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Newsletter
Spring 2014

CMS Restructuring and Insolvency in Europe

Editorial

Welcome to the Spring 2014 edition of the CMS newsletter.

We have interesting commentaries on restructuring and insolvency from 8 different European CMS offices. Specialist lawyers in those 8 different jurisdictions have set out their thoughts on a wide range of topics. The fact that such a variety of subjects has sparked interest in these different jurisdictions illustrates the diverse nature of Europe's restructuring and insolvency regimes. We are very far from having one standard way of operating in this field; and this newsletter underlines the importance, in such a highly technical area, of strong local experience and expertise.

Our colleagues in Poland and Switzerland write about fundamental changes to the rules that prevail in their countries, while articles from France, Spain, Belgium, Austria, Scotland and the United kingdom deal with more nuanced developments.

From Poland, the message is that we should look out for new provisions which will enable a huge step forward in local restructurings. So far, interested parties have been limited to working with the very blunt tool of Polish Bankruptcy law, but help is at hand: 2014's expected "Restructuring Law" will open up a much more realistic approach to saving corporate entities and jobs.

Relevant new Swiss legislation came into force from 1 January this year, built on lessons learned from the 2001 collapse of Swissair. Helpfully, the thrust of these new provisions is to promote restructuring ahead of insolvency.

We are sure that you will find interesting material in this edition of the newsletter. As before, do please contact us with your comments or questions.

With best wishes,

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The Majority Shareholder's Obligation to Apply for the Opening of Insolvency Proceedings of a Domestic or Foreign Stock Corporation that Lacks Legal Representatives

Since 1 July 2013 the majority shareholder of a domestic or foreign stock corporation is required to apply for the opening of insolvency proceedings in the event of the entity's insolvency and if the entity lacks legal representatives. While the exact scope of the new law is not yet entirely clear, shareholders who hold more than 50% of the share capital of an Austrian corporation (or a foreign corporation with its centre of main interests in Austria) should place a special focus on the financial situation of the corporation.

Under Austrian insolvency law, the legal representatives of an entity are required to apply for the opening of insolvency proceedings in the event of the entity's insolvency, i.e. the entity's inability to pay its debts when due (*Zahlungsunfähigkeit*) or the entity's over-indebtedness (*Überschuldung*), without undue delay. The application may be delayed for up to 60 days or, in the case of natural disasters, for up to 120 days in order to make diligent restructuring efforts (*Sanierungsmaßnahmen*).

In 2013 the Austrian parliament introduced a new law that extends the obligation to apply for the opening of insolvency proceedings in the event of the insolvency of a domestic or foreign stock corporation (*Kapitalgesellschaft*) to the majority shareholder if the insolvent company lacks legal representatives. The new law entered into effect on 1 July 2013.

Domestic or foreign stock corporation

While some commentators take the view that the new law appears to target private limited liability companies (*Gesellschaft mit beschränkter Haftung*), most commentators argue that it applies to all stock corporations, including Austrian private limited liability companies, Austrian public limited liability companies (*Aktiengesellschaft*), European companies (*Societas Europaea*), Austrian cooperatives (*Genossenschaft*) and foreign corporations that have their centre of main interests in Austria and their registered seat in an EU/EEA Member State.

Lack of legal representatives

It is currently unclear whether the new law only covers the formal lack of legal representatives, e.g. as a consequence of their resignation, revocation, death or continuing legal incapacity, or whether the law also applies to the factual unavailability of a company's legal representatives, such as the legal representatives' refusal to or inability to carry out their duties.

Majority shareholder

The obligation to file for the opening of insolvency proceedings of an insolvent stock corporation that lacks legal representatives applies to any shareholder who holds a participation of more than 50% in the share capital of the relevant stock corporation. In cases where the majority shareholder of a stock corporation is either a non-incorporated firm (*Personengesellschaft*) or a stock corporation, the legal representatives of the majority shareholder are required to apply for the opening of insolvency proceedings. The new law does not apply to minority shareholders.

According to the explanatory notes to the new law, the obligation is not limited to the legal default situation, i.e. to cases where the majority shareholder has the factual power to appoint the legal representatives of a company. Consequently, the obligation also applies if the majority shareholder is unable to terminate the state of the company's lack of legal representatives on its own, but requires the assistance of the minority shareholders to do so, e.g. due to higher voting thresholds stipulated in the company's articles of association or if the minority shareholder has been granted the right to appoint the legal representatives of a company. In addition, the obligation to file for the opening of insolvency proceedings also applies to the majority shareholder of a public limited liability company lacking legal representatives that becomes insolvent, and not to its supervisory board (i.e. the body that appoints the entity's management board).

No (express) exception for majority shareholders who are unaware of their company's insolvency and/or their company's lack of legal representatives

The new law does not provide for an (express) exception if the majority shareholder has no knowledge of the grounds for the opening of insolvency proceedings or the entity's lack of legal representatives. Consequently, the objective perceptibility (*objektive Erkennbarkeit*) of the entity's inability to pay its debts when due or its over-indebtedness triggers the obligation to file for the opening of insolvency proceedings. Majority shareholders of a stock corporation should therefore make a special effort to inform themselves about the financial situation of their company.

Liability

Majority shareholders who are not compliant with the obligations set out above may be held liable for a delay in applying for the opening of insolvency proceedings (*Insolvenzverschleppung*).

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Belgium

The Belgian Continuity of Enterprises Act Strengthened

The Belgian Continuity of Enterprises Act (the "Act") recently celebrated the fifth anniversary of its adoption by the Belgian parliament. Since its entry into force on 1 April 2009, the Act has been quite successful. In comparison with the former Judicial Composition Act of 17 July 1997, a significantly large number of enterprises resort to it. The Act offers a new range of options, including a potential judicial settlement with the debtors intended to encourage the recovery of distressed companies. However, it appears that many companies are taking advantage of the procedures provided by the Act and still eventually being declared bankrupt.

It was therefore necessary for the legislator to consider the Act's disadvantage and to try and provide a remedy. On 27 May 2013, the legislator passed a new law (the "Amending Act"), which adjusted certain provisions of the Act. The Amending Act does not intend to amend the fundamental principles of the Act but instead aims to "facilitate the detection and sanction of the abuses of the Act", "better inform creditors", and "curb the reckless filing of requests". In order to achieve these aims, the Amending Act provides a number of significant amendments, the most important of which are described below.

The scope of the Act has been expanded to allow farmers (agriculteur) (natural persons) to initiate a judicial reorganisation procedure. This amendment was inevitable since the Constitutional Court stated that the exclusion of farmers from the benefit of the law was unconstitutional. Many observers agree that the Constitutional Court's recent case law suggests that the Act may expand to include any natural person engaged in economic activities, excluding those that are self-employed.

The Amending Act has strengthened the formal conditions imposed on a debtor attempting to initiate a procedure to avoid a late filing of the petition and avoid a bankruptcy process. The new requirements are intended to raise the access threshold and prevent abuse of the Commercial Courts.

Among other things, the Amending Act imposes a fee of EUR 1,000 for procedural costs. This provision is currently not applicable, but will come into force on 31 December 2014 at the latest.

Furthermore, the legislator imposes that any debtor who wishes to initiate a judicial procedure must submit all the documents required by law to the clerk's office along with the petition, otherwise it will be deemed inadmissible. Accordingly the debtor can no longer benefit from the fourteen day period that was initially granted to complete the filing of documents after filing a petition. Nevertheless, the court may in some circumstances allow the debtor to remedy the omission or irregularity.

In support of his petition, the debtor must include "*an accounting statement showing the assets and liabilities and the profit and loss account of the company which is no more than three months old and has been drawn up under the supervision of an auditor, an external accountant, an external certified accountant or an external tax specialist", as well as "a budget with an estimate of the income and expenses for at least the duration of the requested moratorium, drawn up with the assistance of an external accountant, an external certified accountant, an external tax specialist or an auditor*". The role of the "figure professional" is to renew the preparatory papers, and provide verification, rather than to conduct a thorough review of the financial position of the company. The impact of these professionals is undoubtedly a positive step to curb abuses related to accounting statements.

The new law places a further obligation on the debtor. In addition to the requirement to draw up the aforementioned financial statements, the law now obliges the debtor, when submitting his petition, to indicate "*the measures and proposals he is considering to restore the profitability and solvency of the company, to implement a possible social plan and to pay his creditors*". This information will enable the court to have a comprehensive view of the development of the procedure. Before this modification of the law, the debtor was solely required to state these measures and proposals if he was able to do so.

Pursuant to Article 10 of the Act, a "figure professional" who encounters "*serious and corroborating facts which may jeopardize the continuity of the company*" is required to inform the debtor in detail. Thereafter, if the debtor does not take the necessary measures to ensure the continuity of his company for at least a period of twelve months, the figure professional may inform the president of the Commercial Court in writing. The professional must give management advice and keep evidence of the steps he has taken. A professional may be liable to third parties if they do not formally inform management of its obligations.

A first review of the amendments to the Act shows the legislator's clear intention to raise the low access threshold to the procedure, preventing obvious abuses and making it more effective. In general, we agree with the modifications implemented by the Act. We only regret that the strict conditions imposed from the beginning of the procedure, combined with the greater costs, will unavoidably discourage many debtors from meeting the requirements to initiate a petition. Without a doubt, what the Act gains in effectiveness, it loses in flexibility.

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The special administration regime – a review of recommendations

Introduction

The Special Administration Regime **("SAR")** was introduced in February 2011 following the Government's review of resolution arrangements for failing investment firms carried out under powers granted in the Banking Act 2009 (the **"Act"**). The SAR is set out in the Investment Bank Special Administration Regulations 2011 (SI 2011/245) and provides objectives for administrators to pursue when winding-up an investment firm's business. The three high level objectives are:

- ensuring the timely return of client assets and money;
- engaging with market infrastructure bodies and authorities; and
- winding-up or rescuing the firm.

In return for allowing the use of secondary rather than primary legislation for the creation of the SAR, the Act required an independent review to be undertaken within two years of the SAR coming into force. The Treasury appointed Peter Bloxham to carry out this review in two stages: a first interim review to consider whether the SAR had met the objectives set for it in the Act; and a final review to consider the provisions contained within it in more detail and provide more recommendations.

This article summarises the main recommendations contained in the final report.

Links with the CASS Rules

The Client Asset Sourcebook Rules **("CASS")** are Financial Conduct Authority **("FCA")** rules which are rules applicable to firms in 'going-concern' mode holding client money and custody assets in connection with investment business and insurance mediation activity. These include rules for the distribution of client money on the failure of a firm.

Under CASS, a statutory trust arises when the firm receives client money, with the firm deemed to be a trustee for the client. Custody assets, although not giving rise to an express trust, must also be segregated from the general assets of the firm. In 'gone-concern' mode i.e. once the rescue of the firm is no longer considered possible, the SAR enables the administrator to step in as trustee and deal with client assets in line with CASS.

The protection of client assets is therefore dealt with largely by CASS and not the SAR; indeed substantive provisions dealing with clients or client assets in the SAR are limited. The SAR is essentially a mechanism for adapting general legal principles applicable in non-investment firm administrations to the requirements of a failed firm which holds or controls client assets.

Key recommendations

Peter Bloxham's interim report, published in April 2013, recommended that the SAR be retained, with some modifications. The final report, published in January 2014, provides a number of recommendations for improving the SAR. Although the report contains more than 70 recommendations, the key recommendations are as follows:

Facilitating transfers

A mechanism under the SAR should be introduced to facilitate the rapid transfer of customer relationships and positions. This means that more emphasis should be placed on transferring client assets rather than simply returning assets to clients. The report also suggests that the FCA should, where appropriate, encourage firms to use a wholly owned subsidiary as a nominee company to hold legal title to non-cash client investments. This is common practice for investment firms with a largely private client customer base. In the case of Worldspreads Limited, a spread betting company which went into the SAR in March 2012, the use of a nominee company has facilitated the rapid return of substantially all custody assets to clients.

Bar Date reforms

The SAR provides that an administrator may set a cut-off date **("Bar Date")** for claiming client assets held by the investment bank. Although the Bar Date procedure under the SAR is currently limited to custody assets, the report recommends that it should be extended to include client monies.

Making CASS and SAR work together better

The Bloxham report makes it clear that CASS and the SAR regulations should work together effectively and not conflict (for example, by adopting the 'hindsight principle' as a means of calculating the likely value of a claim under both CASS and the SAR). The report also clarifies that CASS determines the regime for distributing client assets, whereas the SAR primarily determines the method for distributions to creditors.

Financial Services Compensation Scheme ("FSCS") recommendations

The FCA should consider extending FSCS compensation to cover shortfalls in custody assets (compensation under the FSCS is currently available in relation to failed investment firms only in relation to client monies). It is also suggested that firms should do more to ensure that their records assist administrators in understanding whether their clients may be eligible for compensation under the FSCS and in relation to which financial products.

Information sharing and cooperation duties

The report notes that the overall objective of the SAR can only be achieved if there is a degree of cooperation between the administrator and all parties who have had dealings with the failed firm prior to its failure. The report thus recommends that cooperation provisions within the SAR should be extended to include cooperation between the administrator on the one hand and the FSCS, market infrastructure bodies, counterparties of the failed firm, banks holding client money deposits and HMRC on the other.

Other SAR recommendations

One of the potential recommendations that attracted much interest prior to the report's publication was the prospect of administrator immunity. Essentially it was argued that administrators' fear of incurring personal liability when distributing assets was delaying the return of client assets. However, following feedback from insolvency practitioners, Bloxham suggests that bestowing personal immunity on administrators would not make the SAR more efficient; rather immunity for administrators should be considered in more limited circumstances, for example, in return for agreeing rapid returns to individual clients in simple or small value cases.

Role of the Courts and dispute resolution

The courts have played a significant role in the LBIE and MF Global administrations, resulting in delays and increased costs. The report proposes that a fast track process should be introduced to determine major issues arising in large insolvencies, as was suggested by the judge involved in the LBIE case, Briggs L.J. The report suggests that consideration should also be given to whether the FCA should be empowered to make binding rulings on points that are unclear or not covered by CASS.

General recommendations

At the same time that Bloxham was reviewing the SAR, the FCA was considering revisions to CASS 7A, which deals with the client assets distribution regime. At present, the focus is on ensuring an accurate return of client assets, but this has contributed to long delays in clients receiving their money after a firm's insolvency. However, the FCA has suggested a new, two-stage process for the return of client assets, whereby an initial distribution could be made by an administrator from money held in client money and transaction bank accounts based on the failed firm's own records, if the administrator was satisfied that these reasonably allowed a determination of entitlements to be made. A second distribution would then follow, comprised of any surplus left in the original client money pool as well as any identifiable money held in the firm's house account. This would enable a return of client money within weeks rather than months or even years. Bloxham suggests that if the FCA decides to implement this 'Speed Proposal', there should be a mechanism for the FCA to endorse the administrator's decisions to use it.

Behavioural recommendations

A number of behavioural recommendations were made in the interim report which are reiterated in the final report. The need for good record-keeping by investment firms is emphasised, as well as the need for firms to more clearly explain the contents of client statements, possibly via standardisation of the data supplied.

Conclusion

Although only five investment firms have been subject to the SAR since its introduction, the final Bloxham report is generally positive about it. Following publication of the report, the Treasury has decided to retain the SAR, although it is likely that a further consultation will take place on which of the recommendations made in the final report will be implemented.

Whatever changes are eventually made, the SAR will not be the 'universal panacea' for resolving all issues faced during a firm's administration. However, improvements made to the SAR (as well as those to CASS) should result in a better outcome for clients affected by the failure of an investment firm, as well as ensuring that the effect of such a failure on business and markets in the UK is minimised.

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Declaration of claims in French insolvency proceedings: Application of the Council Regulation n° 1346/2000 of 29 May 2000 to European Creditors

The declaration of claims is the first step to be taken by a creditor of an insolvent company in order to preserve its rights in the insolvency proceedings and must be drafted with the utmost care. Indeed, the declaration of claims entitles the creditor to participate in the allocation of funds and the distribution of dividends. A creditor who fails to declare its claims shall be excluded from participating.

Under French Insolvency Law, the debts must be declared to the "*mandataire judiciaire*" (a special court-appointed agent) within two months from the publication in the "*Bulletin officiel des annonces civiles et commerciales*" (French legal gazette) (the "BODACC") of a notice of the judgment opening the insolvency proceedings. Creditors not domiciled in France are granted an additional period of two month, so to file their claim. Consequently, foreign creditors are granted a four-month time period (Article R.622-24 of the French commercial code) (the "Code").

However, French law offers a possibility to declare the claims after the expiration of this time period. Article L.622-26 of the Code provides that a creditor may file a request before the "*juge-commissaire*" (dedicated judge appointed to supervise the insolvency proceedings) allowing him to declare his claims after the period has expired. This procedure is called "*relevé de forclusion*". This request must be filed:

- within six months from the publication in the BODACC of a notice of the judgment opening the insolvency proceedings; or
- within one year from this publication for the creditors who were not aware of the existence of the debt before the expiration of the aforementioned time limit.

A few months ago, however, the French Supreme Court (decision n° 13-40.034, dated 5 September 2013) decided that such strict time limits cannot be applied where it was impossible for a creditor to act during the course of the delay (i.e. "*contra non valentem agere non currit praescriptio*").

The barred creditor will have to prove that the failure to declare its claims on time was not the result of its negligence, or that the delay is due to the omission of the creditor's name from the list of creditors drawn up by the debtor at the opening of the proceedings.

This rule also applies to European creditors not domiciled in France. In addition to the rules of French Insolvency Law, the rules of the Council Regulation n° 1346/2000 dated 29 May 2000 shall also apply to the declaration of claims by European creditors.

Articles 40 and 42 of the Council Regulation n° 1346/2000 oblige the Court of the Member State opening of the proceedings or the court-appointed *mandataire judiciaire* to inform the known creditors who have their habitual residence, domicile or registered offices in other Member States.

Article 40 provides that "*information provided by an individual notice, shall in particular include the time limits, the penalties laid down in regard to those time limits, the body or authority empowered to accept the lodging of claims and the other measures laid down. Such notice shall also indicate whether creditors whose claims are preferential or secured in rem need to lodge their claims*". European creditors shall be individually informed of the insolvency proceedings of their debtor in order to declare their claims. A special form is to be used to send this notice. Article 42 of the Council Regulation provides

that "*a form shall be used bearing the heading 'Invitation to lodge a claim'*" in one of the official languages of the Member State opening the insolvency proceedings. However, the Council Regulation n° 1346/2000 does not provide for the consequences where there is a failure to inform the creditor.

An interesting decision of the French Supreme Court was handed down on 17 December 2013 n° 12-26.411 on this issue. A Dutch creditor of a company placed in *Sauvegarde* proceedings declared its claims as an ordinary creditor after the expiry of the four-month time period allocated to foreign creditors. Therefore, the creditor filed a request for a *relevé de forclusion.* The Court of Appeal approved this request.

The debtor and its *mandataire judiciaire* challenged the decision.

The French Supreme Court upheld the decision of the appeal judges. The Court held that since no sanction is provided by the Council Regulation n° 1346/2000, it is up to the Member State of the opening judgment to determine the consequences of the failure to inform the creditor. In France, only the *relevé de forclusion* procedure is available and since the creditor had not been individually informed by the *Mandataire judiciaire* of the opening of the insolvency proceedings under the rules of the Council Regulation, failure to declare its claims on time was not due to its negligence. As a consequence, the conditions for the *relevé de forclusion* were fullfiled and the Court of Appeal had justified its decision.

This decision is favorable to European creditors as it allows them to declare their claims after the expiry of the four month period in cases where the agent appointed by the Court of the relevant Member State (i.e *the mandataire judiciaire* in France) did not follow the provisions of Council Regulation n° 1346/2000.

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Poland

New restructuring possibilities planned in Poland

Over the past few years there has been much discussion regarding the lack of sufficient and effective regulations governing restructuring possibilities in Poland. Although Polish Bankruptcy Law allows for the restructuring of an entity facing financial crisis, the options available are perceived as either unachievable or not fit for purpose. The recent years have seen a significant number of liquidation bankruptcies in Poland and so the need for updating the Polish restructuring legal framework has attracted the urgent attention of Polish legislative bodies.

A team of experts has been appointed by the Ministry of Justice to propose relevant amendments to the bankruptcy and restructuring system. The outcome of this work (in which CMS has been involved) is that the current Polish Bankruptcy Law is to be dedicated only to liquidation bankruptcy cases, with restructuring options to be regulated in a new statute called "Restructuring Law".

The draft of this statute is being prepared and is expected to be published in the first half of 2014. The main aims of the new regulation are to:

— significantly shorten the time necessary to make a restructuring arrangement;

— increase the use of restructuring procedures by entrepreneurs; and

— allow the institution of court proceedings at an early stage of the crisis of a company and to encourage earlier submission of a debtor's undertaking to court proceedings. This is expected to limit any further indebtedness of the company and prevent the disposal of assets by the debtor in order to cause detriment to his creditors or prefer one creditor over another.

According to the so called "assumptions" to the new Restructuring Law approved by the Ministry of Justice, four restructuring proceedings aimed at arrangements between debtors and creditors are to be introduced. Each proceeding is directed at not only insolvent companies, but also those threatened with insolvency. The most important features of each proposed restructuring option are set out below:

Simplified Arrangement Proceedings

The first two types of restructuring proceedings which are to be introduced are jointly referred to as the "simplified proceedings". These proceedings are aimed at reaching an agreement between the debtor and its creditors and will consist of the making and approving of an arrangement without instituting a separate legal procedure. The primary role of the court will be to confirm the arrangement, and so the average length of reorganisation proceedings is likely to be much shorter than is currently the case. There are no pre-conditions to such an arrangement and the only ground for not approving an arrangement is if more than 15 percent of the debtor's liabilities are contentious receivables.

Proceedings regarding the approval of the arrangement

The first "simplified proceeding" involves the debtor gathering creditors' votes before instituting formal court proceedings. It is intended that this will enable the debtor to undertake individual negotiations with its creditors and present the outcome to the court for the court's approval. Formal requirements concerning the petition itself will be limited to the absolute minimum, a feature which is particularly important for small businesses. The debtor will be able to choose a licensed trustee to act as the arrangement supervisor, which will help to secure the interests of the creditors. The debtor's participation in the proceedings will be made public only after the filing of a petition in bankruptcy, a feature which is likely to have a positive effect on the debtor's market position in the period after the filing of the petition for approval of the arrangement. The approval of the arrangement is expected to occur within a relatively short period of no more than two weeks, in order to avoid affecting the debtor's interests.

Proceedings regarding making an arrangement at the preliminary meeting of creditors

This procedure is based on the institution of a preliminary meeting of creditors, in which the votes concerning the proposed arrangement are not gathered by the debtor itself but are delivered by its creditors directly to the court. This procedure, which is already set out in the Polish Bankruptcy Law, is insignificant in practice because it can only be used before the formal announcement of bankruptcy, meaning that the debtor has to file a petition in bankruptcy in order to conclude an arrangement at the preliminary meeting of creditors. It is now proposed that this procedure will be completely separate and independent from bankruptcy. Moreover, it will be possible to obtain a moratorium against enforcement proceedings carried out in relation to a debt constituting a part of the arrangement, if such enforcement would prevent or hinder the approval of the arrangement.

Arrangement proceedings

The bankruptcy procedure aimed at a debtor making an arrangement with its creditors which currently exists under the Polish Bankruptcy Law will be transferred to the new Restructuring Law. These proceedings will be the least affected. As a result of this change, this procedure will be applicable to both solvent and insolvent companies. Contrary to the current provisions of the Polish Bankruptcy Law, the company will be able to make an arrangement with its creditors without the need for a prior declaration of bankruptcy. In contrast with the simplified arrangement proceedings discussed above, this procedure will involve the court and court-appointed officers to a greater extent and more management power will be relinquished by the debtor.

Reorganisation proceedings

Reorganisation proceedings are intended to provide the legal framework for carrying out a deep economic restructuring (i.e. "rehabilitation") of the company (limited only to the extent necessary to secure the interests of creditors), including the removal of management by the "debtor-in-possession" and the appointment of an administrator with powers that are currently reserved solely to the trustee in liquidation proceedings (such as cherry picking). It should be possible to:

— stay all enforcement proceedings during the period necessary to increase revenue and reduce costs of the business, or while searching for a buyer of the business;

— rescind unfavourable contracts;

— flexibly adjust the numbers of employees to current needs; and

— sell the undertaking's assets.

Reorganisation will require the co-operation of the debtor and the administrator and will allow for input from economists, advisers, and specialists from particular industries. Above all, the implementation of reorganisation actions will be enabled due to the temporary staying of enforcement proceedings concerning debts that are outside the scope of the arrangement.

Relationship between the proceedings

The implementation of the proceedings discussed above should make completely new and diverse restructuring options available to Polish companies and enable a company to make an arrangement despite a declaration of bankruptcy. If a bankruptcy petition and a petition for the commencement of restructuring proceedings are filed simultaneously, the court would first examine the petition for the commencement of restructuring proceedings, unless it is obvious that this would be detrimental to credit.

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Scotland

Disclaimer in liquidation – update

A previous edition of our Newsletter contained an article on the decision of the Court of Session in Scotland regarding the issue of disclaimer in the liquidation of Scottish Coal Company Limited ("SCC"). This decision has now been successfully appealed.

Background

SCC carried on several businesses including the operation of open-cast mining at seven sites in Scotland. Some sites had been sold but several disused open-cast sites (and the statutory obligations attached to them) remained an issue. The liquidators sought to abandon or disclaim these disused sites on the basis of the onerous maintenance and restoration costs. In the original case (decided July 2013) the court held that the liquidators could disclaim the sites and the attached statutory licences or permits. As there is no statutory power in Scotland allowing a liquidator to disclaim onerous property (which a liquidator has in England and Wales under s.178 of the Insolvency Act 1986) the decision was unprecedented in Scots law.

As mentioned in our previous article, it was anticipated that the decision would be appealed due to the number of interested parties and the significant restoration costs should the original decision be allowed to stand. There was also the question of who would be responsible for meeting these costs (estimated at around GBP 73m) following disclaimer by the liquidator. Interested parties involved in the appeal included The Scottish Environment Protection Agency (SEPA), local authorities and the Lord Advocate.

The original decision

The judge at first instance held that liquidators could abandon the land either by declining to use funds held for the benefit of creditors to deal with it or by taking steps to terminate the company's ownership of the land. Similarly the liquidator could disclaim the associated licences.

The Appeal decision

This decision was subject to an Appeal and in reversing the original decision, the Inner House of the Court of Session has decided that:

- The liquidator cannot disclaim/abandon the sites as these are heritable property in which the company has a real, registered right.
- The liquidator does not have the power to disclaim the statutory licences attached to the sites. Any rights to termination will depend on the provisions in the individual regulations under which the licences have been granted.

The Court held that a person cannot abandon land in such a way as to render it ownerless and thus avoid any obligations which run with the land. A liquidator can elect not to realise an asset with a negative value and leave it in the ownership of the company until such times as the company is dissolved.

In addition, the Court's view was that the liquidator is responsible for the sites in terms of the licences and governing regulations and is bound to comply with the requirements of the licences until such times as the licence is surrendered or the company is dissolved and the liquidator vacates office.

Issues arising

In the original application, the court was asked to address the ranking of the costs of complying with the obligations to restore the sites. The question was whether these costs would rank as 'expenses' in the liquidation (giving them a 'super-priority') ranking ahead of the liquidator's fees. This issue was deemed as non-urgent when the original application was heard and it remains outstanding as the Appeal decision did not address the issue either.

It remains to be seen how matters will now progress with the liquidation of SCC. It is clear that there are insufficient funds available to enable full compliance with the statutory obligations. The question now is whether the liquidator is expected to exhaust available funds on maintenance and restoration (leaving nothing for the body of ordinary creditors) before moving to dissolution. Presumably then the same issue arises post dissolution as would have arisen post disclaimer in terms of who will bear responsibility for the costs thereafter?

Next steps

The Appeal decision brings Scottish insolvency law back to where many thought it was prior to the initial SCC decision. It affirms that there is no power to disclaim onerous assets (equivalent to s.178 of the Insolvency Act 1986 or otherwise) available to a Scottish liquidator. Therefore prospective liquidators in Scotland will remain cautious about taking appointments over companies with toxic assets.

As to liquidators in England, the position is less clear. Whilst a liquidator in England would, on the face of it, have the power to disclaim property situated in Scotland (under s.178 as mentioned above) this may be incompetent under Scottish property law. Therefore a situation could arise where a disclaimer of Scottish property is recognised under English insolvency law for the purposes of realisation and distribution of the insolvent estate but is not effective under Scots law. Consequently, title to the property remains with the insolvent company.

There has been a suggestion that there may be a further Appeal (to the Supreme Court) in this case which may bring clarity to the various unresolved issues. The ranking of the maintenance and restoration costs also falls to be decided at a later date which will be a key issue for practitioners.

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Spain

The advantages of acquiring a business unit in an insolvency proceeding

Ever since the Spanish Act on Insolvency (the "Act") was amended in 2011, the number of cases in which insolvency proceedings are resolved through the sale of business units has rocketed. Article 149 of the Act enables an insolvent company to sell its business unit as a whole which increases the company's chances of continuing its activity. This operation is performed through auctions, with the highest bidder acquiring the unit. In the event of identical bids, the unit is sold to the bidder that offers the best conditions for the interest of the company, which may include the safeguarding of jobs and the continuity of the company's activity. If the auction ends without a winning bid, the Court may order the direct sale of the business unit.

Although disposals of business units have traditionally taken place during the winding-up phase of insolvency proceedings, it is now very frequent to see a disposal during the common phase of the proceedings. At such an early stage of the insolvency proceedings, acquiring a business unit is far more appealing to prospective buyers than at a later stage, when the company will have fewer opportunities of successfully continuing its activity. Waiting for the winding-up phase to carry out the sale of the business unit also means that the assets of the company would have a much lower market value. This would lead to far lower offers from prospective buyers, potentially affecting the creditors and employees of the company. Furthermore, the Spanish Courts have agreed that there is no reason to rule out a sale at the common phase as opposed to the winding-up phase, especially when some phases take place simultaneously.

In addition, the Act establishes further advantages for buyers and insolvent companies. According to Article 149 of the Act, the Insolvency Court must normally order that the acquirer of a business unit will not assume liability for salaries or compensations pending payment prior to the disposal of the unit that are covered by the Salary Guarantee Fund pursuant to Article 33 of the Statute of Workers. This regulation has been contested unsuccessfully by Social Security, with numerous judgments providing that the Act must at all times prevail over any regulations on Social Security pursuant to the principle of specification. The same regulations apply to credits in favour of the State Tax Administration. The acquirer will not assume liability for the debt pending payment prior to the disposal of the unit when the creditor is the State Tax Administration. Naturally, these advantages are offered to acquirers both at the common phase and the winding-up phase. Although *prima facie* they can only be applied to the disposal of business units during the winding-up phase, Courts have agreed that these rules are to be extended to those cases in which the disposal takes place during the common phase.

Even though both Social Security and the State Tax Administration have special regulations of their own, the principle of specification in Spanish law states that the Act will always prevail over any other regulations when it comes to an insolvency proceeding. The Act was approved based on the principle of legal unity. This principle states that all matters regarding the insolvency proceeding or the insolvent company itself are to be regulated under the Act, which will prevail over any other law. Therefore, the so-called 'interest of the insolvency proceedings' shall guide all operations and decisions made concerning the insolvent company, regardless of any individual interests. It is for this reason that only the Insolvency Court has jurisdiction in this matter, to ensure that the interest of the insolvency proceeding is followed throughout the whole proceeding. The jurisdiction of the Insolvency Court will involve authorising both the disposal of the business unit and its conditions.

There is, however, one exception to this general rule: the acquirer of the business unit will assume these debts in cases where the former owner of the unit and its new acquirer are identical, i.e. the owner of the insolvent company and the owner of the acquirer of the business unit are the same. This will happen, for example, when the main shareholder of the acquiring company is the same main shareholder of the insolvent company. As the identity of the debtor remains the same in these cases, the Insolvency Court will rule that the acquirer is in fact responsible for the payment of the pending debt to the Social Security and the Tax Administration State Agency.

Apart from the above exception, which only applies in very specific cases, the general rule is that the acquirer benefits from the advantages established in the Act. The disposal of business units is encouraged both by the Act and by the Spanish Courts. As a result, it has been widely concluded that the acquisition of business units by solvent buyers not only prevents mass dismissal of employees but also increases the chances of survival of the insolvent company.

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The New Swiss Insolvency Law: Effective Measures to Facilitate the Restructuring of Companies?

Introduction

On 1 January 2014, the revised provisions of the Swiss Federal Act on Debt Enforcement and Bankruptcy **("DEBA")** came into force. The revision process was mainly triggered by the collapse of SAirGroup **("Swissair")** in 2001 and other major Swiss companies, as well as the subsequent bankruptcy and composition proceedings, which revealed the gaps and deficiencies in the Swiss insolvency legislation.

Although the Swiss insolvency law, with the moratorium and composition proceedings, has always provided for restructuring schemes, most proceedings "de facto" ended in a liquidation of the debtor rather than in the implementation of restructuring measures. The liquidation of financially distressed companies, however, is quite often detrimental to the creditors' interests, which usually consist of restoring a company's solvency. The main reason for this outcome was the debtor's obligation to submit to the court a draft of a composition agreement in order to initiate the composition proceedings. This provision forced debtors into a negotiation process with its creditors before they could even apply for such proceeding. This meant that the debtor had to reveal their insolvency, thereby putting itself at risk of immediate bankruptcy proceedings. Therefore, unsurprisingly, in practice, financially distressed companies were usually hesitant to enter into formal insolvency proceedings, the consequence frequently being that the restructuring process was initiated too late.

Material Changes to the Restructuring and Composition Proceedings

In General

In light of the legal deficiencies outlined above, revisions to DEBA were made. The material changes are set out below:

— Under the amended law, the debtor can seek a moratorium without necessarily entering into subsequent composition proceedings. If the restructuring is successful, the debtor can file an application with the court for suspension of the moratorium. Furthermore, the debtor is entitled to request the moratorium and to initiate the composition proceedings by (*inter alia*) submitting a provisional restructuring plan (instead of a draft composition agreement). The court will only do a cursory assessment of such restructuring plan and will refrain from turning it down unless there are obvious indications that it will not work. Finally, the moratorium always commences on a provisional basis with a maximum duration of four months, thus granting the debtor easier access to the proceedings.

— Contrary to the previous rules, the provisional moratorium does not have to be published in the event of good cause and if the creditors' (and other third parties') interests are protected. This gives the debtor some time to discreetly prepare the restructuring plan and its publication.

— The effects of the (provisional) moratorium coming into force just after the granting of the moratorium by the court have been expanded considerably to the debtor's benefit. First of all, enforcement proceedings cannot be initiated or continued, not even those leading to seizure for first class claims (e.g. claims of employees derived from the employment relationship). However, enforcement proceedings for the realisation of collateral secured by a mortgage over property are still excluded from this rule.

Furthermore, attachments and other remedies freezing the debtor's assets will no longer be feasible. Secondly, all litigation against the debtor is suspended (except for urgent cases). Thirdly, the assignment of future receivables is not effective with respect to receivables arising after the court has granted the moratorium.

— Another substantial change to the legislation is the debtor's entitlement to terminate long-term contracts at any time if the restructuring cannot be achieved without such termination. However, this right of termination is subject to the commissioner's approval (a commissioner is usually appointed by the court when granting the moratorium) and the other party to the contract must be compensated. It should be noted that such compensation is considered a pre-petition claim and is therefore limited to a dividend.

Rules Facilitating the Sale of Business or Parts thereof

Implementing restructuring measures often requires the sale of parts of a company's business, aimed either at generating liquidity or at ceasing unprofitable activities. The latest revision introduced some provisions facilitating such transactions.

— Under the previous law there was no requirement to consult creditors with regard to such sales. Therefore, the law provided for the voidability of such transactions by the creditors, leading to substantial legal uncertainty. Under the new legal regime, when granting the moratorium, the court can install a creditors' committee which has to agree to every sale of capital assets by the debtor. As a result, such transactions are no longer voidable (not even in cases where no creditors' committee was installed by the court). This improves the predictability of legal decisions and hence facilitates the sale of businesses.

— Pursuant to the previous Swiss employment law, the employment relationships and all related rights and obligations automatically passed to the purchaser in the case of a transfer of the company (irrespective of the purchaser's will or intention). Under the new regime, such transfer during a moratorium (or other specific circumstances) only includes employment relationships if this has been agreed with the purchaser (and if the employee does not object to the transfer). Furthermore, the purchaser will not be jointly and severally liable with the former employer for any pre-transaction claims brought by an employee. However, the new law requires a social plan to be established by medium to large size companies in case of a larger number of redundancies, increasing the complexity and the costs of such transfer.

Rules regarding Fraudulent Transfer

The fraudulent transfer rules challenging transactions between the debtor and third parties have also been amended in order to further facilitate restructuring efforts.

— Transactions at an undervalue can be challenged if they have been carried out within the period of one year prior to the opening of the insolvency proceedings. Under the new law, the counter-party which is related to the insolvent party bears the burden of proof that the transaction was not at an undervalue. Pursuant to the new law, transactions between group companies will be considered as related party transactions.

— Finally, all transactions carried out by the debtor during the five years preceding the opening of the insolvency proceedings with the intention, apparent to the other party, of disadvantaging his creditors or to favour certain of his creditors to the disadvantage of others, are voidable. Again, under the new legal regime, it is presumed that the counterparty which is related to the insolvent party (including affiliated companies) knew or should have known of the insolvent party's respective intention. Hence the burden of proof is again imposed on the counterparty.

Conclusion

Although the revision of DEBA was not extensive, which may be surprising considering that its underlying legal system has remained unchanged since 1892, it in fact comprises several facilitations with regard to the restructuring of companies in the context of composition proceedings. However, implementation in daily practice will show whether the revision's purpose of enhancing successful restructurings and reducing liquidations of financially distressed companies will be accomplished.

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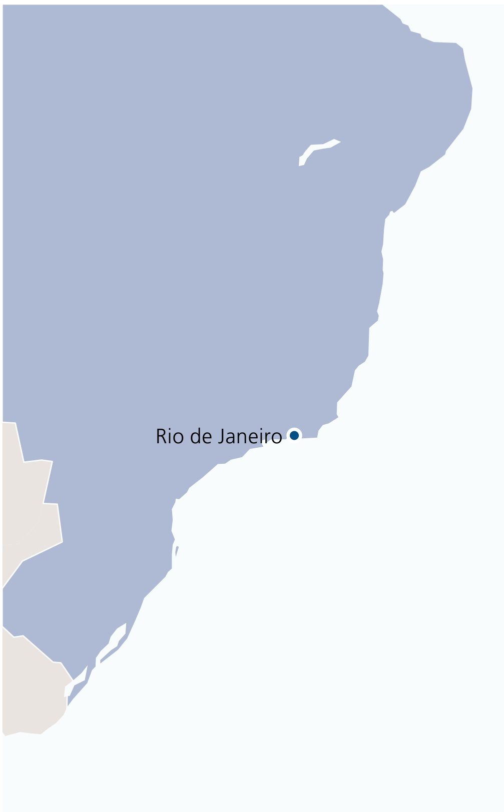


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