevant foreign law as the case may be.
- 15.3 Second, there exist the Cross-Border Insolvency Regulations 2006 based on the UNCITRAL Model Law on Cross-Border Insolvency. No reciprocity is involved or needed and a number of important jurisdictions have adopted the Model Law, eg particularly the United States and Australia.
- 15.4 The Model Law applies to corporate and individual debtors, principally those which have a COMI (based on similar principles in the EC Insolvency Regulation) in the foreign country concerned and where the foreign court or foreign representative in that country seeks assistance from the English court in respect of the foreign insolvency. In addition, the foreign representative or the foreign court can seek assistance in connection with proceedings under British insolvency law. Finally the Model Law deals with proceedings which are concurrent in Great Britain and in another country, or where foreign creditors seek to become involved in insolvency proceedings in Great Britain.
- 15.5 Generally, in practice, this means that a foreign representative can seek to apply directly to the British courts for assistance, recognition and relief.
- 15.6 A distinction is made very much in line with the distinctions set out in the EC Insolvency Regulation between foreign main proceedings and secondary proceedings. Once an order for recognition has been made, there is an automatic stay in the case of a foreign main proceeding which is based on a showing of main interest similar to COMI under the EC Insolvency Regulation as indicated above.
- 15.7 The Cross-Border Regulations also provide a regime for cooperation between a British courts and foreign courts.
- 15.8 Thirdly and finally, in cases where neither section 426 nor the Cross-Border Regulations apply in the case of a non-EU insolvency, the English common law will often allow for the recognition of a properly authorised and constituted foreign insolvency where proper jurisdictional links are shown to exist between the insolvency and the State where the insolvency is taking place. However, in general terms, the English court will only assist in respect of such a response for recognition to the extent of applying only English law and not the foreign law to the recognised insolvency proceedings.



DIRECTORATE-GENERAL FOR INTERNAL POLICIES

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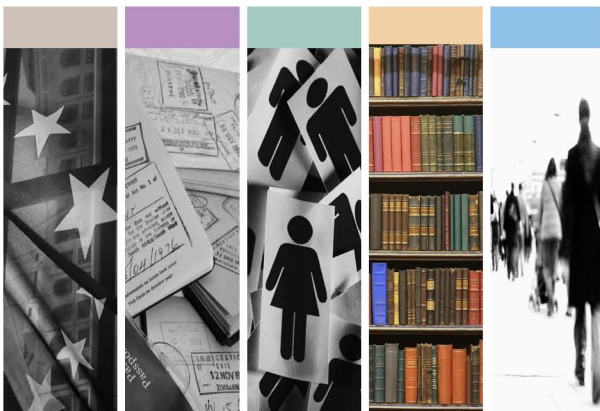
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