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Newsletter

CMS Restructuring and Insolvency in Europe

Spring 2013

Introduction

We are pleased to present this spring 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 Czech insolvency law which aim to increase the transparency of appointments and strengthen the rights of creditors;

— the advantages of English schemes of arrangement and recent case law on the recognition of schemes by English and German courts;

— a recent decision of the German Federal Court of Justice which potentially widens the scope for challenging transfers of shareholder loans;

— a proposed amendment aimed at broadening the powers of the Hungarian Government to put a company into a special insolvency regime;

— recent Italian case law regarding the lease of business units by companies in insolvency procedures;

— the potential for the formal introduction of the pre-pack procedure in Dutch law;

— recent case law demonstrating the more active role Scottish courts are willing to play in respect of approving insolvency practitioners' fees; and

— the introduction of amendments to Ukrainian insolvency procedures aimed at strengthening the position of creditors.

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 29 countries with 54 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

The spring edition of the CMS Restructuring & Insolvency in Europe Newsletter brings together a variety of contributions from our CMS offices all over Europe. We are happy to present articles from eight different jurisdictions in this edition.

You will find an interesting article from our Kiev office discussing the implementation of a new insolvency law which came into force in January 2013. The new law introduces more modern regulations, particularly in respect of cross-border situations. For example, the new law has abolished the former rigid 30-day deadline for submitting creditors' unsecured claims in insolvency proceedings. This deadline was a particular burden for foreign creditors. Furthermore, from January 2014 onwards, notice of the initiation of insolvency proceedings must be published on the official website of the High Commercial Court of Ukraine.

Issues relating to English law schemes of arrangement impact not only on companies incorporated in England and Wales, but also on many large companies or groups both within and outside the EU. As schemes of arrangement are not prescribed in Annex A to the EC Regulation on Insolvency Proceedings, they are not subject to the Centre of Main Interests (COMI) test. Consequently, they can provide a more flexible restructuring tool in international restructurings. However, there still remains some debate as to when schemes are applicable or indeed enforceable in cases which have a limited legal or factual connection with England and Wales. These issues are the subject of a contribution from our London office.

Our Czech colleagues examine the main changes envisaged in the recent proposal for an amendment to the Czech insolvency law. The proposal covers, amongst other matters, the strengthening of creditors` rights.

The cost of insolvency proceedings – especially those relating to the reimbursement and remuneration of insolvency practitioners – are subject to debate in many jurisdictions. The article from our Edinburgh office discusses recent cases which demonstrate that the Scottish courts are adopting a more "hands-on" approach in the approval of insolvency practitioners' fees. By taking a more active role in this process, the courts aim to increase the transparency of the profession.

The Hungarian parliament has decided to extend the time period during which the government may designate a company as being of enhanced strategic importance (CESI), and therefore subject to the special liquidation regime for a year following the commencement of the liquidation. The regulation came into force in 2011 and is aimed at making insolvency proceedings against CESIs more efficient. Our Hungarian colleagues question whether this goal has been achieved by discussing ongoing proceedings under the special regime and some criticisms of the amendment, including the opinion that it creates further lack of transparency.

In addition to reviewing new legislation on insolvency and restructuring matters, we provide you with analysis on interesting recent cases in various jurisdictions. Our Italian colleagues report on the courts' treatment of lease contracts under the court restructuring procedure *"concordato preventivo con continuità"*. You will also find an article from our Stuttgart office on a recent decision of the German Supreme Court on insolvency avoidance by way of shareholder loans, creating additional risks when such loans are transferred to a non-shareholder.

The Netherlands continue to labour under an insolvency regime which – in essence – dates back to 1893. An article from our Utrecht colleagues discusses the problems this has caused Dutch courts, for example the District Court in Maastricht recently refused to facilitate a "pre-pack" insolvency procedure under the existing legislation. It is evident that Dutch companies in financial difficulty seeking to restructure by way of insolvency proceedings face many challenges and obstacles.

The variety of articles and reports are a good example of the wide scope of expertise CMS has in restructuring and insolvency matters. We – the authors and editors – trust that you will enjoy the newsletter and look forward to receiving your feedback.

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Current topics in Czech insolvency law

In March 2013 the government submitted an amendment to insolvency law **("the proposal")** which is currently being discussed in the Lower Chamber of Parliament. The aim of this proposal is to, *inter alia,* improve the quality and standards of insolvency law, shorten the duration and increase the transparency of insolvency proceedings and strengthen the rights of creditors. This proposal is likely to be effective from January 2014.

In this article we will examine the main changes suggested by the proposal.

Transparent appointment of insolvency trustees

The question in relation to the transparent appointment of insolvency trustees has been an issue in the Czech Republic for a long time. This is because there are no formal rules for courts to follow on how to choose an insolvency trustee meaning that each court has, over time, adopted its own procedure. The proposal suggests that this will change and that rules regarding the appointment of insolvency trustees will be harmonised to reach a more transparent and objective outcome in insolvency proceedings. According to the proposal, insolvency trustees will be chosen on a regular basis from a specific list and choosing a trustee outside of this list will be prohibited. This rule will help to reach better, faster and more transparent insolvency proceedings in the long run and will also help to avoid improper use of personal connections in this area.

The priority of insolvency law

The issues surrounding the relationship between collective insolvency and self-help recovery of assets, and which has priority, are currently highly debated amongst professionals. According to current insolvency law *"in respect of corporate insolvency, self-help recovery of assets can be ordered but may not be carried out".* This rule causes many problems in practice because of its vague wording and the fact it is only applicable in respect of corporate insolvency (and not in respect of reorganisation or personal bankruptcy). Furthermore, many debtors abuse this rule by launching collective insolvency petitions to prevent creditors taking action to recover their assets. The proposal suggests setting out a clear rule which prioritises collective insolvency law over self-help recovery of assets and additionally the power to prohibit recovery being carried out in respect of all three types of insolvency, i.e. corporate insolvency, personal bankruptcy and reorganisation. This change will help improve the protection of creditors and their rights and will also help them to decrease costs as currently the unclear rule regarding the relationship between insolvency and recovery of assets results in creditors often being forced to pay back the insolvency and recovery fee to protect their rights in respect of a debtor's insolvency.

Pari passu principle versus special claims

Czech insolvency law, which is similar to most other European countries, applies the rule that claims in insolvency law are satisfied on the *pari passu principle.* Czech insolvency law however also contains a special category of claims which have priority over all other claims (e.g. labour law claims, maintenance claims, state claims) and therefore these claims are satisfied before any claim by another creditor. Nowadays Czech insolvency law is facing a potential expansion of this special category and new claims will soon have priority over the claims of other (non-priority) creditors. The proposal argues therefore that if the category of priority claims is not prohibited, insolvency law will become unpredictable and unclear. Additionally the creditor who loses their priority claim will have a smaller chance of his/her claim being satisfied because all the debtor's assets will be used to cover the priority claims leaving fewer assets to satisfy the non-priority claim. The proposal (inspired by German insolvency law which has no category of priority claims) suggests that the category of priority claims should be enumerative with no legislative provision to allow this category to be extended.

Reorganisations for more debtors

The aim of a reorganisation procedure (as opposed to the corporate insolvency leading to the termination of a debtor's business) is to stabilize entrepreneurial businesses and allow them to continue trading (under some conditions). Under current insolvency law, the rules regarding reorganisation are fairly strict: businessmen may ask for a reorganisation only if: (a) the entrepreneur has turnover higher than CZK 100,000,000; (b) the entrepreneur has more than 100 employees; or (c) the reorganisation plan has been approved by at least 50% of the secured creditors and 50% of the non-secured creditors. Any entrepreneurs who do not satisfy one of the above criteria will not be allowed to seek the reorganisation (and will therefore be declared insolvent). The proposal suggests loosening the above criteria regarding turnover and employees by half. The reason for this is that the reorganisation, as the only solution in insolvency which does not lead to termination of the business, has to be more accessible for debtors. This will also help creditors by giving them a greater chance of having their claims satisfied or allowing entrepreneurial businesses to overcome possible insolvency and continue trading.

A further change regarding insolvency law is expected in January 2014 when a new Act on Corporations will come into effect in the Czech Republic. The most important change is that insolvency courts will have new statutory powers to prohibit directors of a company from being a member of a statutory body (or in a similar company body) in any corporation for up to 3 years. The reasoning behind this exclusion is based on the perception that it is normally the directors' management that leads a company to insolvency or causes a reduction in the company's assets, putting the creditors of the company at a disadvantage. The proposal to exclude such directors may be submitted by the company itself, the insolvency trustee, creditors or any persons with valid concerns on the matter.

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Schemes of arrangement: an attractive restructuring tool for non-UK registered companies

Introduction

English schemes of arrangement are becoming an increasingly popular tool for the restructuring of non-UK registered companies. The key reason for this trend is often that there is no similar local law alternative which does not require the unanimous consent of creditors. The flexibility of a scheme is particularly advantageous in large restructurings involving syndicated lending.

The jurisdiction of the UK courts to sanction a scheme of arrangement proposed by a non-UK company has been the subject of much case law. This article reviews the current position in light of recent decisions.

What is a scheme?

A scheme of arrangement is a formal procedure under Part 26 of the Companies Act 2006 whereby a company may make a compromise or arrangement with its members or creditors, or any class of them. The scheme must be approved by at least 50% in number constituting 75% in value of each class of creditor, and then requires the sanction (approval) of the court. Once effective, a scheme will bind all the members and creditors of each class that approved the scheme. Therefore, schemes are a useful mechanism for overcoming the difficulties (and sometimes the impossibility) of obtaining the unanimous consent of creditors, as well as preventing a minority of creditors from frustrating the interests of the scheme company's creditors generally.

Recognition of schemes for non-UK companies

Common law conditions

Recent cases have illustrated the English courts' willingness to accept jurisdiction to sanction schemes proposed by non-UK companies.

There are 3 common law conditions governing when the court can make a winding-up order over a non-UK company:

(i) there must be a "sufficient connection" with England & Wales, which may include assets in the jurisdiction or English law formed finance documentation;

(ii) there must be a reasonable possibility of benefit to those applying for the winding-up order; and

(iii) there must be one or more persons interested in the distribution of assets who are persons over whom the English court can exercise jurisdiction.

In *Drax Holdings Ltd [2003] EWHC 2743 (Ch)* and *Re Rodenstock [2011] EWHC 1104 (Ch)* the court considered these conditions relevant to its <u>discretion</u> rather than its <u>jurisdiction</u> to sanction a scheme for a non-UK company. Nevertheless, a company seeking a sanctioning order from a UK court should seek to fulfil these common law conditions.

*EC Regulation on Insolvency Proceedings (1346/2000/EC) (the **"Insolvency Regulation"**)*

In December 2012, the Commission proposed that the definition of "insolvency proceedings" in Art (1)1 of the Insolvency Regulation be broadened to potentially include schemes of arrangement. If the Insolvency Regulation were to apply, a company would be required to have either its COMI or an establishment in the UK for the English court to have jurisdiction to sanction any proposed scheme.

Annex A to the Insolvency Regulation provides an exhaustive list of the national insolvency procedures governed by the regulation. However, the Commission does not have authority to unilaterally add specific proceedings to Annex A. It remains open to the UK Government to specifically request that schemes be included, but it appears unlikely that such request will be made. In the absence of such request, the Insolvency Regulation would not appear to restrict the English courts' jurisdiction to sanction a scheme proposed by a non-UK company.

*Council Regulation (EC) No 44/2001 on Jurisdiction and the Recognition of Enforcement of Judgments in Civil and Commercial Matters (the **"Judgments Regulation"**)*

In *PrimaCom Holding GmbH and others v Credit Agricole and others [2011] EWHC 3746 (Ch) (20 December 2011) and [2012] EWHC 164 (Ch) (20 January 2012)* the High Court sanctioned a scheme for a company incorporated and managed in Germany, none of whose creditors were domiciled in the UK. The court held that the company had sufficiently close connections with England & Wales to establish the court's jurisdiction on the basis that the governing law of all the company's scheme debts was English law, and importantly, the intercreditor agreement was also governed by English law.

The court also addressed the legal challenge arising under the Judgments Regulation. Article 2 of the Judgments Regulation states that persons domiciled in a Member State shall, whatever their nationality, be sued in the courts of that Member State. In *Re Rodenstock,* the court considered that a scheme company's creditors were potentially analogous to defendants. In light of this and as the majority of creditors in *PrimaCom* were domiciled outside the UK, Article 2 could arguably deprive the English courts of jurisdiction to sanction a scheme proposed by a non-UK company. To overcome this challenge, Hildyard J identified four possible solutions in *PrimaCom* that would allow the court to assume scheme jurisdiction, despite the Judgments Regulation:

(i) Article 2 of the Judgments Regulation has no application to schemes as they are not adversarial proceedings and there are no 'defendants' being sued;

(ii) if Article 2 were to apply to schemes, it remains subject to the Judgments Regulation as a whole. Article 23 of the Judgments Regulation will disapply Article 2 as the scheme creditors in *PrimaCom* had contracted out of it by means of the exclusive jurisdiction clauses in each of the lending documents;

(iii) Article 24 of the Judgments Regulation, which states that a court of a Member State before which a defendant enters an appearance shall have jurisdiction, could also disapply Article 2 and in *PrimaCom* the majority of scheme creditors had submitted to the English court's jurisdiction by appearing before it;

(iv) each Member State should apply its own domestic rules of private international law in the context of a process such as a scheme, by analogy with Article 4 of the Judgments Regulation which represents the fallback position where none of the provisions of the regulation are applicable.

Whilst the court in *PrimaCom* did express a preference in favour of option (i) and a reluctance to adopt option (iv), each of the four possibilities provide a basis for concluding that the Judgments Regulation does not prevent English courts from having jurisdiction to sanction a proposed scheme of arrangement for companies incorporated in another Member State.

Recognition of UK schemes abroad

When deciding whether to sanction a scheme proposed by a non-UK company, the English courts will seek evidence that the scheme will be recognised by the domestic courts in the jurisdiction of the company's registered office (or alternatively its COMI) and that the scheme can take effect in that jurisdiction. This is particularly important where there is a risk that the creditors who voted against the scheme may attempt to challenge it in the foreign court.

The law relating to the formal recognition of English schemes in certain Member States is in some doubt and has come under scrutiny since a regional appellate court in Germany refused to recognise the English scheme in *Equitable Life (OLG Celle 8 U 46/09).*

The German court held that the *Equitable Life* scheme could not be given effect in Germany for two reasons:

(i) Schemes are not recognised as "insolvency proceedings" under the German Insolvency Code, but are regarded as being more akin to settlement arrangements among a specific group of creditors; and

(ii) *Equitable Life* being an insurance matter invoked Articles 8, 12(1) and 35 of the Judgements Regulation which provide specific regulation on jurisdiction.

In practice, the *Equitable Life* decision is of limited relevance for future schemes. The German court based its judgment on specific insurance-related provisions and left open-ended the question of whether non-insurance related schemes could qualify as 'judgments' under the Judgments Regulation.

The decision in *Equitable Life* may also be distinguishable on the basis that all the relevant contracts in those proceedings were governed by German law. Where a non-UK company has entered into finance documents which grant exclusive jurisdiction to the English courts, an English judge may be more easily persuaded that there would be a reasonable prospect of a foreign court accepting any sanctioning order ultimately granted and that the scheme could take practical effect in another Member State.

Comment

We expect schemes to remain an attractive restructuring tool for both UK and non-UK companies due to their flexibility, the power they grant to majority consenting creditors to cram down non-consenting secured and non-secured creditors and their ability to shield a company from the stigma and the associated reputational damage of a formal insolvency process under the IA 1986.

The question of when the English courts have jurisdiction to sanction schemes for non-UK companies remains unresolved. Recent case law including *PrimaCom* and *Re Rodenstock* would suggest that provided sufficient connections with England & Wales are established to allow the court to disapply Article 2 of the Judgments Regulation, the legal hurdle of establishing jurisdiction will be overcome.

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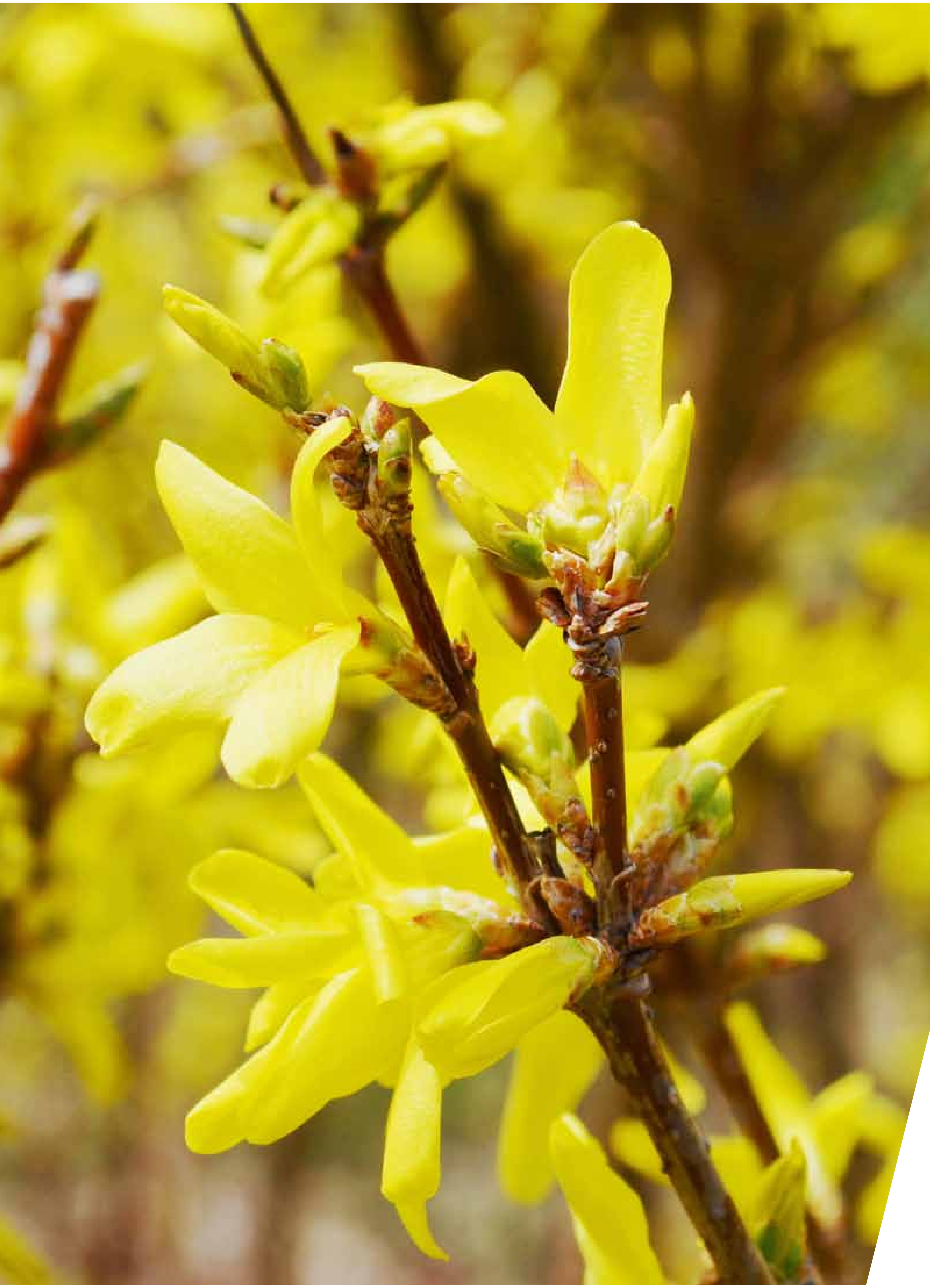

// **Germany**

Shareholder loans in insolvency: new liability risks for shareholders in corporate transactions

Not only shares and assets are transferred to the purchaser during corporate transactions, usually, intra-group financing is also transferred with the business assets. If the loan transferred is a shareholder loan the previous loan-giving shareholder faces the risk of potentially enormous liabilities as a result of the latest decision of the Federal Court of Justice dated 21 February 2013 *(BGH IX ZR 31/12)*. If the company pays the shareholder loan back to the purchaser the (previous) loan-giving shareholder may face liability if the repayment of the shareholder's loan is challenged **("shareholder loan claims")** in corporate insolvency.

The background to shareholder loan claims

The circumstances justifying challenge in the German Insolvency Act (InsO) serve to recover lost assets to the insolvent estate and better satisfy creditors. The German insolvency challenge law recognises a variety of circumstances some of which are based upon a subjective criteria specific to the debtor or creditor. The assessment of these criteria is often difficult. In contrast, a shareholder loan claim under § 135 InsO does not require evidence that this subjective criteria has been met. It is sufficient that the shareholder loan claim or an equivalent claim **("shareholder loan")** is paid back to the shareholder within a year of filing insolvency proceedings.

While the subordinate ranking of shareholder loans under § 39 (1) No. 5 InsO means that any outstanding shareholder claims in corporate insolvency are ultimately without value economically, a shareholder loan claim can be used to cream off the benefits the shareholder has obtained shortly before insolvency of the company by collecting its own claims as first priority at the expense of the creditors.

The scope of application regarding shareholder loan claims – principles of the prevailing case law of the Federal Court of Justice

Case law seeks to protect creditors by defining broadly the criteria for shareholder loan claims. In previous decisions the Federal Court of Justice stipulated that the scope of application of § 135 InsO does not only cover shareholder loans from direct shareholders: loans from affiliated companies or even outside third parties are covered by § 135 InsO if these are to be attributed to the direct shareholder economically. The objective scope of application of § 135 InsO has also been broadly defined to cover classic loan guarantees and also all shareholder benefits which have a crediting effect.

To protect creditors the Federal Court of Justice also decided that a shareholder loan claim transferred to a third party for a period of one year after transfer will retain the characteristics of a shareholder loan, including the subordinate ranking and shareholder loan claim. This principle also applies if the shareholder surrenders his interest but still remains the owner of the claim.

Facts of the decision by the Federal Court of Justice

The Federal Court of Justice has repeated these principles regarding the scope of the application of shareholder loan claims in its latest decision in February 2013 and added further aspects increasing the risk of liability. The Federal Court of Justice decided on a case, the facts of which are common in practice. The indirect shareholder granted a loan to the subsequently insolvent debtor. A few months after the loan was paid out, the indirect shareholder sold the loan to the purchaser. The insolvent debtor was informed and paid the loan amount back to the purchaser when it was due, a few weeks before insolvency proceedings were filed. The insolvency administrator requested that the indirect shareholder pay back the total amount of the loan on the grounds of the shareholder loan claim clause under § 135 (1) No. 2 InsO. Successful legal action by the insolvency administrator in the first instance was rejected by Stuttgart Higher Regional Court on the appeal of the direct shareholder. The Federal Court of Justice has now restored the decision made in the first instance.

Extension to the shareholder's liability due to the new decision by the Federal Court of Justice

The Federal Court of Justice justifies the liability of the (previous) shareholder by saying that the joint and several liability of the (previous) shareholder and the purchaser on repayment of the shareholder loan should prevent the shareholder from passing the risk of the loan guarantee on to the creditor and exploiting the shareholder loan for its own advantage. In particular in cases where the purchaser does not have the necessary assets or it is not possible to assert claims against the purchaser in court, the (previous) shareholder must assume liability for protecting creditors.

The court has left open the question of whether there is an allocation in economic terms each time a shareholder loan is transferred or whether further conditions are required. On the facts upon which the decision was based, there was collusion between the direct shareholder and the purchaser which justified an allocation in economic terms. In practice, there is not always collusion between the parties each time a shareholder loan is transferred. Aside from that, it is unclear from the decision of the Federal Court of Justice whether the joint and several liability of the (previous) shareholder has a time limit. The decision does indicate that the deadline of one year stipulated in § 135 (1) No. 2 InsO should also be applicable in this case. However, this statement is not clear. In addition, it is also unclear whether the deadline of one year begins when the shareholder loan is transferred or paid back.

Individual provisions are necessary

The prevailing case law of the Federal Court of Justice necessitates new provisions for corporate transactions involving the transfer of shareholder loans. Each individual case must be carefully examined to decide whether and which provisions come into consideration. The multitude of aspects associated with shareholder financing in distressed and insolvent situations will certainly provoke plenty of discussion in future.

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"Concordato preventivo con continuità" and the lease of business units

Law Decree no. 83 of 22 June 2012, which has now been passed into Law no. 134 of 3 August 2012, introduced several new regimes to Italian Insolvency Law **("IIL")** including the *"concordato preventivo con continuità"* and the "Blank Application" procedure.

Both regimes have been discussed in previous editions. By way of reminder, the *"concordato preventivo con continuità"* is a type of creditors' composition which allows the distressed company to keep the business running. The "Blank Application" procedure allows a company to file a preliminary application at Court seeking a creditors' composition whilst reserving the right to file the restructuring plan and the related documents required at a later stage but within the 60-120 day limit.

Under the *"concordato preventivo con continuità"* procedure the applicant company benefits from the option to repay existing debts for goods and services, if proven to be necessary for the continuation of the business, or a one-year moratorium for the repayment of priority creditors.

As a consequence, Italian insolvency law adopts a restrictive interpretation of the conditions which a company is required to meet when applying for a *"concordato preventivo con continuità"*.

The conditions (as prescribed in Art. 186 *bis* of IIL) state that (i) the relevant application shall include a detailed description of expected costs and income, (ii) an independent expert must confirm that the continued trading of the business is beneficial for the company, and (iii) the *"concordato preventivo con continuità"* must be structured to achieve one of the following three outcomes:

A) continuation of the business by the debtor itself;

B) sale of the business as a going concern; or

C) merger of the business into one or more other businesses.

The wording of Art. 186 *bis* is such that the lease of business units is not included in the outcomes (listed under A, B and C above) required for the applicant company to request a *"concordato preventivo con continuità"*.

Since the introduction of the *"concordato preventivo con continuità"* courts have confirmed the restrictive interpretation above (*inter alia,* Court of Terni, 28 January 2013) stating that by leasing its business, the company no longer bears the corporate risks associated with the continuation of the business, which is thereafter borne by the lessee only.

Also, through the lease of the business, the lessor typically obtains a fixed rent and consequently, there would be no need to fulfill the requirement, imposed by Art. 186 *bis* of IIL, to describe in detail the expected costs and income, given that any variables relating to the leased business will affect the lessee's organisation only.

However, a recent decision of the Court of Bolzano, dated 27 February 2013, has introduced a broader interpretation of Art. 186 *bis* finding that the lease of business units meets the conditions to allow a company to apply for a *"concordato preventivo con continuità"*.

The Court of Bolzano was asked to grant an order authorising the applicant company to sign a sub-lease agreement of one of its strategic business units, in the course of a "Blank Application".

The local Municipality had granted a lease to the company over a horse-racing track which was an integral part of the business. The company commenced the "Blank Application" procedure at the Court of Bolzano specifying an intention to continue trading, but no formal request for a *"concordato preventivo con continuità"* had been made.

Therefore, the Court of Bolzano deemed that it was necessary to carry out a preliminary inquiry into the possibility that the lease of a business unit could fall within the outcomes set out in Art. 186 *bis* for the application for a *"concordato preventivo con continuità"*.

The decision of the Court, which overturned existing case law, considered that despite the lease of business units, the distressed company continued to trade and bear the corporate risks of that trading, given that Art. 186 *bis* does not distinguish between the <u>direct</u> or <u>indirect</u> continuation of the business by the applicant company.

For example, where there is a lease agreement in respect of business units, the company continues to incur costs and generate income such that the outcomes set out in Art. 186 *bis* are met, regardless of the fixed or fluctuating nature of the rental income. The company is only required to demonstrate that the income is sufficient to allow it to continue trading and that it is beneficial to creditors.

The Court of Bolzano also stated that the benefits of the lease of business units shall be evaluated on a case-by-case analysis.

Incidentally the Court also stated that when a "Blank Application" is filed the company may subsequently seek a *"concordato preventivo con continuità"* even if this was not expressly mentioned in the application.

In the light of the above, the Court authorized the Company to execute the sub-lease agreement (provided that the Municipality granted consent) and clarified that such agreement is compatible with a *"concordato preventivo con continuità".*

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Extension of the "Companies of Enhanced Strategic Importance" regime in Hungary

The Hungarian Parliament introduced a special regulation in 2011 for the insolvency of those companies which the Government designates as being of enhanced strategic importance **("CESIs").**

The amendment of Act XLIX of 1991 on bankruptcy and liquidation proceedings **("Hungarian Bankruptcy Act")** was published in the Official Gazette on 19 April 2013 which extends the period during which the Government can issue a decree on designation of a company as a CESI for 365 days from the commencement date of the liquidation proceedings.

The above amendment will be applicable to ongoing proceedings too.

The official reasoning attached to the proposal of the amendment states that by such extension to 365 days, the Government will have more time to put a company under the special liquidation regime. This does not answer the question of why such an extension would be indeed necessary.

The ongoing liquidation proceedings against CESIs have not demonstrated that the aim of introducing the special regime (i.e. these insolvency proceedings are to be conducted at a much faster rate) would have been fulfilled (see for example the case of MALÉV). The above amendment also raises serious questions in the event that the normal liquidation proceedings of the company must be stopped and taken over by the state-owned liquidator at a later stage of the proceedings, in particular that:

— the "late" CESIs will lose the benefit which the "normal" CESIs can have from the extraordinary moratorium which commences on the date when such moratorium is published in the Company Gazette, i.e. within one business day from the receipt by the court of the liquidation request of the debtor company or the creditor. This extraordinary moratorium turns into a 90-day moratorium upon the court declaring the debtor company insolvent. During this moratorium, *inter alia,* the licenses and permits of the CESI may not be revoked; no creditor may terminate or rescind any agreement entered into with the CESI, nor can such agreements be automatically terminated due to the insolvency of this CESI; and the management is obliged to establish a reserve for payments that are expected to be made during the course of the moratorium for normal trading activities;

— it will be almost impossible to reinstate licences which are usually withdrawn at the outset of the liquidation proceedings;

— suppliers who have stopped supplying to the CESI are unlikely to reinstate supply;

— if the liquidation proceedings cannot be completed within 365 days, it could be because a buyer has not been found for the assets. In this case, when the special regime applies, if the liquidator so chooses, the sale of the assets can be performed in a non-transparent manner, excluding the public (e.g. closed tender process or direct negotiations).

In our view, this amendment creates further lack of transparency in liquidation proceedings.

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A future for the pre-pack?

All around Europe the flexibility of insolvency proceedings is a hot topic. As in other jurisdictions, in the Netherlands the market is in need of (additional) restructuring tools. Under the Dutch Insolvency Act of 1893 there are two corporate insolvency proceedings: insolvency and moratorium. Other insolvency proceedings, such as a pre-pack, are not included in the Dutch Insolvency Act.

There are examples of Dutch companies, such as European Directories (Gouden Gids), who have moved part of the group companies to the United Kingdom to benefit from an English pre-pack administration.

Recently in the Netherlands the issue has been raised whether there is a need for a procedure which is comparable to the pre-pack administration in England and if so, whether this is permitted by the (current) Dutch Insolvency Act.

Pre-pack

The term "pre-pack" is a term (and restructuring strategy) that is common in the United Kingdom and the Unites States. Generally the term is used to describe the process through which a company is put into administration and its business or assets (or both) immediately sold under a sale which was arranged before an administrator was appointed. Pre-packs are not a new restructuring strategy but their use is growing. Often a pre-pack involves the sale of a company's business, together with its assets, on a going concern basis. However, sometimes a pre-pack will just involve the sale of some or all of the assets of the company. The rest of the company's assets or the business may be sold off in a separate pre-pack transaction, or the company may be put into liquidation.

Over recent years, several jurisdictions have created a procedure which is comparable to a pre-pack in the United Kingdom. The competition between the jurisdictions involved is one of the reasons for jurisdictions introducing the pre-pack procedure. Furthermore, the proposed changes to the EC Regulation on Insolvency Proceedings (No. 1346/2000) take this into account, but are not discussed in detail here.

District Court Maastricht

In the Netherlands the case-law concerning the (in)admissibility of alternative restructuring strategies, such as a pre-pack, is limited. Taking the limited case-law into account, the decision of the District Court in Maastricht of 28 November 2012 about the (in)admissibility of granting a pre-pack as a part of procedural law, is interesting.

The facts of this case are as follows. The company with limited liability Sieswerda Taxi's B.V. filed an application before the court to grant an insolvency order on the condition that the court would – prior to the commencement of the insolvency proceedings – appoint an expert. This expert should be instructed to investigate, during a period of two weeks and on a confidential basis, the possibility of a sale of the company's business and assets. The results of this investigation were to be reported to the court. In its request before the court the company declared that its goal was to apply a pre-pack mechanism to optimize the possibilities of a sale on a going concern basis. It was the intention of the company that the court would appoint this expert as receiver as soon as the company was declared insolvent by the court. Furthermore, the company requested the court to announce (in advance) which member of the court would act as supervisory judge in the insolvency.

District Court Maastricht found that it was not bound, at the request of the market, to sanction the use of a pre-pack. The court rejected the application filed by the company and ruled that the company was unable to pay its debts and declared the company insolvent. With respect to the request of the company to appoint an expert, the court ruled that there is no legal ground for this request. An investigation as requested is possible only as far as it is related to the legal requirement for insolvency, namely whether the company has ceased to pay its debts. By superfluous reasoning the court noted that an investigation by an expert prior to insolvency should not include an investigation about the (im)possibilities of a sale of the companies' business and/or assets.

Criticisms of District Court Maastricht's decision

A pre-pack as a restructuring proceeding itself is not provided for in Dutch legislation. Nevertheless the judgment of District Court Maastricht has been received with criticism.

Lately there have been judgments about pre-packs in two other cases. In both judgments an expert has been appointed to investigate whether the company had ceased to pay its debts. In addition to this task, the expert was explicitly requested by the court in one of these judgments to investigate the possibility of a sale of the business. In the other judgment the expert was additionally ordered to seek possibilities for the company to pay the outstanding debt of the petitioner of the insolvency proceedings as well as possibilities for reaching a settlement with the petitioner. In both of these judgments the judge discussed the interests and circumstances of the parties involved extensively. The decisions in both cases were pragmatic and consistent with the market's need for the application of a procedure analogous to a pre-pack.

In legal literature and in the legal market, this decision of District Court Maastricht has been criticized and has been seen as a departure from previous case law. The Supreme Court has not yet expressed a substantive opinion about the possibilities of the application for a pre-pack under Dutch law.

Benefits of introducing the pre-pack to Dutch insolvency law

In legal literature the benefits of permitting a pre-pack in the Netherlands are made clear. These benefits are, *inter alia,* (i) the possibility to avoid – as much as possible – loss of value of the company's business and assets; (ii) the ability to realise a sale of the company's business and assets within a short period; (iii) the confidentiality of the prepared sale through pre-pack administration; (iv) the involvement of a receiver at an early stage as a result of which the receiver is in a better position to collect as much information as necessary; (v) the possibility for potential buyers to have more opportunities to perform due diligence; (vi) a successful sale through a pre-pack will generally result in the preservation of jobs and value as much as possible and (vii) the value of the company as a going concern will be significantly higher than the sale of the company's business and assets in regular insolvency proceedings.

In addition to the well known benefits of a pre-pack, Dutch insolvency law brings additional advantages if the pre-pack procedure were to be sanctioned under Dutch law. One of these benefits is that a supervisory judge (who is an officer of the court) is involved in the insolvency proceedings. The receiver needs prior approval of this supervisory judge for a sale of the company's business and assets. During a pre-pack this supervisory judge will be involved already and will discuss the state of affairs with the receiver. The involvement and assessment by this independent, supervisory judge in the actions of the receivers is expected to limit the risks of complaints or challenge after a sale has been completed.

Secondly an expected benefit of the Dutch legal system would be that the employment regulations concerning transfer of undertakings (under which certain employees are protected from dismissal) are not applicable during insolvency. As a result of this, employees of the company will not receive any protection of their position during a pre-pack arranged sale of the companies' business and/or assets. Based on recent case law, this may be an important difference from the United Kingdom.

In conclusion

In practice market players do feel the need for more flexible ways of effecting a corporate restructuring. In legal literature most commentators agree that a pre-pack should be allowed. No coherent view has been established from recent case law on whether or not a pre-pack is permitted according to the current Dutch insolvency law and the question has not yet been presented before the Supreme Court.

The lack of clarity about the (formal) allowance of a pre-pack is overcome in practice by the use of an "informal pre-pack". In these circumstances, the company requests the court informally (by letter) to involve in the companies' affairs a person who is officially registered as receiver and a supervisory judge. Both of them do not have an official role in the pre-insolvency stage, but will be engaged in advising on the structure of the sale which will be arranged. The court confirms informally that these persons will – at the moment the company is declared insolvent– be appointed as receiver respectively by the supervisory judge.

With this informal route CMS and other advisors are trying to create a more flexible alternative for companies in financial difficulty. This route seems to have been successful to date. However, the Netherlands are ready for a legally formalized pre-pack procedure as a restructuring tool in the future which requires the legislator to be sufficiently convinced to take the necessary action.

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A look at IPs' fees and the role of the courts

The increased scrutiny and suggestion of tighter regulation of insolvency practitioners (IPs) is a UK wide issue and the cost of insolvency remains a hot topic in the press and within the profession. As IPs' remuneration is paid in priority to creditors in an insolvency, it is understandable (particularly in the current climate) that these costs are often subject to close examination.

In Scotland there have been a couple of recent decisions of the Court of Session which indicate that the commercial court is taking an active interest in the issue of IPs' fees.

Scottish liquidation – approval of fees

In short, it is for the liquidation committee (if there is one) to fix the liquidator's remuneration and approve disbursements. The liquidation committee is made up of between 3 and 5 creditor members and is usually formed at the initial creditors' meeting. Approval by committee provides an objective review of fees but from a practical point of view, it can be difficult to get creditors engaged in the insolvency process. Therefore in many cases no committee is formed and so the liquidator must apply to court for approval for fees. It should also be noted that where a provisional liquidator is appointed (often between the date the petition is presented and the date of the winding up order when the interim liquidator is appointed) only the Court can approve the remuneration for that period.

Approval by the Court

In seeking approval from the Court, the liquidator asks the Court to appoint a Reporter (also an insolvency practitioner) to examine the remuneration charged. The Court Reporter prepares a report, confers with the Auditor of Court to agree the level of remuneration and finally the Court issues an interlocutor (court order) approving the remuneration. The final sign-off by the Court was previously viewed as something of a formality on the basis that the cross-checking by the appointed Court Reporter and Auditor of Court was sufficiently robust. However, recent decisions suggest that the Court is seeking to take a more active role.

Court decisions

At the start of 2011, Lord Glennie issued a decision relative to the joint administrators' fees in a trading jewellery business which was critical of the chargeout rate basis and also of the level of vouching produced for time spent. The Reporter and Auditor had already discounted the level of remuneration sought, removing time for pre-appointment work/strategy and also applying a 12% reduction across the board in relation to the rates charged. When asked to approve the discounted remuneration, Lord Glennie then reduced the remuneration further by applying a 'broad-brush' discount of one third to two large categories of work which concerned him. This was the first real indication of a pro-active stance being taken by the Court in a reported case.

There have now been two recent cases in point which are of interest: *Quantum Distribution Ltd* (Lord Hodge, 18 December 2012) and *St Margaret's School* (Lord Malcolm, 11 January 2013).

In *Quantum,* the liquidator sought approval for remuneration of around GBP 39,000. Although a liquidation committee had been established, it had been disbanded due to potential conflict of interest issues. The liquidator therefore applied to the Court for approval and a Court Reporter was duly appointed.

Unusually, the Reporter said he was unable to confirm the suitable level of remuneration to be paid due to irregularities within the case. In particular, the compromise of a claim with a related company which led to the sum of GBP 100,000 being paid over by this company, GBP 50,000 of which came in to the liquidation with GBP 50,000 being paid directly to the landlord (who was majority and petitioning creditor). There was also a suggestion that solicitors may have been in a conflict of interest situation in acting for both the landlord and the liquidator.

Due to concerns raised by the Reporter, the Auditor was similarly unable to report on the appropriate level of remuneration. No application was subsequently made to the Court for the remuneration to be approved (as would be the norm) or to take issue with the reports which had been produced. Instead, the liquidator sought to obtain approval by other means by convening a new creditors' committee and seeking approval for remuneration from them.

The Court Reporter's fee was not paid, which highlighted an irregularity in the process and led to the court fixing a hearing. Lord Hodge viewed the conduct of the matter as a deliberate attempt to get around the court process and said that those involved showed a "striking disregard of their obligations to the court". He also indicated that whilst it would be acceptable in many cases for a solicitor to act for both the petitioning creditor and the liquidator, a solicitor cannot act for both in cases where the creditor's claim is complex and open to dispute. The tone of the decision is very scathing and there are lessons to be learned for both IPs and solicitors regarding their professional duties to the court, clients and other stakeholders.

In *St Margarets School,* the Court was asked to approve the remuneration of the provisional liquidator for a period of 20 days, amounting to around GBP 120,000 (approx 421 hours of time). The liquidation committee had approved remuneration for the periods following the winding up but, as noted above, only the Court can approve the provisional liquidator's remuneration. The Reporter and Auditor in this case had approved the level of the provisional liquidator's remuneration but, due to the level of fees involved in a relatively short period, the Court fixed a hearing to be addressed further.

The background was that the Edinburgh private school traded for 3 weeks (post appointment of the provisional liquidator) to the end of the academic year. There was a great deal of front-loading of the job including preparing a sales memoranda, dealing with the various stakeholders and regulatory bodies and handling the media. The Reporter's view was that the work undertaken was fully justified and supported by the underlying case records. The realisations in the liquidation ultimately amounted to GBP 4,627,000 and it was clearly a complex job which required a larger firm and senior personnel within that firm with the requisite skills and experience.

The Court was satisfied with the further information provided at the hearing and the remuneration sought was approved without deduction.

Going forward

It is clear that the Court is prepared to take a more active role in the fee approval process, and will not hesitate to fix a hearing where there are concerns. The suggestion from the recent decisions is that the Court will be closely monitoring the situation and looking for ways to strengthen the fee approval process and improve the transparency of the profession.

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New insolvency regulations come into effect

On 18 January 2013 the Law of Ukraine on Introducing Changes to the Law on Restoring Debtor Solvency or Declaring Insolvency **(the "New Insolvency Law")** came into effect. It makes a number of important changes to insolvency procedures in Ukraine.

The New Insolvency Law provides better protection for creditors whose claims are secured with a pledge. It also changes the framework for starting and carrying out an insolvency procedure in the Ukrainian commercial courts. There are also changes to the out-of-court debtors' rehabilitation procedure which may be followed before starting insolvency proceedings at a commercial court. The New Insolvency Law adds a new chapter of legislation on international cooperation in cross-border insolvency procedures.

A significant change concerns the restrictions on when unsecured creditors can join ongoing insolvency proceedings at a commercial court. Previously an unsecured creditor wishing to join proceedings had to file its claim within thirty days from the date of official publication of the start of proceedings. This period could not be extended, which meant that if an unsecured creditor missed the deadline, it could not join the proceedings regardless of the significance of its claims against the debtor. Now commercial courts handling insolvency cases will be obliged to accept the claim even if it was filed after the expiry of the thirty-day period. Such claims, however, may only be satisfied after the claims filed by unsecured creditors on time have been considered.

The New Insolvency Law requires that if a creditor files a claim expressed in foreign currency, the value of the claim must be specified in Ukrainian Hryvnias according to the National Bank of Ukraine's official exchange rate on the date the claim is filed with the court.

The New Insolvency Law requires that an out-of-court debtors' rehabilitation procedure be established and approved at a general creditors' meeting. It should then be filed with the relevant commercial court for final approval. The term of the rehabilitation procedure may not exceed twelve months from the day the plan is approved by the commercial court. During this term, it is not possible to start insolvency proceedings.

Another significant change is that secured creditors are now protected even if they are excluded from the creditors' committee. The debtor's secured assets are isolated from the main asset pool and reserved for settling secured creditors' claims. Secured creditors now also have the right to reject a reorganisation plan approved by the creditors' committee and to withdraw from insolvency proceedings by having their claims settled by selling the pledged assets or by a direct purchase of the debt by other creditors.

Under the New Insolvency Law, official publication of the start of insolvency proceedings must be made on the official website of the High Commercial Court of Ukraine. However, this rule will only come into effect on 19 January 2014. At the moment publication can only take place in a number of state newspapers, which makes it more difficult for creditors to learn about the start of proceedings and file their claims against the debtor within the thirty-day period.

Overall, the New Insolvency Law provides for more comprehensive and progressive regulation of the insolvency procedure and changes it in accordance with current economic and legal developments.

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