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Newsletter

CMS Restructuring and Insolvency in Europe

August 2012

Introduction

We are pleased to present this summer 2012 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:

— piercing the corporate veil and investors' liability under European and Belgium national law;

— further delays to the changes in the avoidance regime in Bulgaria;

— bullying insolvency petitions in the Czech Republic and protections available to debtors;

— a decision from Germany on the application of "Establishment" and "COMI" to opening secondary proceedings in a Member State;

— piercing the corporate veil in insolvencies in Hungary;

— new laws to simplify access to alternative bankruptcy procedures in Italy;

— Dutch Supreme Court landmark decision limits the potential to pledge recourse claims in advance;

— the effects of increased bankruptcies in the building sector for investors in Poland; and

— commentary on a recent decision of the Court of Justice of the European Union providing further guidance on the application of the EU Insolvency Regulation.

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 28 countries with 52 offices in Western and Central Europe and beyond. CMS was established in 1999 and today comprises ten CMS firms, employing over 2,800 fee earners 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

A recurring theme in this summer 2012 edition of the CMS Restructuring and Insolvency in Europe Newsletter is the effect of national and international insolvency law on shareholders of insolvent companies. In addition to covering general developments in insolvency and restructuring law and practice across our European offices, we examine the extent to which courts are willing to pierce the corporate veil and hold investors accountable for some of the debts of their failed ventures. In this Editorial we highlight the treatment of and risks to shareholders of insolvent entities under European law and under the national laws of Belgium and, later in this edition, our colleagues in Hungary and Poland write on the equivalent provisions in their own jurisdictions.

Under European law, there are no general rules with respect to the liability of a holding company for the debts of its insolvent subsidiary.

The Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings only provides a common framework for insolvency proceedings in the European Union (the **"EU"**). The harmonised rules on insolvency proceedings intend to prevent assets or judicial proceedings being transferred from one EU country to another for the purposes of obtaining a more favourable legal position to the detriment of creditors ("forum shopping").

Unlike the EU antitrust law which contains stipulations enabling liability claims against a holding company for debts of its subsidiary, the EC No. 1346/2000 does not contain such liability provisions.

Therefore, liability claims against a holding company for the debts of its subsidiaries need to be examined only under the laws of the country where the subsidiary exists and has been declared bankrupt.

In Belgium, group liability may arise whenever a company controls or manages another company, and performs certain acts or omissions which are either contrary to the controlled or managed company's corporate interests, or constitute a violation of the law (including the law of tort) or the controlled company's by-laws.

Such liability is not linked to the structural relationship between group companies, or the shareholding. Instead, it is linked to the fact that, in practice, one company, or its representatives, commits certain management faults in 'controlling' or 'managing' another company. In some circumstances, the liability may also be extended to third parties (individuals and companies) that, although not 'controlling' or 'managing' the relevant company (or even being part of the same corporate group), have benefited from the acts or omissions leading to the group's liability and were, or should have been, aware of the irregularity of such acts or omissions.

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Long-awaited changes in the avoidance rules regime put off again

Introduction

The Bulgarian Commerce Act (State Gazette 48 of 1991, as amended) recognises "suspect periods" during which certain actions and transactions of the insolvent debtor are considered ex-lege null and void or can be revoked by the insolvency officer or creditors. This concerns two groups of transactions: (i) transactions entered into after the initial date of the bankruptcy trigger; and (ii) transactions entered into within a certain period prior to the commencement of the bankruptcy proceedings.

Transactions entered into after the initial date of the bankruptcy trigger (insolvency or over-indebtedness of the company)

Within the bankruptcy proceedings, the court determines the initial date of the bankruptcy trigger (insolvency or over-indebtedness of the company). Under Bulgarian law the court is entitled to backdate the initial trigger date, so it may precede the commencement of the bankruptcy proceedings. Currently, the discretion of the court to backdate the initial trigger date is not limited by a maximum period in the law.

Thus, certain actions and transactions undertaken by the debtor after the initial date of the bankruptcy trigger, are considered null and void vis-à-vis the creditors of the bankruptcy estate. Such actions and transactions are:

(i) discharge of monetary obligation (including set-off by the debtor up to the amount that the creditor would have received in the distribution of proceeds);

(ii) transactions for no consideration;

(iii) creation of any security interest in assets of the bankruptcy estate; and

(iv) undervalue transactions.

The fact that there is no time limit on the ability of the court to set the initial trigger date creates insecurity for the creditors. Further, the rights of creditors that received payment from the debtor (or had their claims discharged in some way) may be easily prejudiced. They may have to be forced to return a payment or another asset received in good faith years before the bankruptcy proceedings have been instigated against their debtor, while being left with a claim (and often, having released their security, it will be an unsecured claim) against an insolvent debtor. Court practice generally interprets the law literally and tends to ensure that any of the transactions above are null and void regardless of whether they have actually shrunk the bankruptcy estate or damaged the creditors' interest.

Proposed amendments

There have been a number of draft proposals for amendment of the provisions in the Commerce Act related to insolvency and avoidance of preferences.

Most of these drafts envision (among other changes) that the initial date of the bankruptcy trigger cannot be backdated by more than three years. The drafts show other similarities as well. They clarify that transactions carried out after the date of the bankruptcy trigger should not be considered ex lege null and void; instead, they could be challenged by creditors and the insolvency officer by way of an invalidation claim. According to the draft proposals, transactions could be challenged if carried out after the initial date of the bankruptcy trigger (which cannot be backdated by more than three years) but not earlier than a certain period (one year or six months) from the request for instigating the bankruptcy proceedings. The discharge of monetary obligations could not be challenged if (i) the creditor has fulfilled its obligations to the debtor simultaneously or after the debtor has fulfilled his; and (ii) as a result of the invalidation the creditor would not receive more from the distribution of the insolvency proceeds than what it would have received should the transaction not have been invalidated.

One of the draft proposals, commissioned by the Ministry of Justice in 2010, aims to comprehensively reform the bankruptcy procedure in Bulgaria. It was subject to public consultations in April 2011, but has not yet been filed with Parliament. Another draft has been pending before Parliament since February 2012 but has not yet been scheduled for discussion at a plenary session. It is expected that this draft may be combined with the draft proposal of the Ministry, once the latter is filed with Parliament. However, for now, there is little progress in adopting the long-awaited changes in the Bulgarian insolvency regime.

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Protection against bullying insolvency petitions of creditors

Statistics available from recent years show an increased number of creditor's insolvency petitions. The practice shows that unjustified insolvency petitions form quite a significant portion of insolvency petitions (according to statistics, up to five per cent of the total number of insolvency petitions filed by creditors).

It has become a wide-spread practice in the Czech Republic to use insolvency petitions to fight competition and a number of companies thus have been unreasonably thrown into insolvency proceedings. According to statistics, such bullying manners are most frequently used in the building industry and in sectors which build on long-term and recurrent relationships where there is a risk of disputes. Creditor's conduct is often motivated by their effort to enforce fulfilment from a debtor more easily and quickly by initiating insolvency proceedings rather than by filing an individual action.

Evidently, creditors are not aware of the risks of liability resulting to them from filing defective or bullying insolvency petitions.

Supreme Court assists in the fight against bullying petitions

Those companies which are unreasonably subjected to the regime of insolvency proceedings as a result of a bullying petition filed by a creditor can seek great relief in the resolution of the Supreme Court of the Czech Republic 29 NSČR 14/2011, dated 21 December 2011; recently published in the Collection of Judgments and Opinions.

Through this, the Supreme Court has actually blurred the difference between a creditor's insolvency petition and a debtor's insolvency petition. It is quite common that in their insolvency petitions creditors identify other creditors of the respective debtor (in order to prove multiplicity of claims required by the law), but they fail to provide any particular details about such creditor's claims and maturity dates thereof. Their petitions merely contain general assertions that the respective debtor has monetary obligations which are overdue for more than 30 days, or that the respective debtor has failed to fulfil his monetary obligations for more than three months after the maturity date. According to the court's opinion, any creditor's insolvency petition has to contain a statement of facts evidencing a debtor's bankruptcy; not only particular data concerning other creditors of the relevant debtor, but also particular data about claims of such creditors (including information about maturity dates of such claims to the extent that if such assertions are found to be true, they allow the insolvency court to conclude that a debtor is bankrupt).

Amendment to the Insolvency Act

A draft amendment to the Insolvency Act is currently being discussed by the Senate of the Czech Republic. The amendment should discourage creditors from filing bullying insolvency petitions.

A number of effects are associated with the commencement of insolvency proceedings by the Insolvency Act. The insolvency court initiates insolvency proceedings almost immediately upon delivery of an insolvency petition and then examines whether the entity in question has really gone bankrupt. The actual commencement of insolvency proceedings thus does not mean that the entity in question is bankrupt or is facing the risk of going bankrupt. However, if an indication *"in insolvency proceedings"* is placed next to the business name of a company in insolvency proceedings, the entity in question is automatically perceived by the public as having financial difficulties. This general perception of insolvency proceedings helps bullying creditors to discredit competitors.

Penalty for unreasonableness of insolvency petition

As regards insolvency petitions filed after the effective date of the discussed amendment to the Insolvency Act; the insolvency court would have the opportunity to dismiss an apparently unreasonable insolvency petition without having to factually deal with it. In addition, the insolvency court would also have the option to impose a disciplinary penalty on the petitioner of up to CZK 50,000.

The amendment brings a further protection for debtors against bullying insolvency petitions. If a debtor, immediately after commencement of insolvency proceedings, proves the threat of damage or other loss due to unreasonable commencement of insolvency proceedings or due to measures adopted in the course of such proceedings, the insolvency court will be able to impose an obligation on the creditor who filed such a petition to provide a security deposit to cover any possible compensation for damage or loss. However, the insolvency court will dismiss a debtor's petition if it concludes, based on the recent results of the proceedings, that the court will ultimately find the debtor insolvent.

The right to compensation for damage or other loss caused by discontinuation of proceedings on a creditor's insolvency petition, or by dismissal of an insolvency petition due to the petitioner's fault, can now be claimed by anyone; not only by a debtor or his creditor, but also by other creditors of a debtor. It will be possible to exercise such a right within a time limit which should be extended from the existing three months to six months.

The insolvency court should now also have an opportunity to order a preliminary ruling which would, for reasons "deserving a special consideration", limit some legal effects associated with the commencement of insolvency proceedings. For example, it could limit the ban on execution affecting debtor's assets.

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"Establishment" versus "COMI"

A. Introduction

Many legal (insolvency) issues are of interest far beyond the borders of a country, but some court decisions are extremely valuable. In Germany, the Ferderal Supreme Court (BGH) decided in March 2012 (reference no. IX ZB 178/11) that for the opening of secondary proceedings within a Member State it is only relevant that the debtor possesses an "establishment" within that Member State, regardless of the location of the debtor's centre of main interest ("COMI"). This is remarkable in light of the fact that during the last few years focus has centered on the controversial issue of a company's "COMI".

Pursuant to the legal definition in sec 3 (2) EU Insolvency Regulation No. 1346/2000 (InsReg), the court of another Member State shall have jurisdiction to open secondary insolvency proceedings against a debtor if he possesses an "establishment" within the territory of that other Member State. Therefore, understanding the term "establishment" is essential in order to answer the question of whether a Member State court has international jurisdiction or not.

B. The relevant court judgment

In the relevant case decided by BGH, a German notary registered a business in Birmingham as a sport photographer. To begin with he did not undertake any commercial activity in England. Subsequently he was dismissed from office by the president of the court of appeal in Dusseldorf.

On 17 June 2010 the County Court in Birmingham opened main insolvency proceedings at the request of the debtor. In November, a creditor filed for secondary proceedings in Germany. The Court decided that the debtor did not possess an establishment in Germany and thus rejected the creditor's request. According to the legal definition in sec 2 (h) InsReg "establishment" shall mean any place of operations where the debtor carries out a non-transitory economic activity with human means and goods.

I. Requirements

Thus three main requirements can be derived from sec 2 (h) InsReg:

1. Economic activity with external appearance

A place of operation pursuant to sec 2 (h) InsReg therefore means a place from which economic activities are exercised in the market, whether these activities are commercial, industrial or professional. An occasional place of operation therefore does not constitute an establishment. The external appearance is assessed not by the intention of the debtor but how the activity appears externally.

2. Non-transitory activity

The non-transitory character of the operation shows that a certain level of stability is required.

3. Human means and goods

"Human means" may be employees or other people who have the power to create legal relationships between a creditor and a debtor. Employees of third parties are included if they are assigned by the debtor.

II. Key ruling

The BGH repeated once more that the connection between economic activity and human means shows that a minimum level of organisation and stability is required for an establishment pursuant to sec 2 (h) InsReg. Argumentum e contrario implies that the mere presence of assets or bank accounts within a Member State is not sufficient to be classified as an establishment. Furthermore, the court stated specifically that domestic assets themselves do not constitute an establishment if the debtor does not realise profit from such assets.

The key statement of the court was that if the debtor possesses an establishment within the Member State, international jurisdiction is given regardless of the COMI pursuant to sec 3 (1) InsReg. Therefore, the requirement of an establishment pursuant to sec 3 (2) InsReg cannot be substituted by those established in sec 3 (1) InsReg. This exhibits the exact wording of sec 3 (2) InsReg which expressively requires an establishment within the other Member State but does not take the location of the COMI into account. Moreover there can only be one COMI in the sense of the EU Insolvency Regulation.

Consequently, it is only relevant if an establishment exists. In this case the court of the particular Member State shall be given jurisdiction to open secondary proceedings regardless of whether the establishment at the same moment represents the COMI.

If the court of a Member State opens proceedings pursuant to sec 3 (1) InsReg in the assumption that the COMI lies within the Member State, this decision is binding on all Member States (sec 16 (1) InsReg).

The court correctly stated that even though the effects of those secondary proceedings are restricted to assets situated in the Member State, the opening of secondary proceedings in other Member States only based on sec 3 (1) InsReg would interfere with the Regulations established in sec 16, 17 (1) InsReg.

C. Conclusion

At first sight the decision does not provide us with a groundbreaking new verdict, yet it shows the different points of view of the InsReg compared to the German Insolvency Code (InsO). Whilst the German international Insolvency law in sec 354 (I) InsO gives the opportunity to open a territorially restricted proceeding where assets exist in the jurisdiction – sec 3 (2) InsReg expressively requires an establishment in the jurisdiction pursuant to sec 2 (h) InsReg.

The decisive intention of the European legislation is unmistakably worded in sec 3 (2) InsReg: the opportunity to open a secondary insolvency proceeding, which is limited to a certain Member State, is strictly tied to the presence of an establishment in the Member State. The attempt of expanding the material scope of the application of sec 3 (2) InsReg on matters in which the only connecting factor is the debtor's asset is, following the decision of the BGH, no longer possible.

Considering the increasing prevalence of so called insolvency tourism and forum shopping, this decision of the BGH could be the catalyst for more discussion about the practical grounds for a reform of the InsReg.

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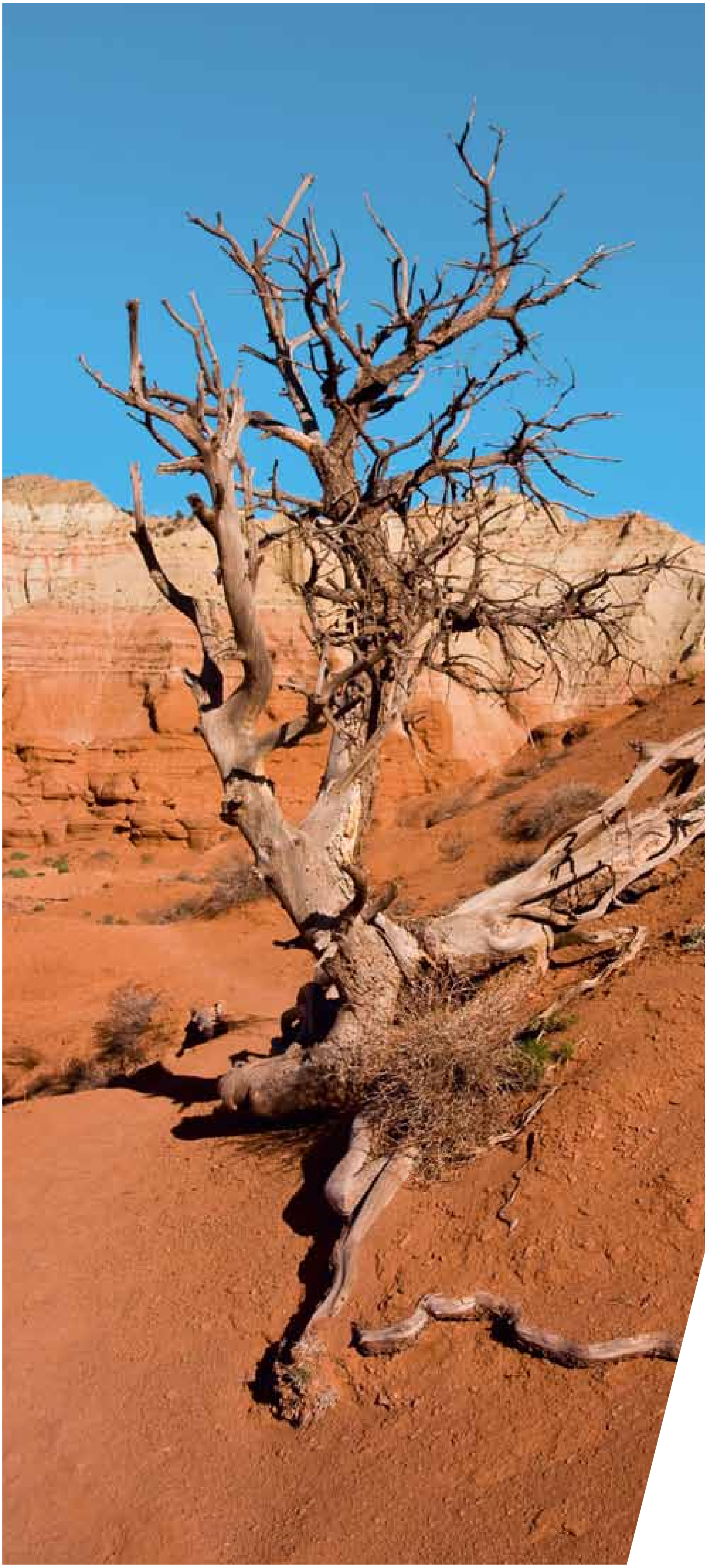

Overview of piercing of the corporate veil rules in the interests of creditors

In Hungary, both company and insolvency laws intend to establish liability for shareholders/members towards the creditors, with respect to the termination of companies without a legal successor. However, the applicable laws are not fully harmonised. Therefore, lawmakers are currently considering how they could make these rules clear and useable from a creditor's perspective.

There are three possible ways a company may be dissolved without a legal successor:

(a) liquidation;

(b) solvent winding up; or

(c) forced deletion from the company register.

Rules of piercing of the corporate veil

Liability of qualifying majority shareholders

The shareholder/member holds a qualifying majority influence if it holds directly or indirectly 75% or more of the voting rights in the controlled company.

In the case of dissolution without a legal successor:

"If a company controlled by qualifying majority shareholder/member is terminated without a legal successor, the qualifying majority shareholder/member shall bear unlimited liability for all debts of the debtor unpaid in liquidation proceedings, provided that the court declares during the liquidation proceedings or after the company is terminated without a legal successor the unlimited and full liability of the qualifying majority shareholder/member due to making permanently unfavorable business decisions." (Section 54 (2) of Act IV of 2006 on Business Association).

This is the general rule applicable to any form of dissolution procedure, irrespective of whether special liability rules with different criteria shall apply to the respective form of dissolution.

The main problem is that court procedure regarding the establishment of liability is regulated only with respect to liquidation proceedings as you can see below.

In the case of liquidation:

"A sole shareholder/member or qualifying majority shareholder/member is liable without limitation for the debtor's unsettled debts, if the court establishes the unlimited and full liability of this shareholder/member during the liquidation proceedings or within 90 days after the closure of liquidation proceedings due to making permanently unfavorable business decisions." (Section 63 (2) of Act XLIX of 1991 on Bankruptcy and Liquidation Proceedings).

Liability of majority shareholders for transferring shares in bad faith

A majority shareholder/member holds over 50% of the voting rights in a company or has dominant influence. A shareholder/member has dominant influence if it is entitled to appoint and recall the majority of the executive officers or supervisory board members, or it holds more than 50% of the votes by virtue of a shareholders' agreement.

In the case of liquidation:

"If the debtor has an amount of debt outstanding which exceeds 50% of its registered capital then the court may declare that a former majority shareholder/member who transferred his/her shares/quotas within three years of the commencement of the liquidation proceedings is liable without limitation for the debtor's unsettled debts, except when the former shareholder/member is able to prove that at the time of transferring his/her shares/quotas the debtor had been still solvent, the accumulation of debt has only happened after or even though the debtor was threatened with insolvency or was insolvent the shareholder/member has acted in good faith and considered the interests of the creditors during the transfer." (Section 63/A of Act XLIX of 1991 on Bankruptcy and Liquidation Proceedings).

Calculating the above based on the registered capital seems arbitrary as the equity of a company does not necessarily relate to its solvency.

In the case of forced deletion:

"If the court deletes the company in a forced deletion procedure notwithstanding that the company left behind unpaid debt then the court may declare that a former majority shareholder/member who transferred his/her shares/quotas within three years of the commencement of the forced deletion procedure is liable without limitation for the debtor's unsettled debts, except when the former shareholder/member is able to prove that at the time of transferring his/her shares/quotas the debtor had been still solvent, loss of assets has only happened after or even though the debtor was insolvent the shareholder/member has acted in good faith during the transfer" (Section 118/A (2) of Act V of 2006 on Public Company Information, Company Registration and Winding-up Proceedings).

This rule seems to mirror the liability rule with respect to liquidation. However, liquidation (insolvent company) is different from a forced deletion procedure (solvent company). Accordingly, the exemption clause as regards establishment of liability in forced deletion cannot be easily proved.

Liability of majority shareholders in the case of forced deletion

"If the court deletes the company in a forced deletion procedure notwithstanding that the company left behind unpaid debt then the court may declare that the shareholder/member is liable without limitation for this debt, except when the shareholder/member is able to prove that the initiation of the forced deletion did not result from his/her negligence." (Section 118/A (1) of Act V of 2006 on Public Company Information, Company Registration and Winding-up Proceedings).

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The Italian "Decreto Sviluppo" amends Italian Bankruptcy Law

The Decreto Sviluppo issued on 22 June 2012, (the Italian Decree no. 83/2012, the "Decree"), subject to conversion into law, will shortly amend Italian Bankruptcy Law by introducing several rules aimed at simplifying the access to alternative procedures to bankruptcy.

The Decree sets forth new provisions concerning:

— the Court-driven creditor composition procedure ("concordato preventivo");

— the restructuring agreements ("accordi di ristrutturazione"); and

— the restructuring plans ("piani di risanamento"),

respectively provided under articles 160, 182-bis and 67, paragraph 3 and letter (d), of Italian Insolvency Law.

1. New requirements for the expert's independence and the certification under the Court-driven creditor composition (Concordato preventivo), the restructuring agreements (Accordi di ristrutturazione) and the restructuring plans (Piani di risanamento)

The Decree has solved the debate between scholars and case law stating that only the company in distress, and not its creditors, has the right to appoint the expert.

Moreover, the new provision expressly gives the faculty to the company in distress to file the restructuring plan with the companies' registry.

With reference to the independence requirements for the expert, the latter is now requested (i) not to be linked to the company in distress by private or professional relationships which may jeopardise his independence; (ii) to meet the requirements set forth by article 2399[1] of the Italian Civil Code for internal auditors (sindaci) of a joint stock company; and (iii) not to have been employed by the company in distress or taken part to its management and supervisory bodies within the last five years.

Under the previous regime, the expert was requested to assess only the reasonableness of the plan. According to the new provision of the Decree, the expert is now obliged to attest the truthfulness of the company's accounting data as well as the feasibility of the restructuring plan.

In accordance with the new provisions, the expert can be deemed criminally liable for false certification and report (reato di falso in attestazioni e relazioni).

2. Court-driven composition with creditors (concordato preventivo)

The Decree provides that when applying for a creditor composition procedure the company in distress, in addition to the documents already listed under Article 161 of Italian Bankruptcy Law (i.e. an updated report of the assets and liabilities, financial and economic status of the company; an analytical and evaluative report of the company's assets and the creditor's list and the list of the owners of rights in immovable property of the debtor), is required to submit a plan containing a detailed description of the modalities and timing for implementing the proposal.

The certification by the expert referred to under paragraph 1 above must be also filed. Every time the company in distress needs to substantially amend the content of the creditor composition with creditor's proposal or the plan, a new expert's certification is requested. The Decree has also improved the advertising regime of the creditor composition procedure by providing that the court's clerk must promptly file the application for the creditor composition procedure with the companies' registry.

Moreover, according to the new provisions, the company in distress is allowed to ask for a stay of 60/120 days ("automatic stay"), which starts from the date of filing the application for the composition with creditors and may be extended by a further 60 days. Therefore, the company in distress may file the application for the composition procedure and reserve the right to file all the required documentation at a later stage without being pressed by enforcement actions by creditors. In particular, during the automatic stay period, creditors are prohibited to start or continue enforcement and foreclosure proceedings and seizure over the company's assets.

Additionally, any judicial mortgage registered in the 90 days prior to the filing of the application for the creditor composition procedure with the companies' registry, are ineffective vis-à-vis the creditors existing at the time of filing of such an application.

During the automatic stay period the company in distress also has the option to switch from the creditor composition procedure to the restructuring plan under article 182 bis of Italian Bankruptcy Law.

Furthermore, the company in distress is empowered to carry out urgent acts for the company's extraordinary and ordinary management subject to authorisation of the Court. In this case, claims deriving from the performance of such acts have a "super-priority" ranking (prededucibilità).

The Decree has also introduced a specific provision stating that the company in distress may request in its application to the Court the authorisation to terminate or suspend (for a period of 60 days which can be extended only once) the agreements in force at the time of the application. It must be pointed out that the above mentioned provision does not apply to employment contracts, preliminary sale agreements of private houses or lease agreements.

Claw back action – new additional exemption

A further amendment introduced by the Decree (by amending article 67 paragraph 3 (e) of the Italian Bankruptcy Law) is that any act, payment or security executed after the filing of the application for a Court-driven composition with creditors cannot be subject to claw back action.

3. Restructuring agreements (Accordi di ristrutturazione)

The Decree has also amended the provisions relating to restructuring agreements pursuant to Article 182 bis of Italian Bankruptcy Law. The Decree provides that payment of creditors not adhering to the restructuring agreement must occur (i) within 120 days from the date of the Court approval of the restructuring agreements if such claims are overdue; or (ii) within 120 days from their maturity date in case of claims not yet due on the approval date.

The Italian Decree also introduces a new article in Italian Insolvency Law (Article 182 quinquies) whereby a company in distress who has filed an application for the composition with creditors or a request of approval of a restructuring agreement can seek the authorisation by the Court to enter into a financing agreement to support the recovery plan. The Court's authorisation is subject to a certification to be issued by an independent expert attesting that the new finance is instrumental to the satisfaction of the creditors. The creditors of the lenders providing new finance are ranked as super-priority.

4. Composition with creditors providing for the continuation of the business by the debtor (Concordato con continuità aziendale)

Finally, the Italian Decree introduces a specific case of a creditor composition procedure named "composition with creditors providing for the continuation of the business by the debtor" (Concordato con continuità aziendale), aimed at allowing the continuation of the business under the procedure. In order to apply for this particular type of creditor composition procedure, the company in distress must file a certification by an expert attesting that the business continuation is instrumental to the satisfaction of the creditors.

In addition to the requirements for the standard creditor composition procedure, the company is also required to clearly identify costs and incomes which are expected to come from the continuation of the business.

In the framework of such a specific case of a creditor composition procedure, the company may postpone payment of secured creditors by up to one year from Court approval of the plan (unless the plan provides for the early liquidation of the secured assets).

The filing of the application for a creditor composition procedure providing for the continuation of the business does not trigger the termination of existing agreements, including those concluded with public entities/bodies.

The Court can also authorise the company to pay existing creditors in derogation to the pari passu principle on the basis of a certification issued by the expert attesting that said payments are necessary and instrumental to the prosecution of the business activity and to the satisfaction of the creditors. Such payments are not subject to claw back action. The certification of the expert is not required for payments carried out by using facilities granted to the company in distress by way of non refundable or subordinated loans.

Finally it has to be noted that the new legal provisions apply to a Court-driven composition with creditors, restructuring plans and the restructuring agreements filed from the 30th day after the date on which the Decree is converted into law.

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1) *The following cannot be elected members of the Board of Auditors (Article 2399 Civil Code): those who are in the condition listed on Article 2382 (Insanity etc.), parent and relatives within the 4th degree of the company's Directors, Directors of the company, parents and relatives within the 4th degree of either controlling or controlled company's Directors; those who are bound to either the company or to controlling/controlled companies by an employment relationship, a continuative consulting relationship, a remunerated service activity, or by other economical interested relationship that affect their independency.*

Landmark decision on recourse claims by the Dutch Supreme Court

On 6 April 2012 the Dutch Supreme Court delivered an important judgment for the finance and restructuring practice. It revised the previous case law on the precise moment at which a recourse claim comes into existence. This new decision limits the potential to pledge recourse claims in advance.

The case deals with the question of what moment a recourse claim of a joint and several debtor against a co-debtor comes into existence. There are two conflicting legal doctrines on this subject. One view is that a recourse claim can be seen as a conditional claim that comes into existence at the same time two debtors become jointly and severally liable. The second view is that a recourse claim only comes into existence after a payment or enforcement of security. In the first view, a recourse claim can be pledged in advance; in the second view, pledging in advance is limited by bankruptcy rules.

The practical difference between the two views is illustrated by the following example:

As security for outstanding loans, a bank has been granted a pledge on all current and future claims of two jointly and severally liable debtors (A and B). Both debtors are then declared bankrupt. The bank first enforces the security granted by B. According to Dutch law, B has a recourse claim against A for the amount that exceeds the amount B has to contribute in its internal relationship with A.

If a payment in the bankruptcy of A is expected, the bank will want to extend its pledge to this recourse claim. If the recourse action already conditionally existed from the start of the joint and several liability, B's recourse claim against A can be validly pledged to the bank. If however the recourse claim would only come into existence after the post-bankruptcy "over-payment" of B, the claim cannot validly be pledged by B to the bank.

Recourse claims tend to be waived in advance in security documentation and, because the validity of such waivers has been questioned, these claims are also pledged in advance to banks and financial institutions.

In 2002 the Supreme Court ruled in the Brandao/Joral decision that a guarantor has a recourse claim against the principal debtor under the condition precedent that he has paid as guarantor. The Supreme Court ruled that such a recourse claim is a conditional claim that exists from the moment the guarantee is signed.

This decision, although highly criticised at the time, was the basis for the view that Dutch case law held, that a recourse claim could be validly pledged in advance. Such a pledge was also considered to be valid if the payment or the enforcement of security, leading to a recourse claim, occurred after the bankruptcy of the (co-) debtor.

If, however, the recourse claim comes into existence at the time of payment or enforcement of security after the bankruptcy of the principal debtor, the recourse claim would not be validly pledged, since Dutch bankruptcy law prevents creation of a pledge of a post-bankruptcy claim without the co-operation of the bankruptcy trustee.

In its decision of 6 April 2012 the Supreme Court revised its previous judgment. The Supreme Court now ruled that the recourse claim only comes into existence the moment the joint and several debtor pays the creditor for an amount exceeding his liability in relation to his co-debtor. This payment by the joint and several debtor is not a condition pursuant to article 6:21 of the Dutch Civil Code (conditional agreement) but it is a legal requirement for the existence of a recourse claim.

In her advisory opinion to the judgment of the Supreme Court of 6 April 2012, the attorney general refers to the parliamentary history of article 6:10 of the Dutch Civil Code, and states that the legislator supports this view.

As a result of this decision of the Supreme Court, a right of pledge does not cover recourse claims as described above. After a bankruptcy of such a debtor, the bank can no longer exercise these post-bankruptcy recourse claims vis-a-vis other jointly and severally liable debtors. This is the prerogative of the trustee in the bankruptcy of the debtor.

The judgment definitely has consequences for the finance and restructuring practice.

In finance documentation, recourse claims are typically pledged to the bank in advance. It is critical that these rights of pledge are bankruptcy-proof, especially when the restructuring demands the severance of financial ties between viable and non-viable group companies.

The question is what happens if one of the remaining non-viable companies subsequently goes bankrupt and the security is enforced: is there a valid pledge on any recourse claims on other group companies? Or can the bankruptcy trustee nullify these pledges pursuant to para. 42 – 45 of the Dutch Bankruptcy Act (the fraudulence conveyance (actio pauliana) provisions in Dutch insolvency law)?

Prior to the Supreme Court decision, banks could take the position that the recourse claims existed long before the bankruptcy, and were therefore the object of existing pledge arrangements. A Supreme Court judgment from 2002 supported this position.

This can no longer be upheld after the new decision of the Supreme Court.

It remains advisable to create a pledge on recourse claims immediately following the execution of security rights. However, if a bankruptcy occurs shortly after the creation of the pledge, the trustee in bankruptcy might be able to nullify the pledge pursuant to the fraudulence conveyance (actio pauliana) provisions in Dutch insolvency law.

An additional way to deal with this issue is to include a provision in the security documents that subordinates any recourse claims between group companies to claims of the bank. This means that group companies can only take recourse after the bank has been paid in full. These subordination agreements would also cover future claims. As a result of the Supreme Court decision, it is to be expected that banks will revert to these subordination constructions more often.

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Increased bankruptcies in the building sector affect investors

Over 80 building sector companies have been declared bankrupt during the last year in Poland and more are expected to become insolvent in the coming months.

The biggest bankruptcies have been among companies involved in infrastructure projects, especially road-building contracts. Many problems resulted from highly unfavourable contracts executed with the Polish General Directorate for National Roads and Motorways (the "GDNRM"). They were entered into in a fiercely competitive atmosphere several years ago when, in order to win tenders, construction companies offered low prices and low margins, which did not always reflect the actual level of costs. The rise in price of main building materials (asphalt, concrete, fuels) by over 40% has seriously damaged profits. It emerged that the bulk of such contracts did not include indexation clauses which would allow remuneration to be adjusted if costs turned out higher than expected. Consequently, the bulk of projects executed with the GDNRM have been running at a loss, causing financial difficulty and even insolvency for construction companies.

This, in turn, creates significant distress not only for the general contractors, but also for other sectors of the economy, such as the chemical industry and producers of the special transportation equipment associated with the industry. Moreover, the same construction companies, apart from being involved in infrastructure projects, render services to investors from various other branches of industry, including building gas pipelines and energy blocks for the energy sector.

The current bankruptcies of general contractors raise particular difficulties for such private (other than GDNRM) investors. This is caused by the combination of two factors:

Firstly, a great deal of the work on the infrastructure projects was outsourced to subcontractors. Secondly, under Polish law, investors are jointly and severally liable with general contractors for the payment of remuneration to subcontractors for building works performed by them. This leads to a situation where, if the general contractor goes bankrupt, the subcontractors whose works have not been paid for by the bankrupt contractor are entitled to demand payment directly from the investors.

Once the general contractor's bankruptcy is announced, its estate constitutes the bankruptcy estate and a trustee (or receiver – depending on the type of bankruptcy) is appointed to – among other things – collect all receivables of the bankrupt. However, although on one hand the investor is obliged under the agreement with the bankrupt to make payments to the bankruptcy trustee (or receiver), on the other hand, the subcontractors are entitled to demand that the payment in full is made directly to them. If an investor pays the remuneration directly to a subcontractor, it may have recourse to the trustee (or receiver) for the amount paid to the subcontractor. This would, however, be included in the list of creditors and satisfied from the bankruptcy estate in accordance with the bankruptcy regime. As a result, such a claim would be very unlikely to be fully satisfied as, in practice, the bankruptcy estate is almost never sufficient to cover the liabilities to all creditors.

Similar types of joint and several liability in subcontracting chains exist in certain European countries, such as Austria, Belgium, Finland, France, Germany, Italy, the Netherlands and Spain (although the specifics differ from country to country). They are all aimed at providing special protection for the subcontractors performing certain works for the investor, even though they are based on an agreement between the general contractor and the subcontractors.

In light of the recent developments in Poland, the *ratio legis* of the joint and several liability becomes more and more questionable; why are the subcontractors, who are usually professional entities operating in the same market sector as the general contractor, afforded higher legal protection than the investor, who – even if a professional – does not usually concentrate on the building market and thus requires more favourable treatment?

The issue of bankruptcy in the construction sector is a subject of heated discussion in Poland. Some blame the GDNRM for executing contracts on terms too unfavourable to the construction companies and which were based on unrealistic assumptions. This, however, is rebutted by GDNRM's reasonable response that nobody was forced to enter into the contracts. A partial solution would be a new regulation on road-building contracts, which is being postulated by certain political circles. This regulation would allow for the making of payments due to subcontractors for works performed in respect of GDNRM investments. The sums would be paid from a special National Road Fund where 10% of the value of each contract would be assigned in order to secure payments in situations of a contractor's bankruptcy.

Another recently discussed scenario is for a national government fund to take over bankrupt construction companies. It would enable the authorities to restructure insolvent companies and complete investments that have been started. The companies that were taken over would subsequently be sold on the stock exchange. This is a highly controversial option which the European Commission might view as prohibited state aid.

The coming months will probably see a solution to the GDNRM contracts and, hopefully, help construction companies facing financial difficulties. The discussed options are not, however, likely to solve the other more significant problem of the need for higher protection of the investors, who are currently unjustifiably exposed to the risk of the general contractor's bankruptcy.

Before the law is amended in this respect, minimising the risk of exposure using the existing legal measures is highly recommended. In particular, special clauses should be included in the building contracts, broadening the scope of the investor's rights in case of their contractor's insolvency. With respect to contracts already executed, the investors are advised to verify them and assess whether the mechanisms used provide sufficient protection against the contractors' insolvency, as well as to introduce a system of managing the contract's fulfilment by the general contractor and their subcontractors.

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Commentary: Erste Bank Hungary Nyrt v Magyar Allam & Ors – Court of Justice of the European Union

Introduction

In its recent judgment in ERSTE Bank Hungary Nyrt v Magyar Állam and Others, the European Court of Justice (the **"ECJ"**) has given some useful guidance concerning the application of Article 5(1) of Council Regulation (EC) No 1346/2000 of 29 May 2000 (the **"Regulation"**), which seeks to preserve the rights *in rem* of creditors or third parties in respect of assets belonging to the debtor that are situated in another Member State to the Member State in which insolvency proceedings have been opened.

In particular, the Court has held that Article 5 applies, even to insolvency proceedings opened in a Member State, before another Member State (in which rights *in rem* existed as to certain assets) acceded to the European Union (the **"EU"**).

Key EU legislative provisions

The key provisions of the Regulation under consideration by the ECJ were the following provisions relating to the opening and conduct of insolvency proceedings in Member States:

Article 3 of the Regulation, which deals with international jurisdiction, states:

"1. The courts of the Member State within the territory of which the centre of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.

2. Where the centre of a debtor's main interests is situated within the territory of a Member State, the courts of another Member State shall have jurisdiction to open insolvency proceedings against that debtor only if he possesses an establishment within the territory of that other Member State. The effects of those proceedings shall be restricted to the assets of the debtor situated in the territory of the latter Member State.

3. Where insolvency proceedings have been opened under paragraph 1, any proceedings opened subsequently under paragraph 2 shall be secondary proceedings. These latter proceedings must be winding up proceedings."

Article 4 of the Regulation, relating to the law applicable, provides:

"1. Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened, hereafter referred to as the "State of the opening of proceedings".

2. The law of the State of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure …"

Article 5 of the Regulation, regarding the rights *in rem* of third parties, states:

"The opening of insolvency proceedings shall not affect the rights *in rem* of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets – both specific assets and collections of indefinite assets as a whole which change from time to time – belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings."

Background Facts

The case concerned certain rights in respect of money paid in to court following the sale of shares which were previously given as a security deposit arising under Hungarian law, as against rights and obligations arising from insolvency proceedings opened in Austria.

Postabank és Takarékpénztár Rt **("Postabank")** had given certain of its shares to BCL Trading GmbH **("BCL")** as security for its obligations under a letter of credit issued in favour of BCL. This transaction was governed by Hungarian law and the deposit of the shares constituted security in respect of which certain rights *in rem* arose.

Subsequently, in December 2003, insolvency proceedings were opened in respect of BCL in Austria.

On 1 May 2004, Hungary acceded to the European Union and became a Member State.

In December 2005, a Hungarian court ordered the shares to be sold, which they were, and the proceeds were paid in to court.

In January 2006, ERSTE Bank Hungary Nyrt **("Erste Bank"),** the legal successor of Postabank, brought proceedings in Hungary seeking an order that it had a right to the share sale proceeds under Hungarian law and further, for an order that secondary insolvency proceedings be opened in Hungary on the basis that BCL has an establishment in Hungary in accordance with Article 3 of the Regulation.

Erste Bank's applications were both dismissed on the basis that:

1. it had not established that BCL possessed an establishment in Hungary; and

2. as insolvency proceedings had already been opened against BCL in Austria, Austrian law was applicable in accordance with Article 4 of the Regulation: that law prevented an action in respect of the cash paid in to court.

Erste Bank appealed the decision at first instance to Court of Appeal, Hungary but the decision of the court at first instance was upheld. In doing so, the Court of Appeal also relied upon Article 4(1) of the Regulation.

Erste Bank further appealed against the decision to refuse the opening of secondary insolvency proceedings in Hungary. Importantly, in doing so, on this occasion Erste Bank argued that because Hungary had not become a member of European Union at the time the Austrian insolvency proceedings were opened, the Regulation did not apply to its application and, accordingly, that the Hungarian court was entitled to act as if no insolvency proceedings had been commenced at all.

In view of the position taken by Erste Bank in this appeal, the Hungarian court took the view that its decision depended upon the interpretation of the Regulation and accordingly referred the following question to the ECJ:

"Does Article 5(1) of … [the Regulation] govern civil proceedings relating to the existence of rights *in rem* (in this case security deposits (óvadék)) where the country in which the bond, and subsequently the money it represented, was deposited as a security was not a Member State of the European Union at the time when insolvency proceedings were opened in another Member State, but was a Member State of the European Union by the time the application initiating the proceedings was submitted?"

It is the ECJ's decision on the question referred to it that we are concerned with.

Decision of the ECJ

In essence, the decision the ECJ was asked to give was whether or not Article 5 applied to the money paid in to court following the sale of the shares even though the jurisdiction in which the proceeds of sale were located was not a Member State at the time the insolvency proceedings were opened.

Consideration was given to Articles 16 and 17 of the Regulation, which relevantly provided as follows.

Article 16, concerning the recognition of insolvency proceedings, states:

"Any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to Article 3 shall be recognised in all the other Member States from the time that it becomes effective in the State of the opening of proceedings."

Article 17, which deals with the effects of the recognition of insolvency proceedings, states:

"The judgment opening the proceedings referred to in Article 3(1) shall, with no further formalities, produce the same effects in any other Member State as under this law of the State of the opening of proceedings, unless this Regulation provides otherwise and as long as no proceedings referred to in Article 3(2) are opened in that other Member State."

Accordingly, the ECJ was satisfied that from the date Hungary acceded to the European Union (1 May 2004):

"The Hungarian courts are required … to recognise any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to Article 3 thereof. Furthermore, pursuant to Article 17(1), any judgment opening insolvency proceedings handed down by a Member State produces in principle in Hungary, from 1 May 2004 and without any further formality, the effects attributed to it by the law of the State of the opening of proceedings.

… from 1 May 2004, the Hungarian courts were therefore required to recognise the judgment opening those proceedings handed down by the Austrian courts."

Following on from that conclusion, it came as no surprise that the ECJ further formed the view, specifically in relation to Article 5 that:

"… the provision of the Regulation are applicable in Hungary from the date of accession [1 May 2004] …"

And:

"… [it] must be interpreted as meaning that the provision is applicable …"

And, finally, on the basis that Article 5 of the Regulation applied, it must:

"… be understood as a provision which, derogating from the rule of law of the State of the opening of proceedings, allows the law of the Member State on whose territory the asset concerned is situated to be applied to the right *in rem* …"

Comment

Although the decision is probably fairly unique to its own peculiar circumstances, it does provide some useful guidance as to the operation of the Regulation in such circumstances were they to arise again in the future when new countries join the EU.

Unfortunately, although the case firmly confirms the application of Article 5, what it does not do (because the court was not asked to do so) is provide any assistance on the operation of Article 5. It may be inferred from the judgment that, regardless of whether BCl has an establishment in Hungary, if Article 5 does, in fact, apply, in so far as Erste Bank is seeking to recover the funds held in court, then to the extent that it is enforcing rights *in rem,* the law of Austria, being the place where the main proceedings have been opened, will not apply and the Hungarian courts will be free to decide Erste Bank's rights as a matter of Hungarian law.

Of course, this would all become irrelevant were the Hungarian court to open secondary proceedings as all doubt as to the operation of Article 5 and the applicability of Hungarian law would be removed.

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