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NEWSLETTER
RESTRUCTURING AND INSOLVENCY IN EUROPE
AUTUMN 2009

INTRODUCTION

We are pleased to present this autumn edition of the CMS Restructuring and Insolvency in Europe Newsletter. We aim to give information on topical issues in insolvency and restructuring law in countries in which CMS offices are located.

This edition looks at:

— an ECJ decision on the jurisdiction for actions connected to insolvency proceedings;

— certain new rules on insolvency proceedings in Austria;

— the new Belgian federal Law on the Continuity of Undertakings;

— the mergers of companies in negative equity in Croatia;

— recent changes to the Czech Commercial Code;

— the appropriate use of the French *sauvegarde* procedure;

— continuation agreements in Germany as a means for insolvent companies to carry on trading;

— the recent reforms to Italian bankruptcy law;

— the principles of due process in the Netherlands, as illustrated in the Yukos Oil Company case;

— the recent amendments to the Polish Bankruptcy and Rehabilitation Law;

— continuation of "current" loan agreements in Romania;

— liabilities and challenges in Russian insolvency;

— certain reforms to Spanish insolvency law;

— insolvency in the Ukrainian banking sector; and

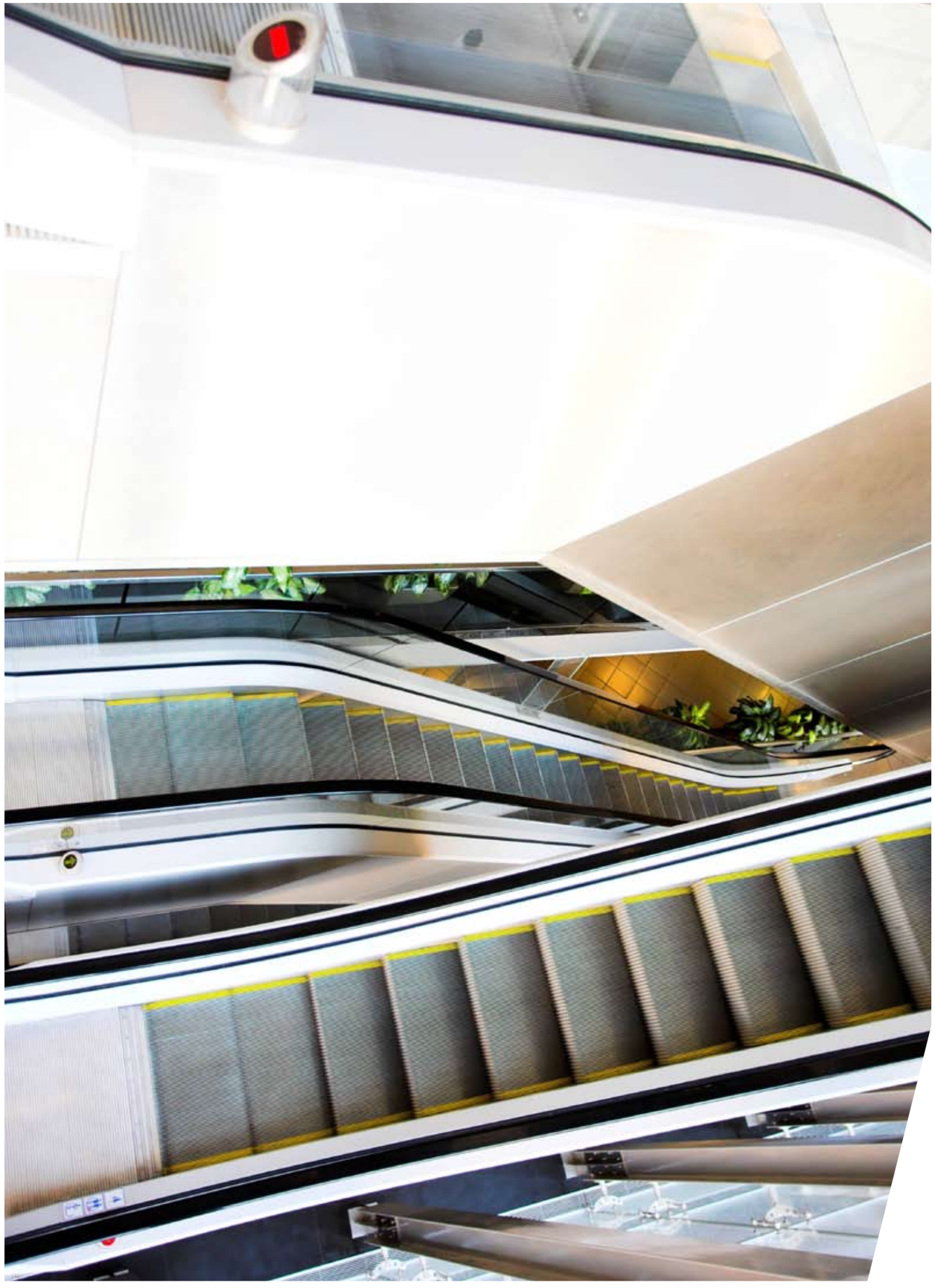
— a High Court decision on COMI and the UNCITRAL Model Law in the United Kingdom.

CMS aims to be recognised as the best European provider of legal and tax services. Clients say that what makes CMS special is a combination of three things: strong, trusted client relationships; high quality advice; and industry specialisation. We combine deep local expertise and the most extensive presence in Europe with cross-border consistency and coordination. CMS has a common culture and a shared heritage which make us distinctively European.

CMS operates in 27 jurisdictions, with 53 offices in Western and Central Europe and beyond. CMS was established in 1999 and today comprises nine CMS firms, employing over 2,400 lawyers. CMS is headquartered in Frankfurt, Germany.

The CMS Practice Group for Restructuring and Insolvency represents all the restructuring and insolvency departments of the various CMS member firms. The restructuring and insolvency departments of each CMS firm have a long history of association and command strong positions, both in our respective homes and on the international market. Individually we bring a strong track record and extensive experience. Together we have created a formidable force within the world's market for professional services. The member firms operate under a common identity, CMS, and offer clients consistent and high-quality services.

Members of the Practice Group advise on restructuring and insolvency issues affecting business across Europe. The group was created in order to meet the growing demand for integrated, multi-jurisdictional legal services. Restructuring and insolvency issues can be particularly complex and there is such a wide range of different laws and regulations affecting them. The integration of our firms across Europe can simplify these complexities, leaving us to concentrate on the legal issues without being hampered by additional barriers. As a consequence we offer coordinated European advice through a single point of contact.



EDITORIAL

I am pleased to present the autumn 2009 edition of the CMS Restructuring and Insolvency in Europe Newsletter. I hope that this edition will provide our readers with a useful insight into the ever-changing face of European insolvency legislation in the current economic downturn.

A little over a year after the collapse of Lehman Brothers, the global economic crisis continues and it appears that it will loom over our horizons for a considerable time into the future.

The German legislator has now extended certain rulings that were initially implemented *ad hoc* in response to the financial crisis in October 2008. These implementations have been extended for three more years until December 2013 and one has to assume that the duration of the crisis must now be counted in years rather than in months. From the advisor's perspective, it becomes even more important to take into account when parties to an agreement fall into insolvency. This is because the rights of the parties change depending on whether the insolvency was triggered before or after the agreement was fulfilled.

A recent ruling of the ECJ (see page 5) has opened a new line of thought in this respect. According to the Court, '*lex fori concursus*' (i.e. the law applicable at the venue of the insolvency proceedings) also indirectly determines the jurisdictional competence for actions initiated by the insolvency administrator. Therefore, a German insolvency administrator was allowed to start a court action against a Belgian counterparty before a German court, since German procedural law allows such advantageous actions for "its" administrators. One of the arguments of the ECJ was that forum shopping in connection with insolvencies was to be prevented. Therefore, the scope of application of the Insolvency Regulation No. 1346/2000 of 29 May 2000 (according to which insolvency proceedings initiated in one EU Member State have legal effect and are automatically recognised in all other Member States (apart from Denmark)) should be as wide as possible.

It has been suggested that if forum shopping with respect to insolvency proceedings is proscribed, parties could at least choose the law under which contractual terms (including insolvency provisions) are to be governed. Of course, according to Article 4 of the Insolvency Regulation local insolvency law prevails in many respects. However, certain exemptions are made and an example of this is Article 13 which deals with disadvantageous actions. According to this article, a party who benefits from an act detrimental to all the creditors can prove that (national) law "does not allow any means of challenging" such an act. Particularly in large and important transactions involving parties in imminent (or at least critical) financial crisis, parties could mitigate a possible risk that a later insolvency administrator may challenge parts of a (or the complete) transaction. This may be done by contracting under the laws of another EU Member State which provide for more stringent criteria before allowing insolvency administrators to challenge detrimental transactions.

Certainly, a choice of law must follow the rules of private international law, which prevent parties from avoiding mandatory law. However, in large transactions, this might be circumvented by replacing one of the parties with a subsidiary whose centre of main interests lies in a state with more favourable insolvency rules. Such a party might then be able to take advantage of the exemption provided under Article 13 of the Insolvency Regulation, and the applicable national insolvency law.

Whether or not the choice of material (insolvency) law will actually help to mitigate any uncertainty has yet to be seen. Nonetheless, it is worth pointing out that one way to get around the prohibition of forum shopping with respect to insolvency proceedings is by planning ahead and carefully choosing the applicable insolvency law to a particular transaction during the contracting stage.

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JURISDICTION FOR ACTIONS CONNECTED TO INSOLVENCY PROCEEDINGS – CONTENT AND CONSEQUENCES OF RECENT ECJ RULING

The European Court of Justice (the "ECJ") recently ruled that where insolvency proceedings are opened in a Member State, that Member State also has jurisdiction for court actions which derive directly from those proceedings and which are closely connected to them.

In a case decided by the ECJ (Case C-339/07, Judgement of the Court (First Chamber) of 12 February 2009), an insolvent company which was based in Germany had transferred money to a company located in Belgium prior to the opening of insolvency proceedings. The German insolvency administrator requested the Regional Court of Marburg to set aside the transaction by virtue of the debtor's insolvency. The Regional Court, as well as the Higher Regional Court of Frankfurt/Main as appellate court, rejected the action for procedural reasons, based on the assumption that it was not subject to its jurisdiction.

The ECJ, however, came to a different conclusion based on the interpretation of Article 3(1) of Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings (the "Insolvency Regulation"). With regard to the Convention on Jurisdiction and the Enforcement of Judgments in civil and commercial matters (Brussels Convention), the ECJ had already determined that an action is related to a bankruptcy or a winding-up (and therefore does not fall within the scope of the convention) if it derives directly from the bankruptcy or winding-up and is closely connected with the proceedings.

Taking into account the intention of the legislature and the effectiveness of the Insolvency Regulation, the ECJ has now come to the conclusion that Article 3(1) of the Insolvency Regulation must be interpreted to mean that it also ascribes jurisdiction to the Member State, where insolvency proceedings were opened, to hear and determine actions which derive directly from those proceedings and which are closely connected to them.

With reference to the case in question, the ECJ stated that it may only be brought by the liquidator in the event of an insolvency with the sole purpose of protecting the interests of the general body of creditors. The ECJ then found that such an action falls within the scope of Article 3(1).

In another recent decision, the ECJ also applied the criteria for an action deriving directly from insolvency proceedings (ECJ, C-111/08). In that case, it was to decide whether the transfer of shares in a company, which has its registered office in one Member State, was to be regarded as invalid on the ground that the court of the first Member State did not recognise the powers of a liquidator from a second Member State in an action deriving directly from (and closely connected to) insolvency proceedings conducted in the second Member State.

For parties involved in pre-insolvency transactions, this recent case law means that the transfer of assets to a company located in another Member State does not prevent an insolvency administrator from raising claims in the home Member State. Therefore, the only way to avoid court proceedings in a certain Member State would be to successfully argue that the centre of main interests of the insolvent company is within another Member State. On the other hand, the insolvent company can now be certain that in connection with the forum for main insolvency proceedings, it also obtains the jurisdiction of the Member State in question for specific actions to be brought by the insolvency administrator against third parties.

Epilogue

The ECJ only has to decide on issues relating to international jurisdiction. Therefore, as a consequence of the ruling by the ECJ, it was up to the German *Bundesgerichtshof* (the "BGH") to decide on the competent court within Germany. The BGH came to the conclusion that the courts in the judicial district where the local court that decided on the opening of the insolvency proceedings is seated have jurisdiction for these actions, making it especially convenient for the German insolvency administrator in this case. However, national courts of other Member States may come to a different conclusion.

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TO REORGANISE INSTEAD OF TO RUIN

New rules on insolvency proceedings aim to reorganise financially distressed companies

Introduction

When a debtor company is unable to pay its debts and other liabilities as they become due (i.e. when a debtor becomes insolvent), Austrian Law currently provides two legal mechanisms to deal with a company's insolvency: composition proceedings in accordance with the Composition Code ("*Ausgleichsordnung*") and bankruptcy proceedings in accordance with the Bankruptcy Code ("*Konkursordnung*").

In the course of bankruptcy proceedings, it should be determined whether a company can be reorganised by alienation or whether a winding-up of the company is necessary. It must be noted that the debtor may also apply for compulsory composition in bankruptcy proceedings. Compulsory composition leads to exemption from residual debt, provided the debtor pays at least 20% of its debts within two years. The approval by a qualified majority of the creditors is also required.

If the debtor aims for a reorganisation of the company from the very beginning, the debtor may then apply for composition proceedings. In this case, the debtor has to offer to pay a minimum of 40% of its debts payable within two years. This also has to be approved by a qualified majority of the creditors.

The issue

In practice, voluntary reorganisation (in the form of composition proceedings) occurs rarely due to the high level of required payment (40% of outstanding debt). Reorganisation as well as winding up following bankruptcy is more frequent, due to much lower payment requirements (20% in two years). Nonetheless, many debtors still try to avoid opening bankruptcy proceedings for different reasons. This means that valuable time can be wasted, as the reorganisation of a company gets more complicated, until it is finally too late. It is worth highlighting that nearly three quarters of all bankruptcies are filed too late. As a result, a further purpose of the draft law is to motivate debtors to file for insolvency in time.

Against the backdrop of the economic crisis, the Austrian government aims to make insolvency proceedings easier and more transparent in the future. Instead of distinguishing between bankruptcy and composition proceedings, a single type of insolvency proceedings would be established and implemented, which sets the framework for allowing a more suitable reorganisation of companies. As a consequence, the debtor should be motivated to file for an earlier petition. In addition, reorganisations related to the bankruptcy proceedings would be extended and debtors will have the opportunity to simultaneously apply for a reorganisation plan and file a bankruptcy petition.

Proposed amendments

As mentioned above, the Austrian government proposed to establish a single type of insolvency proceeding, which shall be called reorganisation proceedings where a reorganisation plan is submitted in time, or bankruptcy proceedings where no reorganisation plan is submitted.

Most debtors hesitate to file for insolvency for fear of being disempowered. Therefore, the proposals also introduce the concept of self-administration which should be available especially to companies facing insolvency as a result of the economic crisis. One of the proposed requirements for self-administration (under the supervision of an administrator) is that the debtor pays a minimum of 30% of its debts (instead of the current 40% threshold) within a two-year period. If this requirement is not met, the conduct of the reorganisation proceedings will then be carried out under a third-party administration.

The so-called reorganisation plan shall replace the existing compulsory composition. The requirements will practically stay the same, except for the following:

— in relation to the number of creditor votes (by headcount) required to approve a reorganisation plan, the threshold will be lowered from three quarters to a simple majority of only those creditors who are actually present or represented at the reorganisation hearing;

— in relation to the required creditor votes by value to approve a reorganisation plan, it will now be sufficient to merely obtain the approval of creditors who represent more than half of the total debts; and

— the removal of the rights of creditors to fully revive their claims in the event that the debtor falls behind schedule of the reorganisation plan.

In the future, contractual partners will not be permitted to withdraw from contracts, especially those that involve recurring benefits, during the six months after the opening of proceedings. A right of termination will also be excluded for the same six-month period. However, there will be special rules for contracts of labour.

According to the current provisions, liquidators are not able to screen companies if the lack of sufficient assets does not initiate insolvency proceedings. As a consequence, potential criminal conduct may be overlooked. To avoid these situations in the future, it is proposed that shareholders could be obliged to make a payment to cover the cost of proceedings in order to ensure that insolvency proceedings will nonetheless be opened in such cases.

Finally, after having completely fulfilled the reorganisation plan, it is also proposed that the debtor will have the option of cancelling its entry on the insolvency register.

The draft law was submitted for appraisal on 20 August 2009, and shall come into force on 1 January 2010. However, it is expected that there will be further amendments to the proposals in the course of the appraisal of the draft law.

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CONVERSION OF DEBT INTO CAPITAL…

A remedy under the new Belgian Law on the Continuity of Undertakings

The new federal Law on the Continuity of Undertakings dated 31 January 2009, which aims to replace the Judicial Composition Legislation of 1997 (the "Law"), provides in Clause 49 that the conversion of debt into capital may be proposed in the reorganisation plan of the debtor as one of the remedies in view of restructuring part of the debtor company.

The decisions to convert will depend exclusively on the strategic and commercial opportunity offered to the lender to exchange its debt into an equity interest in the debtor company.

When a restructuring is planned, each creditor is keen to improve its position. There is, however, no such thing as a standard restructuring. Each one is more or less unique and the remedy offered to creditors will depend on different factors such as the industry of the debtor, the group structure and shareholders involved, the financing in place and the extent of the financial difficulties encountered by the debtor. Whether the conversion of the debt into capital constitutes an attractive remedy for both the lender and the debtor should therefore be assessed on a case by case basis.

From the creditor's perspective, the remedy of conversion offers the benefit of possible future share dividends when (and if) the debtor returns to profitability. The purpose of the remedy will mainly be used to reduce the total debt, bearing in mind that as a result of the debt reduction, the debtor can be seen as an attractive trading entity with reduced indebtedness which may help to attract potential corporate buyers for its business.

Before making the decision to convert debt into capital, the lender (as well as any other creditor) will therefore undertake due diligence on the debtor's finances, in order to accurately assess the debtor's liquidity, solvency, profitability and capital adequacy. The creditor will also need a full understanding of the implications of holding a certain percentage of the debtor's shares (for example, as far as consolidated accounts are concerned) as well as the rights of the relevant class of share.

No obligation on the lender

As a general rule, Article 50 §3 of the Law provides that any measure affecting the rights of a creditor who is a mortgagee or who benefits from any lien (such as a pledge) requires that creditor's consent in order to be implemented. No restrictions or obligations may therefore be imposed on lenders benefiting from such securities in the debtor's plan.

This said, and even though there is a debate in the Belgian doctrine, we consider that no creditor can be forced into a conversion of debt into capital, even those who do not benefit from the above securities. The conversion of debt requires the consent of the creditor to effectively convert its debt into capital and neither the debtor nor the majority of its creditors can therefore compel the creditor to swap the debt into share capital. The conversion is achieved through an increase in capital where the debt will be contributed in kind. The Bank will receive newly issued shares of the debtor in line with the amount of debt which has been converted.

A creditor, however, cannot unilaterally decide to convert debt into equity. As for any increase in capital, a majority of the debtor's shareholders must vote in favour. Save for any mechanism enabling a creditor to "force" the conversion of debt into capital (such as enforcing a pledge over shares and forfeiting all or part of the pledged shares), this remedy will result from a mutual agreement between the creditors and the debtor.

Should the conversion result in taking a minority stake in the debtor's capital, the lender or creditor will want to appoint directors (or at least observers) to the board of the debtor company, even if this may trigger confidentiality and conflict of interest issues.

Certain statutory rules to be complied with…

When deciding to convert debt into capital (and becoming a shareholder of the debtor company), a creditor should consider certain requirements:

1. If the debtor is a listed company, acquiring over a certain level of the shareholding of the debtor may trigger the obligation to launch a public takeover bid. As of 1 September 2007, a person or a company that, either alone or in conjunction with third parties, directly or indirectly, acquires more than 30% of the voting securities of a company admitted to a regulated market must launch a takeover bid for all securities having a voting right. Under the new regime, the obligation to launch such a bid also applies to the acquisition of an equity interest through an increase in capital. However, in order to encourage investors to take security interests in companies facing substantial losses, there is an exception to this obligation which applies if the company involved in the increase in capital has lost more than half the value of its share capital (Article 633 of the Belgian Companies Act).

2. A lender, over the course of its relationship with its client and assuming that the credit documentation provides for an information undertaking, may have access to certain 'privileged' information. When deciding to convert the debt, if the debtor involved is a listed company, the lender will have to consider the market abuse rules provided for in the Transparency Law of 2 August 2002 (which achieved royal assent on 5 March 2006). As a result, the risk of falling foul of the market abuse rules when deciding to convert debt into capital is fairly remote. Given the transparency inherent in any increase in capital, it can be assumed that there is no risk for the lender in that respect. Even from a technical perspective, the latter could be considered as 'dealing' in acquired shares following such restructuring. However, special care should be taken by the lender to ensure that any information about the restructuring is only circulated on a need-to-know basis and that any recipients of the information undertake to keep it confidential at all times.

3. Should the creditor involved be a credit institution (or an investment enterprise), it will have to pay special attention to the statutory threshold of "qualified shareholding" it is authorised to hold (Article 32 of the Banking Law of 1993 as amended by royal decree on 17 June 1996). The total "qualified shareholding" held by a credit institution cannot represent in value more than 45% of its net assets with a maximum of 15% for each single qualified shareholding. A shareholding is considered "qualified" when the credit institution directly or indirectly holds at least 10% of the share capital (or voting rights) of the company, or when the credit institution may have significant influence over the management of the company.

These are just some issues to consider regarding the conversion of debt into the share capital of the debtor. Given the increasing number of reorganisation plans on the horizon, it will be interesting to see whether creditors, and lenders in particular, will acknowledge the benefit of this remedy and decide to take a stake in their client's capital.

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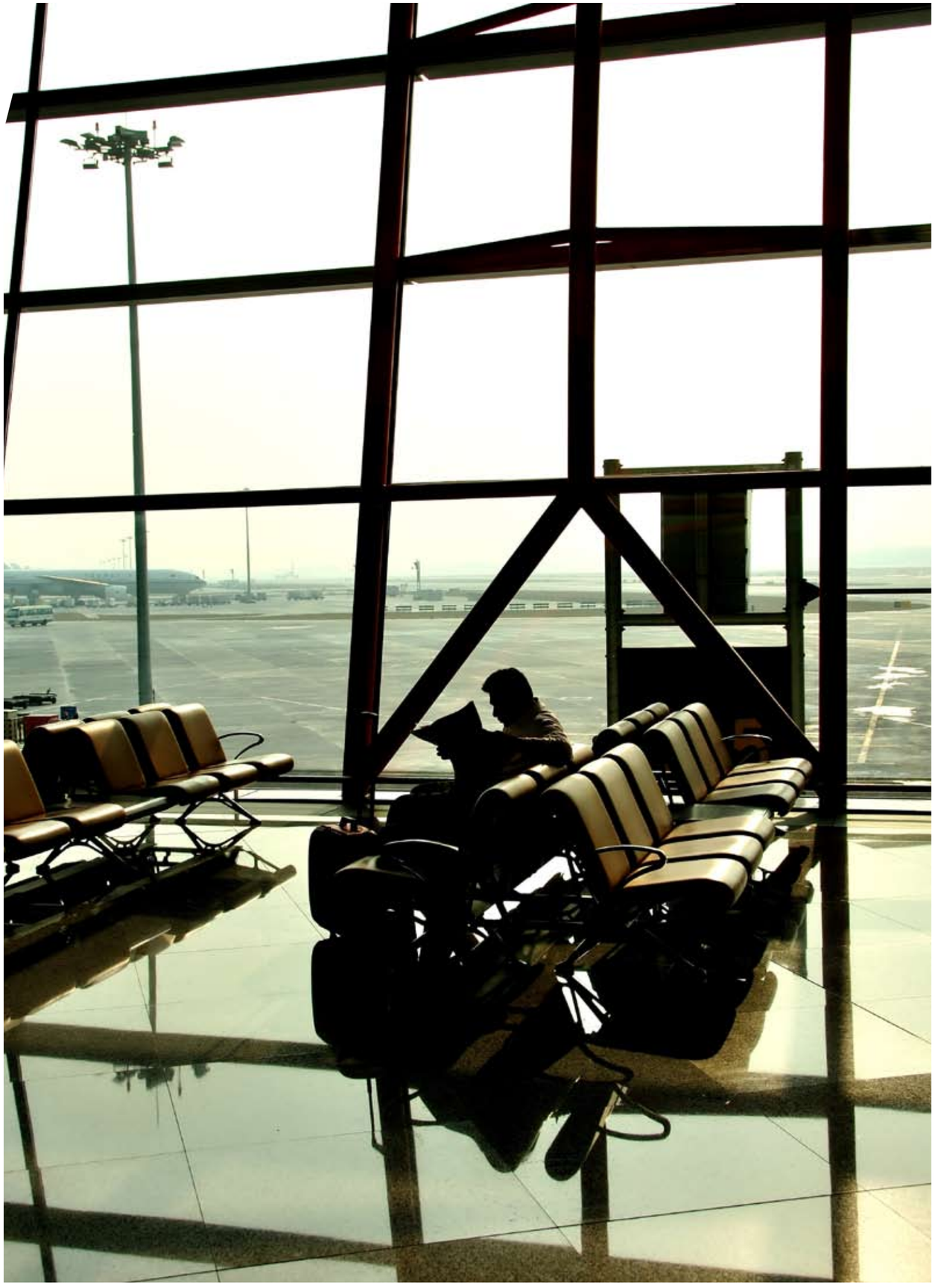

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MERGERS INVOLVING COMPANIES IN NEGATIVE EQUITY IN CROATIA

Introduction

Prevailing European legislation prevents a merger from going ahead if one of the companies involved is in negative equity. In order to avoid this bar to mergers, business plans, appraisals on silent reserves etc. can be used to prove a positive market value.

Current practice in Croatia shows that mergers, where at least one of the companies is in negative equity, can be registered with the court if all formal merger procedures have been complied with. However, Croatia is now preparing to harmonise with EU Regulations and this may mean that negative equity will become an issue when structuring mergers in the future.

The Current Situation in Croatia

The Croatian Companies Act (the "CA") does not prohibit the registration of a merger if one or both of the merged companies happen to be in negative equity.

Nevertheless, the existence of negative equity may force creditors to seek adequate security from the merged entities and could serve as the basis for liability claims against the companies' officers.

Article 523 CA regulates the right of creditors to seek adequate security:

"Creditors of merged/merging companies are entitled to obtain security, provided that they have filed a claim to be secured within 6 months from publication of the merger registration with the court; the creditors are not, however, entitled to request settlement of their receivables. This right is granted to the creditors of the merging companies only if they can prove that the merger process jeopardises the settlement of their receivables."

Creditors must be made aware of their right to seek adequate security when the merger is published (such notification to be registered with the court registry together with the merger registration). The fact that companies in negative equity will be merged with companies in equity threatens to worsen the economic position of the company in equity. Creditors could see this as a dilution of their rights and therefore could use their right to seek adequate security.

However, the merger is not affected in any way if the company does not provide proper security to the creditors. However, this does put the creditors in a difficult position; and in order to protect the creditors, the company's board of directors may be held liable for any damage that was caused to the company/shareholders/creditors due to the merger process.

Article 526 CA regulates the right to hold a company's officers liable as follows:

"Members of the management board and the supervisory board of the merged company are obliged, as joint debtors, to compensate any damage which occurs to the company/shareholders/creditors of the company as a result of the merger of the company. The members of the management board and the supervisory board will not be held liable for any damage which occurs to the company/shareholders/creditors of the company due to the merger of the company, if during the conclusion of the merger agreement and during the audit of the company they have acted with the care of a prudent businessman. …"

This makes it clear that it is the members of the management board and the supervisory board of the merged company, who are potentially liable.

Such officers are jointly and severally liable and this imposes a high level of liability on non-executive board members who are often not directly involved in running the company in question. Furthermore, the officers are liable for damages caused to the company, its shareholders and creditors respectively. This may also seem to impose a high standard; however, in practice, it is difficult to prove the connection between any damage caused and the merger.

Officers who can prove that they have acted with the care of a prudent businessman during the company's audit and during the conclusion of the merger agreement will not be liable. However, the reality is, the board in its entirety is responsible for these actions. Giving one or two board members (for example, the CFO and the head of legal) 'full responsibility' for the merger does not exempt the other officers from liability. This may prove to be onerous to those members of larger boards who are, at the most, only remotely involved in these matters.

Procedurally, such claims for damages may only be submitted to the court through an agent who needs to be appointed by the court upon the request of the company/shareholders/creditors.

Outlook

Since Croatia is in the process of acceding to the European Union, we expect that the CA will be amended to bring it into line with legislation in other EU Member States, which does not allow a company to merge with another if it is in negative equity.

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SIGNIFICANT CHANGES TO THE CZECH COMMERCIAL CODE

The changes to the financial assistance rules and the procedure for increasing the registered capital of companies were introduced on 20 July 2009 as part of substantial amendments to the Commercial Code.

Financial assistance

Until recently, financial assistance was expressly forbidden under Czech law. A company could not secure credit or a loan for the purpose of acquiring its own shares or for other obligations (e.g. debts) relating to the acquisition of its shares.

Companies may now provide financial assistance for the acquisition of their own shares in limited circumstances. The Commercial Code sets out requirements, all of which must be satisfied, in order for financial assistance to be permitted. These requirements may then be extended (but not limited) by a company's articles of association. The changes to the financial assistance rules affect limited liability companies and joint-stock companies differently.

The conditions include:

— approval by the company in a general meeting (which must be given in advance in the case of joint-stock companies);

— a written report from the board or another statutory body, which must be filed in the Collection of Deeds at the relevant Commercial Register, stating the reasons for giving the assistance, the advantages and risks arising from it, the conditions on which it would be given and why it is in the company's interest to do so;

— that the financial assistance will not lead to the company's bankruptcy;

— that the company has no unsettled losses; and

— that the financial assistance is being provided at arm's length.

Simplified procedure for increasing share capital

Previously, non-monetary contributions to the registered capital of Czech companies had to be valued by a certified expert appointed by the court. Following the changes to the Commercial Code, companies can increase their share capital without having to obtain an expert valuation of non-monetary contributions.

This can be done provided:

— the contributions are valued in another way (i.e. by an independent expert, in the audited accounts or in the financial instrument's weighted average market price); and

— the decision not to obtain an expert valuation is approved by the company's board or another statutory body.

New Act on System of Payments

The Czech Republic implemented EU Directive 2007/64/EC by passing the new Payment Services Act (284/2009) in Parliament, which will take effect from 1 November 2009.

New features adopted include:

— a regulatory framework for "non-bank" payment systems providers;

— capital adequacy requirements for all providers and a prohibition on the blending of payment funds held in trust with working capital;

— requirement for Czech National Bank authorisation for new market entrants, with a narrow exemption for "limited service provision" by non-authorised entities;

— amendments to the regulatory framework for the issuance of "e-money"; and

— requirements for both bank and non-bank service providers in respect of know-your-customer information, payment authorisation, payment time-limits and credit or debit card transactions.

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THE APPROPRIATE WAY TO USE THE SAUVEGARDE IN FRANCE

The *sauvegarde* is a formal insolvency procedure which can be used to re-structure debt. The decision to request the opening of such an insolvency procedure and its timing must be carefully assessed.

Voluntary reorganisation

A debtor can always opt to seek a voluntary arrangement with its main creditors, outside a formal insolvency procedure, through negotiations with creditors, in order to implement a restructuring plan. The French Commercial Code (the "FCC") provides that such negotiations can be led by the debtor under one of the following procedures:

— *mandat ad hoc:* provided that the debtor is not yet in a situation of *cessation des paiements*[1], the debtor can request the president of the court to appoint a *mandataire ad hoc* who will assist him in negotiations with the creditors. The court will determine the extent of the *mandataire ad hoc's duties* on a case by case basis.

— *conciliation:* provided that the debtor is not in *cessation des paiements*, or has not been in *cessation des paiements* for more than 45 days, the debtor can also request the benefit of a "*conciliation*". If the court considers that a voluntary arrangement has a genuine prospect of success in terms of rescuing the debtor company, it may appoint a *conciliateur* for a maximum period of five months.

The basic purpose of both *mandataire ad hoc* and *conciliateur* is to facilitate an amicable agreement between the debtor and its creditors. The process is informal, confidential and contractual. All creditors may be invited to participate but none are obliged to accept. The *mandataire ad hoc* and the *conciliateur* have no legal power to force a decision which is favourable to either the debtor or the creditors. Their role is limited to negotiating and suggesting options and possibilities open to the parties.

In both cases, the success of the reorganisation plan highly depends on a quasi unanimous decision of the creditors to adopt the restructuring plan.

Sauvegarde

The *sauvegarde* is a formal insolvency procedure with a view to maintaining the business of the debtor company. It can only be opened at the request of and for the benefit of, a business entity faced with difficulties of any kind that it is unable to overcome by its own means, but which is not yet in *cessation des paiements*.

If the Court accepts the request of the debtor company, it will open an "observation period" during which all creditors claims are frozen, and the debtor will be prevented from making payments in respect of any debts incurred before the commencement of the observation period. All actions and proceedings against the debtor will be stayed insofar as they relate to the debtor's payment of any sum or to the termination of a contract for defaults in payment. Events of default linked to the opening of the *sauvegarde* or comparable events will also not be enforceable. Moreover, secured creditors will not be entitled to enforce their security[2].

The main purpose of the *sauvegarde* is to enable the debtor company to reorganise and maintain its business and to reschedule its debts through a reorganisation plan ("*plan de sauvegarde*", hereafter the "Plan"). The Plan will specify the terms and conditions under which the creditors will be repaid, and may provide for a rescheduling of the debts over a long period of time (in principle, not longer than ten years, unless the creditors' committees have accepted longer).

The FCC (as amended in 2005) provides for the creation of two creditors' committees: the credit institutions' committee and the committee of main suppliers of goods or services.

The proposed Plan must be submitted to the two creditors' committees by the debtor when they have been organised (subject to specific thresholds or at the request of the debtor).

Ordonnance N° 2008-1345 of 18 December 2008 significantly improved the composition and voting rules of these committees. It should be noted, among other rules, that the draft Plan must be approved by committee members representing at least two-thirds of the claims by value of the voting members in each creditor's committee. Should the debtor have issued bonds, a two-thirds majority by value of all bond holders must also approve the draft Plan previously approved by the two creditors' committees.

The draft Plan approved by the creditors' committees must then be submitted to the Court before the end of the "observation period". If it appears to be viable for the

purpose of maintaining the business, the Plan is finally adopted by the Court (taking into consideration the votes of the creditors' committees) and can then be enforced against anyone.

Voluntary reorganisation or the sauvegarde?

A voluntary reorganisation is generally considered preferable, in terms of rescuing a company, to an insolvency procedure, be it a *sauvegarde* or a *redressement judiciaire*. An insolvency procedure can impact negatively on a company through: bad publicity, loss of previous existing credit, loss of customers, etc. Lax management of the potentially negative consequences of a *sauvegarde* or *redressement judiciaire* has the potential to back-fire on the business being rescued.

However, the use of *sauvegarde* to complement a prior preventive procedure may be an effective way to successfully achieve the planned restructuring.

Since creditors may be asked to participate in a voluntary reorganisation but are not obliged to do so, a voluntary reorganisation plan may be approved by a majority of creditors but may remain unsuccessful because of a minority of creditors' refusal. In this case, the *sauvegarde* may prove to be a useful alternative since the creditors' committees mechanism may allow the debtor to force the minority creditors to participate in the restructuring plan negotiated before the opening of the *sauvegarde*. However, the court remains in charge of checking that the interests of all creditors are sufficiently protected by the Plan.

One efficient way of proceeding can be to request the opening of a *sauvegarde* only after having negotiated and obtained an agreement on a restructuring plan with a majority of the creditors. As was illustrated by Autodistribution's *sauvegarde*, executing the *sauvegarde* in this way will allow the debtor to fast-track the pre-packaged deal, thus limiting the negative effect that an insolvency procedure may have.

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1) *i.e. the debtor is not yet in a situation where it cannot pay its outstanding due debts for lack of sufficient available cash.*

2) *Some limited exceptions exist although only in certain specific cases provided for by law.*

// Germany

CONTINUATION AGREEMENTS AS A MEANS TO CARRY ON INSOLVENT COMPANIES

Over the past several months the number of insolvencies in Germany has substantially increased. In particular, when suppliers in the automotive and mechanical engineering sector become insolvent, the customer has a vested interest in continuing the business relationship so that orders already placed are delivered and so that it can continue to place additional orders until it has established a replacement source. This applies especially to "just in time" production where any failure to supply goods leads to a production standstill. For this purpose, the customer, the supplier and the administrator often enter into continuation agreements.

Commercial and legal background

In Germany, insolvency proceedings are divided into two phases:

— If a company goes insolvent, the initial step is that a "preliminary" administrator is appointed. In most cases the rights of such an administrator are limited. For example, the company is still represented by the management, but any transfer of assets requires the consent of the administrator. Furthermore, any contracts entered into by the insolvent company remain (legally) unaffected by the preliminary proceedings; however, suppliers often stop making deliveries for obvious economic reasons. The preliminary proceedings normally last up to three months.

— Subsequently, "final" proceedings are opened, if the competent court does not reject the opening of the proceedings (due to insufficiency of assets), where the company is represented by the insolvency administrator. The administrator is, under certain circumstances, entitled to contest legal actions (including contracts) undertaken prior to commencement of the final insolvency proceedings. In addition, to the extent that contracts have not been completely fulfilled by either party prior to commencement of final insolvency proceedings, the administrator has the power to decide whether the company should perform its obligations under existing contracts (Section 103 Para. 1 German Insolvency Code). If the administrator chooses not to do so, any payments made by a customer under such contracts prior to the commencement of the final proceedings are, by virtue of the company's insolvency, lost.

Typical provisions

Continuation agreements usually contain provisions dealing with the following:

— *Delivery of goods*

Under a continuation agreement an insolvent supplier company undertakes to deliver the goods already ordered by the customer and to accept further orders. However, the terms of these deliveries are varied. For example, the price is increased, upfront payments are higher, and the outstanding instalments become due earlier.

Despite these new terms, continuation agreements do not remedy any payments which have been lost due to the administrator's previous decision not to honour a contract. Therefore by entering into the continuation agreement, the customer is practically agreeing to pay the insolvent supplier company twice for these "lost" payments.

— *Compensation for losses*

The insolvency administrator will usually only be prepared to enter into continuation agreements if the other parties to the agreement undertake to compensate the insolvent company for all of the losses incurred during the term of the continuation agreement. In this regard, the customer should always seek to agree a cap on its obligation to make such payments. In addition, the customer must ensure that the term "losses" is clearly defined and that certain costs are excluded such as costs for M&A advisors and costs associated with the continuation of the business which have not been contemplated in the continuation agreement.

— *Term*

The customer should also try to negotiate a term for the agreement which is long enough to allow them to secure a replacement supplier/provider.

Residual risks

Even if a continuation agreement is concluded, certain risks associated with the insolvency of the supplier remain with the customer. In particular, the goods delivered

to the customer may be encumbered with third-party rights which take precedence over the administrator's right to dispose of such assets pursuant to Section 166 Para. 1 German Insolvency Code. Depending on the actual circumstances, certain mechanisms can be incorporated into the continuation agreement to reduce the aforementioned risk.

There may also be instances when the losses incurred by the insolvent company may be higher than expected. In these circumstances, the insolvency administrator will only comply with the insolvent company's obligations under the continuation agreement if the customer makes payments to the insolvent company in excess of the maximum amount agreed in the continuation agreement.

Finally, the insolvency administrator will not be in a position to make further deliveries if it loses key employees who are necessary for production.

Potential risks relating to preliminary insolvency proceedings

Specific risks may arise when entering into a continuation agreement with a "weak" preliminary insolvency administrator (e.g. selection of non fulfilment or contestation such as the continuation agreement once final insolvency proceedings are commenced). Therefore, additional measures must be taken when entering into continuation agreements at this stage. Firstly, it may be worth asking if the "weak" preliminary insolvency administrator is prepared to accept an appointment as a "strong" preliminary insolvency administrator (this, however, is often rejected as such an appointment triggers additional liability risks for the administrator). Alternatively, an explicit authorisation entering into the continuation agreement may be requested from the insolvency court. Either way, the acts of the preliminary insolvency administrator are, in principle, then treated as if these were acts of a final insolvency administrator.

Summary

It is becoming more commonplace in the automotive or mechanical engineering industry for customers to enter into continuation agreements with insolvent supplier companies and the insolvency administrator until a replacement source is found. Usually the window of opportunity to negotiate the terms of such agreements is very limited. However, the customer should endeavour to place a cap on its undertaking to compensate the insolvent supplier for losses incurred during the term of the continuation agreement. Finally, the potential risks of entering into a continuation agreement before final insolvency proceedings commence must be considered and dealt with.

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ITALIAN BANKRUPTCY LAW REFORM

The recent reforms to the Italian Bankruptcy Law (Royal Decree No. 267/1942) have substantially changed the role of the Creditors' Committee, with the aim of allowing creditors of an insolvent company to take a more active role at every stage of the insolvency procedure.

Overview

The Creditors' Committee (the "Committee") is appointed by the Official Receiver – the judge appointed by the Insolvency Court to supervise the relevant insolvency procedure – within 30 days of the declaration of insolvency. The Committee is formed of three to five members who represent the most significant creditors. There are no specific skill requirements in order to be appointed as a member of the Committee.

The Committee's members elect the President, who calls meetings of the Committee when specific matters need to be resolved on or when at least a third of the Committee's members demand a meeting.

It would be in a creditor's interests, whether Italian or foreign, to be included in the Committee since it puts a creditor in a better position to supervise every step of the insolvency procedure and also entitles a creditor to have its voice heard on the relevant issues relating to the company's assets and the manner in which these assets are to be dealt with. However, membership of the Committee may expose a creditor to liabilities. This is discussed in more detail in the final section of this article.

The Committee acts by the majority of its members and every member is entitled to fully or partially delegate its functions to a third party (who must meet the requirements of professionalism and integrity under the Italian Bankruptcy Law for being appointed as a receiver).

The members of the Committee will be reimbursed for expenses incurred in the course of the insolvency procedure, and may also be entitled to remuneration if the majority of the creditors file a specific request with the Insolvency Court in the course of the hearing, which is held for the examination of the insolvent company's liabilities. Such remuneration shall however not exceed 10% of the compensation being paid to the receiver.

The Committee's role

The Committee plays an important role in bankruptcy proceedings in that it supervises the insolvency procedure, authorises certain acts by the receiver and issues opinions on certain aspects of the insolvency procedure. These are discussed in turn below.

Supervisory task

The Committee is entitled at any time to examine and query company records, company accounts (as drafted by the receiver at least twice annually) and any documents relating to the insolvency procedure. The Committee may also opine and comment on these documents.

In addition, the Committee can prevent the disposal of assets (even if previously approved by the Committee) if for example the assets are being sold at an undervalue.

Furthermore, the Committee must approve the receiver's proposed actions and the receiver must provide the Committee with all information relating to the temporary operations of the business of the insolvent company. The Committee is also entitled to issue a written assessment on whether, in its opinion, it would be better to continue the business of the insolvent company or whether it would be more practical to proceed directly to a winding up if it would not be beneficial to creditors to continue the business of the insolvent company.

Authorisation

The following acts by the receiver must be authorised by the Committee:

— entering into certain extraordinary transactions (*inter alia*, settlements, waivers, cancellation of mortgages);

— appointment of assistants and other professionals;

— filing a claim against a previous receiver/directors of the company; and

— continuation of contracts entered into by the company before insolvency.

The binding authorisation of the Committee in respect of transactions or actions carried out by the receiver on behalf of the insolvent company represents one of the most important changes to the Italian Bankruptcy Law. Before the reform, such authorisations were only granted by the Official Receiver and the Committee's opinion was not binding.

Consultancy

If requested by the Insolvency Court, the Official Receiver or by the receiver, the Committee may issue opinions on either a binding or non-binding basis.

Binding opinions of the Committee are requested, *inter alia*, to:

— remove the receiver;

— suspend the sale procedure if the offered price is too low; and

— analyse proposals for a composition with creditors ("*concordato fallimentare*") filed in the course of the insolvency procedure.

Other circumstances in which the Committee's opinions are binding include opinions on the receiver's proposals to invest cash available to the insolvent company and/or proceeds from the disposal of the company's assets in government bonds, opinions on whether or not to continue trading during insolvency and opinions on the liquidation plan drafted by the receiver. These transactions/actions cannot be carried out should the Committee not grant its approval.

Liability

According to Article 41 of the Italian Bankruptcy Law, the members of the Committee are subject to the same liabilities as those of statutory auditors of Italian companies ("*sindaci*"). However, case law and recent academic discourse tend to mitigate the liability of the Committee's members in respect of non-binding opinions. Nonetheless, a binding opinion may easily expose the Committee's members to a higher degree of liability; for example, if the Committee approves a transaction which is detrimental to the interests of creditors.

As mentioned above, it is however worth noting that the Committee's members are appointed solely on the basis of their creditor status (i.e. privileged/non privileged creditors) and the value of the debt owing to them, without regard to their specific expertise. This, and the fact that the members generally perform their duties for no consideration, further mitigates any liabilities which they may incur (under the general principles of Italian law). However, should a member of the Committee delegate its functions to a professional third party holding specific professional qualifications, the liability of such a nominee will be considered more severely, in line with his / her specialised professional expertise.

Only the receiver (on behalf of all the creditors) is entitled to commence proceedings against the Committee's members during the insolvency procedure. However, once the insolvency procedure is terminated or concluded, third parties are then allowed to sue the Committee's members for any losses suffered.

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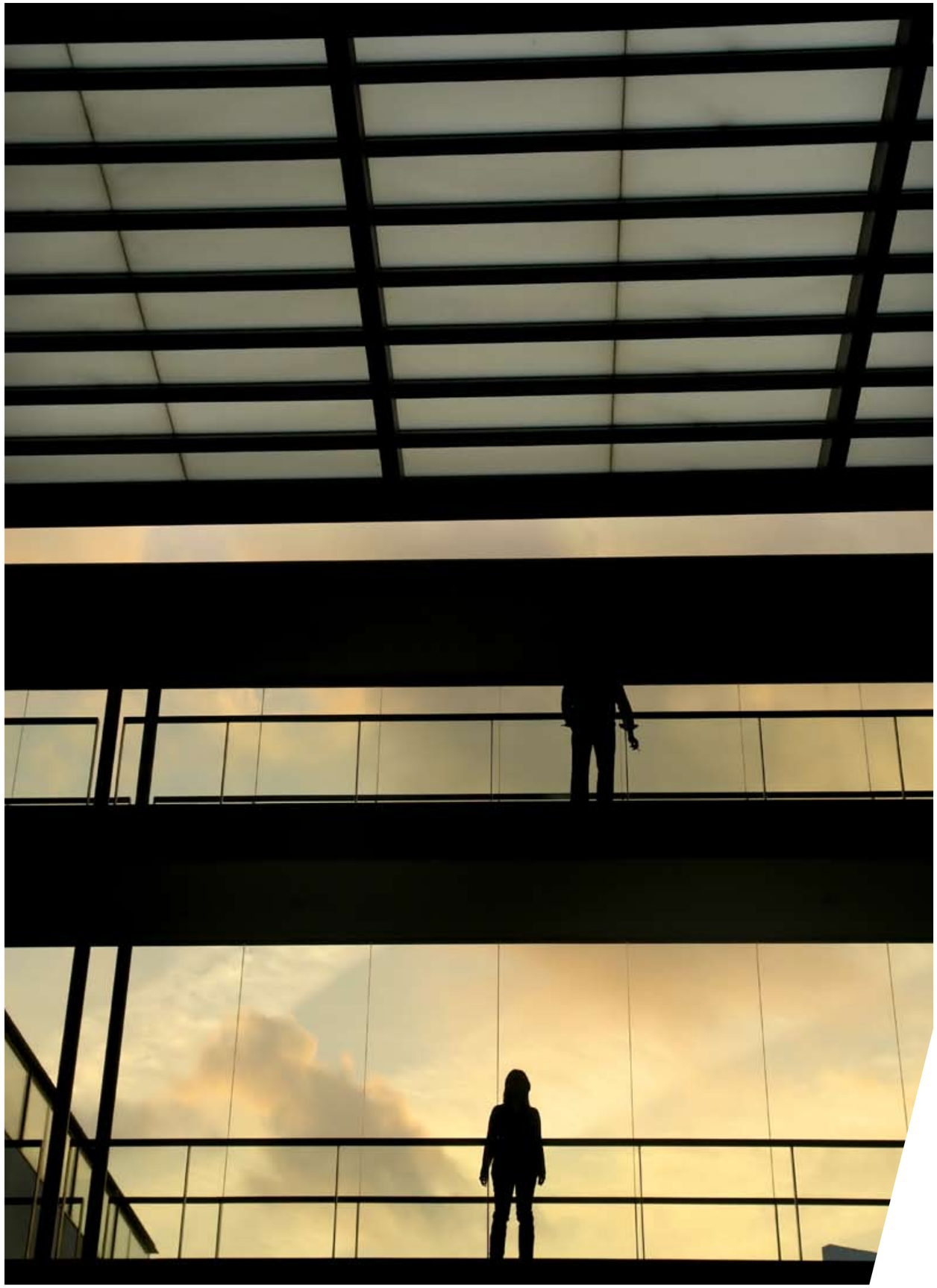

// Netherlands

DUTCH COURT DENIES POWER OF THE RUSSIAN CIVIL COURT

Introduction

In the summer edition of this newsletter the power of a foreign bankruptcy trustee in relation to the Yukos case was examined. In this contribution we turn our attention to another remarkable Yukos case which had to be decided upon by the Dutch court.

Yukos case

Yukos Capital SARL ("Yukos Capital"), a company incorporated in Luxembourg, and OJSC Yuganskneftegaz ("OJSC"), a company incorporated in the Russian Federation, were part of the Yukos group of companies. The sole shareholder of OJSC was Yukos Oil Company, a petroleum company incorporated in the Russian Federation. In December 2004, all the shares in OJSC were transferred from Yukos Oil Company to Baikal Finance Group, which was in turn a 100% subsidiary of Rosneft, a company incorporated in the Russian Federation. Rosneft was owned by the Russian Federation Government and in 2006, it merged with OJSC.

In July and August 2004, four loan agreements were concluded between Yukos Capital as lender and OJSC as borrower. The agreements included an arbitration clause. Subsequently, when a dispute arose in relation to the loan agreements in 2006, OJSC was ordered to pay approximately RUB 13 million to Yukos Capital as a result of the arbitration. By the end of 2006, Yukos Capital had filed for a prejudgment garnishment (*conservatoir derdenbeslag*) with the bailiff in the Netherlands. Following an application by OJSC in 2007, the Russian civil court set aside the arbitral judgments.

In February 2008, Yukos Capital applied to court for permission to have the seat of the arbitration moved to the Netherlands. The District Court of Amsterdam rejected the application in accordance with the principle of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York 1958), which in these circumstances would be to respect the judgment of the Russian civil court, unless extraordinary circumstances had been proven.

On 28 April 2009, the District Court's decision was reversed by the Court of Appeal in Amsterdam declaring that the parties were permitted to enter into the arbitration in the Netherlands.

Principles of due process

The Court of Appeal concluded that the Convention on the Recognition and Enforcement of Foreign Arbitral Awards does not provide for international recognition of decisions of civil courts which set aside or reverse arbitral judgments.

According to the Court of Appeal, the recognition of a foreign judgment by a civil court serves as a starting point, provided that various requirements are met. One such requirement is the adherence to the principles of due process which provide that a judgment must be delivered by an impartial and independent judiciary.

In the Yukos case, the Court of Appeal examined whether the Russian civil court had been impartial and independent. The Court of Appeal found that given the state interest in this case (in that Rosneft was a state-owned entity), and given that the Russian judiciary is appointed by the executive branch of the government, it was not impartial and independent in the issues raised in the Yukos case.

Based on the arguments, reports and statements submitted by Yukos Capital throughout the hearing, the Court of Appeal considered it likely that the Russian civil court judgments reversing the arbitral judgments, were the result of a partial judiciary. The Court of Appeal ruled that the judgments of the Russian civil court in this Yukos case will not be recognised in the Netherlands.

To be continued

As stated in the summer edition of this newsletter, the appeal of the bankruptcy trustee against the District Court's judgment that the bankruptcy order against Yukos was a violation of the principles of due process, is still pending. The Court of Appeal's decision can possibly be seen as an implicit confirmation of the District Court's decision that there has been a violation of due process in the Yukos case. The case continues.

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THE RECENT AMENDMENT TO THE POLISH BANKRUPTCY AND REHABILITATION LAW

The Amendments

An extensive amendment to the Bankruptcy and Rehabilitation Law of 28 February 2003 (the 'Bankruptcy and Rehabilitation Law') came into force on 2 May 2009. The amendments provide more details on the provisions relating to grounds for announcing bankruptcy, proceedings related to announcing bankruptcy and their results. The major changes include:

— introducing the territoriality principle to bankruptcy proceedings;

— revoking the requirement on the court to grant security *ex officio* if a petition for bankruptcy is filed by a debtor. The court can now decide whether to grant security at its discretion;

— simplifying the rules governing preliminary meetings of creditors and the procedure for voting on the arrangement between the debtor and its creditors; and

— making it possible for business entities who are not significantly indebted (and whose indebtedness is of a temporary nature) to conduct rehabilitation proceedings.

These amendments have raised considerable interest and there had been substantial coverage in the press as to whether these changes will have a positive impact on businesses struggling financially during the current economic downturn.

Objective

One of the main objectives of these amendments is to facilitate the use of rehabilitation proceedings. To date, this mechanism has not been properly used in practice mostly due to the fact that a pre-condition to initiating such rehabilitation proceedings used to be the financial solvency of the business. With the introduction of the new regulations, such rehabilitation proceedings have also been made available to businesses which are not significantly indebted.

The new regulations provide that if the delay in performing obligations does not exceed three months, and the total amount of such outstanding obligations does not exceed 10% of the balance sheet value of the debtor's business, the court may dismiss a bankruptcy petition and at the same time agree to the initiation of rehabilitation proceedings by the debtor. However, if the court believes that the company's failure to perform its obligations is of a permanent nature, or that the dismissal of the bankruptcy petition may prejudice creditors, such rehabilitation proceedings will not be sanctioned.

Comments

It is believed that the amendments should have a positive impact in the current economic climate as these mitigate the problems caused by the very wide definition of insolvency as enshrined in the existing regulations. Thanks to the amendments, a default by a small amount will not necessarily lead to a debtor being declared bankrupt anymore; and in such a situation, it would be possible for the court to give its consent to initiate rehabilitation proceedings. Prior to the amendments, any failure to meet more than one due obligation (no matter how small the amount is) could have formed a basis for declaring the debtor bankrupt.

However, these amendments do not go so far as restoring the old principle adopted in the Bankruptcy Law of 1934 which states that a short-term failure to pay off debts due to temporary financial problems does not constitute a ground for filing a bankruptcy petition. However, the reality is that such situations are very frequent particularly due to payment gridlocks caused by the wide use of 'mercantile credits' by businesses and the pressure exerted by big businesses to be granted longer payments terms.

It is also a peculiar feature of the new regulations that there is a requirement to file a bankruptcy petition along with the simultaneous petition to dismiss it and request consent for the initiation of rehabilitation proceedings.

As mentioned above, it is worth emphasising that pursuant to the new regulations, rehabilitation proceedings may only be initiated if the value of outstanding obligations of a company does not exceed 10% of **the balance sheet value** of the business. During the drafting stages of the regulations, it was proposed that the company's **business value** be used (instead of the balance sheet value) as the basis of such valuation. This would have been more sensible as this would provide a more accurate picture of a company's financial position.

Moreover, the new regulations do not apply to businesses which become balance sheet insolvent (meaning when their obligations exceed the value of their assets), even if such businesses are capable of performing their obligations on an ongoing basis (and there is no risk that they may be unable to do so in the foreseeable future). This however happens frequently in practice (although it is very rare that a bankruptcy petition is filed on such grounds).

To illustrate the point, take for example a special purpose vehicle whose main asset is commercial property which it bought when the real estate market was booming, and the purchase of such commercial property was financed with a loan in Euro. Because of the crash in the property market and the depreciation of the Polish Zloty against the Euro, the company has become balance sheet insolvent (and therefore becomes obliged to file for bankruptcy within 14 days). Nonetheless, because this commercial property is being leased out by the company, it receives a constant stream of income by way of rent, making it possible to service the loan and other debts incurred in running its business. It is clear that an announcement of bankruptcy by the company would be harmful to the interests of its shareholders and creditors. It is this very situation which puts company directors in a difficult dilemma.

On the one hand, if the directors follow their statutory duties and file for bankruptcy, they may be accused of acting to the detriment of the company (along with its shareholders and creditors). On the other hand, if the directors decide not to file for bankruptcy, they may face liability (including criminal liability and those liabilities stipulated in Article 373 of the Bankruptcy and Rehabilitation Law), for not adhering to their statutory duties. The new regulations fail to address this predicament.

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INSOLVENCY PROCEEDINGS AND CONTINUATION OF "CURRENT" LOAN AGREEMENTS IN ROMANIA

It is inevitable that when a debtor becomes insolvent there will be various contracts which will not have been fully or substantially performed. Article 4 of Regulation 1346/2000 applies the national law (in this case, the Romanian law) to determine the effects of insolvency on such contracts of the insolvent entity.

Under Romanian Insolvency Law (the "Insolvency Law"), current contracts are, as a rule, maintained as of the date of the opening of the insolvency proceedings. As such, the newly enacted amendments to the Insolvency Law set out this very principle: *"Current contracts are preserved on the date of the opening of [insolvency] proceedings. Any contractual clauses triggering termination of current contracts on commencement of [insolvency] proceedings are void."*

One of the key issues raised by the above provision is whether a judicial administrator may choose to continue a bank loan (on the grounds that its continuation is more beneficial to the debtor than its termination).

For the purposes of the Insolvency Law, "current contracts" are those contracts which, at the commencement of the insolvency proceedings, have not been fully or substantially performed by either the debtor or any of its counterparties. In addition, this rule applies to all types of contracts including employment contracts, lease agreements and bank loan facility agreements.

As such, the Insolvency Law provisions will apply to bank loan facility agreements which have not been fully or substantially drawn down at the time of commencement of the insolvency proceedings against the borrower. However, the law is silent when it comes to current loan agreements which have been executed before the latest amendments to the Insolvency Law came into force.

In addition, while it is market practice that insolvency-related events of default are included in the loan agreements, it also remains to be seen whether these legal provisions could have the effect of removing a clause in a loan agreement entitling the banks to proceed with the acceleration of a loan agreement in the event that insolvency proceedings are commenced against the borrower.

A fundamental Romanian Civil Code principle in relation to agreements between private entities is the liberty of the contracting parties to agree on the terms of the contract (the freedom of contract principle). Generally, to the extent an agreement does not breach any imperative provisions imposed on commercial transactions and provided that the special regulations applicable to credit institutions and financing transactions are observed, lenders and borrowers should have the freedom to determine the terms and conditions of their trade.

And it is in line with this principle that the banks usually include insolvency related events in the agreements concluded with their borrowers. However, the above mentioned amendment to the Insolvency Law may be construed as vesting the administrator with powers to determine whether current agreements, including loan agreements, should continue or not, even if his decision is contrary to terms of the agreement.

Nonetheless, Article 86 Paragraph 3 of the Insolvency Law provides that during the observation period (the first phase of the insolvency proceedings), the judicial administrator may maintain or amend the loan agreements subject to the lender's consent and for the purpose of redressing the balance of each party's performance under such an agreement.

This new legal provision can be taken to mean that, during the observation period, current loan agreements are not subject to the maintenance rule set out above, but can only be maintained with the agreement of the lender.

A further key amendment to the Insolvency Law (Article 112 Paragraph 4) states that monetary claims against the debtor become due when the bankruptcy procedure (the last phase of the insolvency procedure) starts. This legal provision amounts to a legal acceleration of debts which may not yet be due (including debts under a loan agreement).

When this amendment is juxtaposed alongside the other provisions of the Insolvency Law on continuation of current agreements, the effect seems to suggest that:

— during the observation period and during the restructuring procedure, the acceleration of the loan is not permitted; and

— during the bankruptcy procedure (in other words, after the reorganisation

has failed or no reorganisation plan has been approved at all), such acceleration of the loan may occur.

Insolvency practitioners welcome these amendments to the Insolvency Law, especially in the context of the financial downturn and the increase of insolvency-related cases.

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// **Russia**

RUSSIAN INSOLVENCY – LIABILITIES AND CHALLENGES

Russian insolvency law continues to develop rapidly in 2009. June saw the introduction of certain changes (the "New Law")[1] related to the challenging of transactions and to manager and shareholder liabilities upon insolvency, and July saw the Plenum[2] of the Supreme Arbitration Court of Russia issue substantive guidance on what may qualify as "current" (and consequently prioritised) claims.

Liability

The liability of management and other controlling persons within a debtor company has been increased. The New Law introduces a new definition of a controlling person as an individual or a legal entity with the right to give binding instructions on the debtor or to otherwise determine the debtor's actions, including via pressure on the debtors CEO or management bodies. It includes those persons who could do any of the above within a period of two years prior to the initiation of bankruptcy proceedings against the debtor ("Controlling Persons").

Where the actions or instructions of Controlling Persons infringe the property rights of the debtor's creditors, and the debtor's assets are insufficient to satisfy all of the creditor's claims, the Controlling Persons will bear secondary liability for the debtor's financial obligations. The court has the discretion to reduce the level of the Controlling Persons' liability, depending on the circumstances.

The New Law also imposes responsibility for the maintenance of reporting documents. A chief executive officer of the debtor will bear secondary liability if the relevant obligations of the debtor regarding accounting and reporting documents are not complied with as at the date of the commencement of supervision proceedings against the debtor, or as at the date of the declaration of the debtor as bankrupt.

Challenging transactions

The circumstances, under which creditors in a bankruptcy can challenge transactions by the debtor, or with respect to the debtor's assets, have been broadened. The New Law expands the previous definition of '*preferential transactions*' and introduces a new category of '*suspicious transactions*' with an added presumption of intent on the part of the debtor to prejudice the creditors in certain transactions.

The New Law also provides a more detailed description of methods, limitation periods and consequences of challenging transactions extend to any actions undertaken to perform obligations under the civil, labour, tax, customs, family and procedural law.

1. Suspicious transactions

The New Law defines two types of transaction as suspicious: transactions at an undervalue and transactions prejudicing the creditors' property rights.

"**Transactions at an undervalue**": these are transactions in which the counterparty disproportionately performs its obligations. It includes situations where the value and/or terms of the transaction are materially less favourable for the debtor than in comparable transactions.

For the challenge to succeed the transaction must have been completed by the debtor within one year before, or at any time after, bankruptcy proceedings were initiated against the debtor.

"**Transactions prejudicing the creditors' property rights"**: these are transactions which result in any reduction in the debtor's assets and/or any increase in the amount of property claims against the debtor, or any other consequences of the debtor's transactions or actions, resulting in the full or partial inability of creditors to obtain satisfaction of their claims. For the challenge to succeed:

(a) it must have been the debtor's intention to prejudice the creditors' property rights and this prejudice must have actually occurred;

(b) the counterparty to the transaction must have been aware of the above purpose of the transaction; and

(c) the transaction must have been completed within three years before, or at any time after, bankruptcy proceedings were initiated against the debtor.

It is assumed that a transaction was concluded for the purpose of

prejudicing the creditors' property rights if at the time of its conclusion the debtor met the Inability to Pay[3] and/or the Asset Insufficiency[4] criteria, and:

(d) the transaction was completed for no consideration;

(e) entered into with a related party[5];

(f) aimed at repaying a share in the debtor's assets; or

(g) the transaction was completed where the following conditions were met:

(i) the value of assets transferred equals 20% or more (10% in the case of credit organisations) of the book value of the debtor's assets;

(ii) the debtor changed its address without notifying its creditors immediately before or after the transaction, or concealed its assets or destroyed or tampered with title and filing documents; or

(iii) after the conclusion of the transaction, the debtor continued to own and use these assets or instruct the owner on their disposal.

The amendments in this area increase the available bankruptcy assets of the debtor by allowing the debtor's transactions to be challenged in order to alienate its property or assume property-related obligations.

2. Preferential transactions

The New Law states that the court may declare transactions invalid which result in one creditor's claims being prioritised over another. A transaction gives preference to an existing creditor if such a transaction:

(a) provides for security to an existing creditor to secure obligations that arose prior to the transaction ("*condition 1*");

(b) has or may result in a change of ranking in which the existing creditors' claims are satisfied ("*condition 2*");

(c) has or may result in the satisfaction of claims that have not yet matured, provided there are other unsatisfied but due claims; or

(d) results in one creditor's claims, that arose prior to the transaction, being prioritised over other creditors' claims.

For the challenge to succeed the transaction must:

(a) give preference to an existing creditor as described above; and

(b) have been completed one month before, or at any time after, the initiation of bankruptcy proceedings against the debtor; or

(c) have been completed within the six months prior to the initiation of bankruptcy proceedings against the debtor provided that either:

(i) conditions 1 and 2 above are met, the transaction provides security to an existing creditor and has or may result in a change to the priorities in which existing creditor's claims are satisfied; or

(ii) the creditor or another party involved was aware that the debtor met the Inability to Pay and/or the Asset Insufficiency criteria, (in either case "six month criteria preferential transactions").

3. Transactions that may not be challenged

The New Law lists a number of transactions that may not be challenged. These are debtor transactions:

(a) made on a stock exchange;

(b) concluded in the ordinary course of business provided that the value of a transaction does not exceed 1% of the debtor's assets, unless intended to prejudice the property rights of a creditor; or

(c) aimed to fulfil obligations where market value consideration was received, unless intended to prejudice the property rights of a creditor.

4. Consequences of an invalid transaction

Once successfully challenged, all consideration received from the debtor under the relevant transaction will be transferred to the debtor's bankruptcy pool. The counterparty under the invalidated transaction will acquire a claim against the debtor which will be satisfied as follows:

(a) In the case of transactions at an undervalue and preferential transactions (other than six month criteria preferential transactions), the counterparty's claims are satisfied together with the claims of other creditors.

(b) In transactions prejudicing the creditors' property rights and six month criteria preferential transactions, the counterparty's claims are satisfied after claims of creditors who rank third on insolvency (i.e. secured creditors, unsecured creditors and mandatory payments under Russian law).

Current claims

The Plenum, in its July publication, provided some clarification on when a "current claim" obtains priority over ordinary claims of secured and unsecured creditors and Russian mandatory payments (including taxes), may arise. The following would qualify as "current":

— Liabilities which are paid on a rolling basis (e.g. monthly utility bills, lease payments). Relevant claims shall be regarded as current only if they refer to a period ending after the insolvency was initiated.

— For liabilities arising from a loan obligation, the relevant liability will be deemed to have arisen at the moment when the borrower received the amount of the loan or credit. Interest accrued on the principal amount shall be fixed on the date that the bankruptcy is initiated.

— For liabilities under suretyship (and possibly non-Russian guarantees) agreements, the obligation of the surety shall arise on the date when the relevant suretyship was given.

— For liabilities under bank guarantees, the obligation of a principal (debtor) to a guarantor on reimbursement of the paid guarantee amount, shall arise on the date of issue of the relevant guarantee (notwithstanding the actual date that the guarantee is enforced by a beneficiary).

— In relation to assigned liabilities, the relevant claim shall arise on the date of the original liability.

Conclusion

It is understood that the New Law was introduced in response to the growing number of bankruptcy cases and suspected cases of asset stripping prior to, and during, the bankruptcy process. The New Law has gone some way to introduce an improved position for creditors acting in good faith in connection with the insolvency of a Russian company by providing more protection over their interests. It has the potential to create more transparency in the bankruptcy process although it is still too soon to judge how effective this will be. Similarly the guidance on what may qualify as "current claims" is welcome as this has been perceived as an area where claim allocation may be manipulated.

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1) *On 5 June 2009 Federal Law No. 73-FZ "On introduction of amendments to certain regulations of the Russian Federation" came into force.*

2) *Although not legally binding, the Plenum's clarification would likely be determinative in court practice.*

3) *Inability to Pay is the failure of the debtor to perform some of its monetary obligations or obligations to make mandatory payments due to a lack of funds.*

4) *Asset Insufficiency means the excess of the debtor's monetary obligations and mandatory payments over the value of its assets.*

5) *The New Law widened the definition of 'related party' to include an affiliate of the debtor, and a person/entity in the same group as the debtor.*

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INSOLVENCY LAW REFORM

The recently enacted Royal Decree (Law 3/2009 of 27 March 2009) on urgent measures regarding tax, finance and insolvency, introduced a series of procedures, the objective of which is to assist business activity in the current financial downturn.

The enactment involved reforms to approximately 50 articles of Law 22/2003 of 9 July 2003 (the "Insolvency Law"), which are intended to assist debtor companies and their creditors as well as resolve other issues which have hampered the achievement of the insolvency objectives in the past.

The main developments introduced by the reforms are set out below.

Restoration of assets and refinancing of viable businesses

In order to stimulate financial transactions to help insolvent businesses, the reforms establish that refinancing agreements (including contracts, transactions, payments or guarantees related to them) which have been executed by creditors whose stake, in the opinion of an independent expert, represents at least three-fifths of the debtor's liabilities, are non-rescindable. Therefore, subsequent to a declaration of insolvency, only the insolvency practitioner (such as an administrator) will be entitled to challenge these refinancing agreements. The reforms also enshrine the non-rescindable nature of all guarantees granted in favour of public law credits and the Salary Guarantee Fund.

Agreement

With the objective of providing a solution to the unprecedented number of insolvencies, the reforms encourage creditors and debtors to execute advanced agreements which aim to avoid the liquidation of a debtor company.

Furthermore, the reforms suspend the debtor's right to request a declaration of insolvency for three months where it has begun negotiations to enter into an advanced agreement with other parties while in a state of insolvency. Also, the requirements on making proposals for an advanced agreement have been relaxed.

Early liquidation

In conjunction with the provisions on advanced agreements, the reforms also aim to expedite the liquidation of a business when it is clear from the outset that liquidation is the most appropriate insolvency mechanism, thus avoiding unnecessary depreciation of the company's value which results from a protracted liquidation process.

As such, the reforms allow a debtor to present an advanced proposal for an accelerated liquidation, which will then be passed on to the administrator and other interested parties for consideration. The judge will then decide whether to reject or approve the proposed accelerated liquidation after taking into account the interests of those involved in the insolvency.

Procedural rules

Another goal of the reforms to the Insolvency Law is to reduce the duration of a company's insolvency, thereby minimising unnecessary deterioration of an insolvent company's financial condition which may be caused by the mere passage of time. With this in mind, a number of procedural reforms have also been introduced.

It used to be that this abbreviated procedure only applied to debtors (authorised to submit an abridged balance) with liabilities of up to EUR 1 million. With the introduction of the reforms, this limit has been increased to EUR 10 million, thus widening the category of insolvent debtors who can take advantage of this abbreviated procedure.

Other amendments

Aside from those already mentioned above, other noteworthy reforms include:

— the classification of credits (such as the grading of public law credits of the Public Administration and its bodies arising from inspection or verification procedures) as contingent until these are quantified;

— the grading of subordinated credits derived from reciprocal obligations (when the judge finds that the creditor has repeatedly impeded the fulfilment of a contract to the detriment of other creditors);

— reforms to the remuneration of insolvency administrators; and

— reforms to the procedure on publishing insolvency declarations where a Public Insolvency Register has been established to publicly broadcast and publish (via the internet) all insolvency declarations.

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INSOLVENCY IN THE UKRAINIAN BANKING SECTOR

Ukraine's Banking sector has been detrimentally affected by the current global financial crisis, with 12 out of 198 registered banks being liquidated, another 16 under management of temporary administrators appointed by the country's central bank (the National Bank of Ukraine, or the NBU), and seven ready to surrender between 75% to 99% of their shares to the State in exchange for recapitalisation. As a result, unsecured creditors of debtor banks have started to review their enforcement options.

Court judgment

If a bank defaults on a payment, a creditor may apply to the commercial court for judgment compelling the debtor bank to pay the creditor the amount due. An arbitration clause in the relevant loan agreement would prevent such an application as it would oust the court's jurisdiction.

Assuming the court has jurisdiction, the judgment would represent an enforcement document which could be legally enforced against the debtor's assets. It would also make the creditor's claim indisputable, enabling him to initiate insolvency proceedings if the claim is not satisfied within three months.

If the debtor bank does not satisfy the claim within six months of the judgment date, the NBU must revoke its banking licence.

Insolvency proceedings

Statutory insolvency of Ukrainian banks is regulated by the Law of Ukraine *On Banks and Banking Activities* and the Law of Ukraine *On Restoring a Debtor's Solvency* or *Declaring a Debtor Bankrupt*. Where the two laws conflict, the former prevails.

Prior to initiating proceedings, a creditor must apply to the NBU. Permission to proceed will be granted if there is an indisputable claim for at least EUR 16,500 and payment is at least three months overdue. Proceedings must be brought in the commercial court where the bank is located. The legislation remains unclear as to whether the debtor bank can initiate bankruptcy proceedings against itself.

The NBU has a number of statutory powers in relation to insolvency proceedings, including the right to conduct an assessment of the bank, initiate proceedings, revoke licences, appoint a liquidator, and in some cases, a right to veto.

Overall, insolvency proceedings are the same for banks as they are for other debtors. Certain parties have the right to challenge past transactions and banks are subject to the same notification requirements and the same range of proceedings (administration, amicable settlement, financial rehabilitation and liquidation).

Liquidation

Liquidation is the worst-case scenario for an insolvent debtor bank. In a liquidation, the proceeds from a disposal of the bank's assets will be distributed amongst creditors. The claims of secured creditors take priority, and should be satisfied using the proceeds from the disposal of the assets they have security over.

All other claims are satisfied in a strict order of priority, with claims of employees and individual depositors ranking above unsecured corporate creditors. The claims are ranked and categorised as follows:

— damage to life and health

— unpaid salary

— Individual Deposit Guarantee Fund (IDGF) for claims specified by law

— individual depositors for claims above the sum paid by the IDGF

— the NBU for a decrease in the value of collateral for refinancing loans

— refundable financial aid given by the Ministry of Finance

— blocked payments to/from individuals

— all other claims, except those for subordinated debt

— subordinated debt

Licence revocation

If a bank has not satisfied the creditors' claims within six months of a court judgment being obtained, the NBU must revoke its licence. A notice in the national press will be published, either in *Holos Ukrainy* or *Uryadovy Kuryer*.

Revocation of the bank's licence results in the termination of all banking operations. This is done to prevent the leakage of funds and assets from the bank. All management powers then pass to the liquidators; and at this stage, rescue or restructuring of the bank is no longer an option.

Temporary administration

Temporary administration is instigated by the NBU when a bank's solvency is materially threatened.

The NBU appoints a temporary administrator to run the bank for up to one year, with the power to make crucial decisions for its future, including any reorganisation or share issue, and the ability to challenge certain transactions in court. Furthermore, the bank is protected by a three-month moratorium. Should the process be unsuccessful, the bank will go into liquidation.

Practical advice

First and foremost, creditors should closely monitor the notices published in the national press as well as the charges register to check for enforcement actions by other creditors.

Should insolvency become a real prospect, creditors wanting to protect their position against banks in financial difficulty face a number of options. Initially, the creditors may offer the bank some breathing space by signing a standstill agreement to allow it to restructure its business.

Creditors might also consider halting the situation, by asking the NBU to appoint a temporary administrator or to revoke the bank's licence. Before doing so, they should ask the bank to sign the *act of verification of debts*, which may save a creditor valuable time should the restructuring prove insufficient and an insolvency petition needs to be filed at a later date.

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ALLEN STANFORD AND CROSS-BORDER INSOLVENCY: COMI ISSUES

In July 2009 the English High Court made a significant decision in the case of two rival applications for recognition of a foreign proceeding by the two office-holders appointed over Stanford International Bank Limited ("SIB"). This case throws light on how English courts will approach the issue of establishing an insolvent company's Centre of Main Interests ("COMI") outside the European context, as well as providing further guidance on how COMI should be interpreted in cases under the EC Regulation on Insolvency Proceedings. CMS Cameron McKenna LLP acted for the Antiguan liquidators of SIB.

Background

On 16 February 2009, the United States Securities and Exchange Commission ("SEC") shut down Allen Stanford's business operations, and applied to court to have an equity receiver appointed over all Stanford-related assets and entities worldwide.

On 19 February 2009, the Financial Services Regulatory Commission ("FSRC") of Antigua appointed its own receivers over the assets of SIB, a company incorporated in, regulated by, and operating from Antigua. On 15 April 2009, the Antiguan High Court, on an application brought by the FSRC, ordered that SIB be put into liquidation.

The Antiguan liquidators instructed CMS Cameron McKenna to apply for recognition of their appointment in the UK under the Cross Border Insolvency Regulations 2006. This application was opposed by the US receiver on the grounds that he alone should be recognised in the UK and he made a separate application for recognition of his own equity receivership as foreign main proceedings. At stake was the control of approximately GBP 120 million of SIB's assets held by UK institutions.

Relevant legislation

The United Nations Commission on International Trade Law ("UNCITRAL") produced a model law on cross-border insolvency in 1997 (the "Model Law"). The Model Law was incorporated into UK legislation through the Cross-Border Insolvency Regulations in 2006 and into US legislation in the form of Chapter 15 of the Federal Bankruptcy Code in 2005. The UK is also covered by the EC Regulation on Insolvency Proceedings ("EC Regulation") introduced in 2000, which introduced the concept of COMI into the EC legal system. Whilst the EC Regulation and the Model Law are supposed to be interpreted in the same way, the American and European legal systems have had slightly different experiences of applying the principles in practice. As there was no suggestion that SIB's COMI was in the EC, the applications to the English Court were made pursuant to the Model Law and not the EC Regulation. Last week, the High Court considered the differences between European and American approaches, and decided to apply European case law principles on COMI to a non-European context brought to the Court's attention under the Model Law.

The Model Law

Under the terms of the Model Law, a "foreign representative" can apply for recognition in the UK in connection with a "foreign proceeding". Such recognition can be given on the basis that the "foreign proceeding" is a "foreign *main* proceeding" or a "foreign *non-main* proceeding". A "foreign *main* proceeding" is the proceeding taking place in the debtor's COMI. Both the Antiguan liquidators and the US receiver claimed that SIB's COMI was in their respective jurisdiction.

The Antiguan liquidators relied on the decision in *Re Eurofood IFSC Ltd* [2006] Ch 508, the leading European case, and argued that (1) there was a rebuttable presumption that a company's COMI was in the same place as its registered office; and (2) this presumption could only be rebutted by objective factors that were ascertainable by third parties.

The US receiver put forward an alternative case based partly on (effectively obiter) elements of the *Eurofood* decision and partly on American case law. He argued that COMI lies in the jurisdiction where the most material "contacts" are to be found with a heavy emphasis on the head office function. These contacts would include the location of the debtor's headquarters, the location of those who actually manage the debtor, the location of the debtor's primary assets, or the location of the debtor's creditors. It was also put to the court that SIB was simply a vehicle for fraud, and what was therefore relevant was the COMI of the fraudsters themselves.

Factual dispute

Each side put forward a different interpretation of the business being carried on by SIB.

The US receiver argued that SIB was not an entity in its own right, but rather an inseparable part of the wider group of Stanford companies; its affairs were indivisibly intertwined with all of the other group companies; and the whole Stanford empire was a fraudulent enterprise meaning that the court should look through the "fiction" of separate corporate entities. Applying the American approach to the Model Law (which was essentially based on case law relating to offshore letter-box companies) and by arguing that the relevant entity for the COMI analysis was the Stanford group, it was then argued that the majority of SIB's "contacts" were in fact in Texas, where the Stanford *group* was headquartered.

The Antiguan liquidators argued that not only was SIB a separate entity based in Antigua, but that that was also the image that it had projected to the rest of the world. They stated that it did not matter that the business may have been fraudulent, but that what was important was that all of the factors that were objectively ascertainable by third parties dealing with the bank pointed to it being based in Antigua. This evidence included the fact that SIB was headquartered in a 30,000 square foot office in Antigua where it employed 88 people, all of the standard contracts SIB entered into with its customers were subject to Antiguan law and jurisdiction, all of SIB's marketing materials pointed to it being based in Antigua, and indeed when SIB ran into difficulties, many investors came to the bank's headquarters in Antigua.

The decision

The court decided that, because the EC Regulation and the Model Law were intended to be complementary and use the same interpretation of COMI, *Eurofoods* should be followed and therefore SIB's COMI was in Antigua. Not only was that the location of its registered office, but the evidence pointed to Antigua being the place where third parties would have objectively considered SIB's operations to be based. For these purposes fraud was irrelevant and SIB should be dealt with as an individual company.

The court also found that the US receiver could not be recognised under the terms of the Model Law as he did not comply with the definition of a "foreign representative", and the receivership could not qualify as a "foreign proceeding" because an equity receivership is not "pursuant to a law relating to insolvency", which the judge decided needed to be a definitive law that is set out in statute or case law.

Summary

This decision is indicative of the approach that the English courts may adopt in future towards establishing the COMI of multinational companies. It seems that European jurisprudence will still be highly influential even in non-EU cases.

The court agreed with the interpretation of *Eurofood* put forward by the Antiguan liquidators, even under the Model Law:

- There is a presumption that the location of a company's registered office is also the location of that company's COMI.
- The burden of rebutting that presumption lies with anyone trying to disprove it.
- The presumption will only be rebutted by factors that are objective. In the case of SIB, this meant factors such as the location of its headquarters office, the contracts that SIB entered into with its customers and the marketing materials it produced.
- Objective factors will not count unless they are ascertainable by third parties. So, in the case of SIB, third parties would not, in the ordinary course of things, have been able to ascertain that there had been a fraud, and this was therefore irrelevant.
- What is ascertainable by third parties is what is in the public domain, and what they would learn in the ordinary course of business with the company.

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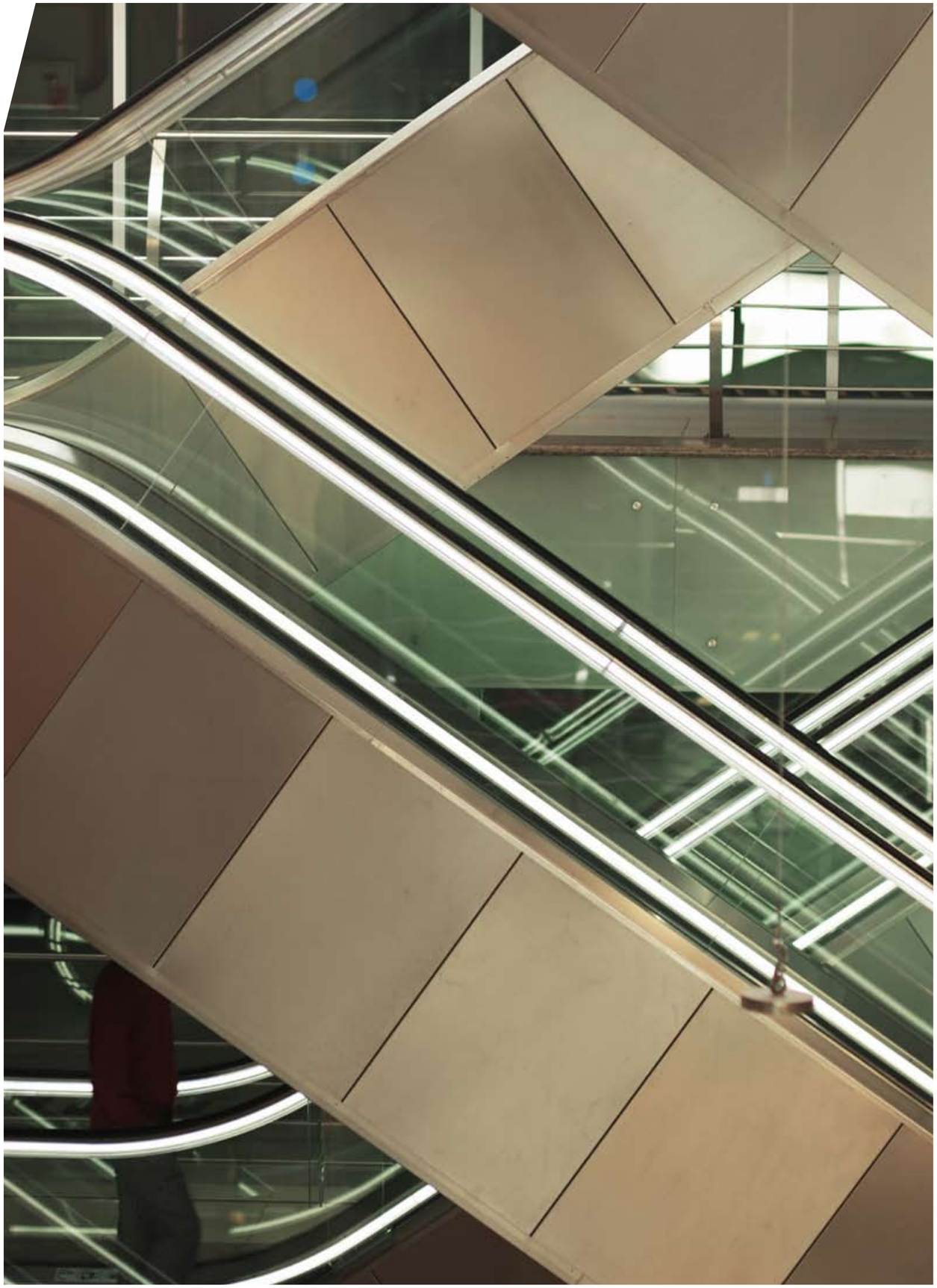

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