# eurofenix

The journal of INSOL Europe

Autumn 2014

INSOL EUROPE

## A forum for debate at the cross-roads of continents

*Featuring:*

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**Case Studies & News**

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Paul Newson, PNDesign
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# *Welcome* from the Editors


ANNEROSE TASHIRO


GUY LOFALK

## Dear readers,

**Greater coherence and increased efficiency in national insolvency laws would result in maximising the return to creditors and encourage cross-border investments. This is how Prof. Bob Wessels describes the demand of the European Commission's Recommendations issued in March this year.**

Coherence maximises. That's the main theme and it must be right. With 28 nations in Europe and hundreds of regions and ethnical groups, separatist's ideology moves us apart.

This year's Annual Congress brings us to the cross-road of continents, to Istanbul, to the bridge between Europe and Asia and the Middle East.

Nowadays, we often see that legal regimes try to keep people together and try to establish frameworks to provide the people with a platform to live and work and do business in coherence - whilst there are many flows in many different often opposite directions.

This was and is not always the way. It often occurs that the people lead the way and the legal regimes try to follow, to adapt and to steer. I found this pretty interesting – this is a very complex interrelation and correlation between the lawmakers and the people and their business – they follow each other or not, they steer and demand from each other or at least try, and they control each other and do also fail.

And it is still true: coherence maximises.

During my vacation in Sicily this year I stumbled over fish couscous and loved it. Couscous was brought to Sicily by the Northern African travellers (likely Berbers) and locals have adopted, adapted and combined it with Sicilian fish cuisine. Today this has become the typical Sicilian fish couscous which is tremendously delicious and known as a local dish in the north west of Sicily. Sicily was visited by the Greeks, the Arabs, the Spanish and the Normans and a lot of other travellers over the centuries and it developed its own unique fascinating and rich culture – and food. Certainly it took a while, but coherence maximised.

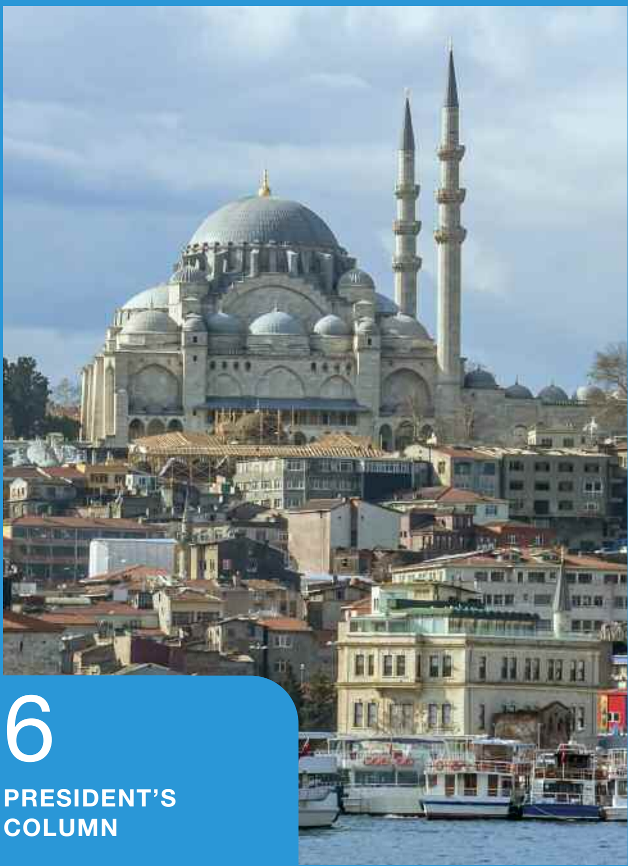
Today, businesses do not really care about borders. Entrepreneurs request smooth travelling and movement of goods and services across and through continents. The law should facilitate, back-up and protect; the law should not hinder, though it should balance everybody's interest.

The business environment has currently developed quicker than the lawmakers could follow. The speed and growth of technology and business concepts in our digital world does not only ignore borders, they are built to cross borders in a blink (think for example of the use of bitcoins).

To request greater coherence for a rescue culture throughout Europe is the only way forward. The European legislator has the chance to facilitate that but it must get up to speed and must not lose momentum. The business environment changes more rapidly than in the past and the legislation process should not only be yapping in the footsteps of new business ideas.

But prospects are not bad to achieve such coherence – for a better return to creditor or something new like the Sicilian fish couscous.

*Annerose Tashiro*



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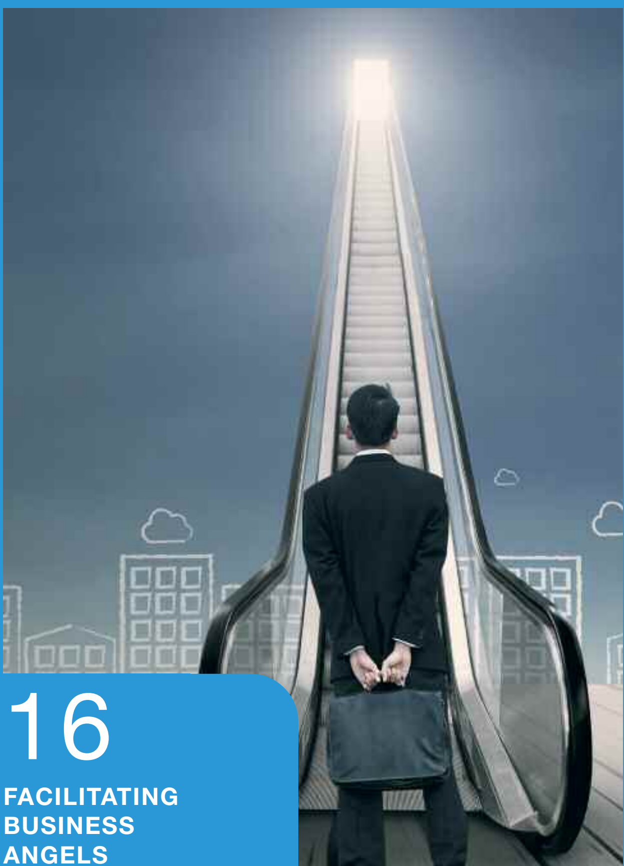

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# A year of change and continuity

CATHERINE OTTAWAY
INSOL Europe President

Catherine Ottaway presents her last editorial as INSOL Europe's President

"ROTATIONAL CHANGES ARE TAKING PLACE, WITH MANY NEW PEOPLE WISHING TO GET INVOLVED"

## Rotations

Our Association continues to flourish through the involvement of its members. This is why rotational changes are taking place, with many new people wishing to get involved. Movement creates actions and willing volunteers.

One of these rotational changes can be seen within the EECC. The next EECC Conference will be held in Vilnius (Lithuania) on 15 May 2015 and will be co-chaired by Radu Lotrean (Romania) for three years, working alongside Carlos Mack (Germany/Italy), who remains on as Western European co-chair in 2015. Our technical chairs for Vilnius will be Frank Heemann and Rimvydas Norkus, both from Lithuania. This editorial gives me another opportunity to deeply thank the previous EECC co-chairs, Marc André (France), Speranta Munteanu (Romania) and Signe Viimsalu (Estonia) for their work and to salute the constant and efficient work of the Prague technical team.

Another rotational change concerns INSOL Europe's next project – the Insolvency Office Holders Supervision Study, where tenders will be invited from European universities. A call for interest from universities which would like to submit a tender has already been circulated via the membership and INSOL Europe Academic Forum summer e-newsletters. The project is intended to take the form of a comparative study on the matter of appointment, remuneration and supervision (including the formal licensing procedures) of Insolvency Office Holders in Europe, including a comparison with the situation in the USA and a recommendation on how INSOL Europe could proceed on the issue. This project could be driven jointly by one or two European universities and we have already received letters of interest from Leiden University, the Business & Law Research Centre of Radboud University Nijmegen, the Centre for Business & Insolvency Law of Nottingham Law School and the Northwestern University School of Law in Vienna. Individual members have also expressed their interest in taking part.

As Gandhi said, be the change you wish to see in the world!

## Increasing visibility and communication

Since 2013, INSOL Europe has been working with Leiden Law School to design Principles and Best Practice guidelines for Insolvency Office Holders. This project is co-chaired by Patricia Godfrey (UK) and Martine Gerber (Luxembourg) for INSOL Europe and by Professor Dr Jan Adriaanse and Professor Iris Wuisman for Leiden Law School. After preparation of Report I on international rules and Report II on national rules, the third phase of the project concerns the formulation of the Principles and Best Practices. Our members' views were requested via an online questionnaire, the deadline being 17 August 2014, to give their opinion on each of the seven Principles and thirty-two Best Practices. INSOL Europe confirmed that it would reward one of the participants by a free registration to the Istanbul Congress and Bart de Moor (Belgium) has been picked as the happy winner of the free prize.

Speaking about the Congress in Istanbul, let's take the opportunity to promote the new INSOL Europe website. This modernisation goes alongside the new App available during our Istanbul Congress. Thanks go to Paul Newson and Caroline Taylor for their dedicated time on these

new facilities for the benefit of our members.

We will also shortly have the pleasure of launching our EIR Case Register website on a new platform with LexisNexis who will publish the Case Register under licence. INSOL Europe will continue to source and moderate the case abstracts. We now have 390 cases uploaded, with approximately 93 in the course of moderation and revision.

Of course, access to the Case Register will be free to INSOL Europe members and it is hoped that by the time of our Congress, all members will have received an email with password access information. Here, I must thank Chris Laughton who negotiated this new partnership with LexisNexis with the help of Emmanuelle Inacio (France) and Myriam Mailly (France). Myriam successfully defended her thesis in Lille in May 2014 and I am taking this opportunity to congratulate her.

In Eurofenix (Spring 2014), Michael Thierhoff's "Love me tender" article described the hard work that had taken place behind the scene concerning INSOL Europe's study and final report on pre-insolvency proceedings to the European Commission, to be delivered on 27 November 2014, to help the drafting of the new Directive on cross-border insolvencies. An EU study booklet will be distributed to the Congress delegates in Istanbul and INSOL Europe and I will take the opportunity to officially thank the dedicated national contributors of this efficient group during the Saturday morning session remitting them an achievement award in recognition and appreciation for the time they gave to make this study such a success.

Our new Young Members Group has now become more active, bringing new ideas to our Association. Slavomir Cauder (Czech Republic), and co-chair Sabina Schellenberg (Switzerland), have reconfirmed that the International Young Lawyers association (AIJA) will be co-ordinating cross marketing efforts with INSOL Europe in the future.

## Welcome to our Istanbul Congress

Last but not least, I wish to all members and delegates an instructive and interactive Congress in this great city of Istanbul. This is a great opportunity for our various working groups to meet – Council and Executive, Academic Forum, Judicial Wing, Lenders Group, Turnaround Wing, Anti-Fraud Forum, Editorial Committee, EECC and our Young Members Group.

Our technical committee, Ian Grier (UK) and Michael Veder (The Netherlands), together with Evert Verwey (The Netherlands), the technical team and all the speakers on the various panels did a great job. I also hope that you will enjoy the entertainments and the gala dinner at the Sait Halim Pasa Pavilion, after a cruise by boat along the Bosphorus.

Again, all our thanks to our faithful, dynamic and professional sponsors without whom this Congress would not be possible.

I shall be honoured to welcome all members at our Ordinary General Meeting which will be taking place on Thursday 9 October 2014 at 18:00, just before the Congress proceedings, where members will be informed of the Council's decisions and will be asked to approve the new changes to the Constitution.

Let's hope that the readers of this column who could not make it this time will be able to join us at the next Congress in Berlin on 1–4 October 2015 were the new technical committee co-chaired by Piya Mukherjee (Denmark) and Renate Mueller (Germany) will prepare another exciting programme.

It has been a great privilege to serve you this year as President and I shall do my best to continue to serve under Robert van Galen's Presidency next year. It was a real pleasure to share with Robert and Caroline Taylor, who has been of a considerable help, our weekly calls concerning the management of the Association. Robert is more than ready to drive it on next year with his Deputy President Alberto Nunez-Lagos.

*Let's get involved in order to learn, share and connect more together!*

"THIS IS A GREAT OPPORTUNITY FOR OUR VARIOUS WORKING GROUPS TO MEET"

*Share your views!*

# News

Send in your news to paulnewson@insol-europe.org

**INSOL Europe now has several LinkedIn groups which you can join and then engage with its members:**

- INSOL Europe (main group)
- Eurofenix: The Journal of INSOL Europe
- INSOL Europe Turnaround Wing
- INSOL Europe Lenders Group
- Eastern European Countries' Committee
- INSOL Europe Anti-Fraud Forum

To join one of the groups, visit: **www.linkedin.com** and search for the group by name.

*Make a comment!*

## Share your views!

You will have noticed that we have added QR Codes to every main article to encourage readers to give us their views. The QR codes take you the LinkedIn group for Eurofenix (see above).

Of course, you are welcome to pass on your comments to any member of the Executive Committee, whether by email or in person!

# Cooperation and Communication in European Cross-Border Insolvency Cases

Europe has faced a strong increase of cross-border insolvency cases over the last years. To improve cooperation between courts in different Member States in these cases, Leiden Law School and Nottingham Law School have been working on what is called the 'EU Cross-Border Insolvency Court-to-Court Cooperation Principles and Guidelines' ('**JudgeCo Project**'). The project is funded by the European Commission and the International Insolvency Institute (III). The aim of the project is to develop non-binding Principles and Guidelines for cross-border communications and cooperation in insolvency cases between courts within the European Union.

Professors Bob Wessels (Leiden) and Paul Omar (Nottingham) act as reporters for the JudgeCo Project and are assisted by a group of some forty insolvency experts, including twenty judges from across Europe.

## Reviewing the Principles and Guidelines

In July 2014, the Final Public Draft of the Principles and Guidelines has been published. This draft is now open for public consultation and will be used for judicial discussion and training that will take place between September and December 2014. The reporters welcome all comments on the Final Public Draft of the JudgeCo Principles and Guidelines by 15 October 2014. The Principles and Guidelines can be downloaded from www.tri-leiden.eu/news/news-overview/final-public-draft-judgeco-project/

NOTTINGHAM LAW SCHOOL
Nottingham Trent University

Universiteit Leiden
The Netherlands

## Judicial Training Sessions

From September 2014 training sessions will take place in several cities across Europe, including Warsaw (22-23 September), Istanbul (10 October), Riga (3-4 November, tbc), Ljubljana (17-18 November, tbc) and Amsterdam (1-2 December). Judges deciding on matters of insolvency are offered the chance to participate in a two-day interactive training. These training sessions enable judges to test the EU Cross-Border Insolvency Court-to-Court Cooperation Principles and Guidelines and provide comments as to their usefulness in practice. Also, it allows judges to enlarge their European network and to discuss other pending issues with colleagues.

Once accepted as participant, travel and accommodation costs are covered by the project. Further information can be found here: www.tri-leiden.eu/projects/judgeco-project/

**Interested judges can express their interest by email at: judgeco@law.leidenuniv.nl**


**We welcome proposals for future articles and relevant news stories at any time.**
**For further details of copy requirements and a production schedule for the forthcoming year, please contact Paul Newson, Publication Manager: paulnewson@insol-europe.org**

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# RICHARD TURTON AWARD

Richard Turton had a unique role in the formation and management of INSOL Europe, INSOL International, The Insolvency Practitioners Association and R3, the Association of Business Recovery professionals in the UK. In recognition of his achievements the four organisations jointly created an award in his memory. The Richard Turton Award is an annual award providing an educational opportunity for a qualifying participant to attend the annual INSOL Europe Conference.

In recognition of those aspects in which Richard had a special interest, the award for 2014 was open to applicants who fulfilled all of the following:

- Work in and are a national of a developing or emerging nation;
- Work in or be actively studying insolvency law & practice;
- Be under 35 years of age at the date of the application;
- Have sufficient command of spoken English to benefit from the conference technical programme;
- Agree to the conditions below.

Applications for the award were invited to write a statement detailing why they should be chosen in less than 200 words. A panel representing the four associations adjudicated the applications. The panel members are as follows: Stephen Adamson – INSOL Europe, Neil Cooper – INSOL International, Patricia Godfrey – R3 and Maurice Moses the IPA. The committee received an outstanding number of applications of exceptional quality for the award this year and it was a very close run decision as the standard of applicants was superb. We are delighted that the award has attracted such enthusiasm and response from the younger members of the profession and know that Richard would also be extremely pleased that there had been such interest.

The Committee is delighted to announce that the winner is Anant Khandelwal from India. Anant works for SBI Capital Markets Limited and is part of the debt restructuring and advisory team in the investment bank. He has been involved in some of the country's largest and landmark debt restructuring deals.

As part of the award Anant is invited to attend the INSOL Europe Conference due to be held on the 9-12 October in Istanbul, Turkey. He will be writing a paper that will be published in summary in one or more of the Member Associations' journals and in full on their websites. We would like to congratulate Anant for his excellent application and also thank all the candidates who applied for the award this year. There were many excellent submissions and the judges task was particularly difficult this year.

Sponsored by:

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Insolvency Practitioners Association

R3 Association of Business Recovery Professionals — Rescue Recovery Renewal

# Technical Update
# Autumn 2014

The Co-Technical Officers of INSOL Europe report on the new technical content available and other updates on the INSOL Europe website

MYRIAM MAILLY
INSOL Europe Co-Technical Officer

EMMANUELLE INACIO
INSOL Europe Co-Technical Officer

“LEGISLATORS HAVE TAKEN INITIATIVES IN ORDER TO ENLARGE THE TYPE OF PREVENTIVE PROCEEDINGS TO ENCOURAGE DIRECTORS TO FILE EARLY”

Make a comment!

## A CLOSER LOOK AT...

### Pre-insolvency proceedings and imminent insolvencies versus liquidations: Some figures and thoughts from Croatia, England & Wales, France and Italy

Following the previous few months, 2013 insolvency statistics have been published in several EU member states. These publications allow us to have a quick look at certain figures from several countries (compared with 2012 when available), and in particular figures relating to pre-insolvency proceedings and imminent insolvencies in order to compare them to the traditional liquidation proceedings.

The figures below concern Croatia, England & Wales, France and Italy (calendar year 2013 – Petitions/Opening).

***Croatia***

- 1,265 (700 solved and 565 unsolved) Pre-insolvency proceedings (unknown for 2012)
- 6,220 (2 991 in 2012) Bankruptcies

***England & Wales***

- 577 (839 in 2012) Company Voluntary Arrangements
- 917 (1 222 in 2012) Receiverships appointments*
- 2,365 (2 532 in 2012) Administrations
- 11,358 (-4.5%) Voluntary liquidations
- 3,624 (-14.9%) Involuntary liquidations
- 18,841 liquidations and other corporate insolvencies

***France***

- 1,505 (+6.3%) Mandat ad hoc
- 1,272 (-1.6%) Conciliations
- 1,633 (+9%) Safeguard proceedings
- 18,464 (-0.1%) Reorganisation proceedings
- 43,003 (+4.1%) Liquidation proceedings
- 63,101 (+3%) judicial proceedings in total

***Italy***

- 3,000 (+53.8%) non-bankruptcy proceedings
- 4,400 “reserved” voluntary arrangements applications (+102.7% re voluntary arrangement with creditors)
- 94,000 (-5.6%) Voluntary liquidations
- 14,000 Involuntary liquidations
- 110,000 Business closures

### Some thoughts

These data on insolvency proceedings and voluntary liquidations indicate that the long recession had a very harsh impact in 2013 on companies in some countries (France/Italy/Croatia) rather than others (England & Wales).

However, statistics also show that the number of these proceedings may have seen a sharp increase due to the increasing use of voluntary arrangements in some countries (France/Italy/Croatia).

If some legislators have taken initiatives for more regulation in preventive proceedings (with the changes made to “reserved” voluntary arrangement last summer in Italian Government legislation or with a recent report published by the British Government which has highlighted some short comings in the Pre-pack Administration process in the UK), others have taken initiatives in order to enlarge the type of preventive proceedings to encourage directors to file early for rescuing the failing business (new French legislation entered into force on 1st July 2014).

*If you want to bring your own statistics to this table or simply share your views, please do not hesitate to contact us at: technical@insol-europe.org*

* Source: https://www.gov.uk/government/collections/insolvency-service-official-statistics: Receivership appointments comprise administrative receivers appointed under the 1986 Insolvency Act (and the 1989 Order for Northern Ireland) and certain other receiver appointments, for example under the Law of Property Act 1925 - due to the use of the same statutory documentation for different types of receivership, it is not possible to give a breakdown between them. Law of Property Act receivers are classed as Enforcement of Security and are not insolvency procedures under the Insolvency Act of 1986. For this reason levels of, and trends in, receivership appointments should be interpreted with caution.

# New technical content on the INSOL Europe website

We invite all Members of INSOL Europe to help to provide contributions to cover all countries around Europe and beyond or to update the information published. Please see the links on the right or contact Emma and Myriam on: **technical@insol-europe.org**

## Glossaries

Since our last column, we published one new contribution for Croatia.

We are grateful to Domagoj Sajter from The Faculty of Economics in Osijek (Croatia) for his kind assistance.

*If you are interested in contributing for Malta and Slovenia (or other countries), please contact us.*

## National Insolvency Statistics

Since our last column, we published updated national insolvency statistics for England & Wales (Second Quarter 2014), Northern Ireland & Scotland (Second Quarter 2014), France (Year 2013, First quarter 2014 and Second Quarter 2014), Italy (Third Quarter 2013, Fourth Quarter 2013 and First Quarter 2014), Ireland (Year 2013) and Spain (Third Quarter 2013, Fourth Quarter 2013 and First Quarter 2014).

*If you are interested in contributing for any uncovered Member States (or beyond), please contact us.*

## How to become an Insolvency Practitioner across Europe?

Thanks to Prof. Catarina Serra (Professor at the University of Minho, Portugal) a new article on "All you need to know about becoming an insolvency practitioner in Portugal" is now available on the INSOL Europe website.

We also published the contribution of Piya Mukherjee (Horten Advokatpartnerselskab, Copenhagen, Denmark) on "All you need to know about becoming an insolvency practitioner in Denmark".

At present, 18 countries are covered (Austria, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Latvia, Lithuania, Luxembourg, Poland, Portugal, Romania, Slovakia, Slovenia, Russia and United Kingdom) and reports from 4 countries should be available soon (Serbia, Sweden, Romania (update) and Cyprus).

*If you are interested in contributing for any uncovered Member States (or beyond), please do not hesitate to contact us.*

## EIR Case Register Website

As at 22th May, 390 abstracts are now uploaded on INSOL Europe's European Insolvency Regulation Case Register website.

93 new abstracts from the CJUE, England & Wales, France, Germany, Luxembourg, Scotland and The Netherlands will be available very soon. ■

# Links

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# Rescue on the rise

Bob Wessels looks at how the European Commission wishes to develop a rescue and recovery culture across the Member States

PROF. BOB WESSELS
Emeritus Professor of International Insolvency Law, University of Leiden

**In a 2012 study, University of Heidelberg professor Andreas Pieckenbrock compared rescue measures in insolvency laws of England, Italy, France, Belgium, Germany and Austria. He concludes that there are five common tendencies in these rescue proceedings.**

***1. Early recourse***

Sometimes there is an earlier moment of starting a rescue process, for instance in the French *Sauvegarde*: the debtor must encounter problems that he can not solve earlier than the traditional moment that the debtor can not pay its financial obligations when they are due;

***2. Debtor in possession***

The board is not fully replaced by the insolvency administrator; in certain proceedings the board stays in control of the business. This is what we call 'debtor-in-possession';

***3. Stay***

In these countries one finds a moratorium or a stay either automatic like in the *Sauvegarde* or at request (for instance *the concordato preventivo* or *réorganisation judiciare*);

***4. Protecting fresh money***

There are special provisions to protect fresh money available for the company while trying to work itself out of its misery;

***5. Debt for equity swap***

The possibility of a debt for equity swap, i.e. the conversion of a creditors claim into shares in the capital of the company.

***6. Binding disapproving creditors***

Generally, as Pieckenbrock explains, such a rescue is based on the principle of a composition or an arrangement concluded between the insolvent debtor and his creditors. Such a rescue plan is binding for those creditors who voted in favour of the plan, but is also binding upon a (given percentage) of a dissenting minority of creditors (sometimes referred to as 'cram-down') or a watering down ('bail-in') for altgesellschafter (ie. existing shareholders).[1]

In the study by INSOL Europe on a new approach to business failure and insolvency, published in April 2014, the reporters (University of Milan professor Stefania Bariatti and Robert van Galen) have studied 28 EU Member States. It is interesting to note that generally professor Piekenbrock's characteristics are available in new or renewed recovery proceedings in nearly all member states.[2]

## EU's policy: A new approach to business failure and insolvency

In 2013 the European Commission expressed its policy, named 'A new European approach to business failure and insolvency' and it wished to identify the issues on which the new European approach should focus '… so as to develop a rescue and recovery culture across the Member States'. It is stated that many European restructuring frameworks '… are still inflexible, costly and value destructive'.[3] Using the outcomes of a public consultation in 2013, the European Commission presented on 12 March 2014 its Recommendation on a new approach to business failure and insolvency.[4] The Recommendation has two major objects. First of all to:

'… ensure that viable enterprises in financial difficulty, wherever they are located in the Union, have access to national insolvency frameworks which enable them to restructure at an early stage with a view to preventing their insolvency, and therefore maximise the total value to creditors, employees, owners and the economy as a whole. The Recommendation also aims at giving honest bankrupt entrepreneurs a second chance across the Union.' (recital (1))

In order to achieve these aims, the Commission deemed it necessary to:

'… encourage greater coherence between the national insolvency frameworks in order to reduce divergences and inefficiencies which hamper the early restructuring of viable companies in financial difficulty and the possibility of a second chance for honest entrepreneurs, and thereby lower the cost of restructuring for both debtors and creditors. Greater coherence and increased efficiency in those national insolvency rules would maximise the returns to all types of creditors and investors and encourage cross-border investment. Greater coherence would also facilitate the restructuring of groups of companies irrespective of where the members of the group are located in the Union.' (recital (11))

*Share your views!*

## Introducing minimum standards on preventative restructuring frameworks

The Recommendation seeks to reach these goals by encouraging Member States to put in place '… a framework that enables the efficient restructuring of viable enterprises in financial difficulty and give honest entrepreneurs a second chance' (R1).[5] The Recommendation provides for 'minimum standards' on 'preventative restructuring frameworks' (R3(a)) to be implemented in all Member States. Through promoting adherence to these standards throughout the Union, the Commission hopes are three of a kind:

- *for national insolvency systems* - to improve the existing means for resolving distress in viable enterprises (R5) and encourage coherence in initiatives or reviews of 'corporate rescue framework' in all Member States (R10),

- *for businesses* - to improve access to credit (R4), encourage investment (R8) and to smoothen '… the adjustment for over-indebted firms, minimizing the economic and social costs involved in their deleveraging process' (R12), and

- *for creditors* - to improve mechanisms for resolving financial distress efficiently, with reduced delays and costs and limited court formalities ('… to where they are necessary and proportionate in order to safeguard the interests of creditors and other interested parties likely to be affected') (R17).

## Six core principles

Oxford associate professor Van Zwieten has analysed the Recommendation in greater detail with as a result that she concludes that there are six core principles on which the minimum standards of the Commission's recommendations for a preventative restructuring framework are based.[6] I will follow her analysis below. These principles apply to any debtor ('… any natural or legal person in financial difficulty when there is a likelihood of insolvency'; R5(a)), excluding financial institutions.[7] The scope of these core principles is 'restructuring', which means '… changing the composition, conditions, or structure of assets and liabilities of debtors, or a combination of those elements, with the objective of enabling the continuation, in whole or in part, of the debtors' activity' (R5(b)).

***1. Early recourse***

A debtor should be able to have recourse to the restructuring framework at an early stage (R6(a)). The framework is only open to a debtor that is already in 'financial difficulty' (R1), such that there is a '… likelihood of insolvency'(R6(a)).

***2. Minimised court involvement***

A debtor should have recourse to the restructuring framework without the need to formally open court proceedings (R8). More generally, a restructuring procedure should not be lengthy and costly and court involvement should be limited to circumstances where necessary and proportionate to safeguard the rights of creditors and others affected by a proposed restructuring plan (R7). On the other hand involvement of a court

> "THERE ARE SIX CORE PRINCIPLES ON WHICH THE MINIMUM STANDARDS FOR A PREVENTATIVE RESTRUCTURING FRAMEWORK ARE BASED"

> THE COMMISSION WILL ASSESS THE STATE OF PLAY, TO EVALUATE WHETHER FURTHER MEASURES ARE NECESSARY TO STRENGTHEN THE EUROPEAN APPROACH

in some other circumstances may be necessary, including the granting of a stay.

***3. Debtor in possession***

A debtor '… should keep control over the day-to-day operation of his or her business' while the restructuring framework is used (R6(b)).[8] This principle provides an incentive for a debtor to use the procedure early, ensures minimum disruption to the operations of the debtor and allows him to carry on his day-to-day operations.[9] Restructuring is a management tool, rather then a signal of failure.[10]

***4. Court-ordered stay***

A debtor should be empowered to seek a temporary stay of individual creditor enforcement actions (including those by secured and preferential creditors), by application to a court (R6(b) and R10). From a debtor's perspective a stay is designed to enable the assets of the business to be kept together, preventing their piecemeal dismemberment by creditors. A stay improves the chances of negotiations by the debtor, but it should be balanced by the need to adequately protect secured creditors' interests, by allowing these creditors to request a relief from the stay under certain specified conditions. The Recommendation proposes a set of safeguards, including time limits (initial stay of up to four months, subject to renewal up to a maximum duration of 12 months; R13), and an obligation to lift the stay when no longer necessary in order to facilitate the adoption of a restructuring plan (R14). In Member States which make the granting of the stay subject to certain conditions, a debtor should be able to be granted a stay in all circumstances where: (a) creditors representing a 'significant amount' of the claims likely to be affected by the restructuring plan support the negotiations on the adoption of a restructuring plan; and (b) the restructuring plan has a reasonable prospect of being implemented and of preventing the insolvency of the debtor (R11).

***5. Ability to bind dissenting creditors to a restructuring plan***

A Member States' preventive restructuring framework should provide for a plan to be negotiated between debtor and creditors (secured and unsecured), and – where approved by the requisite majority of creditors in affected classes, as described by the national law – sanctioned by a court, with the effect that dissenting creditors are bound by it (R6(d), 16, 20, 21, 26). Secured creditors are to be treated as a separate class from unsecured creditors (R17). When a restructuring plan is adopted unanimously by affected creditors it should be binding on 'all those affected creditors', which seems to provide support for a fully out-of-court contractual restructuring, also for those creditors that did not participate in the adoption process itself.

A framework should also allow for the sanctioning of a plan approved by some classes but not others, with the result that it would be possible for a majority of classes to bind dissenting classes (i.e. for those classes to be 'crammed down'). The conditions under which a restructuring plan can be confirmed by a court should be clearly specified and should include at least that the restructuring plan (a) has been adopted in conditions which ensure the protection of the legitimate interests of creditors, (b) has been notified to all creditors likely to be affected by it, and (c) does not reduce the rights of dissenting creditors below what they would reasonably be expected to receive in the absence of the restructuring, if the debtor's business was liquidated or sold as a going concern, as the case may be (the HLR-test, the hypothesis liquidation result-test). In addition (d) any new financing foreseen in the restructuring plan is necessary to implement the plan and does not unfairly prejudice the interests of dissenting creditors (R22). Procedural requirements should safeguard the rights of the creditors to ensure that all creditors are notified about the plan, can object to it, and can appeal against it, except that an appeal should '… not, in principle, suspend the implementation of the restructuring plan' (R24).

***6. Protection for new finance***

Those parties who provide new finance to a debtor in accordance with the terms of a court-sanctioned restructuring plan should be shielded from the operation of avoidance provisions, paulian actions etc. in national insolvency law (R6(e) and 27), as well as from 'civil and criminal liability relating to the restructuring process' (R28) except in the case of fraud (R29).

## What's next?

Within twelve months (so before April 2015) EU Member States are invited to implement the Recommendation's 'principles' (R34). The endgame is that 18 months after adoption of the Recommendation (October 2015) the Commission will assess the state of play, based on the yearly reports of the Member States to evaluate whether further measures are necessary to strengthen the European approach (R36). If all goes well the outcome of the Recommendation will dovetail with the (amendments to the) European Insolvency Regulation, whilst the regulation most probably will also include debtor-in-possession and pre-insolvency procedures. Proceedings based on the 'preventive restructuring framework', drafted in national insolvency systems will potentially benefit from the system of the Regulation.

## Conclusion

The Recommendation, formally, reflects a soft approach. It invites Member States to take or continue action. Substantially it only presents a 'minimum standard', allowing Member States to add specific conditions and components to have the preventive restructuring framework operate within the legal context and economic environment of their national market. It is the bare minimum, as there is no clear principle about the debtor not taking any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) by a certain reference date, or that the debtor should provide, and allow relevant creditors and/or their professional advisers reasonable and timely access to all relevant information relating to his or her assets, liabilities, business and prospects, in order to enable proper evaluation to be made of his or her financial position and any proposals to be made to relevant creditors.[11] A solid, comparative analysis during 2015 will be necessary to assess whether other binding measures are appropriate in order to reach the Commission's policy goals. If the new Commission, under the leadership of Jean-Claude Junker, maintains this policy (which I would endorse), we will hear from the Commission, as most probably in many states the process of legislating takes many years. However, legislation in Germany, Spain, France and proposals in the Netherlands has used quite the same paint as can be seen in the Recommendation. ■

**Footnotes:**

1 Andreas Pieckenbrock, *Das ESUG – fit für Europa?*, NZI 22/2012, 906ff. By the same author the theme has been presented in a broader context with focus on Germany, as a continuous work in progress, see Andreas Pieckenbrock, *Das Insolvenzrecht zu Beginn des 21. Jahrhunderts: ein Dauerbaustelle*, in: Werner Ebke, Christopher Seagon, Michael Blatz (eds.), Solvenz – Insolvenz – Resolvenz, Baden-Baden: Nomos 2013, 79ff.

2 For instance: debtor in possession proceedings (in certain cases supervised by an insolvency practitioner appointed by the court), a rescue plan in which creditors, sometimes even secured creditors, can be crammed down provided a certain qualified majority is reached, the ability to order a stay of the enforcement of claims, the possibility of attracting new loans, although these reporters have generally found that no super-priority was granted to new financing. For an eyewitness account of the machinations behind tendering for and successfully delivering a report to the European Commission: Michael Tierhoff, Love me tender: How a project rocked INSOL Europe, eurofenix Spring 2014, 16ff.

3 See Impact Assessment ('Impact Assessment 2014' or 'IA 2014') accompanying the document Commission Recommendation on a New Approach to Business Failure and Insolvency', 12.3.2014, SWD(2014) 61 final, 2.

4 For the text, see http://ec.europa.eu/justice/newsroom/civil/news/140312_en.htm. For an overview, see Stephan Madaus, The EU Recommendation on Business Rescue – Only Another Statement or a Cause for Legislative Action Across Europe?, in: 27 Insolvency Intelligence 2014, no. 6, 81ff.

5 Recommendations 30-33 relate to a second chance for honest entrepreneurs. These are not discussed here. 'R' stands for Recommendation.

6 Kristin van Zwieten, Restructuring law: recommendations from the European Commission, in: Law in Transition (EBRD publication) 2015 (forthcoming).

7 Recital 15: 'It is appropriate to exclude from the scope of this Recommendation insurance undertakings, credit institutions, investment firms and collective investment undertakings, central counter parties, central securities depositories and other financial institutions which are subject to special recovery and resolution frameworks where national supervisory authorities have wide-ranging powers of intervention …'.

8 The Recommendation does however contemplate (not compulsory, but on a case by case basis) the appointment by a court of a 'supervisor' to oversee debtor activity and safeguard creditor interests: R9(b).

9 IA 2104, 10.

10 See Madaus, o.c., 82.

11 See the Third and Fifth principle in the INSOL International Statement of Principles for A Global Approach To Multi-Creditor Workouts (published October 2000). The publication demonstrates that these Principles are endorsed by the World Bank, the Bank of England and the British Bankers Association. See Bob Wessels, International Insolvency Law, 3rd ed. 2012, par. 10107.

> A SOLID COMPARATIVE ANALYSIS DURING 2015 WILL BE NECESSARY TO ASSESS WHETHER OTHER BINDING MEASURES ARE APPROPRIATE IN ORDER TO REACH THE COMMISSION'S POLICY GOALS

# Facilitating Business Angel investments

## Signe Viimsalu[1] provides a different modus to avoid insolvency of SMEs in Europe

SIGNE VIIMSALU
Estonian Business Angels Network (EstBAN)

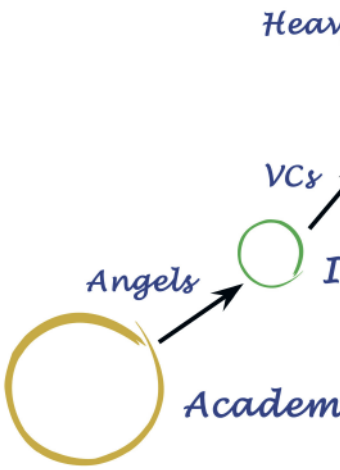
**Access to finance for new, innovative small and medium-sized companies involves both debt, which is a common source of external funding among entrepreneurs, and equity finance.**

During the recent economic recession, support by the financial system for companies, particularly for new ones, disappeared. Even before the recent financial crisis, banks were reluctant to lend to small and young companies due to their perceived riskiness and lack of collateral. In addition, the aversion to risk and the lack of exit opportunities for investors have remained issues and have continued to strain sources of seed and early-stage capital. The financial crisis widened the existing market failure at the seed and early stage with bank lending to falling start-ups and venture capital firms moving to later investment stages where risks are lower. However, there should be co-operation between various sources of capital available for SMEs in Europe. The current market situation with a lack of capital from traditional financial sources seems to affect the business angel market and influence future policy development. The changed economic scene means that business angels must be able to take companies through more rounds of financing since traditional follow-on investment rounds are often unavailable.

> BUSINESS ANGELS ARE OFTEN EXPERIENCED ENTREPRENEURS

### Why are business angel investments important and need promotion?

Business angels, who are often experienced entrepreneurs, have become increasingly recognised as an important source of equity capital at the seed and early stage of company formation in Europe. It is remarkable why individual investors would involve themselves in anything so risky such as financing the valley of death in a company's lifecycle and helping its team where an insolvency situation may be faced practically every day. As it could take 6-7 or even more years to make an exit, a bigger portfolio is necessary for mitigating risks. Understanding which incentives would encourage and support business angels' activity in Europe is important, given their relevance to the economy. With fewer venture capitalists investing at the early stage, the equity-funding gap between individual angel investment and venture capital has grown dramatically. Given this scenario, entrepreneurs are faced with a significant financing gap. Therefore, business angels are a growing part of the investor spectrum that is partially filling the financing gap for SMEs. So far, business angel investors have sought to fill this gap by investing with other business angels through groups and syndicates, increasing the total deal size for companies seeking early-stage financing. According to EBAN, formal venture capital operators invest a minimum of €2,500,000 in companies, which leaves a market gap or failure in smaller amounts of equity. Individual business angels invest between €20,000 and €250,000. The average amount invested per individual in Europe is €80,000 and up to €250,000, depending on the business type and the region. These amounts can increase when business angels co-invest with other investors or through a co-investment fund.[2] In many countries business angels constitute the largest source of external funding, after family and friends, in newly established ventures.[3]



This non-institutional equity finance of business angels, which is still relatively untapped in Europe compared to the US, where the business angel market is five times larger, could become an essential driver to build more high-growth SMEs.[4] In addition to the money they provide, business angels play an important role in providing strategic and operational expertise for new companies as well as social capital.[5] Companies backed by business angel investors have been important contributors to economic growth and creating new jobs. In the US, estimates suggest that approximately 250,000 new jobs were created in 2009 by firms supported by business angel investment, representing all in all 5% of new jobs in the United States.[6] Young firms in the US have improved performance and consequently an increased probability of survival with angel financing and growth of 30-50% on average.[7]

Indeed, for policy makers to intervene in a market, there often needs to be evidence of a market failure. While it does not qualify as a market failure, in the survival rate of the start-ups and SMEs there is a clear financing gap in the seed and early-stage life cycle and this causes much potential to be strained and wasted. Of course, there are many ways to then tap into that potential and make it an asset. Just one method is encouraging private high net worth individuals (business angels) with business knowledge to divert their assets into these start-ups. A forceful argument for policy action to this end relates to the potential positive spillover effects of angel investment.[8] According to the OECD, the public policies for promoting business angel investments include both supply and demand-side measures. On the demand side: investment readiness for entrepreneurs, and developing the entrepreneurial ecosystem. On the supply side: tax incentives, co-investment funds, support to angel associations, networks or groups, and the training and development of angel investors.[9] In addition, in certain European countries, guarantee scheme measures have also been developed, which cover part of the risks taken by the business angels.[10] Policy makers in some countries have sought to address these market gaps through both demand and supply-side measures, although mostly the latter.


## Supporting national angel associations, networks and groups

According to the OECD, the areas in which policy makers have acted to develop the business angel financing market include the provision of support directly to national angel associations or federations as well as networks and groups to help cover operating expenses. National angel associations and networks can help raise awareness regarding business angel investments, which in addition to entrepreneurial ecosystem is another critical step in building the market.[11] EBAN states that the European Commission encourages business angels and business angel networks (BANs) to increase their visibility and raise awareness among entrepreneurs and policy makers. National federations bringing together national or regional networks exist in most European countries. These federations are usually umbrella organisations and are

> IT IS REMARKABLE WHY INDIVIDUAL INVESTORS WOULD INVOLVE THEMSELVES IN ANYTHING SO RISKY SUCH AS FINANCING THE VALLEY OF DEATH IN A COMPANY'S LIFECYCLE

Share your views!

> "BUSINESS ANGELS ARE CONSIDERING INVESTING IN PROPOSITIONS IN DIFFERENT COUNTRIES IN ORDER TO EXPLORE OPPORTUNITIES WITH GOOD GROWTH POTENTIAL"

not in direct contact with entrepreneurs or investors. The main mission of federations consists in promoting the economic role of business angels and their networks with public authorities and collecting information about the venture capital market.[12] Unlike business angel groups, which consist entirely of angel investors, business angel networks include in addition to angel investors also service providers and other non-investors.

As for recent angel investment activity trends amongst business angel networks and groups, it should be noted that business angels around the world have started to co-operate and use remarkable IT solutions. One example is a software platform called Gust.[13] Gust provides the global platform for the sourcing and management of early-stage investments. It is endorsed by the world's leading business angel and venture capital associations, and powers over 1,000 investment organisations in 65 countries. Another example of making use of IT in angel investment activities is through crowd-funding platforms, which offer raising seed and start-up capital. For instance, AngelList[15], a platform for start-ups, connects start-ups with investors and entrepreneurs. Other examples are Crowdfunder[16], Invesdor[17], etc., where investors can invest small amounts of equity in seed investments via the Internet and usually a 5% success fee for the hosting site applies. On the negative side, however, there are often no types of due diligences and 'checks and balances' for investors who are willing to invest. The same concerns can arise for online business angels networks where the network acting as a hosting site may not be undertaking any background checks and due diligences on the investee company before it is registered and promoted to investors[18]. The European Commission has stated that even though the emergence of new sources of funding that employ social media are still at an embryonic stage, the potential risks of such funding and the fragmented European regulatory environment along national lines for cross-border platforms are among the emerging challenges which pose issues for entrepreneurs, platform providers and investors alike.[19]

## Encouragement of cross-border deals

While there has been increasing talk about cross-border deals, the reality is that most angel investments are still local. Historically, based on national policies, the majority of business angel investment has been restricted to national level (usually the target companies have to be incorporated in the same country), with few cross-border investors investing into a different country. However, there seems to be a tendency towards change. Business angels are considering investing in propositions in different countries in order to explore opportunities with good growth potential. Investors are becoming more aware that companies with very high growth potential are not always based in their own country of residence. Even start-up businesses are becoming more globalised; particularly in the high-tech sector.[20] Yet, business angels are still reticent in doing so as they often invest under different laws from their own country's. But there is potential in this area and it is considered good practice to stimulate cross-border activity by the sharing of investment propositions to encourage such activity. Cross-border deals are only possible when the necessary trusted relationships are in place, when there is sufficient knowledge about the other market and the legal and tax systems permit deals to be done under similar terms. There is some evidence on transnational investments in Europe when the fiscal, legal and regulatory environments have been right and human challenges met, such as language skills, knowledge of other markets, building rapport etc. Business angels will only invest in a cross-border deal if a trusted local lead investor exists in the country of the target portfolio company.[21] At the moment, the more prevalent cross-border deals tend to be in local communities situated near borders in which relationships have been built over time. That said, efforts continue to be made

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to build international networks and contacts to facilitate future cross-border deals.[22]

## Summary

A healthy and well-functioning entrepreneurial ecosystem is critical for successful angel investing and for the market to grow. It is important to learn from other experienced countries, but not to simply copy-paste the existing models. A co-operation between various sources of capital is needed. There should be a coordination of public efforts and the right efforts should be taken at the right phase of business angel market development. The entrepreneurial ecosystem should encourage and motivate experienced entrepreneurs to take high risks and become active business angels who would rescue start-ups from the valley of death. It is also crucial to shape the educational system and national culture in favour of an entrepreneurial risk-taking, sales mentality and innovation prone attitude. This includes at least such market players as incubators and accelerators, besides business HUBs and entrepreneurial skills training. However, the main actors in building the business angel market must be business angel investors themselves. ■

*The full version of this article can be found in Santen. van Offeren (Eds.) Perspectives on International Insolvency Law: A Tribute to Bob Wessels. Kluwer Deventer, 2014.*

> “THE ENTREPRENEURIAL ECOSYSTEM SHOULD ENCOURAGE AND MOTIVATE EXPERIENCED ENTREPRENEURS TO TAKE HIGH RISKS AND BECOME ACTIVE BUSINESS ANGELS”

**Footnotes:**

1 Signe Viimsalu, BA, mag.iur, Ph.D is a co-chair of INSOL Europe’s EECC.
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17 https://www.invesdor.com.
18 European Commission (2012), *op.cit.*, p. 30.
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22 OECD (2011), *op. cit.*, p. 77.

# UK pre-packs endorsed… but "clean-up" recommended

The pre-pack is among the armoury of tools that makes the UK an attractive restructuring jurisdiction. A recent independent review has endorsed pre-packs, but also recommended some improvements, explains Glen Flannery

GLEN FLANNERY
Partner, Nabarro LLP's Restructuring & Insolvency group, London

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## Overview

On 16 June 2014, the British Government published the findings and recommendations of an independent review of pre-pack administrations ("**pre-packs**") carried out by Teresa Graham CBE*.

Graham's review was commissioned by Vince Cable, the Secretary of State for Business, Innovation and Skills, to address continued disquiet about the merits of pre-packs, particularly among some unsecured creditor groups.

Despite identifying some shortcomings that could be improved upon, Graham concluded that pre-packs "*definitely have a place in the insolvency arena*" and that to outlaw them to sub-optimal areas of behaviour would be akin to "*throwing the baby out with the bathwater*".

Therefore, instead of a ban on pre-packs, which had been sought by some opponents of the technique, Graham has recommended a "*clean-up*" involving "*major improvements on how they are administered*". She has proposed that this be achieved through a package of six measures.

Two of these measures are directed at pre-packs involving sales to parties connected to the insolvent company ("**connected party purchasers**"), which are typically more controversial than sales to unconnected parties. Before they enter into a pre-pack, Graham wants connected party purchasers voluntarily to:

- approach a "*pre-pack pool*" of independent and experienced business people, to obtain an opinion on the proposed pre-pack; and
- prepare a "*viability review*", stating how the purchaser will survive for at least 12 months from the date of the review and what the purchaser will do differently to the insolvent company to avoid a further failure.

The other measures are intended to improve:

- pre-sale marketing;
- pre-sale valuations;
- disclosure of information to creditors after a pre-pack, through an enhanced Statement of Insolvency Practice 16 ("**SIP 16**"); and
- monitoring of compliance with SIP 16.

Graham has invited the insolvency industry to adopt her proposed measures voluntarily, without the need for new legislation, but she has asked that the Government consider legislating if her measures are not adopted or fail to have the desired impact.

Graham's key findings and her proposed measures are summarised in more detail below. Before this, for those readers who may be less familiar with pre-packs, there is a brief explanation of a pre-pack and the current SIP 16.

## What is a pre-pack?

Administration is a formal insolvency process available under English law, in which a licenced insolvency practitioner (the administrator) is appointed to an insolvent company with the tiered objective of:

- rescuing the company as a going concern;
- achieving a better result for the company's creditors than in an immediate winding-up; or
- realising the company's property to make a distribution to secured or preferential creditors.

In a pre-pack, a sale of all or part of an insolvent company's business is arranged before the company enters into administration and the sale is executed by the administrator on, or shortly after, his or her appointment as administrator.

The sale is structured in this way to minimise the impact of the formal insolvency process on, and thereby to preserve value in, the business. Where the sale is not pre-arranged in this way, there can be a greater risk of losing key suppliers, customers or employees, upon news of the insolvency breaking.

The sale is arranged by the company, the prospective administrator, and the purchaser. Where there is a secured creditor, it may rely on its security to drive the process. Alternatively it may adopt a more passive role, but still be consulted to obtain a release of its security on completion of the sale.

Unsecured creditors are treated differently. Typically, they do not have a voice in whether a pre-pack should be entered into and they only find out about the pre-pack after it has been executed. This leads some to distrust the process, even though they might benefit financially from (a) an increased return to creditors in the insolvency process, and (b) for those whose goods or services are required by the on-going business, the option of dealing with the continuing business.

A pre-pack is not a creature of statute – it is a technique that has been developed by practitioners to


help achieve business rescue and maximise realisations through a business sale where the debtor cannot be rescued as a going concern.

In recent years, approximately a quarter of all administrations in the UK have involved a pre-pack. Examples include the sales of the businesses of Blacks Leisure and Dreams Plc.

## Statement of Insolvency Practice 16 (SIP 16)

SIP 16 was introduced in January 2009 and updated in November 2013. It requires an administrator who executes a pre-pack to provide creditors, within seven days of the pre-pack, with an explanation of why the pre-pack was undertaken (a "**SIP 16 statement**").

A SIP 16 statement should include information on matters such as the alternatives considered, the marketing undertaken, asset valuations obtained, the purchaser, any connection between the purchaser and the insolvent company, and the consideration for the sale.

SIP 16 is a regulatory requirement rather than a legal requirement. Failure to comply with SIP 16 can result in disciplinary action against an administrator by his or her regulatory/professional body.

A legal claim may be brought against an administrator if he or she executes a pre-pack in a manner that is inconsistent with a proper discharge of his or her functions and duties.

## Graham's key findings

Graham analysed information from a variety of sources, including those affected by or otherwise involved in pre-packs (e.g. suppliers, landlords, insolvency practitioners, lawyers, and accountants) and reports issued in the administrations of a random sample of 499 companies who had executed pre-packs in 2010.

### *Advantages of pre-packs*

Graham identified the following positives about pre-packs:

- Pre-packs preserve jobs. This benefits other creditors by reducing claims against the insolvent company.
- Pre-packs are cheaper than alternative upstream restructuring procedures, such as schemes of arrangement which have more court and creditor involvement.
- Deferred consideration is largely paid, such that creditors are not unduly harmed by the presence of deferred consideration in a pre-pack.
- A purchaser is more likely to succeed where it has purchased a business in a pre-pack, rather than after a period of trading in an administration. The odds of failure were 2.4 times higher in a purchase after a period of trading in an administration than in a pre-pack purchase.
- Pre-packs even bring some limited benefit to the overall UK economy ("UK plc") from overseas companies relocating to the UK to take advantage of the pre-pack, i.e. forum shopping to the UK.

### *Disadvantages of pre-packs*

Graham also identified the following shortcomings:

- Pre-packs lack transparency. Inherently, unsecured creditors generally do not find out about the pre-pack until after the event. This leaves them feeling disenfranchised, particularly where the purchaser is a connected party purchaser.
- Marketing of businesses is insufficient. For more than a third of the companies surveyed there was no clear evidence as to when marketing was carried out and for how long. Too often only limited marketing was

> GRAHAM CONCLUDED THAT PRE-PACKS "DEFINITELY HAVE A PLACE IN THE INSOLVENCY ARENA" AND THAT TO OUTLAW THEM TO SUB-OPTIMAL AREAS OF BEHAVIOUR WOULD BE AKIN TO "THROWING THE BABY OUT WITH THE BATHWATER"

> PRE-PACK SALES TO CONNECTED PARTY PURCHASERS TYPICALLY ATTRACT A HIGHER LEVEL OF CRITICISM THAN THOSE TO UNCONNECTED PARTIES BECAUSE OF THE PERCEPTION THAT IT IS THE SAME DIRECTORS "DRIVING THE SAME ROLLS ROYCE THROUGH THE FACTORY GATES"

undertaken and the evidence showed that where no marketing was carried out, returns to creditors were lower.

- Explanations of valuations are insufficient. Although an independent valuation was conducted in the majority of cases surveyed (91%), many were simply desk-top valuations and the valuation did not include all of the available assets, e.g. intellectual property or goodwill.
- There is insufficient attention to the viability of the purchaser. This is a particular concern for both transferring and new suppliers, but it is not a primary concern of the administrator because his/her duties are owed principally to the creditors of the insolvent seller.
- The regulation of pre-packs and the monitoring of that regulation could be better. In particular, more could be done with SIP 16 to discourage bad practices.

Of the 499 pre-packs surveyed by Graham, almost two thirds involved connected party purchasers. Pre-pack sales to connected party purchasers typically attract a higher level of criticism than pre-pack sales to unconnected parties because of the perception that it is the same directors "*driving the same Rolls Royce through the factory gates*".

The evidence showed that 29% of connected party purchasers subsequently failed within three years of the pre-pack, compared to only 16% of unconnected party purchasers.

To address these issues, Graham has focused two of her six measures on pre-packs involving connected party purchasers.

## Graham's recommendations

Graham has recommended the following measures to improve pre-packs.

### *1. Pre-pack pool*

On a voluntary basis, before entering into a pre-pack, a connected party purchaser should approach a "*pre-pack pool*". The pool member should be given details of the proposed deal and asked to provide an opinion on it, for a fee to be paid by the connected party purchaser.

The pool member should be an experienced businessperson, selected from a wide range of industries and disciplines and possibly nominated by an organisation such as the Confederation of British Industry (the CBI).

Graham envisages a small secretariat being established to administer the pool and that cases be allocated on a strict rotation basis. If the pool member issues a negative statement the pre-pack can still proceed, but the negative statement should be disclosed in the SIP 16 statement.

This proposal is aimed at achieving some independent scrutiny of the pre-pack deal before it is executed, but without news breaking more widely in a way that could damage the business before it is sold.

This measure is aimed solely at sales to connected party purchasers.

### *2. Viability report*

On a voluntary basis, a connected party purchaser should prepare a "*viability review*", explaining how the purchaser will survive for at least 12 months thereafter and what the purchaser will do differently with the insolvent company to avoid a further failure.

The viability report should be attached to the SIP 16 statement. The administrator will not be expected to comment or express an opinion on the review. Where a viability review is not provided, the administrator should state that he or she asked for one but it was not provided.

This measure is aimed solely at sales to connected party purchasers.

### *3. Marketing*

All marketing of businesses prior to a pre-pack should comply with six principles of good marketing and any deviation from these principles should be brought to the attention of creditors in the revised SIP 16 statement.

Graham proposes the following marketing principles:

- Broadcast rather than narrowcast. The business should be marketed as widely as possible, proportionately to the nature and size of the company.
- Justify the media used. The SIP 16 statement should fully explain the reasons for the marketing and media strategy adopted.
- Ensure independence. The insolvency practitioner should satisfy himself or herself as to the adequacy of the marketing that has been undertaken and not simply rely on marketing conducted prior to their instruction as a proxy to avoid further marketing.
- Publicise rather than simply publish. Marketing should be undertaken for an appropriate length of time, sufficient for the insolvency practitioner to satisfy himself or herself that the best deal has been sought.
- Connectivity. Online marketing should be used alongside other media by default. Where the internet has not been used to market, the administrator should justify why it has not been used.
- Comply or explain. The administrator must fully explain his or her marketing strategy and how it achieved the best outcome for all creditors, particularly where the sale is to a connected party purchaser.

### *4. Valuation*

SIP 16 should be amended to require valuations to be carried out by valuers who hold professional indemnity insurance. Where this is not the case, the administrator should explain his or her reasons for choosing a valuer without such insurance.

Graham believes that insurers place their own stringent checks on those who apply for cover, so creditors should be more satisfied that a valuation from an insured valuer will represent a fair value.

### *5. Revised SIP 16*

The Joint Insolvency Committee (made up of representatives of the recognised professional bodies who licence and regulate insolvency practitioners) should consider adopting a reinforced version of SIP 16 at the earliest opportunity.

Graham sees SIP 16 as a vehicle for delivering her package of measures and she has prepared a re-draft of the 2013 version of SIP 16 to take into account her recommendations.

***6. Monitoring SIP 16***

The monitoring of SIP 16 statements should be picked up by the recognised professional bodies, in place of the Government's Insolvency Service. Graham considers them better placed to scrutinise compliance with SIP 16, given the level of their practical experience.

## Views on Graham's recommendations

Graham's proposals have received mixed reactions from across the insolvency industry and those affected by insolvency.

R3, the main trade body for insolvency professionals in the UK, has stated that it supports Graham's conclusion that there is a place for pre-packs in the UK's insolvency framework and that it is keen to see the recommendations developed.

The British Property Federation, which represents the views of landlords, has welcomed the recommendations to encourage transparency, but expressed concern about the lack of a statutory obligation which could result in the recommendations not being fully adopted.

The British Government has welcomed Graham's report and committed to work with industry and business to fully implement her recommendations, to improve transparency and confidence in a valuable business rescue tool.

In addition, in a new bill which may soon become law (the Small Business, Enterprise and Employment Bill 2014) the Government has included a power to introduce secondary legislation prohibiting or imposing conditions on pre-pack sales to connected party purchasers. This power may be exercised if Graham's recommendations are not adopted or are not effective enough in practice.

It remains to be seen how Graham's proposals will be implemented in practice (there is still a lot of detail to flesh out) and the impact that they will have on business rescue and outcomes for creditors.

For the moment, British insolvency practitioners who handle cross-border work will be pleased that Graham's recommendations do not seek to outlaw the pre-pack, which will help the UK to maintain its status as a favourable restructuring jurisdiction. ■

**For those who would like to read more, Graham's full report can be found at: https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration.*

> **"GRAHAM'S PROPOSALS HAVE RECEIVED MIXED REACTIONS FROM ACROSS THE INSOLVENCY INDUSTRY AND THOSE AFFECTED BY INSOLVENCY"**

# Do 'Retention of Title' clauses protect the seller in Finnish bankruptcy proceedings?

Elina Pesonen and Pauliina Tenhunen look at how effective such clauses are in practice

ELINA PESONEN
Associate, Castrén & Snellman Attorneys Ltd (Finland)

PAULIINA TENHUNEN
Managing Partner, Castrén & Snellman Attorneys Ltd (Finland)

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## Finnish bankruptcy proceedings in general and Retention of Title clauses

Finnish bankruptcy proceedings are governed by the Finnish Bankruptcy Act (20.2.2004/120). The Bankruptcy Act was totally renewed and modernised in 2004, undergoing major changes compared to the previous Bankruptcy Code. The new Bankruptcy Act also slightly changed the legal state governing the handling of Retention of Title clauses in bankruptcy proceedings.

The purpose of bankruptcy proceedings is to liquidate the assets of the debtor for the benefit of the creditors and, ultimately, to share the surplus equally amongst the creditors whose claims rank equally. One of the leading principles in Finnish bankruptcy proceedings is the principle of '*pari passu*', i.e. principle of creditors' equality when distributing the assets from the bankruptcy estate.

Retention of Title clauses are clauses by which the title to property to be sold is retained by the seller until the purchase price has been paid in full. This kind of a provision is an exception to the general rule provided in Finnish legislation in the Finnish Sale of Goods Act, according to which the title to property is transferred to the buyer at the same time as possession.

The Bankruptcy Act assumes that third-party property is not part of the bankruptcy estate if it can be separated from the debtor's property. Retention of title in bankruptcy situations is expressly provided for in Chapter 5(7) of the Bankruptcy Act, which is applicable to movable property subject to the seller's rights protected retention of title or withdrawal clauses.

## Can Retention of Title clauses be void in bankruptcy?

Retention of Title clauses are not binding in bankruptcy situations if the clause has been agreed after the right of possession has already been transferred to the buyer, i.e. the debtor. In such situations, the property is part of the bankruptcy estate just like the buyer's other property. This is due to the fact that, if the clause is agreed afterwards, this would in practice mean favouring the seller at the expense of other creditors.

In addition, Retention of Title clauses are ineffectual against bankruptcy estates if the buyer, despite the Retention of Title clause, has the right to further transfer the property, link it to other property or otherwise dispose of the property as if being its owner. For example, it would not be possible for the buyer to pledge property or further transfer it in a way that would maintain the validity of the original seller's retention of title against a third-party buyer. Whether or not the buyer has actually used such rights does not matter. The buyer's right to do so alone is enough. This basically means that Retention of Title clauses concerning all kind of property, such as inventories, to be linked to the buyer's property would be considered null.

Foreign suppliers, in particular, should also bear in mind that Finnish law is applicable to the bankruptcy of a Finnish buyer. This being the case, contractual clauses stating that the Retention of Title is subject to the law of some other jurisdiction are not valid in Finnish bankruptcy proceedings especially if the sold assets are situated in Finland.

## Incorporating Retention of Title into contracts

It is important to pay sufficient attention to Retention of Title issues already when drafting contracts. First, Retention of Title must be incorporated into the contract. A unilateral notification that Retention of Title is being applied will not hold up. This being the case, Retention of Title must be agreed in the contract or, for example, in a binding order confirmation. If general terms and conditions are being applied and the Retention of Title clause is included in them, the seller should make certain that the general terms and conditions are properly disclosed to the buyer and become part of the contract.

Second, the seller needs to give some thought to what rights the buyer is given to property sold under a Retention of Title clause. The seller should make sure that the buyer is not given permission to link goods subject to Retention of Title to other property or to otherwise dispose of it as if being its owner. This means that the effectiveness of Retention of Title clauses in bankruptcy situations is particularly questionable in relation to current assets.

In practice, contractual clauses should strictly stipulate that the buyer cannot dispose of the goods on his/her own behalf before the purchase price has been paid in full and the title has been transferred to the buyer. The seller can also consider other forms of collateral. Bank guarantees are certainly the most secure, but not nearly always a practical alternative for shielding oneself from a buyer's bankruptcy. ■

> **IT IS IMPORTANT TO PAY SUFFICIENT ATTENTION TO RETENTION OF TITLE ISSUES ALREADY WHEN DRAFTING CONTRACTS**

# Registration of pledge on movable property and security trustees in Belgium

Dr. Roel Fransis discusses a brief overview of the 2013 reform

DR. ROEL FRANSIS
Lawyer (Bar of Brussels); Partner Banking & Finance – Liedekerke Wolters Waelbroeck Kirkpatrick; Institute for Commercial and Insolvency Law – University of Leuven

## Introduction

The law of 11 July 2013 (the "**Law**") will reform the common legal regime for security rights in movable property (in addition to the regime applicable to financial collateral governed by the Law of 15 December 2004 implementing Directive 2002/47/EC on Financial Collateral Arrangements). The legal regime applicable to mortgages on immovable property and statutory preference rights remains, with a few exceptions, unaffected by the Law. Although the Law's entry into force is scheduled for 1 December 2014, it is expected that it will be probably postponed until 1 January 2017 the latest. This should allow sufficient time to set up the electronic national pledge register.

The Law (i) introduces new rules with respect to a pledge on movable property (whether tangible or intangible, with respect to certain, specific assets or with respect to a pool of assets), (ii) generally recognises the validity and enforceability of reservation of title clauses and (iii) grants a statutory pledge to creditors exercising a right of retention.

The 2013 reform aims at creating a flexible and efficient regime for the creation and enforceability of such security rights, combined with modern, economically oriented enforcement proceedings and a predictable outcome of ranking conflicts between secured creditors. Ultimately this should enhance the access to credit for companies and individuals at a lower cost. The Law is inspired

by international examples such as the 2006 legislative reform in France, the filing system for security interests introduced by the *United States Uniform Commercial Code* and international model laws and guidelines such as the *Uncitral Legislative Guide on Secured Transactions*.

## Pledge on movable property

The creation of a pledge on movable property between the parties (being a creditor or security trustee, and a debtor or third party collateral provider) is now a matter of mere consensus: it exists between the parties as soon as parties have entered into a pledge agreement.

Although not being a validity requirement, it is recommended that parties enter into a written pledge agreement specifying the maximum amount secured by the pledge, as only such a written agreement will (i) by virtue of the Law, provide sufficient evidence of the pledge and (ii) be eligible for the registration of the pledge into the national pledge register. With respect to consumers, a written agreement expressing the value of the collateral is required as a matter of validity of the pledge.

Within the maximum amount specified in the agreement, the pledge secures (i) the principal amount, (ii) interests, (iii) penalties and (iv) enforcement costs, it being understood that, with respect to consumers, the total secured amount of items (ii), (iii) and (iv) may not be higher than 50% of the principal amount.

In order to protect consumers against providing excessive collateral (known in

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German law as *Übersicherung*), the value of the collateral provided by them may not exceed the double of the amount of the secured claim (as defined above).

## Security trustee

In addition to the existing specific regime for financial collateral agreements, the Law now recognises the validity and enforceability of pledge agreements involving a security trustee or agent, holding a pledge on movable property for and acting on behalf of one or more beneficiaries, provided that the identity of the beneficiary(ies) can be determined on the basis of the pledge agreement. The security trustee is jointly liable with the beneficiary(ies), unless provided otherwise in the agreement.

## Registration, ranking and enforcement

Prior to the 2013 reform, the existence and enforceability of a pledge on movable property required the collateral to be handed over physically to the creditor or third party pledge holder. Since the 2013 reform, parties may now opt for the registration of the pledge into a national pledge register. While the debtor remains in possession of the collateral (and is entitled, save as provided otherwise in the agreement, to dispose of the collateral in the ordinary course of the business and to process the collateral into new goods), the registration ensures the enforceability of the pledge against other creditors and third parties and determines the rank of the pledge.

The Law provides for flexible enforcement proceedings with respect to a pledge provided by non-consumers: an *ex ante* court intervention is no longer required; instead, any interested party can request the court to conduct an *a posteriori* control. It is for the parties to determine how the collateral will be enforced: by way of a private or public sale, a rent or by way of appropriation of the collateral by the creditor. The Law requires the enforcement proceedings to be conducted in good faith and in a way that is economically justified. ■

> **THE 2013 REFORM AIMS AT CREATING A FLEXIBLE AND EFFICIENT REGIME FOR THE CREATION AND ENFORCEABILITY OF SECURITY RIGHTS**

# New reform covering financial difficulties and insolvency in France

Marc André outlines some new procedures in France which have recently come into force

MARC ANDRE
Mandataire Judiciaire
Etude Marc André

**Acting on the wishes of the new political majority, the French Government has issued a Ministerial Order (ordonnance) – a method which reduces parliamentary debate – in order to substantially modify the legislation relating to the treatment of companies in difficulty and insolvency.**

The Order of 12 March 2014 (Ordonnance 2014-326 du 12 mars 2014 ), which came into force on 2 July 2014 (Decree 2014-736 du 30 juin 2014 with 145 articles), comprises 117 articles and introduces some innovative solutions.

Firstly, it introduces two new procedures:

- the Accelerated Safeguard Procedure (*Sauvegarde Accélérée*), which will exist alongside the Accelerated Financial Safeguard Procedure;
- the Professional Recovery procedure (*Rétablissement Professionnel*), designed to help insolvent individuals with no assets.

Building on previous reforms, the Order also aims to improve the treatment of companies in difficulty while proposing a more satisfactory balance between the debtor's rights and his/her creditors' rights.

The new reform prioritises preventive measures in order to avoid wherever possible exacerbating existing problems, which would almost inevitably lead to the company being wound up, and accordingly encourages and facilitates the use of pre-insolvency procedures such as "*ad hoc mandate*" and conciliation. Creditors are encouraged to take part in negotiations but are prevented from paralysing the negotiations as they can no longer implement clauses designed to terminate a contract, in case of lack of payment, when any such procedures are started.

The Order therefore clearly curtails the law of contract in order to give the debtor a greater chance of recovery. This seems to be counterbalanced by the introduction of stricter rules governing the payment of creditors who inject money or contribute new assets, also known as the "New Money" privilege.

One quite spectacular innovation, intended as another preventative measure, is the introduction of a French "*pre-pack sale*" (article L611-7).

In a conciliation procedure, the conciliator can now be tasked with arranging the sale of all or part of the business. Article L642-2, which also concerns *ad hoc* mandates, provides in addition that the sale can be implemented at a later date within the framework of safeguard, restructuring (*redressement*) or even liquidation proceedings.

As well as these improved preventative measures, the reform also seeks to improve the handling of temporary or permanent insolvency.

Following on from the 2012 Act, which introduced the Accelerated Financial Safeguard Procedure, the 2014 Order introduces the Accelerated Safeguard Procedure, with the previous Accelerated Financial Safeguard Procedure now existing as a sub-category of this wider procedure.

This is an important change, as a debtor can now benefit from either procedure even when he/she has officially suspended payments (being in cessation des paiements).

The new accelerated procedure extends the solutions available under the earlier procedure from financial institutions to all types of creditors.

As far as safeguard and restructuring procedures are concerned, as a result of the reform the debtor is no longer the only party entitled to apply for the conversion of a safeguard procedure into an restructuring procedure.

Only time will tell whether in practice this modification, which should be considered in conjunction with the creditors' new right to propose an alternative plan to the debtor's recovery plan, will render the safeguard procedure less appealing to debtors. Safeguard was supposed to be giving the debtor the benefit of a court-controlled procedure that suspends actions by its creditors while allowing him/her to retain a certain degree of control over the procedure.

It is important to note that creditors are only entitled to propose an alternative plan in procedures in which a Creditors' Committee has been formed. But the result is less control now by the choice given to the debtor.

The Order also removes the cash payments of current contracts in safeguard procedures.

As regards liquidation procedures, the reform

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introduces a new procedure which will exist alongside court-ordered liquidation: the Professional Recovery procedure (*procédure de rétablissement professionnel*), which is based on a genuine desire to give a second chance to individual debtors who have almost no assets (no more than €5,000). The debtor will not be obliged to use his remaining assets to settle his debts and can keep them. It is an accelerated procedure, following an investigation conducted by a court-appointed insolvency practitioner.

This procedure is initiated by means of a court order following an application by the debtor, who must produce a true statement of assets and liabilities and must confirm that he has no employees.

The Court will appoint a judge and an insolvency practitioner who will verify that the debtor is in good faith, and that his description of his assets and liabilities in the application is accurate. But the debtor must not have been already involved in a liquidation procedure closed without full repayement of the creditors. If he has not, the procedure will be brought to a close after less than four months, and the debtor's debts will be wiped out.

This new liquidation procedure completes France's already admirable range of solutions for distressed and insolvent businesses.

Legislation now exists for all types of debtors, including business people involved in commercial or agricultural activities, a trade or the service sector, legal entities, the self-employed and also private individuals, within the framework of the personal bankruptcy procedure provided for by the French Consumer Code (Code de la consommation). It covers all aspects of insolvency, from prevention through to recovery or liquidation. ■

> **"ONE QUITE SPECTACULAR INNOVATION, INTENDED AS ANOTHER PREVENTATIVE MEASURE, IS THE INTRODUCTION OF A FRENCH "PRE-PACK SALE""**

# Reducing a customer's Accounts Receivable in the zone of Insolvency

David Conaway explains how suppliers can help themselves by being proactive

DAVID H. CONAWAY
Chairman of the Bankruptcy, Insolvency and Creditors' Rights Group, Shumaker, Loop & Kendrick, LLP (USA)


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**Reuters, Bloomberg and Debtwire are all reporting negative financial information about your customer:**

Bond ratings are downgraded, bond prices are falling, a likely "restructuring" to address the bond debt is on the way, bondholders form an "ad hoc" committee to negotiate with the customer, the bondholders retain financial advisors and counsel… as does the customer.

You know what's coming, a Chapter 11 filing, but the customer will not confirm that. In fact, the customer denies the "rumors", fearful of triggering defaults and losing credit terms provided by suppliers.

Your accounts receivable balance is $500,000, which will become a pre-petition general unsecured claim in Chapter 11. You know all too well that such claims are rarely paid in a Chapter 11 proceeding, so the $500,000 accounts receivable is looking like a write-off.

You're in the twilight zone – the zone of insolvency, which often lasts weeks if not months depending on the negotiations among the customer and its lenders and bondholders on DIP financing and on a bond restructuring (often a debt-equity swap). It will likely be a "prepackaged" or "pre-arranged" Chapter 11 filing.

The good news is that you don't have to sit back and watch the painful slide into bankruptcy. You can be proactive and reduce your accounts receivable balance, even absent a material payment default.

Vendors have two powerful tools in Article 2 of the Uniform Commercial Code governing the sale of goods:

*Section 2-609 Anticipatory Breach*

When reasonable grounds for insecurity arise with respect to the performance of either party, the other may demand in writing adequate assurances of due performance and if commercially reasonable, suspend any performance.

*Section 2-702(1) Cash Before Delivery Upon Buyer's Insolvency*

Where the seller discovers the buyer to be insolvent, the seller may refuse delivery except for cash.

Section 2-609 and 2-702(1) work well together. The seller's performance obligations, which may be suspended under 2-609, concern shipping goods and providing any credit terms agreed on between the parties. If reasonable grounds for insecurity exist, the seller may suspend its obligation to ship or to provide credit terms, or both. Section 2-702(1) likewise allows the seller to sell goods on a cash basis.

## Frequently Asked Questions

***1. What are "reasonable grounds" for insecurity?***

Although not defined by Article 2, courts have found that "reasonable grounds" for insecurity exist when a party fails to make required payments pursuant to a contract, such as when a buyer fails to pay outstanding invoices under a supply contract or when the accumulated debt of a buyer making purchases on credit substantially exceeds the buyer's credit limit.

Additionally, courts have held that a report from an apparently trustworthy source that a party is in financial distress can be enough to give the other party reasonable grounds for insecurity, even if those reports ultimately turn out to be untrue.

***2. When does a buyer become insolvent?***

Insolvency is normally defined on a balance sheet basis: liabilities exceed assets. Also, a company may be insolvent if generally it is unable to pay debts as they come due.

In many instances, the customer may be solvent with respect to its working capital facility, and mostly solvent on its trade payables. However, if the customer has insufficient resources to pay its bond debt in accordance with its terms, he is unable to meet its financial obligations as they come due. Also, the amount of bond debt, working capital and term debt, along with all other debt obligations, may cause the customer to be balance-sheet insolvent.

***3. What if the customer is not in material default?***

Neither Section 2-609 nor 2-702(1) hinge on the buyer's default. In fact, Article 2 provides a seller clear remedies when a buyer fails to pay. Section 2-609 addresses the situation where there is no current default, but the seller can reasonably anticipate a default.

Likewise, Section 2-702(1) hinges on the buyer's insolvency, not the buyer's default.

Nevertheless, sellers exercising these remedies can anticipate push-back from buyers because they are current.

Also, well-written "terms of sale" provide that the failure to pay any invoice when due accelerates payment of all open invoices in which case a non-material breach may trigger a breach of the entire open accounts receivable balance.

***4. What if there is a supply contract with the customer?***

In this context, there is little difference between doing business on a purchase order and invoice basis and under a supply contract. In both cases, a seller has an obligation to deliver goods and extend terms and the buyer has the obligation to pay for the goods within terms. However, buyers tend to assert that a supply contract heightens the seller's obligation to perform, regardless of reasonable grounds for insecurity or insolvency.

***5. Can the supplier refuse to ship goods altogether?***

Arguably, yes, but if the seller delivers goods on a cash before delivery basis, the seller fulfills its business mission with no risk of not being paid.

Section 2-609 allows a seller to suspend all performance "*if commercially reasonable*". Moreover, the Uniform Commercial Code imposes a standard good faith, which weighs in favor of continuing to ship, particularly if the buyer's business operations would be damaged without a consistent flow of goods.

***6. How do Sections 2-609 and 2-702(1) benefit the seller?***

If the accounts receivable balance is $500,000 and the credit terms are net 30 days, the $500,000 accounts receivable balance should be zero in 30 days, or $250,000 in 2 weeks. Depending on how long the zone of insolvency lasts, the seller will likely reduce, if not eliminate, its accounts receivable balance before the customer files. These are 100% dollars compared to pennies on the dollar if the accounts receivable balance exists at the time of Chapter 11 filing.

Given this extreme range of outcomes, sellers should always pursue its remedies under Section 2-609 and 2-702(1).

Buyers often use the threat of future business to avert being put on a "cash before delivery" basis. Experience suggests that buyers need quality suppliers, and suppliers need quality customers. They will likely do business again despite the pre-Chapter 11 rhetoric. Perhaps a supplier increases the price discount a point or two for "cash before delivery" payments, for good customer relations.

***7. What about preference risk?***

Accelerated pay-downs of accounts receivable balances during the zone of insolvency normally imply an increased preference risk. This is because accelerated pay-downs are not considered in the "*ordinary course of business*".

However, if the existing accounts receivable balance is paid in accordance with terms during the zone of insolvency, those payments should be protected by the ordinary course of business defense. Future shipments will be on a cash before delivery basis, so the payments by the customer are not "*on account of an antecedent (existing) debt*" since a debt does not arise until after delivery has occurred.

Given the normal Chapter 11 outcome for unsecured claims, minimizing such claims before filing is highly recommended.

*Stay tuned … in a future article, we will address how to respond when your customer, now in Chapter 11, insists on normalized credit terms because the DIP facility approved by the Court provides adequate cash to pay.* ■

> "VENDORS HAVE TWO POWERFUL TOOLS IN ARTICLE 2 OF THE UNIFORM COMMERCIAL CODE GOVERNING THE SALE OF GOODS"

# The impact of social policy on cross-border insolvency

Jennifer L. L. Gant looks at how social policy regulation can impact corporate rescue success

JENNIFER L. L. GANT
Research Assistant and PhD Candidate in Employment, Insolvency and Comparative Law

## Introduction

Cross-border insolvency can often be impeded by the lack of legal coordination between jurisdictions, both in terms of differences in insolvency systems and in other more fundamental differences in legal approach to regulation generally. The European Insolvency Regulation ("**EIR**") is one attempt to increase cross-border coordination in an area that is important to business-related market activities. While the EIR aims to coordinate insolvency proceedings within the EU, gaps remain between Member state insolvency procedures as well as in other regulations linked to insolvency. The content and even the fundamental aims of regulation differ throughout the EU, exemplified through a comparison between the UK and France below. One legal area that can be a particular obstacle to effective cross-border business coordination is social policy regulation which impacts corporate rescue success.

## The individual quality of social policy

Social policy has an influence on the aims of regulation throughout the EU. However, Member states retain their own views and approaches to it. The individual character of social policy is evident in the hands-off approach taken by the EU in relation to social policy legislation. As such, EU social policy regulation primarily takes the form of directives, which only require Member states to achieve a particular result, without dictating the means in which that result should be achieved. The absence of a clearly defined and legislated EU social policy is due to the belief that social policy, and labour law in particular, lies at the heart of national sovereignty. It is also an important element by which the integrity and political stability of Member states is preserved.[1] The individualistic character of social policy in the Member states has consequences for the implementation of any legislation with a social connection. This includes insolvency laws, where social considerations naturally arise because the outcomes of insolvency procedures have an impact on individuals, small businesses and communities, necessitating the protection of these interests.

## Diverse approaches to labour regulation

Jurisdictional differences in labour regulation can be an issue in cases of multinational companies going through restructurings, in which layoffs or redundancies may be required. This is because there will be different rules for compliance in the various Member states. General dismissal rules will differ as will the involvement of unions and employee participation in decision making. Apart from the potential confusion, different treatment of employees in different jurisdictions is likely to affect the morale of the work force, regardless of the fact that any actual or perceived inequitable results may be solely due to the requirements of laws specific to each jurisdiction. In addition, when the success of a corporate rescue procedure is reliant on the need to sell all or part of the undertaking, there are different rules which will affect the way employee contracts are managed. This will be particularly relevant in a case where the buyer is from a different jurisdiction. Even those procedures initiated with a view to liquidation may result in the differential treatment of employees.

## The Acquired Rights Directive[2]

While there are many labour laws which may affect the outcomes of an insolvency procedure, the rules relating to the transfer of employment contracts following a business transfer are of particular importance. Though the Acquired Rights Directive ("**ARD**") provides a common framework for the transfer of employment contracts across the EU, Member states retain considerable flexibility in how they implement it. Differences in implementation derive from the diverse aims of the underlying labour law. These include the consequences of dismissing employees, union involvement, employee participation and the differences in the interpretation between courts in different jurisdictions.[3] These underlying differences are influenced by a jurisdiction's legal family, regulatory style, economic and social policies, among a number of other factors.

## Legal families and regulatory style

The differences in the way in which the rules have been enacted in certain Member states are only partly due to whether they are members of the civil or common

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law legal families, as the former has a reputation for more interventionist legislation than does the latter. In France, the various rules which comply with the ARD are contained throughout the labour code. While Articles L.1224-1 of the labour code state the conditions in which a transfer of employment contracts will take place, rules regarding employee consultation, dismissal for economic reasons, and the effects of a transfer on collective agreements are contained elsewhere in the employment code. In the UK, the effects of a transfer of undertakings on employment contracts are entirely regulated by TUPE 2006, including collective agreements, dismissal and specific insolvency exceptions.

## Social and economic concerns

Business transfers occurring out of corporate rescue procedures are typically caught by acquired rights provisions in both the UK and France. However, attitudes toward this application of acquired rights differ due to differences in the underlying economic and social policies of each jurisdiction. Rules about migration of employment contracts to a buyer upon the sale of a business have been in place within the French labour code since 1928[4] as it was recognised that business transfers could put employee job security at risk, a social concern. However, these rules did not apply in the UK, given the view of their incompatibility with the fundamental principle of freedom of contract, a legal and potentially economic concern. It was not until TUPE 2006[5] was brought into force that the ARD was implemented in such a way as to meet the minimum criteria stipulated by EU law. The differences in approach to the issue of acquired rights demonstrate fundamental jurisdictional differences which alone can cause an impediment to coordination.

## An example of a specific functional difference

The results of a failure to comply with the law, particularly in respect to consultation, vary greatly between the UK and France. A failure to consult in France can lead to penal sanctions of imprisonment and/or a fine. Prior information and consultation is required to be given to the relevant work councils who will provide an opinion on the terms of the agreement which can potentially delay a deal for months. In the UK, consultation with employee representatives is required for a specified period as well[6], but there are no state-organised institutions such as the French work councils to report to. As such, the information and consultation exercise is dependent upon the parties involved and may or may not involve a union. A failure to consult in the UK will only yield a penalty for an employer if an employee chooses to pursue the failure at an employment tribunal.

## Conclusion

Conflicts such as those described above are common between the aims of labour law[7] and the aims of market-driven branches of the law, such as insolvency. As labour laws vary more widely across states due to the individual character of social policy, the discrepancy between levels of labour protection could impede the effective coordination of insolvency proceedings with an international element. This could potentially limit the ability to coordinate cross-border cases to the greatest advantage of the stakeholders in all involved jurisdictions. Awareness of these differences and distinctions could be a key influencing the coordination of cross-border restructurings.

“DIFFERENT TREATMENT OF EMPLOYEES IN DIFFERENT JURISDICTIONS IS LIKELY TO AFFECT THE MORALE OF THE WORK FORCE”

**Footnotes:**

1 C Barnard, *EC Employment Law* (2006, Oxford University Press, Oxford) 7-8.
2 Council Directive 2001/23/EC.
3 Global Human Resources Lawyers, *Transfer of Undertakings Guide* (2009, Ius Laboris, Brussels).
4 Now contained in *Code du travail* Article L. 1224.1-4.
5 SI 2006/246 Transfer of Undertakings (Protection of Employment) Regulations 2006.
6 See TUPE 2006 Articles 13-16.
7 N Bruun and B Hepple, “Economic Policy and Labour Law” in B Hepple and B Veneziani, eds, *The Transformation of Labour Law in Europe* (Hart Publishing, 2009) 31-57.

# The Dutch approach to combating bankruptcy fraud

Willem van Nielen asks if the Dutch approach is threatened by the *nemo tenetur* principle

WILLEM VAN NIELEN
Advocaat/Partner, Van Diepen Van der Kroef (The Netherlands)

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## Preface

In 2012 the Minister of Security and Justice of The Netherlands announced a recalibration of the Dutch Insolvency Law, especially a multi-disciplinary approach to combat bankruptcy fraud. This announcement has led to several initiatives in practice, for example, the introduction of consulting hours about insolvency fraud during which bankruptcy trustees can seek information from several chain partners (public prosecutor, representative of the tax authority, a supervisory judge and a bankruptcy trustee experienced in combating fraud) to combat the fraud. Several Dutch courts have successful experience with such consulting hours.

In order to further such a multi-disciplinary approach, the Minister of Security and Justice has published a draft Act wherein the duty of the bankruptcy trustee will be extended to combat bankruptcy fraud. In that respect the bankruptcy trustee is to investigate and report irregularities (e.g. fraud) to the supervisory judge. The supervisory judge is given the authority to oblige the bankruptcy trustee to report bankruptcy fraud to the public prosecutor. Additionally, when confronted with irregularities that lead to the conclusion of mismanagement (e.g. fraud) by the director, the bankruptcy trustee is given the authority to request disqualification of a director in civil proceedings. As soon as this request is approved by the court, the director's disqualification (for a maximum period of five years) will be published in a public register. Furthermore in the draft Act, the means to obtain information by the bankruptcy trustee have been reinforced, e.g. the group of persons who are obliged to provide the bankruptcy trustee with all relevant information regarding the bankrupt company is expanded (based on case law).

Meanwhile, the Supreme Court of The Netherlands has recently rendered two rulings that limit the possibilities to coerce these information duties of the bankrupt or the bankrupt's director vis-à-vis the bankruptcy trustee based on the *nemo tenetur* principle. These judgements also have an impact on the multi-disciplinary approach to combat bankruptcy fraud in general and have relevance for all European Member States.

## The Supreme Court of The Netherlands

In The Netherlands, a person who has been declared bankrupt or the director of a bankrupt company has the legal obligation to provide the bankruptcy trustee

with all relevant information regarding the bankrupt company – either asked for or unasked for. The bankruptcy trustee has the legal authority to coerce this obligation by requesting the supervisory judge to order the remand in custody of the person concerned. More often, in practice such a person will try to avoid detention by invoking the *nemo tenetur* principle with reference to article 6 of the European Convention for the Protection of Human Rights and Fundamental Freedoms (**ECHR**), as the obligation to provide information relating to fraudulent acts may lead to self-incrimination.

In that respect, Dutch case law provides that coercing the bankrupt or bankrupt's director to provide such legal information by detention in principle yields no violation of article 6 ECHR, because coercing these duties by detention has no punitive nature but is aimed at inducing the person concerned to fulfil his or her legal obligation for the purpose of the liquidation of the bankruptcy.

However, according to earlier judgements of the European Court of Human Rights (**ECtHR**), article 6 ECHR is violated if (i) it cannot be ruled out that the information requested will be used in a '*criminal charge*' against this person and (ii) this information is obtained through methods of coercion without the safeguard that such information will not be used in criminal proceedings against this person (ECtHR 17 December 1996, no 19187/91 (Saunders/United Kingdom). Article 6 ECHR is not violated regarding information that exists independently of the will of the person concerned.

The Supreme Court of The Netherlands concludes in its judgements of 12 July 2013 and 24 January 2014 that Dutch law does not include such a safeguard. Therefore, with reference to the ECtHR case law the Supreme Court of The Netherlands has judged that the supervisory judge has to include a restriction clause in his order for remand in custody (to coerce the person concerned to comply with these information duties). This restriction clause entails that information material that depends on the will of the person concerned may be used exclusively for the benefit of administration and liquidation of the bankruptcy. Following on the judgements of the ECtHR, the Supreme Court rules that coerced declarations consisting of material that is independent of the will of the person concerned, yield no violation of article 6 ECHR. When, despite the restriction, the coerced information is used in criminal proceedings, the criminal judge is to assess about the consequences.

The Supreme Court does not answer the question when information is to be qualified as 'information dependent on the will of the person concerned'. According to the ECtHR judgements, this includes: (i) statements – either oral or in writing (ECtHR 17 December 1996, no 19187/91 (Saunders/United Kingdom)); (ii) documents of whose existence is uncertain (ECtHR 25 February 1993, No. 10828/84 (Funke/France); (iii) documents that are not clearly specified (ECtHR 3 May 2001, no. 31827/96 (J.B./Switzerland)).

## Conclusion

To successfully combat bankruptcy fraud, an international and multi-disciplinary approach is essential. In view of the *nemo tenetur* principle, the legislator, supervisory judges, bankruptcy trustees and criminal prosecutors all have to be aware (i) that the bankruptcy trustee is able to coerce valuable information from the person (or director of the company) that has been declared bankrupt and (ii) which information the bankruptcy trustee can (voluntarily) deliver to the criminal prosecutor and (iii) which information can be used in criminal fraud proceedings.

In order to uphold the strong position of the bankruptcy trustee (and a successful multi-disciplinary approach of combating fraud), it is essential that his primary duty of liquidation of the assets on behalf of the creditors does not become a duty focused on facilitating the public prosecutor's task in a criminal bankruptcy fraud case. ■

> "DUTCH CASE LAW PROVIDES THAT COERCING THE BANKRUPT OR BANKRUPT'S DIRECTOR TO PROVIDE INFORMATION BY DETENTION IN PRINCIPLE YIELDS NO VIOLATION OF ARTICLE 6 ECHR"

# New Dutch bankruptcy legislation, Part II

## Evert Verwey reports on the new Dutch laws set to help the continuity of companies

EVERT VERWEY
CMS Netherlands,
Amsterdam,



### Introduction

In 2013 the Dutch legislature announced that an amendment of the Dutch Bankruptcy Act was necessary and that the "*continuity of companies*" was a priority.

It was announced that three new acts would be drafted:

- *Act on the Continuity of Companies I: Pre-pack proceedings (See: Eurofenix, Spring 2014, p. 33-35.)*
- *Act on the Continuity of Companies II: Composition outside bankruptcy proceedings.*
- *Act on the Continuity of Companies III: Duty for suppliers to continue to supply in bankruptcy.*

The main goal of these new acts is to preserve the value of an insolvent company and to provide more restructuring options in order to achieve a higher return for creditors.

On 14 August 2014, the Dutch Minister of Security and Justice presented a draft bill for an Act on the Continuity of Companies II, which provides a statutory basis for a composition outside of insolvency proceedings. Interested parties have been given until 11 November 2014 to comment on the draft bill, after which it will be submitted, possibly in amended form, to the Dutch parliament.

### Dutch Bankruptcy Act

There are currently two main insolvency proceedings for companies which may be commenced under the Dutch Bankruptcy Act; (i) bankruptcy (*faillissement*) and (ii) suspension of payments (*surseance van betaling*).

In these proceedings a composition (*akkoord*) (hereafter: a "**Restructuring Plan**") with the creditors is already possible. Such a Restructuring Plan is an agreement between the debtor and his or her creditors which provides for (partial) payment of the creditors. The debtor has the ability to restructure unsecured, non-preferential debts by implementing a Restructuring Plan through a mechanism by which a majority of the creditors can bind a dissenting minority (*cram down*). If the Restructuring Plan is accepted by the creditors and sanctioned by the court, then the estate will not be liquidated and the insolvency proceedings will be terminated.

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In these insolvency proceedings a secured or preferred creditor is not bound by a proposed Restructuring Plan and may enforce his or her security during the insolvency proceedings not being obliged in any way to negotiate with the debtor on the Restructuring Plan. Furthermore, during insolvency proceedings the ongoing business and contracts of the company often cease as the estate cannot guarantee payments of the ongoing costs.

## (Draft) Act on the Continuity of Companies II (the "Act")

A Restructuring Plan between the debtor and his or her creditors outside insolvency proceedings is currently not regulated. Consequently, when a debtor does want to propose a Restructuring Plan outside insolvency proceedings, the creditor is free to decline any proposal and is not obliged to cooperate. Furthermore unanimous creditor consent is required to implement the proposal. Consequently there are no recent examples of a successful Restructuring Plan outside of insolvency proceedings.

Under the (statutory) provisions of the Act, debtors will have the ability to offer a Restructuring Plan to their creditors and/or shareholders outside of formal insolvency proceedings. This means that no insolvency administrator will be appointed to, for example, investigate the feasibility and viability of the proposed Restructuring Plan.

If the debtor is not willing to propose a Restructuring Plan and it is foreseeable that the debtor cannot pay his or her debts, the Act creates a right for a single creditor of the debtor to propose a Restructuring Plan to the (other) creditors and/or shareholder(s).

## Content of the Restructuring Plan and formal requirements

Under the Act a Restructuring Plan can be drafted under which creditors and shareholders can be divided in different classes and their respective rights can be amended. In the Restructuring Plan it is also possible to amend the articles of association of the debtor. This means that the debtor has various restructuring methods available (such as a debt-for-equity-swap) and is allowed the flexibility to achieve a successful restructuring.

The draft Restructuring Plan must set out the financial consequences for each class of creditors, inform the creditors about the value of the company and contain an explanation of the Restructuring Plan itself. The Restructuring Plan must also set out a step-by-step plan that the debtor will follow post-implementation.

The next step is that each creditor will have to be informed of the draft Restructuring Plan. If the creditors and debtor differ upon the content of the Restructuring Plan, it is possible that a supervisory judge will be appointed. The supervisory judge is entitled to give his view on the payment system to the creditors and the composition of the creditor classes. Furthermore the supervisory judge is entitled to order the Restructuring Plan to be amended or expanded to enable the creditors to make a decision.

The Restructuring Plan is accepted by the creditors and/or shareholders only if all classes of creditors and/or shareholders have accepted it. A class accepts the Restructuring Plan when; (i) a simple majority in number of the creditors and/or shareholders that took part in the voting votes in favour of the Restructuring Plan and (ii) this simple majority represents at least 75% in value of the total value of claims or issued capital held by the shareholders (in the respective classes).

## Court confirmation

Once the Restructuring Plan has been accepted by the requisite majority of the creditors, the court must sanction the Restructuring Plan, for which purpose a separate court hearing is held. Creditors may inform the court in writing of any reasons why sanction of the Restructuring Plan should be considered undesirable.

If a class of creditors voted against the Restructuring Plan, the court can cram down that class if the dissenting class could not have reasonably voted against the Restructuring Plan. The dissenting class can only be crammed-down where the Restructuring Plan does not provide that the creditors or shareholders will receive a distribution that is at least equal to what they would have received if the company were to be liquidated in insolvency proceedings. Secured creditors are entitled to a distribution that is at least equal to the value of the encumbered asset in a private sale.

The court will refuse to sanction the Restructuring Plan in case; (i) the performance of the Restructuring Plan is not adequately warranted; (ii) the rights of the creditors or shareholders are prejudiced disproportionally; (iii) the Restructuring Plan is the result of fraud; or (iv) the court, in its discretion, considers that there are other important reasons to refuse sanction.

If the court confirms the Restructuring Plan and the decision becomes final, the Restructuring Plan becomes binding.

## Conclusion

The Act creates various options for a debtor to propose a Restructuring Plan to its creditors and shareholders in order to restructure its debt outside formal insolvency proceedings in a more flexible way. The availability of a debt-for-equity-swap and cram down for dissenting creditors are additional benefits to the debtor. ■

"THERE ARE NO RECENT EXAMPLES OF A SUCCESSFUL RESTRUCTURING PLAN OUTSIDE OF INSOLVENCY PROCEEDINGS"

# The Academic Forum reaches 10!

Paul Omar recalls the events and achievements from the last 10 years, and plans for the future

PAUL OMAR
Professor in International Insolvency Law at the Nottingham Law School and Secretary of the INSOL Europe Academic Forum

## From modest beginnings!

Prague, October 2004. A small gathering of academics meets in a room off the conference hall to explore the formation of an Academic Wing of INSOL Europe. With Professor Sebastian Kortmann (now Rector Magnificus (or Vice-Chancellor) of the Radboud University Nijmegen) leading it, the group begins life!

From those modest beginnings, the Academic Forum (as it was re-baptised in 2007) has now reached its 10th Anniversary. Marking the occasion has been a logo redesign and the anticipated production of some anniversary publications. In the time since its foundation, the primary mission of the Academic Forum has been to represent members interested in insolvency law and research, to encourage and assist in the development of research and teaching initiatives in the insolvency field, particularly by younger members, and also to participate in the activities organised by INSOL Europe. The membership of the Academic Forum now includes insolvency academics, insolvency practitioners with recognised academic credentials as well as those more generally engaged in the research, study and teaching of insolvency.

## Places, publications and projects

A roll-call of meetings in the life of the Academic Forum could read like a road-map of the Continent. Although normally following the parent organisation for its main conference annually, the Academic Forum has also held joint events with Law Schools and other research and teaching institutes in Europe. In the 10 years since Prague, the itinerant academic would have been able to visit Amsterdam (2005), Monaco (2007), Leiden and Barcelona (2008), Brighton and Stockholm (2009), Leiden (again) and Vienna (2010), Milan, Venice and Jersey (2011), Nottingham and Brussels (2012) as well as Trier and Paris (2013). In 2014, meetings are taking place in Leiden (for the third time!) and Istanbul, the latter its first foray to the margins of Europe. Future occasions will see the group on a return visit to Trier and also in Berlin and Lisbon.

From the inception of the conference series, events have had a solidly international focus. They have attracted academics and the academically-minded from all across Europe and the World, the list of participants at each meeting never representing fewer than 15-20 jurisdictions. Conferences have always been thoughtful, though also convivial, occasions. The papers by day have always been followed by a reception preceding an Academic Dinner, often with a guest speaker, where over the table friendships are formed and renewed each year, while the discussions range over topics both serious and frivolous! The sense at these occasions is often that of a large community, who may meet each other only occasionally, but who always find a pleasure in catching up with news and re-forming old acquaintances.

Out of the conferences have come many things, principally the reports of conference proceedings, which have been published regularly since 2009. In that year, the Leiden and Barcelona 2008 papers appeared to join the existing inaugural volumes in the Technical Series. By mid-2014, publications included all conference papers given up to end-2013, making a grand total of 15 academic contributions to the series. As they are published, these texts contain the latest information and form a cogent documentation of papers given at Academic Forum events. They are also a good reflection of the state and quality of insolvency research and teaching in Europe and elsewhere, forming a handy library of the ideas and themes associated with each conference.

They are not the only products of these occasions. Ideas have flowed with a vital part being played by the presentations that have simulated many other research papers and projects. Some of these have also been authored through collaborations set up at conferences, while projects have often been undertaken by academic members relying heavily on input from colleagues met through Academic Forum activities. The networking at events has also led to consultations on formal and informal bases with many members of the group meeting at other national and international forums, colloquia and seminars. There are close links too between the Academic Forum and other academic bodies, including the INSOL International Academic Group, which holds its meetings under the aegis of the body of which INSOL Europe is also a part.

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## The importance of funding

The Academic Forum was fortunate early on in being offered the opportunity of sponsorship by Edwin Coe LLP, a firm of insolvency practitioners based in London. This support has enabled a number of things to occur, chiefly the provision of research and travel grants, the latter to provide for younger academics as well as those from post-2004 accession countries and candidates to come present at events. In recent years, the provision of travel grants has seen up to 5 young scholars attend and deliver papers at each conference, in some cases speaking to an international audience for the very first time. Prizes have also been offered for outstanding legal scholarship awarded on the basis of monographs and publications.

The funding has also permitted the inauguration of a series of lectures given by judges, practitioners and academics of international repute and eminence, including Professor Jay Westbrook (University of Texas), Gabriel Moss QC (3/4 South Square, Gray's Inn), The Hon. Mr Justice Ian Kawaley (Chief Justice of the Supreme Court of Bermuda), Professor Karsten Schmidt (President of the Bucerius Law School, Hamburg), Professor Bob Wessels (Leiden Law School) and Professor Ian Fletcher QC (University College London). These lectures have greatly added to the annual conferences, permitting an insight into the great themes of insolvency law existing today, as well as offering an eye towards future developments in the subject area.

## People and personalities

All this, though, would not have been achieved without the participation and assistance of a great number of people, not least the presenters and attendees at each of the conferences and events. The Academic Forum has been also fortunate in the men and women at its helm. After Professor Kortmann (2004-2007), Professor Bob Wessels (2007-2010) and Professor Stefania Bariatti (2010-2013) have in turn become Chair. Each has taken the organisation forward, offering a unique contribution to the workings of the group. Bob was instrumental in helping set up the Young Academics' Network (YAN), which brings together doctoral candidates and post-doctoral early career researchers in a supportive environment. By this means, they are able to form collaborations and to be supported in giving papers at the sessions devoted to YAN presentations at each of the annual conferences.[1] Stefania helped lead the group through the early stages of responding to the consultation on and proposals for the reform of the European Insolvency Regulation. She also acted crucially in fostering links with the Academy of European Law in Trier, which led to a successful conference there in early 2013. Professor Christoph Paulus, who took the reins of leadership in 2013, will take the Academic Forum through the next critical period, which will see the conclusion of the reform project. These are exciting times indeed!

Though the Chairs have been key in the life of the Academic Forum, others have played significant roles. Myriam Mailly and Emmanuelle Inacio became YAN Co-Chairs when the group was first founded and led it through till end-2013, when they ceded their place to Dr Rolef De Weijs. Of immense pleasure (and relief!) to the organisation, both will still be involved in Academic Forum activities, Myriam carrying on as YAN Secretary, while both she and Emmanuelle will continue as INSOL Europe Technical Officers, offering support at the conferences of both INSOL Europe and the Academic Forum. On the management side, the Academic Forum has had the advice and assistance of its Management Body, whose members include Florian Bruder, Jessica Schmidt and Michael Veder, as well as members of the Supervisory Body representing the wider academic community across Europe. As publications editor, mention must also go to Professor Rebecca Parry, who took over responsibility for the production of conference booklets at the Milan 2011 event with impeccable discharge of her duties. Within the INSOL Europe parent body, wholly deserved mentions must go to Marc Udink, who first had the idea for what was to become the Academic Forum, and Caroline Taylor, who liaises with the group and, with her team, ensures that events always run smoothly and efficiently.

## Planning for the future

After ten years, the Academic Forum looks to be on firm foundations. What next though? Conferences and meetings apart, there is the challenge of seeing through the reform of the European Insolvency Regulation, which is still on-going. Modifications are also happening to domestic laws in many jurisdictions. Once concluded, the emphasis will shift to understanding how the new rules work and will be implemented, necessitating the sharing of ideas and best practices as well as the production of good quality commentary. There are also the changes happening to academia in many European jurisdictions, where the profession is in a state of flux as funding and regulatory models alter to adapt to a globalised world. There is also the way in which insolvency, as a subject of research and teaching, continues to fast mutate, requiring considerable ingenuity to keep up with its evolution. There is also the consequent need to ensure that the profession and the subject continue to attract a new generation of researchers and teachers, who will in turn assume the responsibility of leadership of the Academic Forum in times to come! It has been a good first ten years, but here's to the next! ■

**Footnote:**

1 The connection with Bob also explains why the Academic Forum seems to gravitate so often to Leiden.

"THERE IS THE ONGOING NEED TO ENSURE THAT THE PROFESSION AND THE SUBJECT CONTINUE TO ATTRACT A NEW GENERATION OF RESEARCHERS AND TEACHERS"

# *Espirito Santo* and the revival of the controlled management procedure

Martine Gerber-Lemaire asks whether this old-fashioned tool can rescue the Espirito Santo group

MARTINE GERBER-LEMAIRE
OPF Partners, Luxembourg

**It happens in the best of families. The Espirito Santo family, however, hasn't encountered trouble for the first time.**

In the 1970s, when major industries in Portugal were nationalized, including Banco Espirito Santo, leading members of the family fled into exile, where they restarted their fortune. That is how ESI holding was incorporated in 1975 in Luxembourg, the top holding company of the Espirito Santo Group (**GES**), to be followed by two main sub-holdings: Espirito Santo Financial Group (1984) and Espirito Santo Resources (1983), which was to become Rio Forte in 2009.

Almost 40 years later, on 18 July 2014, first Espirito Santo International S.A., which holds 20% of Banco Espirito Santo S.A., asked for controlled management in Luxembourg, after it had been declared in serious financial condition following an audit ordered by Portugal's Central Bank. Not even a week later, on 22 July, Espirito Santo Financial Group S.A., which is 49% held by Espirito Santo International, and Rio Forte Investment S.A. filed for creditor protection, the latter failing to make a €897 million debt payment to Portugal Telecom.

As negative news on the Espirito Santo group accumulate, it is difficult to predict the outcome of the ruling on the future of the group, which is scheduled for 8 October. Although The Portuguese Central Bank has decided to grant €4.9 billion from its resolution fund to rescue Banco Espirito Santo, it is still open whether the Luxembourg judge, based on the opinion of experienced experts analyzing the case (who were involved in the suspension of payment process of three major Icelandic banks in Luxembourg in 2008 and also in the Madoff cases) will allow the three Luxembourg entities to continue their activities after restructuring or if they will be subject to wholesale liquidation and bankruptcy.

Little known and used, controlled management, governed by the Grand Ducal Decree dated May 24, 1935[1] (the "**Decree**") is considered as an old-fashioned or obsolete tool. Is that still the case?

Relatively old and largely inspired from Belgian law[2], controlled management is an alternative for traders – either natural or legal persons – facing a crisis, but wanting to avoid bankruptcy, which is deemed too drastic, or composition with creditors to avoid bankruptcy (*concordat*), which in its turn is criticized for its lack of flexibility. In concrete terms, its benefit is available to entrepreneurs or companies which have either lost their creditworthiness or are having difficulties in meeting all their commitments.

Contrary to bankruptcy, controlled management is not available if the applicant has already been declared bankrupt by final judgment[3]. The application of a controlled management procedure must be used to obtain a re-organization of the business or a better realization of the assets of the applicant[4].

While it is a condition required by Belgian law that the trader act in good faith, the Luxembourg legislator refused to introduce this mention in the Decree. According to the latter, "*the desire to safeguard general interest must prevail over the interest of the trader*[5]". However, judges take it into account and may refuse the benefit of the regime to applicants who appear to have committed fraud or gross mistakes in the management of their business[6].

With the Espirito Santo cases, the rumour of embezzlement is very strong; indeed investigations were opened by both Portuguese and Luxembourg public prosecutors. Therefore some doubts subsist on the good faith of the management, but the European banking sector motto "*too big to fail*" has certainly been applied by the Luxembourg Court in order to give time to the Portuguese bank to find a proper solution.

It would also be interesting to follow this case to ascertain if the ironic motto of certain discouraged creditors would apply as well: "*too big to go to jail*". Let us hope that the Luxembourg public prosecutor will have taken into account the recommendation of his Portuguese colleague and shall exercise caution in relying on the declarations of the directors, shareholders and various managers of the Luxembourg entities. Indeed there has been an interesting sudden new development in the liquidation case of Landsbanki Luxembourg. On 10 July 2014, Luxembourg's Court of Appeal gave an unexpected judgment in relation with alleged criminal offences recognized in other countries but not prosecuted under

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### 1. Filing of the petition

**> The applicant files a formal petition, motivated and justified, with the commercial court.**

2 scenarios:

**a) Petition rejected:** The court may open the bankruptcy procedure.

**b) Petition accepted:** The court designates a judge to assess the situation and draft a report. (Experts could also be appointed to help the judge.)

**Effects of designation of judge**

Suspension of all posterior acts of execution.

Debtor is forbidden to: alienate, constitute liens etc. without authorization of a delegate-judge.

In fact it opens an observation period, where the experts and the appointed judges will enter into informal discussions with major creditors and decide if the company is able to recover or not.

### 2. Development of the report

**> The report of the judge has been filed; the court hears the applicant a second time.**

2 scenarios:

**a) Refuse the application of the procedure:** The court may open the bankruptcy procedure.

**b) Continue the application of the procedure:** The court places the assets of the applicant under control of commissioners.

**Effects of appointment of commissioner**

Commissioners have to draw up: an inventory of assets and a state of the active and passive situation.

The commissioners' duties are relatively wide, they should act in the interest of the applicant and also of his or her creditors.

### 3. Approval or not of the restructuring plan

**> The commissioners submit the restructuring plan.**

Double approval:

**a) Plan first approved by creditors:** It must be accepted by more than 50% of the creditors, representing more than 50% of the liabilities, and

**b) Plan approved or rejected by the court:** If rejected the court may open the bankruptcy procedure or order the commissioners to prepare a new plan.

**Effects of approved plan**

The applicant reclaims his or her properties and recovers the full exercise of his or her rights.

The court is not allowed to declare the dissolution of the company protected by the controlled management regime, or to interfere in the execution of the plan.

The plan becomes compulsory for the business entity, all its creditors, co-debtors and guarantors, and may be removed only in case of cancellation or rescission of law.

Luxembourg court. The court overturned an order of the investigating judge which had ruled that the time limit to prosecute had been reached in respect of facts alleged in a criminal complaint filed by a group of 108 plaintiffs against, among others, Landsbanki. More interesting is a direct claim against the liquidator for alleged offence of money-laundering. Therefore it seems that the time of indulgence is over in Luxembourg courts and the public prosecutor's office.

In any case, the resurgence of interest in controlled management leads to an explanation of the three distinct stages of this mechanism summarized in the timeline with several milestones. (*See chart above.*)

## Court hearing

The next Court hearing for Espirito Santo will take place on 8 October 2014, and the test of having controlled management used for rescuing holding companies could turn out successful or not.

Luxembourg courts are highly pragmatic; the Decree is quite flexible and if there is an opportunity for the whole group to be rescued instead of simply being liquidated, chances are that the formal controlled management procedure will be opened. It seems that some distress funds have offered to finance the group during the "observation period". The suspension of negotiation of certain financial papers declared by the CSSF (Luxembourg financial regulator) on 4 August 2014 was revoked on 18 August; maybe these are clues for a happy end.

Nevertheless, on the other side, everything is in the hands of the Portuguese financial regulator and if the Portuguese bank can be rescued without its holding companies, bankruptcy proceedings will replace controlled management and it will be only pruning branches of the big Espirito Santo tree. Let's hope that it is not also sawing off the branch that creditors are sitting on… ■

**Footnotes:**

1 Grand-Ducal Decree dated May 24, 1935 supplementing the legislation on suspension of payments, preventive concordat of bankruptcy by the institution of the system of controlled management.
2 Belgian Royal decree dated October 15, 1934, repealed on December 31, 1936
3 Idem.
4 Court of Appeal of Luxembourg, November 19, 1986
5 HOMMEL L. et LEVÊQUE F., « La gestion contrôlée », 1934, p.22, n° 7
6 Court of Appeal of Luxembourg, February 17, 1982

> IF THERE IS AN OPPORTUNITY FOR THE WHOLE GROUP TO BE RESCUED CHANCES ARE THAT THE FORMAL CONTROLLED MANAGEMENT PROCEDURE WILL BE OPENED

# The Nürburgring and state aid

Jens Lieser & Dr. Alexander Jüchser report on how a state aid investigation influenced the utilization process in insolvency proceedings

DR. ALEXANDER JÜCHSER
LIESER Rechtsanwälte
Koblenz (Germany)

JENS LIESER
LIESER Rechtsanwälte
Koblenz (Germany)

**In July 2012 the Nürburgring GmbH, 90% owned by the state of Rhineland-Palatine and 10% owned by the district of Bad Neuenahr-Ahrweiler, and two of its subsidiaries, filed for insolvency administration in accordance to sec 270 et. seqq German Insolvency Code (InsO).**

The Chief Restructuring Officer (CRO) is Prof. Dr. Dr. Thomas B. Schmidt (Trier, Germany). The court of Bad Neuenahr-Ahrweiler appointed Jens Lieser (Koblenz, Germany) first as preliminary insolvency administrator, later as permanent insolvency administrator.

The Nürburgring GmbH founded in 1927 is owner of the world famous racetrack Nordschleife, constructed in 1925, a state-of-the-art Grand Prix circuit and its associated infrastructure. The two subsidiaries own accommodation and F&B facilities next to the race tracks. All three companies were and are until today property-holding companies without operations and access to cashflow. At the beginning of the insolvency proceedings only eight employees worked on administrative issues.

Under a business lease agreement dating from April 2010, Nürburgring GmbH and its subsidiaries have leased all assets and operations to a privately owned company. The lessee was not controlled by the Nürburgring GmbH or the local state. The lessee had nearly 300 employees who dealt with all the operations. For several reasons the lease agreement was terminated in Spring 2012 and was disputed by the lessee. When insolvency proceedings started in July 2012 the situation was very unclear.

First of all, the insolvency administration had to end the "outsourcing" of the operation to gain access to cashflows and business information, and to be able to utilize the assets. The insolvency administrator had to retain the event organizers who, because of the unclear situation, were already on their way out. It is impossible to substitute big events in a short time, but the insolvency administration had to calm down the public interest and the local stakeholders.

## State-aid

Apart from these relatively big challenges, attention was drawn

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quickly to a state-aid investigation by the European Commission which was pending since March 2012. This investigation certainly opened a Pandora's box.

Once a state-aid investigation (according to Art. 108 TFEU) is triggered, it cannot be stopped. For the Nürburgring this meant that a formal decision was expected by September 2013. Claims for illegal grants could be filed with the insolvency administrator. These claims cannot rank as senior to the general unsecured claims. In the Nürburgring case they are even partly subordinated, according to sec 39 InsO. Hence, repayment was no option and this had quite severe consequences. Under EU Law, the grants are either paid back within four months after the formal decision or all activities must be closed down. A sale of the assets does not solve the problem as all assets are tainted by the state-aid. There is a high risk that the state-aid in an asset deal will be transferred to the acquirer, a consequence of the legal concept of an undertaking as an economic unit in EU competition law. Only a sales process compliant to EU law cuts off illegal grants and can therefore prevent a shut down, as well as transfer, of the state-aid to the acquirer.

To sum it up: The only option for the insolvency administration was to start a sales process compliant with EU law as soon as possible.

Therefore, such a sales process must be "open, fair, undiscriminating and transparent". These principles are rather not very concrete. Only an open and fair dialogue with the European Commission puts one in a position to access sufficient information to get an idea what is feasible and what is not.

The sales process started in May 2013 by announcements in several newspapers and ended in March 2014 with the signing of the asset purchase agreement.

## Discontinuity

To cut off the grants it was necessary to match one more EU law principle, the principle of discontinuity.

The transfer of assets was allowed, because they were sold at the market price. However, employment contracts were transferred by virtue of Law sec. 613a BGB. To make the discontinuity clearer seemed to be helpful because the future employee structure is deviating from the situation before the deal.

Customer contracts were not to be transferred, to match the discontinuity requirement. The seller OpCO, a private solvent company founded after settlement with the original operater and controlled 100% by the Nürburgring GmbH, operates the 2014 season and will terminate all contracts by the end of 2014. The acquirer OpCo will therefore negotiate a new contract with every customer for 2015 onward. But the insolvency administration had to find a solution in case the closing goes beyond December 2014, because the seller OpCo would then have no more contracts and, on the other side the acquirer OpCo will have no access to the operations. The solution was a lease agreement.

The next question was how to handle the state-aid risk in the asset purchase agreement. It was absolutely clear that no acquirer will take the risk of repayment of up to €500 million. Only a legally binding EU decision could offer enough predictability on this issue.

Now, there are two possible ways to solve the problem of the asset purchase agreement: not closing before such a binding EU decision is taken or imposing a cancellation right for the acquirer, in the event that no EU decision is taken in his favor. Neither way is ideal. As long as waiting for the closing and also waiting for the payment is compliant with EU law, this is less harmful because the risk of a legally binding EU decision has to be taken by the seller in any case.

After the approval of the creditors' committee, the CRO and the insolvency administrator signed the asset purchase agreement in March 2014. Closing will take place after a positive and legally binding decision is taken by the EU commission. ■

> "ATTENTION WAS DRAWN QUICKLY TO A STATE-AID INVESTIGATION BY THE EUROPEAN COMMISSION, PENDING SINCE MARCH 2012, WHICH CERTAINLY OPENED A PANDORA'S BOX"

# Country Reports
# Autumn 2014

Russia, Portugal

ARTUR TRAPITSYN
Chairman of the board NP SOAM Mercury, Russia

## Russia: On raising professional qualification requirements for insolvency practitioners

**Russian insolvency legislation sets out certain requirements an insolvency practitioner has to satisfy before his appointment in an insolvency case can be approved by the court.**

These requirements are: being educated to a degree level, having at least one year management experience, completing a period of internship as an insolvency practitioner, passing relevant professional exams, having no past disqualifications as a result of an administrative offence, having no convictions for premeditated crimes.

For a number of years, self-regulating organisations tried to convince the relevant Ministry that rules and regulations were needed that would require insolvency practitioners to continue their professional development.

On 26 December 2013 the Ministry of Economic Development of the Russian Federation approved the Federal Standard "*Requirements for Provision of Continuos Development Services to Insolvency Practitioners*".

The document provides that starting from 2014, every insolvency practitioner has to do at least 24 academic hours of Continuos Professional Development per year. This can be achieved either by completing a course with a state or private provider of higher education or with some other educational organisations, or through participation in seminars, conferences and other events organised by the National Union of Self-Regulating Organisations of Insolvency Practitioners, self-regulating organisations themselves, or by international organisations in the area of insolvency (bankruptcy).

The adoption of this document will improve the quality of work performed by insolvency practitioners in insolvency proceedings and will have a positive effect on the institute of insolvency (bankruptcy) as a whole.

IEVA STRUNKIENE
Lawyer, Member of Parliament of the Republic of Lithuania

## Lithuania: A new law aiming to reduce the social exclusion of insolvent individuals

**On 10 May 2012, the Lithuanian Parliament adopted the Law on Bankruptcy of Natural Persons of the Republic of Lithuania (hereafter referred to as the 'Law'), which enables individuals to declare personal bankruptcy.**

The Law basically aims at creating an effective legal mechanism which allows to restore the solvency of an honest natural person, farmer or other individual who is engaged in an individual activity in accordance with the laws, to ensure the fulfilment of the creditors' requirements under the Law and at the same time to maintain a fair balance between the creditors' and debtor's interests.

According to the Law, a natural person, who is unable to meet the debt obligations for which payment has become due and the amount of which exceeds 25 minimum monthly salaries as approved by the Government (approx. LTL 25,000 / €7,241), can file a bankruptcy petition with a district court having jurisdiction over his or her place of residence. If the Court establishes that the person can go bankrupt, the latter must prepare a bankruptcy plan. The repayment of debts may take up to five years and shall be supervised by the bankruptcy administrator.

The Law also provides a safety measure that prevents a natural person from abusing bankruptcy too often, i.e. bankruptcy proceedings may be initiated against a natural person not earlier than 10 years after the end of the last bankruptcy proceedings.

It is expected that the Law will contribute to the reduction of social exclusion and will comply with the creditors' principle of equal treatment.

## Portugal: Insolvency Courts vs. Tax Administration – Will rescue culture eventually triumph?

**After three hard years, the programme of international financial assistance to Portugal has finally come to an end, with the Troika leaving our country last May.**

For better and for worse, much has changed concerning the political, economic and social structures.

With regard to insolvency, the Troika required the fostering of a rescue culture concerning both corporations and individuals. The Portuguese Insolvency Act was amended in accordance in 2012. The definition of insolvency proceedings was altered in order to accommodate the priority of rescue purposes, the insolvency plan was renamed "*restructuring plan*" and brand new pre-insolvency proceedings were created (the special revitalisation proceedings). Concerning the possibility of tax claims being affected by restructuring or revitalisation plans, however, no measures were taken, in spite of the Troika Memorandum (2011), which required that obstacles to recovery had to be abolished and expressly referred to the need to "*amend Tax Law with a view to removing impediments to voluntary restructuring of debts*" (2.19. of the Troika Memorandum). At the end of the day, this legislative 'stubbornness' makes us wonder whether the Portuguese legislator was genuinely concerned with recovery and has, in fact, done more than paying 'lip service'.

The 'battle' between courts and the Tax Administration over tax inalienability has been going on for quite a while. The issue may be described in the form of a question: can a restructuring or revitalisation plan provoke modifications to tax claims (discharge, reduce their amount, and reschedule payments)? On the one hand, there is the traditional understanding that tax claims represent an indispensable element to the public welfare and must, therefore, be unattainable. On the other hand, considering that recovery plans depend on the willingness of the creditors to accept changes to their claims, if tax claims are kept intact the purpose of recovery will be jeopardized.

Almost from the start, and even before amendments to the Insolvency Act in 2012, the Portuguese courts fiercely fought the Tax Administration in its attempts to overestimate the principle of inalienability of tax claims. And, in a first stage, they actually managed to stop that. Whenever a recovery agreement negotiated by the debtor and the majority of the creditors modified tax claims and was subsequently challenged by the Tax Administration, the courts would nevertheless approve it, stating that Tax Law could not be given priority over Insolvency Law, given the special nature and purposes of the latter and the fact that the principle of inalienability was designed for general purposes. The legal ground was *lex specialis derogat legi generali*, meaning that a law governing a specific subject matter (*lex specialis*) overrides a law which only governs general matters (*lex generalis*).

It was then that the Portuguese legislator decided to intervene and strengthen the position of tax claims. Tax Law was amended in 2010 so as to provide for the prevalence of the principle of inalienability of tax claims even in cases of special legislation. This represented a major setback. It was no longer possible to confront the Tax Administration with the usual argument since the law clearly contradicted it. The thing that makes us wonder is: how can the legislator amend the Insolvency Act with a view to recovery and at the same time hamper the achievement of this purpose?

After a short period characterized by the absence of an effective reaction, and when everything seemed hopelessly lost, a new line of action gradually emerged. In a recent judgment (of 18 February 2014), the Portuguese Supreme Court ruled that a revitalisation plan may be approved by the court regardless of the nature of the claims that it modifies. The plan has a contractual basis; therefore, whenever the Tax Administration argues that the plan collides with a given provision and requires not to allow it to affect the tax claims, it should still be admissible if it restricts its effectiveness to the remaining creditors.

This Supreme Court ruling made an important point and its judgment will undoubtedly enable a lot of plans being saved. One single problem remains: the plan which is ultimately approved by the court is (may) not (be) the one that was negotiated and agreed upon by the debtor and the creditors. Without the measures designed to change tax claims, will the plan still be able to work in most of the cases? Will recovery still be a realistic and feasible aim?

For this and other reasons, it seems that a rescue culture in Portugal is far from being established. At present, the process of making recovery instruments work relies almost exclusively on courts and how they are able to surmount legal obstacles through the way of interpretation. Given the contradictory paths the Portuguese legislator took recently, maybe this is the only possible way.

> "HOW CAN THE LEGISLATOR AMEND THE INSOLVENCY ACT WITH A VIEW TO RECOVERY AND AT THE SAME TIME HAMPER THE ACHIEVEMENT OF THIS PURPOSE?"

CATARINA SERRA
Professor at the University of Minho, Portugal

## INSOL Europe *Contacts*

INSOL Europe, PO Box 7149,
Clifton, Nottingham NG11 6WD
Enquiries: Caroline Taylor
(carolinetaylor@insol-europe.org)
Tel/Fax: +44 (0) 115 878 0584
Website: www.insol-europe.org

**The Executive**

President: Catherine Ottaway
(ottaway@hocheavocats.com)

Deputy President: Robert Van Galen
(robert.vangalen@nautadutilh.com)

Vice President: Alberto Núñez-Lagos
(alberto.nunez-lagos@uria.com)

Immediate Past President:
Daniel Staehelin
(daniel.staehelin@kellerhals.ch)

Treasurer: David Buchler
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(carolinetaylor@insol-europe.org)

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(ottaway@hocheavocats.com)

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Ian Grier (iangrier@me.com)
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(ottaway@hocheavocats.com)

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European Best Practice Principles for Insolvency Office Holders:
Patricia Godfrey (p.godfrey@nabarro.com)

EU Political Monitors:
Marc Udink (mcudink@insol-europe.org)
Neil Cooper (NCooper@ZolfoCooper.eu)

EU Liaison: Michael Thierhoff
(Michael.thierhoff@tmpartner.de)

Case Register: Chris Laughton
(chrislaughton@mercerhole.co.uk)

Academic Forum: Christoph Paulus
(chrpaulus@t-online.de)
Prof. Paul Omar (Secretary)
(khaemwaset@yahoo.co.uk)

Glossaries: Marc Udink
(mcudink@udink.nl)

Judicial Wing: Heinz Vallender
(hvallender@t-online.de)

Turnaround Wing: Chris Laughton
(chrislaughton@mercerhole.co.uk)
Steffen Koch (steffen.koch@hww.eu)

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(p.godfrey@nabarro.com)

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(robert.vanGalen@nautadutilh.com)

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david.ingram@uk.gt.com

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Further Information: www.insol-europe.org/events

## 2015

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| 14 – 15 May | **INSOL Europe Eastern European Countries' Committee Conference**<br>*Vilnius, Lithuania* |
| 30 Sept. – 1 Oct. | **INSOL Europe Academic Forum Conference**<br>*Berlin, Germany* |
| 1–4 October | **INSOL Europe Annual Congress**<br>*Berlin, Germany* |

## 2016

| | |
|---|---|
| 21–22 September | **INSOL Europe Academic Forum Conference**<br>*Cascais, near Lisbon, Portugal* |
| 22–25 September | **INSOL Europe Annual Congress**<br>*Cascais, near Lisbon, Portugal* |

## 2017

| | |
|---|---|
| 4 & 5 October | **INSOL Europe Academic Forum Conference**<br>*Warsaw, Poland* |
| 5–8 October | **INSOL Europe Annual Congress**<br>*Warsaw, Poland* |

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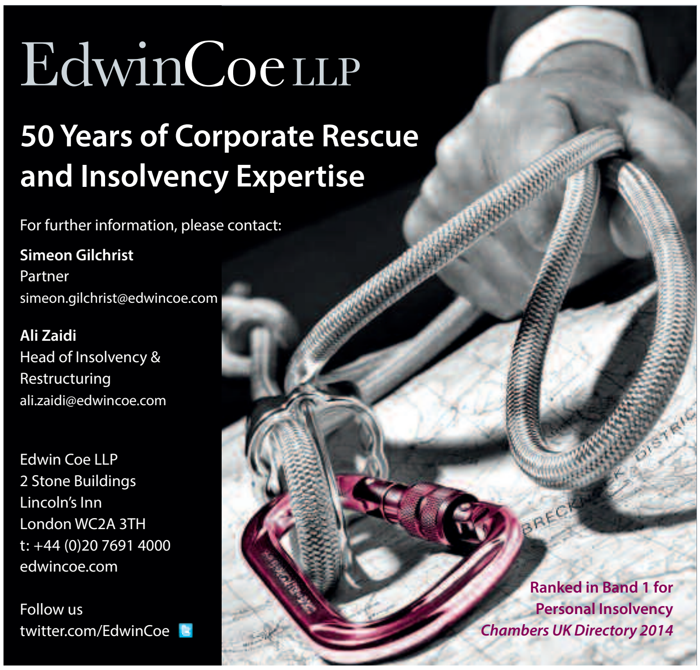


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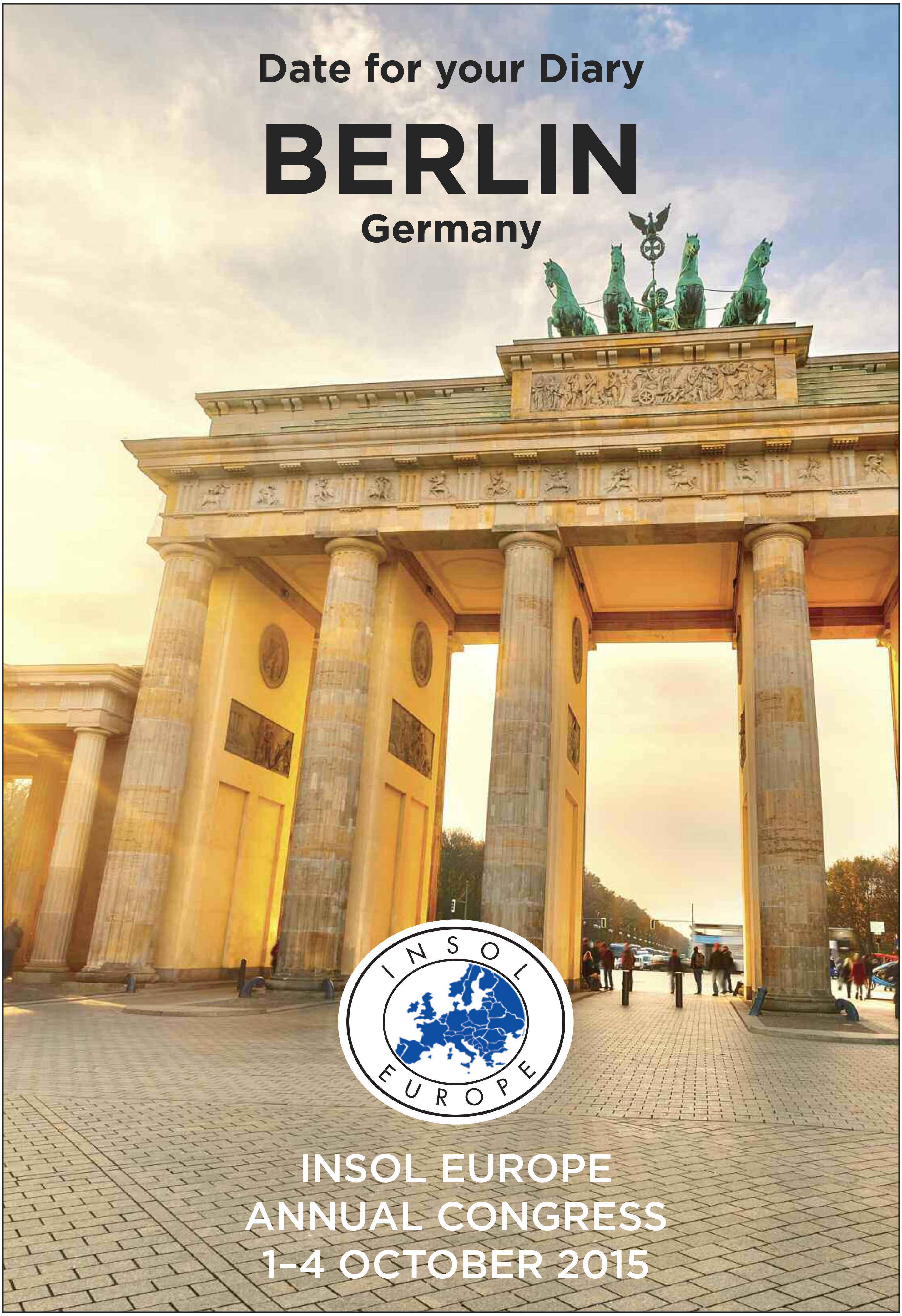
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