eurofenix

The journal of INSOL Europe
Autumn 2016

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Connecting the insolvency profession for 35 years

Brexit

What does it mean?
The UK perspective

Inside this edition:
- Benchmarking insolvency practice frameworks
- Turkey's bankruptcy postponement regime
- How to detect and deal with fraudsters
- New concept in the recast EIR
- Country Reports

and more...

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Welcome
from the Editors


ANNEROSE TASHIRO


GUY LOFALK

Welcome to this excellent new issue of our magazine: it couldn't be more diverse for topics and jurisdictions covered.

Following-up on our last issue, Chris Laughton (*page 12*) is laying out various thoughts about how the Brexit will influence the European regimes on cross-border insolvencies when it comes to the question of recognising UK administration in the Member States of the European Union and what is going to happen to the scheme of arrangement which is, as you all know, not an EIR procedure.

What Chris Laughton is not touching on is the EU's free movement with pet animals. While the wonderfully useful EU pet animal passport is only (almost) fully applicable in the UK since 2012, the question remains – for pet owners – whether the old strict rules will be re-enforced post-Brexit, with the "threat" of up to four months of quarantine.

Speaking of which: Jesper Trommer Volf and Thomas Heering (*page 26*) explore how the Danish courts apply the new rules applicable since January 2014 of *Konkurskarantæne*: the bankruptcy courts may decide in cases of grossly irresponsible business conduct by registered and *de facto* managers to force them into quarantine, that is, to disqualify those individuals from serving as directors and participate in the management of any business.

While the month of July 2016 in particular will be remembered for many nerve-racking days and nights of mentally stressful attention to the news on TV, radio and on the internet, about various brutal terrorist and other attacks and shootings, the attempted coup in Turkey on 15 July remains the most influential event that would also impact both the legislation and the judiciary. 15 July is not only the day of the failed coup, it is also the day of passing a new insolvency law in Turkey that seeks to streamline the rules of the so-called bankruptcy postponing. Orçun Çetinkaya and Burak Baydar (*page 20*) describe the amendments which are meant to make the system of a moratorium more effective by limiting the possible time frame of such postponements and restricting the prerequisites on whose bases such postponements can be ordered by the bankruptcy courts. The question is whether the request for more data-based rescue concepts will actually work. The authors provide their view.

Eitan Erez (*page 28*) follows up on David Ingram's "tsunami of fraud" as a worldwide increasing phenomenon. Identifying fraudsters at first is one challenge. Unwinding the fraud scheme legally by an insolvency practitioner is another. But how can creditors actually help and be encouraged to help? The Tel-Aviv District Court made an interesting move. Eitan Erez writes about his experience in Israel.

Albeit not straight-forward fraudulent, why mini-bonds are still very risky is explained by Carmel King (*page 31*). Indeed, the risk of fraud in an unregulated sector is significant. They are operated in the grey markets, outside the oversight of the financial market regulator and often used by start-up firms via crowd-funding platforms: Carmel advises to better be very cautious.

Did you ever have a clue how insolvency proceedings in Ukraine work? Well, see Igor Dykunskyy and Yaroslav Anikeev's article in this issue (*page 34*): they explain how the legislation helps to rescue businesses in Ukraine.

While the discussion of how the EU Commission's recommendation on the pre-insolvency regime may or may not be adapted is still hot in Germany, Croatia has already a new law in place, enacting these ideas. Jasnica Garasic (*page 36*) tells us more about the new Bankruptcy Act, already celebrating its first anniversary.

…and much more from Lithuania, France, Russia, the Netherlands. Enjoy the reading!

Annerose Tashiro

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Time to reflect, analyze and get ready for next year...

ALBERTO NÚÑEZ-LAGOS
INSOL Europe President

Alberto Núñez-Lagos summarises his year as President of INSOL Europe

> "AT THE INSOL EUROPE ANNUAL CONGRESS 2016 WE WILL PROPOSE A FUTURE CORPORATE EU RESCUE ENVIRONMENT THROUGH THREE KEY TOOLS: PRE-INSOLVENCY, HARMONISATION AND FINANCING"

Share your views!

The INSOL Europe Annual Congress 2016 has arrived – and with it my term as your President ends. It is time to analyze the year's events and get ready for the next year.

October 2015-September 2016 – Very difficult and interesting times

The economic environment during my presidency can be summarised as follows:

- Low growth in the Eurozone;
- Huge amount of liquidity with no boost effect on growth;
- No access to financing for businesses which need to restructure and are able to do so; and
- An EU insolvency framework analysis by the EU Commission in order to find out if and to what extent harmonisation is possible.

These circumstances are accompanied by a high volatility of the financial markets due to several factors which shall continue to exist, at least for the next month, such as:

- Brexit timing and effects;
- Italian late and incomplete restructuring of its banking system; and
- The German policy on (principally) Syrian refugees.

During my presidency INSOL Europe has actively participated and supported the EU Commission in its analysis of the harmonisation of the EU insolvency framework by

- actively participating as one of the appointed stakeholders in the EU Commission program for an insolvency initiative
- answering to the consultation organised by the EU Commission from March 23 to June 14 2016
- presenting INSOL Europe's survey on harmonisation of Insolvency Office Holders at the conference organised by the European Commission, "Insolvency in the EU: the way forward".

In addition, several INSOL Europe members have been appointed to the Commission Expert Group.

This commitment shown during my presidency by INSOL Europe, to contribute to build an efficient Insolvency framework, is a deeply rooted tradition of INSOL Europe. Only in the last years INSOL Europe has produced two very relevant research papers for EU institutions:

(i) INSOL Europe, Harmonisation of Insolvency Law at EU level, 2010; and
(ii) Study on a new approach to business failure and insolvency – A comparative legal analysis of the Member States' relevant provisions and practices, INSOL Europe, December 2013.

Finally, INSOL Europe has been involved during my presidency in the different discussions which are currently conducted in the UNCITRAL Working Group V meetings, as it usually does.

EECC Conference and projects

The EECC Annual Conference this year was held in Cluj-Napoca. The success of the conference was indeed due to our Romanian members and specifically our Vice President Radu Lotrean and our EECC technical committee. The attendance was one of the most important ones in the history of the EECC conferences.

I have launched an educational project for the EECC on insolvency practices and ethics which will start next year under the presidency of Steffen Koch. The project consists of three seminars each year. Two of them will be hosted each year in a different country in Eastern Europe.

Annual Congress 2016, Cascais nr Lisbon

The Annual Congress in Cascais will try to find solutions to the main problems of EU corporate rescue. In addition, concerning pre-insolvency, out-of-court restructuring frameworks and harmonisation, both during panel discussions and separate group discussions, the problems of financing distressed businesses and enforcing or trading NPLs will be treated. UNCITRAL updates and several panels on the IOH profession will complete the panel discussions.

Financing

On financing, there will be several panels in addition to the Financial Institutions Group meeting.

The first panel will be on Global Credit Risk Management. It is well known that more certainty and more predictability lead to less risk and cheaper financing. A harmonised European insolvency framework would maximise the efficiency and predictability of insolvency procedures for the benefit of the wider economy by facilitating an effective credit system. The second panel in this area will discuss financing of companies in distress. Such financing is very difficult in Europe compared to the US and is one of the topics on which the EU Commission is seeking the opinions of all stakeholders.

The discussions on the subject of the harmonisation process are focused on, what I believe to be, the relevant issues, namely:

- Interim financing: the security it should benefit from, a safe harbor against future clawback actions and for lenders which provide such financing against lender liability for permitting the business to trade while insolvent; and
- New financing under a restructuring plan and the possibility of super priority security.

Another area very closely related to finance in a distressed environment is the enforcement and trading of NPLs and the *de facto* enforcement of security through credit bidding on the asset subject to security. Several panels will discuss these topics from different angles.

Alberto Núñez-Lagos addressing the delegates of the EECC Conference in Cluj-Napoca, Romania

Pre-insolvency proceedings and harmonisation

This topic will be addressed in which a representative of the European Commission will also take part. As it stands now the discussions will be focusing on what has been identified as the key issues mainly:

- How to help businesses and specifically SME's to identify the need to restructure as early as possible.
- The benefit of confidentiality.
- Stay of both individual enforcement actions (for all creditors, not only financial creditors) and the right to request opening of insolvency by creditors.
- Suspension of *ipso facto* and early termination clauses (for which a session on Saturday's program is scheduled).
- The possibility to cram down creditors, including secured creditors, to the extent that a vote in each creditors' class is taken.
- The possibility to cram down shareholders, for which also a specific session has been scheduled on Friday.

Conclusion

I am convinced that the 2016 Annual Congress will be a success not only in terms of attendance but also as a think tank venue out of which we all will have a clearer idea on which should be the route to follow to build an efficient European restructuring framework.

I have to thank the technical committee of the Congress and also the panelists for their efforts and good work; and Caroline Taylor and her team for all the efforts and professional success they are having in the set up of this Congress.

Finally, I thank all the members for their support to me during this year. I am very honoured and proud for having had the opportunity to be your President. Thank you. ■

> "I HAVE LAUNCHED AN EDUCATIONAL PROJECT FOR THE EECC ON INSOLVENCY PRACTICES AND ETHICS WHICH WILL START NEXT YEAR"

Issues and challenges facing insolvency office holders in Europe

Emmanuelle Inacio takes a closer look at the Insolvency Officers Forum and current issues and challenges facing the profession

EMMANUELLE INACIO
INSOL Europe Technical Officer

"INSOL EUROPE HAS SEEN A GROWING INTEREST FROM MEMBERS ACROSS EUROPE TO REFLECT AND REACT ON CURRENT ISSUES AND CHALLENGES FACING THE PROFESSION"

The Insolvency Office Holder-project ("IOH Project") is an initiative of Leiden Law School, initiated in early 2013 and commissioned by INSOL Europe.

It researched (the possibilities for) the development of a set of principles and best practices for insolvency office holders ("IOH") by comparing multilateral treaties and soft law recommendations and national legislation within Europe.

In close collaboration with an Academic Committee and a Review & Advisory Group of insolvency practitioners and judges, Professors J.A.A. Adriaanse and I.S. Wuisman and Senior Researcher Dr. Bernard Santen from Leiden Law School designed the Statement. The process towards the Statement has been documented in three reports[1]. The draft INSOL Europe Statement of Principles and Guidelines for Insolvency office holders in Europe contains 7 Principles and 33 Guidelines[2] and is meant to serve as a sound benchmark for the profession, a means to strengthen public confidence in the profession on the market, and a forum for debate on possible future binding rules for IOHs on a European level.

As the Council of INSOL Europe has seen a growing interest from the association's members across Europe to reflect and react on current issues and challenges facing the profession of insolvency office holders throughout Europe, Catherine Ottaway, Past-President of INSOL Europe announced, during the 2014 Annual Congress in Istanbul, the decision of INSOL Europe to create a new forum focused on IOHs: the "Insolvency Office Holders Forum" ("IOH Forum").

Three practicing office holders have agreed to co-chair, support and steer the Forum though its initial stages: Stephen Harris (Ernst & Young, UK); Marc André (Etude Marc André, France) and Daniel F. Fritz (hww hermann wienberg wilhelm, Germany).

Therefore, the co-chairs, together with the executive of INSOL Europe, are currently evaluating how best to meet the interests, needs and expectations of insolvency office holders amongst INSOL Europe's membership in an appropriate way.

In addition, the European Commission is currently working on a common EU legislative framework regarding the harmonisation of the European Insolvency Law and will present a legislative proposal by autumn 2016 which will cover *inter alia* common minimum rules for insolvency practitioners with the aim of allowing both easier exercise of this profession in different Member States and setting standards that can ensure the proper conduct of these professionals[3].

The inaugural meeting of the IOH Forum took place during the INSOL Europe Annual Congress in Berlin on 1st October 2015 where the commissioning of a review of the regulatory framework across Member States was decided, in order to help to learn more about the diversity, common ground and actual needs of the professionals[4].

The day after, the Insolvency Office Holder Forum hold a panel session where together with the audience the current status of affairs of the European insolvency practitioners was discussed, seeking to understand whether the profession was under pressure and fitted for innovation. The IOH Forum also conducted an interactive poll asking the audience how the Guidelines, protocols, law reforms and harmonisation suited the European insolvency practitioners.

What emerged from the poll was that the audience was very divided regarding the need for European legislation, guidelines and harmonisation of IOH at EU level. On the contrary, the IOH Forum was strongly called to assist the profession by identifying and solving "real" problems arising in everyday practice.

As a result, as first mission, the IOH Forum has undergone to gather comprehensive information about the *status quo* of the profession in all the European Member States and to put together a questionnaire. The Survey aimed to summarise, for each EU Member State:

(i) the types of insolvency office holders;
(ii) the size of the profession;
(iii) the practising norms;
(iv) the qualification training and entry into the profession;
(v) the professional bodies;
(vi) the continuing professional education ("CPE");
(vii) whether an IOH may be a body corporate or an individual;
(viii) the sanction for acting as an IOH without proper authorisation;
(ix) bonding and insurance;
(x) the appointment of IOHs;
(xi) their remuneration;
(xii) personal liability of IOHs;
(xiii) the release of IOHs from liability; and
(xiv) their independence.

22 reports have been produced from the following EU Member States: Austria (Norbert Abel from Abel Rechtsanwälte); Belgium (Bart De Moor from Strelia Law Firm); Bulgaria (Peneva Miglena from Georgiev, Todorov & Co. Law Offices); Czech Republic (Ernst Giese from Giese & Partner); Denmark (Piya Mukherjee from Horten Law Firm); Estonia (Peter Viirsalu from Varul); France (André Marc from Etude Marc André); Germany (Axel Bierbach from MHBK Rechtsanwälte, Daniel Fritz from hww hermann wienberg wilhelm and Robert Haenel from Anchor Rechtsanwälte); Greece (George Bazinas and Yiannis Sakkas from Bazinas Law Firm); Ireland (Jim Luby and Enda Lowry from McStay Luby); Italy (Gofredo Caverni from Goffredo Caverni); Latvia (Edvins Draba from Sorainen); Lithuania (Ieva Strunkiene from Triniti); Luxembourg (Martine Gerber from Dentons); The Netherlands (Krijn Hoogenboezem from Boekel); Portugal (Nuno Salazar Casanova and David Sequeira Dinis from Uría Menéndez – Proença de Carvalho); Romania (Radu Lotrean from CITR); Slovakia (Slavomir Cauder from Giese & Partner); Spain (Vicente Estrada from Forest Partners); Sweden (Niklas Körling from Wistrand); Switzerland (Sabina Schellenberg from Froriep) and United Kingdom (Alastair Beveridge from AlixPartners).

A high level review of the responses identifying relevant sub-classes of findings across jurisdictions, where appropriate, was written by Marta Flores (Universidad Autónoma de Madrid) and Emmanuelle Inacio (Université du Littoral Côte d'Opale) and delivered to the IOH Forum on 16 May 2016.

The Survey of Certain Regulation for Insolvency Office Holders was presented by the president of INSOL Europe, Alberto Núñez-Lagos, at the conference organised by the European Commission on 12 July 2016 titled "Convergence of Insolvency Frameworks within the European Union - the Way Forward" and was very well received.

Finally, a Summary Report has been written up by the IOH Forum containing the key findings of the Survey and Recommendations that have been submitted together with the Survey to the DG Justice and Consumers of the European Commission on 25 July 2016.

The second meeting of the IOH will take place immediately before the start of the INSOL Europe Annual Congress in Cascais on Thursday 22 September 2016. A panel session is also programmed on Friday 23 September 2016, where the IOH Forum will present the highlights from the Insolvency Office Holder Survey undertaken by INSOL Europe, the dovetail with the EC Insolvency consultation process and the emerging themes. ■

"THE IOH FORUM WAS STRONGLY CALLED TO ASSIST THE PROFESSION BY IDENTIFYING AND SOLVING "REAL" PROBLEMS ARISING IN EVERYDAY PRACTICE"

Footnotes:

1 These can be retrieved from http://www.tri-leiden.eu/project/categories/ioh-project/.
2 Available at: https://www.insol-europe.org/ioh-forum-documents.
3 According to the EC Inception Impact Assessment – Initiative on Insolvency of 3 March 2016 (http://ec.europa.eu/justice/civil/commercial/insolvency/index_en.htm)
4 With a three-year sponsorship from the law firm Edwin Coe LLP (www.edwincoe.com)

For updates on new technical content recently published on the INSOL Europe website, visit:
www.insol-europe.org/technical-content/introduction
or contact Emma on: technical@insol-europe.org

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

Linked in

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 Financial Institutions 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!

Hindsight bias in insolvency law: foresight in retrospect

The inaugural address of Reinout Vriesendorp as Professor of insolvency law at Leiden University, "[**]it happens; then and now", was the setting for a mini-seminar in Leiden about the underestimated effects of hindsight bias in insolvency cases.

After a general introduction, a number of speakers from abroad spoke about specifics in their respective jurisdictions to an audience of about 25 practitioners and academics.

Introducing the subject, Ruud Hermans (De Brauw Blackstone Westbroek, Amsterdam) indicated how hindsight bias affects the proper judgement of people, as demonstrated in numerous social science experiments. Although professionals, like judges, are aware that they always judge on occurrences and happenings while they know the outcome, those experiments prove, time after time, that these are very hard and almost impossible to avoid. Techniques that may help are the de-biasing strategies, such as using very structured work processes, checking on alternative scenarios that could have led to the same outcome, or investigating more favourable hypothetical outcomes of the same event. Another alternative is to adapt procedural or substantive rules, using *ex ante* standards, increasing the liability threshold, like the US business judgements rule and/or increase the burden of proof.

David Burdette (Nottingham Trent University), Daniel Weiss (Hengeler Mueller), Joeri Vananroye (KU Leuven/Quinz) and Giorgio Corno (Studio Corno Avvocati) addressed the topic from their respective jurisdictional backgrounds (David also replaced Sarah Paterson from the London School of Economics/ Slaughter & May). In their presentations and subsequent discussions, they indicated the various legal instruments prone to invoking the risk of hindsight bias by courts in matters concerning directors' liability, directors' disqualification and impeachable transactions (fraudulent conveyances, preference law). They provided various examples and approaches about mitigating the risks of hindsight bias. Also, certain defences against actions by trustees (and subsequent judgments by courts) to hold directors etc. liable for the negative outcome of the insolvency that – with hindsight – could have been foreseen, were debated.

During the drinks and dinner afterwards, it appeared that the theme of 'hindsight bias' and possible unjustified outcome of court decisions are topics that deserve further attention by the insolvency practice and research by academia.


Reinout D. Vriesendorp making his inaugural speech at Leiden University, 23 June 2016

INSOL Europe Council Elections 2016

Vacancies
Countries with 30 or more members are entitled to a reserved seat on Council and we have received the following nominations for the vacant seats.

Non-Reserved Seats
We received nominations for David Rubin (United Kingdom), Javier Diaz-Galvez (Spain), Alice van der Schee (The Netherlands) and Ernst Giese (Czech Republic)

All members have been invited to cast their vote for the two vacancies by selecting two names, the successful candidates being those receiving the highest number of votes.

Reserved Seat Vacancies
The following nominations have been received for the individual country vacancies:

Susanne Fruhstorfer (Austria), Barry Cahir (Ireland), Marcel Groenewegen (The Netherlands), Simona-Maria Milos (Romania) and Thomas Bauer (Switzerland). These nominees were uncontested and will be formally elected to Council on 22 September.

For the Swedish seat, Hans Renman and Ann Schroeder were nominated so the vacancy has been put to the vote by Swedish members.

Results
The results will be announced to the successful candidates after 10 September and will be formally announced to the membership at the Ordinary General Meeting on 22 September and in the following newsletter.

Date for your Diary

8-9 November 2016

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For further information, please contact carmel.king@uk.gt.com

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Brexit:

The UK perspective

Chris Laughton asks what does it really mean for the UK and other EU Member States?

CHRIS LAUGHTON
Partner, Mercer & Hole,
London (UK)

"THE UK ELECTORATE HAS EXPRESSED ITS VIEW AND THE UK GOVERNMENT HAS SAID THAT IT WILL HONOUR THE RESULT"

What really is Brexit – and what is its impact on European cross-border insolvency proceedings? These are easy and obvious questions to ask, but neither answer is straightforward.

To declare my interests, I voted to remain in the EU and I was disappointed by the referendum result, but I believe that businesses and people in the UK and the EU should look to their own interests and the common interests they identify, pursuing their goals in the context of a constantly changing political environment. Brexit is unlikely to be the most important issue any one of us will face over the next three years.

What happened on 23 June 2016?

The UK[1] conducted a referendum on whether to leave the EU or to remain a member of it. The referendum was not itself legally binding, but the UK government, both before and after voting took place, made clear that it would honour the result.

37% of the electorate voted leave, 35% voted remain and 28% did not vote[2].

The UK electorate has therefore expressed its view and the UK government has said that it will honour the result. But that is not the same as the UK, as an EU Member State, having decided to leave the EU. It has not. For the time being the UK remains a full member of the EU, and European law applies in the UK exactly as it did before the referendum.

So what happens next?

The UK government has said that it will honour the referendum result, but what does that statement mean and when will steps be taken? As with any political statement, it will be interpreted in the future in the light of the then current situation and with the benefit of hindsight. Perhaps the best way to view it is in the context of what Brexit means.

"Brexit means Brexit"
Theresa May,
UK Prime Minister

Brexit might be absolute, with the UK not participating in the EU's freedom of movement of goods, services, capital or people, or indeed in anything else to do with the EU except as a non-EU country. Or it might be some form of "Brexit-lite", such as the so-called Norway model. Or it might, for a variety of reasons, be a "non-Brexit" where something akin to the status quo prevails.

The real problem is that no-one yet knows what Brexit actually means. The UK government had no plan for leaving the EU at the time of the referendum. It was, after all, government policy to remain in the EU. It is now working on that plan and on the development of whatever relationships the UK might establish with the EU and other countries as a result of leaving the EU. Indeed, three Cabinet Ministers[3] are tasked with a variety of pertinent foreign policy briefs (*see box*). The "Three Brexiteers" (all were prominent in the Leave campaign) are nevertheless led firmly by the Prime Minister, who was a moderate Remainer.

How long all this planning and relationship development might take is an interesting question. A variety of EU diplomats and UK politicians are favouring late 2017 as the earliest the UK might be ready to give formal notice of its leaving the EU, with some suggesting 2018. There are several elections that might have a bearing on that timing, from a number of Member State elections in 2017 to the European parliament elections in 2019 and the next scheduled general election in the UK in 2020.

What is the Brexit process?

The mechanism for the UK (or any other Member State) to leave the EU is set out in Article 50 of the Treaty on European Union (The Lisbon Treaty).[4] There is no alternative mechanism for leaving, such as negotiating a separate treaty. Significantly, it is for a Member State to decide to withdraw **in accordance with its own constitutional requirements** (emphasis added). It is not for the EU to trigger that mechanism. Many believe it is not even a matter for the UK government, but for both Houses of Parliament.

Even if the EU were to seek to trigger Article 50 in the case of the UK (on the grounds some commentators have put forward that a Member State that decides to withdraw is obliged to notify the European Council of its decision) it would have to wait until the UK, as a Member State, had made that decision – which, as discussed above, it has not yet done.

A key feature of the mechanism is that absent any other agreement with the European Council (which would have to be unanimous to extend the time), the EU treaties will cease to apply two years from the UK notifying its intention to withdraw. That date of notification is unlikely to be before late 2017 (as discussed above). The effective date of Brexit is therefore unlikely to be before late 2019.

That means it will be at least three years before there is any legal change to the UK's relationship with the EU.

What will be the impact of Brexit on cross-border insolvency proceedings between the UK and EU Member States?

As I feel the need to repeat, there is no change yet. The principal legislation to consider includes the European Insolvency Regulation ("EIR")[5] and the credit institutions and insurers reorganisation and winding-up directives.[6] Until the UK ceases to be an EU Member State, the EIR (and all other EU Regulations, such as the Judgment Regulation and the Rome I Regulation)

> **THE UK GOVERNMENT HAS SAID THAT IT WILL HONOUR THE REFERENDUM RESULT, BUT WHAT DOES THAT STATEMENT MEAN?**

The brief of the Foreign Secretary includes:

- foreign policy.

The brief of the Secretary of State for Exiting the European Union includes:

- the policy work to support the UK's negotiations to leave the European Union and to establish the future relationship between the EU and the UK;
- working very closely with the UK's devolved administrations, Parliament, and a wide range of other interested parties on what the approach to those negotiations should be;
- conducting the negotiations in support of the Prime Minister including supporting bilateral discussions on EU exit with other European countries; and
- leading and co-ordinating cross-government work to seize the opportunities and ensure a smooth process of exit on the best possible terms.

The brief of the International Trade Secretary includes:

- developing, co-ordinating and delivering a new trade and investment policy to promote UK business across the globe;
- developing and negotiating free trade agreements and market access deals with non-EU countries; and
- negotiating plurilateral trade deals (focused on specific sectors or products).

"

THE BULK OF THE RECAST REGULATION WILL APPLY IN THE UK AS IN THE REST OF THE EU (EXCEPT DENMARK) FROM 26 JUNE 2017

"

continue to apply and UK domestic law must continue to align with the directives. Indeed, any new Regulation enacted by the EU will apply to the UK while it remains a Member State, and any existing Regulation not yet in force – such as the Recast Insolvency Regulation ("Recast Regulation")[7] – will come into force in the UK if it is a Member State on the relevant date.

Accordingly, the bulk of the Recast Regulation will apply in the UK as in the rest of the EU (except Denmark) from 26 June 2017. Similarly, the UK and those other Member States will have to have a searchable electronic register of insolvency proceedings in place by 26 June 2018. Whether the UK's electronic register might be connected to those in the rest of the EU by 26 June 2019 seems likely to depend on the timing of Brexit.

What will happen to UK-EU cross-border insolvency proceedings after Brexit is much less clear. An effective cross-border insolvency regime is key to the encouragement of international trade and investment. This is a well-rehearsed argument, similar to that which stimulated the European insolvency harmonisation initiative as part of the drive for Capital Markets Union. European recognition of the UK's post-Brexit insolvency regime and, formally, of the judgments made under it (including the opening of insolvency proceedings) will be a critical consideration as the new regime is put in place.

If the UK sought unilaterally to implement European cross-border insolvency legislation as part of UK domestic law after Brexit, there would, without more, be a significant imbalance due to the reciprocity between Member States inherent in that legislation. In such an implementation, the UK would voluntarily recognise other Member States under the conflicts of law and jurisdiction and the recognition and enforcement of judgments provisions of the EIR and related legislation, but the rest of the EU would not recognise the UK in

those respects.

At the opposite end of the spectrum, if the UK took no steps to replace any of the European cross-border legislation and chose to repeal the domestic regulations made under the various directives, there would again be significant imbalance. Recognition of EU insolvency proceedings within the UK would be facilitated by the Cross-Border Insolvency Regulations 2006 (the UK implementation of the UNCITRAL Model Law), which do not require reciprocal arrangements with the applicant's country. Additionally, for Irish proceedings s426 Insolvency Act 1986 would enable the UK courts to provide assistance. However, beyond general notions of judicial comity and EU Member States' domestic provisions, there would be nothing to facilitate recognition in the EU of UK insolvency proceedings except in Greece, Poland, Romania and Slovenia, which have their own implementations of the Model Law.

The range of solutions – short of a non-Brexit – to address these imbalances varies from the EU agreeing to include the UK within its cross-border insolvency legislation despite it being a non-EU country, to the UK seeking bilateral agreements with EU Member States. Any such arrangement will require significant negotiation. It might therefore appear that the UK's attractiveness as a restructuring centre of activity will be diminished, but such a conclusion would underestimate the resourcefulness of the UK restructuring and insolvency profession.

Schemes of Arrangement

This non-insolvency tool, which can be used for insolvent restructuring, is often regarded by non-UK European commentators with some suspicion (at the same time as being respected by US investors and professionals). After Brexit, as the Judgment

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Regulation and the Rome I Regulation (on the law applicable to contractual obligations) fall away in the UK, questions might arise about schemes' enforceability. The Lugano Convention or the Hague Convention on Choice of Court Agreements could perhaps assist if the UK became a signatory. One should probably also reflect on the number of successful cross-border schemes that involve non-EU countries.

Harmonisation

No discussion of European insolvency law development would be complete without the context of the harmonisation project. As the UK is likely to be a Member State for at least the next three years, it will properly continue to play a full part in the harmonisation debate. The minimum standards directive foreshadowed by the European Commission's Inception Impact Assessment[8] issued on 3 March 2016 appears likely to cover a range of relatively uncontroversial areas where approximation of laws will be required. In this context, the perspective from an efficient and effective insolvency regime, not dissimilar to that in Ireland, will contribute significantly to ensuring that Europe's insolvency law development is fit for purpose on the global stage. ■

Footnotes:

1 The United Kingdom of Great Britain and Northern Ireland, which includes the countries of England, Scotland, Wales and Northern Ireland (and, for EU purposes only, Gibraltar, a British Overseas Territory) but not, for the avoidance of doubt, the British Crown Dependencies of the Channel Islands and the Isle of Man although these have subsidiary relationships with the EU. The UK therefore includes, for EU purposes, four separate legal jurisdictions: England and Wales, Scotland, Northern Ireland and Gibraltar. Whilst the insolvency laws of these four jurisdictions are to an extent similar, they also exhibit some significant differences.

2 The regions where the majority of those who voted sought to remain are London, Scotland, Northern Ireland and Gibraltar.

3 Her Majesty's Principal Secretary of State for Foreign and Commonwealth Affairs, The Rt Hon Boris Johnson MP, has overall responsibility for the work of the Foreign & Commonwealth Office. Her Majesty's Principal Secretary of State for Exiting the European Union, The Rt Hon David Davis MP, is responsible for the work of the Department for Exiting the European Union. Her Majesty's Principal Secretary of State for International Trade and President of the Board of Trade, The Rt Hon Liam Fox MP, is responsible for the work of the Department for International Trade.

4 Further analysis of Article 50 and its consequences may be found in the excellent analysis by INSOL Europe's Technical Officer, Emmanuelle Inacio, on pages 8 & 9 of the Summer 2016 issue of Eurofenix.

5 Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings

6 Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions and Directive 2001/17/EC of the European Parliament and of the Council of 19 March 2001 on the reorganisation and winding-up of insurance undertakings

7 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast)

8 DG JUST (A1), 2016/JUST/025 – Insolvency II

> **AS THE UK IS LIKELY TO BE A MEMBER STATE FOR AT LEAST THE NEXT THREE YEARS, IT WILL PROPERLY CONTINUE TO PLAY A FULL PART IN THE HARMONISATION DEBATE**

New concept in the recast European Insolvency Regulation:

The coordinating insolvency office holder

BERNARD BAUJET
Président, Conseil National des administrateurs judiciaires et des mandataires judiciaires (CNAJMJ)

Share your views!

The recast EIR (2015/848) offers practitioners new tools in answer to their expectations. The collective coordination proceedings which appoint a coordinating insolvency office holder ('the coordinator') is a good example of how can be treated the insolvency of groups of companies.[1]

Before studying of the status of the coordinator, who becomes the real 'conductor' of this new type of proceedings, let us see what the legal context which led to its creation is like.[2]

The EIR n°1346/2000 did not include a rule concerning the insolvency of groups of companies or an obligation of cooperation between the office holders appointed for each member of the group of companies.[3] Though in practice there was a tendency to fill these loopholes by placing all the legal actions dealing with the foreign subsidiaries under the jurisdiction of the country where the mother-company was situated, this "*possibility of consolidated proceedings*"[4] was limited by the European Union's Court of Justice. The Luxembourg court has indeed tried to strengthen the rule of the registered office,[5] thus obliging the courts to minutely motivate the fact that the proceedings were placed together, based on the COMI of the entire group.

The absence of rules adapted to the bankruptcy of a group of companies reduced indeed the usefulness of the EIR n° 1346/2000, thus limiting the possibility of a global solution in a recent case, *Fagor-Brandt*[6].

The authors of the recast EIR took care to integrate these critical views, so that the EIR n° 848/2015 includes now a chapter V, concerning the members of a group of companies. This chapter is divided in two parts, one of which being dedicated to the new coordination proceedings[7] conducted by a new actor, the "coordinator".

In order to better understand the legal status of the coordinator, one must first see the framework of his intervention (I), then the means he has at his disposal in order to work (II).

The framework of the coordinator's intervention

The EIR 2015/848 proposes a number of measures which allow for the treatment of insolvencies related to groups of companies encountering difficulties.[8]

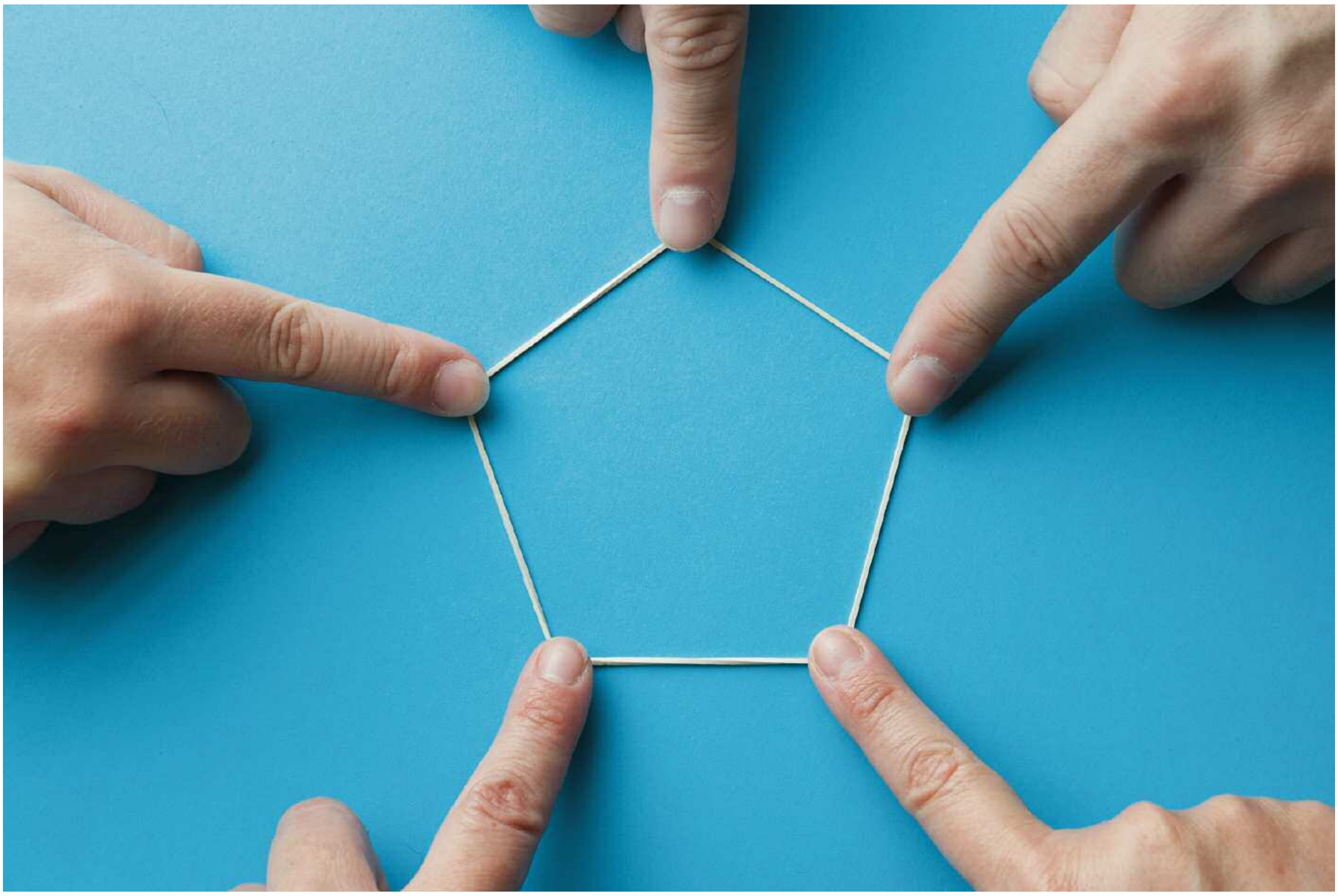
The group coordination proceedings will be mostly reserved to groups of companies which are not completely integrated and whose treatment in case of difficulties cannot be ensured by a number of main proceedings opened at the court of the State where the mother-company is situated.[9]

The intervention of the coordinator supposes that one or more of the subsidiaries which are situated in other States than the one of the mother-company are the objects of main proceedings. Such a situation can justify the opening of group coordination proceedings at the demand of an insolvency practitioner appointed in proceedings opened in relation to a member of a group of companies.[10]

The identity of the coordinator proposed by the insolvency practitioner in the request[11] could be contested by another insolvency practitioner appointed in respect of any group member[12], the last one being able to propose another coordinator if the jurisdiction seized allows it[13].

In the absence of an objection concerning the person proposed as coordinator, the group coordination proceedings are opened and the coordinator is appointed[14]. The EIR 2015/848 also describes the means of revoking the appointment of the coordinator[15].

The Regulation indicates the conditions which this person should fulfil, first of all that of being eligible under the law of a



Member State to act as insolvency practitioner. Article 71 adds that this person shall not be one of the insolvency practitioners appointed to act in respect of any of the group members and shall have no conflict of interest in respect of the group members, their creditors and the insolvency practitioners appointed in respect of any of the group members.

The cost of the group coordination proceedings, especially the coordinator's remuneration, is strictly defined by the recast Regulation. It is clearly stated that the coordinator's remuneration should be *adequate, proportional to the tasks fulfilled and reflect reasonable expenses*[16]. In all, no less than four articles are dealing with the costs and the coordinator's remuneration from the moment of filing for the opening of proceedings to the final court order, but also in the case costs increase during the coordinator's mission till the final statement of costs[17].

The means the coordinator disposes of

Within this new cooperation framework for the entire European Union, barriers between proceedings concerning subsidiaries located in different Member States will no longer exist[18].

Better still, the existence of a coordinator will solve the absence of ranking of the different main proceedings. The coordinator will mainly rely on the means described in Article 72 of the Regulation.

The coordinator can define and establish recommendations for the way the proceedings must unfold. He or she can propose a group coordination plan in view of adopting the same kind of approach for the resolution of the difficulties of all the members of the group.

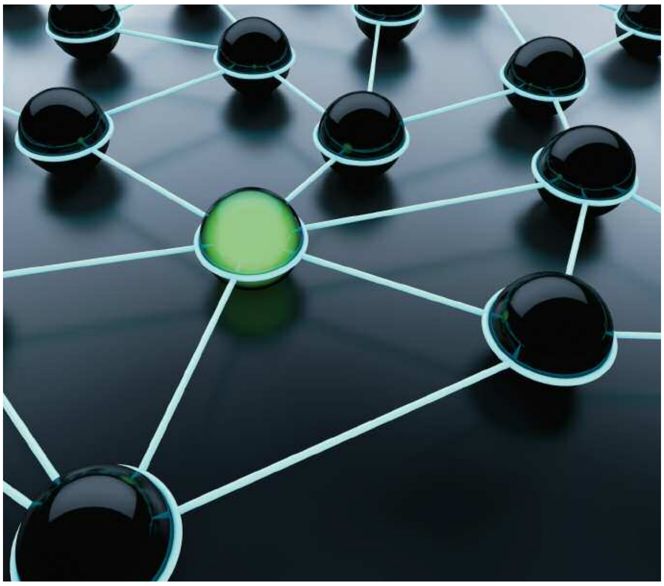
The application of the plan and its improvement on the way will be allowed thanks to the fluidity of his or her intervention in each of the main proceedings[19]. The Regulation gives the coordinator the right to request a stay, for maximum six months, of the proceedings opened in respect of any member of the group of companies, especially if such a stay is necessary for the proper implementation of the plan[20].

However, the coordinator's means of action are limited regarding their mandatory force and their extent.

That is, though the Regulation provides that the insolvency practitioner in the insolvency proceedings in respect of a member of the group of companies is supposed to conduct his or her action by considering the recommendations of the coordinator and the contents of the group coordination plan

> **THE ABSENCE OF RULES ADAPTED TO THE BANKRUPTCY OF A GROUP OF COMPANIES REDUCED INDEED THE USEFULNESS OF THE EIR**

> **THE DECISION TO BE INCLUDED IN GROUP COORDINATION PROCEEDINGS BELONGS TO THE INSOLVENCY PRACTITIONER APPOINTED IN PROCEEDINGS**



devised, this principle is somewhat moderated by the idea that the insolvency practitioners shall not be obliged to follow in whole or in part the recommendations of the coordinator and of the group coordination plan[21]. Thus the recommendations of the coordinator and the plan fixed by him or her are not mandatory for the insolvency practitioners in charge of the main proceedings included in the group coordination proceedings.

The group coordination proceedings' extent is a determining factor because it also fixes the extent of the coordinator's powers. On reading Article 72.4 of the recast EIR, one is aware that the coordinator's tasks and rights do not influence in any way the situation of any member of the group not participating in group coordination proceedings.

As a consequence, the means of action the coordinator disposes of are also limited by the group coordination proceedings and their extent.

In fact, the decision to be included in group coordination proceedings belongs to the insolvency practitioner appointed in proceedings opened in respect of a member of the group, and not to the coordinator of the group coordination proceedings[22].

Nevertheless, even with these moderating provisions, which cannot be ignored[23], the elaboration of a global solution for solving the difficulties of a European group of companies by the creation of the concept of a coordinator remains a reason for joy. ■

Footnotes:

1 The group coordination proceedings are also an answer to the need to reinforce cooperation between insolvency practitioners, to obtain a better coordination of the proceedings and, in a certain way, to consecrate *soft law*.
2 The new EIR 2015/848, Art. 92 will be in force starting from 26 June 2017.
3 The duty of cooperation and information already existing concerned only the main and secondary proceedings (EIR n°1346/2000, Art. 31)
4 Report of the European Parliamentary Commission to the European Council and the European Economic and Social Committee concerning the application of the EIR n° 1436/2000, page 16, 29 May 2000.
5 EUCJ, 2 May 2006, concerning the case C-341/04 (Eurofood) ; EUCJ, 20 Oct. 2011, case C-396/09 (Interedil)
6 On the difficulties encountered by the French trustee see the article *"Inside the Fagor-Brandt case or How to deal with the absence of the notion of 'group of companies' in the European Union"* by S. Trevino, T. Leonard and A.-S. Noury, in Joly Entreprise, 77, 2015.
7 Section 2 of the Chapter V – "Coordination" (Recast EIR, Art. 61-77)
8 H. Bourbouloux and A. Loste : « Towards the improvement of the treatment of the insolvency of groups of companies » in the Collective Proceedings Review 2015, File 8.
9 See above, concerning the difficulties of achieving this improvement because of the very strict case law emanating from the EUCJ regarding registered offices.
10 In order to open group coordination proceedings it will especially be necessary that the Court seized be sure that such proceedings would facilitate the effective administration of the insolvency proceedings relating to the different group members and that no creditor of any group member would be financially disadvantaged by the inclusion of that member in such proceedings. (Recast EIR, Art. 63).
11 Recast EIR, Art. 61, 3 a).
12 Recast EIR, Art. 64, 1 b). The objections must be addressed to the court chosen within 30 days from the reception of the application for the commencement of the collective-coordination proceedings by the office holder.
13 Recast EIR, art. 67.
14 Recast EIR, Art. 68, 1 a).
15 Recast EIR, Art. 75 : *"The court shall revoke the appointment of the of its own motion or at the request of the insolvency practitioner of a participating group member where:*
(a) the coordinator acts to the detriment of the creditors of a participating group member; or
(b) the coordinator fails to comply with his or her obligations under this Chapter."
16 Recast EIR, Art. 77. Also see recast EIR, consideration 58: *"The advantages of group coordination proceedings should not be outweighed by the costs of those proceedings. Therefore, it is necessary to ensure that the costs of the coordination, and the share of those costs that each group member will bear, are adequate, proportionate and reasonable, and are determined in accordance with the national law of the Member State in which group coordination proceedings have been opened. The insolvency practitioners involved should also have the possibility of controlling those costs from an early stage of the proceedings. Where the national law so requires, controlling costs from an early stage of proceedings could involve the insolvency practitioner seeking the approval of a court or creditors' committee."*
17 Recast EIR, Art. 61; 68; 72.6; 77.
18 See, concerning the groups of companies especially, recast EIR, Art. 56; 57; 58. Also *see consideration 52: "Where insolvency proceedings have been opened for several companies of the same group, there should be proper cooperation between the actors involved in those proceedings. The various insolvency practitioners and the courts involved should therefore be under a similar obligation to cooperate and communicate with each other as those involved in main and secondary insolvency proceedings relating to the same debtor. Cooperation between the insolvency practitioners should not run counter to the interests of the creditors in each of the proceedings, and such cooperation should be aimed at finding a solution that would leverage synergies across the group."*
19 Recast EIR, Art. 72.2 : *"The coordinator may also:*
(a) be heard and participate, in particular by attending creditors' meetings, in any of the proceedings opened in respect of any member of the group;
(b) mediate any dispute arising between two or more insolvency practitioners of group members;
(c) present and explain his or her group coordination plan to the persons or bodies that he or she is to report to under his or her national law;
(d) request information from any insolvency practitioner in respect of any member of the group where that information is or might be of use when identifying and outlining strategies and measures in order to coordinate the proceedings;"
20 Recast REI, Art. 72.2 e)
21 Recast EIR, Art. 70.2
22 Recast EIR, Art. 69.
23 Note the remarks of Sergio Trevino, president of the Brandt Group: *"The ideas proposed by the recast Regulation are very interesting (…). However, one is forced to notice that these innovations wouldn't be enough: the principles of cooperation and coordination are not utterly imposed and can be easily fail because of the rules that apply to main proceedings"* in the article "Inside the Fagor-Brandt case or How to deal with the absence of the notion of 'group of companies' in the European Union" by S. Trevino, T. Leonard and A.-S. Noury, in Joly Entreprise, 77, 2015.

RICHARD TURTON AWARD, 2016

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 Congress and have a technical paper published.

In recognition of those aspects in which Richard had a special interest, the award for 2016 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 are actively studying insolvency law & practice;
- 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.

Applicants 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 – IPA. The committee received outstanding applications for this year's award and it was a very close run decision. 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 Dr. Róbert Muzsalyi from Hungary. Róbert works as a judicial clerk in the Supreme Court of Hungary. He is currently studying for his PhD his research topic: The Impact of EU Law on Hungarian Procedural Law at the Doctoral School of Law and Political Sciences at Pázmány Péter Catholic University, Budapest, Hungary. This is the first time that we have had a winner from Hungary. Previous winners have come from Uganda, Belarus, India, Latvia, Lithuania, Poland, PRC, Romania, Russia and Serbia.

As part of the award, Róbert is invited to attend the INSOL Europe Congress on the 22-25 September 2016, which is being held in Lisbon, Portugal. He will be writing a paper on "Directors' liability: what should be the minimum harmonisation in the EU", that will be published in summary in one or more of the Member Associations' journals and in full on their website. We would like to congratulate Róbert for his excellent application and would also thank all the candidates who applied for the award this year.

Sponsored by:

Major changes to Turkey's bankruptcy postponement regime

Orçun Çetinkaya and Burak Baydar explain the changes

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Turkey's bankruptcy postponement mechanism has been regularly criticised for failing to fulfil its intended goals.

Bad-faith debtors would regularly exploit the legislative arrangements and court processes, using them to threaten or bargain with their creditors by depriving them of enforcement and execution avenues for a significant and uncertain amount of time. However, drastic legislative amendments enacted in August 2016 appear to go a significant way towards evening up the balance between creditors and debtors in this area.

The Turkish bankruptcy postponement regime

Companies which have debts exceeding their assets can request the commercial court postpone their bankruptcy[1] (Article 179[2] of Turkish Execution and Enforcement Code). The requesting company must submit a recovery project report, which outlines how and when the company will recover from insolvency. However, Article 179 previously did not specify required content for the recovery project, nor which accounting data or criteria the report should use to evaluate the chances of recovering from insolvency.[3] Rather, bankruptcy postponement would simply be granted if the court found the report to be compelling and serious.[4]

In practice, the prior legislative mechanism would allow applicants with very low chances of financial recovery to postpone their bankruptcy by providing a recovery report based on questionable accounting principles, outlining mythical routes for the company's financial recovery.

When agreeing to postpone bankruptcy, courts are empowered to take any precautions necessary to protect the applicant's assets (Article 178(a) of the Turkish Execution and Enforcement Code) and can issue almost unlimited types of injunctive orders to protect the applicant from creditors. In practice, applicants would take advantage of this and file injunction requests in conjunction with their bankruptcy postponement requests.[5] In this way, applicants commonly request the court halt all ongoing execution proceedings against the applicant, as well as seek to prevent any further execution proceedings being initiated. Thus, the legislative framework would allow an insolvent applicant to become protected from its creditors during the litigation process, including public creditors.

If the court finds the recovery report compelling, it can postpone the bankruptcy for one year. The court also appoints a trustee to the applicant, to replace the board of directors, or to approve the board of directors' decisions. Based on reports given by the trustee, the court could previously extend the postponement period for up to four further years. Another practical factor to consider is that the judicial procedure generally takes around two years in itself, before the court will give a postponement decision.

Therefore, the reality of the legislative regime was that a company in serious financial difficulties could halt creditors' execution proceedings for up to seven years:

- Two years for the judicial processes;
- One year postponement (initial court decision); and
- Four years of extension (based on trustee reports).

Between 2009 and 2014, 3,524 companies applied to postpone bankruptcy in Turkey.[6] However, from the applicants which were ultimately granted a postponement, only 2% were subsequently able to recover from insolvency. The remaining 98% of postponement recipients were ultimately declared bankrupt, despite the court's postponement decision.

Accordingly, it is beyond doubt that the Turkish bankruptcy postponement route was failing to fulfil its intended goal and was vulnerable to abuse. It had become a serious obstacle for banks and other creditors, preventing proper maintenance of commercial activities.

Amendments to the bankruptcy postponement regime

In June 2016, Turkey's Ministry of Finance and the Ministry of Justice put forward draft legislation to reform this area. The draft legislation introduced drastic amendments, seeking to turn the system into a tool which equally addresses both creditors' and debtors' interests. The draft legislation passed parliament on

15 July 2016 and was enacted on 9 August 2016, with approval from the president.

Key amendments under the new legislative mechanism include:

- *Specific document and data requirements:* Under the amendments, legislation now specifies the exact documents and data which companies must submit when applying to postpone bankruptcy. The aim is to eliminate the discretionary power currently held by experts who prepare recovery reports. If the applicant fails to submit the required information within a two-week grace period, the applicant will be immediately declared bankrupt. Accordingly, applicants are now required to submit a list showing:
  - Payment terms and amounts of due debts.
  - Creditors' addresses.
  - Stocks.
  - Waiting periods and amounts.
  - The last balance sheets submitted to tax authorities.
  - Income table.
  - Trade registry certificates.[7]
- *Meeting management expenses and working capital during postponement period:* Under the amendments, the recovery project report must now demonstrate how management expenses and working capital will be met during the postponement period. The demonstration should include tangible sources and precautions, including, but not limited to, adding new funds.[8] The intention is to increase transparency and eliminate bad-faith applications.
- *Codified opportunity for creditors to object to postponement:* Under the amendments, creditors now receive the legislative basis for objecting to bankruptcy postponement, within two weeks of its announcement in the trade registry.[9] Creditors receive two weeks to object (request the application be rejected) on the sole ground that the applicant does not meet the statutory conditions for bankruptcy postponement. A similar mechanism already existed, but courts would apply this inconsistently and only by analogy with other provisions. The amendment codifies the topic and eliminates uncertainties in prior practice.
- *Single revision to recovery report:* Under the amendments, applicants are now only permitted to submit a revised recovery project once during proceedings.[10] The intention is to limit the practice of making bad-faith or non-essential revisions to these reports, in order to extend proceedings.

> **THE PRIOR LEGISLATIVE MECHANISM WOULD ALLOW APPLICANTS WITH VERY LOW CHANCES OF FINANCIAL RECOVERY TO POSTPONE THEIR BANKRUPTCY**

> **A FOUR YEAR EXTENSION TERM HAS PROVED TO BE NOTHING BUT A TOOL TO THREATEN CREDITORS**

- *Postponement period reduced from four years to one year:* Under the amendments, extensions to the postponement period are reduced from four years to one year.[11] Four year extension periods have proved to be statistically unlikely to help applicants recover from insolvency.

- *Postponement not available within one year of prior bankruptcy postponements:* Under the amendments, applicants which have already benefited from a bankruptcy postponement cannot apply for a further postponement within one year of the earlier postponement period ending (including extension periods).

- *Requirements and workload limitations for trustees:* The amendments introduce detailed regulations for trustees. Clear and detailed trustee duties are intended to eliminate uncertainties which arise in current practice. Notable aspects include:
  - The court can now appoint multiple trustees if it believes a single trustee will not be capable to handle all necessary duties.
  - A single trustee is limited to appointment to three companies. Under prior practices, a trustee could be appointed to 50 or 60 companies, making it impossible to reasonably evaluate and control the recovery process for all companies.
  - Courts can now terminate a trustee and appoint new trustees, if necessary.
  - Trustees must now submit a quarterly evaluation report to the court about whether the applicant shows improvements.[12]

- *The fate of injunctions are clearly determined if the postponement decision is later quashed:* Under the amendments, if the Supreme Court reverses the previous court's decision to postpone bankruptcy, measures applied to the debtor's assets are not directly lifted.[13] If the Supreme Court makes such a ruling, it was previously unclear whether injunctions granted by the lower court should remain intact, or be deemed to be quashed along with the court's award.

Will the amendments successfully balance creditors' and debtors' interests?

The legislative amendments are undoubtedly drastic, but outline necessary and overdue changes to Turkey's bankruptcy protection legislation.

Limitation of the postponement extension period is long overdue. A four year extension term has proved to be nothing but a tool to threaten creditors and has statistically proven to have negligible positive effect on an insolvent company's recovery.

It should be borne in mind that bankruptcy postponement, by its nature, is not a debt restructuring institution. Rather, it aims to get the applicant back on its feet and support insolvent companies to continue business. Therefore, the first step in a postponement application should be to determine whether the applicant will be in better shape in one or two years.

The amendments require postponement applicants to submit the same balance sheet which they submitted to the tax authority. Previously, insolvent applicants would submit different balance sheets to different institutions, whilst still complying with financial regulations.

The amendments will undoubtedly have an impact on reducing bad-faith applications. However, related tax regulations continue to allow bad-faith applicants to prepare and submit balance sheets to the tax authorities which do not reflect the real situation. Therefore, despite the amendment, misleading documents can still become admitted during bankruptcy postponement.

Therefore, although the amendments specify the documents and data to be submitted during postponement applications, this measure will likely be insufficient on its own to completely prevent bad-faith applications. Related financial regulations must also be strictly reorganised in parallel, to introduce sanctions for preparing different balance sheets with regard to the same time period. ■

Footnotes:

1 Supreme Court 19th Civil Chamber Decision dated 20.03.2008 (E. 2008/9249) – "*It is stated in the expert report that the assets of the Company are enough to cover its debts. Granting bankruptcy in such a case is against the law and the procedures. The first instance court should have rejected the requests of the claimant*"

2 Article 179. – If and when it is declared by the management and representative bodies or if the company or the cooperative society is in liquidation, by its liquidators or a creditor, or it is determined by the competent court that the liabilities of the capital company or the cooperative society are more than its assets, the capital company or the cooperative society will be adjudged bankrupt without a prior bankruptcy proceeding. Provided, however, that any one of the management and representative bodies or the creditors may demand adjournment of adjudication of bankruptcy by filing to the court a project of recovery proving that the company or the cooperative society may be recovered. If the project of recovery is found serious and persuasive, the court will adjourn adjudication of bankruptcy. Information and documents proving that the project of recovery is serious and persuasive must also be presented to the court. The court may, if deemed necessary, hear the management and representative bodies and the creditors. Demands for adjournment of adjudication of bankruptcy will be tried with priority and as a matter of urgency.

3 Supreme Court 19th Civil Chamber Decision dated 13.06.2002 (E. 2002/1267) – "*The Court shall decide on postponement in the event that it is convinced the measures to be taken are enough for the Company to recover. The Court may request a report from an expert team in order to decide whether or not the measures to be taken are sufficient.*"

4 Supreme Court 19th Civil Chamber Decision dated 25.11.2010 (E. 2009/9027) – "*In the event that the recovery report has been found compelling and serious, the Court shall grant postponement to the Company. Compellingness and seriousness of the recovery report shall be determined on solid facts.*"

5 Supreme Court 23rd Civil Chamber Decision dated 06.05.2013 (E. 2013/3126) – "*In bankruptcy postponement cases the courts are empowered to take any precautions necessary to protect the applicant's assets if they find the reasons presented for it by the claimant compelling. When deciding for the measures, the Court should protect benefits of the creditors as well as the Company. However the Court should not eliminate legal ways enabling creditors to claim their receivables.*"

6 According to main opposition party report dated 22 June 2016 submitted to parliament. *See http://www2.tbmm.gov.tr/d26/2/2-1267.pdf (only available in Turkish)*

7 Article 179/3 of Enforcement and Bankruptcy Law numbered 2004

8 Article 179/2 of Enforcement and Bankruptcy Law numbered 2004

9 Article 179/a-2 of Enforcement and Bankruptcy Law numbered 2004

10 Article 179/a-8 of Enforcement and Bankruptcy Law numbered 2004

11 Article 179/b-4 of Enforcement and Bankruptcy Law numbered 2004

12 Article 179/b-6 of Enforcement and Bankruptcy Law numbered 2004

13 Article 179/c-2 of Enforcement and Bankruptcy Law numbered 2004

"BANKRUPTCY POSTPONEMENT, BY ITS NATURE, IS NOT A DEBT RESTRUCTURING INSTITUTION"

Benchmarking insolvency practice frameworks

Paul Omar and David Burdette discuss the challenges that lie ahead

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DAVID BURDETTE
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> "THE FRAMEWORK FOR PRACTICE FOR IOHs IS IN A STATE OF SOME FLUX"

The state of insolvency office holder ("IOH") regulation worldwide is a matter of some concern to the international bodies active in the insolvency field.

The European Bank of Reconstruction and Development held a conference on 7 November 2014 to disseminate the findings of a two-year project into the IOH regulatory environment in its client group, of which 27 out of 35 were the subject of an assessment.[1] While the laws of many of these States have been the subject of scrutiny with a view to reform, this was apparently the first time that research had been undertaken into the structure of the IOH profession in these jurisdictions.

The most essential component of the project's findings was the great diversity in terms of status, qualification and training of insolvency practitioners, and the framework for their registration, supervision and discipline. Nonetheless, some indications of cross-jurisdictional trends in these countries was possible, a notable example being that where a self-regulatory model or state-sponsored regulatory agency was used, there was a strong correlation with performance overall across the criteria being measured. While most States had a licencing regime in place, less performing countries tended to include those where Government directly exercised supervision over the profession or no regulatory framework existed at all.

Overall, while minimum educational standards and professional entrance exams were often prescribed, the project revealed weak performance in areas such as continuing professional development and training needs. Similarly, lacunae also existed at the level of the development of professional associations and of ethical rules. In many places, however, even where regulatory regimes were sufficiently robust, issues with resources tended to restrict active supervision of IOHs to the context of individual proceedings with the effectiveness of such monitoring dependent on the courts' own supervisory capacity. The role of the courts in the conduct of proceedings was also identified as an issue, particularly in the balance of control and supervision between creditors and the courts. Over-monitoring was stated as potentially a problem where it inhibited IOHs in the performance of their duties.

Finally, the structure of the appointments system in cases, as well as remuneration, were felt to be insufficiently encouraging of competition in the market for IOH services.[2] In summary, the terms of the report revealed that there was much to do in relation to improving the environment and framework for practice in almost all of these States, which also include 11 Member States of the European Union.[3]

Some of the issues reflected in the EBRD assessment were pre-figured in work carried out by the professional associations, including INSOL Europe, which as representative of the European insolvency community, has a watching brief on behalf of their membership over matters connected with reforms to insolvency law and practice. Although written in the context of the then anticipated review of the European Insolvency Regulation, INSOL Europe's 2010 Report on the topic of harmonisation, presented to the European Parliament Committee on Legal Affairs, largely advocated consideration of substantive harmonisation in a number of areas of insolvency law. In dealing with insolvency practice qualifications, however, it concluded that the different systems, especially for remuneration, in the Member States surveyed did not cause any difficulties, obstacles or disadvantages for companies with a cross-border dimension operating in the European Union.

Harmonisation of this area was not deemed necessary pending greater harmonisation in the insolvency and company law fields.[4] Nonetheless, an issue of concern, which has since been reflected in work by the Leiden Law School commissioned by INSOL Europe, is that of a possible ethical code at European level for IOHs.[5]

By way of contrast, however, the European Parliament's Report in 2011, which also picked up the harmonisation theme for insolvency law, did consider it worthwhile to deal with insolvency practice qualifications, insofar as qualification and competence were concerned. Other issues to which reference was made included the desirability of good reputation, independence and the need to avoid conflicts of interests.[6]

A small jump from the European Parliament's position saw IOH regulation appearing as one of the sub-themes in a project on "Substantive

Insolvency Law and the Prospects for Greater EU Harmonisation", which was funded by the European Commission and carried out by the University of Leeds. In this project, which arose from the need to analyse Member State compliance with the 2014 Recommendation,[7] mention is made of the need potentially to re-examine the "caution" explicit in the 2010 INSOL Europe report.[8]

In fact, the IOH-related component of the study is also reflected in the scope of the recently formed European Commission Experts' Group on Restructuring and Insolvency, which began its work in January 2016, whose (ambitious) mission includes the development of, inter alia, common principles and rules in areas connected to insolvency, such as the qualifications of insolvency practitioners.[9]

It is on the basis of the interest shown by the various bodies above that the insolvency practitioner regulation project ("IP Project") has been conceived. It is an international collaborative project involving the Centre for Business and Insolvency Law at Nottingham Law School, as well as the Business Law Research Centre at Radboud University Nijmegen, the Centre for Advanced Corporate and Insolvency Law at the University of Pretoria and the Commercial and Property Law Research Centre at the Queensland University of Technology.

The project has received funding from INSOL International and some interest in the project is also shown by the World Bank. The intention behind this project is to conduct a global survey of some 40 countries in four regions around the world, including those from the emerging, developing and developed worlds, to ascertain trends in regulation under a number of practice-related headings, including selection and appointment, qualification, remuneration, liability, removal and replacement as well as supervision frameworks.

With the information collected, a series of reports will be produced dealing with regional trends as well as common developments across each category (emerging, developing and developed).[10] Ultimately, the intention is to make recommendations for minimum standards of regulation appropriate for jurisdictions at various stages of development and to feed them into the process by which such standards are developed. Already, a submission has been made to the European Commission Experts' Group on a high-level principles-based text that could form the groundwork for future developments in the European Member States.

Summary

In summary, the framework for practice for IOHs is in a state of some flux. While individual States may be making advances in regulation to deal with particular problems, there is as yet no overall sense of whether it is desirable to have closer convergence between regulatory models and practices. Hopefully, the number of studies, both practice- and academic-led, point the way to understanding the critical issues that will face those desiring to improve standards and the benchmarks for practice. ■

Footnotes:

1 A copy may be seen at: http://assessment.ebrd.com/insolvency-office-holders/2014/report.html.
2 Ibid., Executive Summary, at 7-9.
3 Out of 13 countries acceding between 2004-2013 (the exceptions being Malta and the Czech Republic). Of these, only Cyprus was not surveyed.
4 See INSOL Europe, *Harmonisation of Insolvency Law at EU Level* (April 2010), at 23.
5 The IOH Principles and Best Practices, available at: http://www.tri-leiden.eu/project/categories/ioh-project/.
6 *See K-H. Lehne (Rapporteur), Report with Recommendations to the Commission on Insolvency Proceedings in the context of EU Company Law* (Document A7-0355/2011) (17 October 2011), at 10.
7 Recommendation on a New European Approach to Business Failure and Insolvency (Document COM(2014) 1500 Final) (12 March 2014).
8 Interim Report 3 of the Study on Substantive Insolvency Law, at 58.
9 Call for Expressions of Interest in the Experts' Group (September 2015), at paragraph 3.
10 The initial findings of the reports will be presented at the INSOL International Sydney Conference (March 2017) with the regional findings being presented at appropriate events.

"THE PROJECT REVEALED WEAK PERFORMANCE IN AREAS SUCH AS CONTINUING PROFESSIONAL DEVELOPMENT AND TRAINING NEEDS"

Share your views!

Bankruptcy quarantine in Denmark

Jesper Trommer Volf and Thomas Heering sum up the legislation and some of the case law based on it

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On 1 January 2014, Denmark introduced a new law on bankruptcy quarantine. The legislation has now been in force for more than two years and the number of cases is surprisingly high. The article sums up the legislation and some of the case law based on it.

The new law was implemented due to political pressure from a number of Danish political organisations and authorities with a view to protecting both consumers and creditors from losses and to promoting fair competition between enterprises and the overall consumer trust in the system.

The legislation disqualifies an individual from doing business without personal liability "*…if it must be assumed that the person in question is unfit to participate in the management of commercial activities due to grossly irresponsible business conduct…*" (Section 157 of the Danish Bankruptcy Act).

As the disqualification is decided by the Bankruptcy Court based on a recommendation from the trustee of the bankruptcy estate (of the company in which the relevant person has been involved in the management) the ban is called bankruptcy quarantine (in Danish: Konkurskarantæne).

Grossly irresponsible business conduct

Grossly irresponsible business conduct is not defined in the legislation itself, but a number of examples of general, as well as specific, actions and failures to comply with certain rules are mentioned in a report from the Danish bankruptcy council which prepared the legislation. *Here are some examples:*

- Criminal offences;
- Failure to comply with tax law, including failure to file returns and pay VAT, tax and duties;
- Failure to comply with the book-keeping law;
- Shareholders loans;
- Lack of financial management; and
- Disposal of business assets at prices significantly below market value.

However, the legislation is not meant to disqualify individuals who are not able to run a business (cases of incompetence) or who have lost significant contracts or customers (and consequently go into bankruptcy).

In the assessment of (grossly irresponsible) business conduct, it must be taken into account whether the conduct has resulted in losses to the creditors. For instance, the Danish courts acquitted an individual in a case where the sum of the liabilities was of approximately €10,000 (including group liabilities of approximately €6,000).

It is not a requirement that a causal relation between the grossly irresponsible business conduct and the bankruptcy should exist.

The grossly irresponsible business conduct must have taken place within one year of the reference date (the date when the bankruptcy petition was filed with the bankruptcy court) or the date of the authorities' decision to compulsory wind up a company. The Supreme Court has, however, decided that negligence to correct past failures (more than one year before the reference date) may also be regarded as grossly irresponsible business conduct.

Who may be forced into bankruptcy quarantine

Individuals who have participated in the management of a business may be forced into bankruptcy quarantine (disqualified as managers). This means that not only individuals registered (by the authorities), but also individuals who *de facto* have been running a business (e.g. via a frontman) may be forced into bankruptcy quarantine. However, the latter is much more difficult to prove.

The bankruptcy quarantine (director disqualification)

The Bankruptcy Court can initiate a bankruptcy quarantine case based on a recommendation from the trustee of the bankrupt company (the bankruptcy estate), in which the individual was a former manager. Creditors in the bankruptcy estate may not initiate the procedure. It is, however, not uncommon that creditors are active in contributing relevant information and documentation to the trustee.

If the Bankruptcy Court initiates the procedure, the trustee of the bankruptcy estate must file a pleading with the Bankruptcy Court and the defendant may provide a defense. Based on the parties' pleadings, the Bankruptcy Court will make a decision, sometimes hearing submissions by the parties.

The quarantine (disqualification) is set at three years but may be for a shorter period if specific reasons support a reduction of the period.

Consequences of a bankruptcy quarantine

A bankruptcy quarantine is registered in a non-public register. Only the Bankruptcy Court and the Danish authorities have access to the register and the individual subject to it cannot take part in the management of a business without being liable (unlimited) for all liabilities of the business.

If the disqualified individual is imposed a new bankruptcy quarantine during the course of an existing bankruptcy quarantine, the new bankruptcy quarantine will ban the individual from being allowed to participate in the management of any business (irrespective of unlimited personal liability).

Bankruptcy quarantines in Denmark and the future

The Danish bankruptcy council expected approximately 150-250 bankruptcy quarantine cases per year in 2011, when the council released its report/ recommendation regarding the bankruptcy quarantine legislation. According to the annual office report from the Maritime and Commercial Court of Copenhagen, the Insolvency Division handled 460 cases in 2015. The Insolvency Division of the Maritime and Commercial Court of Copenhagen handles approximately one third of all the insolvency cases in Denmark.

Criticism has been levied at the time limit in the law, as a bankruptcy quarantine may only be imposed if the grossly irresponsible business behavior has been conducted one year before the reference date in the bankruptcy estate. This means that grossly irresponsible business conduct immediately prior to the time limit cannot lead to bankruptcy quarantine. A number of examples show that this relatively short timeframe may not be enough to meet the objectives of the law.

There have been examples of companies in which members of the management have deregistered themselves, presumably anticipating it taking more than a year for the authorities to initiate a compulsory winding-up of the company or for a creditor to file for bankruptcy. In those cases, the former actual management of the company cannot be subject to bankruptcy quarantine if the reference date is set more than a year after the deregistration. Sometimes an (unaware) front man or a person with an address in a foreign country is registered when the actual management is deregistered. By the next revision of the law we expect the politicians to consider an extension of the time limit.

Another point of criticism has been the fact that a bankruptcy quarantine bears close resemblance to a criminal penalty, on the one hand, and that the court procedure of the bankruptcy quarantine case follows the rules of civil law suits, on the other hand. Consequently, there have been concerns related to the defendant's legal rights.

The present case-law indicates that the Danish Bankruptcy Courts have led a hard line against former members of managements of bankrupt companies. Some of the appealed cases have, however, led to acquittals and, in our opinion, we might see a softening in the level of what is regarded as "grossly irresponsible business conduct". In our opinion, this falls in line with the objective of the legislation which was (only) to disqualify individuals guilty of gross negligence and intentional bad behavior. ■

> "A POINT OF CRITICISM HAS BEEN THE FACT THAT A BANKRUPTCY QUARANTINE BEARS CLOSE RESEMBLANCE TO A CRIMINAL PENALTY"

Fraudsters: How to detect and deal with them?

Eitan Erez advises on how to detect fraudsters proactively and how to deal with them when they have been exposed

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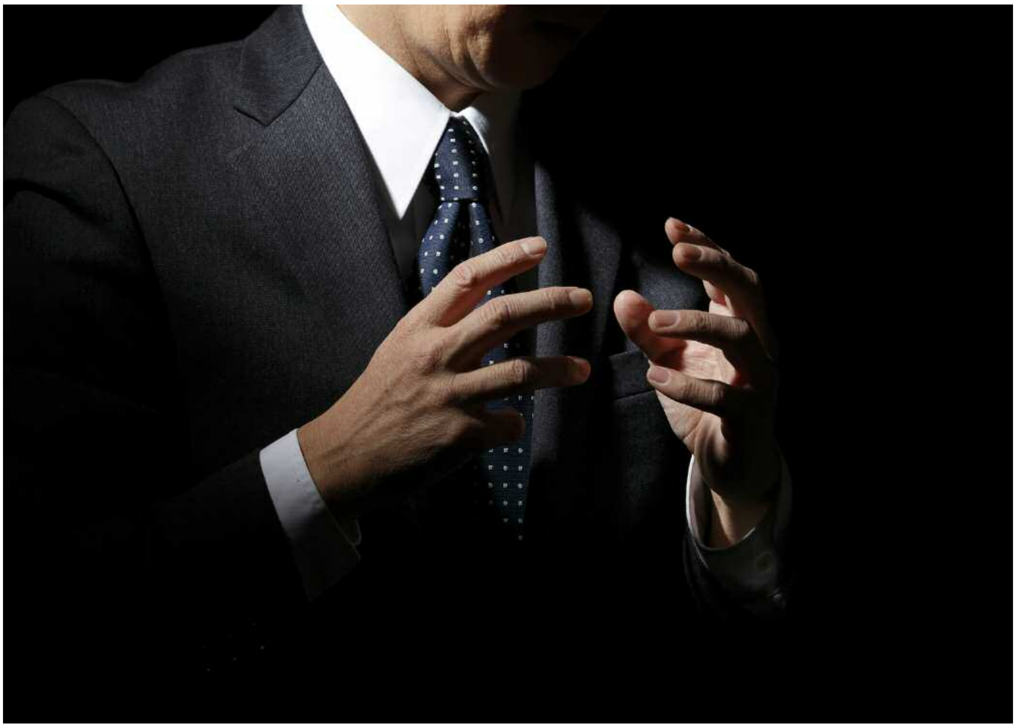

In recent years there has been an increase in frauds around the world. One need only mention the case of Bernard Madoff, who was sentenced to 150 years' imprisonment in the United States, and the "Carbon Scandal" in Europe (relating to CO_2 emission levels according to the Kyoto Protocol).

As insolvency practitioners, we have an interest in being able to detect fraudsters proactively and in dealing with them when they have been exposed.

In this context, it's good to be aware of several unique characteristics that are common to fraudsters, in order to identify them effectively and expeditiously.

In this article, I shall try to share some of my experience regarding practical tools to deal with fraudsters.

The State of Israel is no exception to the "tsunami of fraud" (as my colleague David Ingram defined it in *Eurofenix* in 2013), and it has special characteristics that unfortunately can make it a fertile ground for acts of fraud.

The Madoff and carbon scandals have some connection to Israel. In the Madoff scandal, $110 million found their way to Israel via a mysterious corporate entity and were distributed to some universities. In the carbon scandal, according to media reports, some of the suspects absconded to Israel and France has requested their extradition.

Cases of fraud are usually perpetrated in relatively rich countries where there are large movements of money, some of which is dirty money that people are trying to launder. Israel falls within this definition because of its great economic success in recent years, especially in the fields of hi-tech, smart industries and real estate.

Israel naturally acts as a country that absorbs Jews from all corners of the world as a result of the 'Law of Return,' which grants Israeli citizenship to all Jews who apply for it. In addition, the rapid growth in the population (currently 9,000,000 people, as compared with 600,000 in 1948), the enduring shortage of new apartments and a 'zero interest'

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environment create opportunities for acts of fraud.

When there is a large amount of money and no reason to invest it in banks and people are looking for high returns, a fertile breeding ground is created for all kinds of fraudsters.

In the last five years alone, dozens of fraud scandals have been revealed, some of which are described below.

What does the average fraudster look like and how can we identify him?

Naturally, a fraudster is always a sympathetic and friendly person. He will always greet you cheerfully, dress in impressive clothes, wear a luxury watch and drive around in a fancy new car. It also doesn't hurt to join a golf club.

Moreover, many fraudsters become in a very short timescale – of months, weeks or even days – over familiar and treat you like their best (or only) friend!

A 'good' fraudster is also careful to make charitable donations or at least to make sure people think he makes charitable donations. He likes to be seen at Gala openings of restaurants and clubs, and has a tendency to donate to soccer teams that he does not even support, or to buy a box at a soccer or basketball stadium, in order to appear successful.

The fraudster also likes to eat at expensive restaurants where people will see him and think that he is a successful businessman. By doing this, he creates for himself an image of success, so that naïve people think it is safe to leave their money with him.

Fraudsters are very fond of the use of off-shore companies and every 'respectable' fraudster must own a company in Panama, the British Virgin Islands or Anguilla.

When you examine a fraudster from close up and meet him face to face, there are a few more proven signs:

As long as the fraudster is interested in your money, he will be very interested in you and pay attention to you.

Once he has your money, he will vanish into thin air and it is very hard to reach him.

Over the years, *from my experience*, I have recognised several additional signs that indicate dishonesty. For example, shifty eyes, head scratching and a weak or sticky handshake, or a partial handshake that does not reach the wrist. This may sound amusing, but believe me, it works!

The methods used by fraudsters are becoming more and more sophisticated all the time, and in recent years many frauds have been perpetrated via the Internet or by faking emails or Facebook pages.

The legal tools for dealing with fraudsters

- The insolvency practitioner (IP) should be innovative, always take the offensive and act quickly.
- A good IP needs a good private detective.
- In relevant cases, he also needs the help of the police or should file complaints with the police.
- Another important tool is the filing of motions to rescind transactions at an undervalue.
- In this regard we should distinguish between transfers that are void and transfers that are fraudulent.
- Most jurisdictions distinguish between two kinds of transfers made by a debtor: a void transfer and a fraudulent transfer.
- Such motions are an effective tool in the trustee's search for assets that can be used to pay creditors.

Additional tools

The filing of** ex-parte **motions:

Israeli courts have clearly recognised the right of a trustee in bankruptcy to file classified motions.

Seizing mail with court approval (only applies to physical mail, not email):

Under Israeli law, this is possible.

This is an *ex-parte* motion that is filed with the court. By virtue of this remedy, any item of mail that is addressed to a debtor against whom a receivership order has been made will be referred for a period of no more than three months to the trustee. This remedy makes it possible to discover, for example, bank accounts concealed by the debtor. In one case I received by mail gold medals that one bankrupt individual ordered by mail for himself…

Carrying out covert investigations

In order to locate the debtor's assets, covert investigations may be required. A motion regarding these should be filed as an ex parte motion for court approval to carry out the investigation, stating the cost and purpose of the investigation, and it will be kept in the court safe.

A monthly payment order

Under Israeli law, it is possible to apply to the court to order a bankrupt debtor to make regular payments to the trustee. This is a particularly effective method of dealing with evasive debtors. If the trustee conducts investigations and accumulates sufficient evidence that the debtor is enjoying a high standard of living, significant payments will be

"THE INSOLVENCY PRACTITIONER SHOULD BE INNOVATIVE, ALWAYS TAKE THE OFFENSIVE AND ACT QUICKLY"

> **RECENTLY, THERE HAS BEEN A PRAISEWORTHY INCREASE IN THE FILING OF INDICTMENTS FOR ACTS OF FRAUD**

ordered. If the debtor does not pay the amount ordered, it is possible to petition the court to imprison him for contempt of court.

Imprisonment petitions for non-compliance with court orders

This type of motion is suitable for an ongoing order, when the bankrupt that is required to comply with the court order has breached it once before. After the first breach, the court can impose a fine or imprisonment pursuant to the Ordinance.

Criminal proceedings against fraudsters as a deterrent

It is important that the punishment fits the crime. After all, if a person steals $10,000,000 and sits in jail for only five years, it may be assumed that there are many people who will be happy to earn $2,000,000 a year net of tax, and this will merely increase the temptation to commit acts of fraud. Recently, there has been a praiseworthy increase in the filing of indictments for acts of fraud and also offenses committed in the course of bankruptcy in order to increase the deterrent.

Motions to recover fictitious profits in cases of Ponzi schemes (to sue the first persons who profited)

The debtor takes money from the first round of investors and promises them high yields. At this stage the debtor begins to buy luxury clothes, fancy cars, etc., in order to create an impression that his investments are profitable, and he recruits a second round of investors. The money of the second round of investors is used to pay the first round of investors the 'yield' on their investment. In practice, the first round of investors receive money that was stolen from the second round, and therefore the first round of investors should be sued to recover this money.

Motions against Income Tax to return tax that was charged on 'profits' from Ponzi transactions.

The fraudster sometimes pays income tax on fictitious profits. In practice, this money does not belong to the tax authorities as there was no profit and therefore the income tax on the 'profits' for this transaction should be returned.

An incentive for creditors who discover property of fraudster

The president of the Tel-Aviv District Court, the honourable Justice Eitan Orenstein, gave a precedent-making decision in February 2016 in which he held that when there are several 'indifferent' creditors and an industrious creditor who finds property of the debtor and brings it to the trustee, the industrious creditor is entitled to an additional 70% above the amount of his proven claim.

The judge expressly held that the purpose of the ruling was to solve the 'free rider' problem.

It may be assumed that this ruling will help to locate property of fraudsters in the future. ■

Recent cases in Israel

The following are several examples of acts of fraud that took place in Israel in recent years.

Nicholas Levene

Currently serving a 13-year prison sentence in England, for a Ponzi scheme committed in England and Israel. He invited his victims to his yacht on the French Riviera and promised them high yields. He created debts of tens of millions of GBP.

Eran Mizrahi

Nicknamed 'the Israeli Madoff' – currently serving a 12 year prison sentence for a Ponzi scheme. He promised his victims, most of whom were his friends and family members, interest of 4% per month. He promised these yields at his swimming pool in his lavish mansion while entertaining his victims to barbecues. He even furnished his victims with forged documents from the Swiss-based Heritage Bank that he typed at home. Meanwhile he spent $1,000 a night in the Maldives, and paid another $1,000 to have a private chef in his room. He created debts of $15,000,000.

Eli Reifman

A young genius who graduated from an elite unit in the Israeli Defense Forces. He spent $2 million on his wedding. He served a four-year prison sentence for forgery and his was the largest bankruptcy case in Israel. A high-tech mogul, at his peak when he was only 28 years old, he employed 6,000 people. He invented streaming e-mails and an Israeli cellphone. He owes $55 million personally. Nowadays he is out of prison and works on new legitimate inventions.

Kobi Oren

A young entrepreneur who ran a 'real estate Madoff scheme,' marketing agricultural land as a development site. He bought a $6 million mansion in Tel Aviv for himself and a Maserati car for $300,000, all with victims' money. He is currently under arrest.

Inbal Or

A charming 40-year old lady, who started her career as a realtor and became an entrepreneur. She left 600 families without money or apartments. Her companies accumulated debts of $50 million. She bought herself $1 million-worth of jewelery, paid her ex-husband $0.5 million out of victims' money, and so on. Her companies were dissolved and a receiver was appointed to her assets.

Mini-Bonds:
Risk and Reward?

Carmel King explains why mini-bonds are not nearly as secure as the bank or your mattress...

What are mini-bonds?

Mini-bonds are an increasingly popular way for companies to raise funds by borrowing money directly from individuals. Companies can issue mini-bonds via crowdfunding platforms or market directly to individuals, thereby raising capital for their business. Mini-bonds typically have terms of three to five years, with investors earning regular interest payments for the duration, as well as their initial investment and an interest lump sum at the end of the term. Interest rates on offer can be between 6% and 8% a year, or even higher where investors are given the choice of store credit or other benefits.

Who holds the cards?

Although not without their attractions to investors, it could be said that mini-bonds benefit the issuing company, with the risks entirely passed to the investor. The global financial crisis has left many small and start-up companies unable to qualify for bank loans; mini-bonds offer an easier way to raise funds, with the added benefit of engaging with customers and encouraging customer loyalty. Significantly, mini-bonds are not subject to the same degree of regulation as other products to which they might be compared; there is the potential for real cost savings to the company in relation to compliance issues, including when it comes to the provision of information at issue stage, and throughout the term of the mini-bond.

There are a number of significant risks to investors. Primarily, there is a lack of investor protection in the event of insolvency or the failure of the specific scheme. In the UK, mini-bonds are not protected by the Financial Services Compensation Scheme. Market commentators have observed that funds raised are often secured by charges held against the value of the assets being developed. In the event the company issuing the bond becomes insolvent, investors may find that their security is over assets that are overseas, or assets that are partially completed or not yet in development, depending on the stage at which insolvency occurs. Investors will find themselves with few or no prospects of seeing their investment again. Any identified recovery actions by an insolvency practitioner could take years to complete, and there is no guarantee that they will result in a dividend payment to creditors.

Mini-bonds are predominantly used by small or start-up companies, targeted at individuals as larger funds are unlikely to be attracted to such uncertain opportunities. Start-up businesses have a higher risk of failure.

Mini-bonds are fundamentally risky investments. They cannot be traded, meaning that investors will not be able to cash in early, and will not be able to access their funds until maturity. The mini-bonds can, however, be bought back by the issuing company at parity, for example, in the event the company obtains finance at a more competitive rate. This is not the case with institutional bonds, where the company must pay a premium to buy back the bonds, thereby giving the investor a degree of compensation.

The risk of fraud in an unregulated sector which

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"THE FCA HAS HIGHLIGHTED THAT MINI-BONDS ARE NOT IN REALITY COMPARABLE TO SAVINGS ACCOUNTS, WHERE INVESTORS' CAPITAL IS NOT AT RISK"

traditionally promises high returns to investors is significant. Online fundraising platforms which connect investors with companies looking to raise funds may well be regulated by the Financial Conduct Authority ("FCA") but are highly unlikely to be held responsible should investors end up victims of a determined fraudster using the platform.

So for all of these risks and downsides, what is the attraction for an investor? The interest rates, for the most part. In these times where savings accounts offer similar rates to stashing your cash under the mattress, mini-bonds offer a return that we haven't seen for some years from banks or building societies. Mini-bonds are, on the face of it, accessible and approachable. Crowdfunding platforms allow investment from the comfort of your own laptop. Mini-bonds also offer an interesting way to invest in a hobby or support a particular theme. They can offer higher rates of returns through innovative pay-out schemes. The coffee shop chain Taylor St Baristas offered a choice of an 8% cash return, or 12% in the form of store credit. The Jockey Club offered a 7.75% return, divided into 4.75% cash, and 3% in points that could be used for tickets, food, drink, hospitality and membership at the Club's race courses. It's easy to see the attraction to a coffee or racing enthusiast in being able to visit the issuing company and obtain benefits that, whilst paid for through their investment, have that psychological feeling of being complimentary, or in appreciation of their patronage.

The Regulator

The FCA has expressed concern about the increasing popularity of mini-bonds, citing a number of reasons why investors should be cautious.. The FCA is concerned that companies issuing bonds have failed to make clear that mini-bond investments place investors' capital at risk. Mini-bonds are not deposit-based or capital-protected products. The FCA has highlighted that mini-bonds are not in reality comparable to savings accounts, where, although the return offered may be significantly lower, investors' capital is not at risk. The FCA is also concerned that mini-bonds are not comparable to institutional bonds or other retail bonds, due to the inability to trade mini-bonds, meaning that investors are locked-in for the full term. A requirement highlighted by the FCA is that the lack of FSCS-cover must be highlighted in the mini-bond promotional material. The promotional material must furthermore be fair, clear and not misleading.

The FCA introduced a number of protection rules which apply to crowdfunding and the promotion of non-readily realisable securities (including mini-bonds) by other media, with a view to ensuring that consumers have access to clear information. From October 2014, companies can only make direct offer promotions to individuals who meet certain criteria:

- those who take regulated advice;
- those who qualify as high net-worth or sophisticated investors, and
- those who confirm they will invest less than 10% of their net assets in this type of security.

Companies are also required to check whether individuals understand the risks if they do not take regulated advice. This effort to take largely unregulated activities into the regulated sphere should offer a degree of protection, however investors should be under no illusion, the fundamental risks of investing in mini-bonds remain.

Mitigating the risk

Is there any way to mitigate the risk of investing in mini-bonds? Don't underestimate the risk, for starters. Consider the nature of mini-bonds as being more suited to forming a small part of a wider investment portfolio, perhaps in a cause, hobby or product of particular interest. Mini-bonds are certainly not the answer to the less-than satisfactory rates of return offered by banks and building societies.

It might be possible to spread risk by buying a bond fund, which covers a number of mini-bonds, rather than tying up funds in one company or organisation.

In the case of established larger companies, a detailed review of the filed financials can assist in understanding the

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company's position before investing. Given that mini-bonds are predominantly used by start-ups and small companies, the amount of information publicly available might be limited. The risk could be higher where no historical financial information is available, in comparison to a company that has been trading for a number of years. Cash flow forecasts and business plans should be available to give some idea of anticipated performance. A degree of scepticism is required with future projections, as companies are going to look to paint as positive a picture as possible whilst staying within FCA rules.

The frequent use of words such as "security" and "guarantee" within the invitation document should elicit a degree of wariness in the potential investor. What sort of security is on offer? Do these assets exist yet or is their development part of the investment scheme? Are they controlled by the company directly? Is the security shared with any other party, for example, a bank, which might rank ahead and snaffle up any equity ahead of investors in the event of insolvency? Who is offering a guarantee, and are they likely to be able to pay? Is the guarantee straightforward to enforce? There is a multitude of questions that must be answered before an investor should be handing over his or her hard-earned cash.

Reward

The website *crowdcube.com* has in the past listed as many as 33 mini-bond investment opportunities at the same time, ranging from mouldable glue to a mobile payment app to emergency shelters for the disaster relief market. These opportunities have had fund raising targets of anything ranging from £50,000, to £1,500,000. Mini-bonds are an exciting way to invest money in a variety of products and ventures that are intended to provide a good rate of return to investors. A seasoned investor willing to place funds in a high-risk venture of personal interest might enjoy the gamble, and not be overly upset out if the exercise fails.

Those who are less experienced should exercise extreme caution and carry out as much due diligence as possible before investing in mini-bonds. They should not be dazzled by the impressive rates on offer or the peppering of comforting words such as "security" and "guarantee" because there is no recourse to the FCA or FSCS. Investors need to consider from the outset their ability to be philosophical and "take the hit" if that wine bar, on-demand music-streaming service or pet-beauty competition app fails to capture the imagination of the wider market and insolvency looms. ■

> **"THOSE WHO ARE LESS EXPERIENCED SHOULD EXERCISE EXTREME CAUTION AND CARRY OUT AS MUCH DUE DILIGENCE AS POSSIBLE"**

Insolvency procedure in Ukraine

Igor Dykunskyy and Yaroslav Anikeev discuss the key aspects of the new procedure

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General regulation on the insolvency procedure in Ukraine

Insolvency in Ukraine is governed by the Law of Ukraine "On restoring debtor's solvency or declaring it insolvent" (the Insolvency Law), the Civil Code of Ukraine and the Commercial Code of Ukraine. Furthermore, there are a number of related regulations, which provide for certain details of insolvency procedure. Moreover, some specific aspects of regulations can be found in court practice and clarifications issued by the Ukrainian courts.

Insolvency cases are considered by the commercial courts in Ukraine.

Parties to insolvency proceedings and their rights

Under Ukrainian law, the debtor is exclusively either a legal entity or a private entrepreneur. However, there are initiatives to include the possibility for individuals to undergo the bankruptcy procedure as well. The relevant draft law was submitted to the Parliament almost a year ago, but is still being considered and analyzed by the relevant parliamentary committee.

The Insolvency Law specifies that the appropriate claim for insolvency can be filed either by the creditor or directly, by the debtor.

The creditor may file a claim for insolvency in the event that the debtor is unable to cover the monetary liabilities within three months following the date they fall due. In addition, the amount of such unperformed liabilities shall be of no less than 300 statutory minimal wages[1] at the date of filling of the respective insolvency claim. It is worth mentioning that no penalties are to be included in this amount.

While the creditor has the right to file insolvency claim, it is the obligation of the debtor to undergo insolvency proceedings in the following circumstances:

- satisfaction of claims of one or some of the creditors will lead to inability to fully cover the monetary liabilities due to other creditors;
- during liquidation of the debtor (not connected to insolvency) the inability of the debtor to fully satisfy the creditors' claims is established.

Failure of the debtor to file the respective insolvency claim under the above-mentioned circumstances leads to liability of its owner under the law.

The parties to insolvency proceedings are the debtor and the creditors (secured and competitive). In addition, the director of the debtor, his or her employees or shareholders may also be involved in the proceedings.

The secured creditors (those whose claims are secured by pledge or mortgage) have only the right of advisory vote, and therefore do not directly influence decisions of the competitive creditors.

Insolvency regimes

Rehabilitation

The debtor might be subject to various insolvency regimes. The only regime which can be applied before the court decision on insolvency is rehabilitation, which aims at restoring the debtor's solvency. In order to apply the rehabilitation plan the approval of the owner of the entity and of the creditors who possess more than 50% of the overall debt is required.

The term of rehabilitation regime cannot exceed 12 months. The moratorium on satisfaction of the creditors' claims is imposed during the whole term of rehabilitation.

The other insolvency regimes are: administration of property, liquidation, sanation and amicable settlement.

Any change of insolvency regime is published on the website of the High Commercial Court of Ukraine. It is worth mentioning that as soon as one of the insolvency regimes is applied to a debtor, such a debtor is deemed to have no outstanding monetary liabilities..

Amicable settlement

The amicable settlement is an agreement between the debtor and creditors on deferral and/or installment plan and also debt underwriting. The main feature of the amicable settlement is that it can be concluded at any stage of the insolvency proceedings, but not before the approval of the list of creditors. In addition, the amicable settlement shall not be concluded in relation to creditors' claims of first priority, wages and related payments, such as social and pension contributions.

The amicable settlement shall be approved by court, which results in termination of the insolvency proceedings. However, in the event of failure to perform the terms of the amicable settlement or its termination, the insolvency proceedings are resumed.

Administration of property

As a general rule, following the commencement of the insolvency proceedings, the administration of property is introduced along with a moratorium on satisfaction of the creditors' claims. Such procedure may be referred to as transitional, because, on the one hand, the debtor continues his or her commercial activities, but, on the other hand, the moratorium restricts the debtor in performing any actions concerning the property. During the administration of property regime the debtor is precluded from satisfaction of the creditors' claims, except for the current creditors and the wages of the employees.

In order to identify the exact amount of the debtor's indebtedness, the respective notification is published on the website of the High Commercial Court of Ukraine. After the publication the creditors have 30 calendar days to file a claim to a commercial court regarding any debts owed by the debtor. Upon consideration of such claims the list of creditors is formed, which is the main document for the establishment of the amount of indebtedness and the number of votes of each creditor.

If a creditor fails to file his or her claim within the specified period, such a creditor is not treated as a competitive creditor and his or her claims are satisfied in the last priority rank at the liquidation procedure.

Sanation (restructuring)

The sanation regime is established by the court for up to 18 months if there is a possibility that the debtor may regain solvency. Following the introduction of the sanation regime the manager (director) of the debtor no longer has managing authority, which passes to the sanation manager. The main governing document in the sanation regime is a sanation plan, according to which all measures in relation to restoring the debtor's solvency are implemented. Such measures may include the increase of the share capital, sale of property, alienation of property by way of replacement of assets, sale of a part of the assets, debt restructuring, etc.

As a result of the sanation regime the debtor either regains solvency or the liquidation procedure.

Liquidation

Liquidation is the ultimate regime, which is applied only if no other regimes were successful in restoring the debtor's solvency.

The main feature of the liquidation regime is that no additional liabilities arise, including in relation to tax payments, and the debtor's property is released from any stays. The debtor's assets are sold in order to satisfy the creditors' claims to the maximum extent possible. Such a sale is made by auction, notifications about which are placed on the websites of the High Commercial Court of Ukraine and the Ministry of Justice of Ukraine.

The Insolvency Law provides for priority ranks for satisfaction of the creditors' claims:

- First priority: claims regarding wages payments, court duty, and procedural expenses.
- Second priority: claims regarding social security payments and damages to life and health of citizens.
- Third priority: claims regarding tax payments and state reserves.
- Fourth priority: competitive creditors' claims.
- Fifth priority: claims regarding return of contributions made by the work collective and the additional remuneration of the insolvency practitioner.
- Sixth priority: other claims.

Peculiarities of insolvency of certain debtors

The Insolvency Law also provides for some peculiarities of insolvency of certain debtors. These are: entities with social value or special status; agricultural enterprises; insurance companies; participants to the securities market and joint investment institutions; managers of real estate development; individual entrepreneurs; farming entities. In addition, for the purposes of protection of the state interests, state enterprises, as well as companies in which the state holds more than 50% of the shares, are also subject to special insolvency proceedings.

There is also a possibility to apply for shorter insolvency proceedings under certain circumstances.

Overall, while the Ukrainian insolvency regulation is not fully in line with the best international standards, there are ongoing developments and efforts are made in order to modernise and improve it. ■

“

OVERALL, WHILE THE UKRAINIAN INSOLVENCY REGULATION IS NOT FULLY IN LINE WITH THE BEST INTERNATIONAL STANDARDS, THERE ARE ONGOING EFFORTS TO MODERNISE IT

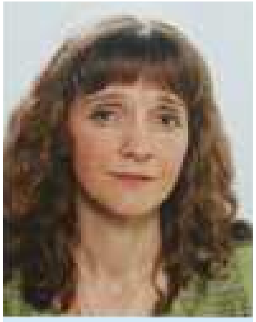
”

Footnote:

1 Currently, one minimal wage in Ukraine amounts to UAH 1,450 (approx. USD 60). Starting from 01 December 2016 the minimal wage will amount to UAH 1,550 (approx. USD 65). The minimal wage is specified each year in the state budget of Ukraine.

New bankruptcy law in Croatia

Prof. Dr. Jasnica Garasic reviews the new law



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The modern development of Croatian bankruptcy law started with the Bankruptcy Act[1] of 1996 which entered into force on 1st January 1997. The Act was drafted along the lines of the German Insolvency Act[2].

The Bankruptcy Act 1996 provided for uniform (integrative) procedures that served the purpose of collective satisfaction of a debtor's creditors by liquidation of the debtor's assets and by distribution of the proceeds, or by reaching an arrangement in a bankruptcy plan, particularly in order to maintain the enterprise. The reorganisation of the insolvent debtor i.e. restructuring of the business was possible only within the opened bankruptcy proceedings by means of a bankruptcy plan. This Act also provided for personal management of the debtor as well as the possible discharge of the residual debt of a natural person. Bankruptcy proceedings were permitted only against legal persons or natural persons who were merchants within the meaning of the Companies Act, or[3] craftsmen.

Most of bankruptcy (insolvency) proceedings in the practice were liquidation (winding up) proceedings. Due to different reasons, bankruptcy plans (reorganisation plans) were very rare as petitions to open them were often filed too late, costs of proceedings were too high for creditors, bankruptcy administrators (trustees) usually did not have enough knowledge about preparing bankruptcy plans, etc.

Therefore, the Croatian Government decided in 2012 that the reorganisation and restructuring proceedings were to take place outside of the bankruptcy proceedings. As a result of this decision, the Ministry of Finance prepared the Financial Operations and Pre-bankruptcy Settlement Act[4] which came into force on 1st October 2012. The main idea of this Act was that every insolvent debtor and his or her creditors had to try to achieve a pre-bankruptcy settlement in the administrative procedure under the strong supervision of the Ministry of Finance and the Financial Agency before filing a petition for the opening of bankruptcy proceedings. At the same time the Act on Changes and Amendments to the Bankruptcy Act of 2012[5] abolished the rules on

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bankruptcy plans regulating the reorganisation of the insolvent debtor i.e. restructuring of his or her business. In other words, the reorganisation of the debtor's company and the restructure of his or her business became possible only within the administrative proceedings based on pre-bankruptcy settlements. Unfortunately, the rules of proceedings based on pre-bankruptcy settlements were written within a very short time and without the participation of the Croatian bankruptcy law experts. These rules so deficiently drafted provided an opportunity for misuse in practice. The public perception of the reached pre-bankruptcy settlements and of the whole administrative procedure was negative.

In consequence, the Croatian Government decided to transform pre-bankruptcy proceedings from the administrative procedures into court procedures and to adapt the rules on a pre-bankruptcy settlement in accordance with the ideas expressed in the European Commission Recommendation of 12th March 2014 on a new approach to business failure and insolvency[6]. The competence for drafting all legislation in connection with bankruptcy law lies with the Ministry of Justice of the Republic of Croatia. It was entrusted with the task of preparing a new bankruptcy law. The new Bankruptcy Act[7] came into force on 1st September 2015.

The new Bankruptcy Act of 2015 follows the basic structure of the old Bankruptcy Act of 1996. Consequently, many solutions of the Croatian bankruptcy law are furthermore similar to those under the German Insolvency Act. The rules on bankruptcy plans regulating the reorganisation of the insolvent debtor i.e. restructuring of his or her business were taken over in the new Act. This new Act abolished the rules on a pre-bankruptcy settlement contained in the Financial Operations and Pre-bankruptcy Settlement Act and introduced provisions on the new court pre-bankruptcy proceedings into its own text.

The aim of the new pre-bankruptcy court proceedings is the same as that of the abolished administrative proceedings on a pre-bankruptcy settlement: to reach a pre-bankruptcy agreement between the debtor and his or her creditors outside of bankruptcy proceedings, which will enable the reorganisation of the debtor i.e. the restructuring of his or her business. Most of the rules, which were misused in the administrative proceedings on pre-bankruptcy settlement have been abolished. As a result, the public has much more trust in the commercial courts which now conduct pre-bankruptcy proceedings.

According to the new Bankruptcy Act the pre-bankruptcy proceedings presents only one possibility. The debtor is no longer under the obligation to initiate pre-bankruptcy proceedings before filing for a petition to open bankruptcy proceedings. The creditors may initiate the pre-bankruptcy proceedings only with the consent of the debtor. In any case, the pre-bankruptcy proceeding can be conducted only if the debtor is faced with imminent insolvency. If the insolvency of the debtor has already occurred or in case of overindebtedness of the debtor, the debtor or any of his or her creditors may file only the petition to open bankruptcy proceedings and not the petition to open pre-bankruptcy proceedings. The reorganisation of the debtor, i.e. the restructuring of his or her business is possible in such a case only within the bankruptcy proceedings by means of a

"THE AIM OF THE NEW COURT PRE-BANKRUPTCY PROCEEDINGS IS TO REACH A PRE-BANKRUPTCY AGREEMENT OF THE DEBTOR AND HIS/HER CREDITORS OUTSIDE OF BANKRUPTCY PROCEEDINGS"

> **BOTH ACTS WERE WRITTEN IN A HURRY BEFORE THE ELECTIONS AND THEY LEAVE MUCH ROOM FOR FURTHER ELABORATION AND IMPROVEMENT**

bankruptcy plan.

The new Bankruptcy Act rendered more stringent rules on directors' liability for insolvency-related duties, i.e. for a timely filing of the petition to open bankruptcy proceedings.

An accepted bankruptcy plan which has been confirmed by the bankruptcy court can limit the security rights of the creditors. Unfortunately, provisions on effects of a pre-bankruptcy agreement on security rights are not sufficiently clear, so that it is questionable whether these rights can be limited by an accepted and confirmed pre-bankruptcy agreement.

A pre-bankruptcy agreement can not affect the claims of the employees. Their claimss are the only privileged claims in the bankruptcy proceedings. These claims are in the first payment rank.

Fraudulent (detrimental) transactions and omissions of the debtor made prior to the opening of the bankruptcy proceedings may be avoided not only by a bankruptcy administrator (trustee) but also by a debtor's creditor. The new Bankruptcy Act contains detailed provisions on the conditions and circumstances in which a creditor instead of the bankruptcy administrator may avoid debtor's fraudulent (detrimental) transactions.

According to the new Bankruptcy Act all submissions in pre-bankruptcy proceedings as well as those in bankruptcy proceedings may be exclusively filed by means of standard forms. As a rule, communications of the court shall be served upon participants in pre-bankruptcy proceedings and in bankruptcy proceedings by means of publication on the website Electronic Notice Board of Courts (https://e-oglasna.pravosudje.hr).

It should be emphasised that differently from the previous Bankruptcy Act, the new Bankruptcy Act provides for a continuous professional training and professional improvement for bankruptcy administrators even after they have passed the state exam for bankruptcy administrators, have been listed as bankruptcy administrators and have obtained a permission to be appointed in pre-bankruptcy and bankruptcy proceedings. This permanent education of bankruptcy administrators should contribute to the increasing of the number of the bankruptcy cases where bankruptcy plans (reorganisation plans) would have been made.

Since 1996 Croatia has very detailed and modern rules on international bankruptcy (insolvency) that regulate *inter alia* the international jurisdiction for the opening of bankruptcy proceedings, presumptions and procedure for the recognition of foreign decisions on opening bankruptcy proceedings, the applicable law, the opening of secondary and particular bankruptcy proceedings, as well as cooperation between main and secondary bankruptcy proceedings. All these rules are taken over in the new Bankruptcy Act. These rules of the Croatian autonomous international bankruptcy law shall be applied towards the countries that are not Member States of the European Union. The European Regulation on Insolvency Proceedings[8] shall be applied between the Member States.

The number of citizens who were unable to pay their due debts would steadily grow and, as a result, the Croatian legislator took the decision to draft a special Consumer Bankruptcy Act[9] in 2015, which entered into force on 1st January 2016. The purpose of this Act is to allow an honest consumer to be discharged of all obligations remaining after his or her assets had been encashed (liquidated), the obtained proceeds had been distributed to his or her creditors and a period of good conduct has elapsed. A judge determines the length of the period of good conduct which can be between 1 to 5 years. It is important to emphasise that a debtor must seek an out-of-court settlement with his/her creditors. For this reason, out-of-court proceedings shall always be carried out before the initiation of consumer bankruptcy proceedings. Croatian consumer bankruptcy proceedings are in many aspects similar to German consumer insolvency proceedings.

The Bankruptcy Act and the and Consumer Bankruptcy Act 2015 are currently the main sources of bankruptcy law in the Republic of Croatia. Unfortunately, both Acts were written in a hurry before the elections. In my opinion, they leave much room for further elaboration and improvement, especially provisions on pre-bankruptcy proceedings and consumer bankruptcy proceedings. ■

Footnotes:

1 Bankruptcy Act, *Stečajni zakon*, Official Gazette Narodne novine nos. 44/1996, 29/1999, 129/2000, 123/2003, 82/2006, 116/2010, 25/2012, 133/2012.

2 Insolvency Act, *Insolvenzordnung*, Official Gazette Bundesgesetzblatt I, no. 1994, p. 2866, entered into force on 1st January 1999, last amendment on 20th November 2015.

3 Companies Act, *Zakon o trgovačkim društvima*, Official Gazette Narodne novine nos. 111/1193, 34/1999, 52/2000, 118/2003, 107/2007, 146/2008, 137/2009, 125/2011, 152/2011, 111/2012, 68/2013, 110/2015.

4 Financial Operations and Pre-bankruptcy Settlement Act, *Zakon o financijskoj nagodbi i predstečajnoj nagodbi*, Official Gazette Narodne novine nos.108/2012, 144/2012, 81/2013, 112/2013, 78/2015.

5 Act on Changes and Amendments to the Bankruptcy Act, *Zakon o izmjenama i dopunama Stečajnog zakona*, Official Gazette Narodne novine no. 133/2012.

6 C(2014) 1500 final.

7 Bankruptcy Act, *Stečajni zakon*, Official Gazette Narodne novine no. 71/2015.

8 Council Regulation (EC) No 1346/2000 of 29 May 2000, Official Journal of the European Communities, L 160/1. The reformed Regulation shall be applied from 26 June 2017: Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), Official Journal of the European Union, L 141/19.

9 Consumer Bankruptcy Act, *Zakon o stečaju potrošača*, Official Gazette Narodne novine no. 100/2015.

Country Reports
Autumn 2016

Updates from France, Lithuania, The Netherlands and Russia

France: Co-employment is strictly defined, but the notion is applied on a case-to-case basis

Co-employment, which allows employees to obtain the recognition of two employers instead of one, was treated by the Supreme Court (Cour de Cassation Soc. 30 November 2011 No. 10-22964) which changed the definition in a restrictive way, especially about the involvement of the parent company in the management of its subsidiary.

In 2014 (Cass. Soc. July 2, 2014 No. 13-15208), the Supreme Court asked the judges to establish that "*beyond the existence of a relationship of subordination, a company belonging to a Group cannot be considered as a co-employer in respect of staff employed by another company of the Group, if a conflict of interests, activities and management manifested by interference in the economic and social management of the latter appears between them, surpassing the necessary coordination of economic actions between companies belonging to the same Group and the state of economic domination that membership in the Group may cause*."

It is thus for the judges of the Court of first instance and Court of appeal to characterise the interference of the parent company in the economic and social management of its subsidiary, situations often used by the employees of companies in difficulty in their challenging petitions.

Two decisions of the French Supreme Court rendered on 6 July 2016 attest the difficulty of obtaining the recognition of co-employment, and therefore, the liability of companies in a Group towards the employees of a subsidiary. See the two cases below: (1) Co-employment is recognised; (2) Co-employment is not recognised.

1. Co-employment recognised in the Group "3 Suisses International" case (Cass. Soc. 6 Jul. 2016, N° 15-15481)

"3 Suisses France" was owned in the proportion of 51% by the German "Otto Group". Group "3 Suisses International" was structured into four business areas including trade for individuals, served by the company "Commerce BtoC", which controlled several shops and companies, among which "3 Suisses France".

In December 2010, the management of "3 Suisses France" met with its employees committee for the submission of a reorganisation plan announcing the closure of some of the shops and the redundancy of all employees who worked in them.

It is in these conditions that sixty-five employees, dismissed in January 2012 because of the closures, have challenged the validity of the redundancy plan for failure of the back-up plan of employment, and asked for the

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> "THE CONCENTRATION OF POWER IN THE HANDS OF THE PARENT COMPANY MAY LEAD TO A COMPLETE LOSS OF ITS AUTONOMY"

condemnation *in solidum* of "3 Suisses France", "3 SI Trade" (formerly "SI 3 BtoC") and "Argosyn", (formerly "3 Suisses International"). They got satisfaction before the Court of Appeal.

This decision was approved by the Supreme Court which found that the concentration of power in the hands of the parent company in the economic and social management of the company, particularly in the field of human resources of its French subsidiary, may lead to a complete loss of its autonomy "*(…) at the time of the reorganisation, when "3 SI Commerce" (formerly named "Commerce BtoC") was one and the same with "3 Suisses International", of which it was only a branch initially, existing only for the purpose of facilitating the transformation of "3 Suisses France" and of other similar companies to become simple "business units" directly depending on the Group).*"

The Supreme Court also decided that:

- "*this reorganisation has led to the interference of "Commerce BtoC" in the economic and social management of "3 Suisses France" by transferring its IT, accounting and especially human resources teams, which dealt with the training, mobility and recruitment of the staff*"; in addition,
- "*Commerce BtoC" took charge of all the contractual, administrative and financial problems encountered by "3 Suisses France", through its accounting client-service and banking service*"; and
- "*considering these facts, the Court of Appeal has shown, beyond the necessary coordination of economic actions between companies belonging to the same Group and the state of economic domination, that this membership in the Group can lead to a confusion of interests, activity and management, manifested by the interference of "Argosyn" (formerly "3 Suisses International") and of "3 SI Commerce"(formerly "Commerce BtoC") in the economic and social management of "3 Suisses France*".

(2) Co-employment not recognised in the Continental Group case (Cass. Soc., 6 Jul. 2016, No. 14-27266)

Following the decision of closure of a tire-production site for passenger vehicles operated in Clairoix where over a thousand employees were employed, the company Continental France, part of the Continental Group and French subsidiary of the German company Continental Aktiengesellschaft (AG), implemented in 2009 a redundancy procedure for economic reasons with a plan to safeguard employment for the entire facility staff.

The procedure included that the employment contracts of the employees who were not proposed another job were to be terminated by letters sent in majority on January 15, 2010, or by amicable termination agreements signed on 2 January, 2010 for others, while on leave for mobility.

Challenging the legitimacy of the termination of their employment contract, 540 employees have filed a petition before the Labour Court, directed against Continental France, but also against Continental AG, as co-employer, requesting the payment of various allowances.

The Social Chamber of the Court of Appeal of Amiens said that the termination of the employment contracts was made without a real and justified cause, and condemned the two companies, *in solidum*, to pay certain amounts to the employees, as well as to reimburse the social bodies which paid unemployment allowances equivalent to six-months salaries to the employees since the termination, without real and justified cause, of their employment contract.

On July 6, 2016, the Court of Cassation partially changed these decisions of the Court of Appeal by removing the responsibility of the German parent company on applications invoking co-employment.

The fact that the policy of the Group determined by the parent policy has an impact on the economic and social activity of its subsidiary, and that following this policy the parent company has taken decisions affecting the future of its subsidiary while guaranteeing its obligations related to the site closure and the loss of jobs, is not sufficient to characterise a situation of co-employment.

The Supreme Court stated that "*beyond the existence of a relationship of subordination, a company belonging to a Group cannot be considered as a co-employer in respect of staff employed by another company of the Group if a conflict of interests, activities and management manifested by interference in the economic and social management of the latter appears between them, surpassing the necessary coordination of economic actions between companies belonging to the same Group and the state of economic domination that the membership in the Group may cause.*"

Conclusion

Do not hesitate to plead your case!

Lithuania: New rules for fixing administration expenses: one step closer to a more effective and transparent insolvency procedure

Recent amendments to the Lithuanian Enterprise Bankruptcy Law (EBL) and new Rules on Calculation of Remuneration and Administration Expenses[1] (Rules) in effect since 1 May 2016 are expected to bring further improvements to Lithuanian insolvency procedures.

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Administration expenses

The Rules form the new basis for determining reimbursability of administration expenses in insolvency proceedings. The Rules only "recommend" the maximum amount that can be reimbursed. Nevertheless, they have a mandatory character, since an administrator exceeding the recommended amount without the creditors' approval faces the risk of having to cover personally any excess amount, unless he can show that costs had to be incurred for urgent measures to protect the creditors' interests.

The reimbursable amount for expenses mainly depends on the category in which the insolvent company falls according to the classifications under the Rules. For this, three categories are foreseen depending on the debtor's size: small, medium and large[2].

Criteria to determine the size of the debtor are the assets, the creditors' claims and the number of the debtor's creditors.

In addition, other factors influence the recommended amount for compensation. For example, cross-border insolvencies and insolvencies of insurance companies or credit institutions increase the compensation amount, as does the continuation of the business during the proceedings. On the other hand, simplified proceedings lead to a reduction.

Remuneration of administrators

Under the Rules, the remuneration of administrators depends, to a certain extent, on the results.

The administrator's remuneration is calculated by the following formula:

remuneration
= minimal recommended administrator's fee
+ bonus for proceeds of asset realisation
+ bonus for civil cases initiated against the company taking into consideration the complexity of the cases
+ bonus for the asset realisation at a higher price.

The criteria to determine the minimal remuneration paid to the administrator are the same as calculating the minimal administration expenses mentioned above (i.e. the core criteria are the size of the debtor, the value of the debtor's estate and the number of creditors). This minimum fee is fixed and approved by the creditors during the first meeting while the bonuses are approved later depending on the results of administration.

Impact of the Rules

By introducing the Rules, Lithuanian lawmakers continued their efforts to establish an objective and transparent framework for the Lithuanian insolvency proceedings. One recent important step into this direction was the change of the way insolvency administrators were appointed. Since 1 January 2015 administrators are usually chosen by a 'lottery', i.e. by a random, computer-generated selection, thus replacing the old system in which the party filing for insolvency had to propose a candidate whom the Court usually had to appoint.

The Rules now provide for a transparent and rather predictable mechanism to calculate the amount of expenses (including remuneration) that an administrator may incur for purposes of the proceedings. The Rules replace the previous legal framework and practice, where it was left entirely to the administrator and the creditors in the proceedings to agree on the remuneration of the administrator and the other permitted expenses. Often, administrators performed their mandate based on a simple fixed monthly fee agreement that provided no incentive for an effective and efficient administration.

Under the new Rules, creditors may now expect administrators to be more motivated to generate proceeds for the benefit of the creditors, or at least, to quickly terminate proceedings against 'assetless debtors'. In this context, we might also expect more diligence in analysing pre-insolvency transactions and bringing related voidance/claw-back claims.

Footnotes:

1 Decision of the Government of the Republic of Lithuania of 27 April 2016, No. 415, regarding the Rules of Recommended Administration Expenses and Remuneration of the Bankruptcy Administrator.

2 The size of the company is extensively regulated by the Selection Rules for Bankruptcy Administrators as approved by the Government Order No 647 of 9 July 2014. This topic was analysed by Frank Heemann and Karolina Gasparke in the Eurofenix article on "Lottery and liability: recent developments in Lithuanian bankruptcy law" in the Spring issue No 59, 2015.

> "CREDITORS MAY NOW EXPECT ADMINISTRATORS TO BE MORE MOTIVATED TO GENERATE PROCEEDS FOR THE BENEFIT OF THE CREDITORS"

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The Netherlands: Pre-Packs, Recalibration of Bankruptcy Law

As part of the legislative programme called 'Recalibration of Bankruptcy Law' the Dutch legislator has provided a statutory footing to the practice of pre-packs (also known as "silent administration").

On 21 June 2016 the Dutch Lower House has adopted the legislative proposal Continuity of Enterprises Act I (the "Act"). The purpose of a pre-pack is to be able to prepare a possible upcoming bankruptcy in relative calm with the parties directly involved.

With this Act a regulation is introduced in the Dutch Bankruptcy Act in which the court is given the possibility to privately appoint, at the request of a debtor and prior to a possible upcoming bankruptcy, an intended bankruptcy trustee. The intended bankruptcy trustee is the person whom the court will appoint as bankruptcy trustee if there should be a bankruptcy. The chances of a sale and the subsequent restart of viable parts of the business of the debtor may be increased with a pre-pack. The Dutch Upper House now needs to approve the Act as well. The expectation is that the Act will come into force after this.

"THE CRUCIAL DIFFERENCE IS THAT THE INTENDED BANKRUPTCY TRUSTEE IS APPOINTED PRIOR TO AN ACTUAL BANKRUPTCY ORDER"

Definition of a pre-pack

A pre-pack means a proceedings in which the court, at the request of a debtor and prior to a possible upcoming bankruptcy, appoints an intended bankruptcy trustee. The crucial difference with a bankruptcy is that the intended bankruptcy trustee is appointed prior to an actual bankruptcy order.

The purpose of a pre-pack is to determine – during the relatively silent preparation phase – whether an enterprise that is close to becoming bankrupt may still be saved and/or whether there are possibilities for a restart after a bankruptcy. The most important task of the intended bankruptcy trustee is to represent the interests of the joint creditors; he does not take over the management of the debtor, but will monitor the silent preparation with a critical eye.

Preparation through a pre-pack needs to have added value

When requesting a pre-pack the debtor also has to demonstrate that in its specific situation it is likely that the silent preparation has added value when compared to an ordinary bankruptcy. Added value is assumed to be present if it can be demonstrated that the preparation can limit the damages for those affected by a possible bankruptcy.

The added value is also assumed to be present when the preparation may increase the possibility of a sale of viable parts of the debtor's enterprise.

No abuse

The Act has several safeguards against abusing the use of pre-pack arrangements. The debtor needs to inform the court correctly about the added value of the private preparations prior to actual bankruptcy. If it turns out that the director of the debtor-company has provided incorrect information about this added value with the intention of using the pre-pack on improper grounds, the Act makes it easier for the bankruptcy trustee to hold the director of the debtor liable for improper management. The bankruptcy may then also start proceedings to disqualify the involved director(s) of the debtor-company.

Participation of employees

When the company has an employees' council or an employee representative body the court will – due to an approved amendment to the Act – stipulate its participation during the 'silent preparation phase' prior to the bankruptcy order, when appointing an intended bankruptcy trustee. In the event that the business of the company is incompatible with this participation, the involvement of the employees is not a precondition in the application of the pre-pack.

Share your views!

Russia:
Rapid jump in insolvency applications

Following the economic downturn in the aftermath of the 2008 financial crisis, the number of insolvency applications in Russia has been fluctuating, but remained relatively stable with approx. 40,000 insolvency applications per year.

However, immediately after the imposition of Western sanctions in 2014 and the oil price drop, this number jumped by 20%, resulting in more than 50,000 insolvency applications filed, with approximately 41,000 accepted by Russian courts in 2015.

Like never before, the Russian insolvency framework had to take the efficiency test, the results of which did not look optimistic. According to the World Bank, the general recovery rate in Russia remains fairly low – 41.3 cents on the dollar (in Moscow) in contrast to 72.3 cents on the dollar in the OECD (High-Income). In reality, the figure for Russia may be even lower, as the recently published statistics indicate that creditors of 70% of the Russian debtors received nothing as a result of liquidation proceedings completed in 2015.

Apart from the low recovery rate, another distinct characteristic of the Russian insolvency regime is that rehabilitation procedures are practically uncommon or absent. In 2015, 80% of insolvency cases ended with a debtor's liquidation, in around 15% of cases insolvency ceased due to the lack of money to fund it, 1.6% resulted in settlement agreements, whereas only 3% entered into one of the rehabilitative procedures (external administration or financial rehabilitation). However, in the vast majority of cases such procedures ultimately ended up with liquidation. Unpopularity of rehabilitation might be explained by a variety of factors, including late insolvency filings (too late to rehabilitate), unprofessional management and unwillingness of secured creditors to vote for rehabilitation (no cram down). This can change in the future, as proposals for introducing a Chapter-11-like restructuring procedure into Russian law are constantly discussed.

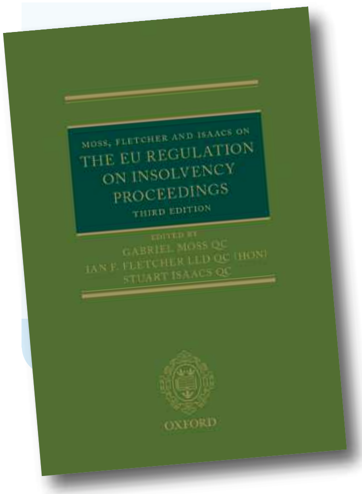
Not everything about the Russian insolvency situation is as grim as we may have pictured it. For instance, recent bankruptcy reforms and supporting case law created useful tools for creditors, allowing them to take a pro-active role in defending and restoring insolvency estate. One of these tools is the possibility to challenge pre-insolvency transactions; last year 3,136 transactions were challenged with around half of them successfully. Another tool in the creditors' belt is the right to bring controlling persons to liability for their bad faith or unreasonable actions, which caused harm to the creditors.

Russian insolvency law is constantly changing, transposing many developments from other jurisdictions. For example, previously impossible personal insolvency was introduced into the insolvency law in 2015. But when considering the above figures, Russian and foreign creditors should keep in mind that their success stays primarily in their own hands. Timely actions (filings to be included in the register of creditors, challenging transactions, bringing controlling persons to liability, etc.) together with pre-emptive protective measures (getting security from the debtor and third parties, linking transfer of ownership with payment) and vigilance are crucial in protecting creditors' rights and guaranteeing the effective handling of otherwise counter-productive insolvency proceedings in Russia.

"RUSSIAN AND FOREIGN CREDITORS SHOULD KEEP IN MIND THAT THEIR SUCCESS STAYS PRIMARILY IN THEIR OWN HANDS"

ILYA KOKORIN
Partner, Buzko & Partners, Russia

Moss, Fletcher and Isaacs on the EU Regulation on Insolvency Proceedings



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Reviewed By Prof. Dr. Héctor José Miguens. Professor of Insolvency Law. Independent Researcher of CONICET at the School of Law, Austral University, Buenos Aires, Argentina.

Share your views!

During the last thirty years there has been something resembling a firestorm of international activity, taking place at both regional and global levels, that has brought about an enormous proliferation of texts of a legislative or quasi-legislative type (including the so-called "soft law") in the International Insolvency Law field.

From *ad hoc* solutions to particular cases devised by practitioners and courts, to formal institutional projects addressing the problems from a more general perspective, the law-generating processes have steadily accelerated and intensified. These years have also witnessed an increased output of instruments and texts relating to cross-border insolvency by regional organisations such as the European Union, the EBRD and the Asian Development Bank, and by global institutions such as the World Bank, UNIDROIT and UNCITRAL. This is where institutions like INSOL International and INSOL Europe also find one of their *raison-d être*.

This is the third edition of a celebrated book first published in 2002, a commentary of the European Union Insolvency Regulation 1346/2000 of 29 May 2000, to which is now added the comment of the Recast Regulation 2015/848 of 20 May 2015, which will commence to apply the 26th of june 2017 onwards.

As Professor Christoph Paulus, of the Humboldt University Berlin, points out in the preface to this welcome work, fifteen years after the existence of the EU Insolvency Regulation as a tool for the coordination of cross-border insolvencies, the recast Regulation is designed to go beyond that, to a strong tendency towards harmonisation within the European countries.

Although the new edition has inevitably expanded by comparison to its predecessor, the overall structure of the book remains unchanged. Both the first Regulation (the "Original Regulation") and the second one (the "Recast Regulation") are thoroughly and richly commented, with elegant style and accurate language. Prominent figures of the insolvency in the UK and outside, both in academia and in practice, contribute to the work, such as the main authors: Gabriel Moss QC, Ian F. Fletcher, QC (Hon.) and Stuart Isaacs QC, as well as the other contributors: Daniel Bayfield QC, Georgina Peters, Felicity Toube QC, Nick Segal, Jennifer Marshall, Prof. Matthias Haentjens, Tom Smith QC, Prof. Michael Bogdan, Justice Timo Esko, Prof. Francisco Garcimartín, Prof. Alberto Piergrossi, Prof. Miguel Virgós, Prof. Bob Wessels and Alex Wood.

The book is organised following the European legislative systematics. It describes the law clearly and concisely. Judicial decisions that interpret the statute are described pithily. Helpfully, the text of the European Regulations of 2001 and 2015 and the Virgós-Schmidt Report on the Convention on Insolvency Proceedings are included as appendices. In addition to citing cases, European legislation, EU directives, international conventions, regulations, statutes of the UK, Australia, Bermuda, Cayman Islands, The Netherlands, the United States of America, statutory instruments, rules and authorities, the authors make frequent reference to monographs, peer-reviewed papers, special reports, unpublished lectures and websites, among other useful resources. Against that volatile background or legal sources, the format adopted by this third edition is particularly useful. It successfully combines general editorial material with in-depth analyses of each of the key legislative and jurisdictional concepts with which practitioners must deal. The thoroughness of the research and depth of consideration revealed by the footnotes creates further confidence in the utility of the text. The contributions – both informative and thought-provoking – are particularly rich because they come from seventeen expert authors in the field. Hence the reader benefits from the widest possible range of ideas and experience.

The authors analyze thoroughly the drafting of the Regulation and its precursors and frequent international issues of insolvency like the scope and jurisdiction, the choice of law rules, the recognition and enforcement, the effect of the Regulation on cross-border security and quasi-security, the rules pertaining to financial institutions and the commentary on the Regulation itself, article by article.

This book is an invaluable resource for UK academics and practitioners dealing with international insolvency cases, as well as for non-UK, European lawyers, counselling foreign representatives, foreign debtors and their advisors, about the regulated themes, applicable in the Member States of the European Union. The sheer volume of domestic and international case law that is continually generated by the European Regulation and the speed at which the law is developing guarantee that this will not be the last edition of the book. Also, this commentary could be useful for future academic streams of inspiration and interpretation of similar issues regulated by both the UNCITRAL Model Law on Cross-Border Insolvency of 1997, with the UNCITRAL Guide to Enactment and Interpretation of 2013 and the UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation of 2009. Beyond that and moreover, this commentary could be of enormous interest for the countries of North America and South America, as an element for the interpretation of similar issues regulated, for example, by the Chapter 15 of the United States Bankruptcy Code and by other International Insolvency Law Systems of American countries. Particularly in respect to the countries which are members of the MERCOSUR, a Treaty in which some members are also part of the Montevideo Treaties of 1889 and 1940 on International Insolvency issues, the book could be an example for the negotiation and issuance of future regulations of internacional insolvency cases within – and outside – the MERCOSUR Treaty.

In sum, the work will be of interest to academics and practitioners involved with the conduct of proceedings and litigation as well as those interested in comparative law in the international insolvency context. It will also prove of immense benefit to those in charge of courts keen to ascertain trends in judicial practice in other similar and not so similar jurisdictions. All law firms, regulatory authorities and universities which have to get to grips with this important subject should find a place for this book on their bookshelves.

The Regulation by which the UNCITRAL Model Law of 1997 has been given effect in the UK is thoroughly covered in this preeminent *magna opera*. As a result, this third edition will prove to be more useful than its predecessor, and deserves to attract a larger following not only in the UK but in any jurisdiction where formal cross-border measures are or may become relevant as well. We must hope new editions of this book will follow regularly as the law evolves. The authors and the Oxford University Press should be congratulated on its production.

In conclusion, this third edition of this valuable contribution is to be even more warmly welcomed than the previous ones.

> **"THIS BOOK IS AN INVALUABLE RESOURCE FOR UK ACADEMICS AND PRACTITIONERS DEALING WITH INTERNATIONAL INSOLVENCY CASES"**

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