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Newsletter

CMS Restructuring and Insolvency in Europe

Spring 2012

Introduction

We are pleased to present this spring 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:

— insolvency proceedings in relation to creditors from other Member States;

— the opening of the *sauvegarde* procedure for the Heart of La Défense;

— the insolvency of groups of companies in Germany and Europe;

— prominent examples of *forum shopping* and their effects on German insolvency law;

— amendments to the Hungarian Bankruptcy Code;

— a new procedure solving over-indebtedness in Italy;

— the Dutch Intervention Act;

— a new Act of Parliament strengthening the position of individual buyers of residential premises in Poland; and

— the European conflicts of laws rules.

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 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

Insolvency law is constantly changing. This is strikingly illustrated by contributions to the CMS Insolvency and Restructuring in Europe Newsletter which time and again re-examines current trends and tendencies in European jurisdictions. The CMS Insolvency and Restructuring in Europe Newsletter thus offers an ideal opportunity to gain an overview of the topics affecting legal practitioners throughout Europe.

Currently in Germany, one of these topics is the Act for Further Facilitating the Restructuring of Enterprises (*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen* – the **"ESUG"**), which came into force on 1 March 2012. As the first of three stages of comprehensive insolvency law reform planned by the German Federal Government, the ESUG introduced fundamental changes to regular insolvency proceedings, insolvency plan proceedings and self-administration. The implications of this reform in practice are being hotly debated at present. There is an array of seminars and lectures addressing the future implications of this reform and first experiences of the new provisions. The impact of the ESUG on *forum shopping* is examined in the article on page 12 of this edition.

Of particular interest and relevance in practice is the relaxation of the requirements when choosing an insolvency administrator. The dogma of the insolvency administrator having to be independent was undisputed for a long time in Germany. Each time a debtor suggested an insolvency administrator or if the candidate had previously been involved in company issues then the person in question could no longer be considered as an insolvency administrator and could not be appointed by the courts. In the past the courts were less sceptical of creditors' recommendations although this matter was handled differently from court to court. The consequence of this was a clear distinction between insolvency administrators and advisors. The ESUG has blurred this distinction. The fact that a creditor's or debtor's recommendation does not lead to exclusion of the candidate in question is a positive sign. However, any involvement in the company prior to insolvency, including general advice, is now no longer deemed detrimental. What determines when it is only a matter of providing general advice, and the degree to which prior involvement in the company is detrimental, is unclear. Moreover, the mixing of insolvency law advice and insolvency administration leads to a conflict of interest for the insolvency administrator involved who may have to examine, or even curtail, either his own actions or those of his colleagues during insolvency proceedings. The requisite objectivity of an insolvency administrator can no longer be guaranteed if he is to provide both advice and deal with insolvency administration.

Great expectations are placed on the entirely new Protective Shield Proceeding (the **"PSP"**). Whereas the ESUG is essentially linked to existing instruments, the PSP has introduced an entirely new aspect to the German Insolvency Act. The PSP enables the debtor to work on an insolvency plan on his own and under the protection of the provisional insolvency proceedings. The debtor has a maximum period of three months to do this. To be able to effectively draft an insolvency plan the debtor is provided with a custodian. The debtor is free to choose the custodian who can only be rejected by the court if he or she is clearly unsuitable as a custodian. The PSP does not grant a moratorium. The creditors can continue to demand that their claims are due and thereby endanger the restructuring of the company and the insolvency plan and as a result cause the PSP to fail. Therefore, the PSP does not replace the consultation and co-operation that is necessary between the debtor and his creditors. Rather, it can provide the time that is needed to draft an insolvency plan without the Sword of Damocles' hanging over a debtor of failing to file for insolvency and the associated liability risks. Introducing a PSP does, however, involve a range of new legal issues which must be dealt with soon. Requirements regarding the content of a restructuring capability certificate, which the debtor must present to be able to gain access to the PSP, are currently being defined by the German Institute of Auditors (IDW). There is hardly any mention of the liability risks for advisors associated therewith or the consequences of a restructuring capability certificate that has been wrongly issued.

The fact that it is easier to carry out a debt-to-equity swap during the insolvency plan proceeding is certainly worth mentioning. This amendment is of particular interest and concern to shareholders. The possibility anchored in law of being able to interfere with shareholders' rights should enable more effective restructuring in the insolvency plan proceeding. General streamlining of the insolvency plan proceedings should reinforce this effect, for instance as regards obstruction measures by creditors.

The German legislative has tried to ease the conditions for restructuring companies with the provisions in the ESUG. Whether this objective can be implemented in practice or not remains to be seen. The first proceedings brought under the ESUG, and in particular relating to the new PSP, have been applied for or are already underway. The popularity that the insolvency plan proceedings and self-administration have gained as a result of the ESUG is advantageous. It is a welcome move that those involved are becoming aware of the possible options of self-administration or insolvency plan proceedings. The hope remains that the courts will be especially open towards these alternatives to regular insolvency proceedings and make use of the new freedom this law provides.

The second stage of the insolvency law reform relates to consumer insolvency proceedings. A first draft has been drawn up by the Federal Ministry. In particular, the Federal Ministry should reduce the period for discharging residual debt to favour the competitiveness of German consumer insolvency proceedings. However, a reduction from six years to three years should only be possible if 25% of creditor claims and the procedural costs can be settled within the first three years. Whether this and other provisions make sense is currently being discussed.

In the third stage of the insolvency law reform the German legislative will consider the provision for group insolvencies. To date, the German Insolvency Act has no separate provisions for such insolvencies. Current developments in the German law relating to group insolvencies is examined in the article on page 9 of this edition.

So the excitement continues. The German legislative reform may give rise to a number of interesting and relevant legal issues, which will provide plenty of material for discussion in future editions of the CMS Insolvency and Restructuring in Europe Newsletter.

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Czech Republic: Insolvency proceedings in relation to creditors from other Member States

The Insolvency Register is an information system where information regarding insolvency administrators, lists of debtors and insolvency files for individual debtors is stored. Creditors can use the Insolvency Register to discover whether their business partners are having difficulties or are in insolvency. Monitoring the Insolvency Register is crucial for creditors, as once bankruptcy of the debtor is declared, the timeframes within which creditors may register their claims are limited.

The Insolvency Court sets the deadline for filing registrations of creditors' claims pursuant to the Czech Insolvency Act. The deadline cannot be less than 30 days or longer than two months. The deadline starts from the date that the declaration of the debtor's bankruptcy is published in the Insolvency Register. In practice, the deadline is usually 30 days. Registrations filed after the expiration of the deadline will not be accepted and no consideration shall be given to additional receivables in the course of the insolvency proceedings. Insolvency proceedings are opened by having been commenced in the public Insolvency Register.

Many foreign creditors are unaware of this procedure for opening insolvency proceedings. Therefore, such creditors may face difficulties in connection with the start of the time limits within which they may register their claims.

The Supreme Court of the Czech Republic declared in its decision in 2008 that creditors from other Member States fall under a less strict regime. The time period within which creditors from other Member States may register their claims begins from the day that the creditors receive a letter from the Insolvency Court (described below); not from the date that bankruptcy is published in the Insolvency Register.

The Czech Insolvency Act sets an obligation upon the Insolvency Court to inform "known creditors" who have their habitual residences, domiciles or registered offices in Member States (save for Denmark) of the opening of insolvency proceedings and of the declaration of bankruptcy of the debtor. "Known creditors" are creditors known to the Court at the time when insolvency proceedings were commenced in the Insolvency Register. As well as relevant Czech insolvency law provisions, the Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings is also directly applicable.

Each respective Insolvency Court shall provide the above mentioned information separately to each "known creditor" in the official language of the state where insolvency proceedings were opened. For these purposes, a special form bearing the heading *"Invitation to lodge a claim. Time limits to be observed"* in all of the official languages of the European Union shall be used. In particular, information on the time limits, the penalties laid down with regards to those time limits, and details of the authority empowered to accept lodging of claims shall be included in the form. Such a notice shall also provide creditors with information as to whether creditors' claims which are preferential, or secured in rem, need to be lodged or not.

The Czech Supreme Court also declared that in the event that the Insolvency Court fails to fulfill its duty and does not inform "known creditors" of the time limits for lodging their claims, then the time limits do not start to run and "known creditors" may lodge their claims at any point during the entire insolvency proceedings. The Insolvency Court is not obliged to provide the above mentioned information to all "known creditors". It shall inform only those "known creditors" who had not yet lodged their claims by the time that insolvency proceedings commenced in the Insolvency Register.

The above described procedure shall not apply to (i) creditors who have their habitual residences, domiciles or registered offices outside Member States (or in Denmark) or to (ii) creditors who are not known to the Insolvency Court at the time when insolvency proceedings are commenced in the Insolvency Register. The Insolvency Court will not provide these creditors with either information on the opening of insolvency proceedings or an individual notice setting out the decision on the bankruptcy of the debtor. These creditors fall under the same regime as local creditors and should therefore check themselves whether commencement of insolvency proceedings, and the decision on the bankruptcy of the debtor, have been published in the Insolvency Register.

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The Heart of La Défense's case End of the story relating to the opening of its *sauvegarde*

The *Cour de Cassation* on 8 March 2011 overruled the decision of the Paris Court of Appeal dated 25 February 2010 which had overturned a debtor's improper use of the *sauvegarde* procedure. The Versailles Court of Appeal, to which the case had been referred by the Supreme Court, rendered its decision on 19 January 2012 regarding the opening of the *sauvegarde* procedure[1] for the SPV company Heart of La Défense **("HOLD")** and its parent company Dame Luxembourg (**"LUXCO"**, part of the Lehman Brothers group).

The HOLD's case

The facts of the case can be summarised as follows: French company HOLD acquired and owns a real estate complex located in the western business district adjacent to Paris. This complex included a business premises, the Towers "Coeur Défense". HOLD is a wholly-owned subsidiary of LUXCO, which is incorporated under Luxembourg law, which is itself controlled by companies in the Lehman Brothers group. In order to finance the acquisition of the building, which amounted to roughly EUR 2.11 billion, HOLD obtained two loans for a total amount of EUR 1,638,950,000. HOLD had granted a mortgage over its assets as security and had also assigned the rental claims arising from the leases of the premises. At the same time, LUXCO had granted the lenders a pledge over its shares in HOLD. Under a clause in the loan agreement, creditors were entitled to demand early repayment for non compliance relating to the LTV ratio and if no new solvent bank could be substituted as counterpart for Lehman Brothers. Following the collapse of Lehman Brothers and its financial rating, the creditors warned the debtor that they would require early repayment of the entire debt. Given the cost of replacing Lehman Brothers and their inability to enter into a new hedging agreement, HOLD and LUXCO applied to court to initiate *sauvegarde* proceedings. The key dates of this long judicial story are as follows:

- **3 November 2008:** Their request was accepted and two separate *sauvegarde* proceedings were opened by the Commercial Court of Paris.

- **8 December 2008:** Eurotitrisation, a creditor, challenged the opening of the *sauvegarde* proceedings. It claimed that the conditions necessary to commence *sauvegarde* proceedings had not been met.

- **7 October 2009:** The first instance court rejected its application. Eurotitrisation appealed to the Paris Court of Appeal.

- **25 February 2011:** The Paris Court of Appeal adopted a strict interpretation of the criteria of the opening of such a procedure and overturned the decision of the Commercial Court of Paris on the grounds that debtor companies did not establish that they faced real difficulties, which adversely affected their core business (i.e. renting business premises for HOLD; and holding shares for LUXCO).

  In particular, the Court found that HOLD had not shown that it was facing difficulties in continuing to let properties and had only used arguments relating to how unforeseen circumstances rendered its contractual obligations under the loan agreement more onerous. As the loan agreement was a binding contract, HOLD could not unilaterally amend it. In the absence of real difficulties impacting its business, HOLD's request to initiate *sauvegarde* proceedings was simply aimed at getting around the legal barriers preventing it from unilaterally modifying the contract.

  The Paris Court of Appeal consequently granted the creditor's request to revoke the decision initiating the *sauvegarde* proceedings in relation to HOLD and LUXCO. This decision automatically revoked the rescheduling plan that had been adopted by the Tribunal de commerce on 9 September 2009.

- **8 March 2011:** The *Cour de Cassation* (i.e. the French Supreme Court) overruled the decision of the Paris Court of Appeal dated 25 February 2010.

- **19 January 2012:** The Versailles Court of Appeal validated the opening of the *sauvegarde* proceedings of HOLD and LUXCO and confirmed the judgments of the Commercial Court of Paris dated 3 November 2008.

The scope of the *sauvegarde* procedure

In this decision, the Versailles Court of Appeal confirmed that the legal provisions defining the conditions for the opening of a *sauvegarde* procedure must be applied literally and cannot be restricted by the addition of other conditions not expressly included in the legal text.

In accordance with the *Cour de Cessation's* decision, the Versailles Court of Appeal upheld a strict application of the law, by stating that even if the *sauvegarde* procedure is intended to facilitate the restructuring of the company, in particular in order to enable the continuation of the business, the law does not require that the difficulties justifying the opening of the *sauvegarde* specifically affect the activity (i.e. operational side). It is therefore improper to add a condition to the law, as the Paris Court of Appeal previously did, by considering that HOLD had to establish it was facing real difficulties which could affect its business premises renting activity, and that LUXCO also had to establish it was facing real difficulties which could affect its holding company activity.

Moreover, the Versailles Court of Appeal held that, aside from fraud, the opening of a *sauvegarde* procedure may not be refused to a debtor on the grounds that it may be requesting an opening merely to try to escape from its contractual obligations. Similarly, a debtor cannot be refused a *sauvegarde* procedure on the grounds that, as a consequence of this procedure, its shareholders may be protected from losing control over the debtor.

Therefore, as long as the debtor can establish it is facing difficulties it cannot overcome, it is entitled to file a request for the opening of a *sauvegarde* procedure, regardless of the nature of the difficulties (financial or operational), and of the characteristics and nature of activity of the debtor company (holding, company special purpose vehicle, operational company, etc.).

Consequently, the argument presented to the Courts by the debtor claiming that he faced unforeseeable circumstances rendering the contractual obligations under the loan agreement more onerous was eligible. A company which could be shortly in breach of covenants and which would then probably have to reimburse important loans can establish it is facing difficulties it cannot overcome. Therefore, a *sauvegarde* procedure can be opened in such circumstances, without any other condition having to be met.

It follows from the Versailles Court of Appeal's decision that, provided that the legal conditions required to open a *sauvegarde* procedure are objectively met, such procedure can freely be used by holding companies or SPV debtors which want to impose rescheduling of their financial debts to their creditors and intend to use such a procedure as a means to force such rescheduling on them.

By this decision, the Versailles Court of Appeal gives its full extent to the scope of the *sauvegarde* procedure, which could apply to various debtors, as holdings in LBO operations which face difficulties due to the financial crisis.

COMI of the LUXCO: the incorporation of a company in Luxembourg does not necessarily prevent the opening of a *sauvegarde* in France

The Versailles Court of Appeal ruled that the center of main interests **("COMI")** of LUXCO, holding company of HOLD, owner of a building situated in France, is located in France, taking into consideration criteria that are both objective and ascertainable by third parties.

Obviously in line with the ruling of the ECJ dated October 20th, 2011 (n° C-396/09 Interedil Case), the Court relies in particular on:

— The detention by LUXCO of all shares of the French Company HOLD whose main asset is this building situated in France.

— The purchase agreement and the security agreements have been executed in France.

The Versailles Court of Appeal, rather than grounding its argumentation on the mere formal observance of obligations relating to the location of the headquarters of LUXCO, grounded its decision on arguments relating to the actual place of business. This position lessens the reliance that can be placed upon the provisions of the constitution of an entity in Luxembourg which aim to fix the COMI outside of France, such as the obligation of its board of directors to hold their meetings in Luxembourg.

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1) *The sauvegarde is a formal insolvency procedure which seeks to maintain the business of the debtor company, essentially by restructuring its business or its debts pre-emptively even though it is still solvent. It places the debtor under court protection against its creditors, so as to allow him to reschedule its debts either through renegotiation with the creditors, or by means of a coercive court order.*

Insolvency of groups of companies in Germany and Europe

1. Introduction

Neither the German Insolvency Act nor the European Insolvency Regulation contain specific rules on the insolvency of groups of companies. Instead they follow the basic principle *"one person, one estate, one insolvency".* This principle can lead to conflicts between different insolvency administrators within an insolvent group of companies. Such conflicts can at best slow down the insolvency procedures and in the worst cases diminish the value of the insolvency estates. The lack of rules concerning the insolvency of groups of companies has been exposed by the financial crisis of the past years and the collapse of numerous groups of companies including the investment bank Lehman Brothers. Therefore, on a German as well as a European level, plans are currently being made to establish adequate rules on the insolvency of groups of companies, which are presented below.

2. German reform plans

The German Ministry of Justice considers the reform of the German Insolvency Code **("InsO")** one of their most important tasks in business law. The first step of the reform, which shall take place in three steps, has recently been completed by the coming into force of the Act for the Further Facilitation of the Restructuring of Enterprises **("ESUG").** While the second step will concern the procedures for customer insolvency and on licence agreements in insolvency, special rules for the insolvency of groups of companies shall be established in the third step of the reform. A concrete timetable for the realisation of the reform plans does not yet exist. However, in a speech on 22 March 2012 in Berlin, the German Minister of Justice provided some interesting insights into the Ministry´s plans.

a) No material consolidation

According to the Minister, the incorporation of rules concerning the insolvency of groups of companies in the InsO shall not interfere with the objectives of German insolvency and corporate law. In particular, the principle of equal treatment of creditors shall remain untouched. Therefore, rules that would lead to a so called material consolidation of the different procedures will not be considered. A material consolidation might disadvantage certain creditors who would receive higher dividends if the procedures were treated separately.

b) Two-stage concept

Instead of a material consolidation the Minister favours a two-stage concept to facilitate the separate procedures: first of all general co-operation duties and rights shall be codified, which make clear the way administrators have to co-operate; and secondly, co-operation mechanisms shall be installed for those cases in which further co-ordination is advantageous.

i) General co-operation duties and rights

Co-operation between insolvency administrators and courts is already possible and sometimes even obligatory on grounds of present German insolvency law. So far the codification of these rights and duties appear to be declaratory rather than constitutive. However, the Minister deems these rules useful for clarification.

ii) Co-operation procedure

In relation to the further co-ordination mechanism, the Minister proposes the installment of a separate co-operation procedure, which shall be opened at the request of a company or its insolvency administrator. According to the Minister´s proposal, this co-ordination procedure shall be the "heart" of the new insolvency rules concerning groups of companies.

As part of the co-ordination procedure a so called 'co-ordination-administrator' shall be appointed, whose task is to co-ordinate the separate procedures. The co-ordination-administrator shall examine the possibilities of consolidating the insolvency, propose concrete strategies as part of insolvency plans, and make sure that the creditors of the separate companies are not disadvantaged by the co-ordination (in comparison to an unco-ordinated procedure). The plans proposed by the co-ordination-administrator shall have no direct effects, but shall serve as a reference for the different recovery or restructuring plans and shall substantiate the insolvency administrators´ co-operation duties.

To determine the co-ordination forum, the Minister proposes a modified priority-system. According to this system, a court shall principally be competent for the whole group where the first petition for the start of insolvency proceedings, over the estate of a company within a group, is filed. This principal priority system shall be modified in so far as companies which are of no material importance to the group shall be of no relevance in determining the co-ordination forum. One company´s importance for a group shall be judged by ratios; such as the company´s part of the group´s balance sheet total, the company´s part of the group´s revenues, or the number of the company´s employees. In addition, the Minister proposes to establish a special forum for insolvency proceedings over a group of companies. However, this special forum shall be optional.

3. European reform plans

Many groups of companies are not only active within one jurisdiction but are often spread over several European states. Therefore, considerations regarding rules on the insolvency of groups of companies are also being made at a European level. A concrete concept can be found in the Report of the European Parliament with recommendations to the Commission on insolvency proceedings in the context of EU company law (2011/2006 (INI)) dated 17 October 2011. The report takes into account that there may be different levels of integration within a group of companies. Therefore, it distinguishes between decentralised and (not expressly) centralised groups.

a) Centralised groups

Whenever the functional or ownership structure allows it, the following approach should apply:

— proceedings should be opened in the Member State where the operational headquarters of the group are located. Recognition of the opening of the proceedings should be automatic (1. A.);

— the opening of main proceedings should result in a stay of proceedings commenced in another Member State against other group members (1. B.); and

— a single insolvency practitioner should be appointed (1. C.).

b) Decentralised groups

For insolvency proceedings in respect of decentralised groups, the regulation shall provide for the following:

— rules of mandatory co-ordination and co-operation between courts, between courts and insolvency representatives and between insolvency representatives (2. A.);

— rules to facilitate and promote the use of various forms of co-operation between courts to co-ordinate the insolvency proceedings and establish the conditions and safeguards that should apply to those forms of co-operation. These would affect the exchange of information, the co-ordination of operations and the drafting of common solutions (2. D.);

— rules allowing and promoting the appointment of a common liquidator for all proceedings (to be nominated by the courts involved and assisted by local representatives forming a steering committee) and rules laying down the procedure governing co-operation between members of the steering committee (2. E.); and

— rules allowing and promoting cross-border insolvency agreements which would address the allocation of responsibility for various aspects of the conduct and administration of the proceedings between the different courts involved and between insolvency representatives (2. F.).

4. Conclusion

The German and European reform plans appear to be quite similar. However, there are some differences. While the German concept generally favors the establishment of a co-ordination procedure, the European concept differentiates between two kinds of groups of companies: (1) concerning centralised groups, the European proposal follows the idea of one common insolvency proceeding and one common insolvency administrator for all companies within the group (2) concerning decentralised groups, the European concept, just like the German proposal, favours a solution based on co-ordination and co-operation. The concept of co-ordination and co-operation, guided by a special co-ordination administrator, is a new idea and will likely spark discussion amongst scholars and practitioners who may question whether this concept is really practical. However, it remains to be seen if the current German and European concepts will find their ways into legislation. If so, it will be very important that the two concepts are carefully co-ordinated. According to the German Minister of Justice, a French-German initiative has already been put in place in order to coordinate the reform plans: definitely a first step in the right direction.

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Forum shopping and regulatory competition

Prominent examples and their effects on German insolvency law

Forum shopping is a phenomenon of international law faced by many legal disciplines, including insolvency law. It is a particularly topical issue today, where big corporations operate in more than one country and technology enables parallel engagement in numerous places and, more generally, there has been a global convergence of economies and legal systems. Particularly within the European Union, the close legal and economic connections between the Member States in the internal market allow the migration of both legal and natural persons in search of the most favourable legal framework.

Terminology

In its broadest meaning, *forum shopping* provides the plaintiff with the choice of bringing an action in more than one jurisdiction. The decision of which jurisdiction the action should be brought in will be based upon the route most likely to result in the best possible solution to the case. From an insolvency perspective, the parties focus on finding the optimal legal system for restructuring a company or managing its insolvency.

Forum shopping and its influence on regulatory competition

Forum shopping may be motivated by various factors including both substantive law issues and practical procedural reasons, such as the promptness of proceedings or costs. The main reason for *forum shopping* in the area of insolvency law is the search for a restructuring mechanism unavailable under the national law of a company.

Recent prominent cases of large German companies are a notable illustration of such motives. Three companies; Schefenacker, Deutsche Nickel and Hans Brochier are good examples of the insolvency law tourism to the United Kingdom for aforementioned reasons. All in financial difficulties, the German companies tried to move their centre of main interests (COMI) across the border in order to benefit from the English insolvency law, on the basis that it was more favourable than the German law.

1. Schefenacker

Based in Esslingen, Germany, the automotive parts manufacturer **Schefenacker AG** got into financial trouble in 2002 after the acquisition of the English mirror manufacturer Britax. In 2007, in order to be able to conduct a debt-equity swap procedure under the UK insolvency regime, the company implemented a restructuring plan providing for the transformation of Schefenacker AG into a German limited partnership with a newly established Schefenacker plc (public limited company under UK law) as one of its general partners. After all other partners ceased to exist, the assets and liabilities were all transferred to the remaining partner. Thus, according to the rules of universal succession, Schefenacker plc assumed all assets and liabilities of Schefenacker AG. The company thereby profited from the restructuring measures provided by the UK insolvency law.

2. Deutsche Nickel

The German manufacturer of nickel wire and bar, **Deutsche Nickel AG,** experienced financial difficulties in 2004, after a price war on the coin market caused by a significant decrease in demand for new euro coins. After the first restructuring attempt had failed under the German law, the company decided to use a procedure similar to the one described above in respect of Schefenacker AG. As a result, all the assets and liabilities of the German company were assumed by DNick Ltd, an English limited company. Consequently, the company filed for insolvency under English insolvency law. In this way the company was able to benefit from different restructuring measures.

3. Hans Brochier

The Hans Brochier's case, however, demonstrates the difficulties associated with the above mentioned procedures. The Nuremberg-based construction company, **Hans Brochier GmbH & Co KG,** tried to follow the Schefenacker/Deutsche Nickel model in 2006; transferring all the assets and liabilities to the UK-incorporated enterprise (Hans Brochier Holdings Ltd). However, there was confusion surrounding the competent court and the appropriate procedure. Following the opening of insolvency proceedings in both Germany and the UK, the English proceedings were annulled and the German insolvency procedure was established.

The cases above demonstrate the practical issue of *forum shopping* in pursuit of a more favourable restructuring regime. It is often noted that German companies seek a legal system that would be more flexible and less formal than the German legal system. The English legal system has been recognised as particularly friendly towards companies in need of an effective restructuring.

The tendency for *forum shopping* has given rise to **regulatory competition** between states. Large international insolvency cases are considered lucrative and worth attracting by countries. Law has been recognised as a product offered by states and searched for by parties to a proceeding; a ranking system of countries has been created, listing jurisdictions by the favourableness of their regulations in specific circumstances.

Depending on whether it is a "race to the bottom" or "race to the top", regulatory competition between the countries might also have positive results. An example of *forum shopping* driving legal reform is the new German law governing the restructuring of companies in 2011 (*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen,* **"ESUG"**). In summary, ESUG makes German insolvency law more flexible, aiming to improve those aspects of the regulation that had forced companies to seek a different legal regime. The most important improvements are:

- strengthening the **influence of creditors** on key decisions in the insolvency proceedings through the new body, a Preliminary Creditors' Committee *(vorläufiger Gläubigerausschuss),* which is entitled, among other things, to participate in the election of the insolvency administrator *(Insolvenzverwalter);*

- facilitation of **debt-equity swaps:** the instrument may be stipulated in an insolvency plan *(Insolvenzplan)* and carried out even without the approval of the shareholders;

- promotion of the **debtor in possession** proceedings *(Eigenverwaltung);* and

- reduction of the potential for **dilatory actions** against an insolvency plan.

Conclusion

Undeniably, the improvement of German insolvency law by the regulation of ESUG should be considered as a positive result of the regulatory competition between states stimulated by the recent prominent examples of *forum shopping*. In this example, the competition between legal systems has produced a "race to the top".

The decision of the German legislative will positively reduce the need for companies to seek other legal solutions in different jurisdictions. As all the adjustments responded to the deficiency of the national regulations, creating a more agreeable legal environment for the restructuring of companies in Germany, it may be that the appetite for *forum shopping* will decrease.

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Amendments to the Hungarian Bankruptcy Code

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As a consequence of numerous problems surrounding the implementation of the new bankruptcy regime and rules on liquidation proceedings in the Hungarian Bankruptcy Code (Act XLIX of 1991 on bankruptcy proceedings and liquidation proceedings) in 2009, lawmakers have introduced extensive (mainly technical) amendments to the Hungarian Bankruptcy Code which have entered or will enter into force on 1 January 2012, 1 March 2012 and 1 July 2012.

We point out the following amendments:

— in order to avoid "forum shopping" by shifting the registered seat before commencing insolvency proceedings, the new rules give jurisdictional competence to the "old insolvency court" for a 180 day period from the change in registered seat;

— creditors are not allowed to initiate bankruptcy proceedings against the debtor;

— the bankruptcy moratorium has been extended to 120 days as the former 90 day period was insufficient for the registration of creditors' claims and preparation of a settlement proposal;

— claims of majority shareholders will not be subordinated in bankruptcy proceedings if they have given a loan to the debtor during the bankruptcy proceedings for reorganisation purposes, of which amount is at least equal to the registered capital of the debtor;

— a limit has been introduced in the insolvency test according to which a liquidation petition can be submitted to the court only if the amount of a creditor's claim exceeds HUF 200,000 (around EUR 680 at the time of printing); and

— the new rules spell out the framework for an electronic liquidation sale procedure to be worked out and introduced by sub-laws.

Although the recent amendments are extensive, not all of the problems encountered in practice have been resolved. Additionally, there is some uncertainty over the correct interpretation of several of the new amendments.

The Hungarian Supreme Court organised a conference for Hungarian insolvency judges in February 2012 to discuss recent amendments and provide non-binding guidance for interpretation. The insolvency judges emphasised that certain amendments could trigger further problems. Therefore, the conference of the insolvency judges recommends amendments to the new changes.

It is advisable to follow the guidance given by the conference (http://www.lb.hu/) whilst the new amendments remain in force.

The new Italian procedure for the composition of the over-indebtedness crisis

A new procedure to solve over-indebtedness *("sovraindebitamento")* (the **"Procedure"**) has recently been introduced by Italian Law no. 3 dated 27 January 2012 (the **"Law"**).

According to the definition provided for under the Law the "over-indebtedness" situation occurs when there is a *"continuing imbalance between the obligations undertaken by the debtor and the assets that can be promptly liquidated in order to fulfil them, and the debtor is definitively unable to duly fulfil its obligations".*

Only debtors (facing a *sovraindebitamento* crisis) which are not **eligible for adjudication in bankruptcy** *("fallimento")* can resort to the Procedure, i.e. physical persons or companies meeting all the following requirements:

(a) not having registered, in the past 3 financial years (or from the beginning of the business, if the company was set up earlier), (i) a net asset value exceeding EUR 300,000.00; and (ii) gross profits exceeding EUR 200,000.00; and

(b) the overall amount of the debts (including those not yet due and payable) do not exceed EUR 500,000.00.

Furthermore, according to the Law, it is required that the debtor has not resorted to the Procedure within the last 3 years.

As a first step, the debtor shall draft a restructuring plan in co-operation with the competent *Organismo di Composizione della Crisi* (i.e. an entity enrolled in a registry to be set up pursuant to the Law) (the **"OCC"**), which shall also certify the feasibility of the restructuring plan. The plan shall then be filed with the competent court and submitted for the approval of the creditors.

The restructuring plan shall set out the date of repayment of the liabilities of the debtor to the adhering creditors; any security guaranteeing such liabilities; and the terms and conditions of any assignment of the assets of the debtor.

The restructuring plan must be approved by creditors representing at least 70% of the company's debts and must ensure the timely and full payment of secured creditors (unless there is a waiver). Under certain circumstances, it may be possible to provide a moratorium of up to 1 year in favour of the debtor binding on those creditors who do not adhere to the plan.

For a period not exceeding 120 days from the first hearing before the competent court, the judge will order that no individual enforcement actions and seizure can be continued or initiated against the debtor's assets.

After approval by the court, the restructuring plan is performed under the supervision of the competent OCC. The restructuring plan can be declared null and void if (i) the debtor's liabilities have been fraudulently increased or decreased; or (ii) a relevant part of the assets has been subtracted or dissimulated or (iii) the debtor's assets have been fraudulently misrepresented by the debtor.

Moreover, the Law provides for a special case of automatic cancellation of the restructuring plan in case the debtor fails to pay any tax agencies and any mandatory social security entity within 90 days from the payment maturity dates indicated in the plan.

For the sake of completeness, it must be noted that the Italian Parliament is currently discussing some amendments to the Law, such as the decrease of the threshold required for the approval from 70% to 60%.

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The Intervention Act: The Special Measures Financial Companies Act

Under current Dutch law the Dutch Central Bank **("DNB")** can intervene when financial institutions (i.e. banks and insurance companies) get into difficulty. According to the Dutch Bankruptcy Act the DNB can request the court to declare the financial institution bankrupt. The DNB can also request the court to impose an emergency regulation. Regulators can issue directives to the distressed institution. These measures are based on the Dutch Financial Supervision Act.

During the credit crunch many governments around the world were forced to assist financial institutions. It then became clear that the existing measures of intervention are not sufficient for the current economic situation. The authorities do not have adequate options to bring about a timely and orderly resolution of the institutions without resorting to bankruptcy. The European Commission has issued a working document called the 'EU Framework for bank recovery and resolution' which will presumably lead to the issuing of a directive. The main purpose is the improvement for distressed financial institutions so that they make less of an impact on the financial system. In anticipation of European regulations the Dutch legislator has filed for a legislative proposal; the Intervention Act, dated 26 October 2011. This proposal is inspired by the *UK Banking Act 2009* and the German *Rettungsübernahmegesetz*.

One purpose of the Intervention Act is the efficient liquidation of financial institutions with irreversible problems. This can be done through the so called 'transfer-plan' that the DNB can draw up for the transfer of deposits, assets and liabilities or shares in the financial institution to a private party. The transfer has to be approved by the Dutch court, including the approval of a reasonable price. The approval of the court effects the transition of title.

Another purpose of the Act is to maintain the stability of the financial market as a whole for which a power is given to the Minister of Finance. In exceptional circumstances, or in the case of a serious and immediate threat to the stability of the financial system, the Minister of Finance has the power to redress the financial problems immediately through temporary actions (i.e. by depriving the voting rights of shareholders and/or suspending powers of the board of directors or the supervisory board). Above that, the Minister of Finance can expropriate assets of the institution or shares of its shareholders.

The third measure of the proposed Act consists of a restriction for contracting parties to invoke certain provisions in agreements. For example, in many agreements, several events of default are being mentioned (which can include measures under the Intervention Act) in which the party/parties have the right to terminate the agreement. With the new provisions, invoking such rights can be avoided. These rules have to be applied no matter what choice of law has been made. As the agreements of Dutch financial institutions are often governed by foreign law (i.e. English or New York law), this addition is of great importance.

Advantages of the Intervention Act are that the costs of the forced transfer will probably be less than the costs under the deposit guarantee scheme and that the Act has a public utility function in that it aims to protect the stability of the financial system. A disadvantage is that it appears that there are not enough legal remedies for the financial institution to enter a protest against the expropriations by the Minister of Finance. This can potentially be contradictory to the European Convention of Human Rights. Moreover, it is likely that the Intervention Act will have to undergo some changes after the European Commission issues its directive on this matter. Therefore it is debatable whether or not the Dutch law should be issued before the European Directive.

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Heated discussions on the eve of new legislation concerning the developers' insolvency

For the past few years there has been a clear growth in the number of bankruptcies in the building sector in Poland and, as the first quarter of 2012 shows, this upward trend is continuing. Such bankruptcies, particularly if they happen during the building of residential developments, inevitably cause concern to individual purchasers who find themselves in a situation of having invested in real estate, whose completion is uncertain. Furthermore, purchasers' efforts to recover their funds generally take a long time and are not usually entirely successful.

The new act of Parliament (the **"Act"**) aims to strengthen the position of individual buyers of residential premises. Following the brief summary of the main institutions introduced by the Act, that were presented in the previous edition of this Newsletter, we would now like to discuss some practical issues. The Act came into force on 29 April 2012 and is currently subject to heated debate among practitioners.

One of the main changes introduced by the Act is an obligation to conduct all settlements between a developer and buyers through specially designed bank accounts – open-ended and closed home buyers' escrow accounts. A separate escrow account must be maintained for each developer's project. In the case of a developer's insolvency the funds in such accounts are to constitute a separate bankruptcy estate designated, in the first place, to satisfy the purchasers.

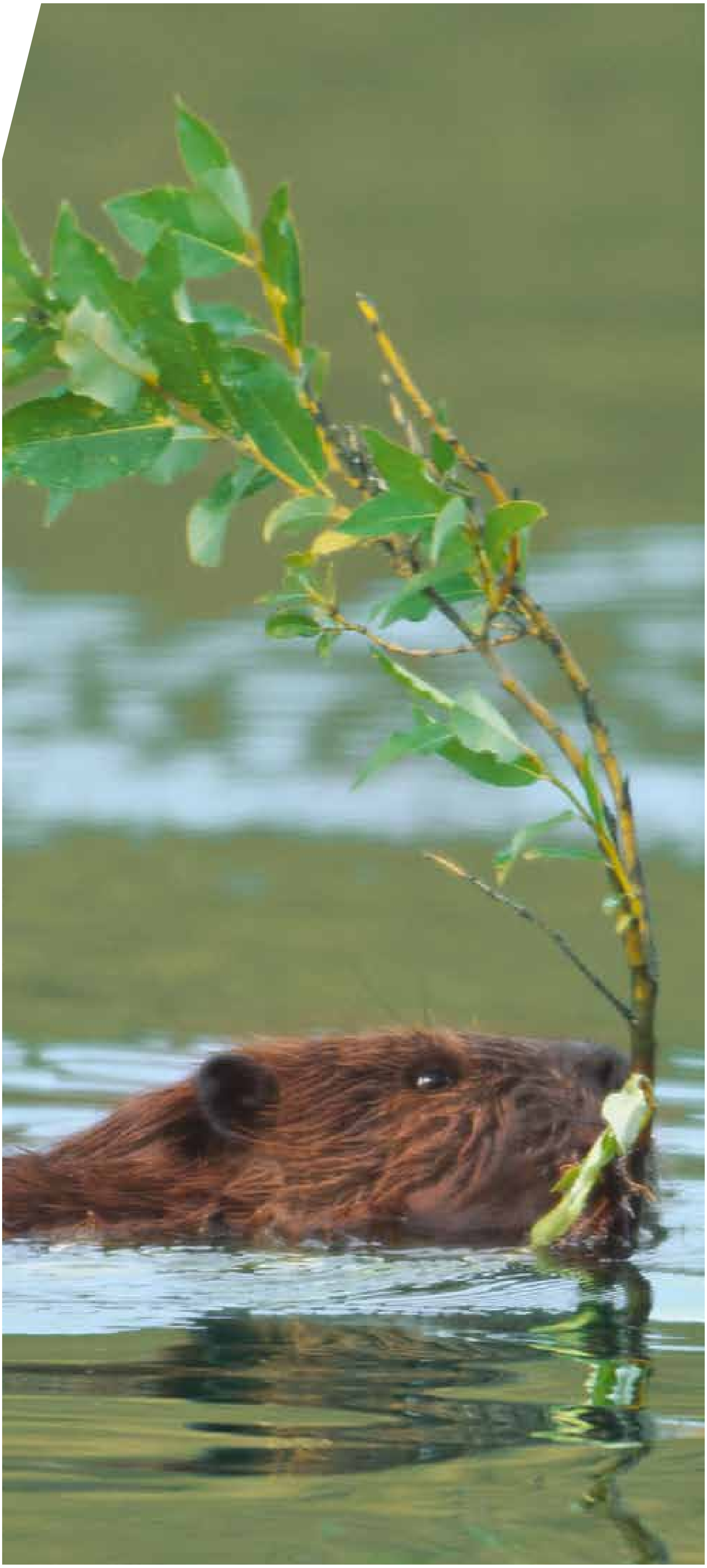
Consequently, all payments are to be made to the purchasers' escrow accounts, and the bank maintaining such accounts is responsible for transferring the funds to the entitled parties. Such transfers are made – in the case of closed escrow accounts – on a one-off basis after the bank has received a copy of the notarial deed confirming that the ownership of the residential premises has been transferred to the buyer, or – in case of open-ended escrow accounts – successively as the consecutive stages of the investment are being completed in accordance with the schedule.

From a legal perspective, it is up to the developer to decide which of the two escrow accounts it will use for a particular development. However, as such "special purpose" escrow accounts are new institutions and are constructed differently to escrow accounts that have previously existed under Polish law, the banks are in practice supposed to introduce such products into their offers.

Choosing between these two legally possible options is an issue where the interests of the bankers are not entirely in line with the interests of the developers. The maintenance of open-ended escrow accounts involves additional obligations for the banks, including checking the completion of consecutive stages of a development before transferring the money to the developer, and, unsurprisingly, banks are unwilling to increase their workload. From the banks' perspective, it would be better to offer only closed-ended escrow accounts as they would not have to get involved with any supervisory responsibilities or in problems connected with a developers' insolvency. Moreover, in the case of open-ended accounts, it may turn out that the funds paid by the bank to the developer from the escrow account, in accordance with the project schedule, may not be recovered by the buyers in the insolvency of the developer, which might consequently adversely affect the bank's reputation.

There are even views in banking circles that some banks will not offer open-ended escrow accounts at all, or, if they do, only developers with a stable market position and reputation, or those known to the banks from previous projects, will be offered such an account. Alternatively, open-ended home buyers' escrow accounts might be offered only together with additional security in the form of expensive bank guarantees or additional mortgages over real estate on which projects are not yet being developed.

On the other hand, a closed escrow account, from which money is paid to the developer after the ownership of the residential premise has been transferred to the buyer, may increase costs of obtaining bank funding and consequently lead to both the gradual exclusion of smaller developers from the market, and to the increase of apartment and house prices.



Another phenomenon worth noting is the recent wave of advertisements and commercials from developers offering apartments in developments in which the construction process has not even started or been precisely scheduled. It is a way for the developers to get around the provisions of the Act obliging them to conduct all settlements with buyers through home buyers' escrow accounts and results from the wording of the provision of the Act on which developers are subject to this obligation, and the imprecise definition of the "commencement of sale". Consequently, publicising information about the commencement of offering apartments avoids the developers the inconvenience of escrow accounts. The Polish Commissioner for Civil Rights Protection has already intervened in this matter with the Ministry of Transport, Building and Marine Economy.

The upcoming months will show whether the new law will be interpreted reasonably. The fact is, however, that although it has not yet even come into force, it has already been the subject of numerous amendment postulates from all sides: including the banking community, the developers and the prospective purchasers themselves.

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Untangling cross border conflicts of laws: EC Insolvency Regulation v Judgments Regulation

F-Tex SIA v Lietuvos-Anglifjos UAB [2012] EUECJ C-213/10 (19 April 2012)

Introduction

Lithuania and Latvia have been trading internationally with European nations for thousands of years. The ancient European Amber Road was an ancient trade route used to transport amber (then an important raw material) from the North Sea and Baltic Sea coasts overland by rivers to Italy, Greece, the Black Sea and Egypt. Despite the passage of time since such international trade began, and the advances in modern commerce and technology, the rules governing international conflicts of laws seem to be struggling to keep pace.

In this case involving German insolvency proceedings, the only creditor (a Latvian incorporated company) had taken an assignment of an insolvency claim, which gave the German liquidator the right to set aside a pre-liquidation payment of 523,700.200 Lithuanian Litas (equivalent to EUR 151,674) made by the insolvent German company to a Lithuanian company, in return for an agreement to pay the liquidator a percentage of any recoveries. The Latvian creditor brought proceedings against the Lithuanian defendant in Lithuania, but the Lithuanian court declined jurisdiction, saying that the case should be heard in Germany, where the insolvency proceedings had been opened. However, the German court also declined jurisdiction on the grounds that the registered office of the defendant was in Lithuania, and not in Germany. Finding itself between a German rock and a Latvian hard place, the Latvian creditor eventually took the problem to the Court of First Instance of the Court of Justice of the European Communities **("CJEC").**

Member States have worked long and hard over our European conflicts of laws rules, as illustrated by the fact that the Council Regulation on Insolvency (No 1346/2000) ("the **Insolvency Regulation**") had a gestation period of some 40 years! Our Latvian creditor could be forgiven for assuming that by now, the European regime governing international conflict of laws should be relatively well established and clear. However, such an assumption would turn out to be a foolish mistake.

The European regime

The main piece of Community legislation governing jurisdiction is the Council Regulation (EC) No 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("the **Judgments Regulation"**). Translating the formal title into every day language means that if you have a legal dispute concerning a civil or commercial matter, then the rules governing which court in which Member State should hear the dispute, and which law should apply to it are contained in the Judgments Regulation.

However, the Judgments Regulation contains some important exceptions, one of which is an exception for "bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings" (Art 2(b) – the **"bankruptcy exception"**), which are intended to be covered in a separate piece of European legislation, namely the Insolvency Regulation.

The Insolvency Regulation governs jurisdiction for opening insolvency proceedings and judgments which are delivered directly on the basis of the insolvency proceedings and are closely connected with such proceedings.

Questions as to the scope of the bankruptcy exception in the Judgments Regulation and its interaction with the Insolvency Regulation have occupied courts in several Members States as well as the CJEC. Some examples are clear cut, for example the opening of insolvency proceedings falls clearly within the bankruptcy exception to the Judgments Regulation, and is governed by the Insolvency Regulation.

Other examples are less clear, for example what about actions by a liquidator in pursuit of a power to challenge pre-insolvency transactions? Or proceedings brought by the liquidator in the name of the company in pursuit of a cause of action vested in the company?

The leading case on the scope of the bankruptcy exception in the Judgments Regulation is *Gourdain* (Case 133/78), which held that in order to fall within the bankruptcy exception of the Judgments Regulation, proceedings must derive directly from the bankruptcy or winding up and be closely connected with the proceedings for realising the assets or judicial supervision. *Gourdain* was actually concerned with the interpretation of the predecessor to the Judgments' Regulation, however another important case *SCT Industri* (Case 111/08) held that an interpretation given concerning its predecessor also applies to the Judgments Regulation where the provisions in question may be treated as equivalent (which they are for these purposes).

Case law has also now established that any proceedings falling within the bankruptcy exception (and so are excluded from the scope of the Judgments Regulation) are supposed to be covered by the Insolvency Regulation. In other words, the two regulations are designed to dovetail completely *(Seagon C339/07).*

Issue

Before commencing proceedings to recover the pre-liquidation payment by the insolvent German company to the Lithuanian defendant, the Latvian creditor had to answer the question whether the proceedings it wished to pursue (based on an assignment of claims granted to it by the liquidator) were directly derived from the insolvency proceedings or closely connected with them?

It is interesting to note in passing, in an article for an international readership, that not all Member States would permit the liquidator to assign this particular type of action. German law expressly permits the assignment of a liquidator's right to have the transaction set aside provided the assignment takes place for consideration which is regarded as equivalent, for the benefit of the general body of creditors.

Non-German lawyers might also be surprised to learn that the right to have the transaction set aside under German law (provided the relevant criteria are established) can apply to a transaction entered into as long before the commencement of the insolvency proceedings as 10 years. In this case the time period between the payment in 2001 and the opening of insolvency proceedings was nearly 4 years.

Contrast the equivalent provisions under UK law: an English liquidator has no power to assign a claim that only he can bring pursuant to his statutory powers as liquidator (as opposed to a cause of action which is vested in the company which he can assign under his powers to sell the company's property). The UK regime also provides for a much shorter equivalent challenge period (up to 2 years).

Decision

The court established that:

- The assigned action could only be brought by the liquidator, with the sole purpose of protecting the interests of the general body of creditors (subject to the liquidator's ability to assign the action as described above).
- It followed that had the action actually been brought by the liquidator then it definitely would have fallen within the bankruptcy exception to the Judgments Regulation as being directly derived from the insolvency proceedings and closely connected with them.
- However, our Latvian creditor was not acting as a liquidator, that is to say as a body responsible for insolvency proceedings, but as the assignee of a right.
- Notwithstanding the fact that the original right on which our Latvian creditor based his action was linked with the insolvency of the director, the court considered the question of whether once the acquired right became owned by the assignee, it retained a "direct link" with the debtor's insolvency.
- The exercise by the Latvian creditor of the acquired right was subject to rules other than those applicable in insolvency proceedings. For example, the assignee could freely decide whether to bring the claim or not. If he did so, and in contrast to the position of the liquidator, he would be acting in his own interest and for his personal benefit (notwithstanding the percentage consideration agreed to be paid by the Latvian creditor to the liquidator). Further, under German law, the closure of the insolvency proceedings would not affect the exercise by the assignee of the right to have the transaction set aside – the right could be exercised by the assignee after the closure of the insolvency proceedings.

The CJEC held that our Latvian creditor's action was therefore not closely connected with the insolvency proceedings. The assignment of the claim from the liquidator to the Latvian creditor broke the direct link to the insolvency proceedings. Therefore the Latvian creditor's action was not within the scope of the bankruptcy exception to the Judgments Regulation. It followed that the applicable rules to determine which court had jurisdiction to hear the claim were to be found in the Judgments Regulation. Under that Regulation, the jurisdiction of the Lithuanian courts was established under Articles 2(1) and 60(1) as courts of the Member State in which the defendant company had its domicile.

Comment

The result is somewhat surprising: it is counter-intuitive that the permissible assignment of a claim from the liquidator to a third party changes the claim's character so substantially that it is no longer derived from, or closely connected with, the insolvency proceedings. The decision also means that the Lithuanian courts will have to apply provisions of German law, which is an uncomfortable outcome.

Somewhat disappointingly, the Court's decision on this point enabled it to avoid having to provide an answer to the potentially more contentious question – namely, does a claimant's right to a judicial remedy (which is guaranteed under the Charter of Fundamental Rights of the European Union) prevent a national court from declining jurisdiction if the national courts of other Member States have already made a declaration of no-jurisdiction? In other words, can you force the last court standing to accept jurisdiction? The answer to this question involves an exploration of the contentious issue of the extent to which the EC regime confers exclusive jurisdiction. It is likely that the CJEC breathed a sigh of relief in being able to side-step this difficult (but important) issue. However, given that we are several thousand years into the course of international trade, and still trying to work out which court should hear a fairly simple commercial dispute, it seems likely that there will be future opportunities to tackle it.

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