NEWSLETTER

CMS RESTRUCTURING AND INSOLVENCY IN EUROPE

AUTUMN 2011

INTRODUCTION

We are pleased to present this Autumn 2011 edition of the CMS Restructuring and Insolvency in Europe Newsletter. We aim to give information on topical issues in insolvency and restructuring law in countries in which CMS offices are located.

This edition looks at:

— the unenforceability of netting arrangements in respect of non-merchants under Belgian law;

— insolvency law developments in the Czech Republic;

— the recent amendment to the Act on Transformations of Commercial Companies and Cooperatives and the Commercial Code in the Czech Republic;

— the use of debt for equity swaps in the German restructuring market;

— challenges to acts and transactions performed by insolvent Bulgarian companies in insolvency proceedings;

— criminal liability in respect of shareholders who finance a company in distress in Italy;

— the special insolvency procedures applicable to Hungarian companies who are deemed to be of strategic importance;

— the law in respect of liability of domestic and foreign directors in the Netherlands;

— the legal framework surrounding the commencement of insolvency proceedings at a debtor's request in Romania;

— the changes to the privileges of secured creditors in Ukraine;

— amendments to the loan market regulations in Ukraine; and

— recent case law regarding the scope and effect of the anti-deprivation principle in the UK.

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 jurisdictions with 54 offices in Western and Central Europe and beyond. CMS was established in 1999 and today comprises nine CMS firms, employing over 2,800 lawyers and is headquartered in Frankfurt, Germany.

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

Members of the Practice Group advise on restructuring and insolvency issues affecting business across Europe. The group was created in order to meet the growing demand for integrated, 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

With pleasure I present the Autumn 2011 edition of the CMS Restructuring and Insolvency in Europe Newsletter. I hope this edition will again increase and broaden your understanding of the insolvency regimes across Europe.

The bankruptcy of Lehman Brothers in the autumn of 2008 was the beginning of a worldwide recession. In 2009, the number of bankruptcies in the Netherlands rose by as much as 50 per cent. Despite the continuing crisis, the number of bankruptcies decreased again in 2010 and 2011. Furthermore, the number of major bankruptcies/insolvencies was relatively small. The moderate recovery of the economy at the beginning of 2011 came to an abrupt halt due to the Greek debt crisis.

The economic upswing in the Netherlands at the beginning of 2011 was to a significant extent caused by a rise in exports and increasing activity in the transport industry, as a result of the strong German economy. With the stagnation of the German economy this has come to an end, while confidence in the recovery of the Dutch economy seems to have disappeared along with it. It is feared that the number of bankruptcies will rapidly increase in the coming months and, in contrast to the period 2008–2009, there will be more major bankruptcies/insolvencies.

A direct consequence of this is that demand in the real estate market has almost disappeared. This concerns both the housing market and non-residential real estate. Liquidity is decreasing rapidly in these markets, while a revaluation of real estate should take place as a result of the rapidly changing market conditions. After revaluation, the equity capital of an enterprise decreases, which has direct consequences for the financing of the enterprise. In the past few years it seemed as if, in expectation of the recovery of the economy, the downward valuation of real estate was not carried out, apparently hoping that the value of real estate would recover in an improving economy.

As a consequence of the stagnating real estate markets across Europe, we have seen a number of companies in the real estate sector falling into financial difficulties. The number of insolvencies in this sector has remained limited in recent years as a result of the reasons outlined above, as well as the effects of the capital still present in these enterprises. However, it must be feared that as a result of the evaporated confidence in the recovery of the European market and the absence of capital in enterprises, the number of companies being placed into a formal insolvency process in the real estate sector will increase rapidly. All this will have far-reaching consequences for consumer spending and thereby, the whole European economy.

With liquidation values of real estate often falling below 50 percent of appraised values, it is feared that an inevitable consequence will be that banks reduce their appetite for lending to enterprises in the real estate sector. Banks that have made sufficient provisions will also not wait for foreclosure but promptly proceed with calling in the debt and selling the real estate.

We have witnessed a significant rise in the number of restructurings taking place in the real estate sector across Europe over the last 12 months. As a result of the previously described problems with the strong devaluation of real estate and the rapidly deteriorating possibilities for financing an enterprise, it is very important for the implementation of restructuring in the real estate sector that a timely start is made. In this way, a large discrepancy between credit and the extent of cover can be avoided. All in all, it is a sombre outlook for those companies engaged in the real estate sector.

The collaboration within the CMS Restructuring and Insolvency practice group is taking ever-more permanent forms. Our CMS lawyers are increasingly involved in cross-border (threatened or actual) insolvencies, where it is of great importance to collaborate effectively with colleagues in other jurisdictions. Valuable time is hereby saved, time that could be instrumental in the success or failure of a restructuring programme.

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NETTING ARRANGEMENTS: UNENFORCEABLE IN BELGIUM AGAINST NON-MERCHANTS, ANY SOLUTIONS?

The Belgian Constitutional Court declared netting arrangements in insolvency proceedings, which are explicitly allowed under the Belgian Financial Collateral Law of 15 December 2004, unconstitutional where such netting arrangements apply to non-merchants. Despite the numerous criticisms on this decision, a legislative proposal was drafted on 13 September 2011 in order to explicitly exclude non-merchants from the application of the Belgian Financial Collateral Law. However, even vis-à-vis non-merchants, financial institutions still have the possibility of claiming the netting by operation of (the more strict conditions of) the Belgian Civil Code.

The Belgian law of 15 December 2004 on financial collateral arrangements and several tax provisions in relation to security collateral arrangements and loans of financial instruments (the so-called *"Financial Collateral Law"*), revolutionized the law as it validated, among other things, general netting and close-out agreements/clauses.

Netting and close-out clauses are often (if not always) contained in agreements between financial institutions and customers, and allow them to terminate the agreement(s) upon the occurrence of an event of default of the counterparty (e.g. bankruptcy or another insolvency proceeding) whereby the parties will set off all their mutual claims arising from the termination of the agreement(s).

Pursuant to articles 14 and 15 of the Belgian Financial Collateral Law, such clauses are enforceable against third parties notwithstanding the opening of a bankruptcy or any other insolvency procedure and regardless of whether the contractual parties are companies or individuals or whether they are commercial or non-commercial parties, as long as the following conditions are met:

(i) the clause has been entered into prior to the opening of an insolvency proceeding; and

(ii) the mutual claims to be netted existed at the moment of the opening of the insolvency proceeding (which includes claims that only become due as a result of the insolvency proceeding).

Moreover, pursuant to article 16 of the Belgian Financial Collateral Law, a bankruptcy receiver or a creditor could only question the validity of a netting arrangement undertaken by the bankrupt entity during the so-called "suspect period" of a maximum of six months prior to the date of bankruptcy if such a netting agreement is entered into without any consideration, or for a consideration which is obviously below market value, or if such agreement is concluded by fraud.

As regards an entity in judicial reorganisation, the law of 31 January 2009 on the continuity of enterprises explicitly provides that netting arrangements are enforceable.

However, with respect to individuals who are non-merchants and who can apply for a collective debt arrangement which protects them against creditors in case of personal bankruptcy, the Belgian Constitutional Court ruled on that the provisions of the Financial Collateral Law regarding the enforceability of netting agreements are unconstitutional if one of the contractual parties is an individual who is not a merchant within the meaning of article 1 of the Belgian Commercial Code. This decision is based on a questionable reasoning that the Financial Collateral Law is inspired by the idea of economic growth and financial stability, and therefore is only applicable to companies and wealthy individuals. The Court argued that, given the intended purpose of enhancing economic growth and stability in the financial sector, the provisions of the Financial Collateral Law allowing credit institutions to enforce netting agreements in insolvency proceedings are *not pertinent* to the extent that they also apply to debtors who are private individuals and who are forced to file a petition for a collective debt arrangement.

In practical terms, this means that financial institutions are, since this decision of the Constitutional Court on 27 November 2008, no longer able to invoke contractual netting against a non-merchant individual.

Despite the numerous criticisms of the Constitutional Court's decision, the legislative proposal drafted on 13 September 2011 has applied the principle applied by the Constitutional Court. If the proposal is accepted by Parliament, article 14 of the Belgian Financial Collateral Law will explicitly exclude non-merchants from its scope. Netting arrangements would, however, remain enforceable in cases of insolvency of ex-merchants provided at least one of the claims arose when he or she was still a merchant.

Does the above mean that financial institutions are, under Belgian Law, unable to apply any set-off of debts and receivables in the relation with their clients in case of insolvency proceedings? No, Belgian Law still foresees the possibility of netting by operation of law in accordance with the articles 1289 and sq. of the Belgian Civil Code. Pursuant to these provisions, a legal right of set-off occurs even if the parties are not aware of the circumstances giving rise to the right of set-off, if, in relation to two debts, the reciprocal claims are established, liquid and mature. In cases of insolvency, netting is allowed if the aforementioned conditions are met and if the claims to be netted arise out of the same agreement or out of different agreements which are closely connected with each other. Even if the appreciation of this "close connection" depends on a factual appraisal by the competent court and is, therefore, uncertain, contractually agreed "connectivity" between claims should constitute valid evidence of such "close connection".

We hope that the legislative proposal of 13 September 2011 is rejected by Parliament and that the legislator adopts a law confirming that netting arrangements are also applicable to non-merchant individuals.

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CHALLENGING THE VALIDITY OF ACTS AND TRANSACTIONS PERFORMED BY AN INSOLVENT COMPANY IN INSOLVENCY PROCEEDINGS

The collection of the insolvency estate is one of the important phases of insolvency proceedings. The Bulgarian Commerce Act (Issue No. 48 dated 18 June 1991, as amended) (the **"Act"**) provides certain tools to facilitate the collection of funds and other assets in order to "maximise" the insolvency estate. One such tool is the ability of the insolvency administrator, or the creditors to the insolvency estate, to challenge the validity of acts and transactions performed by the insolvent company after the insolvency trigger date.

1. Legislative overview

Bulgarian law provides mechanisms by which an insolvency administrator or an insolvent company's creditors may challenge acts or transactions entered into by the insolvent company.

Generally, the acts and transactions which may be deemed null and void vis-à-vis the creditors of the insolvent company may be split into two groups, depending on the period in which they were performed or entered into:

1.1 Acts or transactions performed or entered into after the date of commencement of insolvency proceedings

Under the Act the following actions, if undertaken by the company after the commencement of insolvency proceedings and in violation of the provisions of the Act, are null and void against the insolvent company's creditors:

(a) payment of monetary obligations that existed before the insolvency proceedings commencement date;

(b) granting a contractual mortgage or a pledge over assets of the insolvency estate; or

(c) a disposal of rights or assets of the insolvency estate.

1.2 Acts or transactions performed or entered into after the initial date of the insolvency trigger

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

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

(a) the discharge of monetary obligations;

(b) transactions with assets of the insolvency estate made for no consideration;

(c) the creation of any security interest in assets of the insolvency estate; and

(d) any transactions at an undervalue concerning the assets of the insolvency estate.

Although the Act provides that the acts and transactions listed under paragraphs 1.1 and 1.2 above are null and void against the insolvent Company's creditors, they will only be null and void when declared so by the competent court ruling on the insolvency proceedings.

A key question relates to the filing of claims for invalid acts and transactions and, in particular whether this claim may be made in running court proceedings or in a specific proceedings dealing with this issue.

The Courts have been quite consistent in applying the Act in this respect. As per the specifics of the procedure and the correlation with other claims in the insolvency proceedings, the court tends to declare acts/transactions vis-à-vis a creditor, null and void in specific court proceedings.

Such court practice is mainly based on the effect of the court's decision and its binding power. If the nullity is proclaimed ad hoc, the insolvent company may be deprived of the possibility to rescind the challenged transaction and claim reinstatement of the assets or rights in question under the invalid acts/transactions. Where an act or transaction is successfully declared void, the other party to the challenged act or transaction shall become a creditor of the insolvent company.

2. Proposed amendments to insolvency proceedings

Recently, there have been discussions regarding amendments to the Act and, in particular, to the sections regulating insolvency proceedings. In order for any amendments to be implemented, they will have to be passed through, discussed and adopted by the Bulgarian Parliament and further promulgated in the State Gazette. The proposed amendments are currently in an early stage.

The draft amendments to the Act provide quite significant amendments to the insolvency position, as stated above. For example, they limit the possibility of creditors to challenge acts/transactions performed/entered into by the insolvent company. One of the amendments provides that creditors may challenge the validity of acts/transactions under 1.2 above only if they have been performed/entered into no later than six months prior to the date of filing for the initiation of insolvency proceedings. Such a period is longer in the case of related party transactions.

Further, the draft of the amended text provides that creditors will not be entitled to challenge the validity of acts or transactions if security (a mortgage or pledge) has been granted in relation to credit for the acquisition of the subject of the security; or if the insolvency estate will not increase as a result of the act or transaction being declared invalid and void.

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CZECH CASE LAW DEVELOPMENT

Following last edition's article on the insolvency proceedings of the market-leading Czech betting company, we would like to provide an update on the progress of the company's insolvency proceedings.

As set out in our previous article, the company's private creditors voted for bankruptcy of the company, and on 30 May 2011 the court confirmed the creditors' choice and officially announced the bankruptcy of the company. Following the decision on bankruptcy, the insolvency administrator is expected to convert the assets of the bankrupt company into cash so as to achieve the best result for the company's creditors.

The creditors held a meeting on 11 August 2011 and approved the proposal of the insolvency administrator to sell the whole enterprise of the betting company through one purchase agreement in a tender. Pursuant to the respective provisions of law, such a sale also has to be approved by the court. The court approved the sale of the whole enterprise on 17 August 2011. Following the court's resolution, the insolvency administrator announced the tender on 19 August 2011.

The tender process

The only criterion was that the bidder with the highest price will win the tender and become the owner of the whole enterprise of the bankrupt betting company. Each bidder (individual or legal entity) must have submitted an application and pay a deposit amounting to CZK 500 million (approx. EUR 20 million) within 35 days following the announcement of the tender (i.e. until 23 September 2011) to qualify for participation in the tender. The purchase agreement agreed with the successful bidder must have been approved by the Czech Office for the Protection of Competition (and/or by the European Commission if applicable) to become effective. If the agreement was not approved by the Office for the Protection of Competition, the purchase agreement would not become effective and the bidder must pay a contractual penalty amounting to CZK 1.5 billion (approx EUR 60 million) in such case. These conditions were publicly criticised by several businessmen for being harsh, however the insolvency administrator insisted that they remain in place. The proposal of some of the businessmen for public auction has been rejected by the insolvency administrator as less profitable and more risky due to a threat of scheming during the auction.

The insolvency administrator was entitled to decline all the offers and could cancel the tender at any time.

On 23 September 2011 the insolvency administrator publicly announced that three offers have been submitted in the tender, the highest offer being CZK 3,810,000,000 (approx. EUR 152,400,000). The winner of the tender, an SPV held by a financial group ultimately owned by two Czech top businessmen, has been officially announced by the insolvency administrator on 26 September 2011. On the same day the insolvency administrator as the seller and the winner of the tender as the purchaser entered into an agreement on purchase of the whole enterprise of the bankrupt company for the aforementioned price. On 29 September 2011 the court granted its consent with the execution of the agreement, and on 27 October 2011 the transaction was finally approved by the Czech Office for the Protection of Competition. As a result, the agreement on transfer of enterprise has entered into effect as of 27 October 2011, which means that the winner of the tender has become a rightful owner of the betting company's enterprise, including its trademarks and business name.

Contesting the tender process

Notwithstanding the above, a competing financial group has contested – together with one creditor of the bankrupt company – both the tender process and the conclusion of the agreement to purchase the enterprise. This financial group, supposedly owned by a group of Czech and Slovak businessmen, had previously expressed its interest in acquiring the enterprise of the bankrupt company and presented itself as a fourth serious candidate for the acquisition. However, from the beginning of the tender process it complained that the conditions of the tender were too harsh, unfair and unfavourable, and announced that it would not take part in the tender process. Instead of taking part in the tender process, it sent, on the last day for submitting applications to the tender a letter to the insolvency administrator and to the court that it had a serious interest in acquiring the enterprise of the bankrupt betting company for a price of CZK 4,650,000,000 (approx. EUR 186,000,000, i.e. by EUR 33,600,000 more than the winner of the tender), but only "outside the tender" and under more favourable conditions than those set out in the tender.

This counter offer has been rejected by both the insolvency administrator and the court with the reasoning that (i) it does not contain all formal prerequisites; (ii) the creditors had approved, at the meeting held on 11 August 2011, selling the enterprise of the bankrupt company exclusively in the tender, including the conditions of the tender, and this resolution was duly approved by the court on 17 August 2011; and, as such the counter offer should have been duly submitted in the tender; (iii) the contractual conditions proposed in the counter offer are disadvantageous for the creditors; (iv) there is no guarantee that the price offered would be paid (the parties who duly took part in the tender must have paid a CZK 500 million (approx. EUR 20 million) deposit to the insolvency administrator); (v) entering into negotiations on the counter offer would be discriminative in relation to the parties who duly fulfilled the harsh conditions of the tender process, and would cause further disputes; (vi) entering into negotiations on the counter offer would probably slow down the whole insolvency proceedings and the value of the bankrupt company would decrease as a result, and; (vii) the financial group who submitted the counter offer runs – with financing provided by the creditor who also contested the tender – a competing lottery company who profits from the protraction of the insolvency of the bankrupt betting company. The market share of the competing betting company owned by the financial group who submitted the counter offer has grown rapidly during the months when the bankrupt company has been in insolvency proceedings, it can, therefore, be presumed that the financial group who submitted the counter offer has no real interest in the acquisition of the enterprise of the bankrupt betting company, but only wants to obstruct the completion of the insolvency proceedings and the "resurrection" of the bankrupt betting company in order to improve the economic results of its own betting company.

The insolvency administrator also refused a proposal of the creditor (who is financing that finance group's competing betting business) to cancel the completed tender process and to prepare and announce a new tender process. As the reasons for the refusal the insolvency administrator stated that: (i) there is no guarantee that the competing financial group or other parties would take part in such new tender; (ii) there is no guarantee that even the parties who took part in the previous tender would take part in the proposed new tender; (iii) there could be disputes initiated by the creditors and the parties to the previous tender; and (iv) its approval by creditors and the court would take at least 2 to 5 months, while the value of the bankrupt company would significantly decrease during this period (mainly due to increased market pressure of its competitors), which would have an adverse effect on the creditors of the bankrupt company and the bankrupt company itself. According to the statements of the insolvency administrator (and of the court), the highest price offered in the completed tender is much higher than the value of the enterprise of the bankrupt company as valued by experts, and it is not likely that a higher price would be offered in a new tender.

Current situation, future progress

As the financial group who submitted the counter offer has not been happy with these reasons, it has announced that it will start various court disputes in this matter, as well as file a complaint against the insolvency administrator.

In the meantime, the creditor who provides financing for that finance group's competing betting business has already filed a claim at court against the winner of the tender and against the insolvency administrator. In the claim the creditor is requesting: (i) to declare the agreement of the purchase of the enterprise of the bankrupt company entered into by and between the insolvency administrator and the winner of the tender null and void and (ii) to change the judge due to bias.

Notwithstanding the above, the winner of the tender as the new owner of the enterprise already took over the enterprise and has started doing the betting business and renovating the headquarters of the betting company. The new owner of the enterprise is also preparing a new large advertising campaign with Jaromír Jágr, one of the most famous Czech hockey players.

Although it seems likely that the claim filed by the aforementioned creditor will be unsuccessful and that the winner of the tender will become the undisputed owner of the bankrupt betting company's enterprise in the end, the result of the court dispute still remains uncertain, and we will monitor the progress in this interesting insolvency case (which is one of the most interesting in the past few years) and provide any further updates in due course.

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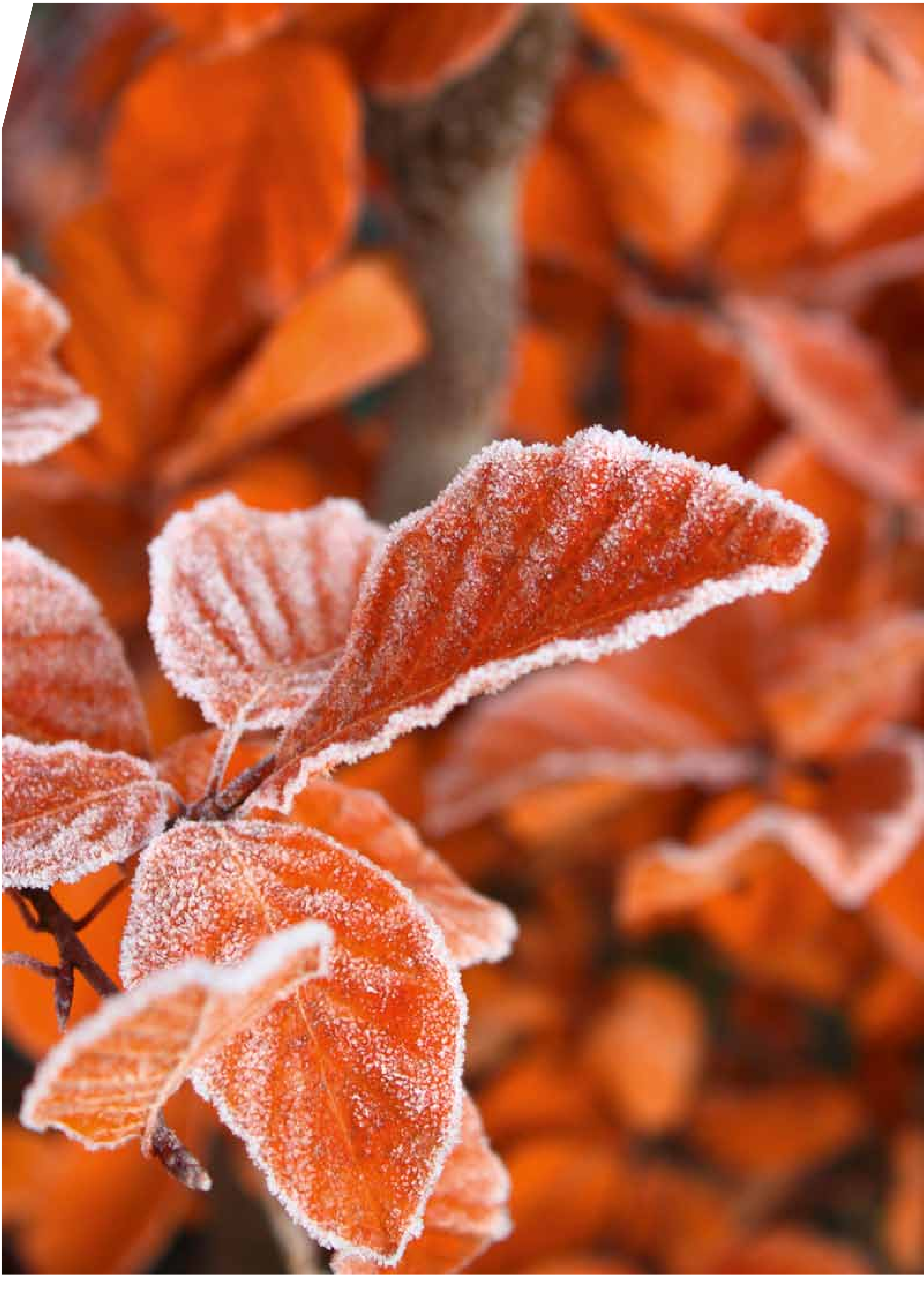

REVOLUTIONARY AMENDMENT TO THE ACT ON TRANSFORMATIONS OF COMMERCIAL COMPANIES AND COOPERATIVES (THE "ACT ON TRANSFORMATIONS") AND TO THE COMMERCIAL CODE

The proposed extensive amendment (the "Amendment") to the Act on Transformations was signed by the Czech President on 11 November 2011 and will come to force on 1 January 2012. The Amendment will considerably change the laws relating to business transformations in the Czech Republic, including the Commercial Code.

The Amendment contains a detailed regulation of all types of cross-border transformations including cross-border divisions or registered office relocations from the Czech Republic into other Member States and vice versa. For example, after the enactment, it will be possible to divide part of a company's assets or liabilities and relocate them into another Member State. The Amendment, among other things, makes it possible for a Czech limited liability company or a shareholding company to be relocated to Germany, Cyprus or anywhere else within the EU. Such relocation is already possible under existing laws. However, the Amendment seeks to regulate cross-border transfers of assets in a more detailed way. It is worth noting that the courts are relatively inexperienced in dealing with such relocations and there is uncertainty as to how the courts will proceed on any particular case.

Domestic Transformations

Within domestic transformations the concept of the "reference date" has changed. The regulation of the "reference date" will be of key importance as it will subsequently affect a number of other legal regulations including accounting and tax laws. The Amendment stipulates that companies will be given the opportunity to select the "reference date" (which may be a date in the future). The long-stop date will be a date on which the transformation has been registered in the Commercial Register. This means that neither the final accounts nor the opening balance sheet of the successor company will be available at the moment the transformation is being approved. This will have far reaching consequences. For example, the expert evaluation will not be bound to the reference date.

In addition, some of the procedures relating to transformations have been simplified. For example, in the case of a division involving equal exchange ratios, it will no longer be necessary to draw up a report on division or the interim accounts, even if otherwise required.

Changes to the Commercial Code

The Amendment will also bring changes to the Commercial Code. According to existing laws, the subscriber of a company's shares becomes a shareholder as late as from the registration of the capital increase in the Commercial Register. Only after the registration does the subscriber acquire shareholder's rights or, if acquiring further shares, a higher number of votes and may exercise its rights within the new scope. The Amendment stipulates that anyone involved in the capital increase will acquire shareholder's rights as early as from the effective date of the subscription (in practice as of the execution date of the subscription deed). Should the court subsequently refuse to register the capital increase or if the resolution of the general meeting regarding the same is cancelled, the shareholder's rights exercised until then (including voting at the general meeting) will not be affected.

The Amendment is expected to become effective on 1 January 2012.

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DEBT-EQUITY SWAPS IN GERMANY: RECENT CASES AND THE FUTURE OF THIS LEGAL INSTRUMENT

The ongoing financial crisis has given rise to an increase in financial restructurings for many German companies, as a way of avoiding possible insolvencies. German companies have taken various approaches towards the painful process of restructuring. For instance, they have streamlined their operations, cut costs and raised capital.

Among several restructuring measures, many companies have chosen to improve their financial position through a debt-equity swap. This measure is an out-of-court restructuring procedure and involves the short-term reorganisation of a company through the conversion of existing liabilities into equity.

The mechanism

To be more precise, the term **debt-equity swap** (also known as "debt-to-equity swap" or "debt-for-equity swap") does not relate to one particular measure. Instead, the term defines various restructuring methods – all of which aim to convert debt into equity.

The essential aspect of the procedure involves the restructuring of the balance sheet of an indebted company. Through this manoeuvre, relevant creditors who are engaged in the company, agree to reduce their debt claims in exchange for equity interests in a reorganised capital structure of the company. This procedure gives creditors, as shareholders of the company, more control over future restructurings of the company.

A debt-equity swap gives direct positive results. The company's balance sheet will show a reduction in the burden of debts whilst simultaneously showing a corresponding increase in equity. Such an increase of equity leads to better prospects of opening up new credit lines; it allows the firm to gain more financial flexibility; and enables the firm to compete more effectively in the market.

In Germany, the legal framework sets out two possible structures for debt-equity swaps:

1. **Capital reduction, followed by the capital increase through the contribution of receivables** (non-cash contribution) – the "Standard Structure". However, under German law, a capital increase requires the approval of 75% of the shareholders, attending and having voting rights at the shareholder meeting.

2. **Direct shares acquisition (share deal), followed by the waiver of receivables** – the "Alternative Structure". This allows the company to avoid capital measures but it is often time-consuming and especially difficult to execute in times of a financial crisis.

Both of these structures, however, create substantial tax and other consequences. Firstly, because the debt-equity swap procedure generates an extraordinary income, this income will be subject to taxation in the usual way. Secondly, like the risk of creditors' liability for the shortfall in the value of the contributed receivables *(Differenzhaftung)*.

The Conergy case

The recent case of Europe's biggest solar company, **Conergy,** is an example of how the Standard Structure has been applied in practice. The company fell into financial difficulty by focusing on too many business areas in the renewable energy sector. The growing competition in Asia compounded the company's financial difficulties.

At the end of 2010, Conergy decided to restructure its balance sheet by executing a debt-equity swap. The company reduced its capital stock by 88 percent in order to increase it again up to 188 million Euros, subsidizing the company with fresh equity. Numerous creditors of the indebted firm agreed to participate in the capital increase by subscribing their claims in the amount of 188 million Euros as a contribution-in-kind.

The debt-equity sway allowed Conergy to reduce its debt burden from 323 million to only 135 million Euros. With a reduced debt level, the Company has been able to pursue strategic options such as joint ventures or cooperation and there have been increased opportunities for new lending.

The Pfleiderer case

Another recent interesting case in Germany was the **Pfleiderer AG** restructuring. The building material company had been almost illiquid because of the latest financial crisis. At the beginning of 2011, the company proposed a restructuring plan, which, after gaining the creditors' approval, led to a large-scale financial restructuring.

The structure of the debt-equity swap was similar to the one presented in the Conergy case. However, the company also decided to make use of new German bond law *(Gesetz über Schuldverschreibungen aus Gesamtemissionen).* Pfleiderer had received a considerable credit line in the form of a first-lien secured loan from the participating banks and funds. The banks and other creditors agreed to the contribution in the form of a waiver of a substantial proportion of owned credit receivables. The holders of previously issued Pfleiderer hybrid bonds, identified as equity, agreed to swap their bonds for the right to acquire shares. These were then exchanged after being cut for a minority equity interest in the firm.

Additionally, the procedure included a decrease in capital, followed by its increase – the participation of creditors was anticipated. This procedure led to the substantial cash injection for the company that permitted Pfleiderer to continue its operations. Furthermore, the company issued an option bond (the assumed subscription involved the creditors participating in the debt waiver, but not in the capital increase).

Conclusion – the future of debt-equity swap in Germany

Companies should carefully consider the consequences of a debt-equity swap before conducting this type of restructuring arrangement. However, notwithstanding this, it is clear that the debt-equity swap has attracted considerable attention from German investors.

Especially appealing is that every party involved in the debt-equity swap is often satisfied with its results – the creditor receives shares in the company's capital and the burdening debt ceases to exist. The company gains credit potential and the creditors are in control of the restructuring procedure, not losing their already invested capital.

Due to the existing regulations, including recently passed laws, such as the *Gesetz über Schuldverschreibungen aus Gesamtemissionen,* and also to the newly prepared, although not yet enacted, German law governing the restructuring of companies *(Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen "ESUG"),* the debt-equity swap is a good alternative to the other out-of-court restructuring procedures and its usage will certainly increase over time.

Moreover, according to the regulations of ESUG the procedure of a debt-equity swap can be used as part of an insolvency plan without the historical need for shareholder approval. Therefore, ESUG will strengthen this instrument and limit the rights of shareholders trying to block the restructuring of a company.

Finally, ESUG will diminish the existing risk of creditors' liability for the difference between the real value of the contribution-in-kind and the contractual agreed contribution.

Although the debt-equity swap is a short-term reorganization procedure and does not solve all the company's problems, its advantages as a basis for a successful reorganization are widely recognized and its usage is likely to become more popular in the restructuring process of a company.

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SPECIAL INSOLVENCY RULES TO BE IMPLEMENTED FOR HUNGARIAN COMPANIES OF STRATEGIC IMPORTANCE

From 4 August 2011 special insolvency rules now apply to those Hungarian companies which the Government classifies as "highly important" from a national economic perspective. Insolvency proceedings can be started as a special procedure.

Classification

Notwithstanding the fact that certain criteria under this classification are listed in the Hungarian Bankruptcy Code, the classification will be exercised at the Government's sole discretion taking into account a number of policy factors. In particular, the Government will consider whether there is a special public interest; a significant project from a national economic perspective; or a significant activity from a national economic perspective.

Appointment of the liquidator

Under these special insolvency proceedings only a state liquidator can be appointed (such as Hitelintézeti Felszámoló Non-Profit Kft.). Any unlawful acts or omissions by the liquidator can be challenged and the liquidator can be liable to pay fines.

Special insolvency rules

Insolvency proceedings can be started as a special procedure. Also, these special insolvency rules can be introduced into ongoing insolvency proceedings within 30 days of commencement of the company's liquidation or within 15 days in the case of bankruptcy.

If the insolvent company or its assets are under the protection of state security, or if the company provides services which, either at international or national level can be considered significant from a national security or energy safety perspective, the following rules will apply:

— no bankruptcy moratorium can be requested;

— the insolvency of the company can be established if (i) the company does not have any resources to pay its liabilities which cannot be remedied due to loss making business; (ii) the business' performance will continue to deteriorate; (iii) neither a rescue loan nor subsidy can be granted but there is a public interest in maintaining their operation as a going concern;

— if the liquidation is ordered, an immediate extraordinary moratorium starts in order to ensure the temporary operability of the debtor (this extraordinary moratorium can be extended up to 90 days);

— under the moratorium, no payment can be made unless it is countersigned by the state liquidator. The expiry of any licences will be extended until the end of the moratorium and these licences can be withdrawn only in cases where the security of the company's assets or its very existence is threatened. No contract with the debtor can be terminated by virtue of the fact that the company has entered into special insolvency proceedings;

— any debts of the debtor accruing during these special insolvency proceedings can be considered as liquidation costs; and

— the sale of the company's assets cannot be public but can be conducted through closed tenders or direct negotiations.

Conclusion

The aim of the introduction of the special rules is to accelerate the termination of the above companies in unified insolvency proceedings. However, it is yet to be seen to what extent these rules will ensure transparency in such insolvency proceedings.

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RECKLESS BANKRUPTCY OF SHAREHOLDERS FINANCING A COMPANY IN DISTRESS

On August 26, 2011 the Italian Supreme Court issued the decision no. 32899 stating that shareholders of a company will commit an offence if they unreasonably provide funds to a company in distress, rather than proceeding with the immediate liquidation of the company.

It should be noted that the Italian insolvency law (Royal Decree no. 267 of 1942) does not contain express provisions obliging the managers of a company in distress to put the company into an insolvency process. However, articles 214 and 224 state that managers (as well any other person involved) may be liable to imprisonment for up to two years, whenever they, *inter alia:*

1) Have performed serious incautious acts aimed at delaying the bankruptcy declaration.

2) Have contributed to cause or worsen the company's distress by failing to apply for the company's insolvency or by not complying with their corporate law duties.

On the basis of such rules, the Italian Supreme Court has recently confirmed the first and second instance decisions whereby two shareholders of a company subsequently adjudicated in insolvency *("fallimento")* were found guilty of reckless bankruptcy *("bancarotta semplice")* because they had worsened the distress of their company through its financing back in 2004.

In this specific case, the defendants argued that the funding provided to the company was aimed at ensuring the continuation of its business and therefore they could in no way be considered to have worsened the company's distress. They claimed that injecting their funds into the company's account was justified by the trust that they had in the entrepreneurial initiative, regardless of the initial losses generated and the eventual unpredicted failure of the project.

The Supreme Court stated that a distress does not mean a condition of "generic disorder" of the company's activity, but rather a situation of economic-patrimonial imbalance, continuous and ingravescent, which, if not faced through proper measures (amongst which can include the shutting down of the entire undertaking) could lead to an unstoppable worsening of the indebtedness and damage to the creditors of the company.

The Court held that the increase of the company's imbalance was substantially caused by the "obstinate and incautious" continuation of the company's activity when the business initiative was manifestly unsuitable. The court opined that an immediate discontinuance of the business was more appropriate.

In such a context, the behaviour of the shareholders worsened the damages to the company and its creditors because the new funds had the sole effect of increasing the indebtedness of the company and at the same time, unreasonably delaying its insolvency.

The decision of the Italian Supreme Court has created a "revolutionary" principle, which will have a significant impact on the behaviour of managers and shareholders in the context of distressed Italian companies. In particular, shareholders will need to carefully consider the implications of injecting funds into a distressed company given that to do so could result in criminal liability. This is likely to restrict the ability of distressed companies to raise funds.

The managers of such subsidiaries should refrain from asking for more funds to continue the business if there is a significant risk that the funding would result in a deterioration of the overall situation of the company, and/or a delay in the declaration of insolvency.

A method of potentially avoiding possible criminal liability would be to provide funding to Italian subsidiaries via the debt restructuring scheme pursuant to either article 160 (composition with creditors procedure – *"concordato preventivo"*), article 67 paragraph 3(d) (recovery plans – *"piani di risanamento"*) or article 182 bis (restructuring agreements – *"accordi di ristrutturazione"*) of the Italian insolvency law, as article 217-bis of the law states that acts, payments and behaviours carried out in order to implement the above schemes cannot be prosecuted.

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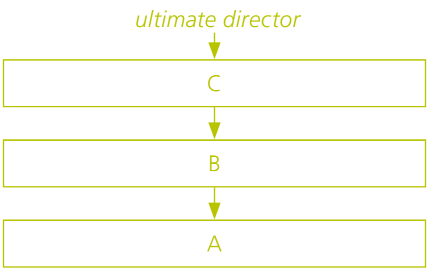
DIRECTORS' LIABILITY AND FOREIGN DIRECTORS IN THE NETHERLANDS

A recent decision of the Dutch Supreme Court *(Hoge Raad)* deals with a question of private international law in respect of the liability of (indirect) foreign directors of Dutch public companies *(naamloze vennootschap),* and Dutch companies with limited liability *(besloten vennootschap met beperkte aansprakelijkheid)* ("BV") and their directors.

Like in many jurisdictions, Dutch law provides that under certain circumstances a director of a company may be held liable against third parties.

Often a legal person *(rechtspersoon)* (i.e. a company) will be appointed as director of another company (a **"Legal Person-Director"**). The Dutch legislator has stipulated in section 2:11 of the Dutch Civil Code that, in addition to that Legal Person-Director, any person, who at the time such liability arose, was a director of that Legal Person-Director, shall be jointly and severally liable as against third parties. The aim is to avoid scenarios where the ultimate director can effectively "hide" itself behind the legal capacity of another Legal Person-Director.

By way of illustration, the diagram below shows that company B is a director of company A. Company C is a director of company B. Ultimate director is the director of company C.



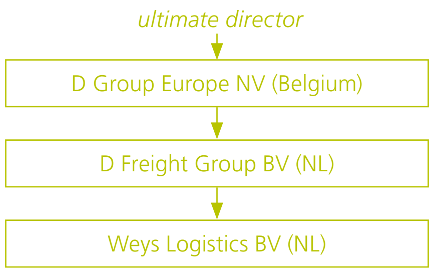
As a result of the aforementioned provision, the director of company B (i.e. company C) may also be held liable as against third parties in addition to company B. In the end, the ultimate director may also be held liable in addition to company C. As a result, both companies B and C, and the ultimate director, may be held jointly and severally liable.

In respect of the liability of directors, no distinction is made under Dutch law between Dutch or foreign directors. In the example above, company B could be replaced with a foreign Legal-Person Director and the same Dutch law provisions would be applicable.

The key questions are whether section 2:11 of the Dutch Civil Code is also applicable to foreign Legal-Person Directors and which laws determine the liability of the directors of that foreign Legal-Person Director in situations where both may be liable.

Facts

In this case, the defendant, D Group Europe NV (a public company governed under the laws of Belgium), was the director of D Freight Group B.V. (a Dutch private company with limited liability) which, in turn, was the director of (amongst others) Weys Logistics B.V. (a Dutch private company with limited liability).



The defendant argued that it could not be held liable by the trustee in the bankruptcy of (amongst others) Weys Logistics B.V. It argued that the relevant provision of Dutch law (section 2:11 of the Dutch Civil Code) on which the claim against the defendant was based, is not applicable to foreign companies. It argued that since it is a company governed by Belgian law, it could not be held liable.

The Decision

It was held by the Supreme Court that foreign Legal-Person Directors (e.g. D Group Europe NV) of a Legal Person-Director (D Freight Group B.V.) may also be held liable pursuant to section 2:11 of the Dutch Civil Code to the extent that such a foreign Legal Person-Director is a director of a company governed by Dutch law. Section 2:11 does not, therefore, limit the liability to Dutch Legal Person-Directors.

Most importantly, the Supreme Court held that the liability of the directors of a foreign Legal Person-Director, in addition to that foreign Legal Person-Director, should be determined by the law applicable to that foreign director. It was specifically held that Dutch law has no influence on the internal relationship between a foreign director and its directors in respect of questions of liability. In that respect, section 2:11 of the Dutch Civil Code is not applicable to these relationships.

This decision is based on the Dutch Conflict of Laws (Corporations) Act *(Wet conflictenrecht corporaties)* (the **"Act"**). Pursuant to the Act, the law governing a corporation shall extend to the question of who, jointly with the corporation, is liable for any acts by which the corporation is bound pursuant to an authority such as that of an incorporator, partner, shareholder, member, director, supervisory board member or other officer of the corporation.

Pursuant to the Act, a corporation which, under its instrument of establishment, has its corporate seat or registered office (or, in the absence thereof, its external centre of activities on the date of establishment) in the territory of the State under the laws of which it is established, shall be governed by the law of that State.

Conclusion

To assess the risks of directors' liability, a foreign Legal Person-Director should take into account the relevant provisions of Dutch law on directors' liability. However, to assess the risks of the derived liability of the directors of that foreign Legal Person-Director next to that foreign Legal Person-Director itself, one should take into account the relevant provisions of the law applicable to the foreign Legal Person-Director.

It is important to note that an ultimate director itself may be held directly liable in certain circumstances, in addition to the foreign Legal Person-Director. The law applicable to the direct liability should be determined in accordance with the relevant provisions of international private law e.g. the Rome II Convention.

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COMMENCEMENT OF INSOLVENCY PROCEEDINGS AT A DEBTOR'S REQUEST

Every business must manage risk. Whenever such risk turns into reality, the consequences must be accepted and declared for the well being of the wider economic environment. The purpose of this article is to analyse the legal framework of the commencement of insolvency proceedings at a debtor's request and the sanctions applicable when such a framework is surpassed.

The law obliges a debtor in financial difficulties to submit an application for the commencement of insolvency proceedings to the Tribunal within 30 days following the occurrence of the state of insolvency. In such circumstances, the Insolvency Law does not prescribe a minimum level of debt before the insolvency proceedings can be commenced. Under Insolvency Law, if the state of insolvency is deemed to be "imminent" as opposed to "current", the debtor is not obliged to (but is permitted to) file for insolvency.

If the debtor submits its application to the Tribunal too early or does so in bad-faith, it shall face patrimonial liability – either as an individual or as a legal entity, for the caused prejudices. Through its application, the debtor may choose to be subjected to the simplified proceedings, in which case the bankruptcy procedure is directly applicable, or to be subjected to the general proceedings, in situations where the debtor expresses its intention to reorganise its activity through a reorganisation plan. The debtor's application will be subjected to urgent judgment in a closed session within 5 days. Clearly, the debtor is the first to become aware of the occurrence of its state of insolvency and by filing for insolvency in due time, in good faith, it will avoid causing serious damage to the interests and patrimony of its creditors.

The debtor's interest in filing for insolvency

At debtor facing an "imminent" or "current" state of insolvency, but who is committed to maintaining and restructuring its commercial enterprise as well as settling its debts, has the judicial means to redress its business throughout the insolvency proceedings, thus continuing its legal and economical existence. Clearly, the debtor is the first to become aware of a state of insolvency state occurrence and, by filing for insolvency in due time laid in good faith, it will avoid causing serious damage to the interests and patrimony of its creditors.

Not filing for insolvency when mandatory

Mandatory application

When a debtor's state of insolvency is deemed to be "current", it is obliged to file for insolvency. The failure to do so triggers the patrimonial liability of the debtor and may also trigger criminal liability.

The Romanian legislature has sought to sanction both a serious abuse in the form of bad-faith (in the case of the prematurity of a debtor's application) and a willful or negligent delay in commencing the proceedings.

A bad-faith premature application

According to article 36 of the Insolvency Law, all the judicial and extrajudicial claims against the debtor are stayed. However, no interest, increase or penalty of any kind may be added to the amount of the claims established before the commencement of the proceedings (except for certain special cases).

Some debtors may take advantage of such provisions, by faking their insolvency state in order to temporarily avoid meeting certain due and payable claims or to remove the company, at least temporarily, from under the control of its shareholders. In the latter situation, an administrator may have an interest to do so when dissatisfied with the shareholders' decisions. Moreover, a debtor may use the insolvency proceedings in order to stay an enforcement made by one or more of its creditors.

The act of prematurely filing for insolvency will have the consequence of patrimonial liability for the debtor as a legal entity.

When the commencement of the insolvency procedure is brought about on false grounds, the natural person responsible for such actions will be criminally liable for fraudulent bankruptcy. This liability is a result of creating a false insolvency state.

This scenario will arise in circumstances where there is:

(a) forgery, theft or destruction of the debtor's records or concealment of a part of its assets; or

(b) presentation in the debtor's records of undue or non-existent debts, having the sole fraudulent intention of injuring its creditors.

The patrimonial liability will arise when the following conditions are met:

— an application for opening the insolvency proceedings was filed;

— the application for commencement of the insolvency is premature. This condition is met when the insolvency state is neither "current" nor "imminent" at the moment the application is filed;

— the debtor filed its request in bad-faith. Such bad-faith must take the form of serious negligence or intention; and

— the creditors of the debtor have suffered damage as a result of the filing of the premature application.

In conclusion, the premature commencement of the proceedings will have a direct impact on the creditor's patrimony. In such cases, the request to commence the insolvency proceedings could be considered abuse of right and thus challenged by any interested person.

This challenge can be made through an intervention in one's own interest, through an opposition or even through a final appeal.

According to article 149 of the Insolvency Law, its provisions shall be completed in accordance with the Civil Procedure Code, whenever compatible. Since such claim is qualified as non-litigious, any interested third party, including the creditors, may file a request in its own interest, opposing the debtor's application on commencing the insolvency proceedings.

Creditors also have the possibility of filing an opposition, which is a judicial tool giving the creditors the ability to contest the Court's decision on commencing the insolvency proceedings. The syndic judge will hold, within 5 days, a meeting assessing all oppositions made against the debtor's request and will deal with these in one decision. The Court could either admit the opposition, revoking the decision on commencing the insolvency, or reject the opposition, and so keep the insolvency proceedings running. The judge may also admit the opposition, maintain the proceedings and sanction the debtor for an abuse of right, when the insolvency state occurred during the assessment of the opposition raised by the company's creditors.

With regard to any appeal, it can be filed by any interested third party who suffered damage by the commencement of such a procedure. It is worth noting that the creditor does not have the power to file an appeal.

Given that the creditors are notified of the commencement of the insolvency proceedings only after such proceedings are actually running, they cannot contest the debtor's application at the time of its assessment by the Court. Creditors are, therefore, being put in the difficult situation of suffering the burden of proof – the inexistence of the debtor's factual insolvency state at the time of the application. They must defeat the debtor's testimony on the existence of such state and, at the same time, bear the consequences of the insolvency proceedings.

Failure to commence or tardiness in commencing proceedings

Failure to comply with the obligation of commencing the proceedings in due time triggers not only the patrimonial liability of the debtor, but also the criminal liability of its statutory or legal representative. The debtor's bad-faith is not required, for it is within its legal duties to be aware of the economical hardship of its activities.

Paragraph (3) of article 27 of the Insolvency Law provides that the application is to be signed by the statutory representatives of the legal entity.

Two questions arise from this provision:

(i) where the application is signed by the statutory representative of the debtor, there have been numerous court decisions stating that a Board of Directors ("BOD") or General

Assembly of the Shareholders ("GA") or Associates decision in the respect of opening the insolvency proceedings is mandatory for the application to be admitted. Moreover, there have been Court decisions stating that the absence of a BOD or GA decision is to be covered by the primacy of the insolvency state. (Decision No. 513/C/2010 – R, Oradea Appeal Court); and

(ii) secondly, where the application is signed by a different person than the statutory representative (i.e. another administrator), the application should be rejected due to the lack of that "representative's" powers.

In a case of non-compliance in respect of the obligation of filing for insolvency, the debtor is liable for damages caused to third parties. Nonetheless, a criminal liability is triggered against the legal representative of the debtor who failed to file or delayed the filing for the commencement of the insolvency proceedings. As a premise of this criminal liability, the existence of the insolvency state has to be determined.

Determining the existence of the insolvency state is a decision made by the syndic judge, and it is questionable whether a Criminal Court is entitled to make a judgement on the existence of such a state of insolvency.

Optional application

Whenever the state of insolvency is solely "imminent", the debtor is not obliged to (but is permitted to) file for insolvency. A state of insolvency is "imminent" when the debtor will not be able to pay its debts upon their maturity (considering its lack of available liquidities at the time). Such state should be predictable in the near future and the evaluation of the debtor concerning the amount of the debt is irrelevant in finding whether such state is "imminent".

Regulating the mechanism of "imminent" insolvency only encourages debtors to take advantage of the possibility of filing for insolvency whenever such state may seem "imminent". This can increase the workload for the Courts.

Conclusion

In regulating the possibility of insolvency commencement at the debtor's request, the legislature protects not only the interests of the creditors but also the interests of the debtor itself by building a legal framework through which the activity of the debtor can be restructured. Such restructuring diminishes the negative effects that bankruptcy has on the economic environment. Failing to meet the legal obligation to file for insolvency will mean that a debtor, in the majority of the cases, will be liable and must suffer the consequences of its state of passivity or its fraudulent intentions.

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SECURED CREDITORS HAVE LOST CERTAIN PRIVILEGES UNDER BANKRUPTCY LAW

On 22 September 2011, the Parliament of Ukraine adopted the Law of Ukraine No. 3795-VI "On Amendments to Several Legislative Acts of Ukraine regarding the Regulation of Legal Relations between Creditors and Receivers of Financial Services" (the "Law"). The Law, among other changes, introduced amendments to the Law of Ukraine "On Restoring Debtor's Solvency or Recognising it Bankrupt", No. 2343-XII, dated 14 May 1992, as amended (the "Bankruptcy Law").

During recent years, Ukrainian court practice has developed in such a way that secured creditors in bankruptcy proceedings (i.e. creditors whose claims were secured by pledges/mortgages over the debtor's assets) were deemed not to belong to either the debtor's pre-bankruptcy creditors *(konkursni kredytory)* or its current creditors *(potochni kredytory)*. Secured creditors were instead recognised as privileged in the sense that, regardless of whether they filed their claims to the debtor, their claims were, by default, to be included by the bankruptcy administrator in the register of creditors' claims with first ranking priority (in accordance with the debtor's records)[1].

Amendments to the Bankruptcy Law have changed the definition of *"konkursni kredytory"* by extending it to include secured creditors. Although such amendments are likely to have certain positive impacts, there are also negative consequences for secured creditors: they are now subject to the same claim filing requirements as other (unsecured) pre-bankruptcy creditors. This means that unless a creditor's claim is submitted to the relevant Ukrainian commercial court within 30 days of the publication of a notice on initiation of bankruptcy proceedings in the official Ukrainian press, such claim is deemed to be discharged.

In light of the above, it is crucial that companies (secured creditors) with business interests in Ukraine monitor the official Ukrainian press. To make this process easier, computer programs are now available that monitor the official press and provide updates on companies that have entered bankruptcy proceedings. It is possible to place certain companies that have a particular importance "on watch".

Law: Law of Ukraine No. 3795-VI "On Amendments to Several Legislative Acts of Ukraine regarding the Regulation of Legal Relations between Creditors and Receivers of Financial Services", dated 22 September 2011.

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1) *Resolution of the Supreme Court of Ukraine (Commercial Cases Chamber) No. Б- 31/10-04/ Б31/01-04, dated 11 October 2005; Resolution of the High Commercial Court of Ukraine No. 23/324-б, dated 10 September 2003; Resolution of the High Commercial Court of Ukraine No. 15/257Б, dated 21 May 2003.*

AMENDMENTS TO THE LOAN MARKET REGULATION

On 22 September 2011, the Parliament of Ukraine adopted Law of Ukraine No. 3795-VI "On Amendments to Several Legislative Acts of Ukraine regarding Regulation of Legal Relations between Creditors and Receivers of Financial Services" (the **"Law"**). The Law became effective on 16 October 2011. Although the positive impact of certain amendments is rather ambiguous at this stage, the Law is likely to reduce risks in the financial system.

The major amendments envisaged by the Law cover the following key areas:

Loans and security

The Law introduces changes to the procedure for mortgage enforcement. Whereas previously only two public auctions were available to sell mortgaged property, the Law now provides for the possibility to hold a third public auction if the mortgagee did not use its right to buy property during the previous two auctions.

The Law amends certain provisions of the Civil Code of Ukraine, dated 16 January 2003, as amended (the **"Civil Code"**), in particular which state definitively that the interest rate under a loan agreement may be fixed or floating and adds certain further details in relation to the same. A fixed interest rate is set for the entire term of the loan agreement and cannot be changed by the bank unilaterally. A floating rate must be calculated on the basis of an index which is published in the mass media and defined by an independent reputable institution. The Bank cannot change the mechanism of floating rate calculation without the borrower's consent. An additional limitation applicable to a floating rate loan agreement is that the agreement must contain a floating rate increase limit. The adopted changes to the Civil Code protect the borrower from disadvantageous loan agreement terms that may be imposed by the bank.

The Law also amends certain provisions of Law of Ukraine No. 1023-XII "On Consumer Rights Protection", dated 12 May 1991, as amended (the **"Law on Consumer Protection"**), the most notable being the prohibition on consumer loans denominated in foreign currency. This amendment is aimed at supporting the national currency and will reduce the currency and credit risks of Ukrainian banks and their borrowers-individuals.

Borrower's responsibility

The Law amends the provisions of the Civil Code regulating the procedure for company reorganisation. According to the amendments, a legal entity-successor formed as a result of the division of or extraction from its legal entity-predecessor holds subsidiary responsibility for the obligations of the legal entity-predecessor, which obligations have been passed to another legal entity-successor. This will help to eliminate reorganisation schemes, which allowed indebted legal entities to evade the repayment of their financial obligations.

The Law also brings changes to the Criminal Code of Ukraine, dated 5 April 2001, as amended, by directly establishing criminal liability for illegal actions concerning pledged property, which will allow to initiate criminal proceedings against former owners/former owner's officials of the pledged property in case they violate the bans and restrictions imposed on the use of such property when it is sold by the bank or other financial institution.

Insolvency matters

Among the other things outlined above, the Law also introduces the following key amendments to Law of Ukraine No. 2343-XII "On Restoring a Debtor's Solvency or Recognising It Bankrupt", dated 14 May 1992, as amended:

(i) the obligations of an individual entrepreneur that arose out of circumstances not connected to his/her business activities (e.g. consumer loans) are now outside the scope of his/her bankruptcy proceedings, so the termination of such obligations upon the commencement of bankruptcy proceedings will not be the case after the Law comes into effect. This will allow reducing the risks of individuals evading liability through the initiation of individual-entrepreneur's bankruptcy proceedings. Furthermore, the pledged property securing the respective creditors' claims cannot be seized and cannot become part of the liquidation assets; and

(ii) the creditors in bankruptcy proceedings may obtain information from the administrator about other creditors' claims accepted by the debtor and/or the administrator. Such creditors in bankruptcy can file an objection to the debtor and at a commercial court against the acceptance of such other creditors' claims. This norm was adopted to prevent the practice of fictitious bankruptcy proceedings, by initiation of which many legal entities avoided performance of their obligations. However, it may adversely affect the creditor's rights if a party related to the bankruptcy starts attacking rights of such a creditor in reliance on the above provision.

Once the bankruptcy proceedings have been initiated against the debtor, the respective court ruling on such initiation must be published on the official website of the judicial authorities of Ukraine. This will allow for better monitoring opportunities and enhanced creditor's awareness of the initiated bankruptcy proceedings.

Law: The Law of Ukraine "On Amendments to Several Legislative Acts of Ukraine regarding Regulation of Legal Relations between the Creditors and Receivers of Financial Services" No. 3795-VI, dated 22 September 2011.

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// **UNITED KINGDOM**

SUPREME COURT CLARIFIES THE SCOPE AND EFFECT OF THE ANTI-DEPRIVATION PRINCIPLE

The English Supreme Court has clarified the scope and application of the 200 year old "anti-deprivation" principle, which is of relevance to international contracts governed by English law across various industries including oil and gas agreements, finance arrangements, and intellectual property licensing. The judgment provides guidance that a properly drafted "flip" clause (see below) in a complex finance transaction is unlikely to offend the principle.

This common-law principle, famously referred to in the "British Eagle" case, a 1975 case with Air France, enables the English courts to invalidate a transaction if its effect is to deprive a company's creditors of property that, on the company's insolvency, would otherwise be realised for their benefit.

Belmont Park Investments PTY Ltd v BNY Corporate Trustee Services Ltd and another [2011] UKSC 38 ("Belmont Park") related to an international debt programme established by Lehman Brothers International (Europe). The Supreme Court confirmed that a commercial transaction entered into in good faith and which is not intended to evade insolvency laws will not offend the anti-deprivation principle.

The facts

Investors (mostly Australian companies, individuals, authorities and charities) ("the Investors") subscribed for floating rate medium-term notes issued by a series of Special Purpose Vehicles ("SPVs") created by Lehman Brothers.

The SPVs bought government bonds and other secure investments with the Investor's monies ("the Collateral"). Lehman Brothers Special Financing Inc ("LBSF") entered into a credit default swap with the SPVS under which it received the interest from the Collateral in consideration for paying (indirectly) the interest due under the notes to the Investors.

The Collateral was secured for LBSF and the Investors. LBSF had priority of security over the Collateral until an "Event of Default" occurred (one such Event of Default being bankruptcy). Upon an Event of Default, in respect of which LBSF (or Lehman Brothers Holding Inc ("LBHI")) was the "Defaulting Party", the priority flipped so that the Investors had priority of security over the Collateral instead ("the Flip").

When LBSF and LBHI applied for Chapter 11 bankruptcy protection in the United States in 2008, both of these events constituted an Event of Default under the swap documentation and the security over the Collateral became enforceable.

The Investors issued proceedings to compel the trustees over the security ("BNY") to realise the Collateral and apply the proceeds in favour of the Investors in priority to LBSF. LBSF argued that the Flip offended the anti-deprivation principle, since LBSF's creditors were being deprived of assets that they would otherwise have been entitled to on insolvency.

The Decision

The Supreme Court unanimously dismissed the appeal by LBSF upholding the validity of the Flip clause.

The Supreme Court made a distinction between the anti-deprivation principle and the "pari passu" rule, whilst confirming the two principles arise out of the same general rule that parties cannot contract out of insolvency legislation.

The pari passu rule states that the statutory provision for pro-rata distribution amongst creditors may not be excluded by a contract which gives one creditor more than its fair share. In contrast the Supreme Court held that the anti-deprivation principle prevents attempts to withdraw an asset on bankruptcy, reducing the value of the insolvent estate to the detriment of its creditors.

The Supreme Court distinguished *British Eagle International Air Lines Ltd v Compagnie Nationale Air France [1975] 2 All ER 390]* in which the pari passu rule was applied, stating that the pari passu rule was not applicable in *Belmont Park* as there was no question of disturbing the pari passu rule as between LBSF's creditors.

The Collateral

When determining whether the Flip was a bona fide commercial agreement, the Supreme Court noted that the Collateral was bought by the SPVs with money subscribed by the Investors and that the Collateral did not come directly or indirectly from LBSF. The Flip did not deprive LBSF of property but ensured that if LBSF became insolvent the Investors would be entitled to the return of what was commercially their property.

The court had regard to the fact that the transactions were designed, arranged and marketed by the Lehman Group and the Investors were in the main not banks but charities, individuals, authorities and companies. The triple-A rating given to the investments was in part dependant on the Flip being in place.

Commercial Intention

The judgement confirmed that the court will explore the commercial purpose of a clause when determining if the anti-deprivation principle is offended. The court will evaluate whether an agreement's purpose was to evade bankruptcy laws or whether the agreement had a legitimate commercial aim.

As per Lord Collins:
"Commercial sense and an absence of intention to evade insolvency laws have been highly relevant factors in the application of the anti-deprivation rule. Despite statutory inroads, party autonomy is at the heart of English commercial law."

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