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Newsletter

CMS Restructuring and Insolvency in Europe

Summer 2013

Introduction

We are pleased to present this summer 2013 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:

— proposed amendments to Belgian legislative provisions aimed at supporting the continuity of a business by providing more options for recovery when facing insolvency, the so called "Belgian Chapter 11";

— the likely consequences of a recent decision of the German Federal Court of Justice which declared cancellation clauses in insolvency situations as invalid;

— changes to Italian insolvency law relating to the procedures governing court-controlled restructuring agreements of a distressed company with its creditors;

— Dutch insolvency legislative proposals for flexible restructuring methods as alternatives to insolvency;

— a recent decision by the Portuguese Supreme Court clarifying the position regarding the priority of the right of retention over a mortgage;

— new Romanian insolvency legislation on financial crisis and insolvency procedure of administrative units;

— new Ukrainian measures for debt to bonds conversion and the amicable settlement agreement;

— a recent decision by the English Court of Appeal suggesting that a more restrictive use of secondary proceedings in England may apply in the future; and

— a landmark decision in the Scottish Coal insolvency disclaiming onerous property.

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 30 countries with 55 offices in Western and Central Europe and beyond. CMS was established in 1999 and today comprises ten 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 businesses across Europe. The group was created in order to meet the growing demand for integrated, multijurisdictional 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

We are pleased to share the summer edition of the CMS newsletter with you, giving us the opportunity to review the most recent key topics in the area of restructuring and insolvency in Europe. CMS offices in nine jurisdictions, from some of our many CMS offices in Europe, have contributed.

Economic crisis

National insolvency proceedings are increasingly influenced by European legislation and regulations. The European Commission launched a proposal in December 2012 to amend the EU Insolvency Regulation on cross-border business insolvency. According to these proposed amendments, businesses hit by the economic crisis should be thrown a lifeline. The proposed amendments aim to shift the focus away from liquidation and develop a new approach towards helping businesses overcome financial difficulties, but at the same time protecting creditors' rights to get their money back. The aim is to increase the efficiency and effectiveness of cross-border insolvency proceedings, which affect an estimated 50,000 companies across the EU every year. However, as of summer 2013, the economic crisis continues and the number of insolvencies is still rising.

Efficiency and effectiveness

As a result of the continuing economic crisis and the rising number of insolvencies, effective and efficient insolvency procedures are very important. I would therefore like to pay special attention to the articles from the Netherlands and Belgium. The Dutch legislator has endorsed the need to introduce more effective procedures by launching a project to revise the insolvency law of the Netherlands, the main purpose being to avoid insolvency wherever possible and to create a more successful process for restructuring a business.

In this respect, the Belgian Law on the Continuity of Enterprises (the 'Continuity Law') aims to provide companies in financial difficulties with a safeguard procedure during which the company is protected from creditors in order to attempt the restructuring of its business. The aim of this law is to support business continuity as far as economically possible, by providing more options for recovery. However, more than 50% of the companies invoking the Continuity Law were declared bankrupt in any case, so the Belgian legislator was forced to intervene. As a result, the Reparation Law amending various legislative provisions of the Continuity Law was recently passed.

The main purpose of both the Dutch and Belgian proposals is to create more effective and efficient processes for the restructuring of businesses. However, because many companies have been declared insolvent as a result of the economic crisis, European member states need to be aware of the potential need for improving their national insolvency procedures and considering legal options for the restructuring of a business, in a similar way to the Netherlands and Belgium.

Increasing creditors' protection

In addition to the importance of having more effective insolvency law procedures, the issue of creditors' protection deserves attention. Related to the Commission's proposal to amend the EU Insolvency Regulation mentioned above, the editorial from the winter version of this newsletter describes the delicate balancing act between the rights of a company in difficulty and its employees on one hand, and the rights of the creditors on the other.

In this respect, there is an interesting article in this summer edition regarding recent amendments of the Italian Insolvency Law and the 'concordato preventivo' procedure, which is the most common and popular pre-insolvency procedure in Italy. The procedure allows the company in distress to come to an agreement with its creditors allowing a corporate restructuring under the control of the court. Prior to the amendments, creditors had no role throughout the first phase of the proceedings. Creditors can now monitor the debtor's activity and can ask the court to take specific measures to stop any abusive conduct. Greater protection has thus been granted to creditors, whilst still making it easy for the company to restructure its debt.

Our Romanian colleagues report on the Government Emergency Ordinance no. 46/2013, enacted by the Romanian Government on financial crisis and insolvency procedures of administrative units. This Ordinance may be beneficial for the administrative unit's creditors because it details the proceedings and sets out the rights, obligations and expectations of the participants in these proceedings.

These articles highlight the continuing challenge of addressing the debtor's financial difficulties while protecting the interests of creditors.

The CMS Portugal article highlights an important Portuguese Supreme Court judgment about limiting the priority of the rights of retention over a mortgage only to circumstances where specific requirements are fulfilled. CMS in England contributes a review of the Olympic Airlines case, which discussed limiting the availability of secondary insolvency proceedings. CMS Germany has reviewed the decision of the German Federal Court of Justice which declared cancellation clauses in insolvency situations as invalid. Our colleagues in CMS Ukraine describe new legislative measures aimed at increasing the number of restructuring and insolvency possibilities available to a company in financial difficulty. Last but not least, CMS in Scotland informs us of a novel application being made to the Court of Session in Scotland regarding the issue of a disclaimer in liquidation.

The various contributions clearly demonstrate that CMS, with offices and restructuring and insolvency experts in as many as 29 jurisdictions, is well placed to handle complicated cross-border cases.

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The Belgian Chapter 11 procedure revised

The Law on the Continuity of Enterprises (the "Continuity Law") dated 31 January 2009 provides companies in financial difficulties with a safeguard procedure during which they are protected from creditors in order to attempt the restructuring of their business. The aim of the Continuity Law, or the so-called "Belgian Chapter 11" is to support the continuity of a business as far as economically possible by providing more options for recovery.

After being in force for more than three years, the Belgian legislator deemed it necessary to evaluate the Continuity Law and its efficiency. Notwithstanding the large number of applications, it was common knowledge that the procedure was subject to much abuse and despite the introduction of this new legislation, greater than 50% of companies invoking the Continuity Law are still declared bankrupt in any case. As a result, the legislator was forced to intervene.

On 2 May 2013 the Chamber of Representatives passed the draft act amending various legislative provisions of the Continuity Law (the "Reparation Law"); this law went into force on 1 August 2013.

A brief overview of the most significant amendments is described below.

Access threshold

Firstly, because many companies which were actually in a state of bankruptcy and could no longer be restructured abused the Continuity Law in order to delay bankruptcy for a few weeks/months, the Reparation Act intends to raise the access threshold for judicial reorganisation proceedings.

The debtor is now required to submit all documents required by law to the clerk's offices, together with his petition. The possibility of adding certain documents to the file after the petition has been submitted no longer exists. Besides certain exceptions, an incomplete file will from now on be treated as inadmissible.

The debtor must now include "an accounting statement showing the assets and liabilities and the profit and loss account, no more than three months old, drawn up under the supervision of an auditor, an external accountant, an external certified accountant or an external certified accountant/tax specialist", as well "a budget with an estimate of the income and expenses for at least the duration of the requested moratorium, drawn up with the assistance of an external accountant, an external certified accountant, an external certified accountant/tax specialist or an auditor".

When submitting his petition, the debtor must also now adopt a position on the measures and proposals he is considering in order to restore the profitability and solvency of his enterprise, whilst implementing a social plan and paying its creditors.

Finally, in addition to the measures described, which already increases the cost of the procedure considerably, the Reparation Act also introduces a new financial threshold: when submitting the petition for the initiation of judicial reorganisation proceedings a fee of EUR 1,000 (instead of the former fee of EUR 60) will have to be paid.

Reorganisation procedure through a collective agreement

When the debtor wishes to pursue a collective agreement within the scope of the judicial reorganisation proceedings, he will have to comply with several new conditions set out in the Reparation Law.

The reorganisation plan must include a payment proposal for a minimum of 15% of the total of all creditors' claims. On the other hand, if the reorganisation plan stipulates a different treatment of different creditors, the treatment of public creditors with a general privilege cannot be less favourable than the treatment of the best-treated ordinary creditor involved in the moratorium.

Furthermore, the reorganisation plan can no longer stipulate a reduction or acquittal for claims originating from work performed before the opening of the proceedings or for criminal penalties. Nor can the reorganisation plan stipulate a reduction for maintenance debts or for debts originating from the debtor's obligation to remedy the damage caused through his own fault and related to death or personal injury.

Another important feature introduced by the Reparation Law is the fact that the court's decision on the ratification of the plan is no longer a matter of all or nothing. If the court concludes that the formalities were not complied with or that the plan violates public order, it can now, before rendering a final judgment, allow the debtor to present an amended reorganisation plan to the creditors. In that case, within the limits stipulated by law, the court may extend the moratorium and determine a hearing date for a vote on the amended plan.

Judicial reorganisation proceedings through a transfer under judicial authority

If judicial reorganisation proceedings aim to transfer all or part of the business under judicial authority, the judicial trustee is only allowed to consider offers in which the offer price is at least equal to the estimated value in the case of a compulsory realisation of the debtor's assets in the event of bankruptcy or liquidation.

Furthermore, it is stipulated that, if an offer is made by persons who supervise or have supervised the company and who simultaneously control rights through other legal entities required for the continuation of the debtor's operations, the offer can only be taken into consideration if the rights are accessible to the other bidders under the same conditions.

The Reparation Law also contains several provisions which will allow the judicial trustee to organise the bidding process more efficiently, for instance by granting him the right to set a deadline for the submission of offers.

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Olympic Airlines: Secondary proceedings did not fly with the Court

On 6 June 2013, the Court of Appeal reversed the judgment handed down by the High Court in which it was ruled that the English courts had jurisdiction to open up secondary proceedings in respect of Olympic Airlines SA. The decision means that members of the Olympic Airlines pension scheme will not be entitled to receive compensation from the Pension Protection Fund (or "PPF")[1]

In addition, secondary proceedings will only be available in the future where the establishment remained engaged in "on the market" trading at the time the petition to open secondary wind-up proceedings is presented.

The Regulation

The Insolvency Regulation[2], which which governs cross-border insolvency proceedings within the EU, makes a distinction between main insolvency proceedings and secondary insolvency proceedings.

Main insolvency proceedings can only be initiated in the member state where the insolvent company has its centre of main interests (or "COMI"), which should correspond to the place where the insolvent company conducts the administration of its interests on a regular basis. There is a rebuttable presumption that this will be the place of the company's registered office.

Secondary proceedings, which run in parallel with main proceedings, can be opened in any member state where the debtor has an establishment. Article 2(h) of the Regulation provides that an establishment is "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods".

Secondary proceedings are limited to the assets located in that state. The primary purpose of secondary proceedings is the "protection of local interests", namely the protection of local creditors who have been dealing with an establishment in the secondary state.

Facts of the case

Olympic Airlines, a company incorporated in Greece, commenced operations as a state-owned airline in December 2003. The Company had three premises in the UK – in Heathrow, London and Manchester – and employed 27 employees, the majority of which were members of the airline's pension scheme.

On 2 October 2009, Olympic Airlines entered "special" liquidation in Greece, which constituted main proceedings for the purpose of the Regulation. Thereafter, the airline's business in the UK was significantly wound down, with only one London office remaining and airline tickets no longer being sold to customers. Instead, the activities focused on assisting the Greek liquidator generally winding down the business.

The Greek liquidator terminated the employment of the airline's employees in England from 14 July 2010. After this date, the airline hired two ex-officers on an ad hoc basis. Both operated out of the London office and dealt primarily with administrative tasks in relation to the liquidation.

The trustees of the airline's pension scheme, which faced a deficit of at least GBP 115 million, sought the protection of the PPF. However, as the airline's main insolvency proceedings in Greece did not constitute a "qualifying insolvency event" under English law, responsibility for the deficit could not be assumed by the PPF. This meant that the employees were left exposed to the deficit.

If secondary proceedings could be opened in the UK, these would qualify as a "qualifying insolvency event" and the PPF would need to step in.

On 20 July 2010, the trustees presented a winding up petition to open secondary proceedings. The petition was opposed by the Greek liquidator on the grounds that, on the relevant date[3], the airline did not have an establishment in England.

The trustees argued that the ongoing activities of the airline in England after the Greek insolvency proceedings had commenced meant that there was a qualifying establishment within the meaning of the Insolvency Regulation.

The High Court agreed. It held that the work carried out by the two ex-officers amounted to ongoing economic activity and that the fact that the premises in London existed and could be visited or contacted by third parties (particularly creditors) confirmed the existence of an establishment. This meant that the English Court had sufficient jurisdiction to make a winding up order. The Greek liquidator appealed.

Court of Appeal decision

The decision of the Court of Appeal centered on the meaning of "establishment" and relied heavily on the commentary of the Virgós-Schmit Report, which is generally regarded as an aid to interpretation of the Regulation, although it was never formally approved by the Council.

According to the Virgós-Schmit Report, in order to qualify as an establishment, the place of operation must be a place from which economic activities are exercised on the market. An establishment must be a place "of operations, involving human and physical resources". A purely occasional place of operation cannot be classified as an "establishment". The mere presence of an office or branch is not sufficient.

By the relevant date, the airline had ceased all external commercial operations and was no longer selling airline tickets. The employees had been dismissed, leaving only the ad-hoc employment of two ex-officers, and the remaining London office had no assets of any value. Fundamentally, there could not be said to be "on the market" activity.

For these reasons, the Court allowed the liquidator's appeal and held that there was no jurisdiction to open secondary insolvency proceedings in England.

Comment

It is worth noting that there is no mention of "on the market" activity in the Regulation itself. In relying heavily on the Virgós-Schmit Report, the Court of Appeal appears to have placed less reliance on the ECJ's guidance on the meaning of an establishment in *Interedil*.[4] Moreover, the EC Commission has suggested an amendment to the Regulation (as part of its wider proposed amendments to Regulation) to clarify that the time for assessing whether an establishment exists should be the time of the opening of main proceedings, rather than secondary proceedings.

However, under the proposed amendments, a liquidator in main proceedings may also request a court postpone or refuse to open secondary proceedings if they are not necessary to "protect the interest of local creditors".

This proposed amendment, along with the decision in the Olympic Airlines, suggest a move towards a more restricted use of secondary proceedings in the future.

In the Olympic Airlines case, the Court of Appeal acknowledged that the decision would leave the beneficiaries of the pension scheme unprotected by the PPF. This regrettable outcome was acknowledged by the Court of Appeal. Restricting the opening of cases of secondary proceedings to "on the market" trading activity may also leave local creditors without the recourse to local proceedings currently envisaged by the Regulation. Moreover, the occasions where an establishment will continue to engage in external market trading after main proceedings have been opened elsewhere will be very limited, as a wind-down of local activities is a natural consequence of insolvency.

Permission to appeal to the Supreme Court has been sought and we await the outcome with interest.

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1) *Section 121 of the Pensions Act 2004 and Regulation 5 of the Pension Protection Fund (Entry Rules) Regulations 2005*

2) *Council Regulation (EC) 1346/2000*

3) *Both the liquidator and the trustees accepted that the relevant date was 20 July 2010, i.e. the date on which the trustees presented the winding up petition.*

4) *Interedil Srl (In Liquidation) v Fallimento Interedil Srl (C-396/09)*

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German Federal Court of Justice (*Bundesgerichtshof*) declares contractual termination clauses in insolvency situations as invalid

In a far-reaching and surprising decision at the end of the last year, the German Federal Court of Justice declared cancellation clauses in contracts which are tied to the filing for insolvency or commencement of insolvency proceedings (insolvency-based cancellation clauses) as invalid.

Insolvency-based cancellation clauses are frequently included in frame agreements or other fixed-term contracts and grant an extraordinary right of termination in the event that the contractual partner files an application to commence insolvency proceedings in relation to his assets or if such proceedings are commenced. These are to be distinguished from **cancellation clauses not based on insolvency** which are linked to circumstances such as default on payment, deterioration of the financial position or breach of contractual obligations. Until now there have been no concerns as to the validity of such clauses, at least in connection with the above mentioned decision of the German Federal Court of Justice.

Legal situation prior to the decision

Prior to the decision of the German Federal Court of Justice, according to the predominant view in the legal literature, there were no concerns as to the validity of cancellation clauses which were linked to an application for a commencement of insolvency proceedings. It was therefore usual in business transactions between companies that, when such an insolvency application or the commencement of insolvency proceedings became known in connection with a contractual partner, the existing fixed-term contracts were terminated with reference to an insolvency-based cancellation clause, provided that such a clause was stipulated. The aim was to thereby reduce the risk of providing advance performance in an uncertain business relationship and subsequently obtaining the recovery rate usual in insolvency proceedings in Germany, which is often only minimal.

Decision of the German Federal Court of Justice

This procedure was considered as impermissible by the German Federal Court of Justice in its decision dated 15 November 2012 which was based on the contract between an energy supply company with a customer for the supply of electrical energy. The energy supply company had cancelled the contract on the basis of the following clause: "*The contract ends automatically without notice of termination if the customer files for insolvency or a preliminary insolvency proceeding is initiated or commenced based on a creditor application.*" The German Federal Court of Justice based its decision on the grounds that insolvency-based cancellation clauses exclude the right of election of the insolvency administrator in advance pursuant to § 103 Insolvency Code (IC). The purpose of this right of election, to protect the insolvency estate, is defeated if the contractual partner can cancel a contract which is favourable for the insolvency estate and can thus circumvent the right of election of the insolvency administrator.

The German Federal Court of Justice did not expressly state in its decision whether in addition to "*contracts for the continuing supply of products or energy*" all other contracts imposing reciprocal obligations within the meaning of § 103 IC are also covered. Even if there are arguments against such an interpretation, it cannot be excluded that the judgment will in the future be interpreted as a precedent judgment, in particular by the lower instance courts, and will be applied to **all contracts imposing reciprocal obligations within the meaning of § 103 IC**, provided that no special legal regime applies, for example for leases and employment contracts.

Consequences in practice

In the future it is to be expected that (preliminary) insolvency administrators will dismiss a contract termination linked to an insolvency-based cancellation clause as unjustified with reference to the judgment of the German Federal Court of Justice and require the terminating party to abide by the contract, e.g. supply goods. Whether such conduct of a (preliminary) insolvency administrator is justified can only be assessed in each individual case, based on the wording of the cancellation clause.

Starting from the application for a commencement of the insolvency proceeding concerning the assets of the debtor it is therefore advisable to **only make use of an insolvency-based cancellation clause after detailed consideration and in any case not prematurely.** An unjustified termination can, in a worst-case scenario, entitle the insolvency administrator to make a counter-termination and (theoretically) assert a damage claim. In most cases the better alternative to a termination is to enter into a business continuation agreement with the preliminary insolvency administrator, according to which deliveries are, for example, made in exchange for advance payment.

What can be done to safeguard against this risk in the future?

When drafting contracts in the future, particular care should be taken in the formulation of cancellation clauses. It is likely that the safest, but not always satisfactory route, is to refrain from stipulating insolvency-based cancellation clauses and instead **optimising cancellation clauses which are not based on insolvency**. Circumstances such as default on payment, other breaches of contract or deterioration of the financial position could be contractually addressed in a more subtle way than up to now in order to create the possibility of a valid extraordinary termination on the basis of other criteria in the time leading up to the insolvency. The breach of contractual obligations could for instance be tied to such factors as "non-performance", "non-delivery" or "non-acceptance". In addition, alternative protection mechanisms should be stipulated, for example, security rights or shorter periods for ordinary terminations.

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Italy increases creditors' protection in restructuring debts

Italian Insolvency Law (Royal Decree no.267/1942) has been recently amended with regard to the rules governing the so called "concordato preventivo" procedure, which allows the company in distress to come to an agreement with its creditors allowing a corporate restructuring under the control of the court.

Courtesy of a 2012 reform, concordato preventivo allows the distressed company to file a blank application and to supply the court with all required documentation, together with the restructuring plan, within the following 60 – 120 days, or 180 in particular cases, as indicated by the judge. During this period creditors cannot start or continue *ad interim* or enforcement actions (the so-called "stay period"), until the Court has officially rejected the company application. The rationale of this new procedure called blank concordato ("concordato in bianco"), is to increase the possibility for the company to restructure its business, providing a simplified procedure which protects the company's assets and as a consequence avoid bankruptcy.

Since its introduction in 2012, the impact of the "concordato in bianco" has produced unexpected consequences because many companies filed the blank application with the sole purpose of delaying their insolvent positions and postponing bankruptcy. This misleading use of the new procedure led the Italian legislator to review the relevant provisions in order to rebalance the interest of the entrepreneur and his creditors, resulting in an increase in protection for creditors.

According to further new rules set forth by the Law Decree no.68 dated 21 June 2013 ("the Decree"), the blank demand alone is no longer sufficient in order to apply for concordato preventivo and the company is now required in the first instance to disclose a detailed record of all its creditors and their relevant claims. Thanks to such additional documentation, the court is now in a position to better evaluate the possibility of the debtor coming to an arrangement with the creditors and to promptly put an end to the procedure if the main intent of the debtor is to delay bankruptcy.

Following the receipt of the application, the judge may appoint a Judicial Commissioner in charge of supervising the company's activity. For this purpose the company must keep the documentation required by law available not only to the court but also to the Commissioner, which shall promptly inform the judicial body if the entrepreneur acts fraudulently and prejudices its creditors. If, during the course of proceedings, the court determines that the conduct of the company has been fraudulent, according to article 173 of Insolvency Law, the judge can conditionally reject the concordato proposal or, based on a request from the Public Prosecutor or from a single creditor, declare bankruptcy.

Between the time of filing the concordato proposal and the issue of the final decree by the court, the debtor is allowed to continue the normal running of the business. Any extraordinary business or unusual transactions are not allowed unless deemed urgent and these must be duly authorised by the court which is first asked to issue a non-binding opinion on the matter by the Judicial Commissioner.

The recent reform has also amended the reporting duties of the debtor. These are no longer subject to the discretion of the Court, but are mandatory and, among other things, shall include not only the financial situation but also the information related to the activities carried out by the company in order to file the arrangement plan. This information must be supplied by the debtor on at least a monthly basis and is publicly disclosed on the companies' register.

Before the reform of 2013 was introduced, the creditors had no role throughout the first phase of the proceedings. As a result of the new reporting duties of the debtor, the creditors can now monitor the debtor's activity and can ask the court to take specific measures in order to stop any abusive conduct being carried out by the company.

In light of the recent amendments to Insolvency Law discussed, the position of creditors in the concordato preventivo procedure, the most common and popular pre-insolvency procedure sought by distressed companies in Italy, has been considerably strengthened. Greater protection has been granted to creditors, although the procedure still remains an easy way for the company to restructure its debt.

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Dutch insolvency legislative proposals for flexible methods as alternatives to bankruptcy

Introduction

According to the current Dutch law system, two insolvency proceedings have a legal basis: bankruptcy and moratorium (suspension of payment). Whilst bankruptcy proceedings focus primarily on the liquidation of the assets of the debtor on behalf of all creditors, the moratorium is intended to be useful for reorganisation of the business of the debtor and to prevent bankruptcy proceedings. For the latter, the debtor is granted temporary relief from the actions of certain categories of creditors and should formulate a proposal for a composition to its creditors. In practice, and contrary to the intention of the Dutch legislator, it appears that almost all moratoriums actually result in bankruptcy of the company.

In recent years, several jurisdictions in the European Union have modified procedures for company restructurings. In several jurisdictions these modifications have created more flexible methods for restructuring as alternatives to bankruptcy. Due to the continuing crisis and the increasing numbers of bankruptcies, the Dutch legislator has also endorsed the need to introduce more effective procedures. In this respect, a project to revise the insolvency law of the Netherlands has recently commenced. The main purpose of this is to avoid insolvencies as far as possible and to create a more successful process for restructuring a business.

In this respect, three elements of the program are, with respect to the scope of this article, of relevance: the legislative proposal regarding the introduction of the (i) unpublished ("quiet") administration, (ii) the pre-pack and (iii) the compulsory composition.[1] The legislative proposals for the amendments concerning these three elements have not yet been drafted. In the most recent official documents from the legislator, the following main principles concerning these elements have been formulated.

(i) Unpublished ("quiet") administration

At the request of a company which finds itself in financial problems, a "quiet" administrator may be appointed by the court. The administrator will advise and assist the company in its contact with creditors as well as attempt to find a suitable solution for the critical financial situation of the company. A possible solution could be a composition out of bankruptcy, the details of which will be determined using the guidance and involvement of the administrator. The administrator will be an extraordinary advisor under the supervision of the court.

The intention of the unpublished ("quiet") administration procedure is to facilitate the restructuring of the company in financial difficulty and to avoid bankruptcy. In relation to this, a comparative law study of the jurisdictions of Belgium, Germany, United Kingdom, France, Italy and Spain has been concluded. The Dutch legislator states that the jurisdictions of Belgium and France contain legislative possibilities for the appointment of an administrator with tasks that could be comparable to the tasks of a “quiet” administrator. It is expected that these jurisdictions will be studied more closely with respect to the draft of the text of the Dutch legislative proposal.

(ii) Pre-pack

The pre-pack has no legal basis in the Netherlands. Over recent years, discussions in the legal literature have highlighted the benefits of permitting a pre-pack in the Netherlands. Pursuant to these arguments and the recent practice of several Dutch courts to permit the application of a pre-pack, the Dutch legislator is willing to introduce a legal basis for the pre-pack. The purpose of such a pre-pack, with a legal basis, is similar to the pre-pack under English law and is intended to prepare a restructuring of the assets of the company prior to insolvency.

The difference with unpublished administration is that a pre-pack implies a bankruptcy. In the case of a pre-pack, all measures necessary for restructuring the assets of the company are taken under the assumption that the company will be declared bankrupt.

It is noted that the majority of the Dutch courts have started to facilitate pre-packs recently, although the legislator is preparing the necessary actions to create a legal basis for this insolvency procedure. The majority of the Dutch courts are willing to inform the parties involved, at their request and prior to insolvency, who will be appointed as bankruptcy trustee as soon as the company is declared insolvent. In close consultation with the company and parties involved, this person will prepare for a restructuring of the company after insolvency has been declared. This procedure appears to be efficient and quick, helping to preserve the value of the company’s assets. As part of the legislator’s project it is emphasised that for reasons of legal certainty it is preferred that a legal basis for the pre-pack is created.

(iii) Compulsory composition

The legislator is preparing a proposal to create a legal basis for a compulsory composition to avoid the insolvency of a company. According to current Dutch insolvency law, such a compulsory composition outside insolvency is not yet possible. The intention of the legislator is to create a legal procedure that facilitates a composition outside insolvency which cannot be blocked by a minority of the creditors or shareholders, providing that it is supported by a majority of the creditors. The inspiration for this procedure comes from the scheme of arrangement created under English law.

In conclusion

As a result of the ongoing crisis in the Netherlands, the Dutch legislator has become aware of the need to improve Dutch insolvency procedures and consider legal options for the restructuring of a business. The prevailing view in the legal literature as well as in practice that a pre-pack should be permitted seems to be supported by the courts. However, the Netherlands are in need of a legal basis for the pre-pack as well as for the introduction of the procedures mentioned in this article. With respect to European relations and the competitive position of the Netherlands, it is important that these amendments are introduced in a timely fashion.

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1) *Besides these three modifications as suggested in Dutch law, several modifications with respect to criminal sanctions and the position of the bankruptcy trustee are formulated. Due to the limited scope of this article, only modifications with respect to the introduction of new insolvency proceedings will be discussed.*

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Right of retention and mortgage, which prevails?

The Portuguese Supreme Court recently delivered an important judgment consolidating case law that put an end to a jurisprudential and doctrinal discussion on the priority of the right of retention over a mortgage. The court's ruling limited the priority of the right of retention over a mortgage to the fulfilment of certain requirements.

The problem under analysis

In the context of loans, a mortgage ('*hipoteca*') on real estate is usually requested and offered in order to ensure that payments are met. Under Portuguese law, a mortgage is a type of security right *in rem* that must be registered at the land registry to be effective and gives the lender the right to be paid, usually with priority over unsecured creditors, against the value of certain real estate owned by the debtor or by third parties.

It should be noted that according to the Portuguese law, the retention right ('*direito de retenção*') over real estate has priority over a mortgage, even if that mortgage has been previously registered. The right of retention is a security *in rem* which is not subject to registration under Portuguese law. This right allows the possessor to hold the real estate until its claim against the debtor is paid.

The question analysed by the Portuguese Supreme Court was whether a promissory buyer that entered into a promissory contract of purchase and sale of real estate (which was not effective vis-à-vis third parties if it had not been subject to registration), had the right of retention over such real estate for payment of its claim with priority over a mortgage on the same property. The promissory buyer was a consumer and the mortgagee creditor was a bank institution.

The First Instance Court recognised the right of retention of the consumer and its priority over the mortgage. However, the mortgagee creditor appealed and the Second Instance Court decided that the mortgage should have priority over the claim from the consumer due to the fact that the promissory contract was only effective between parties. The consumer subsequently appealed to the Portuguese Supreme Court.

Jurisprudence to date has been divided, although the majority view was that the right of retention had priority over the mortgage based on the handover of the real estate being the object of the contract. Doctrine was also not unanimous; some considered that the mortgage should prevail, excluding the right of retention from the promissory buyer when the handover of the real estate had occurred, with the promissory contract not being binding on third parties.

Right of retention and mortgage – reasons for allocation and priority

In 1986, the Portuguese Civil Code extended the right of retention to several cases, among which we specifically highlight the one that refers to the beneficiary of a promise of transfer or constitution of a right *in rem* that had been handed over the object of the promised contract as a result of the non-performance of the contract attributable to the other party pursuant to the deposit regime.

According to the deposit regime, if the breach of contract is attributable to the promissory seller and the real estate object of the promised contract is handed over to the promissory buyer, the latter has the right to be paid by its value with the reduction of the price agreed, as well as to the return of the deposit and part of the price already paid.

The Portuguese Supreme Court stated that the above mentioned deposit regime was introduced by a decree-law in 1980 with the aim of safeguarding the position of the promissory buyer of real estate, in particular when the real estate is for residential purposes.

Moreover, the Portuguese Supreme Court also commented that the decree-law that has extended the right of retention to the situation under analysis in 1986, expressly mentions that in the case of a conflict of interests between mortgagee creditors and consumers, it is reasonable to assign priority to the latter. This comes from the logic of consumer protection and from the fact that consumers are usually the weakest parties in these contracts, because they usually invest their savings in property and incur debt for many years. In contrast, the mortgagee creditor (usually a bank) has economic, legal and logistical advice that allows it to more accurately assess the risks involved and to consider carefully whether to grant credit.

Based on the above, the Portuguese Supreme Court decided to grant priority to the right of retention over the mortgage in cases where the following requirements are fulfilled:

(i) the promissory buyer that holds the retention right is a consumer;

(ii) the promissory buyer has a credit resulting from the non-performance of the promissory contract of purchase and sale of real estate (with effects only between the parties);

(iii) the non-performance of the promissory contract is attributable to the promissory seller;

(iv) the real estate object of the promissory contract was handed over to the consumer; and

(v) the real estate is for residential purposes.

Reference:
Portuguese Supreme Court
delivered on 22 May 2013,
file no. 92/05.6TYVNG-M.P1.S1

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Administrative units' Financial Crisis and Insolvency Procedure

Introduction

The Romanian Government has enacted Government Emergency Ordinance no. 46/2013 on financial crisis and insolvency procedure of administrative units (counties, municipalities and communes) (**"GEO no. 46/2013"**), which entered into force on 24 May 2013. This enactment was an obligation undertaken by Romania towards the International Monetary Fund as part of a Stand-By Arrangement dating from 2012.

Both the financial crisis and insolvency status of administrative units shall be made public on the website of the Ministry of Public Finances.

Financial Crisis

An administrative unit may be in **financial crisis** if it cannot pay:

— its undisputed outstanding obligations that have been due for more than 90 days, if these obligations exceed 15% of the administrative unit's budget; or

— the salaries of its civil servants for more than 90 days, irrespective of the outstanding amounts.

The local public authorities are responsible for determining if the municipality or commune/county is in financial crisis. If so, the prefect will form an *ad hoc* committee for financial crisis situations consisting of at least the following key officials:

— the mayor or the county council president;

— the chief accountant of the administrative unit;

— a representative of the local or county council; and

— a representative of the state financial administration.

The *ad hoc* committee, together with the mayor or the president of the county council, must issue a financial recovery plan which should be voted on and implemented by the local or county council under the supervision of the committee.

The local or county council may decide to end the financial crisis in either one of two situations:

(i) if the administrative unit has been without the financial difficulties that triggered the financial crisis for a period of 180 calendar days; or

(ii) if the insolvency conditions provided by Law no. 273/2006 are met and insolvency proceedings should be commenced.

Insolvency

Insolvency is a more severe financial failure of the administrative unit, and occurs when the administrative unit cannot pay:

— its undisputed outstanding obligations that have been due for more than 120 days, if such obligations represent more than 50% of the administrative unit's budget; or

— the salaries of its civil servants for more than 120 days, irrespective of the outstanding amounts.

As with companies, the administrative unit's insolvency procedure is a judicial procedure.

The insolvency procedure begins if either the administrative unit's creditors, or the mayor or president of the county council, apply to the tribunal to commence insolvency proceedings. If the tribunal concludes that the administrative unit meets the above mentioned insolvency criteria, the proceedings shall be opened and a judicial administrator will be appointed.

The judicial administrator must notify creditors upon opening of insolvency proceedings. Creditors should register their receivables against the administrative unit; otherwise they may only enforce their titles against the administrative unit after the closing of the insolvency proceedings.

The creditors' general meeting may:

— examine the financial statements of the administrative unit;

— appoint a creditors committee;

— assess creditors committee's reports; and/or

— propose measures to the judicial administrator.

The creditors' committee may:

— assess the financial status of the administrative unit; and/or

— propose measures for the recovery plan; and/or

— contest the judicial administrator's reports.

The judicial administrator, together with the mayor or president of the county council, must propose a recovery plan which includes a schedule for paying the administrative unit's debt. This plan has to be approved by financial administration and by the local or county council and confirmed by the judge. The plan must be implemented within three years of being approved. The judicial administrator must also draft the table of receivables against the administrative unit.

At the same time, the judicial administrator may:

— apply for the suspension of the local authorities' powers, and, if granted, the judicial administrator will temporarily exercise the powers of the mayor or the president of the county council;

— propose to the local or county council that new temporary taxes are enacted until the financial difficulties are overcome;

— propose that the local council unilaterally terminates contracts entered into by the administrative unit if such contracts cannot be performed because of the recovery plan implementation;

— ask the syndic judge to order part of the administrative unit's debt to be covered by the administrative unit's officials who are responsible for administration of assets and who are responsible for its insolvency; and/or

— annul fraudulent acts entered into by the administrative unit in the 120 days preceding the petition to commence insolvency proceedings.

The insolvency proceedings may be closed when the insolvency conditions are no longer met and the syndic judge has ruled upon this. There is no need for all of the debts to have been satisfied; any remaining debts shall be included in a financial recovery plan.

Conclusion

The administrative unit's creditors are exposed to several risks. For example, all individual claims against the administrative unit as well as penalties, interest, increases or expenses relating to such claims shall be stayed indefinitely until the closing of insolvency proceedings. Another risk is that the judicial administrator may terminate contracts which are incompatible with the recovery plan. Creditors are nevertheless expressly entitled by law to damages for such early termination, as part of companies' insolvency law.

GEO no. 46/2013 may be beneficial for the administrative unit's creditors because it details the proceedings and sets up the rights, obligations and expectations of the participants to these proceedings.

However, insolvency proceedings may cause legal uncertainty for the commercial partners of the administrative unit due to the possibility of the administrative unit unilaterally terminating contracts.

From the administrative unit's point of view, the legislation may affect its ability to obtain funding from financial institutions due to the risk of not being able to pay back its loans.

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Disclaimer in liquidation

For those practising insolvency law in the UK, there are often quirks with the Scottish system that can spark debate and lead to difficulties with cross-border appointments. Section 178 of the Insolvency Act 1986 has been an issue in the profession for some time.

Section 178 gives a liquidator of a company which is being wound up in England and Wales the power to disclaim 'onerous property' leaving any affected creditor(s) to rank for damages in the liquidation. Onerous property includes any unprofitable contract and any other property which is unsaleable, not readily saleable or would give rise to a liability to pay money or perform any other onerous act. The power to disclaim has been an effective tool for liquidators in England. In Scotland, there is no equivalent provision to Section 178.

This led to a novel application being made to the Court of Session in Scotland regarding the issue of disclaimer in Scotland. The decision of Lord Hodge in the liquidation of the Scottish Coal Company Ltd ("SCC") was issued on 11 July 2013 following an application for directions by the joint liquidators. SCC carried on several businesses including the operation of open-cast mining at seven sites in Scotland. Some of the sites were being actively mined and some were currently disused, having been mined previously. The joint liquidators had managed to sell a number of the sites but the disused open-cast sites, and the statutory obligations attached thereto, remained an issue.

The financial position can be summarised as follows:

— GBP 1.4m per month – expenditure on maintaining all sites prior to partial sale

— GBP 9.7m to GBP 10.5m – estimated realisations in the liquidation

— GBP 478,000 per month – estimated cost of maintaining the retained sites post-sale

— GBP 73m – estimated cost of restoring the sites and the former sites in accordance with planning law

Therefore, the liquidators would have funds to maintain the sites for between 20 and 22 months but would never have the means to meet the restoration costs and comply with the relevant planning obligations.

Compliance with the statutory obligations would swiftly erode the proceeds of sale and the liquidators were keen to protect the available pot for the creditors by arguing that the liquidation created a statutory trust over the company's assets to be divided amongst the creditors in accordance with the usual ranking provisions.

The joint liquidators sought directions from the Court under four heads:

— whether they could abandon or disclaim the sites and former sites thereby transferring ownership to the Crown;

— whether they could abandon or disclaim the statutory licences or permits (which authorised the industrial activities but also imposed the onerous statutory obligations);

— the appropriate procedure to effect abandonment of the property under (i) and (ii); and

— the ranking of the costs of complying with the planning obligations and whether these would be classed as 'expenses'. Note that this head was considered non urgent and so will be decided on at a later date.

Due to the potential implications of the case for the environment and the taxpayer, a number of public bodies lodged answers to the application for directions and were represented at the hearing. Parties included The Scottish Environment Protection Agency (SEPA), local authorities and the Lord Advocate. Parties prepared detailed written submissions and agreed a timetable for the hearing which restricted the time that each could make oral submissions.

It was agreed at the outset that there was no statutory power of disclaimer (as contrasted with Section 178 IA 1986 as discussed above) and the application was without precedent in Scotland.

Head 1 – abandon or disclaim the sites

Legal issues

— s.169(2) IA 1986 provides that a liquidator has the same powers as a trustee on a bankrupt estate. As a trustee in sequestration (bankruptcy) has the power to abandon land, this can be read across to liquidation to be a power similar to s.178 disclaimer.

— Ownerless land is possible under Scots law as the Crown may waive its right to *bona vacantia* (ownerless goods that have fallen to the Crown) for example following dissolution of a company post-liquidation.

— A Scottish liquidator must have a power which is available to his English counterpart. This was not accepted by the Court on the basis that allowance must be made for the very different rules of property law in the two jurisdictions.

— Just as a trustee in sequestration can decline to deal with an asset and avoid the accompanying responsibility, so can a liquidator refuse to manage an asset and meet its related liabilities. In this situation, the asset would remain the property of the company until dissolution.

The decision

A liquidator has the power to disclaim land either by declining to use funds held for the benefit of creditors to deal with it or by taking steps to terminate the company's ownership of the land. However where the land is governed by statutory permits, his ability to disclaim will depend upon whether the licences and permits can also be abandoned.

Head 2 – abandon or disclaim licences/ permits

Legal issues

— SEPA may grant a water use licence to authorise the carrying on of a controlled activity. The liquidator can apply to surrender an authorisation and SEPA must determine the application within two months.

— Reference was made to the English authorities regarding the disclaimer of environmental licences.

— The Court's view was that there was no question of the liquidator spending money to maintain the status quo in the medium term until the money available to the liquidators runs out as no one would gain from that.

— Parties opposing the application suggested that the liquidator should not be allowed to disclaim and, in fact, should be compelled to spend creditors' funds in complying with the terms of the licence. The Court's view was that this would create an obligation which the liquidator would have to meet in priority over the preferential debts set down in statute.

— Opposing submissions also suggested that the liquidator's remuneration should rank equally with the obligation to spend money to comply with the licences.

The decision

The liquidators may disclaim the sites and release themselves from the associated obligations and are entitled to abandon the licences.

Head 3 – the appropriate procedure to effect abandonment of the property and licences

The noters set out a detailed procedure based on the procedures in England for abandoning onerous property. The Court felt the approach was reasonable and stressed that all interested parties should be informed and suggested discussions with local authorities and with the Keeper of the Registers of Scotland.

Conclusion

This unprecedented decision has attracted a lot of attention north of the border but will have wider implications. English IPs will be looking at the decision carefully when appointed to an insolvent company with onerous Scottish assets. The decision may also cause IPs to look more closely at potential 'toxic' jobs in Scotland.

The further issue will be the significant costs of restoring the sites to an acceptable state following the liquidator's disclaimer. Such costs may be enough to send one of the interested parties down the Appeal route. Watch this space…

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Debt restructuring and insolvency in Ukraine: new opportunities for restructuring

It is evident from the adoption of the new version of Ukrainian insolvency law, one of the principal pieces of legislation on restructuring and insolvency, that Ukrainian legislation is continuing to develop in this area. This development is aimed at making the applicable legislation consistent and at establishing specific procedures that are required in order to implement the restructuring options provided by existing legislation. This article highlights the latest developments regarding such procedures.

Debt-to-Bonds conversion available in Ukraine

Debt conversion is a widely used restructuring instrument in many countries. For a long time debt conversion in Ukraine was provided for by the Law of Ukraine On Joint Stock Companies. However, this instrument was not in reality operational, since there was no specific procedure required to be followed by law for the implementation of the debt conversion.

This spring, however, the above situation changed. The National Securities and Stock Market Commission of Ukraine (the "**Securities Commission**") adopted the amendments to the Regulation on Order of Issue of Corporate Bonds and Their Circulation (the "**Regulation**"). These amendments provide detailed procedures for the conversion of debts into corporate bonds.

According to the Regulation, debt-to-bonds conversion is only permitted for joint stock companies and only with respect to their monetary debts; it is not available for debts on salary, unified social contributions, taxes, duties and other mandatory payments. Debt-to-bonds conversion is possible on a voluntary basis at the discretion of a debtor's shareholders and creditors, as well as within solvency rehabilitation proceedings.

If a debtor's shareholders and creditors agree to convert the debtor's debts toward such creditors, it is required that the debtor's authorised body must approve the debt-to-bonds conversion and issue a relevant resolution on private placement of the bonds. In addition, each of the creditors who agreed the conversion of the debts must provide written consent to the conversion. If a creditor is a legal entity rather than an individual, the consent must be approved by the creditor's authorised management body.

If the debt-to-bonds conversion is performed within a solvency rehabilitation proceeding, it must be envisaged by the rehabilitation plan which must be approved by the creditors committee and the relevant commercial court.

The issue of corporate bonds resulting from debt conversion is subject to registration with the Securities Commission according to the procedure established by the Regulation for the registration of all other types of bond issue. The total value of the issued bonds shall not exceed the total amount of the debts converted into such bonds.

All issued corporate bonds are placed among the creditors who gave their written consent to the conversion of debts due to them from the debtor (private placing). The bond placing is performed by way of execution of novation agreements between the creditors and the debtor (bond issuer). The novation agreements provide that the agreements based on which the debts arose are terminated and the new debt obligations arise based on the issued bonds. The termination of the initial debt obligation becomes effective upon transfer of the ownership rights to the bonds to the creditor and registration of the report on the outcome of placing of the bonds with the Securities Commission.

It should be noted that the novation of a debt also entails termination of the additional obligations related to the debt, for example security, unless otherwise agreed in the novation agreement. Payment for the bonds is to be made together with the execution of the novation agreement mentioned above.

The amendments to the Regulation became effective as of 4 June 2013. The debt-to-bonds conversion provides debtors more flexibility in the debt restructuring process and allows them to meet creditors' demands. It thus appears to be a positive development for Ukrainian companies' businesses. As to the creditors, they must carefully assess the debt-to-bonds conversion option from both a legal and commercial standpoint, including with respect to the marketability of such bonds.

Amicable Settlement Agreement and Solvency Rehabilitation Plan Templates approved

One of the issues for the parties of insolvency rehabilitation proceedings was the preparation of insolvency documentation. Insolvency legislation set out the main requirements for such documentation but these requirements were unclear and therefore, in practice, the actual insolvency documentation often varied.

Recently, however, the Ministry of Justice of Ukraine approved templates of the Amicable Settlement Agreement and Solvency Rehabilitation Plan, as well as requirements for their drafting. The relevant resolution of the Ministry came into force as of 12 July 2013.

The templates of the above mentioned documents and the relevant requirements were adopted in order to unify the practice in this field. Although it is not clear whether application of the templates is mandatory, it may be expected to facilitate the accuracy of the documentation prepared within and speed up the rehabilitation procedure. As a result, this may improve Ukrainian bankruptcy and solvency rehabilitation practice.

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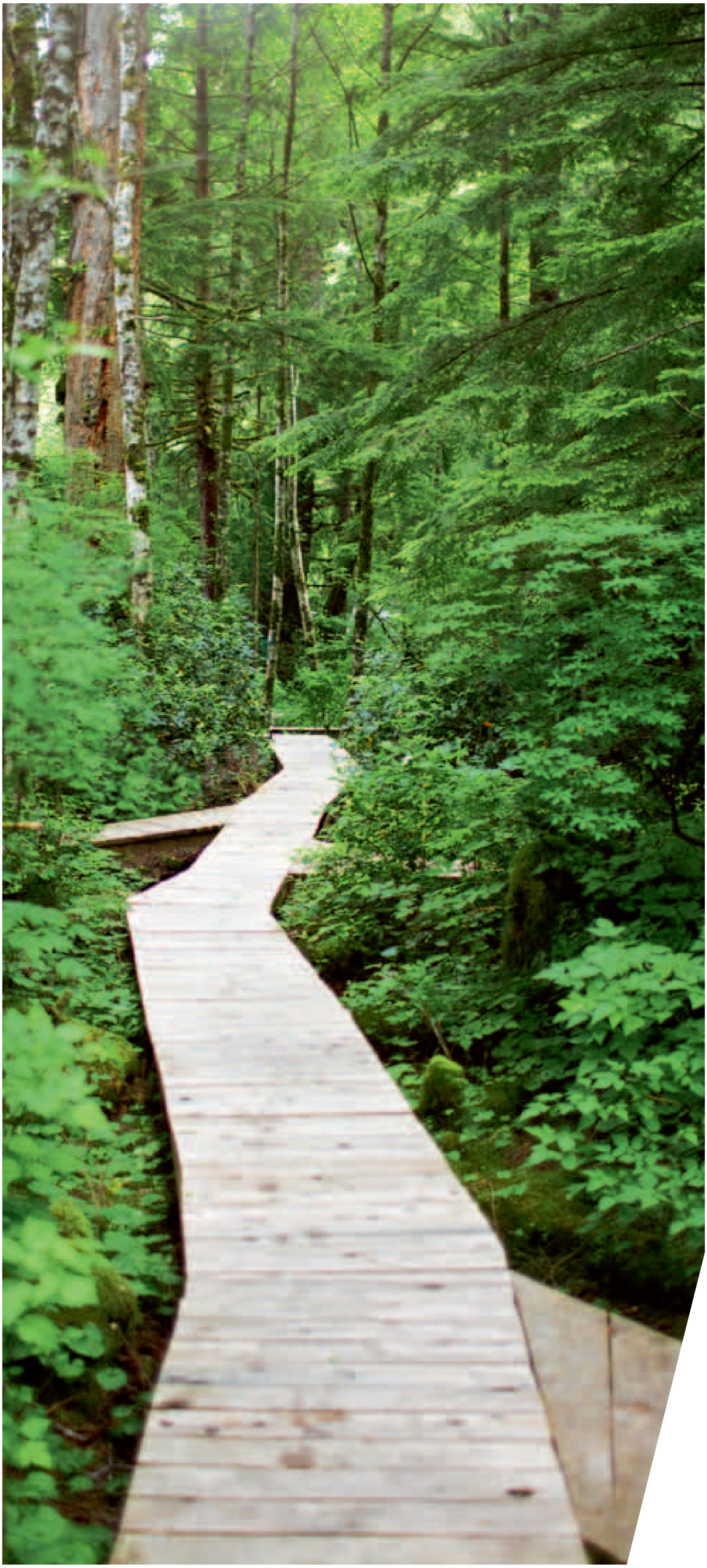

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