C'M'S'
Law . Tax

NEWSLETTER

CMS RESTRUCTURING AND INSOLVENCY IN EUROPE

WINTER 2010/2011

Introduction
2

Editorial
3

Belgium
Law concerning the continuity of enterprises: the tax administration strikes back … illegally
4

Bulgaria
Preservation and collection of an insolvent company's estate during insolvency proceedings
6

Czech Republic
Recent court decisions and their consequences
8

France
Declaration of claims in French insolvency proceedings: a trap for European creditors
10

Germany
How German insolvency proceedings can succeed by means of an insolvency plan
12

Italy
Leases and bankruptcy procedures
14

Poland
Ineffectiveness of a bankrupt's transactions with respect to the bankruptcy estate
15

Romania
Clarification on the scope and application of pre-insolvency work-out plans
17

Spain
Draft bill for the reform of Insolvency Law
19

The Netherlands
Recent developments in The Netherlands
20

United Kingdom
Miss Sixty CVA misses the mark
22

Ukraine
Protecting creditors against asset stripping
24

Contact details
26

INTRODUCTION

We are pleased to present this Winter 2010/2011 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:

— the recovery of reduced tax debts by the Belgian tax administration;

— the preservation and collection of an insolvent debtor's assets in Bulgaria;

— recent case law in the Czech Republic;

— declaration of claims in French insolvency proceedings;

— the use of insolvency plans in Germany;

— issues surrounding leases in the context of Italian bankruptcy procedures;

— the ineffectiveness of certain transactions by bankrupts in Poland;

— the scope and application of pre-insolvency work-out plans in Romania;

— the draft bill for reform of the Spanish Insolvency Law;

— recent developments in The Netherlands;

— the recent Miss Sixty CVA case in the UK; and

— asset stripping in the Ukraine.

CMS is the organisation of independent European law and tax firms of choice for organisations based in, or looking to move into, Europe. CMS provides a deep local understanding of legal, tax and business issues and delivers client-focused services through a joint strategy executed locally across 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 2,800 lawyers and 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. In consequence we offer coordinated European advice through a single point of contact.

EDITORIAL

After the collapse of the socialist bloc in the early nineties, it seemed that the inefficiency of systems based on the nationalisation of the economy and state interventionism was definitively established.

Twenty years later, at the end of the first decade of 21st century, the United States, the United Kingdom and a large part of the capitalist and liberal countries nationalised bank companies and some of the biggest industrial companies, including General Motors (60%).

Was it a revolution? Is it an astrological revolution when all things come back to their starting point? Actually, no! It was "just" the biggest economical and financial crisis since 1929 and the first of a fully globalised economy.

The response caricatured in the opening paragraphs wasn't fundamentally political in nature. It was clearly an expression of the necessary pragmatism against crisis effects. Indeed, pragmatism seems to be the guideline for anti-crisis measures. It shall save as many economic agents as possible!

From a legal perspective, insolvency proceedings are the appropriate response, and the specificity of insolvency law rules are the translation of this pragmatism. High hopes will be firmly placed on this corpus of rules during the next period.

In 2009, the number of corporate and business failures has never been so important in France. This number has begun to decrease in 2010, but the analysts predict that the level will remain high in late 2010 and 2011. Such a situation affects the overall economies of Europe and North America. Indeed, after the black years (2008 and 2009) in which the number of failures increased by more than 75% in Spain and Ireland, 2011 like 2010 will be a year of stabilisation, and in a best case scenario we would see failure rates decrease.

EULER HERMES SFAC (credit insurer, an Allianz company) predicts a 5% decrease in insolvency proceedings in France during 2011.

In response to these needs, adaptation of insolvency law seems to be a permanent move both at national and European level. This explains why the French Legislature, inspired by the US "pre-packed insolvency proceedings", has just introduced a "Financial Express Safeguard" proceeding in which the proceeding's impact will be limited to financial creditors of the insolvent company.

This edition of the CMS Restructuring and Insolvency in Europe Newsletter shows the continued development of insolvency law across Europe, from the scope and application of pre-insolvency work-out plans in Germany, to the collection of an insolvent company's estate during insolvency proceedings in Bulgaria.

It will be interesting to see what further developments there are over the coming months and into 2011.

/
Daniel Carton
CMS Bureau Francis Lefebvre, Paris
E *daniel.carton@cms-bfl.com*

LAW CONCERNING THE CONTINUITY OF ENTERPRISES: THE TAX ADMINISTRATION STRIKES BACK … ILLEGALLY

The tax administration is using a new tool in order to recover reduced tax debts, as determined by a reorganisation plan for 100% by means of withholding tax returns in accordance with article 334 of the Program Law of 27 December 2004. However, article 334 of the Program Law is not applicable to reduced tax debts after the approval of a reorganisation plan in accordance with article 57 of the law concerning the continuity of enterprises (the *"LCE"*).

More than one year after the entry into force of the LCE, the tax administration still seems unwilling to accept its minor role in the process of a reorganisation plan in accordance with article 44 of the LCE.

It appears that the tax administration is, notwithstanding previous negative decisions, always using the same arguments in procedures before the commercial courts (in order to avoid any reduction of taxes in a reorganisation plan):

> *"Exemptions or reductions of taxes cannot be established other than by law. Since the law concerning the continuity of enterprises does not specifically clarify the tax reduction, article 172 of the constitution is violated when any tax reduction or exemption is made. Plans which provide for a reduction of tax debts are therefore unconstitutional and against the rules of public order."*

The arguments put forward by the tax administration to request the annulment of the reorganisation plans are, however, not accepted by the current case-law:

> *"the principle of exemption or reduction of tax as general preferential claims has a legal status since it is determined by law. A reduction of tax does not have to be explicit."*
>
> (Brussels 11th of March 2010, not published).
>
> *"At the hearing, the tax collector stated that the proposed plan would be contrary to public order because the claim of the tax administration has been reduced significantly. The tax administration states that this is impossible and in violation with article 172 of the constitution and therefore would be contrary to public order.*
>
> *However, the tax administration's debt is only generally privileged and it is accepted, even under the old law of the Judicial Moratorium, that its debt may be reduced".*
>
> (Commercial court of Antwerp, 22nd of April 2010, not published).

Aside from the procedure of annulment of reorganisation plans containing tax reductions, the tax administration has found an alternative, and possibly illegal, way to recover its sustained losses. The tax administration is now using article 334 of the Program Law of 27 December 2004 to recover tax debts that were reduced in application of the LCE.

Article 334 of the Program Law states that when there is a sum to be returned or paid by the tax administration (VAT or Corporate tax) to an enterprise, this sum can, without any formalities, be set off against outstanding tax debts.

In a recent case, where the outstanding corporate tax debts were, in application of the LCE, reduced to 10% of their original value, the tax administration used this article on VAT returns despite the fact that a reorganisation plan was approved by all creditors and homologated by the commercial court of Antwerp.

A procedure has been started in order to recover the so-called "outstanding" 90% corporate tax. The court is yet to rule on the merits of the case.

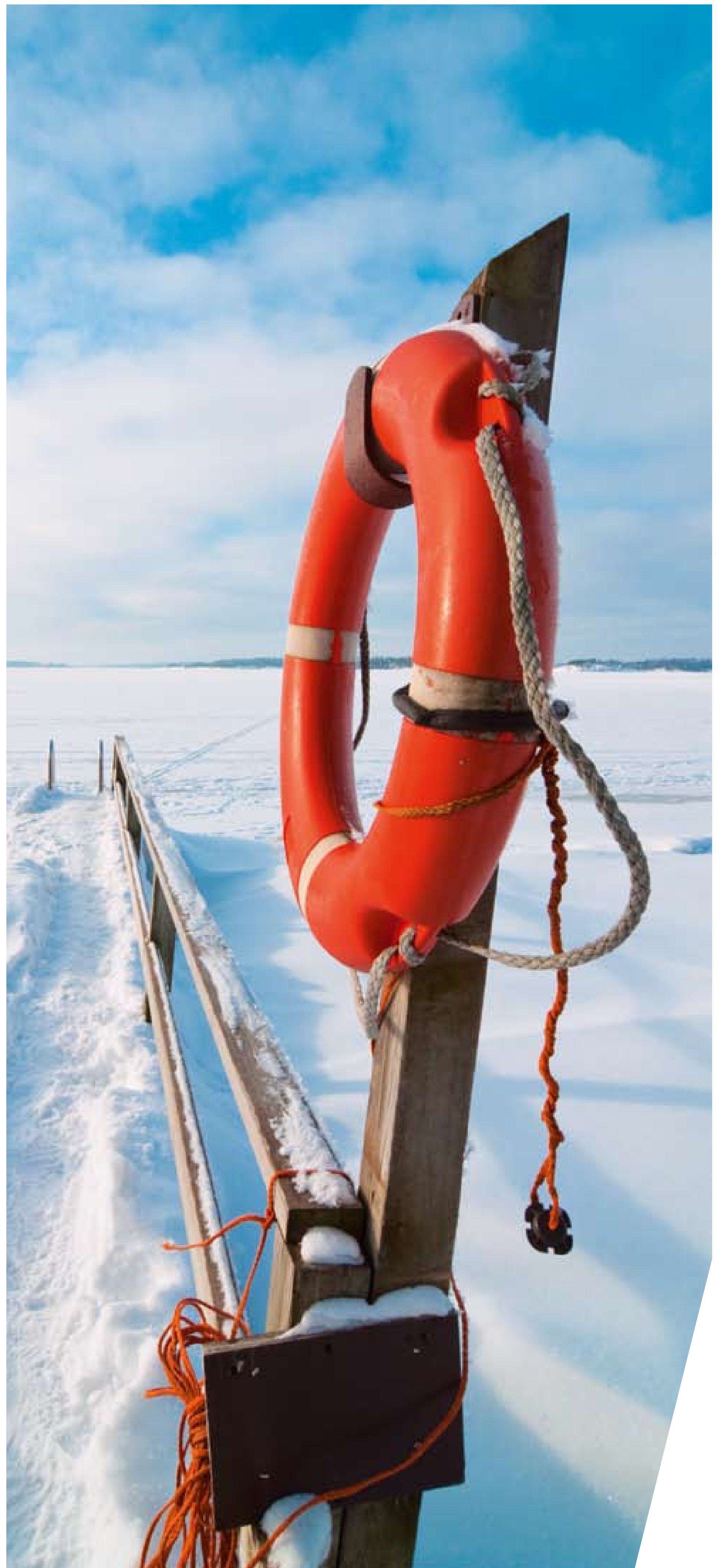
In our opinion, the application of article 334 of the Program Law after the homologation of a reorganisation plan is illegal.

Article 57 of the LCE stipulates very clearly that an approved and homologated reorganisation plan is binding on *all creditors*. This means not only that the reduction of the debt, but also the conditions as to when the debts have to be paid are legally binding for all the creditors.

Upon official approval of the reorganisation plan, the cause of the debts is no longer present, meaning that set off against any so-called "outstanding and historic debts" is not possible. Article 334 of the Program Law can therefore not be used for a circumvention of the LCE.

Therefore, all companies executing a plan of reorganisation containing tax reductions should pay close attention to the practice of the tax administration.

/
Tim De Clercq
CMS DeBacker, Antwerp
E *tim.declercq@cms-db.com*



// BULGARIA

PRESERVATION AND COLLECTION OF AN INSOLVENT COMPANY'S ESTATE DURING INSOLVENCY PROCEEDINGS

Insolvency proceedings serve as a means of satisfying the claims of an insolvent company's creditors. The creditors' claims may be proportionately satisfied from the insolvency estate. Accordingly, the preservation and collecting in of the insolvency estate is an important phase of the insolvency proceedings. The significance of this phase of the insolvency proceedings is even greater in today's market.

Preservation of the insolvency estate

The insolvency estate may be preserved by imposing a general court restriction on all of its assets, or any security available under law.

The Commerce Act, Issue No. 48 dated 18 June 1991, as amended, also provides that with the opening of the insolvency proceedings any pending court, arbitration or enforcement proceedings against the insolvent company are suspended. There are some exceptions to this rule, including:

(a) where a pending court case is a labour dispute and concerns payment of remuneration;

(b) the insolvent company has filed a counter claim or has requested set-off.

In general, the suspended court or arbitration proceedings are terminated where the claim is honoured by the court of insolvency, or the case is continued with the participation of the insolvency administrator *("syndic")*.

After the insolvency proceedings are opened, no new court claims can be opened against the insolvent company alongside the insolvency proceedings, unless a claim concerns either a labour dispute or the protection of third party property rights affected by the insolvency proceedings.

Collection of the insolvency estate

The collection of the insolvency estate is completed by:

(i) paying the outstanding capital contributions of shareholders of the insolvent company (if not already paid);

(ii) termination of agreements that have not been performed or have been performed partially;

(iii) set-off; or

(iv) the challenging of acts and transactions, or requesting from the court certain acts or transactions be declared null and void against the insolvent company's creditors.

Termination of agreements

Agreements to which the insolvent company is a party may be terminated by giving 15 days' prior written notice to the other party (sent by the insolvency administrator). Upon the termination, the aggrieved party may be compensated for any damage caused.

Set-off

Insolvency set-off, broadly speaking, allows a creditor to set-off money that it owes an insolvent company against money it is owed by the same company, provided that certain conditions are met (i.e. the creditor's claim and the counterclaim must exist, be mutual, be of the same kind and be due and payable). These conditions for set-off may be met prior to or even after the commencement of insolvency proceedings. The set-off is effected by a notification addressed to the insolvency administrator.

Notwithstanding the above conditions being met, the set-off may be declared invalid against the other insolvency creditors, if the creditor knew upon the acquisition of its receivables that the company was already insolvent or that an application for commencement of insolvency proceedings had already been filed.

Null and void transactions

Bulgarian law provides mechanisms by which an insolvency administrator or an insolvent company's creditors can challenge transactions entered into by the company. In certain circumstances some transactions may be considered *ex-lege* null and void, and others can be revoked.

Generally, the acts and transactions which can be deemed null and void vis-à-vis the creditors of the insolvent company can

be grouped in two groups, depending on the period when they were performed or entered into:

(i) acts or transactions performed/entered into after the date of commencement of insolvency proceedings

Under the Commerce Act, the following actions which have been undertaken by the company after the commencement of the insolvency proceedings (and in discrepancy with it) are null and void as against the insolvent company's creditors:

- payment of monetary obligations that have existed before the insolvency proceedings commencement date;
- granting of a contractual mortgage or a pledge of assets of the insolvency estate; or
- a disposal of rights or assets of the insolvency estate; and

(ii) acts or transactions performed/entered into after the initial date of the insolvency trigger

During the bankruptcy proceedings, the court determines the initial date of the insolvency trigger. The court is entitled to backdate the initial trigger, so the initial date of the insolvency trigger may precede the commencement of the insolvency proceedings by two or more years.

The following transactions concluded after the initial/commencement date are considered null and void as against the insolvent company's creditors:

- discharge of monetary obligation;
- gratuitous transactions with assets of the insolvency estate;
- creation of any security interest in assets of the insolvency estate; or
- undervalue transactions with assets of the insolvency estate.

Challenging of transactions

The insolvency administrator or creditors of the insolvency estate are entitled to request that certain acts and transactions, effected by the company, be declared invalid, including in particular:

(i) any gratuitous transaction, except for an ordinary gift, entered into within a period of two years prior to the date of the court decision for the commencement of insolvency proceedings. Where the transaction is between related parties the suspect period is longer (three years prior to the date of the court's decision to commence insolvency proceedings);

(ii) transactions at an undervalue, entered into within two years prior to the commencement of insolvency proceedings;

(iii) repayment of a monetary obligation by transfer of property, effected within three months prior to the initial date of insolvency, where the return of the property could result in an increase in the amount to be received by the creditors;

(iv) mortgaging, pledging or providing other security in favour of a previously unsecured claim, effected within one year prior to the start of the insolvency proceedings;

(v) mortgaging, pledging or providing other security in favour of a previously unsecured claim of a partner or shareholder, effected within two years prior to the start of insolvency proceedings; or

(vi) a transaction effected within two years prior to the start of insolvency proceedings, where a party related to the debtor is party to the transaction, which prejudices the creditors.

/
Denitsa Doudevska
CMS Cameron McKenna, Sofia
E *denitsa.dudevska@cms-cmck.com*
/
Teodora Ivanova
CMS Cameron McKenna, Sofia
E *teodora.ivanova@cms-cmck.com*

RECENT COURT DECISIONS AND THEIR CONSEQUENCES

Recently the courts have adopted several decisions influencing Czech insolvency practice (which is regulated by the Insolvency Act No. 182/2006 Coll.). Some consequential changes to the Insolvency Act have already come into effect, while others will become effective later due to their expected greater impact on legal practice.

Two of the four court decisions discussed in this article were adjudicated in the Constitutional Court of the Czech Republic, which is authorised to repeal laws and parts thereof in the event that they are found to be contrary to the Constitution of the Czech Republic. The remaining court decisions were heard in the High Court and Supreme Court of the Czech Republic.

Repudiating right of creditors

The first decision, published under No. 241/2010 in the Collection of Laws of the Czech Republic, repealed the first sentence of Section 192 of the Insolvency Act due to its inconsistency with the Constitution, and in particular with Article 36 of the Charter of Fundamental Rights and Freedoms. Article 36 states that every person has the right to seek protection of his/her/its rights by way of court proceedings (or proceedings under a different institution). The repealed provision contained a list of persons who were entitled to repudiate creditors' claims and raise objections to them. Only the debtor and the insolvency trustee may have repudiated the authenticity, amount (i.e. value) and ranking of submitted claims, while individual creditors were not granted this right. The lack of a so called "repudiating right" of creditors to object to claims of other creditors was the subject matter of the raised legal action, and was found to be unconstitutional as it eliminated the fundamental right of all persons to seek protection in court proceedings (or under a different institution). As a result, this provision created an unlawful advantage for certain parties, and at the same time caused unjustifiable harm to others. The repeal comes into effect on 31 March 2011 and the Ministry of Justice of the Czech Republic has already prepared an amendment to the Insolvency Act granting the repudiating right to creditors to reflect the opinion of the Constitutional Court.

Discharge from debts

The second notable ruling of the Constitutional Court (No. 260/2010 Coll.) became effective on the day of its publication. It relates to "Discharge from debts", a form of insolvency solution for debtors who are not entrepreneurs (usually consumers) to be relieved from debts. It should be noted that the rights of creditors may be affected as well. The Constitutional Court repealed a part of Section 399, Subsection 2 of the Insolvency Act, due to its inconsistency with the Constitution. The respective part imposed an obligation on the debtor to personally attend the meetings of the creditors or provide an apology for non-attendance. If the debtor failed to do so, or if the court found the apology unfounded, the petition for discharge from debts was deemed to be withdrawn and the debtor was declared bankrupt. The Court found this provision to be in conflict with the basic principle of civil procedure: the right to dispose of the proceeding and of the subject matter of the proceeding (to carry out all legal acts necessary to proceed with any type of civil proceedings).

Neither the right to withdraw, nor any other "disposition right" may be "deemed". It may not be deemed that the debtor withdrew the petition when in fact he had not. Moreover, such withdrawal has not only procedural, but also substantive effects for both the debtor and the creditors, and therefore the use of legal fiction in this case is unconstitutional. Even before this particular decision, the Constitutional Court had already ruled unconstitutional (and repealed) part of Section 394, Subsection 2 of the Insolvency Act relating to Discharge from debts, which denied the right to appeal such a resolution on withdrawal of petition to discharge from debts arising out of legal fiction under the then valid Section 399, Subsection 2 (now repealed). The provision had been found to conflict with the right to fair process.

Receivables against a debtor

A resolution of the Supreme Court of the Czech Republic (29 Cdo 2090/2007 from 20 May 2010) overruled a decision of a lower court, stating that where a creditor has a receivable against a debtor, and such receivable can be satisfied either by court enforcement or by execution proceedings, such creditor may not succeed with its insolvency petition against the debtor, and if such petition is filed, it must be dismissed.

Majority creditors' rights in insolvency proceedings

Finally, a breakthrough decision of the High Court in Olomouc, upheld a previously controversial decision of the Regional Court in Brno regarding the rights of majority creditors in insolvency proceedings. In the case, Česká spořitelna, a Czech bank and the majority creditor of OP Prostějov (the debtor, a textile company) due to loan financing was denied the right to attend and participate (in particular to vote) in the creditors' committee. According to both courts, the terms of the loan contract between the bank and the debtor greatly exceeded the regular creditor-debtor duties and gave the bank the ability to control the debtor, hence actually corresponding to relations between controlling and controlled parties under the Commercial Code of the Czech Republic. The bank was, therefore, found to be acting as the owner of the debtor rather than as a regular creditor.

It was found unacceptable that the bank would be able to control the insolvency proceedings and force the debtor to act in a way that would improve the situation of the bank in the proceedings at the expense of other creditors. Furthermore, the bank may not have been a member of the creditors' committee because there were doubts about its impartiality and objectiveness due to the existence of control relations.

The High Court did not uphold the Regional Court's decision that the bank, as the majority creditor, and the debtor form the concern (syndicate), but neither did the High Court overrule that part. Instead, the ruling is silent in this area. While the position of Česká spořitelna in this particular insolvency proceeding is still exceptionally good in comparison with other creditors due to heavy securitisation of their loans (giving the bank a first priority ranking over secured assets), the decision is likely to greatly affect the practice of banks as loan providers. Since the majority of loan contracts contain provisions close to those establishing controlling relations, banks will need to reflect the court interpretation of this issue and change the terms of the contracts or take other measures to avoid similar loss of rights in insolvency proceedings.

While it is clear to most people that banks do not intend to control the debtors by providing finance to them and really only seek repayment of the loans, the court's decision must be taken into account. Česká spořitelna has also filed a constitutional complaint to the Constitutional Court with respect to the primary resolution of the Regional Court in Brno denying the bank the right to participate and vote in the creditors' committee. The bank alleges that the decision of the Regional Court (at the time of filing the complaint not yet upheld by the High Court) breaches the constitutional rights to fair process and to owning the property. The action is currently pending but it will be of great interest should the Constitutional Court hear the case.

As the above resolutions and decisions illustrate, the Insolvency Act is still subject to judicial interpretation and fledgling case law. As many unresolved and controversial provisions and issues remain, we can probably expect more court proceedings in the future.

/
Patrik Przyhoda
CMS Cameron McKenna, Prague
E *patrick.przyhoda@cms-cmck.com*
/
Helen Rodwell
CMS Cameron McKenna, Prague
E *helen.rodwell@cms-cmck.com*

DECLARATION OF CLAIMS IN FRENCH INSOLVENCY PROCEEDINGS: A TRAP FOR EUROPEAN CREDITORS

All creditors (other than employees) of a debtor subjected to French insolvency proceedings must declare their claims within two months from the publication of the judgment opening the proceedings in the *Bulletin Officiel des Annonces Civiles et Commerciales* (*"BODACC"*, a specific legal gazette). Creditors not domiciled in France are granted a two month additional period to file their claim (i.e. a total of four months). The starting point of this period of time may be different in specific circumstances.

This declaration of claims, which must comply with strict formal requirements, must be sent to the court appointed *Mandataire Judiciaire* (acting as the creditors' representative). The declaration must detail, in particular, all the claims against the debtor which exist at the date of the opening of the insolvency proceedings, the cause of their existence, the supporting documentation and the collateral guarantees. It must be signed by the creditor, or a validly empowered representative of the creditor.

In practical terms, failure to properly declare a claim in compliance with the applicable rules will exclude the creditor from participating in the allocation of funds and distribution of dividends.

The declaration of claim is the first fundamental step to be taken by a creditor of the insolvent company to preserve its rights in the insolvency proceedings, and it must be drafted with the utmost care. It is easy for a creditor, and especially for a foreign creditor, to fall into one of several traps, among which is the issue of power to execute and file a declaration of claims.

An interesting decision of the French Supreme Court has recently been rendered on this issue.

French rules governing the power to execute a declaration of claims

The declaration of claim is a legal action (supported by an eponymous document) and as such must, for a legal entity, be signed and certified by one of the following persons:

(a) either the legal representative of the company having power to act on behalf of the company with regard to third parties (i.e. its President or General Manager, depending on the legal type of company); or

(b) a person duly and specifically empowered by him to do so, in which case evidence of the proxy has to be provided together with the declaration (with stricter rules for persons other than employees of the creditor).

The "préposé" (i.e. employee benefiting from a delegation of power acting as agent of the company)

An employee of the creditor can be empowered to declare claims through the means of an appropriate and specific delegation of authority.

This delegation must be written and it must specifically include a delegation of the power to act on behalf of the company before the Courts, and better still, with mention of the declarations of claims in insolvency proceedings. The delegator can only delegate its own powers. It is permissible, if the same conditions are satisfied, for a sub-delegation to exist.

The "mandataire" (i.e. third party "outsider" to the company)

Secondly, a third party "outsider" to the company (i.e. not an employee) may be empowered to act on the creditor's behalf, unless this person is an *"avocat"* (a French attorney). This kind of delegation must be established by way of a specific proxy, who must respect the conditions of the delegation to appear before a court.

In such a case, the power to declare claims in the insolvency proceedings of the debtor must be written, and mentioned expressly and specifically in the delegation.

French case law has held that the proxy must be established before the declaration is made, and sent to the *Mandataire Judiciaire* with the declaration or at least within the limited period of time allotted to file the declaration.

An *avocat* can also sign the declaration, without having to provide a proxy.

Implementation of the French rules in the European context

Article 4§2 of the Council regulation No 1346/2000 provides that:

> *"Law applicable*
> *…*
> *2. The law of the state of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure. It shall determine in particular:*
> *…*
> *(h) The rules governing the lodging, verification and admission of claims."*

Accordingly, if the proceedings are opened in France, French rules (i.e. *lex concursus*) shall determine the conditions of the declaration of claims. No distinction is made as to whether the creditor is a foreign European company or not.

A conflict of laws may then appear between French law and the *lex societatis* of the foreign European company. This is the subject matter of a recent decision rendered by the Commercial chamber of the French *Cour de Cassation* (Cass. com., June 22nd, 2010, n° 09-65.481, n° 696, F-P+B, Sté Danieli Corus b.v. et a. c/ Sté Agintis et a.: JurisData n° 2010-010047) confirming an earlier ruling on the same question (Cass. Com., December 15th, 2009, n° 08-14959, Bull. Civ. n° 164).

Facts of the case

Insolvency proceedings *("redressement judiciaire")* were opened against a French company. An agent of a Dutch creditor company filed the relevant declaration f claims.

The agent had obtained from the General Manager of the company a general delegation of powers including the power:

(a) to represent the company in relation to any question or operation; and

(b) to sign and send any document in relation to the activity of the company.

The power to sue or to declare claims in insolvency proceedings was not clearly mentioned, since it is not required under Dutch law.

Under Dutch law, the agent was duly empowered to file a declaration of claims.

Ruling of the Cour de Cassation

However, the French *Cour de Cassation* decided that this proxy did not comply with French insolvency rules relating to the required power to declare claims. Consequently, the declaration of the agent was held invalid, and the declaration of claims was rejected.

The Court's reasoning was as follows:

(i) the *lex societatis* defines the scope of the proxy;

(ii) the *lex concursus* (French law in this case) defines a valid delegation of power to declare the claims; and

(iii) if the delegation of powers does not comply with the formal requirements of French law, the declaration of claim is invalid.

As a result, a proxy must comply with both regulations of the *lex societatis* and *lex concursus.*

To avoid the risk of rejection of claims on these grounds, it seems advisable for a foreign company to instruct a French avocat to execute and file its declaration of claims on its behalf. This appears a simple way to avoid falling into the trap created by this recent and debatable case law.

/
Alexandre Bastos
CMS Bureau Francis Lefebvre, Paris
E *alexandre.bastos@cms-bfl.com*
/
Daniel Carton
CMS Bureau Francis Lefebvre, Paris
E *daniel.carton@cms-bfl.com*

HOW GERMAN INSOLVENCY PROCEEDINGS CAN SUCCEED BY MEANS OF AN INSOLVENCY PLAN

On 30 September 2010, insolvency proceedings over the assets of Karstadt Warenhaus GmbH ("Karstadt") were finally lifted and one of the biggest insolvency cases in Germany to date came to an end. The proceedings have shown on the one hand how the insolvency plan proceedings introduced to German insolvency law in 1999, can work successfully and on the other hand what difficulties can be encountered on the way to restructuring an insolvent company.

In June 2009, Karstadt, its parent company Arcandor and several other group companies including Quelle, had filed for insolvency with the court in Essen. Attempts to restructure the group avoiding insolvency had failed as METRO, one of the world's largest retail conglomerates, was willing to take over some, but not all, of Karstadt's locations and the German government had rejected the request for a loan guarantee.

As is usual in German insolvency proceedings, it then took some time until the court formally declared Karstadt insolvent on 1 September 2010. Until then, Klaus Hubert Görg as preliminary insolvency administrator had the option to allow Karstadt to continue its business and generate some profit. The phase of preliminary insolvency proceedings is especially advantageous in this respect as VAT need not be paid and will only be an unsecured claim in the later proceedings. Also, employees can receive payment from the Bundesagentur für Arbeit (German employment authorities) who can then only claim such payments as an unsecured creditor in the later proceedings.

During the proceedings, the insolvency administrator was optimistic he would be able to find an investor. Therefore, an insolvency plan was presented to the creditor's assembly in April 2010. For the unsecured creditors the plan offered a dividend of merely 3% of their claims. There was however a major precondition for the plan to become valid; an investor must be found to take over all, or most of, the business of Karstadt and therefore save as many employees as possible.

At the time he drafted the insolvency plan, Görg was planning to finish the sales negotiations by the end of April. However, the process developed slowly and in June 2010, nearly exactly one year after the filing for insolvency, the contract with investor Nicolas Berggruen was signed. However, this contract also included preconditions and the most formal was the requirement of the cartel authorities to give their consent to the plan. The real issue, however, was that Berggruen needed to come to an agreement with the Highstreet consortium (owner of most of the department store buildings) who were not willing to significantly reduce the high rents accepted by Karstadt in the past. The negotiations between Berggruen and Highstreet took time and the insolvency court had to postpone its final decision on the insolvency plan.

The court finally confirmed the plan on 3 September 2010 after Berggruen informed Görg of his agreement with Highstreet, satisfying the precondition and therefore validating the contract on the sale of Karstadt.

With the court's decision the end was in sight, but the German insolvency act still gives creditors the opportunity to raise objections against an insolvency plan after the court's decision. If the objections are founded this can destroy the insolvency plan or at the very least can cause a substantial delay. Two creditors exercised their right to bring an appeal and could have prevented the taking over of the company by Berggruen with the end of the proceedings on 30 September 2010. Informal and internal discussions between those creditors and Berggruen commenced and Berggruen was reportedly able to convince the two appellants to revoke their appeal so that on 30 September 2010 at 08.05 pm the insolvency court declared the end of the proceedings.

As reported in earlier editions of this Newsletter, there are currently changes in insolvency law being discussed that may have some effect on future insolvency plan proceedings. On the one hand, the creditors' right to appeal against the confirmation of an insolvency plan will probably no longer delay the plan becoming effective in the future, and the appellant will only be entitled to damages if he can prove that he would have been financially better off in normal insolvency

proceedings (i.e. without the plan). This will help to put insolvency plans into practice where there are some opposing creditors and is part of the initiative to facilitate the restructuring of insolvent companies by means of an insolvency plan.

On the other hand, as a means to increase budgetary revenues there are plans to have insolvent companies pay the full amount of the VAT that accrues during preliminary proceedings. While the rescue of Karstadt would have been unlikely to fail purely based on these VAT payments, there may be other situations in which the liquidity generated during the preliminary proceedings is just what is needed to find a solution for the continuation of the debtor, or at least its business in the proceedings.

/
Rolf Leithaus
CMS Hasche Sigle, Cologne
E *rolf.leithaus@cms-hs.com*
/
Anne Deike Riewe
CMS Hasche Sigle, Cologne
E *anne.riewe@cms-hs.com*

// ITALY

LEASES AND BANKRUPTCY PROCEDURES

As a general rule, under Article 72 of the Italian Insolvency Law (as amended), whenever a party of an existing contract is adjudicated in bankruptcy, the performance of the contract is suspended until the receiver in bankruptcy, with the authorisation of the creditors' committee, decides to maintain or terminate the contract.

The counterparty may ask the Bankruptcy Judge *("Giudice Delegato")* to fix a term not longer than 60 days for the receiver to decide whether or not to maintain the contract in lieu of the bankrupt party. Upon expiration of any fixed term, the contract is deemed to be terminated.

Article *72 quarter* of the Italian Bankruptcy Law sets forth specific provisions for financial lease agreements in cases of declaration of bankruptcy of the lessee or the lessor. We are now, for the first time, seeing a discussion of the law in this area in the Italian courts.

In the case of the insolvency of the lessee, the general principle under Article 72 of the Bankruptcy Law applies. However, in the event that the receiver of the lessee in bankruptcy opts for the temporary continuation of the business of the insolvent company, the leasing contract is automatically maintained unless the receiver in bankruptcy expressly terminates it.

In the case of termination of the contract following the bankruptcy of the lessee, the lessor is entitled to claim restitution of the leased assets and it has to pay to the receiver the positive difference (if any) between the proceeds deriving from the sale of the leased assets at a market value and the debts owed by the lessee. Should the proceeds of the sale of the leased assets not cover the outstanding debt of the lessee, the lessor is entitled to file a claim against the bankruptcy estate.

With regards to rental payments already made by the lessee, the relevant payments are not subject to claw back actions by the receiver pursuant to Article 67 paragraph 3 lett a) of the Italian Insolvency Law.

If the lessor is adjudicated in bankruptcy, the lease does not terminate. In this case, the lessee is empowered to purchase the leased assets upon expiration of the contract after payment of the remaining rents as well as the agreed purchase price. Therefore, in contrast to the case of bankruptcy of the lessee, in the case of bankruptcy of the lessor the receiver has no choice to continue the contract or to terminate it.

/
Paolo Bonolis
CMS Adonnino Ascoli & Cavasola Scamoni, Rome
E *paolo.bonolis@cms-aacs.com*

INEFFECTIVENESS OF A BANKRUPT'S TRANSACTIONS WITH RESPECT TO THE BANKRUPTCY ESTATE

The essential goal of bankruptcy proceedings is to achieve the fullest satisfaction of creditors' claims against an insolvent debtor as possible. There are certain provisions included in the Polish Bankruptcy and Rehabilitation Law designed to achieve such a goal. The regulations on the ineffectiveness of a bankrupt's transactions towards the bankruptcy estate that result in the deterioration of a creditor's position in bankruptcy proceedings are of key importance in this respect, and will continue to be of interest over the coming months. In this article, we explain the essence of the regulations.

The Polish Bankruptcy and Rehabilitation Law provides that certain transactions of a bankrupt, performed within a defined period before the submission of a bankruptcy petition, are affected by the sanction of ineffectiveness. As a consequence, items by which the bankruptcy estate has been reduced or items that have been excluded from the bankruptcy estate as a result of a bankrupt performing the transactions referred to above, should be transferred back to the bankruptcy estate in kind, or, where such transfer is impossible, an equivalent sum should be given to the bankruptcy estate. At the same time, the other party to such a transaction may request that the bankruptcy trustee returns the consideration for the transaction (if it is held in the bankruptcy estate separately from other assets or in a case where the bankruptcy estate has been enriched by such consideration).

Depending on the kind of transactions performed by a bankrupt, the sanction of ineffectiveness may be applicable either pursuant to a decision issued by a bankruptcy judge or by virtue of law. For example, the following transactions may be deemed ineffective by way of a decision by a bankruptcy judge:

(i) remuneration for work performed by a person representing a bankrupt for the period no longer than six months prior to the date of the submission of a bankruptcy petition, insofar as it grossly exceeds an average remuneration for work of such kind; and

(ii) the encumbering of the estate with a mortgage, pledge or registered pledge in a situation where a bankrupt was not a personal debtor of the secured creditor and the bankrupt's asset was encumbered within the year before the date of the submission of a bankruptcy petition, and the bankrupt received no consideration in connection with such encumbrance.

The transactions below, among others, are ineffective by virtue of law:

(i) transactions performed by a bankrupt within the year before the submission of a bankruptcy petition consisting of the disposal of assets made free of charge or against consideration, insofar as the value of the bankrupt's performance grossly exceeds the value of consideration received by a bankrupt or reserved for himself or for a third party; and

(ii) transactions performed within six months before the submission of a bankruptcy petition by a bankrupt being a company with its shareholders, representatives, as well as with its affiliated companies, their shareholders, representatives or spouses of such persons and other companies, if one of them is a dominant company.

In practice, the last of the situations mentioned above (i.e. a legal transaction performed by a bankrupt company with its affiliated companies) is of key importance. Regulations in this respect are very rigid and provide that all such transactions effected within six months before the submission of a bankruptcy petition are ineffective. Therefore, it is irrelevant for the legal assessment of the effectiveness of the agreement entered into by a bankrupt and its affiliated companies whether the considerations exchanged between the parties were of equal or comparable economic value. Consequently, a legal transaction (e.g. an agreement) under which a bankrupt suffered no damage or even increased its assets will also be deemed ineffective by the operation of law. It is also worth emphasising that the six month period for performing the transaction relates to the date of the legal transaction itself (e.g. the entering into an agreement) and not the performance contemplated by the transaction. Therefore, if an agreement was entered into eight months before the submission of a bankruptcy petition, but it was performed five months before that date, it remains fully valid and effective.

An interesting example of the problems discussed above is a situation where during a six month period before the submission of a bankruptcy petition, a daughter company increases its share capital and a parent company, in consideration for taking up shares in the increased share capital of its subsidiary, contributes receivables due to it from a daughter company. In light of the bankruptcy regulations, such conversion of debt into share capital will be deemed ineffective. A bankruptcy trustee administering the estate of a parent company would have the right to demand the inclusion of funds (receivables) contributed for the share capital of the daughter company into the bankruptcy estate. At the same time, the daughter company would be entitled to demand from the bankruptcy trustee the release of relevant shares only if such shares are separate from other assets forming the bankruptcy estate, or they have enriched the bankruptcy estate. Otherwise, the daughter company could submit its claim during bankruptcy proceedings on a general basis (on the basis of a groundless enrichment of the bankruptcy estate). From a practical point of view, a key problem is the assessment of upon the occurrence of what event are the shares subject to release included in the bankruptcy estate "separately from other assets". As there is no court judgement in this respect, the interpretation of the said provision is unclear.

The regulations discussed in this article, despite certain difficulties with interpretation, have a major influence on the security of the bankrupt's creditors. What is more, they are not exhaustive and in situations where the sanction of ineffectiveness is not applicable on the grounds of the Bankruptcy and Rehabilitation Law (due to a failure to meet certain requirements regarding factual circumstances), the creditors (but also, among others, the bankruptcy trustee) may demand that a doubtful transaction be deemed ineffective on the basis of the general provisions of the Polish Civil Code regarding the protection of creditors' rights in the event of debtor insolvency.

/
Małgorzata Chruściak
CMS Cameron McKenna, Warsaw
E *malgorzata.chrusciak@cms-cmck.com*
/
Anna Tomalska-Wcislo
CMS Cameron McKenna, Warsaw
E *anna.tomalska-wcislo@cms-cmck.com*

CLARIFICATION ON THE SCOPE AND APPLICATION OF PRE-INSOLVENCY WORK-OUT PLANS

In December 2009, the Romanian Parliament enacted Law 381/2009 on pre-insolvency work-out plans *("Concordat Law")* in an attempt to provide a rescue scheme as an alternative to the regular court-led reorganisation route for the increasing number of Romanian companies facing impending insolvency.

The Concordat Law is a step towards creating a rescue scheme that enables companies capable of restoring their business to avoid the downsides of court-led restructurings. Nevertheless, this law is some way from achieving its aim, primarily because it does not integrate well with Law 85/2006 on insolvency *("Insolvency Law")*.

This article explores the relationship between the Concordat Law and the Insolvency Law, and the issues affecting the position of creditors in work-out plans.

Work-out plans v. court-led reorganisations

A company must be in a state of financial distress but not insolvent in order to be eligible for a work-out plan.

The Concordat Law defines a company as in a state of financial distress if that company: (i) shows a decreasing capability of managing its business; and (ii) is actually performing (or is still capable of performing) its due obligations. This definition is problematic for two reasons. Firstly, it provides no mechanism for assessing the actual capability of a company to manage its business and repay its debts. Secondly, whilst the Insolvency Law sets-out three distinct stages of corporate insolvency, the Concordat Law does not indicate at which of these stages a company in financial distress can still enter a work-out plan.

Under the Insolvency Law, the three stages of corporate insolvency are as follows:

(i) a company is facing impending insolvency if it will not have the funds available to repay its outstanding debts;

(ii) a company is in a state of presumed insolvency if it does not discharge a debt owing to one of its creditors within 90 days of that debt falling due. However this presumption can be rebutted by the discharge of the debt; and

(iii) a company is declared insolvent by court upon the examination of a request brought either by the company or by one or more of its creditors. From this point onwards that company is under the restrictions set out in the Insolvency Law and its creditors will decide on how to recover their claims.

There would appear to be an overlap between the state of impending insolvency (and possibly the state of presumed insolvency) under the Insolvency Law, and the state of financial distress under the Concordat Law. However, there is no clear indication in the legislation as to which of the stages of insolvency applies to a company in financial distress.

Therefore, it is possible that a judge would dismiss a petition by a company to enter into a work-out plan if scrutiny

of its financial standing revealed that the company is in a state of impending insolvency or presumed insolvency. In this scenario, the company would be prevented from entering into a work-out plan under the Concordat Law and instead would have to proceed with a court-led reorganisation governed by the Insolvency Law.

A more sensible judicial approach would be to refer to the state of declared insolvency as a benchmark when considering a petition to enter a work plan. Such an approach would enable a company facing impending insolvency or in presumed insolvency to benefit from a work-out plan. Furthermore, some have argued that changes in the law should be made so that the initiation of the insolvency procedure is conditional on the company and its creditors having tried and failed to enter a work-out plan.

The treatment of creditors under the Concordat Law

The Concordat Law has been criticised for not providing a robust framework for a negotiation or encouraging a cooperative process within work-out plans.

The Concordat law fails to provide guidelines on the restructuring or the priority of existing claims and instead imports measures akin to those found in a court-led reorganisation, such as a stay in the accrual of interest, a stay of enforcement procedures and termination of on-going contracts of personnel. These sorts of measures can be detrimental to the interests of creditors and may provide creditors with a disincentive to reaching an agreement under a work-out plan.

Of all creditors, the lenders' position appears to be worse under the Concordat Law than in a court-led reorganisation for the following reasons:

(i) the acceptance by the creditors (including lenders) of a work-out plan in the form of a settlement agreement ("concordat") triggers an automatic stay in the accrual of interest, penalties and generally all expenses due by the company in financial distress in relation to their claims. This contrasts with a court-led reorganisation where creditors agree in the plan upon the specific treatment of their respective claims; and

(ii) all claims must be repaid within 18 months of the date on which the concordat is agreed (with the possibility of a 6 month extension), and this inflexibility may hinder any attempts to agree a concordat.

Another issue to be considered is that the Concordat Law requires approval by at least 80% of the creditors for a concordat to be valid. This majority can be very difficult to achieve in practice, particularly in the case of companies that have a large number of creditors with small claims.

Furthermore, the Concordat Law, unlike the Insolvency Law, gives no recognition to the different categories of creditors. For example, claims held by unsecured creditors are given equal weight as those held by secured creditors. This is an issue which needs to be addressed in any future amendments to the Concordat Law.

Conclusion

The legislative regime in Romania does not provide a clear indication of the point at which a company is no longer in a state of financial distress but has entered a state of insolvency. Legal reform should allow work-out plans to continue to be available to companies throughout the entire course of a reorganisation.

/
Alina Tihan
CMS Cameron McKenna, Bucharest
E *alina.tihan@cms-cmck.com*
/
Mihai Ivanescu
CMS Cameron McKenna, Bucharest
E *mihai.ivanescu@cms-cmck.com*

DRAFT BILL FOR THE REFORM OF INSOLVENCY LAW

The Spanish Ministry for Justice is currently working on a draft bill which would (if approved) be the second reform to the Spanish Insolvency Law within eighteen months. The bill proposes many reforms, mainly procedural in nature, with the aim of adapting the Insolvency Act to the current realities affecting companies.

The main objective of the reform (which is still in its initial procedural stage) is to ensure companies which are in a situation of insolvency, but which have the capacity and resources to exit from the same, will not have liquidation as the sole option at the time of requesting insolvency and may refloat. This would mean that the administration and management of insolvent companies would not necessarily depend on the courts, which operate at a much slower pace than the market.

Currently, almost nine out of ten companies which request insolvency are unable to avoid liquidation, and it is exactly this which the reform seeks to prevent, offering companies the possibility of restructuring themselves prior to requesting insolvency. Some of the most significant reforms proposed in the draft bill include:

— amendment of the *"pre-insolvency"* regulation: This aims to prevent abuse of the possibility granted to companies of negotiating with their creditors when a situation of insolvency is detected, in order to avoid an insolvency request by means of an early agreement proposal. Under the new regulation, once negotiations have begun, insolvency must be requested in all cases, apart from where it can be shown that a state of insolvency no longer exists. The powers of the company to negotiate a possible refinancing with credit organisations are widened by the draft bill;

— amendment of the regulation relating to the request for "necessary insolvency": The alleged fact which gives rise to the insolvency must be declared. This involves a direct insolvency declaration (without the need to expedite the debtor to formulate opposition, to which it may object within a period of ten days following the insolvency declaration) when the request is based on an unsuccessful embargo or enquiry request, or which has given rise to a legal or administrative declaration of insolvency;

— regulation of related insolvencies: This permits a joint declaration of insolvency by various debtors and the accumulation of insolvencies which have already been declared, at the request of a debtor or a creditor. A sole insolvency administration will be appointed and, in cases of the accumulation of insolvencies already declared, just one of the insolvency administrations will be maintained. This is aimed at a coordinated processing of the insolvencies without consolidating the respective active and passive masses of the debtors;

— amendment of the subjective conditions for the appointment of insolvency administrators: This lifts the requirement of 5 years' professional experience. However, experience in insolvency matters must be proven;

— the Insolvency Administration Report: This must include, where appropriate, the Liquidation Plan. Prior to publication, it will be communicated to the creditors in order that they may make statements, and subsequently will be presented in court (this aims to avoid an excessive volume of insolvency incidents);

— new privileges are granted to certain insolvency credits: Widening of the privilege of a creditor who claimed for the "necessary insolvency", to up to 50% of the total amount of credit. There is also a granting of a general privilege to certain Social Security and Inland Revenue credits for civil liability arising from an offence;

— the qualification section will be opened in all cases, apart from when an early proposal agreement has been reached. The qualification will also affect the empowered representatives and not only the directors in fact and in law;

— termination of the insolvency due to insufficient assets may be declared at any time, even in the same resolution granting the insolvency request;

— the reopening of the insolvency may be agreed in the event of breach of the agreement, and certain payments which have already been made may be revoked; and

— total amendment of the regulation of the *"abbreviated insolvency"*: An insolvency will be processed as abbreviated when there are less than fifty creditors and there is less than EUR 5 million of debt.

/
Juan Ignacio Fernández Aguado
CMS Albiñana & Suárez de Lezo, Madrid
E *juanignacio.fernandez@cms-asl.com*

RECENT DEVELOPMENTS IN THE NETHERLANDS

The consequences of the economic downturn have also been felt in The Netherlands, although the downturn did not result in any new legislation in respect of insolvency proceedings. Over the last few years a special committee has reviewed the Dutch Bankruptcy Code of 1897 *(Faillissementswet)* and has provided a draft for a completely renewed Insolvency Act. This draft has been, and is still being, debated in Dutch legal literature, but it is not expected that a new Act will be implemented in the foreseeable future. The special committee has now been dissolved and the old Bankruptcy Code will remain in force without any amendment.

The economic downturn did however result in new legislation and government measures to address certain specific issues. For example, in an attempt to stimulate the building industry, the Dutch government has implemented the "Crisis- en Herstelwet" which came into force on 31 March 2010. This Act aims to speed up administrative procedures that may delay the commencement of infrastructure projects, such as the renewal of motorways.

To provide financial relief to businesses in economic distress, we have seen temporary measures that allow an employer to temporarily reduce its workforce in a situation of overcapacity. In such a situation, the released employees were paid, over a certain period of time, by the Dutch social security institutions. Furthermore, businesses have been given the option to delay the payment of certain taxes, for example VAT *(omzetbelasting)*.

It is expected that in the near future a Parliamentary Investigation *(Parlementaire Enquete)* will be started to review the causes of the downfall of Dutch banking institutions, and the involvement of the Dutch government and supervisory institutions like the Dutch Central Bank *(DNB)* and the Authority for Financial Markets *(AFM)*.

Recent Dutch case law on the European Insolvency Regulation ("EIR")

In the last year, noteworthy Dutch court rulings have been published in respect of the EIR. Below, we provide a brief summary of some of these rulings.

The district court of The Hague had to decide upon a request of two people to be admitted to the *wettelijke schuldsaneringsregeling natuurlijke personen,* one of the insolvency procedures mentioned in Annex A to the EIR. The individuals resided in Germany for almost ten years until approximately 2006. The Dutch courts had to decide whether the centre of main interest of the individuals was located in Germany or The Netherlands as they had relocated to The Netherlands without providing information of their whereabouts to their creditors. Before filing the application in respect of the applicable insolvency procedure, an advisor seeking to conclude a voluntary debt restructuring scheme with the German creditors involved informed these creditors in 2009 about the relocation of the two individuals. As a result, the court ruled that the creditors had been informed of the place where the debtors conducted the administration of their interests on a regular basis, and that their centre of main interests was therefore ascertainable by their creditors. On that basis the court

decided that it was competent in this matter. Nevertheless, the court denied the opening of this specific insolvency procedure for other reasons. (Court The Hague, 21 September 2010, *LJN* BN9606).

In the insolvency proceedings of the Greek airline Olympic Airlines, the court of Haarlem had to decide on the opening of secondary proceedings in The Netherlands in respect of its Dutch establishment. The employees of Olympic Airlines in The Netherlands argued that no legal basis existed to open insolvency proceedings against the Dutch establishment, since it was able to meet its obligations. The court ruled in accordance with article 16 of the EIR that the decision of the Greek court in respect of the opening of a main insolvency procedure was binding and that such a decision had to be recognised. The employees argued on the basis of article 26 of the EIR that the Dutch court could not recognise the Greek procedure since the effects of such recognition or enforcement would be manifestly contrary to Dutch public policy, since apparently no appeal against the decision to open a main procedure had been possible in Greece. The court ruled that article 26 of the EIR could only apply under very special circumstances, and that under the current circumstances the fact that no appeal had been possible in Greece was not sufficient to deny recognition of the Greek insolvency proceeding. (Court Haarlem, 7 September 2010, *LJN* BN9813).

In the Dutch bankruptcy of a limited liability Belgian company (Movietech BVBA), the court of Dordrecht had to decide whether a Belgian director who also resided in Belgium could be held liable for the complete deficit in the bankruptcy on the basis of specific provisions of the Dutch Civil Code in respect of Dutch private companies with limited liability. The specific provisions are only applicable in case of bankruptcy and can only be invoked by a court appointed administrator (curator). The court ruled that the claim fell within the scope of article 4 of the EIR, which provides that the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened (lex concursus). The claim against the director was the result of an insolvency procedure and it was invoked by the administrator. Furthermore the court referred to the Dutch Act Wet Conflictenrecht Corporaties that stipulates that a similar provision in respect of the liability of directors of public companies *(naamloze vennotschappen)* is applicable on foreign companies. A director of a foreign company in the Netherlands should therefore be aware that not only specific provisions of the law of that foreign company are relevant in respect of his (potential) liability, but Dutch law provisions are also relevant. (Court Dordrecht, 3 February 2010, *LJN* BL2214).

The Dutch Supreme Court (Hoge Raad) had to rule in respect of the interpretation of article 15 and article 4 sub-paragraph 2(f) of the EIR. In this matter a claim to pay an amount of approximately EUR 5 million had been filed before a Dutch court by a Dutch bank against a public company under the laws of Belgium. During the court proceedings, the Belgium company was declared bankrupt in Belgium. The question arose of what effect, if any, that bankruptcy had on the court proceedings in The Netherlands. Under Dutch insolvency law, the court proceedings would be suspended and the bank would have to file its claim for verification purposes with the administrator. Only in the event that the claim is rejected by the administrator, the court proceedings will continue. Pursuant to article 15 of the EIR, solely the laws of the Member State in which that lawsuit is pending shall govern the effects of insolvency proceedings on a pending lawsuit concerning an asset or a right of which the debtor has been divested. The Supreme Court referred to an explanation of the Dutch Minister of Justice in which it is mentioned that it is uncertain whether article 15 of the EIR is also applicable to monetary claims, as opposed to claims in respect of assets or rights. The Dutch Minister of Justice specifically referred to article 4 sub-paragraph 2(f) of the EIR pursuant to which the lex concursus determines, in particular, the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of pending lawsuits. Therefore, the Supreme Court ruled that Dutch law was applicable in establishing the consequences of the Belgian bankruptcy on Dutch court proceedings. If not applicable on the basis of article 15 of the EIR, then it would certainly be applicable due to the exception to the lex concursus of article 4 sub-paragraph 2(f) of the EIR. Accordingly, no questions were posed to the European Court of Justice on the interpretation of article 15 of the EIR. (Hoge Raad, 11 December 2009, *LJN* BK0867).

/
David Bos
CMS Derks Star Busmann, Utrecht
E *david.bos@cms-dsb.com*

MISS SIXTY CVA MISSES THE MARK

Guarantees given by Sixty SpA to English landlords should not have been compromised in the CVA of its English subsidiary without adequate compensation

Mourant & Co Trustees Limited, Mourant Property Trustees Limited v Sixty UK Limited (in Administration), Peter Hollis, Nicholas O'Reilly (in their capacity as Joint Administrators and Supervisors of Sixty UK Ltd) [2010] EWHC 1890 (Ch).

The recent *Sixty UK* case has developed the legal landscape in respect of the compromise of third party guarantees under a Company Voluntary Arrangement *("CVA")*. The case gives greater bargaining power to landlords in respect of the valuation of their contingent claims, and the resistance to "guarantee-stripping" under a CVA.

Miss Sixty was established in 1991 as a high-street fashion brand. The ultimate parent company is based in Italy, Sixty SpA, and has subsidiaries in a wide range of countries including Serbia, Saudi Arabia and Brazil. On 29 September 2008, the UK arm, Sixty UK Ltd, entered into administration. On 2 April 2009, a CVA was approved by the creditors of Sixty UK Ltd (in administration) *("Sixty UK")* as an exit from the administration.

A CVA is a recovery procedure where a binding agreement is made with all the creditors of the insolvent company for a payment of all (or part of) its debts over an agreed period of time. To enter into a CVA creditors holding 75% of the debt may bind 100% of the creditors who had notice of the meeting. The terms of a CVA will often require some or all creditors to compromise their debts to some extent.

Sixty SpA had guaranteed the liabilities of Sixty UK as the tenant of two retail units in Liverpool, owned by Jersey-based company Mourant. Under the Sixty UK CVA the administrators sought to take advantage of a landmark High Court decision establishing that the structure of a CVA could deprive a landlord of the benefit of a third party guarantee (*Prudential Assurance Co Ltd v PRG Powerhouse Ltd* [2007] EWHC 1002 (Ch)). The terms of the CVA provided for a payment of GBP 300,000 to Mourant, which was deemed to represent their total financial exposure. Crucially, the CVA prevented Mourant from enforcing any claims under the guarantees from Sixty SpA.

The Sixty UK CVA provided for all other creditors (being more than 75% in value) to be paid in full, save as to the landlords of another two stores who received only 21% of the amount estimated to be payable on surrender of the leases.

The challenge to the CVA was brought by Mourant and was based on the principal of unfair prejudice, focussing on the inadequacy of the compensation and the compulsory deprivation of the guarantees. Mourant claimed that the compensation represented less than a third of the amount they should receive and that the documentary evidence gives rise to a clear inference that the sums offered were dictated by Sixty SpA, rather than being fairly based on expert evidence.

As the matter neared the court date, the administrators took a number of actions to delay the hearing without giving any comfort to Mourant that their position was accepted and that the CVA would be modified accordingly.

On the date of the hearing, the administrators did not attend. Instead, the administrators requested an adjournment through their legal counsel. The reason put forward for the adjournment was that the CVA had failed, Sixty UK would be liquidated, and therefore the landlords' claims would be dealt with in the course of a liquidation. Despite the failure of the CVA, the administrators refused to accept the merits of Mourant's case. The judge refused the adjournment, so Sixty UK's legal counsel withdrew and the case proceeded in their absence.

In assessing the fairness of the CVA, the judge noted that: on a winding up Mourant would still have had the benefit of the guarantees and there was no reason to doubt the ability of Sixty SpA to honour them; the guaranteed landlords would have formed a separate class for the purposes of a formal scheme of arrangement and would clearly have vetoed any such scheme; and the CVA was passed by the votes of the unsecured creditors who stood to lose nothing from the CVA. Further, the judge noted Sixty SpA was a public company with significant assets, and that Italy is a Member State of the European Union and bound by Council Regulation (EC) 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. Accordingly, there was no evidence that could persuade the court that the guarantees were not of significant commercial value. The judge held that it was unfair to require the landlords to give up their guarantees, particularly in such times of commercial and financial turmoil.

On the basis that the level of compensation offered to Mourant was far too low, and not all creditors had been treated the same

under the CVA, there was clear evidence of unfair prejudice. The CVA was, accordingly, set aside.

One implication of this case is an improvement of the negotiating position of landlords with respect to the assessment of their claims and the treatment of their contingent claims under a CVA. An implication for corporate groups is that parent companies that give guarantees in respect of their subsidiaries should not try to use insolvency law to unfairly improve their position in the event of a subsidiary's insolvency. For the insolvency industry in the UK, the case reinforces the strict requirement for insolvency practitioners to remain objective, independent, and to always act in good faith to all creditors.

/
Andrew Jackson
CMS Cameron McKenna LLP, London
E *andrew.jackson@cms-cmck.com*

PROTECTING CREDITORS AGAINST ASSET STRIPPING

During a financial downturn, dishonest borrowers are more likely to try to escape their financial obligations towards creditors. In this regard, one of the unlawful schemes that has recently been seen in Ukraine on a number of occasions is a so-called "express bankruptcy" of the borrower or a third-party security provider. We cannot say that this is a common practice, but rather it is an exceptional case of a planned set of actions initiated and carried out to deprive banks of security assets. As such, banks and other creditors should be vigilant and endeavour to recognise "express bankruptcy" of their counterparties as early as possible in order to take timely action to protect their position.

Brief Overview of Bankruptcy in Ukraine

Regular bankruptcy proceedings in Ukraine consist of four possible steps: asset management (i.e. administration) as an initial stage; followed by amicable settlement; financial rehabilitation; and, as a last resort, liquidation. Bankruptcy proceedings can be trigged by an unsecured creditor who has an indisputable claim that exceeds 300 minimum monthly statutory wages (currently about EUR 24,500), and is three months overdue. However, a debtor-company must initiate bankruptcy proceedings itself if, as a result of paying one creditor, it becomes unable to meet its obligations to other creditors.

Regardless of which creditor initiated bankruptcy proceedings, the majority creditor can obtain and exercise control over the debtor-company and all subsequent proceedings, provided that the claims of the majority creditor are properly documented and are filed in time. Typically, change of control takes place at the end of the asset management stage – when the register of creditors' claims is formed, the general meeting of creditors is conveyed, and the creditors committee is elected. Change of control can also be reinforced at the stage of financial rehabilitation, where the former management of the company is removed and substituted by a financial rehabilitation manager nominated by the creditors committee.

Through the creditors committee, the majority creditor can decide what to do with the debtor-company (rehabilitate or liquidate), as well as approve procedures for the disposal of its assets. In the case of liquidation, creditors' claims are satisfied in strict order of priority, with secured creditors and employees ranking before unsecured corporate creditors.

"Express Bankruptcy" Scheme

This unlawful scheme is triggered by the shareholders of an insolvent borrower or third party security provider. The shareholders carry on as if the company were solvent and take the decision to liquidate it without initiating regular bankruptcy proceedings. After the decision to liquidate the debtor-company has already been made, the insolvency is "discovered" and an application for a simplified bankruptcy proceeding is made. In such proceedings, control over the debtor-company does not pass to its creditors due to the absence of the initial stage of regular bankruptcy proceedings (i.e. asset management, where a register of creditors' claims is formed, a general

meeting of creditors is conveyed, and the creditors committee is elected). Furthermore, due to the pre-existing decision on liquidation, the debtor-company cannot undergo any courses of action other than liquidation.

A liquidator nominated by the shareholders then arranges for a valuation of the assets (including collateral) by an "independent" appraiser (independence of these actors appears questionable); the appraisal report typically indicates the price of the assets below their market value (as viewed by the creditors). An "independent" auctioneer (independence of these actors appears questionable), who is also appointed by the liquidator, decreases the price even further by holding two unsuccessful auctions: the auctions are advertised poorly, evidenced by the fact that no buyers show up; and for each subsequent auction, the price is decreased by 30%. The buyer acquiring the assets (including collateral) at the third auction is most likely somehow related to the debtor-company or its shareholders.

Usually, by the time the creditors file their claims to the assets of the debtor-company (which is done in due course upon finding a relevant bankruptcy notice in the press) and become party to the proceedings, the first of the three auctions is already completed. Within a relatively short period of time after the first auction, the property is sold without the creditors' knowledge. The greatly reduced proceeds of sale are then transferred to the accounts of creditors.

Is there a criminal offence?

Unfortunately, we have to state that the poorly drafted insolvency law and weak enforcement infrastructure in Ukraine allows for the above to happen. Although, on its own, each individual step taken by the debtor-company and other actors in the situation as described above can be formally viewed as a legitimate action taken by the relevant person at the relevant time, in aggregate the actions constitute stripping of assets (the collateral secured in favour of the banks) through a so-called "express bankruptcy" of the security provider. It would appear that these actions are well planned and implemented by an organised group.

The actions described above are likely to trigger Articles 190 ("Fraud") and 364 ("Abuse of authority or office") of the Criminal Code of Ukraine. Alternatively, actions of a director of the debtor-company, the liquidator and the auctioneer may be proved negligent according to Article 367 ("Officer Negligence") of the Criminal Code. Bringing criminal charges against the debtor and his likely accomplices may help force the former to repay the loan and will enable the creditors to seek damages directly from the director of the debtor-company, the liquidator and the auctioneer in addition to the debtor.

Recommendations to Banks and Other Creditors

General recommendations to creditors to help prevent "express bankruptcy" of their counterparties:

— when documenting new transactions, obtain an undertaking from the obligors' shareholders that they will not take decisions on liquidation without the creditor's prior written consent;

— monitor notices on liquidation of the obligors published in the official press. To make this process easier, computer programs/services are now available and it is possible to place certain companies that are of particular importance "on watch";

— as soon as any decision on liquidation of any obligor is detected, take legal actions in order to challenge such a decision;

— if the "express bankruptcy" scheme is about to start (or has just started), take legal actions to initiate regular bankruptcy proceedings (or to convert the "express bankruptcy" into a regular bankruptcy);

— where "express bankruptcy" has started, it is necessary to take actions to challenge the appointment of a "puppet liquidator" as early as possible, and to take actions to monitor the liquidator's activities and/or to obtain court injunctions prohibiting the sale of assets; and

— launch a criminal investigation against the group that is attempting to strip the company in insolvent liquidation of its assets (i.e., as the case may be, its shareholders, general director, liquidator, appraiser, auctioneer, etc.).

/
Taras Burhan
CMS Cameron McKenna LLC, Kyiv
E *taras.burhan@cms-cmck.com*

CONTACT DETAILS

AUSTRIA
Vienna
CMS Reich-Rohrwig Hainz
Rechtsanwälte GmbH
Günther Hanslik
T +43 1 40443 3550
F +43 1 40443 93550
E guenther.hanslik@cms-rrh.com

BELGIUM
Brussels
CMS DeBacker
Jean-François Goffin
T +32 2 74369 24
F +32 2 74369 01
E jeanfrancois.goffin@cms-db.com

BULGARIA
Sofia
Petkova & Sirleshtov Law Office
in cooperation with
CMS Cameron McKenna
Teodora Ivanova
T +359 2 92199 10
F +359 2 92199 19
E teodora.ivanova@cms-cmck.com

CROATIA
Zagreb
CMS Zagreb
Gregor Famira
T +385 1 4825 600
F +385 1 4825 601
E gregor.famira@cms-rrh.com

CZECH REPUBLIC
Prague
CMS Cameron McKenna v.o.s.
Ian Parker
T +420 2 96798 815
F +420 2 96798 000
E ian.parker@cms-cmck.com

FRANCE
Paris
CMS Bureau Francis Lefebvre
Daniel Carton
T +33 1 4738 5651
F +33 1 4738 5555
E daniel.carton@cms-bfl.com

GERMANY
Cologne
CMS Hasche Sigle
Rolf Leithaus
T +49 221 7716 234
F +49 221 7716 335
E rolf.leithaus@cms-hs.com

HUNGARY
Budapest
Ormai és Társai
CMS Cameron McKenna LLP
Erika Papp
T +36 1 48348 00
F +36 1 48348 01
E erika.papp@cms-cmck.com

ITALY
Rome
CMS Adonnino Ascoli & Cavasola Scamoni
Paolo Bonolis
T +39 06 4781 51
F +39 06 4837 55
E paolo.bonolis@cms-aacs.com

THE NETHERLANDS
Utrecht
CMS Derks Star Busmann
Jan Willem Bouman
T +31 30 2121 285
F +31 30 2121 227
E janwillem.bouman@cms-dsb.com

POLAND
Warsaw
CMS Cameron McKenna
Dariusz Greszta Spólka Komandytowa
Małgorzata Chruściak
T +48 22 520 5555
F +48 22 520 5556
E malgorzata.chrusciak@cms-cmck.com

ROMANIA
Bucharest
CMS Cameron McKenna SCA
Alina Tihan
T +40 21 4073 875
F +40 21 4073 900
E alina.tihan@cms-cmck.com

RUSSIA
Moscow
CMS, Russia
Karen Young
T +7 495 786 3080
F +7 495 786 4001
E karen.young@cmslegal.ru

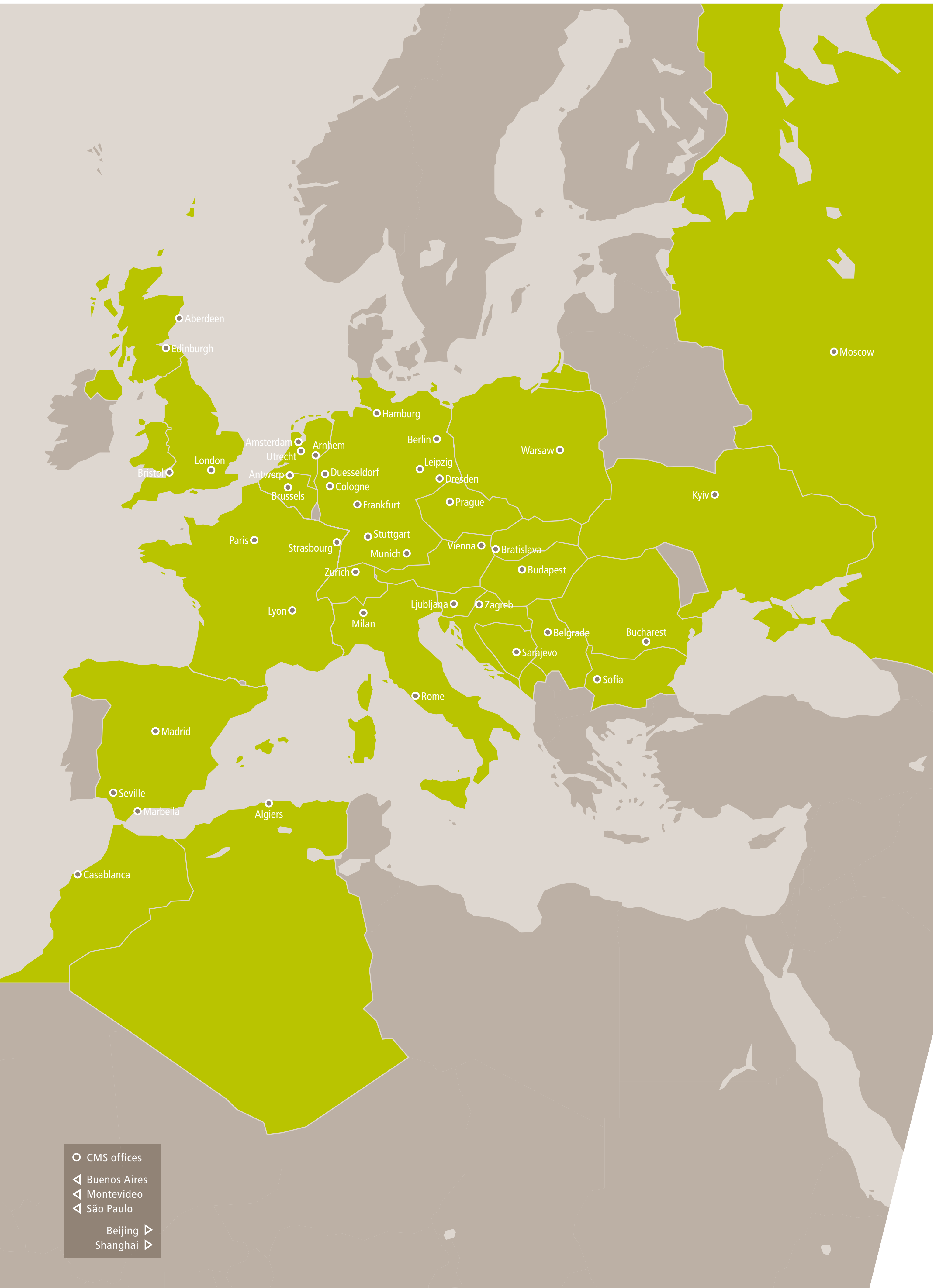
SLOVAKIA
Bratislava
Ružička Csekes s.r.o.
in association with members of CMS
Ian Parker
T +421 2 5443 3490
F +421 2 3233 3443
E ian.parker@cms-cmck.com

SPAIN
Madrid
CMS Albiñana & Suárez de Lezo, S.L.P.
Juan Ignacio Fernández Aguado
T +34 91 4519 300
F +34 91 4426 070
E juanignacio.fernandez@cms-asl.com

SWITZERLAND
Zurich
CMS von Erlach Henrici Ltd.
Philipp Dickenmann
T +41 44 2851 111
F +41 44 2851 122
E philipp.dickenmann@cms-veh.com

UKRAINE
Kyiv
CMS Cameron McKenna LLC
Taras Burhan
T +380 44 39133 77
F +380 44 39133 88
E taras.burhan@cms-cmck.com

UNITED KINGDOM
London
CMS Cameron McKenna LLP
Martin Brown
T +44 20 7367 3000
F +44 20 7367 2000
E martin.brown@cms-cmck.com



Aberdeen
Edinburgh
Moscow
Hamburg
Amsterdam
Arnhem
Utrecht
Berlin
Warsaw
London
Bristol
Leipzig
Antwerp
Duesseldorf
Dresden
Cologne
Brussels
Kyiv
Frankfurt
Prague
Paris
Stuttgart
Strasbourg
Vienna
Bratislava
Munich
Budapest
Zurich
Ljubljana
Zagreb
Lyon
Milan
Belgrade
Bucharest
Sarajevo
Sofia
Rome
Madrid
Seville
Marbella
Algiers
Casablanca
CMS offices
Buenos Aires
Montevideo
São Paulo
Beijing
Shanghai

CMS Legal Services EEIG is a European Economic Interest Grouping that coordinates an organisation of independent member firms. CMS Legal Services EEIG provides no client services. Such services are solely provided by the member firms in their respective jurisdictions. In certain circumstances, CMS is used as a brand or business name of some or all of the member firms. CMS Legal Services EEIG and its member firms are legally distinct and separate entities. They do not have, and nothing contained herein shall be construed to place these entities in, the relationship of parents, subsidiaries, agents, partners or joint ventures. No member firm has any authority (actual, apparent, implied or otherwise) to bind CMS Legal Services EEIG or any other member firm in any manner whatsoever.

CMS member firms are: CMS Adonnino Ascoli & Cavasola Scamoni (Italy); CMS Albiñana & Suárez de Lezo, S.L.P. (Spain); CMS Bureau Francis Lefebvre (France); CMS Cameron McKenna LLP (UK); CMS DeBacker (Belgium); CMS Derks Star Busmann (The Netherlands); CMS von Erlach Henrici Ltd (Switzerland); CMS Hasche Sigle (Germany) and CMS Reich-Rohrwig Hainz Rechtsanwälte GmbH (Austria).

CMS offices and associated offices: Amsterdam, Berlin, Brussels, London, Madrid, Paris, Rome, Vienna, Zurich, Aberdeen, Algiers, Antwerp, Arnhem, Beijing, Belgrade, Bratislava, Bristol, Bucharest, Budapest, Buenos Aires, Casablanca, Cologne, Dresden, Duesseldorf, Edinburgh, Frankfurt, Hamburg, Kyiv, Leipzig, Ljubljana, Lyon, Marbella, Milan, Montevideo, Moscow, Munich, Prague, São Paulo, Sarajevo, Seville, Shanghai, Sofia, Strasbourg, Stuttgart, Utrecht, Warsaw and Zagreb.

www.cmslegal.com

© CMS Legal Services EEIG (December 2010)