INTERNATIONAL INSOLVENCY AND RESTRUCTURING REVIEW

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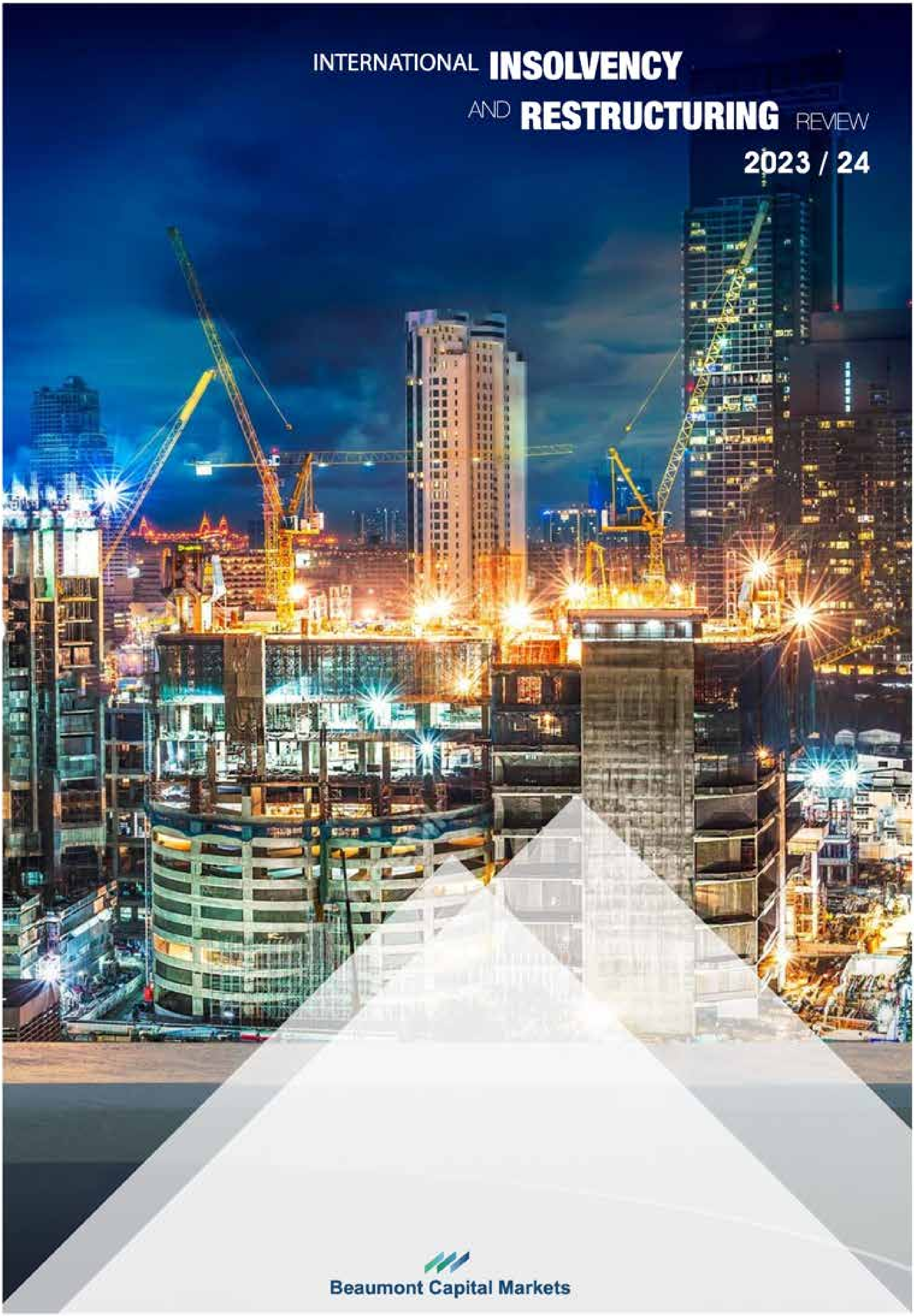

Beaumont Capital Markets

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FOREWORD
Insolvency and Financial Sector Stability: Dark clouds gathering

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BIO

Andres F. Martinez is a senior financial sector specialist with the World Bank's Insolvency and Debt Resolution team, in the Finance, Competitiveness and Innovation ("FCI") Global Practice.

Andres has been a lawyer for over 20 years, has a master's degree in Corporate law and specialises in insolvency and creditors' rights. For over 12 years, Andrés has been advising countries from Latin America, Middle East, Europe and Asia on legal reforms with focus on debt recovery, insolvency laws and workout mechanisms.

Before joining the World Bank in 2008, Andres worked in private practice representing large creditors in debt recovery and insolvency cases.

Andres has published extensively, is an "INSOL Fellow", is a member of the International Insolvency Institute, a member of the international advisory committee of the Singapore Global Restructuring Initiative (SGRI), co-chairs the World Bank Insolvency Task Force and Chairs the World Bank and INSOL International Legislative and Regulatory Colloquium.

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Antonia Menezes is a Senior Financial Sector Specialist with the Insolvency & Debt Resolution Team of the World Bank Group based in Washington D.C. The focus of her work is providing technical assistance and advice to governments on insolvency and debt resolution reforms, including legal aspects of NPL management, with a particular emphasis on work in South Asia, Sub-Saharan Africa and the Caribbean.

Antonia has published widely in the field of insolvency and represents the World Bank Group at Working Group V (Insolvency) of the United Nations Commission on International Trade Law (UNCITRAL).

She is also a Co-Chair of the World Bank Group Insolvency & Creditor/Debtor Regimes (ICR) Task Force, which is responsible for testing and evaluating the effectiveness of the World Bank Group ICR Principles. She is one of the founders of the World Bank-INSOL International Judicial Insolvency Program.

Antonia is a Member of the International Insolvency Institute, a 2014 INSOL International Fellow and sits on the INSOL Fellow's Cross-Border Insolvency Committee. Prior to joining the World Bank Group, Antonia was a UK-qualified solicitor at two leading international law firms in Paris and London.

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In most countries, it appears that the worst health effects of the COVID pandemic are finally behind us. However, the effects arising from the economic fallout are only beginning to become apparent. When the pandemic started to unfold, the initial, widely held impressions were that there would be a major increase in the number of bankruptcies. Words such as "tidal wave" and "tsunami" were used in the context of bankruptcy filing forecasts, which never ultimately materialised. The reasons for the lower-than-usual bankruptcy numbers were, among others, due to the unprecedented emergency responses from governments, including in the form of abundant fiscal stimuli, widespread payment and enforcement moratoria, lenders' accommodating behaviour and, in some countries, formal court proceedings and judicial hearings that were temporarily suspended.

We are now starting to see an uptick of bankruptcy cases in many parts of the world. This follows the wind-down of emergency measures in most economies coupled with a spate of global macro-economic challenges, including rising interest rates, elevated inflation, Russia's invasion of Ukraine, and higher than ever sovereign debt levels. Recent data suggests an increase in insolvencies globally: in the Eurozone, bankruptcies for Q4 of 2022 rose by 26.8%,[1] and in the US, commercial chapter 11 filings increased 79 percent in March 2023.[2] Data also shows that corporate balance sheet vulnerabilities of listed firms fell in 2021, but grew again in the course of 2022.[3] Further, corporate stress tests reveal that balance sheets of listed corporates are now more vulnerable to moderately adverse scenarios than a year ago, particularly in East and South Asia.[4] As moratoria are increasingly discontinued and creditors' patience becomes strained, hidden pressures in banks' asset quality might start coming to light.

Should non-performing loans (NPLs) start to increase sharply, several pillars need to be examined by authorities to help address high NPLs.[5] Some of these key pillars include strong banking regulation and supervision, proficient workout departments at commercial banks, an environment that encourages workouts[6] as well as debt restructurings (including favourable or neutral tax treatment), protected creditors' rights, a legal environment conducive to NPL sales and, of course, efficient and predictable insolvency proceedings.

Efficient and predictable insolvency regimes have been found to improve loan repayment and decrease borrower's risk taking behaviour.[7] Moreover, the adoption of effective insolvency tools, particularly those strengthening creditors' rights, has been shown to reduce default rates, resulting – at least in the short-term – in lower NPL occurrence.[8] Similarly, effective insolvency regimes can facilitate faster NPL level adjustments and private sector deleveraging.[9] The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes and the UNCITRAL Legislative Guide on Insolvency Law have been recognised by the Financial Stability Board as representing the international consensus on best practices for evaluating and developing national insolvency regimes.

1. Compared to the previous quarter. Eurostat, 'Quarterly registrations of new businesses and declarations of bankruptcies – statistics'. Available at: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Quarterly_registrations_of_new_businesses_and_declarations_of_bankruptcies_-_statistics#Quarterly_comparison_in_the_EU_and_euro_area
2. From March 2022 levels. American Bankruptcy Institute, 'Bankruptcy Statistics'. Available at: https://www.abi.org/newsroom/bankruptcy-statistics
3. Erik Feyen and Nepomuk Dunz in the discussion on corporate vulnerability data during the World Bank Insolvency & Creditor/Debtor Regimes Task Force (April 2023)
4. Erik Feyen and Nepomuk Dunz in the discussion on corporate vulnerability data during the World Bank Insolvency & Creditor/Debtor Regimes Task Force (April 2023)
5. Dijkman, M., A. Martinez, V. Salomao, and K. Bauze. 2020. "COVID-19 and Non-Performing Loan Resolution in the Europe and Central Asia Region: Lessons Learned from the Global Financial Crisis for the Pandemic." Policy Note, December 2020, World Bank, Washington, DC. https://thedocs.worldbank.org/en/doc/460131608647127680-0130022020/original/FinSACCOVID19andNPLPolicyNoteDec2020.pdf.
6. Enterprise workouts as well as their enabling environment was the topic of the recent World Bank Insolvency & Creditor/Debtor Regimes ICR Task Force (April 2023).
7. Menezes, A., S. Muro, C. Pereira, and M. Uttamchandani. 2021. "How Insolvency and Creditor-Debtor Regimes Can Help Address Nonperforming Loans." World Bank Group, Washington, DC.
8. Padilla, A.J., and A. Requejo. 2000. "The Costs and Benefits of the Strict Protection of Creditor Rights: Theory and Evidence." Inter-American Development Bank, Washington, DC.
9. Consolo, A., F. Malfa, and B. Pierluigi. 2018. "Insolvency Frameworks and Private Debt: An Empirical Investigation." European Central Bank Working Paper 2189. European Central Bank,

Increasingly, policymakers are recognising the positive influence of effective insolvency frameworks in addressing NPL levels.[10] The Insolvency & Debt Resolution Team of the World Bank has witnessed an extremely high number of reforms in insolvency laws around the world in the last few years. Across developed and emerging markets, there has been a growing emphasis on specialised micro and small firm insolvency proceedings, the inclusion of debtor-in-possession (DIP) financing provisions, the ability of creditors to file for a restructuring plan, and the introduction of pre-insolvency or preventive proceedings in line with the latest European Directive, among others. Many of these reforms are still being absorbed by practitioners and institutions.
In most emerging countries, while the legal systems have been reformed and updated as a result of the recent crises, institutional capacity and restructuring culture remains a challenge and implementation work, a priority.

Given the critical role that insolvency systems play at times like these, it is more important than ever to ensure that they meet their primary economic function of triage: saving viable firms and facilitating exit by non-viable firms, preventing them from becoming zombies. While uncertain times are ahead, it is clear that improvements in insolvency systems have multiple positive effects, including in job preservation, greater access and less costly credit, among other key factors that may become critical in the coming years.[11] Storm clouds might be gathering but insolvency tools can provide some "blue-sky" opportunities to preserve economic value and enhance market efficiency.

10. European Council of the European Union. 2017. "Council Conclusions on Action Plan to Tackle Non-Performing Loans in Europe" July 11. 2017. European Council of the European Union, Brussels, Belgium. Available at https://www.consilium.europa.eu/en/press/pressreleases/2017/07/11/conclusions-non-performing-loans/.
11. World Bank Group. 2014. "Insolvency Reform for Credit, Entrepreneurship and Growth." Insolvency & Debt Resolution Viewpoint. World Bank, Washington, DC.

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Emily specialises in corporate restructuring, turnaround and insolvency. Emily is an Insolvency Practitioner in Australia and qualified accountant. She is a partner of KPMG Australia and leads KPMG Australia's restructuring and turnaround offering for ESG. Emily is also the co-head of KPMG Australia's restructuring infrastructure sector.

Emily has broad experience in leading complex insolvencies across a number of industry sectors. Emily has significant cross-border insolvency experience having worked with corporates in Australia, the UK, US, the British Virgin Islands, Ireland, Cyprus, Ukraine, Sweden, Hong Kong and Singapore. Her experience also includes multijurisdictional restructurings and informal advisory roles. Emily regularly acts as an advisor to governments.

Emily is a fellow of the Institute of Chartered Accountants in England and Wales and a member of Chartered Accountants Australia and New Zealand. Emily is a member of the Turnaround Management Association and of Women in Insolvency and Restructuring Victoria. Emily is also an Australian registered liquidator.

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Mary has eight years of restructuring and insolvency experience, including formal insolvency appointments, expert reports, and informal advisory roles throughout Australia. She has worked across a range of industries, including financial services, hospitality, and mining and natural resources.

Mary has been working over the last 15 months to develop and embed KPMG Australia's ESG expertise in restructuring and deals, tax and legal. Mary has also been exploring how restructuring experts can combine ESG expertise with insolvency expertise to solve ESG challenges. Mary wrote her Honours thesis on the positive correlation between the adoption of sustainability reporting and company market value.

Mary holds a Bachelor of Commerce (Honours) from the University of New South Wales (Australia). Mary is a member of Chartered Accountants Australia & New Zealand and a member of the Australian Restructuring Insolvency & Turnaround Association.

KPMG

Globally, ESG – which stands for Environment, Social and Governance – has become an increasingly important consideration for investors, company stakeholders, boards, governments and communities. ESG is no longer just the domain of socially conscious investors; it has entered the mainstream as a lending consideration, as a shaper of government policy and a driver of corporate strategy towards shaping a better world.

At KPMG Australia, we believe ESG, and the investment required to meet the new community standard, will impact business restructuring as corporations adapt to increased reputational and risk concerns. The future cost of ESG compliance will test business balance sheets, cashflows and operating models in a way that has, until recently, been unprecedented.

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> Safe or valuable, are now subject to a different lens that assesses their values and risk profiles based on non-financial factors.

ESG is also causing fundamental shifts in how the lending community, alternative capital and shareholders reflect on the ways in which businesses are capitalised and financed. Companies may face ESG hurdles that may go to the core of their very existence. An extreme scenario is one where some sectors become unbankable to mainstream lenders, while new lenders with a greater appetite for risk, move in to fill the void.

> "ESG issues are a wakeup call about the impending consequences of climate and social change. Companies, lenders and investors alike have already begun their journey to address and adapt to immediate ESG issues. As their advisors, we too must adapt so we can understand and meet both the current and future business needs." *– Adrian King, Head of Climate Change & Sustainability Services, KPMG Australia*

The business bottom line is rapidly shifting…

ESG considerations bring to light *responsibilities* that may not have been considered, acknowledged or known, in addition to liabilities and obligations brought about by regulatory changes. These off-balance sheet liabilities are growing fast in response to new regulations and an evolving corporate philosophy driven by an organisation's values and stakeholder demands.

> "As off-balance sheet ESG obligations crystallise in monetary terms, businesses will increasingly experience ESG-related distress. The sting in the tail is likely to be the funding obligations attached to the resolution of ESG issues which hitherto may not have been transparent to all stakeholders."*– James Stewart, National Head of Restructuring Services, KPMG Australia*

It is not just liabilities shifting the sands either. Assets previously considered sound, safe or valuable, are now subject to a different lens that assesses their values and risk profiles based on non-financial factors. Assets are becoming stranded. Businesses linked to "dirty" practices are coming under the spotlight, and corporates are at risk of being "cancelled" overnight.

… and with it, so is the attitude of our key stakeholders

Banks

In the last 36 months in Australia, we have seen banks and alternative capital turn their minds to ESG issues and their effects like never before, not just on their roles as facilitators of capital flows, but on the impacts on their customers and asset portfolios.

Banks have been focusing on embedding ESG into their business strategy. This has given rise to a new suite of products for banking customers, including sustainability-linked loans and funds, and improvements to sustainability risk management frameworks.

Decarbonisation is the fastest-moving ESG metric to factor into lending decisions, with Australian major banks already reducing their lending portfolios to thermal coal mining and oil and gas exposures and targeting fully ceasing lending to these sectors by 2035.[1]

There are many key questions to answer: How long will it be until banks start to refuse lending to customers with no clear plan to reach net zero or that are classified as non-ESG customers? As the ESG environment continues to evolve, which ESG issue will result in the next lending exodus? Where will companies be on their ESG journeys when banks decide to tie their lending criteria and risk assessment to a customer's ESG maturity? How long might it be until we have an "ESG bad bank" for customers who don't have a Plan B for ESG issues?

Showcase: Climetric
KPMG Australia has developed Climetric to assist financial service providers with quantifying economic financial transition risks and physical risks associated with their lending portfolio. The tool quantifies the impacts of climate transition risks and key chronic and acute hazards, such as natural disasters, bushfires, and drought stress, on collateral values and credit risk.

Corporates

KPMG Australia's 2022 Survey of Sustainability Reporting reveals that 89% of ASX100 companies have set carbon targets.[2] Whilst this increase in voluntary target setting is welcomed, this has attracted attention from corporate regulators, who are keeping a close eye on ESG disclosures and the potential for widescale greenwashing.

"Greenwashing can give rise to legal and reputational risk for a business. It is a global theme that must be managed by businesses on their ESG transformation journey. It is essential that ESG disclosures are clear and that any claims are reasonable and substantiated." – *John Moutsopoulos, Law, KPMG Australia*

In Australia, companies have been warned by both the Australian Securities and Investments Commission (ASIC) and the Australian Competition and Consumer Commission (ACCC) to take their climate change disclosures seriously, with the regulators prepared to use existing powers to act against companies making false claims about their environmental credentials.

Some Australian companies have been forced to start their ESG journeys due to the impacts of bushfires and floods over the past three years. Businesses have already begun adjusting their operations in line with the physical risk that comes with the climate crisis. This transition is also accelerated by the increasing costs of insurance (or the inability to insure altogether) as insurance providers start to quantify the impacts of climate risks.

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Some Australian companies have been forced to start their ESG journeys due to the impacts of bushfires and floods over the past three years.

Organisations that have not yet begun their ESG journeys are now facing some time pressure. European regulators have already issued mandates holding directors accountable for their company's decisions when it comes to environmental and social action. By 2030, we expect this regulatory approach to have spread across the globe including Australia.[3]

KPMG's Regulatory Horizon tool, which tracks changes to the regulatory landscape around the globe, has been adapted to include ESG-related regulation and is a useful tool to identify regulatory changes affecting organisations.

1 Banks' climate-related disclosures (Phase 1) (KPMG International Standards Group)
2 Sustainability Reporting Survey 2022 | ASX100 & G250 (KPMG Australia)
3 30 Voices on 2030 The ESG Revolution (KPMG Australia)

Business models are also changing in response to ESG

One of the impacts of the ESG revolution include redefining capital and the emergence of *non-financial* capital. This includes:

- Natural Capital, the Earth's renewable and non-renewable resources and processes that support the prosperity of an organisation (such as water, land, forests and minerals)[4]; and

- Biodiversity, which measures the variety of life on earth and the ecosystems in which they live.

With the ongoing focus on environmental and climate issues, management and conservation of natural capital and biodiversity are becoming key priorities for organisations. Nature-related risks are increasingly scrutinised by investors and consumers alike. There is also opportunity for businesses to unlock synergies from adopting a *nature-positive* approach to decarbonisation.

Nature-positive means enhancing the resilience of our planet and societies to halt and reverse nature loss. A nature-positive approach enriches biodiversity, stores carbon, purifies water and reduces pandemic risks.[5]

The pivot to considerations of non-financial capital will impact investment and resource allocation decisions. Understanding non-financial capital can also help businesses improve decision-making and strengthen their social licences to operate.

Case study: Forico and Natural Capital

In 2020, Forico released its inaugural Natural Capital Report to value the most material ecosystem assets under Forico's custodianship. In valuing the forests and vegetation under Forico's management, there was consideration of the social and economic benefits beyond the production of high-quality wood fibre.

Forico's 2021 Natural Capital Report valued its net Natural Capital at AU$3.4 billion, comprised of:

- AU$463 million of environmental assets utilised in the production of wood fibre, like biomass;
- AU$2.9 billion of environmental assets benefitting society in terms of carbon sequestration, provision of natural forest habitat and water flows to downstream communities and businesses.[6]

"We are seeing the Natural Capital reporting landscape evolve rapidly as investors and regulators and the broader society look to better understand value adding and value diminishing practices by industry. Forico's Natural Capital Report is a unique illustrative example demonstrating that traditional financial measures alone are no longer enough to value a business' impacts and dependencies on people, planet, and profit. This shift to more fulsome environmental reporting expressed in financial terms provides stakeholders with more holistic and integrated information that can be used to evaluate a business and its contribution to responsible practices." – *Julia Bilyanska, Partner, Climate Change & Sustainability, KPMG Australia*

So what now for restructuring and insolvency…?

Restructuring professionals face a new paradigm as the industry turns its mind to the opportunities and challenges that ESG creates, and to the tools and methods that we have available to provide solutions. Increasingly, the fork in the road for a consensual restructure vs a formal insolvency process, will be the off-balance sheet liabilities that ESG can create. These liabilities usually go to brand and reputation and are often driven by regulator enquiry or stakeholder activism. The changing ESG environment creates challenges, issues and opportunities for restructuring and insolvency practitioners.

4 Integrated Reporting Framework (International Integrated Reporting Council)
5 Demystifying natural capital and biodiversity (KPMG Australia)
6 Why it's vital to value Nature (KPMG Australia)

Using a turnaround methodology to resolve an ESG challenge

At its simplest, turnaround is a process by which a company addresses elements of underperformance and rehabilitates itself to meet the objectives of its controlling stakeholders. Traditionally, turnaround has been focused on financial underperformance, but the same tools and methodologies (when combined with ESG expertise) can be applied to addressing ESG underperformance and rehabilitation.

The four phases for rebuilding value in a financial underperformance turnaround can also be used to tackle ESG underperformance:

- Quick Focused appraisal: An initial appraisal focused on answering two questions: 1) is stabilisation possible? and 2) is the ESG turnaround possible?

- Stabilisation: To gain control of the situation and stabilise stakeholders, in order to attempt to develop and agree an ESG rehabilitation plan;

- Rehabilitation plan: Identifies the problems and issues that the business faces, set out the operational and financial impact of addressing those issues, describes the future state for the company and quantifies the cost of achieving the transition to that future state. Ultimately, the rehabilitation plan must provide an operational and financial solution to address the ESG underperformance;
- Restoration: In the last phase of the process the management team (and advisors) implement the ESG turnaround plan to deliver actual and sustainable ESG performance improvement.

Insolvency - changing the way in which success is measured

The wholesale adoption of ESG criteria is changing the way in which success is measured in insolvency and restructuring. Traditionally, success in these situations was measured by the monetary return to stakeholders. The incorporation of ESG criteria introduces non-financial thresholds as measures of success. This means that an acceptable monetary return to one stakeholder may also be evaluated against the quality of outcome for all stakeholders. This may take the form of:

- Impacts on the environment and natural capital;

- Societal impacts, including impacts on employees, local communities and future generations; and

- Broader economic impacts, such as antitrust or consumer protection.

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> The wholesale adoption of ESG criteria is changing the way in which success is measured in insolvency and restructuring.

In Australia, an insolvency Administrator or Liquidator has a duty to act in the best interests of all creditors, but interests are not defined in monetary terms. The adoption of ESG criteria will create a shift to non-financial aspects of a restructuring process and restructuring professionals will increasingly give greater consideration to these aspects in making decisions.

Case study: Disability Services Australia Group (DSA)

DSA entered Voluntary Administration in mid-2021. DSA looked after 600 participants in the Australian National Disability Insurance Scheme and employed 500 persons with disability needs.

Gayle Dickerson, Peter Gothard and James Dampney of KPMG Australia worked to recapitalise DSA over a period of four months, which included receiving over 20 offers to return DSA's business to solvency.

To assess these offers the Administrators developed a set of non-financial criteria, including assessments of:

- The continuity of employment for all employees;
- Retention of DSA's not-for-profit status; and
- Long-term commitments to the preservation of the core business.

"Our first priority during the administration was the welfare of DSA's participants. Our assessment of the proposals to recapitalise DSA, was centred around social and governance factors and the provision of ongoing quality support services by DSA." – *Gayle Dickerson, Restructuring Partner, KPMG Australia*

Conclusion

The world is not just changing; it has changed. We believe that business restructuring success in the future will increasingly be defined not only by the commercial outcome to stakeholders, but also by the benefit to the community more broadly. ESG will no longer be a separate consideration but will be at the heart of our work.

To embed ESG into our restructuring work, we must change our mindset. Without an ESG mindset, we may not be able to critically assess what pathways may return businesses to long-term, sustainable profitability, or understand the true toll that a non-performing business can have on society.

We must also establish specialist capability in understanding how ESG issues must be prioritised in times of distress or underperformance. Our ability to triage ESG issues in an insolvency process or turnaround will be key to effectively utilising ESG expertise and capability as part of a company's rehabilitation.

> “
> To embed ESG into our restructuring work, we must change our mindset.

As an industry we have already grown accustomed to adapting, whether it is in response to global financial crises or changing stakeholder appetites. We now have a rare opportunity to pro-actively adapt and embed ESG into the work that we do. It is time for us to begin the ESG journey.

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BIO

Charles Dumont de Chassart is a qualified Belgian attorney admitted to the Brussels Bar since 2006.

He has a strong experience in insolvency procedures (bankruptcy, liquidation, judicial reorganisation), business restructuring and corporate law. He acts on a regular basis for creditors, banks and companies in distress. He is regularly appointed as trustee and liquidator by the Undertaking Court of Brussels. He is also an experienced litigator in commercial and corporate matters, white collar crimes and directors liability.

He has over 15 years of professional expertise in business restructuring and insolvency law: law on continuity of undertakings, collective negotiations with creditors, debts restructuring and haircuts, distressed acquisitions and transfers under supervision of the Court, bankruptcy and liquidations.

Charles holds a Master's degree from the Université Catholique de Louvain, and a Master of Laws L.L.M in European Law from the University of Aberdeen, Scotland.

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Stéphanie Nachsem is a member of the Brussels Bar since 2021.

She practices in commercial law and business restructuring, with particular focus on litigation, insolvency law and judicial reorganisation procedures.

She advises companies in the context of commercial dispute resolution. She also assists within the framework of bankruptcy operations, notably assets recovery and directors' liability.

She holds a Master's degree in Business law from the University of Liège, during which she took part to the 28th Willem C. Vis International Commercial Arbitration Moot (Vis moot). She also did an exchange program at the University of Kobe (Japan) in International Business Law.

Introduction

Though the COVID-19 crisis seems to be coming to an end, the European and global economy is already facing changes of a much greater magnitude and of a different nature.

Governments are now dealing with new challenges: inflation, the climate and geopolitical tensions from the war in Ukraine. The terms "economic recession" and "inflation" come up frequently, and there has been a significant increase in bankruptcies in Belgium.

> "
> Belgian insolvency law, which has already been considerably strengthened in recent years, is now on the verge of a new major reform.

In this unstable macroeconomic context, a draft bill to transpose the Restructuring and Insolvency Directive ((EU) 2019/1023) was approved in November 2022 by the Belgian Council of Ministers.

Belgian insolvency law, which has already been considerably strengthened in recent years, is now on the verge of a new major reform, which should be adopted shortly.

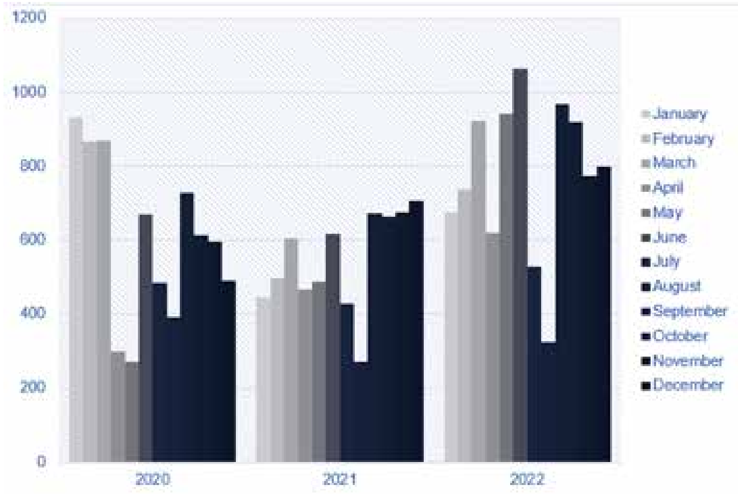
This new reform aims to improve the efficiency of restructuring procedures. Inspired by the US Chapter 11, it provides for a framework of private insolvency procedures and preventive actions to be implemented before insolvency becomes irreversible.

In these challenging times, and with all the indications that they will be here for the long term, the question is whether this new legislation will allow companies to find the tools to preserve their most essential resources and tools.

Latest trends and developments in Belgium

Latest figures

2022 saw a net increase in the number of bankruptcies pronounced by the courts in Belgium. The figures for the first six months of the year are more than 50% higher than in 2021 and the figures for the second half of the year have remained at a high level.



The latest increase is primarily explained by the lifting of the various measures put in place by the Belgian government to support businesses during the COVID-19 crisis. Even if they are significant, the figures are not exceptional. They are gradually returning to levels that were already seen during the pre-crisis situation.

The economy now has to face the new challenge of rising energy and raw material costs in the context of the war in Ukraine. But these events are more recent and cannot yet be considered as the main cause of the increase in bankruptcies in 2022. However, they are gradually reinforcing the upward trend. With high international tensions, 2023 could bring an even greater challenge for Belgian companies. In any case, the figures will have to be monitored closely.

Sectors concerned

The largest increase was recorded in the construction sector. There are several reasons for this. First, construction companies have to index wages in advance of other sectors. In addition, public work orders have declined. Finally, construction companies have seen their energy and material costs increase significantly in the past few months. The second most affected sector is the hotel and catering industry. Here too, the sector had been supported by the government, which put in place numerous business support measures during the COVID-19 crisis. This has now ended. And it has long been known that the post-COVID-19 months would be difficult.

Landmark cases

Belgian judicial news on insolvability was marked in 2022 by several important cases. In March 2021, Liberty Steel, the steel subsidiary of Sanjeev Gupta's conglomerate GFG Alliance, had to deal with the possible bankruptcy of Greensill Capital, its main financier in the UK, and, as a result, a possible dismantling.

Liberty Steel has two major industrial sites in the region of Liège.

In 2021, a reorganisation plan by collective agreement with the different creditors was negotiated and was approved by the Belgian courts. This was obviously not sufficient, as in 2022, the sites in Liège were shut down for several months.

Faced with this situation, the Liège courts took exceptional measures. Liberty Steel's activities in Belgium were put under judicial reorganisation while a trustee took over the management. The aim of the procedure is the dismantling and the sale of the activities to other players in the steel industry. A new judicial reorganisation measure was pronounced, with the sole aim of transferring the activities. This measure has been pronounced not at the request of Liberty, but by judicial offices appointed by the Court, ie against the will of the debtor. The procedure for the sale of the assets is currently underway. The sale of the Liberty Steel business was organised at court level.

Main options under Belgian law for a company to overcome an insolvency situation

General

The objective of judicial reorganisation procedures is to allow companies facing difficulties to avoid bankruptcy and to effectively continue its activities while restructuring them (ie the equivalent of Chapter 11 of the United States Bankruptcy Code). Under Belgian law, this can be achieved by the company negotiating an agreement with its creditors on its debt, either by negotiating an amicable agreement (*accord amiable/minnelijk akkoord*) with some of them or a collective agreement (*accord collectif/collectief akkoord*) that can be imposed on certain creditors. Or by transferring all or part of its business, under the supervision of the Court (*transfert sous autorité de justice/overdracht onder gerechtelijk gezag*). This way the debtor remains, in principle, in control of its activities. Whichever option is chosen, the debtor benefits from protection from creditors in the form of a stay of enforcement proceedings.

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> Belgian judicial news on insolvability was marked in 2022 by several important cases.

Latest developments

Draft Belgian law underway to implement the EU Directive 2019/1023 of 20 June 2019 on preventive restructuring frameworks

Latest state of legislative process

As a reminder, a new restructuring and insolvency Belgian law has been expected for several months to transpose the EU Restructuring and Insolvency Directive 2019/1023.[1]

1. Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency), Document 32019L1023, ELI: http://data.europa.eu/eli/dir/2019/1023/oj.

A draft bill was finally approved in November 2022 by the Belgian Council of Ministers. The bill has yet to be submitted to the Council of State and could be presented to the Belgian Parliament in early 2023. The law is likely to come into force in 2023.

Key/Main changes expected

Under the new reform, the economic value of the company continues to be at the heart of the debate. The reform should lead to a faster and more efficient restructuring of distressed companies, more homogeneity within the EU and, hopefully, a positive impact on its economy.

The new law mainly:
- introduces creditor classes for large companies;
- adapts the legislation on judicial reorganisation by transfer of business under judicial authority to the requirements laid down by the Court of Justice of the EU following the Smallsteps, Plessers, and – the most recent – Heiploeg judgments;
- introduces private preparation for bankruptcy; and
- increases the possibilities for immediate liquidation in bankruptcy scenarios.

Collective agreement with creditors – Creditor classes for large companies

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The division into classes of creditors in the framework of the reorganisation procedure by collective agreement is the most important innovation of the reform.

The current text of the law (before the reform) does not contain any distinction between classes of creditors. So far, the creditors – taking part in the reorganisation plan of their debtor – vote in a single class under the majority rule of creditors and claims. There are only specific provisions that protect security holders and public creditors.

Under the prospected new law, a "restructuring expert" (ie a neutral person with no links to shareholders, directors or creditors) will draw up a list of all parties, including the shareholders, involved in the restructuring. This list will start with the shareholders and will also divide the creditors into categories: for example those who have or do not have a mortgage; those who have or do not have other privileges; those who are likely to make bigger concessions in the rescue of the company and those who will be asked to compromise less.

A vote will then be held on the restructuring plan (one vote per category). If the plan is approved by a majority in each category, the matter is closed. However if there is no unanimity, the judge can – as far as other specific conditions set out by the new law are met – override the opposing votes from a class of shareholders or creditors who have lost everything anyway. The debt restructuring can then continue.

To put it simply, a plan should be validated if the value of the continuing business is greater than the proceeds from its liquidation. It is no longer just a question of preserving the business at all costs, as historically supported by the legislator with a view to safeguarding jobs. It is also a question of protecting the interests of creditors, given the potential for significant and cascading losses. In this context, the approach is rather pragmatic: the aim is to assess as best as possible the future situation of creditors in the event of insolvency and not to allow a collective agreement to be refused when the creditor cannot obtain anything more in the event of liquidation. The majority of the classes of affected parties will be able to impose a restructuring plan on recalcitrant creditors who do not want it.

The new rules should only apply to large companies. For SMEs, the current rules continue to apply. As for "large companies," it should be understood as a company that exceeds one or more of the following criteria during two consecutive accounting periods:
- annual average number of workers: 250;
- annual turnover excluding value added tax: EUR40 million;
- balance sheet total: EUR20 million.

Amicable agreement concluded out of court

7. CJUE, judgment Plessers, 16 May 2019, C-509/17, ECLI:EU:C:2019:424.
8. P. Lambrecht, N. Ragheno, « Continuité des entreprises : succès ou faillite de la loi ? », Wymeersch, E. and al. (ed.), het vennootschapsbelang, 1e edition, Brussels, Intersentia, 2017, p. 305.

The bill should also introduce the conclusion of an amicable agreement with creditors outside the context of a judicial reorganisation procedure. The debtor may have the agreement endorsed by the court upon request to the president, to make it enforceable. The decision is not subject to any publication or notification. The judge may only refuse to homologate the agreement if the debtor clearly has no prospect of economic viability or if the agreement clearly cannot be implemented without jeopardising the rights of third parties to the debtor's assets.

Private judicial reorganisation procedure

So far, the general rule is that a judicial reorganisation procedure has to be conducted in a public manner, ie the opening of the procedure is announced in the Belgian Official Gazette. This has the immediate consequence of making all suppliers suspicious and accelerating the company's difficulties.

A clear demarcation between public and private proceedings should now be instituted in the new provisions for all judicial reorganisation proceedings (either by amicable agreement, collective agreement or private preparation for bankruptcy).

The so-called "private procedure" (and their related court decisions) will not be subject to any publication. The material contained in the register will be confidential and will only be accessible to the debtor, the reorganisation practitioner, the creditors involved in the proceedings and the members of the courts and tribunals by mean of their functions. Any application will be dealt within private chambers of the court.

These private procedures are of great interest for distressed companies as they will be able to carry out a reorganisation in a confidential manner, without creditors immediately becoming distrustful, which generally creates difficulties in continuing the business and reinforcing the cash drain situation.

The new reform should also allow companies to carry out a continuation of business along with a private preparation for bankruptcy. The debtor may apply to the court to declare themself bankrupt, and request that, before the declaration of bankruptcy, preparations be made for the transfer of all or part of their property and activities. The procedure must not be subject to any publicity. For the judge to grant this request, the debtor must demonstrate in their application that this method of bankruptcy preparation:

- facilitates the liquidation of the company, which allows the highest possible amount to be paid to creditors; and
- preserves employment as much as possible.

Silent bankruptcy preparation makes it possible to find a buyer for the business, to sell the business after bankruptcy – without the debts – and to save jobs.

Efficiency measures through electronic procedure

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> The so-called "private procedure" (and their related court decisions) will not be subject to any publication.

The use of "RegSol" (the electronic platform/register for reorganisation and insolvency proceedings) should be considerably expanded in the new reform. Belgium has already opted for a full electronic management of insolvency proceedings, in which RegSol plays a central role. What the Directive requires for the future has already been achieved to a large extent in Belgian law. For the time being, bankruptcies are fully managed by the electronic platform, which allows a much better visibility for the different actors.

In the future, a large number of actors would be allowed to consult the reorganisation file. This access will be given to any creditor who has registered in the register and to staff representatives.

In addition, a number of applications will now have to be filed on RegSol (ie applications for the release of seizures, application for the fixing of the creditors' meeting once the liquidation of the bankruptcy is completed, application for discharge filed by the bankrupt's personal surety).

Implementation of Court of Justice case law – Plessers

9. Law of 21 March 2021 amending Book XX of the Economic Law Code and the Income Tax Code 1992, article 6, M.B., 26 March 2021.

Following the rulings of the Court of Justice of the European Union, the Belgian legislator should adapt the Belgian transfer reorganisation procedure to European law. As a reminder, the European Court of Justice had considered that the Belgian judicial reorganisation procedure did not conform with EU law in that it allowed the purchaser of a business to choose the employees it intended to take over. The European Court of Justice ruled that this possibility of choice was only possible in a liquidation or bankruptcy, whereas this was not the case with the judicial reorganisation procedure (see Smallsteps[2], Plessers[3] and Heiploeg cases[4]).

The new law should clarify that the judicial reorganisation procedure by transfer must lead to the liquidation of the company – so the freedom of choice to take back certain employees is preserved.

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> Measures have been taken to allow a quicker winding up of companies for which a (sometimes) lengthy bankruptcy procedure is not justified.

In this respect, the procedure will in all cases result in the subsequent declaration of liquidation or bankruptcy of the debtor. The insolvency practitioner will make provision for the amounts necessary for the management of the liquidation or bankruptcy after the transfer.

In addition, the insolvency court will now be obliged, while authorising the transfer, to check the reasons for the transferee's choice not to take over certain employees in relation to the various categories of employees.

These measures and adjustments should make it possible to definitively confirm the possibility for the transferee to choose the employees to be taken over. This is an important correction: it guarantees legal certainty for the buyer and facilitates the takeover of companies in difficulty under clear and transparent conditions.

Simplified liquidation

Access to liquidation should be eased. Measures have been taken to allow a quicker winding up of companies for which a (sometimes) lengthy bankruptcy procedure is not justified. This mainly concerns companies that are not in a suspicious situation and have no assets left to realise.

Any person requesting bankruptcy (through summons or by confession of the debtor) may request by the same act that the court, after having ascertained that the conditions for bankruptcy have been met, pronounce the judicial dissolution of the debtor.

The court may pronounce the dissolution if it considers that the conditions for bankruptcy have been met but that there are no significant assets and that the public interest so requires.

Proposal for new EU Directive harmonising certain aspects of insolvency law

Though the EU Directive on Restructuring and Insolvency has not yet been implemented in all Member States (eg Belgium), the Commission published another proposal for harmonizing insolvency on 7 December 2022.

The proposal aims at encouraging cross-border investment in the single market through targeted further harmonisation of insolvency proceedings, with a particular focus on the recovery of assets from the liquidated insolvency estate, the efficiency of procedures; and the predictable and fair distribution of recovered value among creditors.

2. Judgment of the Court (Third Chamber) of 22 June 2017, Federatie Nederlandse Vakvereniging and Others v Smallsteps BV, C-126/16, ECLI:EU:C:2017:489
3. Judgment of the Court (Third Chamber) of 16 May 2019, Christa Plessers v PREFACO NV and Belgische Staat, C-509/17, ECLI:EU:C:2019:424
4. Judgment of the Court (Third Chamber) of 28 April 2022, Federatie Nederlandse Vakbeweging v Heiploeg Seafood International BV and Heitrans International BV, C-237/20, ECLI:EU:C:2022:321

As announced by the European Commission[5], the proposal provides for:

- a minimum set of harmonised conditions for exercising avoidance actions;
- strengthening asset traceability through improved access by insolvency practitioners to asset registers, including in a cross-border setting;
- provisions to introduce "pre-pack" liquidation procedures;
- provisions on a duty of directors to file for insolvency on time to avoid potential asset value losses for creditors;
- simplified liquidation procedure for insolvent microenterprises;
- requirements for improving the representation of creditors' interests in the proceedings through creditors' committees;
- enhanced transparency for creditors on the key features of national insolvency regimes, including on the rules governing insolvency triggers and the ranking of claims.

The next step is to examine to what extent Belgian insolvency law needs to be adapted. But it is clear that national law already largely meets several of the objectives of the Directive.

Perspectives for the future and conclusion

Belgian insolvency law will undergo further significant developments in the coming months. The new law has not yet been adopted and debates may still take place on certain provisions. But the main guidelines appear to have been adopted in the draft bill of November 2022. The law is intended to be as pragmatic as possible, to give the company as many chances as possible to safeguard its activities. This is to be welcomed. But this is at the expense of a certain simplicity. The law is becoming more complex; for example, with regard to the mechanisms for voting by creditors on a collective agreement.

With the prospected new law and the classes of affected parties, the creditors refusing the plan may be outvoted and will then have to follow the plan voted in by the majority of creditors under certain conditions. The ability of the insolvency practitioner to defend the value as a going concern will be fundamental, as will the ability to obtain a consensus on that value from all creditors and from shareholders and potential new lenders.

The company facing difficulties will have a greater chance of finding a solution to its problems under Belgian law. But companies will need specialist advice in a field that is becoming significantly more complex.

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Belgian insolvency law will undergo further significant developments in the coming months.

5. *Insolvency proceedings*, (s. d.), European Commission, https://commission.europa.eu/strategy-and-policy/policies/justice-and-fundamental-rights/civil-justice/civil-and-commercial-law/insolvency-proceedings_en

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Owen is a fellow member of the Institute of Chartered Accountants of England and Wales, a member of American Bankruptcy Institute and a member of RISA, the Cayman chapter of INSOL.

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A member of Nexia International

The Cayman Islands remain at the forefront of developments in offshore restructuring and insolvency law, benefiting from a well established and dynamic financial and legal sector. During 2022, the long anticipated Restructuring Officer Regime was enacted and came into effect, further enhancing the reputation of the Cayman Islands as a modern and sophisticated restructuring jurisdiction and a leader in global insolvency and business rescue practices.

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> Historically in the Cayman Islands a provisional liquidation was the principal statutory restructuring tool available to a company in financial difficulty.

In addition to the recent introduction of a formal Restructuring Officer regime, we have also seen the implementation of the Private Funding of Legal Services Act 2020 which provided mechanisms for liquidators to utilise litigation funding and agree contingency fee arrangements, if appropriate, as tools for financing and bringing litigation claims. This legislation has effectively removed the offence of champerty and maintenance under common law which previously existed in the Cayman Islands, and is a further example of how the Cayman Islands have continued to evolve to accommodate developing trends in the wider litigation and restructuring markets.

The restructuring and insolvency regime in the Cayman Islands has its roots in the English legal system. The main legislation governing insolvency procedures is as follows:

- Companies Act (2022 Revision) (the "Companies Act");
- Companies Winding Up Rules 2018; and
- Insolvency Practitioners' Regulations 2018 ("IPR").

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During 2022, the Insolvency Practitioners' Regulations (Amendment) Regulations 2022 ("IPAR") also became effective, and provided for an uplift in the prescribed rates of remuneration for official liquidators with effect from 1 September 2022. This was the first revision to the minimum and maximum rates which can be charged by official liquidators and their staff in the Cayman Islands since 2013.

The Restructuring Officer regime

Historically in the Cayman Islands a provisional liquidation was the principal statutory restructuring tool available to a company in financial difficulty. Whilst not strictly intended for the purpose of facilitating a restructuring, the practice of presenting a winding up petition in the Cayman Islands combined with the appointment of what has been termed "light-touch" provisional liquidators for restructuring purposes became the commonly used tool for facilitating a financial restructuring in the jurisdiction.

While the "light-touch" provisional liquidation procedure has often been used to good effect to implement a restructuring plan, it was far from ideal as it required the simultaneous presentation of a winding up petition which had the ability to create reputational and commercial issues for a company looking for a way through short term financial difficulties.

The new Restructuring Officer regime came into effect in the Cayman Islands on 31 August 2022 after an extensive period of consultation between legislators and industry members. The new regime will significantly enhance the existing provisions under Cayman Islands law by:

- Removing the need to file a winding up petition in order to obtain a stay on creditor action;

- Providing for the stay to arise automatically on filing the papers without the need for any Grand Court ("Court") hearing (under the prior law the moratorium only came into effect on the appointment of provisional liquidators);

- Providing that, as a matter of Cayman Island law, the stay will have extraterritorial effect; and

- Including provisions which provide the potential for Cayman Islands schemes of arrangement to compromise debt governed by English law.

The new Restructuring Officer regime will enable a company to seek the appointment of a Restructuring Officer ("RO") by the Court and to allow the company breathing room to pursue a restructuring plan. The test for the appointment of an RO will be substantially the same as for an application for the appointment of provisional liquidators under the old legislation, namely that the company is or is likely to become unable to pay its debts and intends to present a compromise or arrangement to its creditors. It should be noted that the new regime supplements the provisional liquidation process as opposed to replacing it in its entirety.

Practically, under the new Restructuring Officer regime the company itself will be able to apply to Court for the appointment of an RO, and a winding up petition does not need to be issued against the company. This removes the prior difficulty of a company needing to find a friendly creditor to bring a winding up petition, or to obtain a shareholder resolution placing the company into liquidation, both of which have practical drawbacks.

Whilst the new RO regime undoubtedly introduces additional debtor protections in comparison to those available under the previous legislation, in particular the imposition of an automatic stay with extra-territorial effect upon filing, it also preserves and enshrines certain creditor rights. Key protections include the following:

a) there remains no stay in any Cayman Islands insolvency or restructuring procedures on the enforcement of security by secured creditors; and

b) the default position remains that all restructuring petitions must be advertised and heard on notice to all stakeholders.

There are further safeguards built into the new legislation which provide protection for creditors from debtor companies that may seek to use the statutory moratorium to buy time, without properly progressing the application, or that do not have a genuine intention to restructure the company. These safeguards include a requirement for petitions to be heard within 21 days (subject to order of the Court), the prescription of specific matters which must be addressed in a debtor company's affidavit filed in support of a petition, and the requirement for the RO to report to the Court within 28 days of their appointment. These provisions within the legislation are designed to ensure that creditors are protected from potential abuses of the process that might otherwise have occurred.

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The new Restructuring Officer regime came into effect in the Cayman Islands on 31 August 2022 after an extensive period of consultation between legislators and industry members.

From an implementation and reorganisation perspective there are further benefits to both debtors and their stakeholders from the new RO regime. Notably, an application may be made to sanction a compromise or arrangement with the creditors or members of a company, without the need to commence separate proceedings to sanction the scheme of arrangement under section 86 of the Companies Act. Alongside these cost savings and efficiency benefits, there is also no longer a requirement to comply with the "headcount test". A members' scheme of arrangement will be deemed to be binding on the members of a company if the scheme is approved by a majority of 75% of members in value and no longer also requires the approval by the majority of members in number.

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Like many jurisdictions, the restructuring and insolvency market in the Cayman Islands has been impacted by the global economic challenges arising from the coronavirus.

The new legislation is in its infancy and its full impact is yet to be seen. Nevertheless it represents a clear commitment to the continued evolution of the Cayman Islands legal system to meet the complexities and challenges of cross-border restructurings and business turnarounds in the modern global economy and is a welcome addition to the insolvency practitioner's tool kit.

General Restructuring and Insolvency Market Trends

Like many jurisdictions, the restructuring and insolvency market in the Cayman Islands has been impacted by the global economic challenges arising from the coronavirus (COVID-19) pandemic and more recently the war in Ukraine. We have also felt the effects of a growing debt issue in the People's Republic of China ("PRC") and the knock on impact of these macro-economic events on capital markets, monetary policy and supply chains around the world.

Despite these strong headwinds, the number of formal insolvency appointments in the Cayman Islands has remained fairly modest in the first three quarters of 2022 and is tracking behind pre-pandemic levels. Unsurprisingly, the principal activity in the market has been a focus on debt restructurings which will no doubt continue given the pessimistic general global economic outlook for 2023/24.

Notwithstanding the above, we are fortunate to have been involved with a number of interesting new appointments in the last 12 months. HQP Corporation Limited ("HQP") is one such engagement which involved an initial provisional liquidation appointment with the aim of determining whether a restructuring of a wider group structure was appropriate. HQP is a Cayman Islands holding company with subsidiary entities in Hong Kong and the PRC. It was set up as a financing vehicle for the purpose of raising capital for the operating entity of the group, a company developing a business to business auto parts trading platform in the PRC. A group structure of this nature and purpose is relatively common in the jurisdiction.

Following allegations of fraud, the shareholders of the company filed a petition with the Grand Court to have the company placed initially into provisional liquidation to explore the possibility of restructuring the group, however, after several months of financial analysis it was determined that a restructuring would not be viable and that a winding up order should be made.

Given the increasingly pessimistic global economic outlook it is likely that we will see more engagements featuring misfeasance in the future which we expect to lead to an increased need for specialist forensic investigations and reviews to be performed by office holders as they look to trace and recover funds and other assets which have been misappropriated.

Often this recovery and investigation work takes place in the context of an official liquidation and we are increasingly seeing the benefits of using new technology to assist with the preservation and reconstruction of company records to assist with both physical asset recoveries and also the pursuit of claims via litigation. The ability to fund such actions is key to the successful outcome and recovery of assets for the benefit of creditors and the market has seen an inflow of third party litigation and insolvency funding options in recent years. Overall we see this as a positive trend if it allows office holders to pursue claims and advance matters that might otherwise not have been possible due to a lack of funding. We have seen the direct benefit of such funding in the well-publicised case of Platinum Partners Value Arbitrage Fund L.P.

Another ongoing trend in the jurisdiction is the bringing of claims under section 238 of the Companies Act, which involves the Court in determining fair value of shares following a merger or consolidation. These cases are typically brought by disenfranchised shareholders who feel "squeezed out" and not adequately compensated for their investment and often lead to significant disputes over valuation and competing expert opinions as to fair value.

Cross border recognition and challenges

With the cross border nature of insolvency proceedings often seen in the Cayman Islands, stakeholders regularly need to consider the most appropriate venue or jurisdiction in which to file their claim or file a winding up proceeding. This can sometimes lead to confusion and conflicting officeholders in different jurisdictions appointed over the same company and assets.

Recently, we have seen a trend in Hong Kong where the High Court has granted winding up petitions in respect of entities incorporated in the Cayman Islands where the principal operations of the company are conducted in the PRC. The basis of these orders is often that the centre of main interests ("COMI") of the company is located in Hong Kong, whereas the law in the Cayman Islands is based on the seat of a company's incorporation.

Historically we have also seen a significant number of provisional and official liquidations of Cayman Islands incorporated entities with operations in the PRC and listed on the Hong Kong Stock Exchange. The Hong Kong court's recent resistance in recognising Cayman officeholders in Hong Kong and a developing trend to make winding up orders in Hong Kong despite the appointment of restructuring professionals in the Cayman Islands has raised significant hurdles for liquidators looking to carry out their duties in a meaningful way. This approach has resulted in parallel proceedings being conducted in two jurisdictions over the same entity, often leading to a duplication of costs and challenges for office holders looking to protect the interests of the same group of creditors.

This topic continues to evolve and is not isolated to the Cayman Islands. Nevertheless, recent judgments concerning Silver Base Group and GTI Holdings Limited suggest that we will continue to see parallel proceedings occurring in Hong Kong and jurisdictions such as the Cayman Islands, at least in the short term.

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Recently, we have seen a trend in Hong Kong where the High Court has granted winding up petitions in respect of entities incorporated in the Cayman Islands.

On a more positive note, we have seen some useful clarification from the US Bankruptcy Court in the recent Modern Land (China) Co. Ltd ("Modern Land") case which confirmed that a Cayman Islands scheme of arrangement recognised as a main proceeding under Chapter 15 would constitute a substantive discharge of New York law governed debt. This followed the Rare Earth Magnesium Technology Group sanction order, issued by the Hong Kong court earlier in the year, which seemed to suggest that an offshore scheme of arrangement recognised in the US might not bind a creditor say in Hong Kong, who did not participate in the scheme of arrangement process.

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Future Drivers to the Market

The global economy has been shaken by the war in Ukraine at the start of 2022. The war shows no sign of being concluded in the short term and has compounded the challenges already faced by markets and economies looking to recover from the well documented impacts of the COVID pandemic.

Rising energy and food prices as a result of the war and associated sanctions introduced both against and by Russia, have now combined with global inflationary pressures as businesses have looked to pass on higher energy, transportation and labour costs to consumers. We have also continued to see supply chain issues caused by China's now seemingly abandoned zero COVID-19 policy which has further impacted and exacerbated these inflationary pressures and had the effect of putting the brakes on global economic growth in 2022.

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> Given the attraction of the jurisdiction to crypto funds and other blockchain start-ups we would expect to see a potential fallout from the cooling off in this particular market after its staggering expansion in recent years.

This has resulted in a general tightening of monetary policy in the second half of 2022 as economic activity has struggled to rebound in line with projections post pandemic, whilst global GDP growth has stagnated in Q2 2022. Capital markets have inevitably tightened as a result of the darkening economic outlook and the low costs of borrowing which many businesses have become accustomed to since the 2008 financial crisis are potentially a thing of the past.

Rising interest rates, inflationary pressures across the board and continuing supply chain issues coupled with a more fractious geopolitical environment mean that many businesses will face significant challenges over the next few years. This will no doubt have an impact on the funds market as well as traditional asset holding companies which are popular in the jurisdiction.

Given the attraction of the jurisdiction to crypto funds and other blockchain start-ups we would expect to see further fallout from the cooling off in this particular market after its staggering expansion in recent years. A number of high profile crypto-related companies are having well publicised financial difficulties following the collapse of exchanges like FTX in December 2022 and the turbulence and general devaluation experienced in many cryptocurrencies over the last 12 months. Our view is the challenges and contagion caused by recent failures in the market will continue into 2023.

Another potential driver to general trends in the market place might be the recent decision from the Supreme Court in England in BTI v Sequana which has clarified when directors owe duties to the company that should take into account creditors' interests. The decision will be highly persuasive in the Cayman Islands and should be borne in mind by companies and their directors, particularly in the current economic environment.

BULGARIA
Overview, key developments & the latest trends in Bulgaria – from a legal perspective

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(Chambers Europe, 2022)

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Overview

The current Bulgarian regime governing insolvency and restructuring proceedings dates back to the late 1990s and has undergone a number of amendments throughout the years. Certain remaining deficiencies in the regime still drive efforts by lawmakers for improvement.

> "The current Bulgarian regime governing insolvency and restructuring proceedings dates back to the late 1990s and has undergone a number of amendments throughout the years.

Insolvency proceedings tend to last on average for over three years, while the reported average for the European Union is two years. The extra length of the proceedings makes them associated with higher costs. Between 2017 and 2021, the number of applications for the opening of insolvency proceedings totalled nearly 4,000, with applications gradually increasing on average each year. In contrast, only a handful of applications have been made for restructuring (so-called stabilisation proceedings), revealing that the available restructuring framework does not provide effective tools for distressed companies to be recovered into viable businesses. Coupled with the low collection rate for creditors of 35% in comparison to the 65% average for the European Union, these aspects highlight the need for amendments to the current regime.

To improve the legislative framework and respond to the needs of distressed companies, in 2022, the Bulgarian government took steps towards addressing the above deficiencies, most notably by introducing a draft law ("**Restructuring Draft Law**"), amending and supplementing the existing insolvency and restructuring regime under the Bulgarian Commerce Act, which is expected to be adopted in 2023. While the fundamentals of the existing insolvency and restructuring regime, such as their court-driven character, are kept in place, the new amendments aim to ensure greater efficiency, preservation of the insolvency estate, and removal of obstacles for the use of restructuring proceedings.

Basic legal framework

As a member of the European Union, Bulgaria directly applies Regulation (EU) No. 2015/848 of the European Parliament and the Council of 20 May 2015 on insolvency proceedings (recast), whereas the specific local rules are set out under Part IV (Insolvency) of the Bulgarian Commerce Act.

In case the debtor is deemed insolvent, the framework on court-governed insolvency proceedings (in Bulgarian: „производство по несъстоятелност") will apply. Such proceedings may lead to two main outcomes – either (i) liquidation of the debtor, or (ii) continuation of its business activity on the basis of a recovery plan.

In case the debtor is not yet insolvent but in imminent threat of insolvency, the framework on court-governed stabilisation proceedings (in Bulgarian: „производство по стабилзиация") will apply. Such proceedings (as opposed to insolvency proceedings) provide an option to such debtor as a means of restructuring the debtor's obligations.

Grounds for initiation of the insolvency proceedings

There are two main grounds for initiation of insolvency proceedings: (i) financial insolvency (in Bulgarian: „неплатежоспособност"), generally meaning the inability to perform payment obligations as they fall due, and (ii) over-indebtedness (in Bulgarian: „свръхзадълженост"), generally meaning that the assets of the debtor are not sufficient to cover its monetary (payment) obligations.

Over-indebtedness tends to be the more common reason for companies to declare insolvency. Therefore, the legislators have taken steps through the Restructuring Draft Law to refine the term over-indebtedness by introducing a proposal for over-indebtedness to now encompass not only monetary obligations but all liabilities of a company, therefore introducing the negative equity balance-sheet test, where the debtor is considered "over-indebted" if its assets are not enough to cover all of its liabilities.

Initiation and measures against "forum shopping"

Insolvency proceedings may be initiated either by the insolvent company or by its creditors by an application to the competent district court. In line with the aim of avoiding lengthy and inefficient proceedings in the future, the Bulgarian government has proposed changes to the procedure for reviewing applications for the opening of insolvency proceedings in the case of competing applications. In particular, if the debtor files an application within a certain time period while the proceedings on a competing creditor's application are on-going, the court will now accept both applications for joint examination. This step will ensure that no procedural time is wasted, as insolvency proceedings will be initiated on the basis of the debtor's application, even if the creditor's application is not accepted.

An important proposal in the Restructuring Draft Law concerns the competent court that can hear insolvency cases. In particular, it is envisaged that if the seat of the debtor has been changed less than six months prior to the initiation of insolvency proceedings, the competent court to hear the case would be determined based on the seat of the debtor prior to this change. This is aimed as a measure against "forum shopping" practices, where debtors change their seat shortly before insolvency proceedings, in order for their case to be heard by a court that will treat it more favourably.

Timeline

Insolvency proceedings in Bulgaria consist of three main phases:

(i) Preliminary phase – during this phase, the court analyses the insolvency application and the grounds for opening insolvency proceedings. If submitted by the debtor, the court reviews the application immediately in a closed session. If submitted by a creditor, the application is reviewed within 14 days of filing, after summoning the debtor.

The company may generally continue operating business as usual during this phase. However, creditors may request from the court or the court upon its own initiative may impose interim measures in order to preserve the company's assets. As an interim measure, the court may appoint a temporary insolvency administrator, who is responsible for monitoring the business of the company.

(ii) Opened insolvency proceedings phase – upon finding that the company is insolvent or over-indebted, the court orders the opening of insolvency proceedings. The term "insolvency proceedings" used in the Bulgarian Commerce Act encompasses the following outcomes: (i) the debtor is declared insolvent and subsequently liquidated, or (ii) a recovery plan is accepted instead of liquidation. Both of these outcomes would ultimately be the result of the initial application submitted to the court for the opening of insolvency proceedings.

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> Insolvency proceedings may be initiated either by the insolvent company or by its creditors by an application to the competent district court.

From the opening of the insolvency proceedings phase, court, arbitration and enforcement proceedings against the debtor are suspended (with the exception of monetary claims under labour disputes) and with certain exceptions, no new proceedings against the debtor may be initiated. This rule has been proposed to be amended in line with the legislator's aim of ensuring more expedited proceedings by allowing certain individual enforcement proceedings to continue at the expense of the habitually slower and more expensive universal enforcement proceedings.

During this phase, the first creditors' meeting is held, whereby the creditors listed in the trading books of the debtor examine the report of the temporary insolvency administrator, appoint a permanent insolvency administrator (which may be the same person) and appoint a creditors' committee to supplement and assist the activities of the insolvency administrator. The first creditors' meeting has proven to be inefficient in the past years, which is why the Restructuring Draft Law proposes for this step to be removed in its entirety, further streamlining the insolvency regime and allowing creditors with accepted claims to meet and decide on the appointment of the permanent insolvency administrator.

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> If no recovery plan is proposed or if the debtor does not follow the recovery plan, the court declares the insolvency of the debtor.

The current framework allows for insolvency proceedings during this phase to be suspended under certain conditions. Such suspensions have been found to be key drivers for delays of the proceedings. The Restructuring Draft Law now introduces amendments that limit the use of certain grounds for suspension, pushing the insolvency framework closer to achieving efficiency.

(iii) Recovery phase (optional)

A recovery plan may be proposed to allow creditors to be satisfied not from the liquidated property of the debtor, but from the company's revenue.

A recovery plan may be proposed up to one month from publication of the court ruling for approval of creditor claims. The current one-month timeframe for proposing the recovery plan is expected to increase to up to two months following the court's ruling for the approval of claims. The necessary change is driven by the difficulty of meeting the requirements for a recovery plan within the timeframe set in the current law. Ultimately, the idea is to ensure that creditors are satisfied, i.e., that one of the main objectives of insolvency proceedings is feasible and properly secured.

After reviewing the contents of the recovery plan, the court admits it for vote by the creditors. Upon the approval of the recovery plan, the court terminates the insolvency proceedings and appoints a body of creditors to supervise the performance of the plan.

If the debtor does not follow the recovery plan, the body of creditors or at least fifteen per cent of the creditors under the plan may request the resumption of the insolvency proceedings.

(iv) Liquidation phase

If no recovery plan is proposed or if the debtor does not follow the recovery plan, the court declares the insolvency of the debtor. With its decision the court further (i) terminates the business activity of the debtor, (ii) orders a general distraint over the property, (iii) terminates the rights of the management bodies, (iv) deprives the debtor of the right to dispose of the property included in the insolvency estate, and (v) orders initiation of the liquidation of the property included in the insolvency estate and distribution of the proceeds.

While the traditional liquidation process is carried out by an insolvency administrator through court-approved public tenders for the sale of property, the new legislative amendment introduces the option for organising the tender sale electronically. This is expected to increase the transparency of the liquidation procedure and lead to a higher collection rate for creditors.

After collection of sufficient funds, the insolvency administrator prepares a distribution list in compliance with the priority ranking of creditors under the law. After the approval of the distribution list by the court, the insolvency administrator distributes the proceeds.

Upon payment of the obligations or exhaustion of the insolvency estate, the insolvency court terminates the insolvency proceedings.

Basic rules of and recent developments in the restructuring proceedings (stabilisation)

Bulgarian law implements a restructuring option for companies under the local framework for stabilisation proceedings (in Bulgarian: „производство по стабилизация") currently regulated under Part V of the Bulgarian Commerce Act. This regime provides an option to companies that are at a risk of not meeting current obligations to restructure their debt. Debtors have an opportunity to reach an agreement with their creditors in a way that allows them to continue their business operations and prevent them from becoming insolvent.

A debtor may initiate stabilisation proceedings by filing an application to the court, which shall be immediately reviewed. Among other things, the court application shall list the objectives of the stabilisation plan, the terms for paying creditors, and the extent to which each class of creditors will be satisfied upon completion of the stabilisation plan when compared against the satisfaction amount that they would obtain if the assets were realised. When the plan envisions a partial discharge of debts, the reduction in the amount of the recovery of creditor claims may not be more than fifty per cent (except with respect to affiliates of the debtor, whereby a higher reduction may be envisaged). When the plan envisions deferring payments, the term for payment may not be longer than three years from the end of stabilisation proceedings. Stabilisation proceedings formally end upon the final court approval of the stabilisation plan with the appointment of a supervising administrator, if such is proposed under the stabilisation plan or chosen by creditors.

Since 2016, when stabilisation proceedings were introduced in Bulgaria, there have been only 12 requests filed with the courts from companies that intended to take advantage of this restructuring option (there were zero requests filed with the courts in the first half of 2022). The low number of stabilisation requests highlights the need for a rework of the framework in a way that stabilisation proceedings become a viable restructuring option for businesses.
The adoption of the Preventive Restructuring Directive[1] marked a notable step by the European Union towards harmonising the legal frameworks across Member States in the field of restructuring and insolvency. Its principal aim to provide access to a variety of restructuring options for viable businesses to avoid insolvency denotes a new trend in the development of the insolvency legal framework in the European Union – the refinement of existing insolvency and pre-insolvency proceedings of Member States and the development of novel restructuring mechanisms.

Although after the initial implementation deadline, in 2022 the Bulgarian government took steps towards the implementation of the Preventive Restructuring Directive by introducing the Restructuring Draft Law. Some of the key revisions introduced by the Restructuring Draft Law are related to the amendments made to the existing framework for "stabilisation proceedings" in Bulgaria.

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> A debtor may initiate stabilisation proceedings by filing an application to the court, which shall be immediately reviewed.

The Restructuring Draft Law refines the court-driven restructuring process by specifying what the restructuring of a business entails, introducing certainty in the options for entities seeking to avoid insolvency. A positive step forward is also found under the protections introduced for new and interim financings – incentivising creditors to provide such financings is a primary driver for the success of the stabilisation process, in view of their importance in allowing debtors to remain viable.

1. Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

In addition, certain changes are introduced to the legal prerequisites to the initiation of the stabilisation proceedings to allow for an expansion of the scope of application. The period in which the debtor must be at a risk of not meeting its obligations is extended from six months to 12 months, and the scope of entities that are allowed to benefit from the stabilisation proceedings now includes "entrepreneurs", defined as a natural person carrying out a business, trade or profession.

The Restructuring Draft Law also introduces a number of changes related to the content, submission and approval of stabilisation plans. Importantly, the Restructuring Draft Law mandates that the Bulgarian Ministry of Justice and Ministry of Economics shall issue practical guidelines on the preparation of the stabilisation plan. Given that the stabilisation plan needs to be prepared by the debtor, these practical guidelines would be instrumental in making the stabilisation proceedings more accessible, especially in the context of micro, small and medium enterprises and entrepreneurs who wish to benefit.

> "Upon violation of this obligation, the responsible person is jointly liable to the creditors for any damages resulting from the delayed filing or failure to file.

Specifics of directors' liability in relation to insolvency

The obligations of company directors within the insolvency and restructuring process is of particular importance, linked to the proper management of the proceedings and the avoidance of potential liability. Below we have outlined the key obligations that directors need to be aware of in relation to the insolvency and restructuring of their companies.

Obligation to file for insolvency

Civil liability

The members of the management bodies and the legal representatives of the company are obliged to submit an application for insolvency within 30 days from the occurrence of insolvency or over-indebtedness.

Upon violation of this obligation, the responsible person is jointly liable to the creditors for any damages resulting from the delayed filing or failure to file. As confirmed by the Bulgarian Supreme Cassation Court in 2022, directors need to be mindful of the fact that, even if they have ceased to be directors of a company before an application for its insolvency has been filed, where that director had an obligation to file such an application while serving as a director, the courts will still consider that director to be liable to creditors.

Further, the members of management or supervisory bodies bear general liability for damages towards the company.

Criminal liability

Pursuant to the Bulgarian Criminal Code, if the members of management bodies do not file for insolvency within 30 days from the cessation of payments, they bear criminal liability. Notably, the cessation of payments may be also be deemed to exist if the debtor has paid the claims of some creditors fully or partially.

Obligation to cooperate

Insolvency proceedings

During the insolvency proceeding, the members of the management bodies of the debtor are obliged to cooperate with the insolvency administrator and the court.

Further, upon request, the members of the management bodies must present to the insolvency administrator or the court any information and documents related to the economic activity or property of the debtor.

Stabilisation proceedings

During the stabilisation proceedings, the members of the management bodies of the debtor are obliged to cooperate with the administrator and, upon request, (i) to notify the undertaking of a new obligation, conclusion of a new contract or their termination; (ii) to provide access to the administrator to its premises; and (iii) to provide access to the administrator to its accounting books.

Upon request by the court, the administrator or the examiner, the members of the management bodies of the debtor should provide any information and documents on the economic activity or property of the debtor.

Specifics of shareholders' liability in relation to insolvency

Shareholders' claims in relation to loans granted to the insolvent company rank below the claims of other unsecured creditors.

Where an insolvency proceeding is opened with respect to a general partnership or a limited partnership, such insolvency proceeding is opened also with respect to the general partners that bear unlimited liability. There are no imminent obligations upon shareholders in a limited liability company or a joint-stock company with respect to insolvency and stabilisation proceedings. Their only potential involvement in such proceedings may be proposing a recovery plan to avoid liquidation and dissolution of the debtor, provided that they own at least one-third of the share capital.

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> Shareholders' claims in relation to loans granted to the insolvent company rank below the claims of other unsecured creditors.

Nevertheless, shareholders may be liable for outstanding tax and social security contributions in proportion to their share capital if they transfer their shares acting in bad faith. Shareholders are considered to have acted in bad faith if they knew that the company was over-indebted or insolvent and carried out the share transfer before the public announcement for opening insolvency proceedings.

CROATIA

Overview, key developments & the latest trends in Croatia – from a legal perspective

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In addition, Mihovil regularly advises international clients on M&A and various day-to-day corporate and commercial matters related to their operations in Croatia.

Mihovil speaks Croatian and English.

Mihovil Granić is a well-known name in litigation in Croatia and is valued for his strategic thinking, business-oriented advice and ability to think outside of the box when it comes to high-profile litigation.

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Overview, key developments & the latest trends in Croatia – from a legal perspective

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Overview

The current Croatian regime governing insolvency and restructuring proceedings dates back to 1996 and the first Bankruptcy Law, which has undergone a number of amendments throughout the years and was finally replaced in 2015 with the currently applicable Bankruptcy Law, which was also significantly amended in 2022 to implement Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on the discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and the discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

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> As a member of the European Union, Croatia directly applies Regulation (EU) No. 2015/848 of the European Parliament and the Council of 20 May 2015 on insolvency proceedings.

Generally, the complexity and costs of ordinary bankruptcy proceedings often become a disincentive for entrepreneurs facing financial distress to seek timely access to the insolvency system.

However, since the introduction in 2012 of the pre-bankruptcy settlement proceeding into the Croatian legislative framework, numerous entrepreneurs (almost 9,000) have requested admission to the mentioned procedure in the attempt to financially restructure and continue their business. This demonstrates that interest for less complex and costly restructuring proceedings exists among companies in Croatia.

Basic legal framework

As a member of the European Union, Croatia directly applies Regulation (EU) No. 2015/848 of the European Parliament and the Council of 20 May 2015 on insolvency proceedings.

There are two general regimes for entrepreneurs that are insolvent: (i) the pre-bankruptcy settlement procedure and (ii) bankruptcy procedure in its two forms, ordinary and brief.

Both procedures are currently covered by the same legislative act, the Bankruptcy Law (in Croatian: *Stečajni zakon*).

In addition to these general regimes, there is an extraordinary administration proceeding for companies of systemic importance for the Republic of Croatia. Currently, the Croatian legislative framework does not provide any specific treatment of SMEs.

Pre-bankruptcy proceedings and extraordinary administration proceedings are primarily focused on restructuring (financial and operational) and the continuance of a debtor's business activities. Although restructuring is also possible in bankruptcy proceedings, the main purpose of such procedure is the collective settlement of creditors by the sale of the debtor's assets and the distribution of collected funds to creditors, ending with the liquidation of the debtor.

Grounds for initiation of insolvency proceedings

A bankruptcy proceeding may commence if one of the following conditions (bankruptcy reasons) are met:

- the debtor's inability to fulfil due and existing obligations (in Croatian: *nesposobnost za plaćanje*); or
- the debtor is over-indebted (in Croatian: *prezaduženost*).

The proposal for the opening of a bankruptcy proceeding can be submitted by the debtor, creditor or by the Croatian Financial Agency (FINA).

The debtor is obliged to submit the proposal for the opening of a bankruptcy proceeding within 21 days from the day of occurrence of the bankruptcy reason.

FINA is obliged to submit the request for the opening of the bankruptcy proceeding against a legal entity if a legal entity has a record of unexecuted title for payment in an uninterrupted period of 120 days in the Register of the Order of Payment Titles held by FINA. In practice, this would mean that a legal entity would have its bank account blocked for a period of 120 days.

In case of a debtor's probable inability to fulfil due and existing obligations (in Croatian: *prijeteća nesposobnost za plaćanje*), only the debtor is authorised to file a proposal for the opening pre-bankruptcy proceedings.

Pre-bankruptcy proceedings can commence if the court determines the debtor's probable inability to fulfil due its existing obligations. It will be considered that such inability exists if at the time of submission of the proposal:

- the debtor has one or more non-executed payment titles recorded in the Register of the Order of Payment Titles;
- the debtor is more than 30 days late with salary and related social contribution payments.

The role of the courts

All insolvency proceedings are conducted before the competent commercial courts. The court's local competency is determined by the registered office of the debtor.

The court in bankruptcy proceedings has, inter alia, the following competences:

- decides on initiating a preliminary procedure for the purpose of determining the existence of bankruptcy grounds and conducts that procedure;
- decides on the opening of bankruptcy proceedings;
- appoints and dismisses the bankruptcy administrator, supervises his work and issues mandatory instructions to him;
- monitors the work of the creditors' committee;
- determines on-going business operations to be completed during the bankruptcy procedure, in accordance with the Bankruptcy Law; and
- determines the fee of the bankruptcy administrator.

The role of the court in pre-bankruptcy proceedings is, among other tasks:

- to decide on the commencement of pre-bankruptcy proceedings;
- supervision of the work of FINA; and
- ruling on established and disputed claims.

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The debtor is obliged to submit the proposal for the opening of a bankruptcy proceeding within 21 days from the day of occurrence of the bankruptcy reason.

Bankruptcy proceedings – timeline and basic rules

(i) Preliminary phase

Based on the proposal for the opening of bankruptcy proceedings, the court decides on the initiation of preliminary proceedings in order to determine the prerequisites for opening bankruptcy proceedings (preliminary proceedings). In the decision on the initiation of the preliminary procedure, the court can appoint a temporary bankruptcy administrator. The preliminary procedure can last no longer than 60 days from the submission of the proposal for the opening of the bankruptcy proceedings.

If a preliminary proceeding has been initiated, the court will schedule a hearing to discuss the prerequisites for opening bankruptcy proceedings.

The petitioner, authorised representatives of the debtor, the temporary bankruptcy administrator and, if necessary, court experts will be invited to the hearing to discuss the prerequisites for the opening of bankruptcy proceedings.

The court can issue a decision on the opening of bankruptcy proceedings without carrying out the previous procedure, if, for example, based on the proposal for the opening of pre-bankruptcy proceedings, it determines the existence of grounds for bankruptcy or if the debtor's authorised representative submits a proposal for the opening of bankruptcy proceedings.

> "The bankruptcy plan provides the possibility to deviate from the mandatory legal provisions on selling and distributing the bankruptcy estate.

As temporary measures, a court can prohibit the disposal of the debtor's assets and prohibit payments from the debtor's account.

(ii) Opened insolvency proceedings phase

By ruling on the opening of bankruptcy proceedings, the court will schedule:

- a creditors' hearing, at which the reported claims are examined (examination hearing);
- a creditors' hearing where, based on the bankruptcy administrator's report, the further course of the bankruptcy proceedings will be decided (report hearing).

Some of the main legal consequences of the opening of an insolvency proceeding are the following:

- the debtor's corporate bodies cease to have authority, as this passes to the bankruptcy administrator;
- the bankruptcy administrator is obliged to immediately take possession and manage all assets that are part of the bankruptcy estate;
- after the opening of bankruptcy proceedings, the bankruptcy proceedings status is registered with the companies register;
- all overdue obligations become due.

The bankruptcy administrator will also take management over litigations related to the bankruptcy estate, including the arbitration proceedings that were on-going at the time the bankruptcy proceedings were opened. Litigation related to claims filed in bankruptcy proceedings cannot be continued until they have been examined at an examination hearing. A similar procedure applies to the enforcement procedures that are on-going at the time of the opening of bankruptcy proceedings.

(iii) Recovery phase (optional)

According to most recent amendments of the Bankruptcy Law, a recovery plan can now be submitted by the debtor together with the proposal for opening of bankruptcy proceedings. This right remains even after the opening of bankruptcy proceedings, when the bankruptcy administrator also has the right to submit the bankruptcy plan to the court.

The bankruptcy plan provides the possibility to deviate from the mandatory legal provisions on selling and distributing the bankruptcy estate. Among others, a bankruptcy plan can envisage that all or part of the property can be left to the debtor for the purpose of continuing the debtor's business, as well as be transferred to one or more already existing persons or persons to be established.

Creditors will be considered to have accepted the bankruptcy plan if in each group of creditors the majority of creditors voted in favour of the plan. An additional condition is that the sum of the claims of creditors who voted for the plan exceeds twice the sum of the claims of creditors who voted against the bankruptcy plan.

According to the Bankruptcy Law, creditors are classified by different legal positions regarding the bankruptcy plan:

- creditors with the right to separate settlement, if the bankruptcy plan also encroaches on their rights;
- bankruptcy creditors who are not in the lower order of payment;
- bankruptcy creditors of certain lower payment orders;
- shareholders and holders of other similar founding rights of legal entities, if the bankruptcy plan encroaches on their rights.

(iv) Monetisation of assets and settlement of creditors phase

After the creditors' claims have been examined and determined, the creditors will decide on monetisation of the remaining part of the bankruptcy debtor's assets.

In the decision on sale, the creditors will determine the terms and the method of sale. If they decide to conduct sale by electronic public auction, it will be carried out with the appropriate application of the rules of enforcement procedure.

Settlement of the claims of bankruptcy creditors is carried out according to cash inflow and the distribution list prepared by a bankruptcy administrator in compliance with the priority of creditors ranking set under the Bankruptcy Law.

After all obligations have been settled or the insolvency estate has been exhausted, upon proposal of the bankruptcy administrator the insolvency court will render a decision on the termination of insolvency proceedings.

Pre-bankruptcy proceedings

The pre-bankruptcy regime provides an option to companies that are at a risk of not meeting current obligations to regulate their legal position and relationships with creditors, as well as to structure/shape their inability to pay and maintain their business activities. The goal of the pre-bankruptcy procedure is to save the debtor from opening bankruptcy proceedings.

From the date of submission of the proposal for the opening of the pre-bankruptcy procedure until the decision on the opening of pre-bankruptcy, a debtor can only make payments that are necessary for regular business.

In order to prevent the debtor's over-indebtedness, measures are proposed for the recovery of the debtor, i.e., a restructuring plan that seeks to extend the time for debt repayment or to write off part of the debt and thus avoid the possibility of opening bankruptcy proceedings. The debtor proposes a restructuring plan containing, among others, measures of financial and operational restructuring with effects on the company's liquidity and business operations, a detailed business plan for period of the next two years, and a proposal for different categories of creditors on the method, terms and conditions of settlement.

The court will issue a decision on the conclusion of the pre-bankruptcy proceeding as soon as the decision on the confirmation of the restructuring plan becomes final. Each group of creditors votes separately on the restructuring plan, and if they accept the plan with a majority of votes, the court will determine the acceptance of the restructuring plan and confirm the pre-bankruptcy agreement.

Extraordinary administration proceedings

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> After the creditors' claims have been examined and determined, the creditors will decide on monetisation of the remaining part of the bankruptcy debtor's assets.

For companies of systemic importance for the Republic of Croatia there is an additional special procedure, the extraordinary administration proceedings introduced and foreseen by the Law on the Procedure of Extraordinary Administration in Companies of Systemic Importance for Republic of Croatia (in Croatian: *Zakon o postupku izvanredne uprave u trgovačkim društvima od sistemskog značaja za Republiku Hrvatsku*), which was tailor made for a "too big to fail" restructuring case – the biggest retail, food and agriculture group, Agrokor d.d., which had more than 50,000 employees in Croatia, Slovenia, Serbia, Bosnia & Herzegovina and Hungary.

Companies of systemic importance are defined as joint-stock companies (in Croatian: *dionička društva*), excluding credit and financial institutions, that cumulatively meet the following criteria: (i) average of more than 5,000 employees in a calendar year, including its affiliated companies, and (ii) debt of more than HRK 7,500,000,000 (approx. EUR 1 billion), including its affiliated companies.

Only one extraordinary administration proceeding resulting in a settlement has been carried out in the Agrokor case, which was successfully implemented and closed on 19 July 2022 by the ruling of the Commercial Court in Zagreb. The company's total debt amounted to HRK 56 billion (approx. EUR 7.5 billion), with a debt to operating profit ratio of around 30 times. The main purpose of the extraordinary administration proceeding, besides the accomplished settlement and preserved business operations, was the fact that during the procedure the debts of 2,400 micro and small suppliers were settled in full, while other creditors' recoveries amounted to 60 percent on average. In this case, payments to suppliers and the overall costs were settled from Agrokor's operations and assets.

Persons authorised to submit a proposal for the commencement of an extraordinary administration procedure are:

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> Director's duties and liabilities are determined in both the Companies Law and the Bankruptcy Law.

- the debtor – a joint-stock company of systemic importance for the Republic of Croatia (authorised representatives/ member of the supervisory board/ member of the board of directors);
- the creditor and/or the debtor's affiliated and dependent companies, with the debtor's consent.

The bodies of the extraordinary administration proceeding are the court, the extraordinary administrator, the advisory body and the creditors' council.

The extraordinary administration proceeding is an urgent proceeding, and unless otherwise specified, the procedural rules of the Bankruptcy Law will be applied.

Specifics of directors' liability in relation to insolvency

Director's duties and liabilities are determined in both the Companies Law and the Bankruptcy Law.

Prior to their possible civil and criminal liability, each director must conduct business in good faith as well as apply the business judgement rule determined in the Companies Law.

Additionally, authorised representatives of the Company are liable if they violate their duties. In the event of a dispute, they must prove that they acted properly and conscientiously in the performance of their duties.

Obligation to file for insolvency

Civil liability

In case of occurrence of any of the insolvency cases, each director is required to initiate bankruptcy proceedings within 21 days from the moment the bankruptcy reason occurred.

Furthermore, the liquidator, supervisory board members and each shareholder are also required to file a request to open a bankruptcy proceeding.

If there is probable inability to fulfil due and existing obligations, directors are obliged to take into account the interests of creditors, shareholders and other persons with a special interest, taking measures to avoid insolvency and avoidance of deliberate actions or actions due to gross negligence that endanger the viability of business.

Also, failure to initiate bankruptcy proceedings within the set time frame by the responsible person means he/she will be personally liable for damages caused to creditors by failing to fulfil his/her duty.

Criminal liability

Importantly, failure to initiate bankruptcy proceedings when required is considered as a criminal offence according to the Companies Law. The envisaged punishment is a monetary fine or up to two years of imprisonment.

Obligation to cooperate

The management board or director(s) of the debtor against which the proposal for the opening of bankruptcy proceedings was filed, will be obliged to provide the court, the bankruptcy administrator, the creditors' committee and, according to the order of the court, the creditors, with all necessary information about the circumstances related to the procedure. The management board or director(s) of the debtor are also obliged to assist the bankruptcy administrator in fulfilling its tasks. The debtor, represented by its management board or director(s), must refrain from all actions that could hinder the fulfilment of the debtor's obligations.

The bankruptcy administrator is obliged to compile a list of individual items of the bankruptcy estate, and the debtor/ previous authorised representatives of the debtor are obliged to cooperate with the bankruptcy administrator, as well regarding the bankruptcy plan.

During the preliminary proceeding, the temporary bankruptcy administrator is authorised to enter the business premises of the debtor and carry out the necessary activities. Authorised representatives of the debtor are obliged to allow the temporary bankruptcy administrator to inspect the business books and business documentation of the debtor.

Specifics of shareholders' liability in relation to insolvency

In this respect, it is important to note that according to the Companies Law, shareholders can be liable in case of piercing the corporate veil – inter alia, if the shareholder:

- uses the company to damage creditors; or
- manages the assets of the company as if they were his own; or
- reduces the assets of the company for his own benefit or for the benefit of another entity, even though the shareholder knew or should have known that another entity is not able to meet its obligations.

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> Importantly, failure to initiate bankruptcy proceedings when required is considered as a criminal offence according to the Companies Law.

CZECH REPUBLIC

Overview, key developments & the latest trends in the Czech Republic – from a legal perspective

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Václav speaks Czech, English, and German.

Overview, key developments & the latest trends in the Czech Republic – from a legal perspective

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Overview

Insolvency proceedings in the Czech Republic are governed by Act no. 182/2006 Coll., the Insolvency Act (the "**Insolvency Act**") that became effective in 2008 and has undergone a number of amendments throughout the years. Czech insolvency law was also temporarily heavily influenced by the Covid-19 pandemic by providing certain ad hoc relief measures for distressed companies and their management, which were applicable only over the course of the Covid-19 pandemic.

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Grounds for the initiation of an insolvency proceeding an insolvency proceeding is initiated by a petition filed either by the debtor or by one or more creditors to the competent insolvency court.

As of yet, there has been no preventive restructuring tool implemented into Czech legislation, which is required under the EU Directive on Preventive Restructuring Frameworks. For that reason, adoption of the Czech Restructuring Act is among the main challenges for Czech lawmakers at the moment.

There are three ways of resolving insolvency in the Czech Republic:

(i) bankruptcy (in Czech: *konkurs*);

(ii) reorganisation (in Czech: *reorganizace*); and

(iii) discharging of debts (in Czech: *oddlužení*), which is available only for natural persons and non-entrepreneurial legal entities.

This article focuses on the bankruptcy and reorganisation methods, as these are the only options of insolvency resolution for businesses. Moreover, there are specific rules for the treatment of insolvent financial institutions (such as banks or insurance companies) due to the impact on a large group of creditors.

As for the latest statistical data, in 2022, about 21,000 insolvency applications were filed, and a vast majority of insolvencies were solved by debt discharge (approx. 93%), whereas only approx. 5%. were solved by bankruptcy and only 2%. were solved by reorganisation[1]. Long-term statistical data suggests that the satisfaction of unsecured creditors in bankruptcy is around 4.5% of the nominal value of respective receivables, compared to 10.5% with reorganisations.

Legal framework

As an EU member state, the Czech Republic directly applies the EU Regulation on Insolvency Proceedings, while specific local rules are set out in the Insolvency Act.

In the event of insolvency of a debtor, Czech law provides a legal framework for a court-supervised insolvency proceeding (in Czech: ***insolvenční řízení***) administered by a court-appointed insolvency administrator.

Provided that a court decides on the insolvency of a debtor, the insolvency proceeding may result in two outcomes:(i) liquidation of the debtor´s assets (bankruptcy method), or (ii) continuation of its business activity on the basis of a reorganisation plan (reorganisation method).

Grounds for the initiation of an insolvency proceeding

An insolvency proceeding is initiated by a petition filed either by the debtor or by one or more creditors to the competent insolvency court. In case of the insolvency of a corporation, the management thereof is legally obliged to file the insolvency petition.

A debtor is deemed to be insolvent (in Czech: *v úpadku*) when (i) it has two or more creditors and its debts have been overdue for more than 30 days and it is unable to pay its debts (*cash-flow insolvency*); or (ii) it is overburdened with debts (*balance-sheet insolvency*).

1. https://www.ceskenoviny.cz/zpravy/insolcentrum-v-cr-bylo-loni-podano-nejmene-insolvencnich-navrhu-od-roku-2011/2299844

Cash-flow insolvency

Generally, a debtor is deemed to be unable to pay its debts if:

(i) it stopped paying significant parts of its monetary obligations; or

(ii) its monetary obligations have been overdue for more than three months; or

(iii) its creditors cannot satisfy any of their overdue claims by enforcement against the debtor's assets;

(iv) it fails to comply with a duty imposed on it by a court to provide an overview of its financial situation.

Balance-sheet insolvency

A debtor who is a legal entity or an individual – entrepreneur, is insolvent also if over-indebted, i.e., when it has multiple creditors and the sum of its debts exceeds the value of its assets. When determining the value of the assets, further outlook should also be considered with regard to the maintenance of the assets or continuation of the debtor's business, provided that this is to be expected in light of all circumstances.

Commencement of an insolvency proceeding

In order to avoid lengthy and inefficient proceedings, if both the debtor and the creditor(s) file concurrent applications, the court accepts both applications for joint examination. This principle ensures that no procedural time is wasted, as the insolvency proceeding is initiated on the basis of the debtor's application, even if the creditor's application is rejected.

If the debtor changes its seat six months prior to the filing of the insolvency application, the competent court to conduct the insolvency proceeding is determined based on the previous registered seat. This rule aims to narrow "forum shopping" practices, where debtors change their registered office shortly before the insolvency proceeding is initiated.

Effects associated with commencement of an insolvency proceeding

The opening of an insolvency proceeding has, among others, the following effects:

(i) claims cannot be enforced outside the insolvency proceedings (i.e., by enforcement/execution in courts);

(ii) security over the debtor's assets can only be enforced or newly created to the extent permitted under Czech insolvency law;

(iii) the company must refrain from taking any action that would impair the value of the company's assets (with some exceptions, such as business conducted in the ordinary course of business).

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> When determining the value of the assets, further outlook should also be considered with regard to the maintenance of the assets or continuation of the debtor's business.

As of the commencement of an insolvency proceeding, interim measures (such as appointment of a preliminary insolvency administrator or preliminary creditors' committee) may be imposed to preserve the company's assets.

Acts of a debtor that violate the above restrictions may be declared ineffective towards creditors by the insolvency court.

Timeline of an insolvency proceeding

Insolvency proceedings in the Czech Republic contain the following steps:

(i) Insolvency proceedings commence only when the petition for insolvency is filed with the competent court.

(ii) The court publishes a notice of the initiation of insolvency proceedings in the insolvency register within two hours following the delivery of the petition to the court. The insolvency court may delay publishing the notice by up to seven days if at the time of receiving the insolvency petition it has reasonable doubts whether the insolvency of the debtor has been proven by the insolvency petition.

(iii) In the event that one or more creditors file the petition for insolvency, the court issues a decision on insolvency without undue delay, and in the event of a debtor's petition within 15 days.

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> A debtor – entrepreneur may request that the court grants it with a moratorium, which is a protective period for a maximum of three months.

(iv) If the debtor is insolvent, the insolvency court issues a decision on its insolvency containing a notice to creditors who have not filed their claims yet, to do so within two months.

(v) The court convenes a committee of creditors, which is held within three months of the decision on insolvency.

(vi) In general, the insolvency court decides on how to resolve insolvency within three months after the decision on insolvency. The court may not issue this decision before the committee of the creditors' meeting has been dissolved. However, this three-month period applies, with several exceptions.

(vii) Realisation of the chosen method of resolving insolvency, which is either reorganisation or bankruptcy.

Moratorium (optional phase)

A debtor – entrepreneur may request that the court grants it with a moratorium, which is a protective period for a maximum of three months, in which the debtor has the possibility to overcome its difficulties on its own and cannot be declared insolvent. A request for a moratorium may be filed to the court by the debtor prior to or after the submission of the insolvency application.

During the moratorium the debtor may prioritise the payment of the claims of creditors who are pivotal to the operation of the debtor's business (as an exception from the *pari passu* principle). Further, termination of certain essential contracts and the set-off of mutual claims by the creditors is not permissible.

Moratoriums are not widely used in the Czech Republic and only seven moratoriums were approved in 2022.[2]

Decision on insolvency

The insolvency court issues a decision on insolvency if the applying debtor or creditor have provided evidence of the debtor's insolvency.

Once an insolvency decision is issued by the court, it has, in particular, the following consequences:

(i) the insolvency court appoints an insolvency administrator;

(ii) the insolvency court invites the creditors of the debtor to register their claims with the court (within two months).

Following the insolvency decision, the first creditors' meeting is held in order to vote (in particular) on the:

(i) appointment of a creditors' committee (or possibly a creditors' representative in case there are less than 50 registered creditors);

(ii) manner of resolving of the insolvency, provided that the insolvent debtor is eligible for reorganisation (please see the conditions below).

2. https://www.ceskenoviny.cz/zpravy/insolcentrum-v-cr-bylo-loni-podano-nejmene-insolvencnich-navrhu-od-roku-2011/2299844

Types of claims

The Insolvency Act divides creditors primarily into two groups: those holding secured claims and those holding unsecured claims.

A secured creditor has the right to realise a secured asset owned by the debtor. Secured creditors may be satisfied ahead of any claims of other creditors and can instruct the insolvency administrator on the manner of monetisation of the asset(s).

In addition to secured creditors, there are other types of claims that are treated specially and have priority over the claims of unsecured creditors, such as the fee of the insolvency administrator or taxes, fees, customs duties, social insurance, contributions to the state employment fund and public health insurance payments.

Generally, the insolvency administrator and has the authority to contest any of the creditor's claims regarding their validity, amount or ranking. If a claim is contested, the creditor may file a petition to the court in order to prove its claim.

Methods of resolving an insolvency

Reorganisation

Reorganisations are only available for medium to large companies with a yearly turnover of more than approx. EUR 2,000,000 or with at least 50 employees. This approach may be preferred by creditors, as one of the legal conditions is that the satisfaction of creditors will not be lower than under bankruptcy.

If the conditions for reorganisation are not met, or neither the debtor nor the creditors propose a reorganisation plan, the insolvency court rules that the insolvency of the debtor will be resolved by bankruptcy.

Reorganisation is carried out in line with a reorganisation plan, which must be approved by the creditors and the insolvency court. The debtor retains its right to dispose with the insolvency estate, and its actions are supervised by the insolvency administrator and the creditors.

Czech insolvency law also provides for the possibility of a so-called pre-packed reorganisation, which is agreed between the insolvent company and its creditors before filing an insolvency petition and filed with the reorganisation plan.

Bankruptcy

Bankruptcy leads to disposing of all the debtor's assets and using the proceeds to at least partially satisfy the creditors. If this resolution method is chosen and the court declares the debtor bankrupt, the following effects apply:

(i) powers to exercise rights and to fulfil duties pertaining legally to the debtor pass to the insolvency administrator;

(ii) those of the debtor's debts that are not yet due, provided that these are to be satisfied from the debtor's estate, are regarded as having become payable;

(iii) the Insolvency Act stipulates rules under which the insolvency administrator is entitled to cancel certain contracts concluded by the debtor; it also stipulates that performance cannot be claimed with respect to fixed-term contracts where the debtor's performance is due after bankruptcy was declared; and

(iv) the Insolvency Act stipulates rules under which the insolvency administrator can deal with the performance of bilateral contracts that have not yet been fully performed.

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Reorganisation is carried out in line with a reorganisation plan, which must be approved by the creditors and the insolvency court.

Once the debtor's assets are disposed of, the insolvency administrator has to distribute the profit in line with the rules mentioned in the section "Creditor´s Receivables" of this article. The final distribution of assets has to be approved by the court. This ends the insolvency proceedings and the debtor corporation is deregistered from the Commercial Register.

Obligations of the debtor and its corporate bodies

Liability of the statutory body

The members of the statutory body of a company are obliged to submit an application for insolvency against the company without undue delay from the moment that the company is insolvent on the basis of "due managerial care".

"Under certain circumstances, criminal sanctions may also be imposed against the members of the statutory body of an insolvent company.

The obligation to file an insolvency petition is with the debtor's legal representatives and its statutory body (and the liquidator if the debtor is a legal entity in the process of liquidation). A breach of the obligation to file for insolvency results in liability to the creditor(s) for any damage caused as a consequence.

Under certain circumstances, criminal sanctions may also be imposed against the members of the statutory body of an insolvent company.

Obligation to cooperate

Over the course of an insolvency proceeding, the members of the debtor's statutory body are obliged to fully cooperate with the insolvency administrator. In case a reorganisation is approved, the members of the statutory body take on some of the duties usually reserved for the insolvency administrator in bankruptcy proceedings.

Implementation of the EU Directive on Preventive Restructuring Frameworks

The EU Directive on Preventive Restructuring Frameworks marked a notable step by the European Union towards harmonising the legal frameworks across Member States in the field of restructuring and insolvency.

Its principal aim, to provide access to a variety of restructuring options for viable businesses to avoid insolvency, denotes a new trend in the development of the insolvency legal framework in the European Union—the refinement of existing insolvency and pre-insolvency proceedings of Member States and the development of novel restructuring mechanisms.

The Czech Restructuring Act was not implemented within the deadline set by the EU Directive on Preventive Restructuring Frameworks, and a draft Restructuring Act (the "**Draft**") is now in the legislative procedure in the lower house of Czech parliament. It can be expected that the Czech Restructuring Act will become effective in 2023.

The Draft outlines a voluntary flexible restructuring process intended to prevent a debtor's insolvency. The restructuring process implies a rehabilitation project and a financial restructuring plan drafted by the debtor. Both the rehabilitation project and the restructuring plan must describe the recovery and restructuring measures to be taken to overcome financial difficulties and shall explain why these measures are necessary. The preventive restructuring procedure is commenced when the rehabilitation plain is delivered to the concerned creditors together with a call for the initiation of restructuring negotiations. The commencement of the restructuring proceeding must be notified to a restructuring court, and adoption of the restructuring plan by creditors is required for the procedure to move forward.

The Draft further implies significantly reduced interference of a (restructuring) court as opposed to the ordinary insolvency proceeding and appointment of a restructuring administrator, but only in case of specific situations. In order to avoid the enforcement of creditor claims while the preventive restructuring is pending, a debtor can apply for a moratorium of up to twelve months, during which the debtor is protected against insolvency petitions and enforcement proceedings.

The preventive restructuring framework proposed by the Draft will introduce creditor voting in specific classes, inspired by the reorganisation/insolvency procedures and certain other measures, which may address some of the current drawbacks of informal, contractual restructuring. As a less formal procedure, this will, however, fully depend on the parties' willingness to engage in negotiations with debtors. As a result, there is a legitimate worry that distressed companies would utilise preventative restructuring more as a way to postpone inevitable bankruptcy proceedings through a moratorium than as a valid instrument to prevent bankruptcy.

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The preventive restructuring framework proposed by the Draft will introduce creditor voting in specific classes.

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He has more than 13 years of experience in banking and finance matters, especially in acquisition, real estate, project finance and syndicated finance transactions, restructuring and insolvency matters as well as in financial supervision legislation.

In addition, Levente specialises in capital market transactions and has led the Hungarian team on transactions related to bond and share issues, IPOs and complex capital market transactions.

Levente speaks Hungarian and English.

A client appreciates that he "understands the market well and keeps us on a tight track with the processes".

(Chambers Europe, 2022)

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Overview

The current Hungarian regime governing bankruptcy, liquidation and restructuring proceedings dates back to the late 1990s and has undergone a number of amendments throughout the years aimed at implementing EU legislation as well as increasing the efficiency of the proceedings and is currently being impacted by the state of emergency in force since 2020, allowing the Hungarian Government to amend legislation through governmental decrees.

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> As a member of the European Union, Hungary directly applies Regulation (EU) No. 2015/848 of the European Parliament and the Council of 20 May 2015 on insolvency proceedings.

Liquidation proceedings tend to last on average for approximately one to two years, which is in line with the reported average for the European Union. Between 2017 and 2021, the number of applications for the opening of liquidation proceedings averaged 12,300 applications per year, with applications gradually decreasing on average each year. In contrast, during the same timeframe, on average only 85 applications per year have been made for bankruptcy proceedings. Considering that the World Bank rates Hungary's collection rate for creditors at 44.2%, compared with 70.2% for high income OECD countries and 65% for the European Union, there are still ways to improve the efficiency of the Hungarian insolvency framework, even if its results are slightly above the regional average for Europe and Asia (38.5%).

Basic legal framework

As a member of the European Union, Hungary directly applies Regulation (EU) No. 2015/848 of the European Parliament and the Council of 20 May 2015 on insolvency proceedings. The Regulation has universal scope and applies only to proceedings in respect of a debtor whose centre of main interests is located in the European Union. The specific local rules are set out in Act XLIX of 1991 on Bankruptcy Proceedings and Liquidation Proceedings (Bankruptcy Act) with regards to bankruptcy and liquidation proceedings, while Act LXIV of 2021 on Restructuring and on the Amendment of Certain Acts for the Purpose of Approximation (Restructuring Act) covers restructuring proceedings. Pursuant to the Bankruptcy Act, there are two types of insolvency-related proceedings under Hungarian law:

(i) bankruptcy proceedings, whereby the insolvent debtor initiates a moratorium for payment without winding up (terminating) the debtor in order to work out a restructuring plan and reach a bankruptcy settlement; and

(ii) liquidation proceedings, which aim to secure the satisfaction of creditors' claims in the course of winding up the insolvent debtor without a legal successor.

We note that most of the relevant procedural and liability rules are laid down in laws and government decrees. However, since 2020, the Hungarian legal system has shifted towards recognising the decisions of the Curia (i.e. the Supreme Court of Hungary) establishing a system of "limited precedent" and generally giving greater weight to judicial decisions, which signals the beginning of an interesting trend also with respect to precedent in bankruptcy, liquidation and restructuring proceedings.

Basic rules of bankruptcy proceedings

Initiation of bankruptcy proceedings

Bankruptcy proceedings can be initiated by the executive officer(s) of the debtor with the consent of its shareholders by an application to its court of registration. If the court orders to commence the bankruptcy of the debtor, it will appoint at random via an electronic selection process an asset inspector, whose duty is to monitor the debtor's business activities. Furthermore, the court will call upon its creditors to register their claims with the asset inspector and the debtor within 30 days.

Moratorium during bankruptcy proceedings

During bankruptcy proceedings, for 180 days from the commencement of the proceedings a moratorium will be applicable during which the debtor cannot perform any of its payment obligations arising on or before the commencement of the bankruptcy proceedings and creditors cannot demand payment of their claims; all enforcement of payment obligations are suspended and no new enforcement can be ordered against the debtor; the debtor may only undertake new obligations and may only make payments with the consent of the asset inspector.

Restructuring plan and bankruptcy settlement

During the course of the moratorium, the debtor will convene a restructuring meeting in order to agree with its creditors on a restructuring plan and a bankruptcy settlement. A bankruptcy settlement requires the majority votes of the creditors as well as the countersignature of the asset inspector.

The bankruptcy settlement needs to be submitted to the court. Should it comply with the relevant laws, the court will declare the bankruptcy proceedings complete. However, should it not comply with such laws, or in the absence of any settlement, the court will cease the bankruptcy proceedings, declare the insolvency of the debtor and order the liquidation of the company, the procedure of which we discuss below.

Basic rules of liquidation proceedings

Grounds for initiation of the liquidation proceedings

Liquidation proceedings can be ordered, among others, by a court upon the request of a creditor, the debtor itself or by the court of registration of the debtor.

If the proceedings are initiated by a creditor, the request must be filed with the court and it shall include certain elements and evidences required by law (e.g., underlying reasons why the debtor should be considered to be insolvent and related evidence (such as payment notices and demands)).

If the proceedings are initiated by the debtor company, the debtor must first procure the prior consent of the debtor's supreme body exercising the founder's (shareholder's) rights, and the debtor's employees, trade unions and works councils must be notified of the initiation.

Although liquidation proceedings are usually commenced by an application filed with the competent court of the debtor's registered seat (by either the debtor or a creditor), the Hungarian Government recently made somewhat bespoke changes to the liquidation regime by special, extraordinary government decrees leading to the automatic court-ordered initiation of liquidation proceedings for companies with revenue exceeding HUF 10 billion (i.e., approx. EUR 26 million) that failed to disclose their annual financial statements for more than 400 days, which led to one of the largest insolvency cases in recent Hungarian corporate history—the liquidation of Dunaferr, the largest metallurgy plant in Hungary, ordered in January 2023. Also, in such liquidation proceedings, the Government introduced, through the same type of extraordinary decrees, special characteristics of restructuring/bankruptcy proceedings creating a somewhat hybrid insolvency proceeding framework for such liquidation. These extraordinary legislative measures signal one of the most important latest trends in the restructuring & insolvency space: the increased, direct, rapid and extraordinary legislative measures and changes introduced by the Hungarian Government, which may heavily impact restructuring and insolvency laws as well as the legal system in Hungary in the upcoming years.

> "During the course of the moratorium, the debtor will convene a restructuring meeting in order to agree with its creditors on a restructuring plan and a bankruptcy settlement.

Timeline

Liquidation proceedings in Hungary consist of three main phases:

> If the court finds that the debtor is insolvent, it is obliged to order the commencement of liquidation within 60 calendar days after the receipt of the request for liquidation proceedings.

(i) Preliminary phase: - during this phase, the court analyses the liquidation application and will assess whether the debtor is insolvent.

The company may generally continue operating business as usual during this phase, and the directors of the company retain their control over the company. However, creditors may request the court to impose interim measures in order to preserve the company's assets, such as the appointment of a temporary asset inspector, who is responsible for monitoring the business of the company and the debtor's assets in this phase.

The court will establish that the debtor is insolvent, among others, if:

(a) the debtor has failed to pay its acknowledged or uncontested debt within 20 calendar days from the due date after having been requested in writing by the creditor to do so;

(b) the debtor has not paid an enforceable court decision or order for payment (in Hungarian "fizetési meghagyás");

(c) enforcement against the debtor was unsuccessful;

(d) failure to pay obligations resulting from a bankruptcy or liquidation settlement agreement or court-approved reorganisation or restructuring plan; or

(e) the indebtedness of the debtor is higher than the assets of the debtor (this insolvency trigger is applicable only in case of debtor-initiated liquidation).

If the court finds that the debtor is insolvent, it is obliged to order the commencement of liquidation within 60 calendar days after the receipt of the request for liquidation proceedings. However, should the court find that the debtor is solvent, it will terminate the liquidation proceedings.

(ii) Opening of liquidation phase

Once the liquidation is ordered by the court, the debtor's management is effectively "replaced" by a liquidator, appointed at random via an electronic selection process, who has sole authority to act in respect of the debtor's assets, and the management loses its power to run the debtor's business. The liquidator is required to convene a meeting of registered creditors to form a creditors' committee, which has the right to be informed and comment on the key developments of the liquidation proceedings. Moreover, at this point the business activity of the debtor can only be continued if the creditors' committee so consents.

There are several other legal consequences of the commencement date of the liquidation, including that:

(a) all of the debtor's liabilities become due on this date;

(b) all enforcement procedures against the debtor are terminated;

(c) within 40 calendar days of this date (but no later than within 180 calendar days thereafter) creditors need to register their claims with the liquidator, as only registered claims can be satisfied during the course of the liquidation proceedings.

(iii) Liquidation phase

The liquidator is obliged to collect and enforce the debtor's claims by their due date. In addition, the liquidator may sell the debtor's assets via a public auction or a public tender. The Bankruptcy Act establishes a mandatory order for the payment of claims against the debtor. The claims duly registered within the prescribed period are allocated into eight categories, and a claim may be paid only if all the claims belonging to the higher-ranking categories have first been duly paid. In these categories of mandatory payment order, the costs of liquidation are in the first priority position while claims of certain entities affiliated or associated with the debtor are at the lowest ranking. However, there are certain exceptions to the above mandatory order of payment, most notably, secured creditors may seek satisfaction almost exclusively from proceeds of the sale of assets charged or mortgaged in favour of them.

Rules relating to the insolvency of strategically important undertakings

The Hungarian Government can decree certain undertakings to be deemed as strategically important if the settlement of their debts is in the national interest or where their liquidation is given priority due to national economic consideration. Such undertakings need to operate in a field that is of national importance, or be involved in the implementation of a project significant for the national economy, or be the recipient of a significant amount of state aid. Regarding these undertakings, the above detailed rules of bankruptcy and liquidation proceedings have to be applied with a few key differences. These include, among others, significantly shorter procedural deadlines; the debtor is entitled to a moratorium of 365 days during bankruptcy proceedings; the Hungarian State has right of first refusal over the assets of the debtor exceeding HUF 25 million (i.e., approx. EUR 65,000); the option to sell a debtor's assets as a going concern, and the option to sell a debtor's assets via a private auction/ tender.

Basic rules of Hungarian restructuring proceedings

In line with the promptly transposed EU Directive 2019/1023 on restructuring and insolvency, Hungarian law recently introduced a restructuring option for companies under the Restructuring Act. This regime provides an option to companies that are at a risk of not meeting current obligations to restructure their debt. Debtors have an opportunity to reach an agreement with their creditors in a way that allows them to continue their business operations and prevent them from becoming insolvent.

Initiating restructuring proceedings

A debtor may decide to rely on restructuring in case of probability of insolvency and will designate the commencement date of the restructuring proceedings in its decision. The debtor will request the court to commence the restructuring proceedings within five days of its resolution regarding the proceedings.

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> The liquidator is obliged to collect and enforce the debtor's claims by their due date.

Requesting and legal effects of a moratorium

The debtor may also request the court to order a moratorium to facilitate negotiations on a restructuring plan. The moratorium can be established for a maximum period of four months, while the total duration of the moratorium (including the time limit for any extension or the duration of a new moratorium ordered after the expiry of the moratorium) cannot exceed 12 months.

During the moratorium, the creditor subject to the respective moratorium cannot initiate enforcement proceedings (and enforcement proceedings initiated after the commencement date of the proceedings are suspended), liquidation proceedings or otherwise satisfy its claims with set-offs.

Furthermore, creditors subject to the moratorium cannot suspend the performance of essential agreements (i.e., which are necessary for the day-to-day running of the business of the debtor); cannot withhold or suspend the performance of other agreements or terminate and amend them on the basis of the debtor's restructuring or moratorium; and they cannot terminate or amend these agreements if it would be unfavourable to the debtor.

Restructuring plan

Hungarian restructuring proceedings are aimed at the creation and implementation of a restructuring plan, whereby the debtor registers and classifies the known claims of the respective creditors into groups (i.e., secured claims, claims related to economic activity, other claims and claims arising from a transaction in the interest of the debtor).

> "The directors of Hungarian companies are not obliged to automatically file for liquidation if the company is in the threat of insolvency or already insolvent or overindebted.

The restructuring plan has to ensure the principle of equal treatment of the respective creditors belonging to the same group, and it cannot be aimed exclusively at the partial or total waiver of the claims of the creditors against the debtor.

During the restructuring, a restructuring expert may be appointed by the court ex officio or upon the request of the debtor or the majority of creditors, whose primary task is assisting in the preparation and negotiation of the restructuring plan as well as supervising the debtor's actions and management during the negotiations.

Following negotiations, the restructuring plan is adopted by the majority votes of the creditors and—in case one was voted for—countersigned by the restructuring expert. For the restructuring plan to have any legal effect, it has to be approved by the court.

Specifics of directors' liability and obligations in relation to insolvency

The directors of Hungarian companies are not obliged to automatically file for liquidation if the company is in the threat of insolvency or already insolvent or overindebted. However, failure to do so and/or to notify shareholders to take actions in such circumstances may eventually lead to wrongful trading and director's liability issues in certain cases. Below we have outlined the key obligations that directors need to be aware of in relation to the insolvency and restructuring of their companies.

Wrongful trading liability

Company directors, who in the span of three years prior to the ordering of liquidation failed to consider the interest of the debtor's creditors when the company became subject to the threat of insolvency (i.e., when the company director was able to foresee or reasonably should have been expected to foresee that the debtor was not going to be able to satisfy its liabilities when due) are personally responsible for the damage caused.

Criminal liability

Pursuant to the Hungarian Criminal Code, any person who, in connection with the imminent insolvency of the debtor, actually or fictitiously diminishes the debtor's assets by concealing, disguising, damaging, destroying, etc., or concluding fictitious transactions, or recognising doubtful claims or by any other means contrary to the requirements of prudent management, commits a felony and may be subject to imprisonment.

Obligation to cooperate in liquidation proceedings

During liquidation, the members of the management bodies of the debtor are obliged to cooperate with the liquidator, various governmental and municipal authorities and the court. This entails, among others, the obligation to prepare a closing inventory; the obligation to prepare a list of non-discardable, essential documents and deliver those documents as well as any relevant archived documents to the liquidator.

Specifics of shareholders' liability in relation to insolvency

Shareholders' claims against the insolvent company rank last in the mandatory order of satisfaction, below the claims of other unsecured creditors.

Former majority shareholders who transferred their shares (quotas) in the three years prior to the ordering of liquidation may be personally liable for claims of creditors, provided that the debtor's debts are in excess of 50 per cent of its equity capital. A former majority shareholder may avoid responsibility if it can prove that the debtor was solvent at the time of the transfer of its share (quota), and that threat of insolvency or insolvency occurred subsequently, or that it acted in good faith, bearing the interests of creditors in mind when transferring its share (quota).

Similarly, majority shareholders may be held personally liable for claims of creditors on account of the debtor's continuous, disadvantageous business decisions, as a result of which the claims of creditors could not be satisfied during the liquidation proceedings.

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A former majority shareholder may avoid responsibility if it can prove that the debtor was solvent at the time of t he transfer of its share (quota).

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Remus pursues the interests of creditors, including financial institutions, in the recovery of assets in several high-profile insolvencies, both at national and cross-border levels. His most recent credentials include advising one of the richest businessmen in Romania on more than 30 on-going complex and sensitive insolvency and criminal cases, and advising a leading Romanian property manager on a series of complex and sensitive Romanian court cases involving property title, contractual, regulatory and insolvency angles.

Remus speaks Romanian and English.

Remus Codreanu has outstanding experience. A highly professional lawyer with solid and broad experience in the field, deep and efficient understanding of cases, knowledge of relevant strategies, fully committed to serving our needs and having managed to implement proper strategies for wining our complex and sensitive cases.
(Legal 500, 2022)

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Vlad Simion is a Managing Associate in Kinstellar's Bucharest office. He mainly focuses on dispute resolution, compliance, risk and sensitive investigations, public procurement, and restructuring & insolvency matters.

Vlad has gained significant experience in representing clients before the relevant courts and has been involved in multiple insolvency proceedings and restructuring processes. He is currently advising one of the richest businessmen in Romania on more than 30 on-going complex and sensitive insolvency and criminal cases.

Vlad speaks Romanian and English.

We appreciated the team for its strong commitment to our cases, deep involvement, hard and efficient work and 24/7 availability. They delivered the best solutions always on a timely basis.
(Legal 500, 2022)

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Overview

The first Romanian insolvency and restructuring law dates from 1995. However, the respective legislation was replaced several times, in 2006 and, most recently in 2014. The current applicable Insolvency Law, which entered in force in 2014, has undergone a number of amendments throughout the years and was significantly amended in July 2022 in order to implement Directive (EU) 2019/1023 of the European Parliament of the Council of 20 June 2019 on preventive restructuring frameworks, on the discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and the discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

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> If a debtor is deemed insolvent, the framework on court-governed insolvency proceedings will apply.

Generally, prior to 2014, insolvency proceedings in Romania lasted several years until a final resolution of reorganisation of activity/bankruptcy was rendered. After the current applicable Insolvency Law entered into force in 2014, an observation period of one year after the opening of insolvency proceedings was introduced, a fact that led to a significant reduction of the duration of insolvency proceedings. Nonetheless, in practice, insolvency proceedings in Romania still tend to last on average for more than three years, and a majority exceed five years if a reorganisation procedure is also applied.

The 2014 Insolvency Law introduced certain pre-insolvency settlement proceedings into the Romanian legislative framework. However, in practice, these are rarely used by local entrepreneurs, and insolvency proceedings still remain the go-to solution for financial restructuring and continuation of the business. There is still hope, however, as the July 2022 amendments to Romanian insolvency law significantly modified and completed the legal provisions for pre-insolvency proceedings, offering a clearer understanding on how these procedures work and, in this way, making them more appealing. It remains to be seen how these pre-insolvency proceedings will be applied in the future and if debtors will prefer to access these pre-insolvency proceedings instead of the old-fashioned and trustworthy insolvency procedure.

Basic legal framework

As a member of the European Union, Romania directly applies Regulation (EU) No. 2015/848 of the European Parliament and the Council of 20 May 2015 on insolvency proceedings.

If a debtor is deemed insolvent, the framework on court-governed insolvency proceedings will apply. Such proceedings may lead to two main outcomes, i.e., either (i) liquidation of the debtor, or (ii) continuation of its business activity on the basis of a reorganisation plan. Prior to these outcomes, each insolvency proceeding has a cool-down period, known as the "observation period".

If a debtor is not yet insolvent but is in imminent threat of insolvency, the Insolvency Law also provides pre-insolvency proceedings and extraordinary administration proceedings, which are primarily focused on restructuring (financial and operational) and the continuance of the debtor's business activities. Although restructuring is also possible in insolvency proceedings, the main purpose of such procedure is the collective settlement of creditors by sale of the debtor's assets and distributing collected funds to creditors, ending with the liquidation of debtor. However, as mentioned above, these pre-insolvency proceedings are rarely used by local entrepreneurs.

Pre-insolvency proceedings

Pre-insolvency proceedings are applicable to debtors that are in financial distress without being insolvent. There are, however, restrictions in respect to debtors that in the last three years prior to the pre-insolvency procedure request were convicted for the perpetration of certain criminal offences (e.g., tax evasion, corruption criminal offences, money laundering, etc.).

During the pre-insolvency proceedings, the debtor maintains the right to manage its activity, and the individual and collective rights of the debtor's employees are not affected by these proceedings. If a pre-insolvency proceeding is successful, the debtor cannot access another pre-insolvency procedure in the next 12 months.

There are two pre-insolvency proceedings regulated by the Romanian insolvency law, namely (1) the restructuring agreement procedure and, (2) the preventive concordat (in Romanian: "*concordatul preventiv*").

Under the restructuring agreement procedure, a restructuring agreement is proposed by a debtor that is in financial distress. The agreement must be drafted by the restructuring administrator (an active insolvency practitioner) or by the debtor with the assistance of the restructuring administrator. The proposed restructuring agreement is subject to the approval of the creditors whose receivables are affected by it and, afterwards, to confirmation by the court of law. The judge can reject the approved restructuring agreement only on the grounds of unlawfulness.

The preventive concordat procedure starts following the request of a debtor that is in financial distress filed with the court of law. The preventive concordat procedure can start also at the request of one or several creditors having against the debtor an undisputed and liquid receivable, with the condition of obtaining the prior approval of the debtor.

From the date of opening the preventive concordat procedure, enforcement procedures against the debtor are suspended or cannot start for a period of four months, which in certain cases can be extended by the judge.

Within a 60-day deadline from the date of opening the preventive concordat procedure, the concordat administrator drafts and / or assists the debtor in drafting the restructuring plan. The restructuring plan must be approved by the creditors within a 60-day deadline from the date the restructuring plan is presented, with the possibility for the deadline to be extended by the judge by an additional maximum 30 days.

The approved restructuring plan must be confirmed by the judge. The confirmed restructuring plan can be amended, subject to another approval of the creditors and later confirmation of the judge.

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> If a pre-insolvency proceeding is successful, the debtor cannot access another pre-insolvency procedure in the next 12 months.

From the date of approval of the restructuring plan, all enforcement procedures against the debtor concerning receivables that are affected by the restructuring plan are suspended. Creditors whose receivable are not affected by the plan have to notify the debtor prior to starting any enforcement procedure—the debtor having the option to negotiate adherence to the restructuring plan within a maximum 30-day deadline from receiving the notice.

Insolvency proceedings—timeline and basic rules

Insolvency proceedings commence if one of the following legal conditions is met:

- the debtor is insolvent—lacking therefore the ability to fulfil existing payment obligations exceeding a threshold of EUR 10,000 and a due date of more than 60 days;
- the debtor is in imminent insolvency—meaning that, based on the financial and accounting data of the debtor, the debtor does not have sufficient funds to cover its monetary (payment) obligations in the near future.

The request to open insolvency proceedings can be submitted by the debtor and/or by any creditor having a receivable that is undisputed, due for more than 60 days and exceeds a threshold of EUR 10,000. The court of law where the debtor had its headquarters in the last six months prior to the filing of the request has jurisdiction to hear the case.

If the request to open insolvency proceedings is filed by the creditors, the debtor will have 10 days to either acknowledge the insolvency status or contest the request to open insolvency proceedings, in which case the creditor in question can be obliged to provide a bail guarantee that will be used to repair the eventual damages suffered by the debtor if this request will be eventually rejected.

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> If the request to open insolvency proceedings is filed by the creditors, the debtor will have 10 days to either acknowledge the insolvency status or contest the request

Insolvency proceedings in Romania consist of three phases, namely:

(i) The Observation Period phase

During this phase, the court analyses the request to open insolvency proceedings, as well as the grounds for opening the insolvency proceedings. If submitted by the debtor, the request to open insolvency proceedings shall be reviewed by the court immediately in a closed session. If submitted by a creditor, the request shall be reviewed by the court after summoning the debtor and, depending if the debtor contests this request or not, the first hearing for the request filed by a creditor could be scheduled after one to two months from the date of filing.

Through the decision for opening the insolvency proceedings—which triggers the start of the observation period phase—the court appoints a temporary judicial receiver in accordance with the proposal of the debtor or, if the request to open insolvency proceedings was filed by a creditor, in accordance with the proposal of the respective creditor. If both the debtor and a creditor filed for insolvency, the proposal of the creditor, in respect to the temporary judicial receiver, shall prevail.

The opening of the insolvency proceedings automatically triggers the suspension of any judicial, extrajudicial or enforcement procedure against the assets of the debtor. In certain express situations, secured creditors can request to the court to lift the suspension with respect to the secured assets and to approve the sale of these assets in order for their secured receivables to be recovered (such requests are often rejected, as the assets in question, most of the time, are considered mandatory for an eventual reorganisation procedure).

The debtor may generally continue operating business as usual during this phase, and its management bodies can keep management rights under the supervision of the judicial receiver. The court can decide to strip the debtor of management rights, in which case the judicial receiver will take over the management of the debtor.

The observation period shall not exceed one year from the date of opening the insolvency proceedings—a deadline that can, however, be extended by the court at the request of the judicial receiver. During the observation period, the preliminary table of creditors is drafted, a committee of creditors is appointed, the shareholders of the debtor appoint a special administrator to represent their interest and, respectively, other preliminary measures related to the insolvency proceedings (i.e., keeping or terminating the pending agreements concluded by the debtor) are performed.

During this phase, the first creditors' meeting is held, whereby the creditors listed in the preliminary table of creditors examine the report of the temporary judicial receiver, appoint a permanent judicial receiver (which may be the same person) and appoint a creditors' committee to supplement and assist the activities of the judicial receiver.

(ii) The Reorganisation Phase (optional)

A final table of creditors is drafted by the judicial receiver after all complaints against the preliminary table of creditors are resolved by the court. After this moment, the judicial receiver, the debtor through its special administrator or the creditors can propose, within a 30-day deadline (which can be extended by the court by an additional 30 days) a reorganisation plan.

The reorganisation plan provides the possibility to deviate from mandatory legal provisions on selling and distributing the insolvency estate. Among others, the reorganisation plan can envisage that all or part of the property can be left to the debtor for the purpose of continuing the debtor's business, as well as be transferred to one or more already existing persons or persons to be established, or even be subject to a sale procedure.

The reorganisation plan is subject to the prior approval of the creditors, through a decision of the creditors' meeting, and afterward, a validation and confirmation from the court. The performance of the reorganisation plan falls on the judicial receiver and the debtor, who will implement the plan and provide trimestral updates on the status of the plan and of the debtor's current activity. In practice, the reorganisation phase is quite often applied.

(iii) The Bankruptcy Phase (the liquidation of the debtor)

If a reorganisation plan is not approved by the creditors or validated by the court or fully implemented, this results in termination of the reorganisation phase and opening of the bankruptcy phase of the debtor. With its decision, the court further (i) terminates the business activity of the debtor, (ii) orders a general distraint over the property, (iii) terminates the rights of the management bodies, (iv) deprives the debtor of the right to dispose of the property included in the insolvency estate and, respectively, (v) orders the initiation of the liquidation of the property included in the insolvency estate, as well as the distribution of the proceeds.

After collection of sufficient funds, the bankruptcy receiver prepares a distribution plan or several such distribution plans in compliance with the priority ranking of creditors under the law. After the approval of the distribution plan/s by the court, the judicial receiver distributes the proceeds.

Upon payment of the obligations or exhaustion of the insolvency estate, the court terminates the insolvency proceedings and orders the dissolution of the company. Any remaining assets/money following the termination of the insolvency proceedings will be split between the shareholders of the debtor.

Specifics of directors' liability in relation to insolvency

Director's duties and liabilities are determined in both the Companies Law and the Insolvency Law. Prior to their possible civil and criminal liability, each director shall conduct the business in good faith, as well as apply the business judgement rule determined in the Companies Law.

Additionally, the authorised representatives of the company are legally liable if they violate their duties. In the event of a dispute, they must prove that they acted properly and conscientiously in the performance of their duties.

Further to a December 2022 High Court of Cassation and Justice decision issued in an appeal in the interest of law procedure (in Romanian: "*recurs in interesul legii*"), the insolvency procedure of a debtor cannot be closed if a request for civil liability, carried out under the Romanian insolvency law provisions, is still pending.

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The reorganisation plan is subject to the prior approval of the creditors, through a decision of the creditors' meeting, and afterward, a validation and confirmation from the court.

Obligation to file for insolvency

Civil liability

The members of the management bodies and the legal representatives of the company/debtor are obliged to apply for insolvency within 30 days from occurrence of the insolvency case. Upon violation of this Romanian legal obligation, the responsible person is jointly liable to the creditors for any damages, resulting from the delayed filing or failure to file.

Further, the members of management or supervisory bodies can also bear general liability for damages towards the company/debtor.

Criminal liability

The Romanian Criminal Code regulates two criminal offences related to insolvency proceedings, namely:

- **the simple bankruptcy criminal offence** (in Romanian: "*bancruta simpla*"), which states that the non-introduction or late introduction by the debtor (natural person) or by the legal representative of the debtor (legal entity) of the request to open insolvency proceedings by a term that exceeds by more than six months the term provided by law from the emergence of the state of insolvency shall be punished with imprisonment from three months to one year or with a fine;
- the fraudulent bankruptcy criminal offence (in Romanian: "bancruta frauduloasa"), which sanctions with imprisonment from six months to five years the deed of the person who, defrauding the creditors: (i) falsifies, steals or destroys the debtor's records or hides a part of his assets; (ii) shows non-existent debts or presents unpaid amounts in the debtor's records, in another document or in the financial statement; or, respectively (iii) unlawfully disposes, in case of insolvency of the debtor, part of the assets.

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> Shareholders' claims in relation to loans granted to the insolvent company/debtor rank below the claims of other unsecured creditors.

Obligation to cooperate

During the insolvency proceedings, the members of the management bodies of the debtor are obliged to cooperate with the judicial receiver and the court. They must also provide, upon request, all the information and documents deemed necessary regarding the debtor's activity and wealth, as well as the list including the payments made in the last six months prior to the opening of the insolvency proceedings and the property transfers made in the two years prior to the opening of the insolvency proceedings, under the penalty of lifting the management rights.

The judicial receiver is obliged to compile a list of individual items of the bankruptcy estate, and the debtor/previous authorised representatives of the debtor are obliged to cooperate with the judicial receiver for this task.

Specifics of shareholders' liability in relation to insolvency

Shareholders' claims in relation to loans granted to the insolvent company/debtor rank below the claims of other unsecured creditors. In addition, if through a reorganisation plan, the respective shareholders, as creditors of the debtor, would receive more money than they would receive in case of bankruptcy, they will not be entitled to vote in respect to the reorganisation plan.

There are no imminent obligations upon shareholders in a limited liability company or a joint-stock company with respect to insolvency and stabilisation proceedings. Their only potential involvement in such proceedings may be proposing a reorganisation plan to avoid liquidation and dissolution of the debtor, provided that they decide, through a meeting of the shareholders at the beginning of the insolvency proceedings, to appoint a special administrator that will represent them and the debtor, if the management right is not excluded.

Nevertheless, shareholders may be subject to civil liability under the Insolvency Law and be obliged to support part of the debts of the debtor if, through their actions, they have acted in bad faith and these actions led the debtor to enter insolvency proceedings.

SLOVAKIA

Overview & key developments in Slovakia – from a legal perspective

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He speaks Slovak, English and French.

"Viliam Myšička handles a broad caseload that includes both M&A and corporate mandates. He is a very strong negotiator and M&A lawyer.

Viliam Myšička is focused and goal-oriented, he is very experienced and always available and ready to help."

(Chambers Europe 2022/Legal 500, 2022)

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Overview & key developments in Slovakia – from a legal perspective

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Overview

The Slovak insolvency regime is regulated by the Insolvency & Restructuring Act, No. 7/2005 Coll., as amended and can be considered as creditor friendly.

In 2021, the duration of proceedings in the majority of insolvency cases (both bankruptcy and restructuring proceedings) was between three to five years. Considering these results, the adoption of the Act on Resolution of Impending Insolvency (the "**Preventive Restructuring Act**") by the Slovak Parliament in 2022, which, inter alia, transposes the Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring, insolvency and disqualification frameworks (the "**Directive**"), constitutes a very welcome step in the development of Insolvency & Restructuring practice in Slovakia.

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> The Slovak Insolvency & Restructuring Act recognises two essential types of insolvency situations: (i) bankruptcy, and (ii) restructuring.

The Preventive Restructuring Act goes beyond the Directive and introduces several novelties, such as (i) the distinction between general bankruptcy and large bankruptcy (above EUR 10 million in value), (ii) the creation of the special category of a specialised trustee, (iii) defining the role of an advisor (such as a law firm or audit company), and more.

In 2022, several controversial decisions were adopted by the Slovak courts, on the basis of which banks were also recognised as an affiliated party in accordance with the above-mentioned definition, as a result of financing provided to a debtor and the related powers to exercise influence over (certain) business decisions of debtors.

According to the latest available information, parliament is currently working on the adoption of legislation that will change the current legislation that enables banks to fall under the definition of an affiliated party in insolvency proceedings and address the above.

More changes to Insolvency & Restructuring legislation are thus awaited in Slovakia.

Legal framework

The Slovak Insolvency & Restructuring Act recognises two essential types of insolvency situations: (i) bankruptcy, and (ii) restructuring.

The distinguishing feature of both types is the preservation of the debtor's business. In the case of restructuring, the continuation of the business of the debtor is a prerequisite for the success of the restructuring. By contrast, bankruptcy will generally involve the winding up of the debtor's business.

Both bankruptcy and restructuring proceedings are formal processes managed by a court-appointed trustee, with the participation of the debtor and its creditors.

Bankruptcy proceedings

Grounds for initiation of the bankruptcy proceedings

The reason for the initiation of insolvency proceedings is a debtor's bankruptcy (in Slovak: *úpadok*). According to the Slovak Insolvency & Restructuring Act, a debtor is bankrupt if it is (i) financially insolvent or (ii) overindebted. If a debtor files for bankruptcy, it is presumed to be insolvent.

A legal entity is financially insolvent if it is unable to meet at least two monetary obligations to more than one creditor 90 days after their due dates.

An overindebted entity (in Slovak: *predlžený*) is an entity with liabilities that exceed the value of its assets. For this purpose, affiliated receivables are excluded. Furthermore, the going-concern test applies here to the exclusion of the over indebtedness test.

Finally, for the purpose of the Preventive Restructuring Act, a third test is applicable: the test of threatening (impending) bankruptcy, described further in this article.

Timeline

Bankruptcy proceedings consist of four main phases:

(a) Filing – the court reviews the application. The insolvency application may be filed by a debtor, a creditor, or a liquidator on behalf of the debtor. The debtor and its director(s) have the duty to file a petition for bankruptcy within 30 days from: (i) becoming aware of the company's bankruptcy or (ii) the day they should had become aware if they acted with due care.

After commencement of bankruptcy proceedings, a company may continue operating its business, however limited to ordinary legal acts.

Once the bankruptcy petition is filed, the court decides on the commencement of the bankruptcy proceedings within 15 days (or within five days, if based on the application from a debtor).

(b) Initiation – upon declaration of bankruptcy by the court, the court will initiate bankruptcy proceedings. In this phase, creditors submit their claims within a deadline of 45 days from the declaration of bankruptcy by the court.

As of 1 March 2023, the submission is done electronically and delivered to the trustee's electronic mailbox, who then continuously enters the submitted claims to the list of claims.

By declaration of bankruptcy by the court, the debtor's authority to dispose of assets subject to bankruptcy, and the authority to act for the debtor in matters relating to those assets, passes to a randomly selected trustee who acts in the name and on behalf of the debtor. Such randomly selected trustee is either selected from general licensed trustees (regional license) or, if a matter involves a company whose assets or turnover exceeded EUR 10 million, from specialised licensed trustees (Slovakia-wide license).

The randomly selected trustee can be exchanged (replaced) by a majority of creditors' during the first creditors' meeting.

(c) Monetisation / sale of assets – following the declaration of bankruptcy of the debtor, the trustee commences with the ascertainment of assets that are subject to bankruptcy.

The election of the members of the creditors' committee and a first creditors' meeting is usually convened at this stage of the bankruptcy proceedings.

Satisfaction of the individual creditors in bankruptcy proceedings depends primarily on whether they are secured or unsecured creditors. A secured claim of a secured creditor is satisfied from proceeds of the realisation of assets forming the separated estate of the secured creditor.

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> Restructuring in Slovakia is a court-driven turnaround process capable of bringing higher satisfaction to creditors than bankruptcy.

(d) Termination – the bankruptcy is terminated by publishing a notice on the validity of the court's decision on the termination of bankruptcy in the Commercial Bulletin, after all assets entered in the list of assets have been monetised and the final schedule of proceeds for the unsecured creditors has been prepared by the trustee. The usual duration of proceedings is two to five years.

Restructuring proceedings

Restructuring in Slovakia is a court-driven turnaround process capable of bringing higher satisfaction to creditors than bankruptcy. Slovak law recognises two types of restructuring proceedings:

(i) Formal restructuring – more suitable for a company that is insolvent; and

(ii) Public / non-public preventive restructuring – more suitable for a company on the verge of insolvency.

Restructuring always takes priority over bankruptcy, if filed simultaneously.

An important restraint on court restructuring (applicable only to formal restructuring) is the requirement that the compensation to general unsecured creditors in the restructuring must not be less than 50% of the claim value.

> "According to the new regulation, a debtor is in impending insolvency in particular if it is threatened with insolvency.

In case the debtor is not yet bankrupt, the above-mentioned Preventive Restructuring Act provides a solution to the impending bankruptcy through preventive proceedings.

Formal restructuring

The formal restructuring proceedings consist of the following four main phases:

(a) Proposal – an insolvent debtor or a creditor in cooperation with the debtor may instruct the trustee (preferably a specialised trustee) to prepare a restructuring opinion for the purpose of determining whether the prerequisites for its restructuring are met.

(b) Initiation – the court decides within a deadline of 15 days on the initiation of restructuring proceedings based on the application received under point (a) above. The restructuring proceedings are initiated by the publishing of the resolution in the Commercial Bulletin.

The debtor automatically enjoys a moratorium (protection against old debts) as of such date. After initiation of the restructuring proceedings, the court examines prerequisites for authorisation of the restructuring. Once these are met, the court decides on the restructuring within the deadline of 30 days following the initiation of the restructuring proceedings.

Within an additional 30 days from the permitting of restructuring, creditors register their claims and the trustee organises the first creditor's meeting.

(c) Negotiation of plan – the restructuring plan is a special type of contract, drawn by the debtor in order to change obligations between the debtor and its creditors. It must be approved by the creditors' meeting (specific rules apply) and subsequently by the court.

The final draft of the restructuring plan must be submitted to the creditors' committee for approval within 120 days of the approval, and the committee has to approve the plan within 15 days of its submission.

(d) Approval – the plan adopted at the approval meeting should be confirmed by the court within 15 days of receipt thereof. In the decision confirming the plan, the court will also decide on the termination of the restructuring and publish the decision in the Commercial Bulletin.

Public preventive restructuring

According to the new regulation, a debtor is in impending insolvency in particular if it is threatened with insolvency. Insolvency is impending if considering all circumstances it can reasonably be assumed that financial insolvency will occur within 12 calendar months. Thus, impending insolvency is tied to a cash-flow prediction test for insolvency.

Preventive restructuring has in fact many similarities with formal restructuring, as both are court-driven processes. However, preventive restructuring has its benefits (e.g., the 50% minimum satisfaction requirement for unsecured creditors does not apply, and failure to complete preventive restructuring does not immediately result in the company's bankruptcy). Nonetheless, as parliament did not cover all tax implications in the new legislation (in particular, the write-off of receivables is taxable for a debtor), it remains questionable whether this method will be used on the market.

The concept of a public plan

The application for public preventive restructuring must be accompanied by a draft public plan, often to be prepared by an advisor. This is another novelty of Slovak legislation – the concept of an advisor is defined, and it could be any reputable law firm or tax/audit company. The first and final draft plan cannot differ substantially (e.g., not more than by 10% in relation to a creditor's satisfaction).

If the court authorises a preventive public restructuring, the debtor must hold an approval meeting to inform the creditors concerned of the reasons for the impending insolvency, to present a public plan, and to vote on the acceptance of the public plan by the creditors.

Temporary protection in preventive restructuring

The Preventive Restructuring Act also regulates the conditions for temporary protection (moratorium), which represents a period of three months (renewable for a maximum of six months) when a debtor is not obliged to file for bankruptcy. A moratorium is not automatically granted to a debtor, but only if a majority of the creditors approve it.

Non-public preventive restructuring

Non-public preventive restructuring is designed to deal with situations where the creditor is an entity subject to the supervision of the National Bank of Slovakia. Typically, such form of restructuring would or could be used for a situation of financial stand-stills negotiated between a client as debtor and bank (or syndicate of banks) as lender(s).

In contrast to a public preventive restructuring, the proceedings and the preventive restructuring plan are not public. A non-public plan is binding only for creditors who have signed a written consent to the plan.

Specifics of directors' liability in relation to insolvency

The company is obliged through its statutory body to regularly monitor its financial situation and the status of its equity and liabilities in order to avoid any possible impending insolvency in time and take measures to prevent it.

Obligation to file for insolvency

Civil liability

The legal representative of the company is obliged to file a petition for bankruptcy or restructuring within 30 days of becoming aware, or in the exercise of due care could have become aware, of the company's insolvency.

If the legal representative does not file a petition for bankruptcy in time, he/she is obliged to pay the company a penalty in the amount of EUR 12,500.

Further, the members of management bear a general liability for damages towards the company and its creditors, who can assert the company's claims for damages against its management members in their own name and on their own account if they cannot satisfy their claim from the company's assets. If the company is bankrupt, the claims of the company's creditors against the company's management members will be asserted by the trustee.

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> If the court authorises a preventive public restructuring, the debtor must hold an approval meeting to inform the creditors concerned of the reasons for the impending insolvency.

Criminal liability

Pursuant to the Slovak Criminal Code, if the members of management bodies do not file for insolvency within 30 days from the cessation of payments, they bear criminal liability. Such action may result in the offence of obstruction of bankruptcy and insolvency proceedings, which is punishable by imprisonment from six months to five years.

Obligation to cooperate

During insolvency a debtor is obliged to cooperate with the trustee and the court and provide all reasonably required assistance and, upon request, provide the administrator with any explanations requested.

Specifics of shareholders' liability in relation to insolvency

Shareholders' claims in relation to loans granted to the insolvent company rank below the claims of the other unsecured creditors and normally receive zero satisfaction.

There are no impending obligations upon shareholders in a limited liability company or a joint-stock company with respect to insolvency and restructuring proceedings.

Liability of controlling person for damage caused by the bankruptcy of a controlled person

Slovak legislation regulates the concept of the controlling person being liable to the creditors of the controlled person for damages caused by the bankruptcy of the controlled person.

> "There are no impending obligations upon shareholders in a limited liability company or a joint-stock company with respect to insolvency and restructuring proceedings.

A controlled person is a company in which an entity has a majority of voting rights due to its shareholding interest in the company or shares therein, to which are attached the majority of the voting rights or because, by agreement with other eligible entities, it can exercise a majority of voting rights, irrespective of the validity or invalidity of such agreement.

A controlling person is a person who has a position in the controlled person as referred to in the preceding sentence.

The liability will be triggered in the event that the controlled person has substantially contributed to the bankruptcy of the controlled person by its actions. This liability will be discharged if the controlling person proves that it acted knowingly and in good faith that it was acting for the benefit of the controlled person.

Contestability of legal acts

Legal acts relating to a debtor's property are ineffective against a debtor's creditors in bankruptcy if they are contested by the trustee or a creditor in the insolvency proceedings.

The legal acts of shareholders or other affiliates of a debtor can be thus contested in connection with insolvency proceedings in case any non-arms' length transaction occurred between them and the debtor in the past five years. Typically, these would include contracts or transactions considered as undervalued or concluded without adequate remuneration. In such cases (which are mandatorily reviewed by a trustee), the beneficiary (i.e., a shareholder or an affiliate) would be obliged to return any benefit received from such transaction.

Repayment of dividend

As a part of the concept of the "prohibition on return of contributions to a company", if a dividend payment was made during the time of (or in specific cases before) the bankruptcy of the company, the trustee could request repayment of such dividends or similar payments from the company's shareholders.

Affiliation of persons in insolvency proceedings

The Insolvency & Restructuring Act contains a quite harsh definition of an affiliated person of the debtor. It is defined as an entity in which the natural person or a close person of the natural person has a qualified participation, which means a direct or an indirect interest representing at least 5% of the debtor's (i) share capital, (ii) voting, rights or (iii) the possibility to exercise influence on management of the legal entity.

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KPMG is a global organisation of independent professional services firms, providing Audit, Tax and Advisory services. We have a dedicated team providing a broad range of business recovery services including Insolvency, Turnaround, Asset Recovery, Restructuring and Debt Advisory, with an international focus and proven track record. KPMG's international footprint provides practical banking, restructuring, turnaround and insolvency experience across the business lifecycle.

KPMG in Cyprus provides a wide-range of services, backed by years of accumulated international and local expertise. Our dedicated Restructuring and Debt Advisory team can assist on the adjacent services:

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Rennos has over 28 years of experience in the financial and advisory fields respectively with a deep understanding of the lending and NPL sectors. He has been involved for over 20 years in the management of corporate and retail loans, both performing and distressed, as well as with distressed and onboarded real estate assets.

Since joining KPMG Cyprus in 2016, Rennos has taken a key role in leading the fields of corporate financial restructurings and insolvency work, being a licensed Insolvency Practitioner (receiverships, liquidations, examinerships, corporate and personal schemes of arrangement), independent business reviews and lenders' due diligence for existing and new financing, the provision of debt advisory services to corporate clients and expert training to the financial and corporate sectors. Rennos has also been involved in various real estate market studies, real estate onboarding, options assessment and monetisation strategies.

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Elena started with KPMG Cyprus in 2012. She has completed numerous engagements with clients in a number of industry sectors including financial services, retail, tourism & leisure and other sectors.

Elena has an extensive experience in the provision of financial restructuring services as she was involved in various projects including option analysis on the restructuring/ recovery strategy of major banks, independent Business Reviews on the financial performance of corporate clients, and review of Borrower Summaries at the request of financial institutions, providing an insight into the background, current position and recoverability of their NPL exposure.

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BIO

Athos joined KPMG Cyprus in 2014. He has been involved in delivering various engagements to clients in a number of industry sectors including real estate, financial services, retail, tourism & leisure and other sectors.

Athos has a wide experience in the provision of debt advisory services, financial restructuring services and insolvency work. He has been involved in many projects including receiverships for trading and non-trading companies, independent Business Reviews on the financial performance of corporate clients, options analysis on the restructuring/ recovery strategy of major banks and review of Borrower Summaries at the request of financial institutions, providing an insight into the background, current position and recoverability of their NPL exposure.

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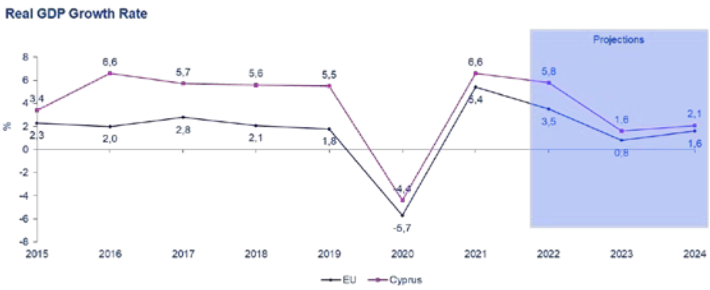
Cyprus economy at a glance

The Republic of Cyprus, a member country of the European Union since 2004, is a small, open and service oriented economy. Due to its strategic location, at the cross roads of Europe, Middle East-Asia and Africa, Cyprus is considered to be a business gateway between the three continents.

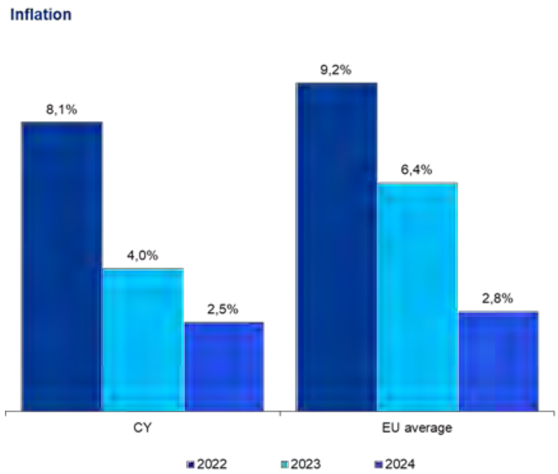
In the first half of 2022, the real GDP growth rate reached 6,3%.

It is expected that it will reach 5,8% for the full year compared to 3,5% in the EU.



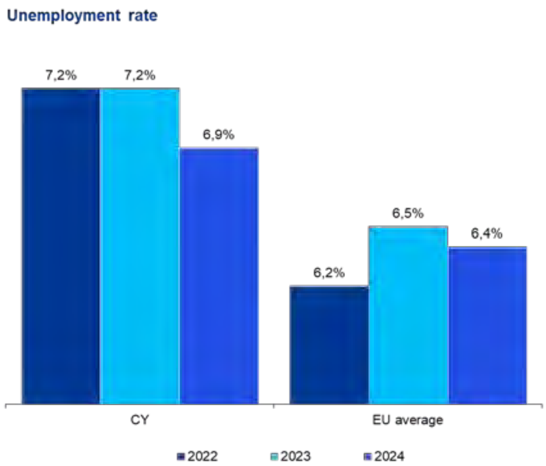
Source: Eurostat, European commission, KPMG analysis

The high level of inflation in 2022 is expected to decline to 2,5% in 2024.



Source: European commission, KPMG analysis

The unemployment rate is expected to remain steady in the next few years.



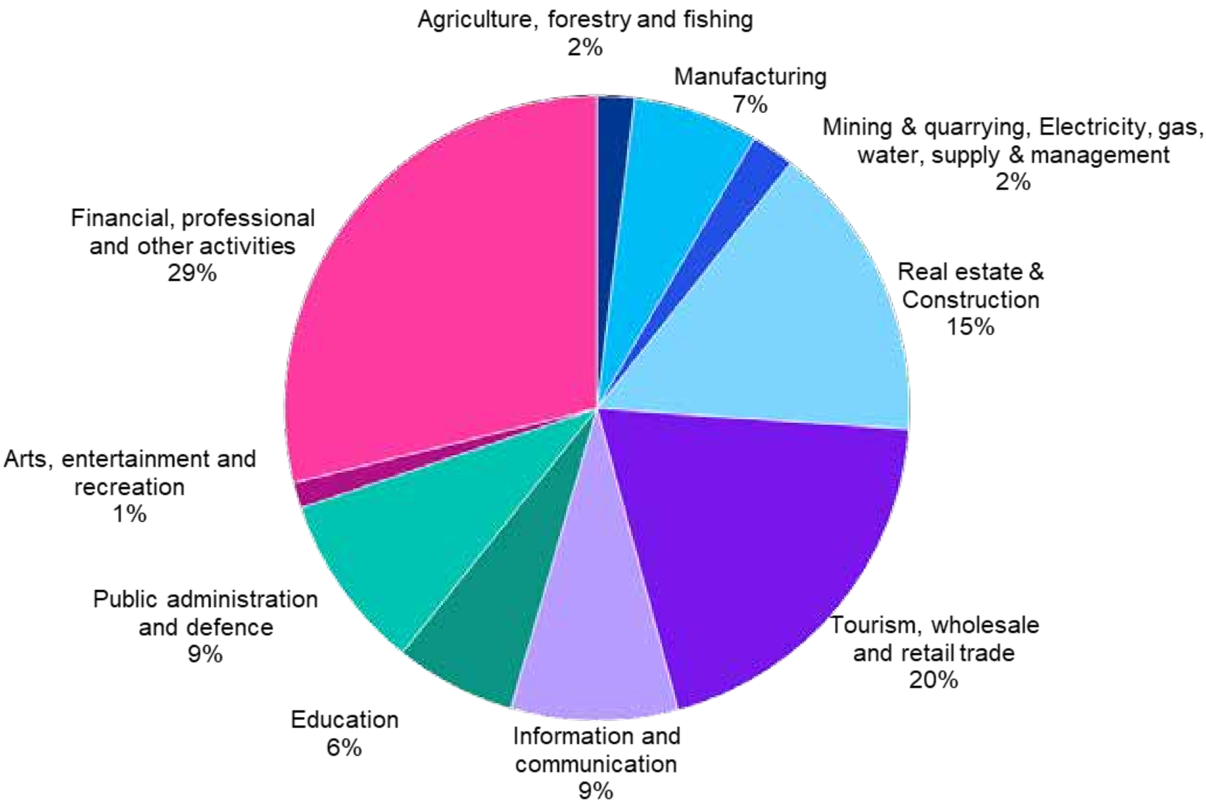
Source: European commission, KPMG analysis

Financial, professional and other activities are by far the greatest contributor to the local economy.

The economy is highly dependent on tourism as this sector has large spillover effects to other sectors (food services, retail, transport and other services). It is noteworthy that the tourism sector has recovered most of the ground lost during the pandemic.

The real estate and construction sector continues to grow, albeit moderately. The Government aims to develop the sector further by modernising relevant legislation and by speeding up and streamlining administrative procedures.

The Information communication and technology (ICT) sector is expected to grow further due to recent incentives implemented by the Cypriot government to attract foreign investment and talent.



Source: Cystat

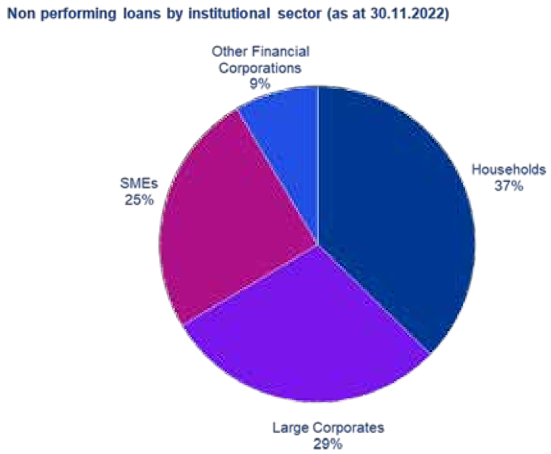
The restructuring of the banking sector over the past few years has helped Cyprus to attract significant foreign investment from institutional investors and to increase sales of non-performing loans (NPLs). Nevertheless, the NPLs ratio still remains at high levels compared to the European average.

A large portion of NPLs has been offloaded by local banks through portfolio sales to credit acquiring companies (CACs).

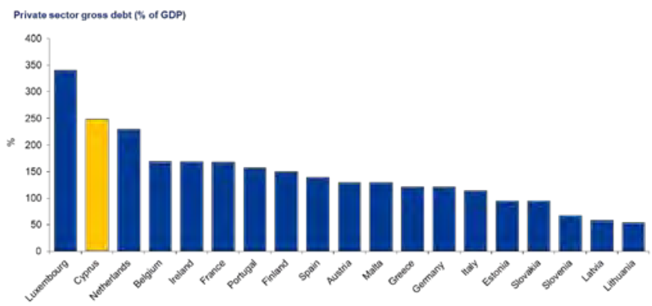
The magnitude of private and public debt is at comparatively high levels.

Note: EU NPL ratio as at 30 September 2022

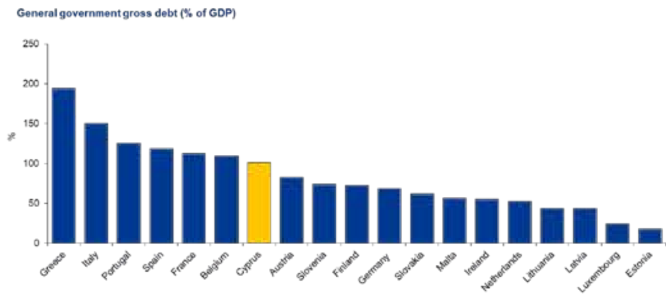
Source: Central Bank of Cyprus, European Central Bank, KPMG analysis



Source: Central Bank of Cyprus, KMPG analysis



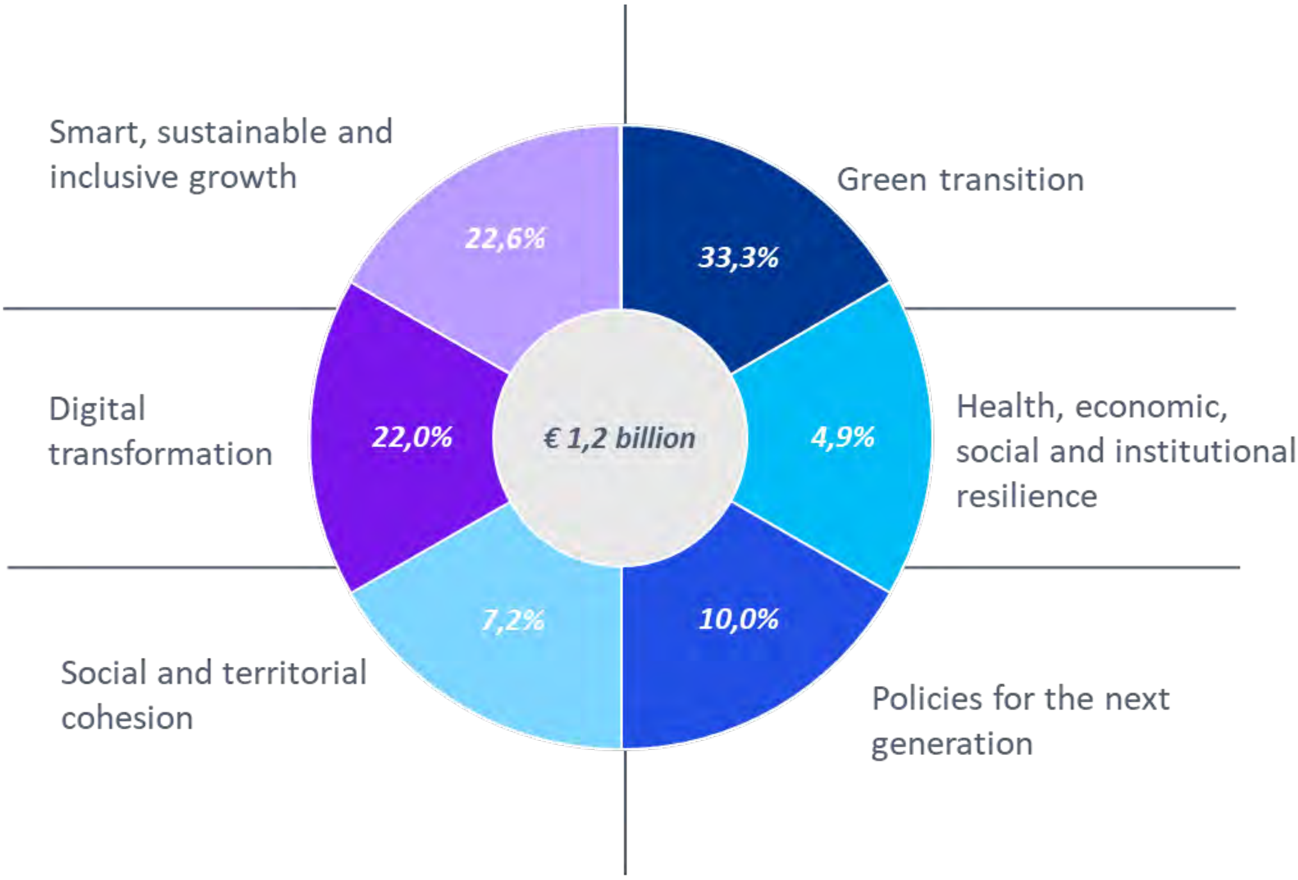
Source: Eurostat



Source: Eurostat

Recovery and Resilience Plan

Cyprus is in the process of receiving from the EU €1,2 billion in grants and loans for structural transformation to address country-specific challenges



Source: European Commission

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Cyprus, an increasingly competitive economy

54th In Ease of Doing Business*

"Ease of Doing business" captures several important aspects across 10 major topics of the regulatory environment of each of the 190 economies under evaluation.

31st In Resolving Insolvency*

The Republic of Cyprus is characterised by a strong insolvency framework that allows for the debtor or creditor to initiate insolvency proceedings and the adequate management of the debtor's estate

73,8%

The recovery rate of insolvency proceedings involving domestic entities, recorded as cents on the euro recovered by secured creditors through reorganisation, liquidation or debt enforcement (foreclosure or receivership) proceedings, is estimated at 73,8 cents on the euro

14,5%

The cost arising from receivership procedures is estimated at 14,5% of the value of the debtor's estate (including legal and receiver's fees)

1,5

The average receivership proceeding takes 1,5 years to complete

21st In Protecting Minority Investors*

The Republic of Cyprus has a strong framework in place regarding the protection of minority investors.

9/10 Extent of disclosure Index*

Measures the extent of transparency in the execution of buyer-seller transactions

6/6 Extent of shareholder rights index*

Measures the role of shareholders in key corporate decisions

7/7 Extent of corporate transparency index*

Measures the level of information that companies must share regarding their structure and economic indicators

*according to the report "Doing Business 2020" issued by the World Bank which ranked 190 economies based on certain variables

Judicial system digitalisation, paving the way for streamlined insolvency procedures

Further to the EU Directive 2019/1023 of the European Parliament and of the Council of the European Union, reforms have been implemented in the Republic of Cyprus in order to modernise and strengthen the Insolvency Framework.
The most important milestones of the reforms concern the digitalisation of the current framework's operations with the introduction of the e-justice and i-justice systems.

E-justice is a system currently in development that will lay the foundations for the modernisation and digitalisation of the judicial system in the Republic of Cyprus. The e-justice system involves the implementation of digitalisation of all major aspects of court administration and hearing procedures.

1. The system will provide for the electronic lodgment of documents and lawsuits
2. The system will allow for information to be filed and utilised into a central register accessible by stakeholders
3. The system will improve the efficiency relating to the collation and presentation of pleadings

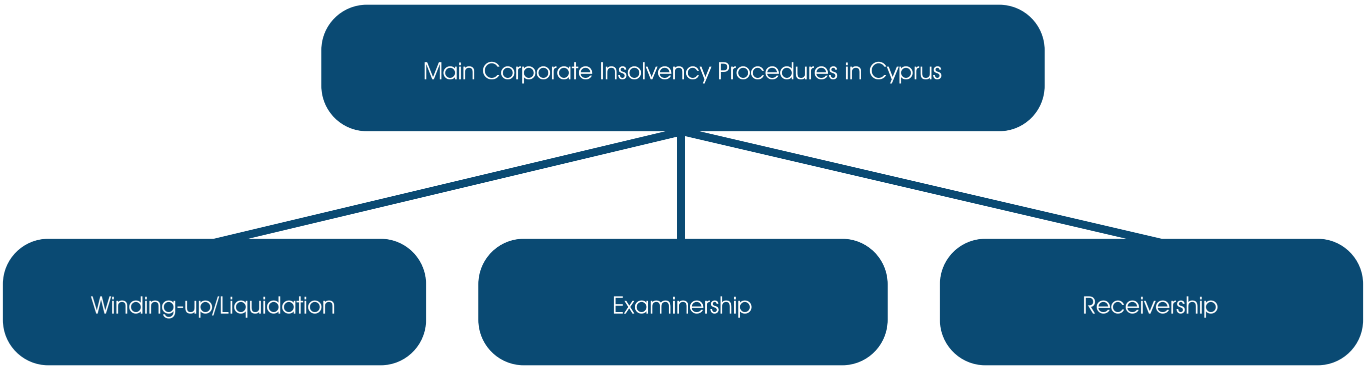
The system is expected to be fully implemented within 2023, however, an interim solution has been introduced and recently implemented, called "i-justice".

A modernised, fully regulated and robust Insolvency Framework

Cyprus Corporate Insolvency Framework

The legal framework for insolvency and corporate matters in Cyprus is governed by the Companies Law (Cap113) and is supplemented by the Companies (Winding-up) Rules 1933–2013 and the Civil Procedure Rules.

The provisions apply to all companies registered in the Republic of Cyprus. However, special insolvency rules apply to banking institutions under the Business of Credit Institutions Law (66(I)/1997, as amended) and to insurance companies under the Law on Insurance and Reinsurance Business and Related Issues (38(I)2016, as amended).



Winding Up/Liquidation: This is the process of terminating a company's activities, paying off its debts from available assets, and winding up the company in an orderly manner. In order to achieve this, a licensed Insolvency Practitioner is appointed as a Liquidator. There are two forms of Liquidation in Cyprus: compulsory and voluntary.

i. Compulsory liquidation is related to insolvent companies and can only occur after a petition is filed and submitted to the relevant Court. This can be done by the company itself, a creditor, a contributory, an Examiner, an Insolvency Practitioner from another member state in accordance with Article 2 (b) of the Insolvency Regulation (EC) 1346/2000, or a temporary Insolvency Practitioner appointed by a Court of another member state under Article 38 of the Insolvency Regulation.
ii. Voluntary Liquidation, on the other hand, is initiated by the company's members or creditors. Creditors' Voluntary Liquidation is used to distribute the available assets of an insolvent company among the creditors, whilst Members' Voluntary Liquidation is a method of dissolving a solvent company that is no longer needed and distributing its assets among its members.

According to Companies Law (Cap 113), a compulsory Liquidation must be completed within a period of eighteen (18) months from its commencement. If this does not prove possible, an application must be submitted by the Liquidator to the Court to obtain an extension. The expected timeframe for a voluntary Liquidation, varies from case to case.

Examinership: This is a debt restructuring and corporate rescue procedure, which aims to assist viable businesses in surviving. The Court appoints a licensed Insolvency Practitioner as an Examiner over a company, who is responsible to prepare a restructuring plan, which is then presented to the Court. The Court can under certain conditions, ratify, amend, or reject the plan at its discretion. When the Examiner's proposed restructuring plan takes effect, the company ceases to be under Court's protection and the appointment of the Examiner is terminated.

The Court provides a period of protection from creditors initially for four months, with a possible extension of up to six months.
An Examiner is appointed based on the following criteria:
i. the company is or will probably be unable to pay off its debts
ii. there is no resolution or order for the company's winding-up,and
iii. there is a reasonable survival prospect for the company as an active economic unit.

Cyprus Corporate Insolvency Framework (continued)

Receivership: The purpose of a Receivership is to recover the secured creditor's debt, without ending the existence of the corporate debtor as in Liquidation. There are two ways a Receiver can be appointed: through a Court decision or by a secured creditor who holds a relevant charge over the company's assets (either a floating charge over the company's entire undertaking and assets or a fixed charge on specific assets). The appointee must be a licensed Insolvency Practitioner.

The appointment of a Receiver terminates the directors' powers of management over the assets under Receivership and transfers those powers to the Receiver. The extent of the powers is defined in the document that appoints the Receiver or by the relevant Court decision.

The expected timeframe for Receivership varies in relation, inter alia, to the activities and complexities of the company, the nature of its assets and any legal challenges during the appointment.

The Insolvency of Physical Persons

The insolvency of physical persons is governed and regulated by the Bankruptcy Law, Cap 5 and by the Bankruptcy Rules, Cap 6.

According to the Bankruptcy Law, any debtor who commits or suffers any act of bankruptcy (listed in Section 3(1)) and meets the following conditions at that time (based on Section 3(2)), can be adjudged as bankrupt by the Cypriot Courts. For this to apply the debtor must be:

i. ordinarily resident in Cyprus
ii. conducting his business personally or by means of an agent in Cyprus
iii. a member of a firm and/or partnership which conducts its business in Cyprus.

In cases where the protection of the debtor's property is necessary, the Court may, at any time after the filing of a bankruptcy petition and before a bankruptcy decree is issued, appoint the Official Receiver or a licensed Insolvency Practitioner as an interim administrator of the debtor's property, or any part of it, with an order to immediately take possession of the property.

Under Section 27 of the law, a bankrupt individual is automatically rehabilitated and discharged from his debts upon completion of three years from the date of issuance of the bankruptcy decree. In case the entire bankruptcy estate has not been distributed within that period, the bankrupt individual must assist and cooperate with the administrator until the full distribution of his property to the benefit of creditors.

Additionally, as per relevant legislation, two alternative insolvency tools are in place with an aim to assisting in preventive restructuring of the debts of physical persons.

Cyprus Insolvency Framework Latest Reforms

Cyprus has made substantial efforts to modernise its Insolvency framework through various reforms. The latest reforms aiming towards the enhancement of the Insolvency framework and its efficiency, include:

i. The organisational reform of the Department of Insolvency and the provision of specialised training to its personnel

ii. The establishment of a customer service line which will assist in strengthening the level of service provided to all stakeholders, ensuring the effective implementation of all relevant laws

Licensed Insolvency Practitioners in Cyprus

Insolvency Practitioners in Cyprus are licensed, regulated, and supervised by three authorities:

i. Department of Insolvency

ii. Cyprus Bar Association

iii. The Institute of Certified Public Accountants of Cyprus.

The Insolvency Practitioners Law N. 64(I)/2015 outlines the regulations regarding the licensing, training, supervision, and disciplinary monitoring.

The Law prescribes the relevant requirements for the certification of the licensed Insolvency Practitioners, whose conduct is governed by the relevant Code of Ethics. The code provides ethical guidance and sets the fundamental principles that every Insolvency Practitioner must abide by, including integrity, objectivity, professional competence and diligence, confidentiality, and professional conduct.

As part of the efforts to modernise the Insolvency regime, a framework has been established for continuous professional development for Insolvency Practitioners leading to the strengthening and harmonisation of the profession.

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Enforcement Procedures fully aligned with international best practices

There are several instances of companies internationally, which initiate legal proceedings against companies that may hold investments or other types of assets, through Cyprus registered companies.

In Cyprus, there is no single system for enforcing foreign Court judgments. However, the Cypriot Courts will assist in the enforcement of a foreign Court judgment if certain conditions are met.

When a foreign Court judgment is recognised and registered within the Cypriot jurisdiction, it can have the same legal impact as if it had been issued by a Cypriot Court. Therefore, foreign Court judgments that support the execution of actions or the winding up/bankruptcy-liquidation petition against a judgment debtor in Cyprus, must be ratified by the Cypriot judicial system in order to be enforceable.

Enforcing EU Court Judgments	Enforcing non-EU Court Judgments
In insolvency proceedings, Regulation (EU) 848/2015 (Recast Insolvency Regulation) applies and aims to ensure the efficient administration of insolvency proceedings involving an individual or business with business activities or financial interests in an EU country other than the one in which they are usually based. The regulation sets out EU-wide rules to establish: i. which Court has jurisdiction to open an insolvency case ii. the applicable national law iii. recognition of the Court's decision when a company, a trader or an individual becomes insolvent.	For the recognition and enforcement of non-EU Court judgments, there are several bilateral treaties between Cyprus and other countries that define the ways these Court judgments can be ratified in the Cypriot judicial system. Examples include the HCCH Convention on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters 1971 and the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention).

Special thank you to our colleagues from the Restructuring and Debt Advisory department, KPMG in Cyprus, for their contribution to the above publication: Andreas Papamichael (Assistant Manager), Ioanna Kanari (Senior Advisor), Dionysios Kollyriotis (Senior Advsior), Maria Zenonos (Senior Advisor), Vagia Dimogiannis (Senior Advisor), Alexandros Demetriou (Advisor).

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BIO

Korbinian Gennies is a Turnaround and Restructuring Strategy Partner at EY-Parthenon. With more than 15 years professional experience, he is a proven expert in advising clients in challenging business environments in a wide variety of projects and across various industries. His areas of expertise include planning and executing large scale transformation programs, restructuring concepts and target operating models, as well as optimizing SG&A costs.

Before joining EY-Parthenon in 2020, he held various interim management roles after starting his career in a restructuring consulting boutique in 2008. Having worked both in consulting and management roles, Korbinian developed a pragmatic, solution-oriented and empathic approach, highly valued by his clients. Korbinian takes responsibility for EY-Parthenon's restructuring business in the greater Stuttgart area, focusing mainly on automotive, retail, and machinery equipment industry.

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BIO

Andreas Warner is member of the EY-Parthenon Leadership for Europe West and responsible for Turnaround & Restructuring Strategy. He supports companies in special situations ranging from performance improvement to restructuring. Andreas is also member of the EY Global Restructuring Leadership.

Andreas has two decades of experience in strategic operations and restructuring businesses. Combining that with his engineering background and mindset for solving the most complex of challenges, he takes pride in finding the best solutions for clients' biggest challenges.

His career prior to EY-Parthenon includes leading operations in mid-cap firms, and once in consulting, heading up restructuring services in Germany and Central Europe. He has also led value creation services across EMEIA, deploying private equity and operational restructuring techniques to identify and deliver performance improvement with a sharp focus on delivery of cash and earnings before interest, taxes, depreciation, and amortization (EBITDA) benefits.

Andreas holds a Diploma in Engineering and a Master's degree in Science (production management) from the Chalmers University of Technology, Sweden.

As wistful memories of European economic expansion and growth fade into history, we are now facing a prolonged series of crises, from the COVID-19 global pandemic overhang to a range of geopolitical and macroeconomic shockwaves. It is therefore hardly surprising that the subject of company restructuring is back on board agendas, as well as in the public consciousness. But is today's approach to restructuring the same as for crises of the past? Is restructuring a sledgehammer for simply driving cost-cutting and rationalisation? Or does today's complex world demand a more surgical approach and a whole new definition of restructuring as crises start to pile up?

“

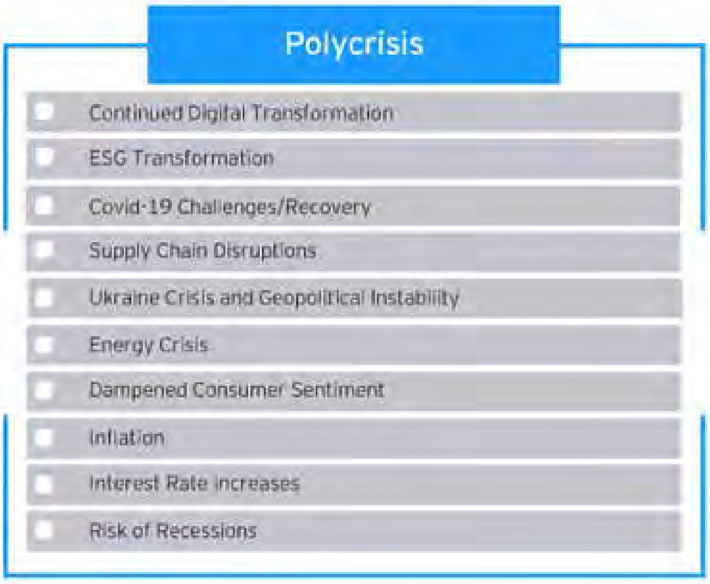
In view of the multiple challenges created by this polycrisis, more and more companies are calling for restructuring.

Companies are facing a polycrisis

The current pressure on businesses is immense. Despite some recent glimmers of hope, the overall economic picture for the Eurozone remains weak, with growth forecast to be low in 2023. In Germany, for example, the Ifo Institute for Economic Research expects to see a recession, or at least flat economic growth for Germany in 2023. The mood in the German economy has been downbeat for years, with the government rolling out one bailout package after another to soften the impact of the multiple crises. The boom years of the last decade are clearly over.

There are numerous reasons for this economic trend: businesses are battling price hikes amid persistently high inflation and elevated energy prices, an ongoing and worsening shortage of skilled workers, cybersecurity issues, fickle supply chains and a growing need to deliver on sustainability expectations. Geopolitical frictions, especially in connection with the war in Ukraine, are also perpetuating mass uncertainty and volatility. The latest crises aside, companies have been in the grip of disruption to their business models for some time, and not just because of the COVID-19 global pandemic. Take the automotive industry, for example, with its shift to e-mobility or brick-and-mortar retailers, who have been contending with the aggressive growth of online competitors for many years now.

This polycrisis is unlike any series of crises of the recent past and is pushing entrepreneurs and executives beyond their limits.



Restructuring is more sophisticated than just cost-cutting

In view of the multiple challenges created by this polycrisis, more and more companies are calling for restructuring. However, when they do, they are often aiming for more than just better results on the cost and liquidity side. A typical project will still inevitably start with stabilising the business — focusing on liquidity and stopping the bleeding, while swiftly adjusting unnecessary costs. But this is just the start of the journey to a sustainable restructuring.

Many companies face a vast range of issues that must be solved holistically for the long-term if they want to restore their competitive edge. These companies require a complete overhaul, and their business models must be challenged and adjusted as necessary. It's no surprise then that there has been a significant shift in emphasis away from conventional cost-cutting toward fundamental strategic issues over the last few years. Anecdotally, it can be estimated that in pre-polycrisis times, around 75% of a restructuring project focused on resolving operational issues, with 15% on financial issues and only 10% on strategic aspects. Today, in comparison, more than 60% of a project is devoted to the strategic side of restructuring. Effective restructurers are placing more of an emphasis on the interaction between strategic foresight and operational feasibility for a plan to be successful.

Maintaining a steady path within a changing global environment

In recent years, rapidly growing markets have helped European companies flourish geographically and enter new areas of business. However, sentiment from the World Economic Forum (WEF) in Davos has recently challenged whether this development poses some risk, asserting that geographical parameters, once considered indisputable, should be revisited.

Increasing protectionism and friction between the major world powers are raising uncertainties for companies with large geographical footprints. It comes as no surprise that decisions on geographic footprints are coming under the microscope in the current polycrisis, with companies asking themselves more frequently where to focus their business model. In the context of restructuring, many companies are turning their attention back to their core business and reassessing the value of non-core activities. As a result, restructurers are placing a renewed emphasis on selling business units that don't belong to the company's core geographic or economic operations. Transactions will, therefore, increasingly form a key element of restructuring, although this does not necessarily mean disposing of business segments.

The fundamental transformation that a large number of companies are currently undergoing frequently requires the opposite – for them to acquire specific skills, market access or capabilities to underpin their long-term competitiveness. For example, a large contingent of companies in the automotive sector are disposing of their combustion engine divisions, while at the same time investing in sustainable emerging technologies, such as electromobility or connectivity.

From just-in-time to just-in-case: ESG-compliant supply chain resilience

A classic lever in any restructuring project is unlocking cash from internal funding through working capital management. In the past, businesses responded to a crisis by improving debtor and creditor payment terms and processes and by optimising current assets. Just-in-time strategies along the value chain led to leaner supply chains, which regularly released significant additional cash for the business. New geopolitical uncertainties, and recent experience from combating the pandemic, have exposed the significance of goods availability as an additional and pivotal decision-making factor. Combined with ESG-compliant supply chains, this adds to the long list of new and difficult challenges for current restructuring projects.

“

Increasing protectionism and friction between the major world powers are raising uncertainties for companies with large geographical footprints.

Profound social change and vertical integration

The quest for the right level of vertical integration that promises lasting success is a burning issue. The number one driver of this trend is the increasing scarcity of skilled workers. From IT and finance, through to manufacturing and distribution, companies are grappling with an ever-widening gap between labor demand and supply. The scope of this problem is clear when you consider that, in the last 10 years, job vacancy rates have increased across Europe from 1.3% in 2013, to 3.1% at the end of 2022. Taking Germany as an example, the Cologne Institute for Economic Research forecasts that the number of people in the labor force will drop by around three million by 2035, even when factoring in effects from immigration.

> "The overarching objective of restructuring is not to reduce headcount to a minimum, but to free up capacities for use in other business areas to realise further growth.

In light of such dramatic developments and forecasts, reducing headcount has long ceased to be the obvious go-to for companies going through restructuring. Instead, they need to devise creative solutions for retaining, engaging and developing existing employees, so they can be more flexibly assigned within the organisation. They need to be deployed optimally and efficiently to keep repetitive work activities that do not add value to a minimum.

In this context, the level of vertical integration within the business, as well as more efficient organisation within and across departments, is gaining importance.

Companies should pay close attention to three significant success factors on their path to successful restructuring:

1. Key resources and skills should be defined and identified early on. Attracting suitably experienced and qualified employees, or training and developing the existing workforce, are essential in a market characterised by a shortage of skilled labor. The long-term retention of talent is a central imperative for successful restructuring.

2. Scrutinise the entire organisation as part of the restructuring process. This ensures efficient use of available resources and existing know-how. Successful methods for streamlining resources include eliminating organisational levels that do not add value and paring back organisational complexity.

3. Selecting the right leadership is pivotal to motivating and multiplying employees. Flat hierarchies facilitate leading-class networking and use of employee skills. In the context of employee enablement, companies should increasingly assess their executives in terms of their ability to effectively lead and inspire during times of complex change, rather than based on just their professional expertise.

The overarching objective of restructuring is not to reduce headcount to a minimum, but to free up capacities for use in other business areas to realise further growth.

Technology: a mainstay of an efficient organisation

In addition to organisational and human resource adjustments, the use of technology to unlock further growth potential plays a central part of restructuring projects today. In the past, technological advancements were often neglected due to prohibitive investment costs or a reluctance to roll out procedural changes. Breakthrough achievements in artificial intelligence (AI), leading to a broader scope of applications in the real world, now mean that a successful restructuring process can no longer bypass the integration of leading-edge digital tools. For example, we are only beginning to see the potentially ground-breaking commercial opportunities for advancements such as ChatGPT, an AI chatbot, in the market. The use of comparable technology, especially in administration, but also in creative fields, will be a decisive factor in restructuring projects. Technology allows companies to minimise demand for resources, boost efficiency and facilitate further growth. However, success is not guaranteed and hinges not only on focusing on the most appropriate new technologies for the business, but also on the essential upstream review and overhaul of core processes. Efficiently designed and clearly defined core process can then form the basis for the use of new technology.

Target operating model: the basis for sustainable business success

Companies need to be vigilant on a growing range of factors to safeguard the resilience of their business models while working on a range of highly complex issues at the same time. What a suitable target operating model (TOM) should look like also plays an important role.

The following questions must be answered in a turnaround situation:

- Which markets will we serve going forward?
- How do we want to be organised?
- What risks do we anticipate and how can we prepare for them?
- What are our core resources and how can we retain and build on them?
- How do we structure our core processes efficiently, making the best use of technology?

> “
>
> In addition to organisational and human resource adjustments, the use of technology to unlock further growth potential plays a central part of restructuring projects today.

Successful restructuring projects and transformations combine strategic foresight and operational feasibility. In today's polycrisis market environment, restructuring is focused less on cutting costs and more on enabling growth through an optimised and targeted use of available resources. But the question remains — how to achieve a cost base that is as flexible as possible with cost structures that fit the expected sales scenario.

Putting pen to paper – advise, transform and operate

Operationalising these considerations requires strategic objectives to be translated into operational metrics. Embedding clearly defined and measurable targets in the implementation of defined restructuring steps allows management to detect failures early on and to define and initiate operational resolutions. Technical tools to track defined metrics are vital to enabling real-time monitoring and to providing the best possible support to the responsible executives.

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> Technical tools to track defined metrics are vital to enabling real-time monitoring and to providing the best possible support to the responsible executives.

In addition, it is important to keep an eye on implementation and what needs to be in place before starting out. Consulting a broad spectrum of expertise is essential to avoid ending up developing unworkable strategy designs or getting bogged down in the operational details.

During a corporate restructuring process, EY-Parthenon's seasoned teams of functional, operational and strategic professionals helped a sustainable blueprint, working in concert with our clients' teams to devise and implement clear action plans to get them to the finish line. And we don't stop when implementation starts. We support clients throughout the restructuring process, measuring our performance by the success of the outcome.

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Shivam is a Chartered Accountant and has completed his Bachelor of Commerce from Delhi University.

A long road to resolving non-performing assets (NPAs)

Timely and successful resolution of NPAs[1] has been a priority for every economy. The Sick Industrial Companies Act (SICA) was introduced in India in 1985 for the revival and rehabilitation of sick assets which were identified based on their net worth erosion. The primary body governing the act was the Board for Industrial and Financial Reconstruction (BIFR), which was established to revive companies which had the potential to sustain themselves and liquidate those that did not. Though creditors under the SICA had the right to approve the scheme, the onus of decision-making and managing the operations of a company remained in the hands of the management. Despite the SICA being in place, by 2016, India's stock of NPAs had risen to USD 3,498 billion. The alarming fact was that the gross NPAs (as a percentage of total debt) reached 9.6 %[2]. This was a result of multiple factors such as multiple laws/ regulations that governed insolvency resolution, a debtor-in-possession model which further delayed decision-making due to lack of borrower intent to resolve insolvency and poor lending practices. This led to the establishment of a new insolvency resolution regime, which would not only be more effective and efficient but also serve as a deterrent to the creation of new NPAs.

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> In 2016, legislators orchestrated a paradigm shift from a 'debtor-in-possession' model to a 'creditor in control' model.

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The Insolvency and Bankruptcy Code (IBC) – a new dawn

In 2016, legislators orchestrated a paradigm shift from a 'debtor-in-possession' model to a 'creditor in control' model. The IBC was published in the official gazette on 28 May 2016. Thereafter, SICA was fully repealed in December 2016, making the IBC the one law which would govern insolvency resolution. The IBC lays down the insolvency resolution process for corporate persons, partnership firms and individuals in a time-bound manner with the goal of maximising the value and promoting entrepreneurship. With the objective of proceeding incrementally and building capacity, the Corporate Insolvency Resolution Process (CIRP) for companies and limited liability partnerships was introduced. In due course, provisions related to pre-packs with directions to resolve the asset faster for micro, medium and small enterprises and individual insolvency for personal guarantors to corporate debtors were also introduced. The IBC also includes clauses for Liquidation in case CIRP fails or clauses on Voluntary Liquidation. This article focuses on the CIRP and its progress so far.

Salient features of the IBC

Since 2016, the act has undergone various amendments and with every amendment, lawmakers have tried to make it more practical and accessible for all stakeholders, including investors both domestic and global (high net worth individuals, private equity funds, hedge funds, asset reconstruction companies, financial institutions, alternative investment funds, interim fund providers, etc.) to promote value maximisation and entrepreneurship.

1. https://thelawdictionary.org/non-performing-asset
2. https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSR2316BB76DB39BF964542B9D1EBE2CBC273E7.PDF

CIRP is a time-bound, well-drafted process which needs to be concluded by either approving a resolution plan for continuing the asset as a going concern or initiating the liquidation of the CD. The initial time period for conclusion of CIRP is 180 days, which can be further extended by 90 days, subject to the approval of the Adjudicating Authority (AA).

CIRP can be initiated upon establishment of default[3] for an amount exceeding or equal to USD INR 1 Cr by the CD. The creditor (either operational or financial) files an application against the CD to the AA requesting the AA to initiate CIRP against the CD. Upon admission of the application, a moratorium[4] is imposed to prevent any coercive action against the CD while the powers of management is suspended. A qualified insolvency professional is appointed as the interim resolution professional or the resolution professional (IRP or RP) to run the process and manage the affairs of the CD. The RP works along with the Committee of Creditors (CoC) which is formed within 30 days from the date of initiation of CIRP comprising financial creditors who are not a related party of the CD. Such financial creditors, forming the part of CoC, have voting rights that are directly proportional to the amount of their admitted claim as on the date of initiation of CIRP.

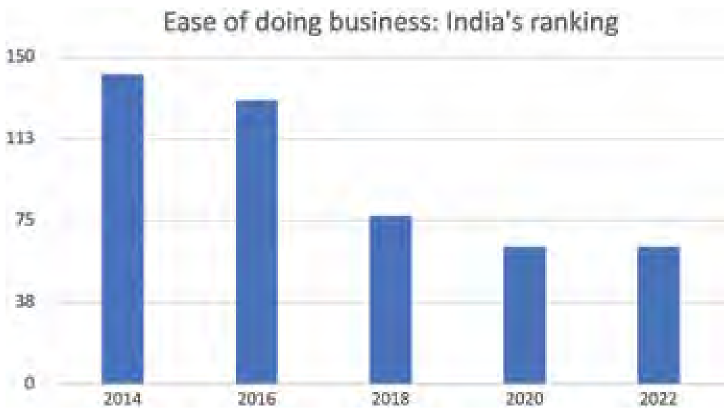
The RP is entrusted with two key tasks:
1. preserving the value of the CD and
2. finding the right investor (resolution applicant or RA) who is able to offer a comprehensive resolution plan maximising the value for each stakeholder of the CD.

The RP has independent powers under the IBC and works under the supervision of the CoC for certain critical matters which require their consent such as the approval of the resolution plan.

On receipt of the resolution plans, all the legally compliant resolution plans are put to vote and the one that attains maximum votes by the CoC (not less than 66%) is filed with the AA for its final approval. Upon obtaining such approval, the resolution plan is to be implemented by the RA in a timebound manner.

IBC report card

The shift from debtor-in-possession model to creditor-in-control has given a lot of power and autonomy to the creditors and resulted in speedier resolution of NPAs. The implementation of the IBC has raised India's rank of 'Ease of doing business' from 130th in 2016 to 63rd in 2022.[5]



When the law was introduced in 2016, India's federal bank, the Reserve Bank of India (RBI), directed banks to initiate insolvency proceedings against the twelve largest NPA accounts, referred to as the 'dirty dozen'. This was done with the objective of resolving the biggest NPA accounts to ease the balance sheet pressure on banks and to test the IBC at its seams. The dirty dozen accounted for 25%[6] of the total gross NPA at that time. Since the IBC began with 12 of the largest NPA accounts, it caught the attention of investors and regulators and ensured a fast-learning curve with a series of swift amendments to mend the loopholes in the IBC. Out of these twelve, as on today, eight have been resolved successfully (two are still under CIRP and two are under liquidation).

To understand the progress, as on 30 April 2022, 5349 applications have been admitted under CIRP, out of which 500 have been resolved successfully, resulting in a realisation which is almost double the amount in comparison to the liquidation value of the corporate debtor.[7]

Acquisitions under the IBC – the clean slate

3. Section 3 (12) of The Insolvency and Bankruptcy Code, 2016
4. Section 14 of The Insolvency and Bankruptcy Code, 2016
5. https://tradingeconomics.com/india/ease-of-doing-business; https://inc42.com/buzz/economic-survey-2022-23-india-reduced-39000-compliances-ease-of-doing- business/#:~:text=According%20to%20the%20World%20Bank,rank%20from%20142%20in%202014.
6. https://rbidocs.rbi.org.in/rdocs/AnnualReport/PDFs/RBIAR201617_FE1DA2F97D61249B1B21C4EA66250841F.PDF
7. Status Note on CIRP – IBBI website.

principle

Acquisitions under IBC provides an asset on a 'clean slate principle' that provides the new buyer protection from all past civil and criminal liabilities. Various case laws can be accounted as judicial precedents which bring clarity to the stated 'clean slate' doctrine.

Once the plan is approved by the AA, it becomes binding to all the stakeholders including and not limited to the central government, state government or any local authority to whom the debt is owed, guarantors and any other stakeholders. Additionally, a few other benefits are available under IBC such as the carrying forward of accumulated tax losses which offers a healthy tax shield to the new owner post the turnaround of the CD. In a normal mergers and acquisition (M&A) scenario, such accumulated losses and unabsorbed depreciation are allowed subject to certain conditions. The IBC (enabled by amendments in other acts/regulations) also envisages a single-window clearance from the AA through the resolution plan to give effect to all kinds of restructuring (carve-out, merger, demerger, delisting) and ensures speedy implementation of the resolution plan.

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> While IBC has largely been a success story, the participation of foreign investors as RAs has been limited.

Strengthening the ecosystem

While IBC has largely been a success story, the participation of foreign investors as RAs has been limited. The biggest deterrent for RAs to participate is the inordinate delay in the admission of CD and approval of the resolution plan by the AA[8]. A number of amendments have been proposed to the Insolvency and Bankruptcy Board of India (Regulator or IBBI), which shall hasten both the admission process as well as the approval of the resolution plan by AA. The amendments proposed in this regard have been produced for the ease of reference below:

- AA to mandatorily consider the application for the initiation of CIRP filed by the financial creditor on the occurrence of default and upon fulfilment of necessary requirements.

- AA to rely on information utility (IU is the platform where the occurrence of default by the CD is to be filed by financial creditors, operational creditors or CD) for applications filed by the financial or operational creditor to initiate the insolvency rather than the AA assessing the claim by itself.

In addition to the amendments brought under the IBC framework, the following amendments have been introduced in other RBI frameworks as well, with the endeavour to put the stressed asset sector at a platform that shall enable wider reach and participation from both financial and strategic investors. Given below is a brief overview of the amendments:

- Under the existing Alternative Investment Fund (AIF), regulations Special Situations Funds (SSF) has been introduced as a special category to invest in stressed assets in India in which a pool of investors (be it foreign or domestic) collaborate and create a special fund. SSF should be with a corpus of at least USD INR 100 Cr. These SSFs can either act as a RA or may acquire the loan from an existing financial creditor.

8. https://www.mca.gov.in/content/dam/mca/pdf/IBC-2016-20230118.pdf

- Loans raised from foreign lenders by an Indian entity, known as External Commercial Borrowings (ECB), can now be availed for restructuring/refinancing of stressed assets. Successful resolution applicant, who are also eligible borrowers, can raise ECB from foreign lenders and such an ECB shall be considered under the automatic route and can be processed without the prior approval of the RBI.

- In the year 2002, Asset Reconstruction Companies (ARCs) were introduced under The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) with the objective of transferring the NPAs from the banks. ARCs, having a certain net worth, have now been allowed to come forward as Resolution Applicants and submit a resolution plan under the CIRP, subject to the fulfilment of conditions as specified.

- Apart from private ARCs, a bad bank has been established in India, known as National Asset Reconstruction Company Limited (NARCL) along with an Asset Management Company (AMC) called India Debt Resolution Company Limited (IRDCL) for the aggregation and resolution of NPAs. A majority of the stake in NARCL is held by public sector banks and the remaining is held by private sector banks. Recently, it has been observed that the NARCL has started submitting Resolution Plans for CDs under IBC.[9]

- IBC regulations were amended to formulate the strategy of marketing the assets of the CD in consultation with the CoC for a wider reach and potential RAs as the targeted audience. As per the law, the RP should mandatorily publish the Expression of Interest (EOI) in the newspaper (both English and regional language) in the state of registered office. With this amendment, RPs shall now work on the strategy to market the asset as much as possible, be it via publication, or running road shows.

Enhancing the role of the IBC

The Insolvency and Bankruptcy Board of India (IBBI), the esteemed regulatory body responsible to monitor the principles laws and regulations as laid down under the IBC, disseminates discussion paper from time to time, to solicit comments from public and stakeholders in the insolvency ecosystem. One such recent recommendation is 'reimagining the consideration of the resolution plan' which suggests the examination of multiple plans for the same CD during the CIRP. Within this proposed framework, it is suggested to call for multiple resolution plans for one CD to achieve value maximisation by attaining an optimal resolution plan that would feature the provisions necessary to acquire the CD as a going concern and manage its affairs post approval by the AA. As proposed in this amendment, the RP can call upon multiple resolution applicants to bid for whole or part of the CD leading to a better value and increased participation (and sum of parts approach). Certain other measures have been proposed, which are aimed at enhancing the efficacy of IBC: [10]

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> IBC regulations were amended to formulate the strategy of marketing the assets of the CD in consultation with the CoC for a wider reach and potential RAs as the targeted audience.

- Expanding the applicability and bringing the amendments to pre-packaged insolvency resolution framework and fast-track CIRP to the prescribed categories of CDs as notified by the central government. This is expected to result in a speedy resolution for wider category of CDs and gain more traction with the RAs.

9. https://timesofindia.indiatimes.com/city/kolkata/bad-bank-narcl-is-highest-bidder-for-2-troubled-srei-cos/articleshow/96751590.cms
10. https://www.mca.gov.in/content/dam/mca/pdf/IBC-2016-20230118.pdf)

- Disclosure of valuation estimates of the CD in the IM shall serve as a guidance on expected value to the RAs, thereby, avoiding protracted negotiations to maximise the value of the CD.

- Protection of a RA after the implementation of the resolution plan with respect to various past liabilities – either by any government or statutory authority regarding the claims arising before the commencement of the CIRP.

> Until now, ARCs (be it public like NARCL or private) would acquire the NPAs from the bank and work towards their resolution.

- Incentivising interim finance providers by allowing them to be a part of the CoC meeting, therefore, making it more attractive (in addition to getting paid in priority under waterfall mechanism) for financial institutions to lend to the CD during CIRP and help preserve value.

Another discussion paper issued by the RBI on securitisation of stressed assets framework[11] acts as an instrumental amendment which would bring about a paradigm shift for the stressed assets in India. Currently, securitisation is allowed only through ARCs wherein stressed loans are acquired from the lenders (or by CD as per the new amendment). With this framework, there would be more private players (as per the eligible norms) who would come forward to acquire these NPAs, manage and engage with a new pool of investors who would be ready to subscribe to the security receipts of the stressed sector. To sum up, until now, ARCs (be it public like NARCL or private) would acquire the NPAs from the bank and work towards their resolution. At present, there are 28 ARCs in India sharing the burden of NPAs from banks. With this amendment, there would be a new category of special purpose vehicle (SPE) apart from SSF, who would be competing with these ARCs to attain a better price discovery.

It is also proposed that the originator would sell their identified NPAs to these SPEs who would further appoint the servicing entity to manage the stressed funds and maximise recoveries. While it might take some time to finalise this, the objective is certainly inclined towards finding a better resolution and a more focused team. Participating in the Indian stressed asset landscape The insolvency law is meant to work in conjunction with amendments to various regulations, such as those governing banking, the Securities Exchange Board of India (SEBI), the Income-tax Act, 1961, and the Companies Act. The goal is to achieve a comprehensive solution to resolve NPAs and make the process easier and accessible to a wider range of investors. These efforts are aimed at creating synergies that can help tackle the various problems related to NPAs.

To summarise, while the investor can surely participate directly as a RA, there are multiple indirect ways for investors (foreign or domestic) through which they can participate in the Indian stressed asset landscape:

- A pool of investors getting registered under AIF, known as SSF, with a minimum corpus of INR 100 Cr can either choose to put a resolution plan or acquire a loan from the existing lender.

- Alternatively, eligible foreign players might extend lending in the form of ECB at the time of submission of resolution plan.

- Incorporate private ARCs with minimum net owned fund of USD INR 1000 Cr along with fulfilling other requirements as mentioned under the regulatory framework of ARCs issued by the RBI and can undertake activities as RA apart from acquiring the loan.

- Incorporating the SPE (proposed) once the securitization of stressed asset framework comes into the picture.

11. https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=21728

These amendments, and the ones that may come in the future, shall accelerate the flow of funds into the Indian economy to resolve stressed assets which have potential. The formation of the bad bank (NARCL) in the resolution process, registration of a number of SSFs and the introduction of many amendments in the applicable legal framework are all aimed at resolving India's NPA problem in the most effective manner. These measures offer investors an opportunity to participate in India's stressed assets landscape, just like they would invest in a systematic investment plan (SIP).

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JAPAN

TRANSFORMING THE INDUSTRIAL STRUCTURE OF THE AGRICULTURAL SEGMENT THROUGH THE USE OF NEW TECHNOLOGIES AND FINANCIAL FUNCTIONS

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He has expertise in the financial domain, ranging from financing services in Japan and abroad to new business start-ups and financial services.

KPMG

TRANSFORMING THE INDUSTRIAL STRUCTURE OF THE AGRICULTURAL SEGMENT THROUGH THE USE OF NEW TECHNOLOGIES AND FINANCIAL FUNCTIONS

I. Introduction

- The impact of the Covid-19 infection, inflation, and supply chain disruption are being discussed around the world, and each country is seeing these as pressing issues.

- As these global changes occur, structural changes are beginning to emerge in various industries. Among other things, the agricultural sector has begun to transform itself into a new industrial structure.

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> The agricultural sector has begun to transform itself into a new industrial structure.

- The agricultural sector faces many challenges related to the supply chain, and the use of new technologies and financial functions to solve these issues is attracting attention. Also, agriculture has been positioned as an important agenda item since it is related to the national security of each country.

- In this article, I would like to introduce how the use of new technologies and financial functions has brought about a transformation in the industrial structure of the agricultural sector.

II. Summary

- By utilising new technologies and financial functions within the agricultural sector, which is traditionally an industrial area, many problems and issues are being solved and the traditional industrial structure is being transformed into a new industrial structure.

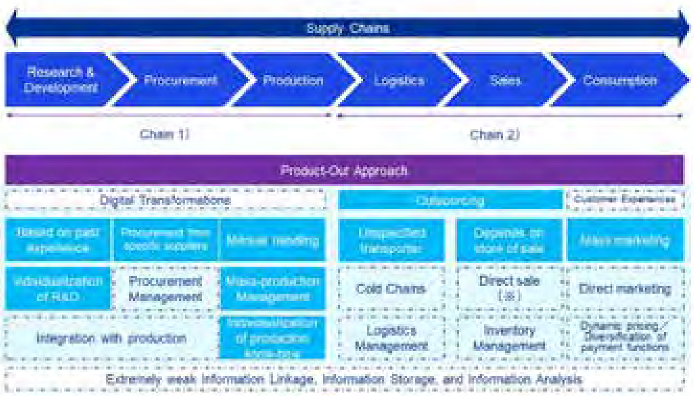
- By utilising new technologies and financial functions, the supply chain from R&D to consumption, which is currently vertically divided and fragmented, will be transformed into a unified horizontal flow, and an optimal structure in the supply chain will be established, leading to further development of the agricultural sector.

- The transformation of the agricultural sector is supported by the financial sector. Along with the transformation of the agricultural sector, the financial sector will move from the provision of traditional financial functions to a more business side, aiming to make a leap into new business areas.

【Formulas for industrial transformation in the agricultural sector】

III. Conventional industrial structure and Current Issues in the Agricultural Segment

- The traditional industrial structure in agriculture is set forth in the figure below. Dotted areas indicate no implementation or weak implementation.
- The supply chain in the aforementioned industrial



Source: Based on original research by KPMG FAS Co., Ltd.

* A method of selling directly from the production place to the consumer without going through wholesalers.

structure, as in other industries, consists of a series of functions from R&D to consumption. While many issues remain in the agricultural segment, the main challenges in each of these areas are summarised in Chain 1) and 2. Chain 2).

1. Chain 1)

a. Declining global agricultural population and aging farmers

The number or ratio of new farmers is declining based on data from the World Bank's statistics*1 and the aging of the farming population in Japan*2 and the U.S.*3 is beginning to pose a challenge for business takeovers, and there might be also concerns about declining production in the future.

*1 Source: Employment in agriculture (% of total employment) (modeled ILO estimate)

*2 Source: Based on Ministry of Agriculture, Forestry and Fisheries

*3 Source: Based on 2017 Census Full Report of United States Department of Agriculture

b. Inefficient production system

Production system and R&D rely on manuals and past experience, and reproducibility of the production system and R&D has decreased due to the individualisation of production know-how.

c. Lack of integration of R&D, Procurement and Production

Even if an efficient production system is in place, it is difficult to achieve efficient production without efficient procurement management that can be applied to that production system. In addition, an efficient production system cannot be achieved overnight; it is necessary to conduct several rounds of R&D, involving trial and error, and it is necessary to upgrade the production system through R&D and trial and error.

d. Low profitability

Many low-priced products are not profitable despite the amount of labour required, and a transition to a highly profitable structure is needed.

2. Chain 2)

a. Limited sales channels

When selling to designated wholesalers and to designated stores, sales methods and products sold are dependent on the stores. Establishment of efficient sales routes and Sales Marketing is required.

b. Product-out approach

Failure to break away from a product-out approach to consumers, and inability to satisfy consumers' needs (taste, size, price, etc.).

c. Logistics management

It is not well developed, including timely deliveries and deliveries with refrigeration capabilities whenever possible.

- In each area in the supply chain, DX and automation are not advanced, and functions and services that can provide CX to consumers have not been developed.

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> The number of new farmers is declining and the aging of the farming population is beginning to pose a challenge for business takeovers.

- Finally, each area of the chain 1) and chain 2) is vertically segmented, and each area does not have a unified flow, resulting in an inefficient structure.

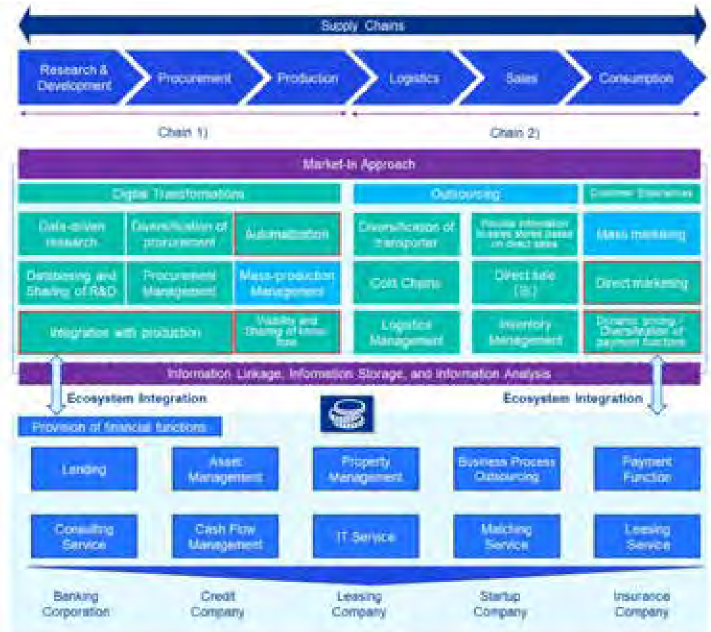
- In the agricultural sector, one of the traditional industries, there are many such issues, but many of them remain unresolved, and conventional efforts have continued and have not brought about major changes. Under these circumstances, the financial sector, which is utilising new technologies, is expected to play a more in-depth role than in the past, and it will be explained in detail in the following section.

IV. Transformation of the agricultural segment into a new industrial structure

- To illustrate how the transformation from a traditional industrial structure to a new one is being achieved through the use of new technologies and financial functions, a diagram has been created and is set forth below.
- The green areas in this diagram show the changes from the conventional structure. As you can see, many changes have been brought about dramatically.

- You can also see that the financial segment is supporting the transformation from a traditional industrial structure to a new industrial structure.

- Due to space limitations, not all items can be explained here, so I will focus on the items outlined in red and explain how these changes have been brought about.



Source: Based on original research by KPMG FAS Co., Ltd.

- First of all, with regard to the Automatisation mentioned in Chain 1), the conventional manual application of pesticides, crop monitoring, crop harvesting, and post-harvest quality inspections can now be carried out by drones and image analysis technology, which enables pesticides to be applied by drones and the quality of the crops to be inspected by the drone's on-board equipment. The use of drones and image analysis technology has made it possible to apply pesticides by drone and monitor crop growth using image sensors mounted on the drone. This enables pesticides to be applied to the right places at the right time according to the growth status of the crops, thereby reducing the adverse effects on crops caused by wasteful or excessive application of pesticides, and improving production efficiency by reducing labor and pesticide costs, which account for a large proportion of agricultural costs. The drone and image analysis technology has also been used to improve the efficiency of production.

- In addition, by accumulating and analysing data collected by drones and image analysis technology, more appropriate application of pesticides could be realised, and a high level of reproducibility could be ensured so that many people can implement the system, instead of relying on know-how and experience, which had previously been the responsibility of the individual.

- Furthermore, by monitoring the growth of crops and collecting, accumulating, and analysing data, research is also being conducted to predict the appropriate timing for harvesting, the production period of crops, and the quantity of crops to be harvested. Based on the data accumulated, data is used to manage the purchasing of agricultural chemicals and crop seeds etc., and to share data with procurement companies / suppliers so that necessary items can be procured at the appropriate time.

- The introduction of drones and imaging sensors is costly. It is difficult for farmers alone to tackle this issue, as methods of image analysis and methods of storing and analysing the collected data require specialised knowledge. Leasing companies are beginning to offer services in which they partner with drone manufacturers, sales companies, and IT companies (including start-ups) to procure drones, lease them to farmers, manage and analyse the data collected by the IT companies, and return the information to the farmers. In these services, in addition to the provision of leasing services by leasing companies, there are also partnerships with drone manufacturers to conduct drone maintenance and repairs (Property Management), partnerships with IT companies to provide IT services, and consulting services using this data, and leasing companies may focus on building these ecological systems.

- Next, Chain 2) provides retailers with e-wallet and mobile payment functions and POS systems to diversify consumers' payment methods and increase convenience and has also begun to analyse consumer purchasing trends and hot-selling products based on data collected through the provision of these functions and services. In addition, research has begun to analyse consumer purchasing trends and hot-selling products based on data collected through the provision of these functions and services, and to conduct research on dynamic pricing, such as changing product prices based on business hours.

- Based on the results of these analyses, retailers are beginning to introduce hot-selling products to their members, provide dynamic pricing, and offer direct sales with cash back and point rewards as membership benefits.

- The results of these analyses and data are not limited to the domain of Chain 2), but can be returned to the production domain (farmers) of Chain 1), enabling production activities based on consumer trends, which is expected to further improve productivity.

- As in Chain 1), these ecosystems cannot be established solely by farmers and retailers but require the cooperation of financial segment and IT companies to provide payment functions, POS systems, and data analysis. In the provision of payment functions, financial segment and IT companies are collaborating to design and build systems and other components. In the case where the leasing companies introduced in Chain 1) above lease POS systems and other equipment to retailers, it may become possible to analyse the data and return the analysis results to the production domain "Market-In Approach" in partnership with IT companies, and Chain 1) and Chain 2) may begin to function as a coherent ecosystem.

- In this way, we can see that new technologies and financial segment are transforming the industrial structure of agriculture and forming a new ecosystem to support the industry.

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> In the provision of payment functions, financial segment and IT companies are collaborating to design and build systems and other components.

V. Further development in the future

- In addition to improving production efficiency and profitability through the use of technology and data analysis in the production domain, there is the potential to subdivide the supply chain by each crop and implement appropriate production, distribution, and sales management in the future as technology evolves.

- By establishing an integrated supply chain structure from R&D to consumption through the use of various financial functions, the financial segment and the agricultural segment will be synergised, and the financial segment will also transform from the conventional framework of providing financial services and shift to a more business-oriented approach.

- This combination of the agricultural sector and the financial sector is beginning to develop not only in the agricultural sector but in other sectors as well, and the financial sector is beginning to support and drive the growth of these sectors.

VI. Conclusion

- With the impact of the Covid-19 infection, worldwide inflation, and supply chain disruption still recognised as pressing issues around the world, we are at a major turning point not only in the agricultural segment, but also in other industrial sectors.

- The combination of new technology, finance, and the agricultural segment is expected to transform the industrial structure and provide significant insights into future development possibilities in other industrial sectors as well.

- In this article, an explanation of the relationship between the traditional agricultural segment and the financial segment, as well as their roles in the industry, is given. I hope that you have been able to see how the financial segment, in particular, is bringing about change within traditional industries by adopting these cutting-edge technologies. Not only those who are involved in the agricultural segment, but also those in the financial segment may gain new perspectives by looking at how the recent changes in the industrial structure were brought about.

- I hope you will use the information presented in this article as a starting point for looking at the transformation of the industrial structure in other fields and for analysing what kind of transformation will be brought about in the future. As we enter the new year 2023, I hope this article will contribute to the development of your business.

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> The combination of new technology, finance, and the agricultural segment is expected to transform the industrial structure.

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In recent years, out-of-court workouts, particularly turnaround ADR (*Jigyo Saisei ADR*) ("**Turnaround ADR**") under the Industrial Competitiveness Enhancement Act (the "**Act**"), have increased in popularity in Japan compared to judicial insolvency proceedings, such as civil rehabilitation (*Minji Saisei*) or corporate reorganization (Kaisha Kosei) proceedings.

The Act provides schemes that enhance the chances of success of out-of-court workouts under Turnaround ADR, and there is a pioneer workout case last year in which one of these schemes was used. This is anticipated to have a significant impact on insolvencies in Japan.

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> Under Turnaround ADR, the unanimous consent of all participating creditors is required for a rehabilitation plan to be approved.

This article outlines the key features of Turnaround ADR and the above mentioned pioneer case.

1. Overview of Turnaround ADR

Large and medium-sized companies in Japan are increasingly turning to Turnaround ADR as compared to judicial insolvency proceedings. This trend is particularly notable for listed companies as in-court insolvency procedures would trigger a de-listing, while informal workouts would not.

Turnaround ADR proceedings commence when a debtor files an application with the Japanese Association of Turnaround Professionals ("**JATP**") and sends a "standstill" notice in the joint names of the debtor and the JATP to financial creditors. A debtor is expected to negotiate with its financial creditors during the standstill period.

The followings are the main characteristics of Turnaround ADR:

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(1) Only financial creditors are subject to the proceedings

Turnaround ADR focuses primarily on the workout of debts owed to financial creditors. In principle, trade creditors are not subject to Turnaround ADR. This enables trade debtor companies to avoid deterioration in the value of their businesses.

As Turnaround ADR does not exclude overseas financial creditors, it is theoretically possible for a debtor to include its overseas financial creditors in its business rehabilitation through Turnaround ADR even if such creditors have no business presence in Japan. However, overseas financial creditors, especially those without any business presence in Japan, would not usually be subject to Turnaround ADR procedures as their claims usually account for only a small portion of the target claims and because communications with such creditors would involve additional time and costs.

(2) Proceedings are presided over by fair and neutral mediators

Turnaround ADR procedures are supervised by three mediators (typically comprising two attorneys and a certified public accountant) specialising in company turnarounds, selected by the JATP, and settlements among debtors and financial creditors are facilitated by the mediators. This keeps the process fair among creditors.

(3) Unanimous consent of all creditors is required

Under Turnaround ADR, the unanimous consent of all participating creditors is required for a rehabilitation plan to be approved. This means a single "hold-out" creditor, even one with a small amount of claim ("**Small-Claim Creditor**") would be able to block a rehabilitation plan and cause the Turnaround ADR to fail.

2. Measures to enable smooth restructuring of business under Turnaround ADR

(1) Concerns about treatment of financing claims and trade claims in judicial insolvency proceedings following failure of Turnaround ADR

Debtors undergoing Turnaround ADR may fail to obtain the unanimous consent of all participating creditors. In such cases, it is not uncommon for the debtors to file civil rehabilitation or corporate reorganisation proceedings. These judicial insolvency proceedings, however, give rise to two primary concerns, namely:

(a) whether claims in respect of debtor-in-possession ("**DIP**") financing that was provided during the Turnaround ADR proceedings (i.e., prior to the commencement of judicial insolvency proceedings) ("**Pre-DIP Financing Claims**") would be given priority over other pre-filing claims in the judicial insolvency proceedings; and

(b) whether the claims of trade creditors would enjoy the same level of protection in the judicial insolvency proceedings as they would in the Turnaround ADR proceedings.

In judicial insolvency proceedings, unsecured pre-commencement claims (i.e., unsecured claims that arise prior to the commencement of judicial insolvency proceedings) should in principle be given equal treatment. Thus, without special treatment, Pre-DIP Financing Claims would be treated as unsecured pre-commencement claims with no priority over other pre-commencement claims should the debtor subsequently undergo judicial insolvency proceedings. This would make it difficult for a debtor to obtain the DIP financing it needs to restructure its business in the Turnaround ADR proceedings.

Similarly, trade creditors, whose claims are generally paid in full in the Turnaround ADR proceedings, are not guaranteed the same level of protection in judicial insolvency proceedings. Aware of this risk, trade creditors will sometimes cease their business dealings with a debtor in the course of the Turnaround ADR proceedings, if it seems to them that it is likely that the debtor will eventually undergo judicial insolvency proceedings. Such risk mitigation by trade creditors has sometimes made it difficult for debtors to restructure their businesses.

(2) Giving priority to DIP-Financing Claims

To overcome the aforementioned difficulties associated with Pre-DIP Financing Claims, the Act requires a court to take the JATP's "Confirmation" into account when determining whether a rehabilitation or reorganisation plan would impair the requirement that claims are treated equally, in situations where a rehabilitation or reorganisation plan submitted to the court or approved by creditors contains amendments to the terms of the Pre-DIP Financing Claims, and such amendments are different from those pertaining to other pre-commencement claims.

"Aware of this risk, trade creditors will sometimes cease their business dealings with a debtor in the course of the Turnaround ADR proceedings.

(3) Giving priority to trade creditor claims

The Act also provides a scheme to render similar protection to trade creditors in judicial insolvency proceedings to address the difficulties in respect of trade creditor claims. More specifically, under the Act:

(a) if the JATP provides confirmation that (i) the claim of a trade creditor involves a small amount and (ii) the settlement of such claim is necessary to avoid significant impairment to the debtor's business ("**Confirmed Claim**"); and

(b) if civil rehabilitation or corporate reorganisation proceedings are filed or commenced against the debtor following the failure of Turnaround ADR proceedings, the court will take the JATP's Confirmation into account:

(x) to determine whether settlement of the Confirmed Claim is prohibited by a temporary restraining order (in situations where, following a petition for commencement of civil rehabilitation or corporate reorganisation proceedings, the court wishes to issue a temporary restraining order prohibiting payment of pre-injunction debts and disposition of the debtor's assets);

(y) to determine whether settlement of the Confirmed Claim is necessary to avoid significant impairment to the debtor's business (in situations where, following the commencement of civil rehabilitation or corporate reorganisation proceedings, the debtor has filed a petition for court approval for settlement of a Confirmed Claim on grounds that it involves a small amount, and that such settlement is necessary to avoid significant impairment to the debtor's business); or

> "When Turnaround ADR fails, it is not uncommon for a debtor to file for judicial insolvency proceedings.

(z) to determine whether such difference would impair the requirement that the claims be treated equally (in situations where, following the commencement of civil rehabilitation or corporate reorganisation proceedings, a rehabilitation or reorganisation plan submitted to the court or approved by the creditors contains amendments to the terms of a Confirmed Claim, and such amendments are different from those pertaining to other pre-commencement claims).

3. Scheme that makes it easier for debtors in Turnaround ADR proceedings to apply for simplified rehabilitation proceedings (*Kan-i Saisei*)

(1) Remaining concerns with judicial insolvency proceedings following the failure of Turnaround ADR

As noted above, the unanimous consent of all participating creditors is required for a rehabilitation plan to be approved under Turnaround ADR. Accordingly, even a Small-Claim Creditor will be able to block the plan.

When Turnaround ADR fails, it is not uncommon for a debtor to file for judicial insolvency proceedings, which would lead to a significant deterioration in the creditworthiness of the debtor. Moreover, if the judicial insolvency proceedings following the failure of Turnaround ADR takes time to process, the value of the debtor's business would be considerably damaged.

(2) Transition to Simplified Rehabilitation Proceedings (*Kan-i Saisei*)

To mitigate the concerns above, the Act was amended on June 16, 2021. The Act provides a scheme that makes it easier for debtors to apply for simplified rehabilitation proceedings (**Kan-i Saisei**). *Kan-i Saisei* is a special type of civil rehabilitation proceedings which enables a rehabilitation plan to be speedily and smoothly approved and confirmed after civil rehabilitation proceedings are commenced, by omitting certain procedures including those used for investigating and determining claims required for ordinary civil rehabilitation proceedings. Under this scheme:

(a) if the debtor has, via a resolution on a proposed rehabilitation plan under the Turnaround ADR, obtained the consent of its creditors who collectively hold claims amounting to at least three-fifths (3/5) or more of the total claims (by value), the debtor may request the JATP to provide confirmation that the reduction of claims under the rehabilitation plan is indispensable for the rehabilitation of the debtor's business; and

(b) if a petition is filed for the commencement of simplified rehabilitation proceedings (*Kan-i Saisei*), the court will be required to take the JATP's confirmation (if any) into account in determining whether the rehabilitation plan is detrimental to the common interests of creditors and, in turn, whether simplified rehabilitation proceedings (*Kan-i Saisei*) should be commenced.

Under this scheme, the rehabilitation plan that has been rejected in a Turnaround ADR due to the opposition of Small-Claim Creditors may immediately be proposed to creditors in simplified rehabilitation proceedings (Kan-i Saisei).

4. Workout of Marelli

A pioneering case using this scheme has recently been concluded, where a rehabilitation plan under simplified rehabilitation proceedings (*Kan-i Saisei*) was speedily and smoothly approved after the failure of a Turnaround ADR.

Marelli Holdings Co. Ltd. ("**Marelli**"), one of the world's leading suppliers of automobile products, and its group companies experienced financial difficulties due to a decline in demand for automobile products caused by the COVID-19 pandemic and shortages of semiconductors. In March 2022, Marelli commenced Turnaround ADR proceedings seeking an agreement with its creditors on the discharge of its debts.

In the Turnaround ADR proceedings, Marelli submitted a rehabilitation plan for the Turnaround ADR to the participating financial creditors, including a request for a partial discharge of its debts (approximately 450 billion JPY) and new equity investments from an existing shareholder, and obtained the consent of approximately 95% of the participating financial creditors. However, the Turnaround ADR proceedings failed in June 24, 2022 because Marelli could not obtain the consent of all of the financial creditors.

On that same day, Marelli filed a petition for civil rehabilitation proceedings to immediately shift to simplified rehabilitation proceedings (*Kan-i Saisei*), and 13 days after the date of that filing, it further filed for simplified rehabilitation proceedings. A rehabilitation plan with the same contents as the one under the Turnaround ADR was approved by the required number of financial creditors and confirmed by the court on July 19, 2022, which was just 25 days after the date of the filing of the civil rehabilitation proceedings. The confirmation order became final and binding and the proceedings were terminated on August 9, 2022, which was much faster than the usual type of civil rehabilitation proceedings.

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In March 2022, Marelli commenced Turnaround ADR proceedings seeking an agreement with its creditors on the discharge of its debts.

Given the speediness and smoothness of the shift from Turnaround ADR proceedings to simplified rehabilitation proceedings (*Kan-i Saisei*) as attested to by this case in practice, it is expected that the simplified rehabilitation (*Kan-i Saisei*) scheme will be frequently used as necessary in the future. In addition, this scheme may have the effect of discouraging Small-Claim Creditors from rejecting a rehabilitation plan under Turnaround ADR, since it is likely that the debtor would be able to obtain the approval for such rehabilitation plan from creditors holding claims amounting to at least three-fifths (3/5) or more of total claims (by value) under this scheme. In such circumstances, creditors would not be likely to block the rehabilitation plan proposed under the Turnaround ADR, as this would simply damage the value of the debtor's business during the transition period between the Turnaround ADR and the simplified rehabilitation proceedings (*Kan-i Saisei*).

5. Conclusion

With the aforementioned schemes under the Act and the pioneer case of Marelli, Turnaround ADR has now become a much more effective restructuring tool for debtors in financial difficulty. This is anticipated to have a significant impact on insolvencies and further facilitate out-of-court restructuring schemes in Japan.

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With the aforementioned schemes under the Act and the pioneer case of Marelli, Turnaround ADR has now become a much more effective restructuring tool for debtors in financial difficulty.

Luxembourg
The uncertain consequences of the new Article 536-2 of the Commercial Code

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The uncertain consequences of the new Article 536-2 of the Commercial Code

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Introduction

Is this the end of Luxembourg bankruptcy law? A relevant question, albeit a provocative one. In a separate article we already stressed the lack of a proper restructuring legislative framework in Luxembourg, outlining that, to date, bankruptcy was the only relevant procedure available in Luxembourg for reorganising a distressed company in certain circumstances.[1]

Following the entry into force of Bill No. 6539B, it now appears that Luxembourg's legislator has deprived Luxembourg legal practitioners of their last available tool for restructuring distressed companies.

Let us take a step back. Bill No. 6539B was introduced as part of the division on 22 July 2021 of Bill No. 6539 into two different bills, namely Bill No. 6539A, which introduces preventive and curative measures to address shortcomings in Luxembourg's current legislative framework for corporate restructuring and insolvency, and Bill No. 6539B (the "**Bill**"), which creates a new procedure for judicial dissolution without liquidation that can be availed of by certain businesses without assets, activities or employees.

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> This addition to Luxembourg bankruptcy legislation, minor if not forgettable at first glance, entails serious legal issues.

Bill No. 6539B was adopted on 28 October 2022; the corresponding Law of 28 October 2022, which created the procedure for administrative dissolution without liquidation (the "**Law**"), was published on 4 November 2022 in the Memorial A n° 541 of 2022.[2] It entered into force on 1 February 2023 pursuant to the provisions of Article 20 of the Law. This article does not aspire to explain in detail or otherwise comment on the new procedure for administrative dissolution without liquidation, but instead focuses on Article 14 of the Law, which is as short as it is potentially disruptive. It reads as follows:

"Following Article 536-1 of the Commercial Code, a new Article 536-2 is inserted, with the following wording

"Article 536-2.

The judgment closing the bankruptcy operations shall dissolve the legal person and shall entail immediate closure of its liquidation."

In the course of the deliberations on the Bill, the content of Article 14 did not raise criticism except from the Luxembourg Bar in its opinion dated 29 June 2022[3] (the "**Opinion**"). However, this addition to Luxembourg bankruptcy legislation, minor if not forgettable at first glance, entails serious legal issues, in particular with regard to legal title to remaining assets (if any) of the bankrupt company following its dissolution (I). In the absence of textual guidance or provisions addressing these issues, one might hope that the new Article 536-2 of the Commercial Code ("**Article 536-2**") will not be interpreted literally by the courts and that the legislator will consider a revision of the article in question (II).

I. Legal uncertainty surrounding title to remaining assets of bankrupt companies

In its Opinion, the Luxembourg Bar raised several points concerning the application of the new Article 536-2 introduced by Article 14 of the Bill, its main point being that the article in question fails to distinguish between a bankruptcy closed in *bonis* and a bankruptcy closed with insufficient assets, thus giving rise to serious legal issues.

In most cases, and prior to the entry into force of the new Article 536-2, bankrupt companies would be wound up by their shareholders following the closure of the bankruptcy, taking into account their distressed situation already prior to the bankruptcy pronouncement and the liquidation of their remaining assets in the course of the bankruptcy.[4]

1. For a comprehensive study of the reform of corporate restructuring and insolvency legislation under Bill No. 6539A, by the same authors, "*Implementation of Directive (EU) 2019/1023 in Luxembourg: Struggles and Pitfalls*", Beaumont Capital Markets, International Insolvency and Restructuring Review 2022 / 23.
2. https://legilux.public.lu/eli/etat/leg/loi/2022/10/28/a541/jo
3. Avis du Conseil de l'Ordre des Avocats du Barreau de Luxembourg, 29 June 2022. https://wdocs-pub.chd.lu/docs/exped/0132/130/265304.pdf
4. For a reminder of the criteria for the opening of bankruptcy proceedings in Luxembourg, op. cit.

The dissolution of the bankrupt company with no assets remaining upon closure of the bankruptcy does not raise further comment (except in the rare cases where additional assets are discovered after dissolution of the company).

However, it was also possible for a company to emerge from bankruptcy and continue its activities as a going concern if assets remained after the settlement of all claims. This is why in very limited cases, bankruptcy was also used as a restructuring tool by practitioners in Luxembourg.[5] Such an outcome was, of course, the result of the joint efforts, in close coordination, of the bankruptcy trustee (*curateur*), the bankrupt company's shareholders, its creditors, and their respective lawyers.

Should a *prima facie* consideration of the new Article 536-2, straightforward and general in its application, without distinction as to the company's financial situation at closure of the bankruptcy, prompt the conclusion that the opening of bankruptcy proceedings could necessarily be equated with a corporate death sentence?

As explained below, the lack of nuance of the provisions of Article 536-2 will most certainly have an adverse effect on the various strategies and practices devised by legal experts for pulling companies from bankruptcy. The provisions of Article 1 of the Grand-Ducal Regulation of 3 February 2023[6] echo the provisions of Article 536-2 and unfortunately do not clarify the scope of said article.[7]

An indiscriminate application of the new Article 536-2 will give rise to new legal issues:

- considering the current Luxembourg legislative framework and the obvious lack of effective statutory tools to facilitate judicial or extrajudicial restructuring, it is clear - and unfortunate - that Luxembourg does not qualify as a restructuring jurisdiction.[8] This will likely push lenders and debtors to pursue extrajudicial restructuring in foreign jurisdictions (i.e., forum shopping). This could further impact Luxembourg's international reputation as a creditor-friendly jurisdiction for the entire lifecycle of companies;
- the provisions of Article 536-2 could have another damaging side effect for creditors. In some cases, a bankrupt company's shareholder(s), supported by the bankruptcy trustee, may reach out to the company's creditors to try to negotiate the settlement of claims with a view to the potential financial rescue of the company. Such course of action can usually benefit both shareholders and creditors: shareholders can negotiate the settlement of the bankrupt's liabilities at a discount and creditors can receive an agreed lump sum for contingent claims.[9] In light of the new Article 536-2, shareholders are unlikely to have an interest in negotiating the settlement of claims of their bankrupt affiliates since the latter will ultimately be dissolved, unless such rescue is primarily aimed at avoiding a spread of the bankruptcy throughout the group (e.g., in the case of guarantees and other commitments extended to the bankrupt company by other members of the same group). As a result, creditors will not be able to negotiate the payment of their claims (even at a discount) and will only be paid from whatever assets of the bankrupt company remain;

"

The lack of nuance of the provisions of Article 536-2 will most certainly have an adverse effect on the various strategies and practices devised by legal experts for pulling companies from bankruptcy.

- strong uncertainty remains as to the title to any remaining assets of the bankrupt company after its dissolution. In this regard, three main hypotheses should first be considered with respect to the closure of bankruptcy proceedings:

5. For the use of bankruptcy proceedings as a restructuring tool in Luxembourg, *op. cit*.
6. Article 1 of the Grand-Ducal Regulation of 3 February 2023 amending the amended Grand-Ducal Regulation of 23 January 2003 implementing the amended law of 19 December 2002 on the Trade and Companies Register and the accounting and annual accounts of undertakings. https://legilux.public.lu/eli/etat/leg/rgd/2023/02/03/a82/jo
7. *"Sont rayées d'office, les sociétés commerciales dont la faillite a été clôturée (…)"*
8. For our analysis of the lack of restructuring tools in Luxembourg, *op. cit*.
9. With regards to contingent claims, by the same authors, "Admission of contingent claims in bankruptcy proceedings in Luxembourg", International Law Office, 1 July 2022 https://www.lexology.com/commentary/insolvency-restructuring/2702ce31-9684-4459-a594-fde814ccac80?utm_source=ILO+Newsletter&utm_medium=email&utm_content=Newsletter+2022-07-01&utm_campaign=Insolvency+%26+Restructuring+Newsletter

i. the bankruptcy was closed due to the absence of liabilities or the settlement in full of all claims and a surplus remains, following either the liquidation of (all or part of) the assets of the bankrupt company or the financial rescue of the company by its shareholder(s). It should be noted that as a matter of good practice, the bankruptcy trustee (*curateur*) will not liquidate more assets than necessary to settle the declared and accepted claims, so it is possible that assets and a liquidation surplus could remain after the closure of the bankruptcy. The rationale is to minimise the disruption of the bankrupt entity's affairs since it may well emerge from bankruptcy and continue its activities as a going concern;[10]

ii. the bankruptcy was closed following liquidation of the identified assets of the bankrupt company, but the claims were not fully settled due to a lack of assets; or

iii. the bankruptcy was closed for lack of assets (*insuffisance d'actifs*), i.e., it was assessed that the bankrupt company did not have enough assets to settle even the bankruptcy fees and costs. The bankruptcy is therefore closed on the basis of Article 536 of the Commercial Code. In this scenario, the potential creditors' claims (except for salary claims) are not verified by the bankruptcy trustee.

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> Ultimately, it might be possible that assets remain following the settlement of all remaining claims

In scenario i., the bankrupt company would typically emerge from bankruptcy and continue its activities as a going concern. Any surplus remaining from the liquidation would either be transferred to the *Caisse de Consignation* or directly to the company itself, but never to the company's shareholders, since the bankruptcy in this situation would not entail the dissolution and liquidation of the company. It would be up to the reinstated management of the company and its shareholders to decide, following the closure of the bankruptcy, to either continue the company's activities or dissolve the company and liquidate its remaining assets so that the surplus could be distributed to the shareholders.

In the situations set out in ii. and iii. above, the company has no (more) assets and the bankruptcy is closed. However, it is possible to request the re-opening of the bankruptcy proceedings if assets are discovered afterwards, so that these can be liquidated and used in further settlement of the creditors' remaining claims.

In the case of a bankruptcy closed for lack of assets (*insuffisance d'actifs*), such re-opening will be made on the basis of Article 536 al. 4 of the Commercial Code.[11] It is generally accepted that a re-opening of a bankruptcy is possible in the case of a closure following a liquidation of assets, to the extent that the discovered assets were concealed or omitted during the liquidation process[12] and all or some of the declared and accepted claims were not settled. Ultimately, it might be possible that assets remain following the settlement of all remaining claims.

Following the entry into force of Article 536-2, new problems will arise with respect to such remaining assets. If assets remain (scenario i.) or are discovered following the closure of the bankruptcy and all claims have been settled in full (scenarios ii. and iii.), who will be entitled to those assets? There is no definite answer to this and the legislator neither addressed this issue in the Bill nor considered the Luxembourg Bar's concerns in this regard as expressed in its Opinion.

10. Max Mailliet, "*Manuel de droit luxembourgeois de la faillite*", Larcier Luxembourg, 2022, p. 606.
11. Luxembourg Court of Appeal, 11 November 2015, n° 40783 and 41078. *"It is accepted that a judgement closing the bankruptcy for lack of assets, taken on the basis of Article 536 of the Commercial Code, simply suspends the bankruptcy operations and reinstate each creditors in its right to exercise individual actions on the bankrupt's assets. The bankruptcy regime ceases to exist, but the debtor remains under the threat of the reopening of a bankruptcy which virtually survives."*
12. Luxembourg Court of Appeal, 1 February 2022, n° CAL-2020-00314 and CAL-2020-01019. "*Article 536 of the Commercial Code deals with the closure of a bankruptcy due to insufficient assets and no specific provision of the Commercial Code regulates the question of the reopening of a bankruptcy following the presentation of accounts. The legal doctrine has deduced that a bankruptcy closed by liquidation cannot be reopened because of the existence of new assets. However, it can be reopened, as is the case with closure for lack of assets, if assets have been concealed or omitted during the liquidation, in other words if assets have escaped liquidation.*"

Nevertheless, a few hypotheses can be posited for the fate of such assets:

- the remaining assets will have no owner in the absence of liquidation: the Luxembourg Bar is of the opinion that following the dissolution of the bankrupt company, these assets would have no owner as they would not have been liquidated.[13] This view is consistent with settled case law whereby the shareholders do not acquire ownership of the company's assets as a consequence of its dissolution.[14] This outcome is of course intellectually unacceptable as it would amount to denying the bankrupt company's shareholders their rights to the company's remaining assets. In our view it is obvious that the provisions of Article 536-2 cannot and will not be interpreted in such a simple and dangerous fashion, as it would be rationally unjustified;

- the remaining assets will be liquidated by the bankruptcy trustee: considering that pursuant to the provisions of Article 536-2, the closure of the bankruptcy entails the closure of the liquidation, one might also wonder whether the concept of the closure of the liquidation should be interpreted so broadly as to be equated with judicial liquidation. In such a case, one may support the idea that all the assets of the bankrupt company should be liquidated by the bankruptcy trustee in the context of the bankruptcy and that the shareholders would, *ergo*, be entitled to any surplus. But these are mere conjectures which are not backed by any textual reference and they contradict the *ratio legis* of bankruptcy legislation. Such an interpretation is at best dubious, therefore, and the concept of "closure of liquidation" should in our opinion be interpreted exclusively in the context of the Chapter under which Article 536-2 appears, which is concerned with the liquidation as part of bankruptcy, an operation limited to realising the bankrupt company's assets with a view to settling the declared and verified creditors' claims, and not a standard liquidation where all the assets are liquidated indiscriminately.

- the remaining assets will be held as undivided property by the shareholders: should we instead apply *mutatis mutandis* the provisions of Article 1879 of the Civil Code, whereby "*the rules concerning the division of estates, the form of such division, and the resulting obligations between co-heirs, shall apply to divisions between shareholders*"? Pursuant to these provisions, legal doctrine,[15] and case law,[16] the remaining assets are transferred by operation of law to the company's shareholders as undivided property, and the rules applicable to division of estate shall apply to the division of the remaining assets. No agreement or other positive act is required to effect such a transfer from the company to its shareholders. It would in that case be tempting to argue that the assets remaining after closure of the bankruptcy (and dissolution and closure of the liquidation of the bankrupt company) would become the undivided property of the shareholders by operation of law, and that it would therefore be their responsibility to organise the liquidation of the undivided property after the closure of the bankruptcy. This position would result in the burden of liquidating the remaining assets being shifted to the shareholders (as opposed to the scenario set out above, in which the bankruptcy trustee would organise the final liquidation of the remaining assets for their distribution to the shareholders). But again, this is not a satisfactory answer, as bankruptcy is not designed to be a liquidation procedure in the first place, and the Bill does not purport to pose such a solution, as explained by the Luxembourg Bar in its Opinion;[17]

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> The Luxembourg Bar is of the opinion that following the dissolution of the bankrupt company, these assets would have no owner as they would not have been liquidated.

13. *"By applying the Bill, the company was declared dissolved without liquidation as a result of the bankruptcy proceedings. The property becomes ownerless; the shareholder loses all his rights."*
14. Luxembourg Court of Cassation, 2 December 1952.
15. J.-P. Winandy, "*Manuel de droit des sociétés*", 2019, p. 287
16. Luxembourg Court of Cassation, 2 December 1952, "*The property making up the net assets of the company became the property of the defendants as a result of the closure of the liquidation.*"
17. "*Liquidation is the only way to remedy these problems, unless the Bill wanted to transfer the universality of the assets to the shareholders, which however does not result from the text of the Draft and which generates other difficulties.*"

- the shareholders should file a contingent claim for any liquidation surplus: to avoid a situation where assets remain at the closure of the bankruptcy, must the shareholders, acting in their capacity as such, proactively file a contingent claim[18] with the bankruptcy trustee for an amount up to the total net assets of the company (according to its latest balance sheet), to be apportioned amongst themselves according to the distribution rules under the bankrupt company's articles of association, so in the event that all creditors' claims are satisfied and a surplus remains, the bankruptcy trustee could reduce the shareholders' claim down to the remaining assets and further proceed to a final liquidation and distribution to said shareholders? This solution is also unacceptable: it would result in bankruptcy being reduced to a "special" judicial liquidation in which the bankruptcy trustee acts merely as a liquidator. This neither does justice to the philosophy behind bankruptcy proceedings, which are not intended to be a judicial liquidation procedure where any liquidation surplus is distributed to the shareholders (liquidation in the course of bankruptcy is limited to realising assets in order to settle third-party claims and nothing more), nor do the new provisions of Article 536-2 provide for such a procedure or even reference the articles pertaining to judicial liquidation (Article 536-2 could therefore not be interpreted that broadly). However, considering the uncertainty surrounding the fate of assets remaining after closure of the bankruptcy, shareholders would be advised to act cautiously and proceed with a contingent claim filing.

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> The safest and most desirable direction would come from an interpretation by the courts taking into account the requirements of justice and avoiding inconsistent or rationally unjustified solutions

We have set out certain theories regarding the title to assets remaining after the closure of bankruptcy. For the reasons set out above, however, none of these is satisfactory from a legal perspective. What are the alternatives? In the face of legal uncertainty, the safest and most desirable direction would come from an interpretation by the courts taking into account the requirements of justice and avoiding inconsistent or rationally unjustified solutions and, hopefully, a clarification from the legislator.

II. The need for a clarification in the application of Article 536-2

It is clear that a strict interpretation of the provisions of Article 536-2, whereby all companies would be dissolved following the closure of bankruptcy, without distinction as to their financial situation, is neither desirable nor rationally justified and would create legal uncertainty. It would furthermore create an additional burden either on the bankruptcy trustee or the shareholders with regard to the liquidation of remaining assets, such burden being incompatible with the rationale and intent of bankruptcy legislation.

In our opinion, with respect to Article 536-2, the Luxembourg courts should avoid a simple application of the clear act theory (*théorie de l'acte clair*), whereby this article would be applied in a literal fashion, i.e., to each and every bankruptcy scenario, with no regard for the circumstances and financial situation of the bankrupt company.[19] When adopting a new piece of legislation, the legislator cannot provide for each and every situation and factual matrix, and it is therefore possible that the Luxembourg legislator deliberately chose to ignore the Luxembourg Bar's legitimate concerns with regard to the hypothesis where companies emerge from bankruptcy as a going concern with assets remaining after the settlement of all claims, such cases being rare in practice (and therefore potentially deemed irrelevant). After all, none of the Luxembourg Bar's concerns was addressed, either by amending the provisions of Article 536-2 or by providing useful commentary which may have shed some light on the legislator's intent as to the extent of said provisions.

18. With regards to contingent claims, by the same authors, "Admission of contingent claims in bankruptcy proceedings in Luxembourg", International Law Office, 1 July 2022
19. Luxembourg Court of Appeal, 27 October 2021, n° CAL-2019-00826. "*The notion of clarity evoked in this theory calls for a purely literal, formalist approach to the text as drafted by the legislator in that the text is deemed to be clear if its scope is obvious and identical to everyone who reads it.*"

Instead, the Luxembourg courts should aim to give the provisions of Article 536-2 their useful effect, *"by taking into account the requirements of justice and avoiding inconsistent or rationally unjustified solutions"*,[20] and for this purpose, strictly limit their application to cases where the bankruptcy is closed due to insufficient assets. In this respect, Article 536-2 should be read in conjunction with the two articles immediately preceding it, i.e., Articles 536 and 536-1, which are concerned only with the closure of bankruptcy due to insufficient assets, and which we consider as forming a coherent unit.

After all, according to the provisions of Article 536 of the Commercial Code, it is because the company has insufficient assets that the bankruptcy is immediately closed, and it is also because the company has no assets that would make it appropriate, pursuant to Article 536-2, to proceed immediately to its dissolution, in order to avoid a situation where a company with no assets, no employees and no activities would remain registered with the Luxembourg Trade and Companies Register. Such interpretation would be in line with the *ratio legis* of the new procedure of administrative dissolution without liquidation provided for by Bill No. 6539B, the aim of which is to *"quickly and effectively evacuate judicial liquidation proceedings, which often originate in repeated breaches of company law (lack of a registered office, resignation of the entire board of directors who are not replaced, failure to file annual accounts with the RCS, etc.)."*[21]

It could be argued that following the closure of its bankruptcy proceedings, a company with no assets, no employees and no activities will always be wound up as it has no prospect of financial recovery whatsoever. To the extent it is not wound up, it will ultimately degenerate into one of these so-called 'zombie companies' specifically targeted by the new procedure of administrative dissolution without liquidation. To immediately dissolve these companies as a consequence of the closure of the liquidation is therefore entirely justified.

This solution depends entirely on the Luxembourg courts, of course. In this respect, there could be a plausible risk that the content of bankruptcy closure judgments might not deviate from current standards and the Luxembourg courts might not take a position thereunder as to the application of Article 536-2 and the entitlement to any remaining assets. This would of course be the worst possible outcome, as the validity of the steps taken by the shareholders of companies pronounced bankrupt (and then dissolved) as concerns remaining assets would be shrouded in legal uncertainty. Alas, in such cases, the regime introduced by new Article 536-2 is likely doomed to be defined at the price of lengthy litigation and potential losses.

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> The procedure for rehabilitation provided in Articles 586 and following of the Commercial Code will become, at best, irrelevant and useless for bankrupt companies.

The automatic dissolution of bankrupt companies upon the closure of bankruptcy will also have an adverse effect for several other provisions of the Commercial Code which will consequently become obsolete or irrelevant. To cite an example raised by the Luxembourg Bar in its Opinion, the procedure for rehabilitation provided in Articles 586 and following of the Commercial Code will become, at best, irrelevant and useless for bankrupt companies. This while a reform of the rehabilitation procedure and its legal outcomes would have been a welcome addition to Bill No. 6539B, to take into account the new provisions of Article 536-2 or perhaps as a mitigation thereof.

20. *Op. cit.*
21. https://data.legilux.public.lu/file/load?uri=http://data.legilux.public.lu/filestore/eli/etat/projet/pl/20170494/doc/1/fr/1/pdf/manifestation/eli-etat-projet-pl-20170494-doc-1-fr-1-pdf-manifestation.pdf

One may cynically argue that it is possible for the bankrupt to be rehabilitated after their death[22] and that it would therefore be possible, *mutatis mutandis*, to request the rehabilitation of dissolved companies (after the closure of their bankruptcy). But such procedure will necessarily fall into relative disuse with regard to commercial companies, as rehabilitation is useful to a bankrupt company only to the extent it can emerge from bankruptcy and continue its activities as a going concern. However, in certain limited cases, the manager of a bankrupt (and dissolved) company may have an interest in requesting the rehabilitation of the bankrupt company. Although this will not be of any use to the bankrupt entity, it can still be beneficial to its manager with a view to satisfying the criteria of sufficient honourability for the grant of business licences and CSSF approvals.[23]

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> A literal application of Article 536-2, providing for the dissolution of each and every company upon closure of bankruptcy, takes the opposite direction of the current European legislative trend.

Therefore, to add legal certainty and avoid contradictory applications of Article 536-2, but also mitigate its impact on surrounding provisions, it is desirable that the legislator amend the provisions of said article in order to limit its scope to companies where bankruptcy was closed due to insufficient assets.

It should also be noted that a literal application of Article 536-2, providing for the dissolution of each and every company upon closure of bankruptcy, takes the opposite direction of the current European legislative trend upheld under Directive (EU) 2019/1023 on preventive restructuring frameworks (the "**Directive**")[24], aimed at allowing viable enterprises a second chance[25] and the preservation of business[26]. At a national level, the Bill No 6539A aims at similar goals[27] and it would therefore be difficult to understand that the legislator did not pursue the same philosophy with Article 536-2.

22. Article 586 of the Commercial Code, paragraph 3: "*Le failli pourra être réhabilité après sa mort.*"
23. Max Mailliet, "*Manuel de droit luxembourgeois de la faillite*", Larcier Luxembourg, 2022, p. 644.
24. See https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX:32019L1023
25. First Whereas of the Directive: "*this Directive aims to remove such obstacles by ensuring that (…) : viable enterprises and entrepreneurs that are in financial difficulties have access to effective national preventive restructuring frameworks which enable them to continue operating; honest insolvent or over-indebted entrepreneurs can benefit from a full discharge of debt after a reasonable period of time, thereby allowing them a second chance; and that the effectiveness of procedures concerning restructuring, insolvency and discharge of debt is improved, in particular with a view to shortening their length*."
26. Eighty-fifth Whereas of the Directive: "*It is necessary to maintain and enhance the transparency and predictability of the procedures in delivering outcomes that are favourable to the preservation of businesses and to allowing entrepreneurs to have a second chance or that permit the efficient liquidation of non-viable enterprises*."
27. For a reminder of the goals of the Bill No. 6539A, by the same authors, "*Implementation of Directive (EU) 2019/1023 in Luxembourg: Struggles and Pitfalls*", Beaumont Capital Markets, International Insolvency and Restructuring Review 2022 / 23.

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Victor brings with him 30 years of experience, specialising in crisis management work with a commitment to create value for stakeholders in a distressed environment.

His areas of expertise include dispute resolution, insolvency, investigations, corporate and debt restructuring. He serves a wide range of clients from industries as varied as plantation, property development, investment holding, manufacturing, financial services, trading, hospitality, and aviation.

Victor is a licensed Insolvency Practitioner from the Ministry of Finance Malaysia and Labuan Financial Services Authority. He is also a Certified Practising Accountant of CPA Australia, a Chartered Accountant of the Malaysian Institute of Accountants (MIA) and a Certified Public Accountant of the Malaysian Institute of Certified Public Accountants (MICPA). Victor is a member of the Insolvency Practice Committee of MIA and MICPA respectively and currently serves as the Secretary of the Insolvency Practitioners Association of Malaysia (iPAM).

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Roger brings with him over 28 years of insolvency and restructuring experience. He has worked with clients from a variety of industries such as manufacturing, trading, property investment, property development and airlines.

His work includes liquidation and receivership of companies in distress with responsibilities over operations and overall management of companies in various industries. Roger was involved in the revival of abandoned housing projects in Malaysia, cash flow monitoring of distressed companies and the administration of a national carrier. He also provides expertise to renowned financial institutions for disposal of non-performing loans including bilateral and syndicated corporate loans.

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Surendran specialises in crisis management, in particular, corporate rescue, restructuring and recovery. Surendran has been with PwC for over 20 years including 4 years with PwC Bristol, United Kingdom, and a secondment to PwC Vietnam for 2 years.

His work includes corporate and debt restructuring and liquidation in various sectors such as aviation, property development, plantation, and oil and gas. He has also been involved in investigations, global asset tracing and recovery across multiple jurisdictions.

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Stronger economic growth but with headwinds

Highest GDP growth in the last 22 years

The Malaysian central bank reported a stronger gross domestic growth ("GDP") of 8.7% for 2022 compared to a GDP of 3.1% for 2021. The reported 8.7% growth was a record high in the last 22 years.

The growth was primarily underpinned by improvement in the labour market, stronger exports and recovery of inbound tourism following the COVID-19 lockdowns. Sectors such as plantation, electrical and electronics ("E&E) and aviation have benefited from the reopening of the economy.

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Given the challenges ahead and the limited ability to provide further stimulus, it is likely that we could see further increases in the number of voluntary and compulsory winding-up cases in the near term.

Risks remains in the immediate term

Nevertheless, there are strong headwinds. Supply chain disruptions and inflationary pressures caused by the lingering impact of the COVID-19 pandemic and geopolitical conflicts in addition to weaker global growth continue to weigh down business sentiments.

Malaysian banks' non-performing loan (NPL) ratio was 1.7% in December 2022, a marginal uptick compared to 1.4% in December 2021. However, NPL remains a risk with recent rises in interest rates to curtail higher inflation with an already-elevated level of household indebtedness.

It is worth noting that like many governments around the world, the Malaysian government embarked on significant stimulus during the COVID-19 pandemic, such as the automatic loan moratorium package which was worth more than RM320b (c.USD80b) or about 20% of GDP. The new government, following a General Election in November 2022 is under fiscal constraint because of previous debt reliefs and stimulus packages announced during the pandemic. Therefore, the ability to provide more stimulus to the economy may be limited.

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Furthermore, while the economy is opening up, working capital and capital expenditure required by some businesses to restart may be too steep compared to the expected increase in revenues. With government support and moratoriums now ended, we have seen an uptick in distressed businesses in certain sectors such as oil and gas ("O&G"), property development and hospitality.

Rise in insolvency and restructuring cases

Rise in winding-up cases following cessation of moratoriums

Year	2018	2019	2020	2021	2022
Reported voluntary winding-up cases	1,022	1,216	863	1,133	1,331
Reported compulsory winding-up cases	1,411	1,968	1,191	1,113	1,336

Source: Malaysian Department of Insolvency

As the above table shows, the dip in the number of cases in 2020 compared to 2019 was primarily due to government stimulus measures, as mentioned previously. Since then, the number of new voluntary and compulsory winding-up cases have increased year on year since 2020, consistent with the uptick in distressed activity observed since the cessation in moratoriums. Based on the Malaysian Department of Insolvency's statistics, trading, construction and property development reported the most number of cases.

Given the challenges ahead and the limited ability to provide further stimulus, it is likely that we could see further increases in the number of voluntary and compulsory winding-up cases in the near term.

Rise in disputes and fraud related insolvencies

During times of distress, disputes and fraud related insolvencies tend to be on the rise. This may arise from shareholders disputing over the sudden decrease in dividends or the loss of funding to cover-up fraudulent activities and service existing obligations. Recent scandals such as the USD 8 billion FTX crypto scandal that resulted in a bankruptcy in November 2022 due to a liquidity crisis and now subject to an ongoing liquidation, further highlights the rise in fraud related insolvencies during times of distress or crisis.

Malaysia is no different. There have been a number of high-profile cases leading to court appointed interim liquidator / liquidator on the back of fraud allegations.

Increased debt restructuring activity

Insolvencies aside, debt restructuring activity has also been on the rise, as illustrated by the table below.

Year	2020	2021	2022*
Court reported restructuring cases	50	66	54

Source: Companies Commission of Malaysia
*Scheme of Arrangement reported as at 15 September 2022 while Judicial Management and Corporate Voluntary Arrangements reports as at May 2022

During the pandemic, businesses were most affected such as aviation, hospitality and certain retail and consumer segments (e.g. cinemas, fashion retail chains) took more proactive measures to address their liabilities and cost structure. For example, the national airlines, Malaysia Aviation Group's subsidiary completed a UK scheme of arrangement in 2021 to compromise and restructure more than RM 10 billion of liabilities. Air Asia X, undertook a Malaysian scheme of arrangement in 2022 to address more than RM 33 billion of liabilities and to terminate supply contracts.

However, many businesses adopted a 'wait and see' approach instead during the pandemic, but nonetheless focused on managing their liquidity by applying for the various moratoriums and payment deferrals. At the start of the pandemic, many business leaders felt that the pandemic would last between 3-6 months and they had sufficient liquidity to 'mothball' their business temporarily, but kept their headcount and cost structure relatively unchanged. Yet as the pandemic and lockdowns prolonged, many businesses had to borrow to survive the pandemic.

As the economy opened up post-pandemic, some businesses had no choice but to further borrow to sustain operations because of continued supply chain disruptions, escalating costs and deteriorating margins. And now, with tightening monetary policy to curtail inflation, interest rates have been on an increasing trend. The "borrow-borrow" malady and the impact from higher interest costs have impacted a number of capital intensive sectors in Malaysia.

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> During the pandemic, businesses most affected such as aviation, hospitality and certain retail and consumer segments (e.g. cinemas, fashion retail chains) took more proactive measures to address their liabilities and cost structure.

In particular, the Malaysian oil and gas industry, which contributes 20% of Malaysian annual GDP, already faced a challenging environment even prior to the pandemic, mainly attributed to prolonged periods of low oil prices, following the oil price shock in 2014, low vessel utilisation and ballooning debt obligations from past M&As. The "borrow-borrow" malady faced in recent times has forced many to undertake a restructuring to address its high debt levels. Most notably, Sapura Engineering Berhad is currently undertaking a debt restructuring exercise to address more than RM 10 billion of debt.

Corporate rescue mechanisms

The corporate insolvency regime in Malaysia was primarily crafted with the theme of protecting creditors whilst there were insolvency and restructuring processes in the Companies Act 1965, they lacked true rescue mechanisms. This changed when the Companies Act 2016 introduced two new corporate rescue mechanisms, namely Corporate Voluntary Arrangement (CVA) and Judicial Management (JM), and refined the existing Schemes of Arrangement (SOA).

> "The corporate insolvency regime in Malaysia was primarily crafted with the theme of protecting creditors.

The key features of corporate rescue mechanisms are as follows:

CVA

- Only available to unlisted companies. It is debtor-in-possession (allows for management to remain in control) and allows for the distressed company to work with an insolvency practitioner to draw up a proposed restructuring scheme.

- An automatic moratorium is available to protect the company from any creditor actions for an initial period of 28 days and subject to a further extension of up to 60 days. The CVA process permits a proposed scheme to be imposed on and bind all creditors, if the statutory voting threshold is achieved.

JM

- Only available to unlisted companies. Management of the company will be placed in the hands of an insolvency practitioner appointed by the Court (i.e. a judicial manager) if there is a reasonable prospect to keep the distressed company as a going concern rather than being wound up.

- Application for JM triggers an automatic moratorium upon filing of court papers. The moratorium stays in effect while the court application is still pending. Once the judicial management order is granted, the judicial manager has an initial term of 6 months to try to put forward a restructuring proposal to the company's creditors with the aim to achieve the statutory voting threshold.

SOA

- Open to all private and pubic companies and is debtor-in-possession. Application for a moratorium from the Courts however is not automatic and companies often face difficulties in meeting the necessary requirements for a moratorium. If granted, the moratorium will last for 3 months, and can be extended further for up to 9 months.

- The scheme of arrangement process permits a proposed scheme to be imposed on and bind all creditors, if the statutory voting threshold is achieved. However, there is a requirement to separate creditors into separate classes for the purposes of approving the proposed scheme. Once obtained, there is then the process of obtaining the court sanction for the scheme of arrangement to be imposed on and bind all creditors.

Low take-up rate for CVAs and JMs

The number of reported cases by type of corporate rescue mechanism, is illustrated below.

Year /Number of reported cases	2020	2021	2022
Scheme of Arrangement	14	37	33*
Judicial Management	35	27	21**
Corporate Voluntary Arrangements	1	2	0**

Source: Companies Commission of Malaysia
* Reported as at 15 September 2022
** Reported as at May 2022

Despite being new rescue tools, the take up rate for both CVAs and JMs have been relatively low. The CVA, which is meant to be a relatively efficient and a simpler rescue tool in terms of process, has seen only 3 new reported cases in the last three years. On the other hand, there is a downward trend for the take-up rate of JMs.

Some criticisms of the current corporate rescue mechanisms are as follows:

- The CVA is available for private companies that have no secured debt or any charge over its property. This has led to the criticism of CVA as a rescue tool. A distressed company would have likely obtained some form of financing and security may have been created.

- Any secured creditor can veto the JM application. This can be a disadvantage as a rescue mechanism. Furthermore, the initial 6 months term may only be extended for a further 6 months. This means that a more complicated restructuring would fail as the JM would simply run out of time after the 12 months.

- There is no automatic moratorium under SOAs. Restraining orders are subject to certain conditions, such as the nomination of a director to represent the creditor and require at least majority creditor support. It can be a challenge to expeditiously find an independent director to represent the creditors given the risks involved and time commitment plus the need to satisfy the majority of creditors as part of the restraining order requirements.

Impending legislative changes to the corporate rescue mechanisms

Given some of the limitations and criticisms of the current corporate rescue mechanisms, the Companies Commission of Malaysia ("CCM") issued a consultative document in August 2020 to propose changes to the corporate rescue mechanisms.

The proposed changes are anticipated to be a significant shift in the restructuring scene in Malaysia, as it includes, amongst others:

- Wider access to JMs in that it may be applicable for listed companies and removal of the restriction of secured debt to enable greater use of CVAs

- Restraining order under SOAs will be an automatic moratorium from legal proceedings for an initial period of 60 days

- Introduction of cross-class cram downs in SOAs which will avoid a scheme being hijacked by a class of minority creditors

- Introduction of rescue financing and super priority which will enable greater participation of specialist debt and capital providers in the restructuring and insolvency scene

- Continuation of essential goods and services in that termination clauses in contracts due to insolvency-related events will cease to have any effect

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> Despite being new rescue tools, the take up rate for both CVA and JMs have been relatively low.

Whilst the consultative document was issued at the time of COVID-19 lockdowns, the government has not been able push through for a bill encompassing the proposed reforms to the Companies Act 2016 to be approved in Parliament as yet. As such, some of these much needed reforms have not become law. Restructuring and insolvency practitioners are keenly watching this space as the proposed changes will provide a new dimension to corporate rescue mechanisms in Malaysia.

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