INSOL INTERNATIONAL

CREDITORS' RIGHTS IN INSOLVENCY PROCEEDINGS

A PRACTICAL GUIDE FOR SMALLER PRACTICES

INSOL INTERNATIONAL

International Association of Restructuring, Insolvency & Bankruptcy Professionals

Creditors' Rights in Insolvency Proceedings

A Practical Guide for Smaller Practices

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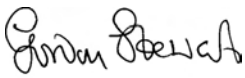
Philosophically, the role of insolvency law and procedures is to recycle the assets of a financially distressed business in as efficient and economical a fashion as possible. This may give the existing proprietors or managers another chance or put the assets in the hands of someone more competent.

But a key part of this recycling is to get the proceeds of the asset realisations out to the creditors efficiently, as that capital also needs redeploying in the wider economy. Creditors in an insolvency are key stakeholders. They may precipitate the insolvency, they will have claims to make, and they can have varying degrees of involvement in the process from monitoring through to active participation. And finally, with powers come responsibilities.

Creditors appear in many shapes and sizes: secured, unsecured, preferential, subordinated, equitably subordinated - all with different rights in the insolvency payout waterfall. Not surprisingly, different jurisdictions have different rules for creditors and their claims. As so many businesses nowadays have some cross-border or international aspect to their affairs, these variations have great importance for all insolvency practitioners and their advisers.

I wholeheartedly welcome this Practical Guide to creditors' rights, covering as it does a range of jurisdictions. And I am particularly glad to see it is aimed at the Smaller Practitioner. This is part of INSOL's determined efforts to provide services across the whole range of our membership. Finally it just remains to say thank you and well done to Karl-Heinz and his team of contributors.



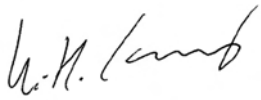
Gordon Stewart
President
INSOL International

Foreword

The idea that led to this publication was first discussed by the "Smaller Practice Issues Committee" of INSOL International in order to provide its members with a practical guide illustrating the rights (and obligations!) of creditors within the most important insolvency systems around the globe. This publication, while focusing on the position of creditors, also offers a short introduction into the structure of the insolvency proceedings in respect of the countries that are covered in this publication. You will see that the most important jurisdictions in the world are in fact included.

Each article is structured based on a template of questions as far as this is actually possible in consideration of the great differences that mark the various proceedings around the world. This allows an easier and more immediate comparison between the position of creditors in the different countries. It wasn't always easy for the authors to follow the given template. The Insolvency laws of the world are too varied to be limited to an exact structure that is capable of fitting into the responsers received by each and every country. In my opinion however, all authors have succeeded very well in outlining creditors' rights in jurisdictions and proceedings worldwide.

It is a personal wish of mine to extend my sincere appreciation and thanks to all authors who presented their valuable contributions and have invested their time in order to create this publication and provide it to the members of INSOL International. Many thanks to all the people at INSOL International who have managed the project "backstage" without appearing in the first line of this publication.



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Introduction

There are four main insolvency proceedings in Australia: receivership, voluntary administration, scheme of arrangement and liquidation (which includes both court-ordered and voluntary forms). A receiver is responsible for recovering, holding or realising property on behalf of the individual who will ultimately be entitled to that property. In a voluntary administration, an administrator takes control of a company's affairs for the purpose of putting together a deed of company arrangement (a compromise agreement between a company and its creditors). There are two objects of a voluntary administration: the first is to rescue the company from ruin; if such a rescue is impossible, the purpose of an administration is then to ensure a better return for creditors than would result from an immediate winding up of the company. A scheme of arrangement is a compromise or arrangement between a company and its creditors or members. Where a company is or is close to being insolvent, a scheme can be executed to alter or extinguish a company's debts. However, unlike a deed of company arrangement, a scheme of arrangement requires a court order to be made in addition to the approval of creditors before the scheme will take effect. Liquidation is the process by which the affairs of a company are wound up in preparation for its deregistration. During a liquidation, a liquidator will investigate the affairs of the company and realise its assets in order to discharge the debts of the company.

QUESTION 1

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1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

Australian courts can order the winding up of companies on myriad grounds and insolvency is the most common basis for such an order. Numerous parties, including creditors, directors and a company itself can bring an application for a winding up order before the court. To expedite the application process, the *Corporations Act 2001* (Cth) (the *Corporations Act*) lists several circumstances in which the court may presume that a company is insolvent. Failure to pay a statutory demand within the statutory period is the least onerous of these grounds and therefore most often relied upon by creditors when applying to the court for a winding-up order.

1.2 Choice of insolvency representative

Receivers, administrators, scheme administrators and liquidators in a voluntary winding up must all be registered liquidators. Registered liquidators are registered by the Australian Securities and Investments Commission (*ASIC*) (Australia's corporate regulator) under the *Corporations Act*. In court-ordered liquidations, liquidators must be 'official liquidators', which is a title awarded to an experienced registered liquidator at ASIC's discretion.

In Australia receivers may be court appointed or privately appointed. The appointment of a receiver by a court is an oppressive measure and one courts are reluctant to take. Privately appointed receivers are usually appointed by secured creditors exercising rights under a security document.

An administrator may be appointed by a company (once its board resolves that the company is insolvent or is likely to become insolvent), a liquidator, or a chargee with a charge over the whole, or substantially the whole of a company's property (a *substantial charge*) where that charge is enforceable.

If a company's creditors elect to execute a Deed of Company Arrangement (*DOCA*) (*below, 1.4*), then the administrator becomes the administrator of the Deed (unless the creditors appoint a different representative).

The terms of a Scheme of Arrangement (*Scheme*) (*below, 1.4*) normally provide for the appointment of a Scheme administrator, although such an appointment is not mandatory under the *Corporations Act*.

In both a members' and a creditors' voluntary winding up, a company may be wound up voluntarily without the involvement of the court. Both processes begin with a company's members passing a special resolution that the company be wound up voluntarily, and at which time the members will appoint the liquidator. Only a solvent company may pursue a members' voluntary winding up. To establish a company's solvency, the majority of its directors must make a declaration that they have formed the opinion that the company will be able to pay its debts in full within the period not exceeding 12 months after the commencement of the winding up. In this form of winding up, the creditors are unable to replace the liquidator. Where a company is insolvent but wishes to be wound up voluntarily, it must pursue a creditors' voluntary winding up. In this circumstance, however, the creditors are able to replace the liquidator appointed by the members. In a court-ordered winding up, creditors cannot replace the liquidator.

1.3 Pre-packaged insolvencies

A pre-packaged insolvency involves an agreement by a company's directors to sell the company prior to the appointment of insolvency representatives. Before sale, the company is placed into formal insolvency for as short as possible in order to access the restructure mechanisms afforded to insolvent companies by the *Corporations Act*. An Australian example could include the preparation of a DOCA (*below, 1.4*) when there is already a buyer for the company. In Australia, s 420A of the *Corporations Act* complicates packaged insolvencies in the event of receivership. Section 420A requires a receiver to sell property (where necessary) at its market value or obtain the best price reasonably obtainable. Case law has (generally) interpreted this provision as requiring a receiver to be properly informed of the market value of the property (i.e. obtain an independent valuation or equivalent advice) and to reasonably act on this information. The courts will have primary regard to the process leading up to the sale, rather than the sale price itself. Some controversy surrounds whether or not this section bestows a private right to recover on aggrieved persons.

1.4 Rights related to reorganization plans and proceedings

Schemes of arrangement

A Scheme of arrangement is a court approved compromise or arrangement between a company and its creditors or members. Schemes are very flexible and can be utilised by companies to provide for a modification or adjustment of

the rights of the company's creditors or members which, if approved, will be binding on all creditors or members. A creditors' Scheme will often involve a proposal to defer, compromise or extinguish the company's debts.

The use of creditors' Schemes for insolvent companies, however, largely fell away with the introduction of the voluntary administration provisions in Part 5.3A of the *Corporations Act*, primarily because the administration and DOCA processes set out in Part 5.3A are generally simpler (as there is little or no involvement of the court) and provide greater certainty than the Scheme process (because there are no separate classes of creditors and the voting percentages required are lower). Schemes may involve third parties; but, if they are not creditors, then they will not be bound by an order made by the court.

Schemes can be proposed by the company, one or more of its creditors or members and a liquidator. The parties proposing the Scheme must apply to the court for orders convening a meeting (or meetings) of creditors to consider the Scheme. The Court may order that there be separate meetings for different classes of creditors, if that course is considered appropriate or necessary. It may be appropriate to divide creditors into different classes having regard to the interests of different groups of creditors under the Scheme. Generally, secured and unsecured creditors will be in different classes.

At the meetings, each class of creditors votes on a resolution to approve the Scheme. A special majority is required to carry a resolution, being greater than 50% in number and greater than 75% in value of all creditors voting at the meeting for that class of creditor. This is an important right, as Schemes are often used where it is proposed that there be a departure from the principle of *parri passu* distribution which has the potential to deprive certain creditors of their entitlements (though a court will not necessarily approve a Scheme that seeks to alter the statutory priority regime).

Deeds of Company Arrangement

The rights afforded to creditors when a DOCA is used are different. A DOCA is effectively a compromise agreement between the company and its creditors. It can contain essentially whatever agreement the creditors want it to (though courts retain the power to set aside DOCAs on various grounds).

Soon after the administration of a company begins, the administrator must investigate the company's business, property, affairs and financial circumstances. The administrator must also convene a meeting of the creditors (the second compulsory meeting) within the stipulated convening period (generally within 21 days of the administration commencing) in order to decide the company's future and provide a report outlining the results of his investigation. At the meeting, the creditors may resolve that the company execute a DOCA specified in a resolution.

Once executed, the DOCA binds all creditors of the company in respect of claims arising on or prior to the date the deed is expressed to take effect. This includes unsecured creditors who may have voted against the execution of the deed. The deed also binds the company, its officers and members and the deed's administrators. Furthermore, creditors bound by the deed cannot (except with leave of the court):

- make an application for an order to wind up the company or proceed with an existing application; or
- begin or proceed with proceedings against the company or in relation to any of its property; or
- begin or proceed with enforcement proceedings in relation to the property of the company.

However, the deed can neither prevent a secured creditor from realising or otherwise dealing with its security, nor affect the rights of an owner or lessor of the property. These limitations do not apply, however, if the deed specifically affects those rights and the relevant party either voted in favour of the deed or the Court ordered that the deed should apply. Finally, where a creditor has a substantial charge, that creditor may enforce its security within 13 days of the appointment of an administrator or otherwise with the administrator's consent or court approval.

QUESTION 2

2. Creditor's rights aimed to meet claims

2.1 Filing a claim

Creditors may lodge proofs of debt in liquidations, DOCAs and Schemes. In an administration, for a creditor to be eligible to vote at the second creditors' meeting, the creditor must have either had its claim admitted by the liquidator or administrator, or have lodged particulars of that claim with either the chairperson of the meeting or nominated person.

In a liquidation (as for a voluntary administration) creditors may prove debts informally unless required to do so formally by the liquidator. To prove a debt formally, creditors must include detailed particulars of their claim and lodge that claim in the prescribed form. The terms of both a DOCA and a Scheme will dictate how a creditor is to prove a claim in each of those proceedings, although this process is normally similar to that in a liquidation.

Liquidators and deed administrators must give notice in writing of the deadline set for a debt to be proved by notifying all creditors who have not lodged a claim and by publishing a notice of the deadline in a relevant newspaper (although these requirements can be altered by the terms of a DOCA). In a Scheme, the company must notify its creditors of the Scheme meeting in writing by sending such notice to the creditor's address and by advertising that meeting in the newspaper.

If a liquidator rejects a proof of debt, he or she must inform the creditor of both the reasons for that rejection and his or her right to appeal to the court within the time specified in the notice. The terms of a DOCA or Scheme will often provide that similar notice be given to creditors with unsuccessful proofs of

debt. If a proof of debt is rejected in any of the above situations, a creditor can appeal to the court to have the decision reversed or modified.

2.2 Privileges for secured claims

Under the *Corporations Act*, there is a statutory order of priority in which a company's assets are distributed in a winding up. The order is essentially as follows:

- secured creditors under fixed charges;
- expenses of winding up;
- unpaid wages and employee entitlements;
- secured creditors under a floating charge;
- unsecured creditors; and
- shareholders.

This order of priority however, may change under the terms of a DOCA or Scheme.

On 1 October 2011 the *Personal Properties Securities Act 2009* (Cth) (*PPSA*) will come into effect. The PPSA provides for a register of security interests, perfection of title mechanisms, and modifies the statutory order of priority in the *Corporations Act*. In order to perfect a security interest under the PPSA it must be registered on the PPS Register, or the security holder must have 'possession' (eg physical possession of a share certificate) or 'control' of the collateral (eg a bank's security interest in its customer's account). In order for an interest to be perfected and enforceable it must also 'attach' to the collateral. 'Attachment' refers to the act creating the security interest (e.g. entering into a security agreement). Once an interest has attached it is enforceable against the grantor. In order to be enforceable against third parties, the secured party must have possession or control of the collateral, or there must be a security agreement in place. Whether or not an interest has been perfected has ramifications under the new priority rules. In cases of competing priorities, the following prevail:

- Unperfected vs. Unperfected – first in time with effective 'Attachment';
- Perfected vs. Unperfected – 'Perfected';
- Perfected vs. Perfected – first in 'priority time' takes priority.

Priority time occurs (s55(5)) at:

- Registration;
- Perfection, where secured party takes 'control' or 'possession';
- Temporary perfection (or when otherwise perfected by the PPSA) provided that there has been 'continuous perfection'.

Purchase Money Security Interests (*PMSIs*) (security interests of unpaid sellers, security interests under loans used to acquire personal property, a lessor's or bailor's interests in goods under a PPS lease, or interests under commercial consignments of goods) have a form of 'super priority' allowing them to take precedence over perfected security interests. In cases of competing priorities involving PMSIs, the following prevail:

- PMSI vs. Perfected Security Interest: PMSI will have priority if it relates to inventory, personal property or proceeds of either, subject to the satisfaction of certain conditions (s 62);

- PMSI vs. PMSI: First in time with possession or attachment, depending on the nature of the collateral (s 63 PPSA).

PMSIs lose their priority in insolvency if they are not perfected.

It should be noted that the PPSA does not distinguish between fixed and floating charges. All security interests under the PPSA are 'fixed'. Accordingly crystallisation process is not relevant to interests that attract the PPSA. References to floating charges in the *Corporations Act* will be changed to 'circulating security interests' by the *Personal Property Securities (Corporations and Other Amendments) Act 2010* (Cth).

Whether or not the PPSA applies to a foreign security is determined by s 6. Broadly speaking, the PPSA applies where:

(a) The grantor is an Australian entity; or

(b) There is some other connecting factor to Australia.

Whether or not there is a requisite connection depends on the type of property. It is also important to note that under the PPSA, on insolvency a security interest will not vest in the grantor if its perfection (or lack thereof) is governed by foreign law. There are special rules providing for continuous perfection of security interests for collateral that is relocated to Australia. Under s 267(3) of the *Personal Property Securities (Corporations and Other Amendments) Act*, if the grantor is a foreign company with a registered office in Australia and the interest is enforceable against third parties under foreign law, and the foreign jurisdiction provides for the registration of interests, then the interest may need to be registered overseas to ensure its survival in a liquidation or voluntary administration.

2.3 Continuation of contracts entered into with the debtor

Neither entrance into external administration nor the execution of a DOCA or Scheme will automatically terminate a contract by operation of statute. However, most contracts include termination clauses which will be triggered by any of those events and the rights can be exercised.

Discretion of insolvency practitioners to terminate contracts

As agents of the company to which they were appointed, both receivers and administrators have the power to repudiate company contracts. A receiver's power of repudiation is more limited than an administrator's, as the former

cannot repudiate a contract where it would impair the realisation of assets or excessively damage the company's business reputation. If a DOCA or Scheme is in place, its terms will dictate the powers of the deed/scheme administrator, and such terms commonly include a repudiatory power. Liquidators have power to disclaim a variety of property, including contracts (although court leave is required for a liquidator to disclaim a profitable contract). Any such disclaimer 'is taken to have terminated…the company's rights, interests, liabilities and property in or in respect of' the contract. The disclaimer, however, does not affect any other person's rights or liabilities under a contract except so far as necessary in order to release the company and its property from liability.

Consequences of repudiation

In insolvency proceedings, when a company repudiates a contract, the counterparty to that contract accrues an action in damages against that company and so becomes an unsecured creditor of the company. Similarly, when a liquidator disclaims contracts or property, a person who has incurred a loss from the disclaimer is 'taken to be a creditor of the company to the extent of any loss suffered by the person because of the disclaimer and may prove such a loss as a debt in the winding up.'

When a company is in voluntary administration or being wound up in insolvency, individuals such as those described above, with a claim against the company are barred from initiating or pursuing such a claim in court without court leave or the approval of an administrator or liquidator (as the case may be). Unless such leave or consent is given, in both circumstances an individual can only lodge a proof of debt with the liquidator or administrator.

Special contracts

Despite the comments above, there are several exceptions to the way that insolvency proceedings will generally affect contracts. Two such examples are purchase contracts subject to retention of title clauses (*ROTC*) and employment contracts.

Where a company enters receivership or liquidation or executes a DOCA, the vendor of property subject to a ROTC will, in general, be able to demand the return of that property. The *Corporations Act*, however, denies owners the right to take back possession of property during an administration, unless they first obtain either the administrators' written consent or leave of the court. In addition, an administrator may dispose of property subject to a ROTC in the 'ordinary course of a company's business,' although the administrator must issue the proceeds of sale to the owner in discharge of the debt owed to the owner under the original contract. This statutory moratorium expires when the administration ends, and an owner is then able to demand the return of its property if it is still in the company's possession.

Insolvency proceedings do not automatically terminate or alter employment contracts (although a company's entrance into liquidation is sometimes considered to be a repudiation of an employee's contract). Nonetheless, wages and other employee entitlements that have accrued prior to insolvency have priority above both unsecured creditors and creditors whose debts are secured by a floating charge.

QUESTION 3

3. Creditors' rights aimed to monitor the insolvency proceedings

3.1 General creditors rights

The purpose of each insolvency proceeding is different. Accordingly, the rights and powers of creditors differ in each proceeding to reflect those varied purposes. For example, the rights of creditors are far more constrained during a receivership, as the primary function of that process is to allow a secured creditor to realise its security in order to recover a debt owed to it. In contrast, creditors are vested with a range of powers in a voluntary administration, including the ability to determine a company's future. The various categories and forums for creditors rights are analysed in more detail below.

3.2 Specific rights of information during the proceeding

Right to receive general periodic reports

The *Corporations Act* imposes numerous reporting obligations on an administrator, receiver or liquidator of a company. In an administration, liquidation and Scheme, reports on the company's affairs are furnished in creditors' meetings. In a receivership, reports must be duly lodged with ASIC.

The Corporations Act imposes various reporting obligations on receivers, including the need to lodge a report from the company's reporting officers with any comments to ASIC. Receivership accounts must also be lodged with ASIC. A failure to perform these obligations is an offence.

In a voluntary administration, the administrator must provide a detailed report when giving a company's creditors notice of the second creditors meeting: that report must set out his or her opinions in a clear manner in order for the creditors to make an informed decision about the fate of the company. The report should contain information about the company gathered from the administrator's investigations, including details about the company's business, property, affairs and financial circumstances.

There are no statutory provisions governing reporting obligations of a deed administrator and therefore the terms of that deed, as agreed to by the creditors, will govern the reporting requirements of the deed administrator. However, administrators are bound by the *Corporations Act* and *Corporations Regulations*, some provisions of which require them to file certain documents within specific time frames.

In a Scheme, a Scheme Booklet must be sent to shareholders by the scheme company which contains certain prescribed information on which shareholders can base their decision as to how to vote on the scheme. This includes disclosure documents such as the Explanatory Statement. If material events occur after the first court hearing, these should also be disclosed at the meeting of members.

In a creditors' winding up, a liquidator must prepare a report summarising the affairs of the company to issue to each creditor with a notice convening the original creditors' meeting. A liquidator of a company that turns out to be insolvent in a members' winding up must also issue a notice (which includes an estimated amount of the creditors' claims) convening a meeting of the company's creditors. At that meeting, the liquidator must also provide a statement of the assets and liabilities of the company.

If a creditors' winding up continues for more than one year, the liquidator must annually either convene a meeting of creditors or lodge a preliminary report with ASIC regarding the status and future of the winding up. This report must contain several details about the winding up, including past and future dealings of the liquidator.

In both a court-ordered and voluntary winding up, a liquidator or provisional liquidator must keep proper books including minutes of proceedings at meetings, and any creditor or contributory may inspect those books unless the court orders otherwise. A liquidator must lodge a report with ASIC in certain circumstances (such as where the company is unable to pay its creditors more than 50 cents in the dollar). Liquidators also have an obligation to keep proper accounts, and, for each six month period of the liquidation, must lodge an account in the prescribed form setting out the receipts and payments made during that period.

3.3 Approval rights not delegated to a creditors' committee

Both a committee of creditors and a committee of inspection (discussed below) can exercise many of the same powers as creditors themselves. This delegation of power seeks to expedite the insolvency process without prejudicing the rights of creditors. However, in general, those rights of approval which most greatly effect the future of a company can only be exercised by the body of creditors. For example:

- In a voluntary administration, only a meeting of creditors can determine whether the voluntary administration should end by returning control to the directors, executing a DOCA or entering the company into liquidation;
- In a voluntary liquidation, only a meeting of creditors may elect the liquidator; and
- Only creditors may agree to a Scheme (though the scheme is not binding until the court makes the relevant order approving it).

QUESTION 4

4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

Creditors' meetings play an important part in insolvency administrations (with the exception of receiverships where no such meetings take place). In particular, these meetings are often necessary to approve the intended conduct of an insolvency practitioner and for the creditors to receive important information regarding an insolvency proceeding.

Creditors' meetings are most significant in voluntary administrations and Schemes. In the former, there are two compulsory meetings of creditors: at the first of these meetings, the creditors determine whether to appoint a committee of creditors (discussed below) and whether to replace an existing administrator. At the second meeting, creditors determine the future of the company. In particular, creditors may determine whether to execute a DOCA, end the administration and return control of a company to its directors, or have the company wound up. If creditors elect to execute a DOCA, a meeting can be called to either vary the terms of the deed or to terminate it and place the company into liquidation. Similarly, a Scheme must be approved at the relevant creditors' meeting to be effective.

In both voluntary and involuntary liquidations, creditors' meetings perform several important functions, although their role is more limited than in either administrations or Schemes. The powers vested in the creditors' meeting also vary between voluntary and involuntary liquidations. Nonetheless, in a winding up generally, a meeting of creditors can:

- approve the liquidator's remuneration;
- authorise the comprising of debts above a certain amount; and
- authorise the formation of contracts beyond a certain duration.

4.2 Creditors' committees

The functions of the committee of creditors and the committee of inspection are to advise and supervise the actions of an insolvency practitioner. These committees provide a practical alternative to calling a general meeting of creditors when an insolvency practitioner requires guidance or approval of his or her conduct. While the role of committees of creditors and inspection are similar, the purpose and powers of each differ. In an administration, creditors can decide at their first meeting whether to form a committee and which of them is to be a member of that committee. Under a DOCA or in a liquidation, creditors can require the formation of a committee of inspection. In the former case, the terms of the DOCA will outline the powers and means of electing that committee. In a winding up, creditors or contributories can require the formation of a committee of inspection. However, only a contributory or creditor, the

attorney of either such an individual, and a person whom a contributory or creditor have authorised in writing can sit on that committee.

The powers and role of the committees of inspection are generally more substantive than that of the creditors' committee. Indeed, the more passive role of the latter is codified in the *Corporations Act* which states that the functions of creditors' committees are:

- to consult with the administrator about matters relating to the administration; and
- to receive and consider reports from the administrator.

The *Corporation Regulations 2001* (Cth) (*Corporation Regulations*) prescribe certain provisions that will form part of a DOCA unless the deed provides otherwise. These provisions delineate a largely advisory role for the committee of inspection, although the terms of DOCA may increase the powers and function of that committee as the creditors see fit.

In a liquidation, the *Corporations Act* endows committees of inspection with a broad range of supervisory powers. Examples include powers to approve:

- a liquidators remuneration;
- the compromising of a debt above a certain amount; and
- entrance into contracts beyond a certain duration.

4.3 Other forms of direct creditors' participation

Other means by which creditors can participate will depend on the relevant winding up process. To use liquidation as an example, aside from creditors' meetings and committees, creditors are also entitled to:

- obtain a court order to inspect the company's books;
- inspect the liquidator's books and records;
- apply to the court to seek determination of any question arising in the winding up; and
- appeal to the court in relation to any act or omission of the liquidator and complain to either ASIC or the court concerning the liquidator's conduct and may apply to have the liquidator removed.

QUESTION 5

5. Creditors' entitlements aimed at controlling the activities of the insolvency representative

Creditors have various entitlements to supervise or control the exercise of an insolvency representative's powers. It should be noted that these differ between privately appointed representatives and court appointed representatives – the latter are officers of the court and accordingly have different duties.

Secured creditors are entitled to set the remuneration of privately appointed receivers and to remove or replace them in accordance with the contractual terms of their appointment. Creditors in court appointed scenarios do not have a right to remove or replace a representative, but may show cause to the court why he or she should be replaced and may apply for a remuneration review where the creditors have a shareholding worth more than 10% of the company's issued capital, or have 10% of the total debts owed by the company.

In a creditors' voluntary winding up, creditors are entitled to remove or replace a liquidator. This is also the case when a members' voluntary winding up reveals that a company is insolvent. In a winding up generally, a court may remove and replace a liquidator on cause shown. Creditors of a company in voluntary administration may apply to have the administrator removed.

In the case of receivers and liquidators, creditors (and others) may apply to the court or ASIC to inquire into the exercise of the receiver's / liquidator's powers and the court/ASIC may take such action as it thinks fit. On application by the company a court may order that a receiver is guilty of misconduct and remove them.

In both court appointed and privately appointed representative scenarios, interested parties (including ASIC) have the power to seek injunctive relief to compel or restrain a representative from undertaking certain activities.

Creditors may also complain to ASIC or the Australian Prudential Regulation Authority (*APRA*) about the conduct of insolvency representatives. The *Australian Securities and Investments Commission Act 2001* (Cth) establishes the Companies Auditors and Liquidators Disciplinary Board (*CALDB*) (Part 11 of that Act, see also Part 9.2 of the *Corporations Act*). The CALDB conducts hearings to determine whether a registered auditor or liquidator has contravened provisions of the *Corporations Act*, has failed to carry out his or her duties and functions adequately and properly, is otherwise not a fit and proper person to remain registered or is subject to disqualification or ineligibility to remain registered. While only ASIC and APRA may apply to the CALDB, the impetus may come from a complaint by a third party (e.g. a creditor) about the conduct of a practitioner which ASIC or APRA then investigates and determines whether to refer it to the CALDB. A recent decision indicates that it is also possible for registered liquidators, while acting as receivers, to be disciplined by the board for their conduct in the receivership.

QUESTION 6

6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

In Australia, practitioners generally calculate their remuneration based on an hourly rate. However, there is no comprehensive and binding system under statute or otherwise that dictates how an insolvency practitioner is to calculate that remuneration. Nonetheless, the Insolvency Practitioners Association of Australia (*IPA*), of which many such practitioners are a member, publishes a code that includes provisions on practitioners' remuneration which the IPA's members are expected to follow. In particular, that code states that an insolvency practitioner is only entitled to remuneration for work done that was 'necessary' and 'properly performed'.

Authorising bodies

The security documents entitling a secured creditor to appoint a receiver will normally stipulate the quantity of a receiver's remuneration and that the company is responsible for such remuneration. In contrast, the remuneration of both voluntary and deed administrators is determined by the relevant committee, a creditors' resolution or the court. In both a court-ordered and a creditors' voluntary winding up, a committee of inspection will normally determine a liquidator's remuneration. However, if that committee does not make such a determination, it may also be made by a resolution of the creditors or, in a court-ordered liquidation, by the court. In a Scheme, the Scheme itself will determine the Scheme administrator's remuneration. Administrators and liquidators must prepare a report setting out such things to assist the relevant committee or creditors in making an informed assessment and a summary of major tasks performed. The court is empowered to review the remuneration awarded to an insolvency practitioner in any of the above proceedings.

Priority and Liens

Insolvency practitioners generally have a right to be indemnified for any remuneration owing to them by the company to which they were appointed (in addition, privately appointed receivers often enter into a contract of indemnity with the secured creditor that appointed them). In addition, those practitioners will have either a statutory or equitable lien over certain assets of a company (although a voluntary administrator has both) in respect of the remuneration owing to them, and these liens will often take priority over secured creditors. If such a lien is insufficient to satisfy the remuneration owed to a liquidator, voluntary administrator or deed administrator, then those practitioners must rely upon the priority given to their remuneration under the Corporations Act, which places those debts above those of unsecured creditors.

BRAZIL

Introduction

Brazil's insolvency system has undergone a major change in 2005 with the enactment of Law 11,101/2005 (Brazilian Bankruptcy Law or BRL) which replaced the previous outdated law (Decree Law 7,661 of 1945) that had governed insolvency and liquidation procedures for sixty years. Basically, the Brazilian Bankruptcy Law, which became effective on June 9, 2005 attends the needs of market sectors by, among other innovations, introducing the institute of judicial recovery.

The Brazilian Bankruptcy Law replaces the old law and establishes two new recovery procedures: the judicial and extra-judicial recovery procedures. The extra-judicial recovery is an option to be used before the judicial recovery procedure and it allows the debtor to negotiate and agree directly with the creditors a plan for its financial recovery. The judicial recovery allows the debtor to propose a recovery plan to rescue a company from financial crisis. Its main objective is to preserve the company and prevent its liquidation. The *falência* is an insolvency proceeding for the collection, disposition and liquidation of estate assets carried out by a court appointed trustee (the *administrador judicial* or judicial administrator) followed by a *pro rata* distribution.

The main objectives of the Brazilian bankruptcy law are:

- Protection of honest debtors through a proceeding that governs the rehabilitation of the company, known as the recovery procedure (akin to US Chapter 11); with emphasis on negotiation between creditors and debtors so that under its management the enterprise is able to continue as a productive unit of the national economy;

- Acceleration of the liquidation procedure (akin to US Chapter 7) of a debtor that fails to meet the requirements of the recovery procedure;

- Adoption of protective procedures (akin to the automatic stay) such as temporary moratorium for recovery proceedings;

- Appointment of a disinterested, independent administrator and/or a committee to oversee, but not replace, the debtor's management in a recovery proceeding;

- Reformulation of the judiciary's role in the recovery procedure as a supervisor of the negotiations between creditors and debtor;

- Reclassification of priorities of claims and credits; and

- Establishment of a summary recovery proceeding for smaller organizations.

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

Both the debtor and creditors can request to a court that the debtor be liquidated. A creditor can request the declaration of the debtor's liquidation if the debtor, among other things, as per article 94 of the Brazilian Bankruptcy Law:

- not pay, when due and without good cause, the amount represented in a valid bond or document, provided the amount is higher than 40 minimum monthly wages;
- in case of a collection suit for any net amount, when the debtor does not pay or does not make a deposit, and does not provide adequate assets for attachment within the legal term;
- liquidates its assets in a wasteful or fraudulent way in order to make payments;
- to defraud creditors or delay payments to them by carrying out fraudulent activities;
- transfers the establishment to a third party, without all the creditors' consent and without keeping enough assets to settle the debts;
- does not fulfil, within the term, the obligations assumed in the judicial recovery plan.

1.2 Appointment of a judicial administrator

(a) An adjudication of corporate bankruptcy / liquidation. In liquidation the debtor and its administrators are no longer responsible for carrying out business activities. A court-appointed trustee (the judicial administrator) is chosen to collect, dispose of and liquidate the debtor's assets and distribute its proceeds to creditors.

The judicial administrator can, in certain cases, take a semi-management role since the company's contracts are not terminated on liquidation and can be fulfilled by the judicial administrator if this either reduces or avoids an increase in the bankruptcy estate's liabilities, or if necessary to maintain and safeguard the bankruptcy estate's assets.

(b) The commencement of a formal corporate rescue process. During the judicial recovery procedure the debtor and its administrators are generally responsible for carrying out business activities under the inspection of the creditors' committee (if any) and the judicial administrator. The recovery plan may call for the removal of the debtor and its administrators. The

courts can also remove the company's administrator if he or she does not perform his or her duties according to the law and the recovery plan.

During the judicial recovery procedure, the judicial administrator supervises the company's activities and its compliance with the judicial recovery plan; the judicial administrator presents monthly reports on the debtor's activities to be filed with the court; and the creditors can opt to elect a creditors' committee to inspect the debtor's activities; the debtor's compliance with the judicial recovery plan; and the accounts of the judicial administrator.

(c) The initiation of an informal corporate rescue process. - During the extra-judicial recovery procedure the debtor and its administrators are responsible for carrying out business activities.

The creditors are not involved in the nomination of a judicial administrator, as the Bankruptcy Law has not foreseen any other party to participate in the picking procedure other than the judge. The judicial administrator, then, who is appointed by the court is responsible for managing the process in all these situations. The judicial administrator's main responsibilities include:

- claims;
- the legal steps of the process, such as calling a general creditors' meeting;
- recommendations for court decisions; and
- at general creditors' meetings.

In bankruptcy the judicial administrator is responsible for the collection and disposal of the assets and the distribution of the proceeds according to the priorities established in law.

In both judicial and extra-judicial recovery, the management remains responsible for managing the day-to-day business. If there is evidence of fraud the court may replace the management.

The creditors are entitled to form a committee to oversee the process. However, despite having significant influence over the process, the committee cannot interfere directly with the management of the company and its decisions are not binding on creditors.

1.3 Packaged insolvencies

The extra-judicial recovery procedure was disallowed by the old Brazilian bankruptcy law. The debtor can use the extra-judicial recovery procedure to solve a liquidity problem by proposing to his creditors payment extensions or reductions in the amount of the debt. This procedure aims to give clarity and safety to the negotiations, provided that all creditors receive the same treatment. The extra-judicial plan does not rearrange the company. It is only a negotiation between the debtor and some of his creditors, as not every creditor is obliged to approve the plan or join the out-of-court agreed payments arrangements.

There is also no need for a general meeting to discuss the plan, because this kind of agreement depends on a previous proposal for a reduction or an extension of the payment of the debts.

The extra-judicial recovery procedure allows the debtor to negotiate and agree directly with its creditors a plan for its financial recovery (it can request its creditors for a reduction in, or an extension for the payment of, the debts payable). This procedure cannot be used to recover debts relating to tax, labour relations and accidents in the workplace, or if the creditor is the fiduciary owner of movable and immovable assets. The extra-judicial plan cannot include the anticipated payments of debts or the unfavourable treatment of the creditors that are not subject to the plan. As with the judicial recovery, only entrepreneurs and private companies can apply to the courts for a judicial recovery procedure. The bankruptcy law does not apply to State-owned companies, joint stock companies (*sociedades de economia mista*), financial institutions, credit unions, consortiums, pension funds, healthcare institutions, insurance companies or capitalisation companies.

The debtor must comply with the pre requisites set out in section 48 of the law to propose and negotiate with the creditors an extra-judicial recovery plan. In order to do so it must:

- have been in business for at least two years;
- have never been declared bankrupt, or if it has been declared as such, the liabilities arising out of the bankruptcy have been declared terminated by a court ruling that is final and conclusive;
- not have been granted a recovery procedure within the previous five years; and
- not have been convicted, as manager or controlling quotaholder or shareholder, of any of the crimes provided by the Brazilian Bankruptcy Law. The Brazilian Bankruptcy Law (BRL) does not stipulate a fixed term for the extra-judicial recovery procedure. It is estimated to take up to three months.

The debtor can request the court's ratification of the extra-judicial recovery plan, which binds all the creditors if it is executed by creditors owed more than three-fifths of all debts (BRL, section 163).

After receiving the request for approval of the extra-judicial recovery plan, the court publishes it in the official gazette and in a national newspaper of sufficient distribution (or in the newspaper distributed where the debtor's headquarters and branches are located). This is to notify all creditors and enable them to dispute the extra-judicial recovery plan. The plan binds all the creditors involved once judicially ratified. Approval of the plan does not suspend the creditors' rights, or any cases or execution proceedings against the debtor's assets nor does it protect the debtor against any liquidation request.

Once all obligations in the extra-judicial recovery plan are performed, the debtor files a final report and the procedure is terminated.

1.4 Cross-border insolvencies and specific country rights

The Brazilian Bankruptcy Law does not contain any cross-border insolvency rules. However, local courts can rule on insolvency cases in relation to the Brazilian branch of a company that has its headquarters abroad (BRL, section 3).

However, Brazil is not party to any international treaty on insolvency procedure and/or cross-border insolvency rules, which is still a major obstacle for foreign creditors or even national creditors seeking to seize assets outside the country.

The bankruptcy law does not provide special procedures for foreign creditors, but sets out specific requirements such as paragraph 2 of section 97, which requires creditors without a domicile in Brazil to deposit a judicial bond for court costs and indemnify the courts if the request is later ruled as a deceitful request for liquidation.

QUESTION 2

2. Creditors' rights aimed to meet claims

2.1 Filing a claim

Once the filing for judicial recovery occurs, the judge may or may not grant the processing of the judicial recovery. The list of creditors provided in § 1 of Section 7 of the law is published in the official gazette. Two separate deadlines begin to elapse as of the ruling that grants the processing of the judicial recovery: (i) the 15 days deadline for the creditors to request the inclusion of their credits not mentioned in the list and or to state that the values listed are incorrect, and (ii) the 60 days deadline for company in judicial recovery to present its recovery plan.

The filings of the credits recovery claims (or proofs of claims) requires, minimum types of documents, although some are indispensable such as invoices, receipts or any official documents evidencing a crediting relation between the bankrupt party and the creditor. A creditor without residency in Brazil must be represented by a Brazilian attorney and all claims must be filed in Portuguese.

2.2 Privileges for secured claims

The most common types of secured credits are mortgage, pledge and fiduciary sale.

In the judicial recovery procedure, these credits are paid in the order that is proposed in the judicial recovery plan.

However, in the liquidation procedure, the Brazilian Bankruptcy Law has intended to protect creditors by means of having them classified in a preference order so as to receive their credits. Articles 83 and 84 of the Bankruptcy law set out the order in which creditors are paid in the liquidation procedure:

- **Section 84 -** The following are defined by the law as "extra concourse" (*extra concursal*) credits, are paid before the debts specified in section 83 (see below) and in the order listed: the legal administrator's (and his assistants') remuneration and debts payable under labour legislation or as a result of accidents at work, only the ones which occur after the declaration of the debtor's bankruptcy; amounts supplied to the bankrupt estate by the creditors (for example, a creditor may supply money to the bankruptcy estate to pay for the liquidation costs); legal costs of lawsuits and executions in which the bankrupt's assets are involved; costs resulting from valid judicial acts (which have not been ruled null and void by the bankruptcy court) carried out during the judicial recovery period and after the declaration of bankruptcy (for example, a sale of a asset that has not been challenged).

- **Section 83 -** Debts under this section are paid in the following order: debts due under labour legislation (limited to a maximum of 150 minimum wages per creditor; and any surplus is received as unsecured credit) and those resulting from accidents at work; debts secured by a real guarantee (for example, a mortgage or a pledge) up to the value of the property offered in guarantee; tax credits (excluding tax fines); claims of creditors with special privilege (those recognized by civil and commercial law as having a special privilege and those having the right to retain specific assets given as a guarantee); claims of creditors with a general privilege (for example, *Civil Code*, section 965 mentions credits from funeral expenses); claims of unsecured creditors; contractual fines and pecuniary penalties for breaches of criminal or administrative law, including tax fines; and claims of subordinates creditors (those that have been subordinated by law or agreement, and debts of partners and administrators with no employment relationship with the liquidated company).

Hence, in the liquidation procedure, the secured credits have privilege in the order of payment of their debts.

Moreover, the creditors are able to retrieve any property of their own located in the debtor's facilities as in accordance to the Brazilian Bankruptcy Law in its article 85 that foresees the possibility of the owner of an asset which is in the possession of the debtor at the time the bankruptcy is decreed filing for the restitution request before the court that granted the bankruptcy ruling.

It must be stated that in the event the asset is no longer physically available, for example, should it have been sold by the debtor, then the creditors, under the terms of the Brazilian Bankruptcy Law, shall be eligible to claim for a cash compensation, after the fulfilment of the payments related to the payment of labor wages that are stated in article 151 of the Bankruptcy Law.

2.3 Continuation of contracts entered into with the debtor

The Brazilian Bankruptcy Law provides two different treatments for the continuation of contracts entered into with the debtor depending on the procedure that was adopted.

In the judicial recovery, under the terms of the Article 49, second paragraph of the Brazilian Bankruptcy Law, obligations undertaken before the judicial recovery will remain under the conditions which were originally contracted, unless the judicial recovery plan sets forth differently.

Hence, contracts entered into with the debtor will normally continue being valid. However, the judicial recovery plan approved by the creditors may set out new terms and conditions to the contracts.

In the liquidation procedure, the Brazilian Bankruptcy Law provides that the bilateral contracts do not rescind due to the bankruptcy and can be fulfilled by the judicial administrator if such fulfilment reduces or avoids the increase of the liability of the bankrupt state or if it is necessary to the maintenance and safekeeping of its assets, upon authorization to be granted by the Creditors' Committee.

Therefore, the assessment by the judicial administrator about the benefits and prejudices resulting from the continuation of contracts to the bankrupt state is a decisive factor to determine if the contract is to be fulfilled or not.

In case the continuation of the contract is regarded as an undermining factor that may worsen the debtor's present difficult situation, then the contract shall be considered terminated and the creditor may seek its rights through the filing of a claim in the liquidation procedure.

2.4 Cross-border and specific country entitlements

The Brazilian Bankruptcy Law does not set forth any different or uneven treatment for foreign creditors to meet claims, except the compulsory need of being represented by a Brazilian registered attorney.

QUESTION 3

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3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

The Brazilian Bankruptcy Law guarantees several rights to the creditor during the entire course of the insolvency proceedings.

Any creditor is entitled to object to the recovery plan presented by the debtor. If even one creditor objects to the recovery plan, then the judge must call upon a general assembly of creditors to approve the plan (or not). Should the

recovery plan not be approved in this general assembly of creditors then the judge must rule in favour of the liquidation of the debtor company.

Moreover, a creditor can file the proofs of claims to habilitate its credits in an insolvency proceeding if a credit is not included in the list of creditors filed by the judicial administrator.

Furthermore, the creditor can file a challenge to correct the amount of his credit in the event that the value of the credit is not accurate.

3.2 Specific rights of information during the proceeding

The creditors have the entitlement to be informed by the judicial administrator about several relevant issues (e.g. the date of the request for the judicial recovery or of the ruling of the liquidation, the nature, the value and the classification of the credit).

In addition, the creditors can request that the judicial administrator give any information relating to the insolvency proceeding.

Creditors have also the right to inspect the court dockets.

3.3 Approval rights not delegated to a creditors' committee

The creditors' meeting must be made up of the following classes of creditors: owners of credits derived from labour legislation or labour accidents; owners of security interests; and, owners of subordinated credits with special, general or subordinated privileges.

All classes must approve the judicial recovery plan.

The general rule is that the proposal must be approved by creditors representing more than half of the total value of credits present at the meeting and cumulatively by the simple majority of creditors present. In the class of owners of credits derived from labour legislation or labour accidents, the proposal must be approved by the simple majority of creditors present, irrespective of the value of their credits.

3.4 Cross-border and specific country rights *(entitlements)*

According to Brazilian Bankruptcy Law, both local and foreign creditors are treated in the same manner.

QUESTION 4

4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

The recovery plan must be submitted for approval to the creditors. Any creditor can object to the plan within 30 days from the publication of the creditors' list (BRL, section 55). If a creditor objects, the courts must require the creditors to hold a meeting within 150 days counted from the granting of the processing of the judicial recovery. The court must rule the company bankrupt if the recovery plan is not approved.

4.2 Creditors' committee

Brazilian Bankruptcy Law does not provide for a mandatory Creditors Committee.

If the creditors opt to form one, then the Creditors' Committee may have a minimum of three and a maximum of eleven members. Its composition is divided in the following order: (i) one representative designated by the class of the labour credits, with two deputy members; (ii) one representative designated by the class of credits secured by a real guarantee or with special privilege, also with two deputy members; and (iii) one representative designated by the class of unsecured credits or with general privilege, with two deputy members as well.

Some of the powers of the Creditors Committee are listed as follows:

- supervise and examine the accounts of the judicial administrator;
- look after the good development of the process and ensure compliance with the law;
- inform the Judge in the event violations of rights or prejudice to creditor's interest or if a threat of these violations is detected;
- verify and issue report on any complaints of the interested parties.

The members of the Creditors Committee are not paid by the debtor or by the estate. The only exception in which the member of the Committee shall receive money for the costs incurred occurs when it is properly supported and upon the judge's authorization (when there is availability of funds).

4.3 Other forms of direct creditors' participation

The Brazilian Bankruptcy Law guarantees to the Creditors only these two means (General Meeting and Creditors' Committee) to actively participate in the insolvency proceeding.

4.4 Rights related to reorganization plans and proceedings

The court can authorise the judicial recovery based on a plan that has not been approved in the form provided above if, in the same meeting of creditors, it is approved in a cumulative form by: creditors representing more than half the value of all credits present in the meeting, irrespective of the classes; two classes of creditors in accordance with the terms provided above (or where there are only two classes of voting creditors, the approval of at least one of them); and in the class with a negative vote, the favourable vote of at least one-third of the creditors, counted in accordance with the provisions of the general rule mentioned above.

The judicial recovery procedure lasts for two years. The recovery plan approved by the creditors specifies the terms and the deadlines for the payment of the outstanding claims which can surpass these two years.

The judicial recovery procedure prevents a liquidation taking place. The debtor can continue to run its business under supervision of an independent administrator (or an administrator and a committee) and the court, while it arranges to pay its debts to the creditors (BRL, sections 22 and 52). The credits are stayed once the court grants the processing of the recovery procedure. This ruling is later confirmed by a ruling that grants the recovery of the company according to the approved recovery plan.

4.5 Cross-border and specific country rights

Creditors who are not resident in Brazil may be appointed as members of the creditors committee.

QUESTION 5

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5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

Any creditor will assess and may challenge any infringement of the law on the part of the judicial administrator. Example: Article 22, third paragraph, of the Law foresees that the judicial administrator cannot, without judicial authorization, deliberate on the obligations and rights of the bankrupt estate and grant debt reduction, even if the debt is considered difficult to be received.

The judicial administrator can be substituted by request of the debtor, any creditor or the Public Prosecutor's Office based on non-compliance of the law breach of duty, omission, negligence or harmful act to the debtor or third parties.

5.2 Substitution of the insolvency representative

The debtor, any creditor or the Public Prosecutor's Office may request the judge to replace the insolvency representative (judicial administrator).

However, the request to replace the judicial administrator must be based on clear disobedience of the law. The judge shall decide within twenty-four hours of such request.

The judge can dismiss (*ex officio*) the judicial administrator in case of disobedience of law, breach of duty, omission, negligence or harmful act to the debtor or third parties.

As soon as an office bearer is dismissed the judge appoints a new judicial administrator.

5.3 Cross-border and specific country rights (entitlements)

The foreign creditors have the same right and means that national creditors have to control the activities of the judicial administrator.

QUESTION 6

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6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

Concerning the administrator's remuneration, the judicial administrator is remunerated in accordance with the debtor's capacity for payment, the complexity of the work and the market prices. The amount of its remuneration shall be determined by the judge presiding the case. The total amount paid to the judicial administrator cannot exceed 5% of the total value of the claims subject to the judicial recovery or of the amount acquired in the sale of assets in a bankruptcy.

6.2 Funding special activities of the insolvency representative *(liquidator)*

The debtor (or the assets of the debtor company) shall be responsible for the payment of the remuneration of the judicial administrator and all persons eventually hired to assist him.

The Brazilian Bankruptcy Law does not provide that a creditor be directly responsible for bearing with the expenses related to the judicial administrator.

However, as the debtor pays the amount of the judicial administrator's remuneration, in the event of the liquidation of the company, the creditors are affected by this expense. In this case, the creditors are indirectly responsible for financing the activities of the judicial administrator, as an amount equivalent to 60% (sixty percent) of the administrator's remuneration shall be paid

coincidentally with the payment of the general class of creditors.
Creditors may challenge the figure of the administrator when being called on to receive their credits. Brazilian Bankruptcy Law provides preference to the payment of remuneration by the judicial administrator in order to provide an incentive to good professionals to undertake this type of activity, that involves dealing with several risk factors.

6.3 Specific country entitlements

Foreign creditors are equally obliged to disclose relevant information to the judicial administrator concerning issues related to the insolvency procedures.

BRITISH VIRGIN ISLANDS

Introduction

The BVI insolvency regime has been considered by some to be essentially a creditor friendly one. The Insolvency Act 2003 ("the Act") and the Insolvency Rules 2005 ("the Rules") provide the legislative framework which is largely responsible for the jurisdiction earning this characterization. Within that framework there are a number of insolvency mechanisms available in the BVI namely: liquidation, creditor arrangements, receivership, administrative receivership and (possibly in the future) administration. It should be noted that the administration regime under Part III of the Act, which allows insolvent companies to be reorganised and refinanced, supported by a statutory moratorium has not yet come into force and it appears that it is unlikely to be brought into force in the near future.

The companies covered under the Act and Rules are companies registered under the BVI Business Companies Act 2004 and companies registered under the International Business Companies Act, which were re-registered as BVI business companies on 1 January 2007. Licensed entities such as banks, trust companies and investment funds are subject to the same proceedings as BVI business companies, except for the additional requirement of notice to the relevant regulator. There are separate provisions for licensed BVI insurance companies, which we do not intend to address in this article.

Before considering insolvency proceedings in the BVI, we should first consider what 'insolvency" means, as a matter of BVI law. A company is insolvent if: (i) it fails to comply with a statutory demand; (ii) an execution or process issued on a judgment, decree or order of the BVI court in favour of a creditors is returned wholly or partly unsatisfied; (iii) the value of the company's liabilities exceed its assets (the established balance sheet test); and (iv) the company is unable to pay its debts as they fall due (the established cash flow test).

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

1.1.1 Court appointed liquidator

A creditor may initiate the corporate insolvency process by serving a statutory demand on the debtor company in the sum of at least US$2,000 that being the prescribed minimum. Non-compliance with the statutory demand within 14 days of the debtor being served, results in the debtor company being 'deemed' to be insolvent. This period within which the debtor can satisfy the debt or apply to the Court to have the statutory demand set aside is non-negotiable. It cannot be extended. Recent judicial determinations have explored the extent to which a debtor who fails to challenge a statutory demand can raise arguments as to the validity of the debt at the stage when the application to appoint a liquidator is determined.

In addition to the insolvency ground, a Company may also be liquidated by the Court if it is satisfied that it is just and equitable to do so, or that it is in the public interest.

1.1.2 Members' appointed liquidator

The members of an insolvent company may appoint a liquidator by a resolution passed at a properly constituted meeting of the company by a majority of 75 per cent, or if a higher majority is required by the Memorandum and Article of Association, by that higher majority, of the votes of those members who are present at the meeting and entitled to vote on the resolution.

It is important to note that a resolution to appoint a liquidator by the members of a company would be void and of no effect if:

- an application to the Court to appoint a liquidator has been filed and served but not yet determined;
- a liquidator has been appointed by the Court; or
- the person to be appointed liquidator has not consented in writing to his appointment.

1.2 Choice of the insolvency representative

Whilst the appointment of the liquidator is made by the Court, the applicant / creditor may propose a liquidator to the Court. In reality, the applicant always proposes the intended liquidator. That proposed liquidator must be an 'eligible person', that is an insolvency practitioner licensed to practice in the BVI. A notice of eligibility and consent to act signed by the proposed liquidator must be attached to the supporting documentation.

If there is already a creditors' arrangement in place, the court may appoint the supervisor of the arrangement as liquidator of the company.

1.3 Packaged insolvencies

The concept of the "pre-pack" is not a widely recognised one in the BVI, largely on account of the fact that most BVI Companies that are subject to restructuring are holding entities. In principle, there is, however, no objection to them, although as noted above, given the lack of an effective administration/moratorium provision, it can be appreciated that the scope for using such mechanisms is inherently more limited than might otherwise be the case. Subject to proper discharge of the duties of a mortgagee BVI receivership offers a potential route to effecting a pre-pack solution.

1.4 Cross-border insolvencies and specific country rights

Whilst the BVI is not a signatory to any treaties on international insolvency, the Act has adopted the United Nations Commission on International Trade Law ("UNICTRAL") Model Law on Cross-Border Insolvency. That said, those provisions are not presently in force, and again, it is not anticipated that this state of affairs will change anytime soon.

Nevertheless, the rights of creditors who reside in the BVI and those outside of the jurisdiction are the same. Once the liquidator is appointed by the Court and he has called for claims to be submitted to him, it does not matter where the debt was incurred or what law governs it. Of course whether a debt actually exists is a matter for the proper law of the debt to determine, but once the creditor has an existing debt then a claim can be made in the liquidation.

Even where the assets of the debtor company are relocated outside of the BVI (as is most frequently the case in this jurisdiction) such assets fall within the scope of the liquidator's powers. The only hurdle for him at that point, is obtaining recognition of his authority abroad, but the Courts in common-law jurisdictions will generally recognise a liquidator of a foreign company appointed by the court of the place of incorporation as having the authority to administer the assets of the debtor company worldwide.

If a BVI company has been wound up by a foreign court, it can nevertheless still be placed in liquidation in the BVI by either the appointment of a liquidator by the court or by the members. It is considered that only the liquidation of the company in its place of incorporation (that is, the BVI) will generally be regarded as finally winding up the company. It is of course open for the foreign liquidator to apply to the BVI courts for the recognition of his authority as liquidator.

Other insolvency mechanisms specified under the Act are also available to a BVI company which is in liquidation abroad, and these regimes by themselves will not negate the foreign liquidation of the company although on a practical level, it can be anticipated that conflicts might arise as to control of particular assets.

QUESTION 2

2. Creditors' rights aimed to meet claims

2.1 Filing a claim

Where the liquidator of a company has sufficient funds to make a distribution, after taking into consideration the sums that may be necessary for his remuneration and the other costs and expenses of the liquidation, a notice is sent to the creditors of the company, fixing a date on or before which creditors are to submit their claims to him.

A specific claim form is provided in the rules and it sets out the total amount of claim as at the date of appointment of liquidator; particulars of how and when debt incurred; details of documents by reference to which the debt can be substantiated; and particulars of any security held, the value of the security and the date it was given. It is the liquidator's responsibility to send the claim form to each creditor he is aware of at the time. The claim form must be signed by the creditor or on his behalf and returned to the liquidator.

Where a creditor does not submit a claim by the date specified in the notice he is excluded from the benefit of any distribution on or after that date that is made before he submits his claim. The liquidator would have discharged his burden by placing a notice in the appropriate publications to ensure that it is widely advertised. If he can be proved to be negligent a creditor may have a cause of action against him on those grounds, but not otherwise. Thereafter, when the creditor makes a late claim and it is accepted by the liquidator, the creditor is entitled to be paid, out of any money available for distributing a further dividend, and he should be paid before that money is used to distribute a further dividend to creditors.

It is up to the liquidator to reject or accept the claim, in whole or in part, and if he rejects it, the liquidator must provide a notice to the creditor stating the reasons for rejecting the claim.

2.2 Privileges for secured claims

A liquidator will apply the proceeds of the realised assets and pay creditors in the following order:

(a) creditors secured by a fixed charge or mortgage out of the proceeds of the asset subject to the fixed charge or mortgage;

(b) the liquidator's costs and remuneration;

(c) preferential creditors;

(d) all other claims; and

(e) interest on claims.

2.2.1 Secured creditors

The Act expressly provides that liquidation does not affect the rights of secured creditors to enforce their security.

Creditors who can establish valid retention of title and other proprietary claims will be entitled to look to their security, irrespective of the making of a liquidation order. A secured creditor may opt to either value the assets subject to the security interest and claim in the liquidation of a company as an unsecured creditor for the balance of its debt; alternatively it may choose to surrender its security interest to the liquidator for the general benefit of creditors and claim in the liquidation as an unsecured creditor for the whole of his debt. Of course it may decide to take neither route.

If a secured creditor omits to disclose his security interest when submitting a claim in the liquidation of a company, he surrenders his security interest for the general benefit of the creditors.

2.2.2 Preferential creditors

Preferential claims include the following:

Government

- sums due to the government in respect of any tax, duty, including stamp duty, licence fee or permit; and
- sums due to the Financial Services Commission of the British Virgin Islands.

Non-government

- wages and salaries owing to present or past employees that are due during the period of six months immediately prior to the winding up of the company;
- amount due to the BVI Social Security Board in respect of employees' contributions deducted from the employee and in respect of employer's contributions payable for the six months immediately before the liquidation date; and
- amount due in respect of pension contributions or contributions in respect of medical insurance payable during 12 months immediately before the liquidation date.

The Act provides that so far as the assets of a company in liquidation available for payment of the claims of unsecured creditors are insufficient to pay the costs and expenses of the liquidation in accordance with the prescribed priority and the preferential creditors, those costs, expenses and claims have priority over the claims of chargees in respect of assets that are subject to a floating charge created by the company and shall be paid accordingly out of those assets.

Most companies incorporated in the BVI will not be operating from within the BVI and therefore the likelihood of preferential creditors arising other than fees payable in respect of annual fees for maintenance of the company is generally low.

2.2.3 Unsecured creditors

It is a central principle of BVI insolvency law that unsecured creditors share in the assets available to them *pari passu*.

2.3 Continuation of contracts entered into with the debtor

On the application of a person who is, as against the liquidator of a company, entitled to the benefit or subject to the burden of a contract made with the company, the Court may make an order rescinding the contract on such terms as to payment by or to either party of damages for the non-performance of the contract, or otherwise as the Court considers just. Otherwise, and subject to any express contractual stipulation to the contrary, liquidation does not of itself affect the operation of any outstanding contractual obligations of or enjoyed by a BVI company.

2.4 Cross-border and specific country entitlements

In relation to security interests, the proper law of the instrument that creates the security governs the right of enforcement and the legislation does not add to those rights or detract from them. Certain foreign jurisdictions may impose limitations on the rights of secured creditors to enforce their security in insolvency and, if the assets over which the security is granted are situated there, questions are likely to arise as to whether the secured creditor is subject to such limitations.

QUESTION 3

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3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

Creditors are entitled to file their claims with the appointed liquidator, and if a creditor's claim is not rejected by the liquidator, he is entitled to inspect the claims which have been submitted to the liquidator.

Before the date of the first creditors' meeting, the creditor may request and receive from the liquidator a list of the creditors of the company known to the liquidator; and any other information concerning the affairs of the company that the liquidator is reasonably able to provide.

After the distribution of a dividend, each creditor participating in that dividend is entitled to receive from the liquidator a statement with respect to the company's assets and affairs, so as to enable the creditors to understand the calculation of the amount of the dividend.

3.2 Specific rights of information during the proceeding

3.2.1 Right to examine court documents

There is no right under BVI law automatically entitling a creditor to obtain disclosure of documents filed in insolvency proceedings. A creditor may however under the Rules request a copy of the application from the applicant.

If a creditors' arrangement has been proposed or accepted, a copy of the application must be sent to the interim supervisor or supervisor appointed in respect of the arrangement or the proposed arrangement.

3.2.2 Right to be heard

Once an application has been made to appoint a liquidator over a company, the applicant must advertise the application at least seven days before the hearing date. This advertisement which is placed in the newspaper and Gazette gives creditors the opportunity to file and serve a notice of intention to appear at the hearing, stating their entitlement to do so, the amount of debt owing and

whether their appearance will be to support or object to the application. The Act and Rules do not specify where the newspaper advertisement should appear, but in addition to a local BVI newspaper, applicants are well advised to also consider advertising in publications that appear where creditors are likely to be located.

If a creditor fails to file and serve his notice on the applicant within the time frame allowed, he may seek leave from the Court to appear at the hearing for the appointment of the liquidator.

The hearing of an application to appoint a liquidator is invariably held in open court to where the public are admitted, a creditor or its representative may attend the hearing; subject to the above, it may also formally appear.

If the applicant proposes as liquidator the supervisor of an established creditors arrangement, the supervisor must send a notice to each creditor of the company stating that an application has been made for the appointment of a liquidator of the company and that he has been proposed to be appointed liquidator; and he must advise the creditor of the date fixed for the hearing of the application. The creditor may respond to the notice for example if he wishes to raise any objections.

Claims submitted by unsecured creditors may be amended or withdrawn by the creditor at any time before the liquidator has admitted it. The Court may on application by a creditor expunge or amend an admitted claim if it is satisfied that the claim should not have been admitted or should be reduced.

3.2.3 Right to receive periodic general report

The liquidator is required to prepare a preliminary report covering, to the best of his knowledge and belief the amount of capital issued, subscribed and paid up; the assets and liabilities of the company; and if the company has failed, the causes of the failure. A copy of this report must be sent to each creditor. It is not uncommon for the Order appointing a liquidator to require him to provide periodic reports on the course of the liquidation, however these tend to be reports to the Court, and not to creditors.

3.2.4 Right to inspect company documents

At any time after the appointment of a liquidator of a company, a creditor may make an application to the Court to grant an order for the inspection of specified books, records and documents of the company that are in its possession; other than that, there is no general right.

3.2.5 Right to enforce liquidator's duties

If a liquidator fails to file any notice, return, account or other document, a creditor may serve a notice on the liquidator requiring him to remedy the default. If the liquidator fails to remedy the default a creditor may apply to the Court for an order that the liquidator remedy the default within such time as the Court may specify.

3.3 Approval rights not delegated to a creditors' committee

The creditors' arrangement which will be discussed below is the only regime provided under the Act whereby any kind of acceptance of compromise agreements or proposals by the creditors can be made.

3.4 Cross-border and specific country rights *(entitlements)*

Foreign creditors have the same entitlements as local creditors.

QUESTION 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

The first creditors' meeting is usually called within 21 days of the appointment of the liquidator. However the liquidator is not obligated to call a creditors meeting if he considers given the state of affairs of the company it is not necessary for a meeting to be held.This decision can be overturned however, if 10 per cent in value of the creditors give written notice to the liquidator within 10 days of receiving his notice, that they require a meeting to be called. A list of the creditors supporting the requisition, showing the amounts of their respective claims; and the written confirmation of each creditor on the list that he supports the requisition should accompany the notice.

At this first meeting if the creditors are dissatisfied with the liquidator, they can vote to appoint someone in his place and also form a creditors committee.

The quorum for a meeting of creditors is at least one creditor entitled to vote.

The majority required for the passing of a resolution at a creditors' meeting is in excess of 50 per cent in value of the creditors present in person or by proxy who vote on the resolution.

A creditor who wishes to vote at a creditors' meeting must give written notice of his claim to the liquidator and any proxy that he intends to be used on his behalf. The votes of a creditor are calculated on the value of the creditor's claim. A creditor may not vote in respect of a claim for an unliquidated or undetermined amount. A secured creditor is entitled to vote only in respect of the balance, if there is any, of his debt after deducting the value of his security interest.

If the liquidator or chairman of the creditors meeting decides that a creditor cannot vote for whatever reason, then the creditor may appeal to the Court to reverse his decision.

4.2 Creditors' committee

4.2.1 Nomination

A resolution to establish a creditors' committee and also appointing the first members of the committee may be passed at the first creditors meeting. Where the liquidator is satisfied that a creditors' committee has been validly established he must file a notice with the Court to that effect. The notice should specify the names and addresses of the persons appointed to the creditors' committee. Until such time as the notice is filed the creditors' committee, cannot act.

A person is eligible to be a member of the committee if he is a creditor and has consented to serving on the committee. If a creditor's claim has been rejected by the liquidator, he cannot serve on the committee. A creditors committee consists of at least three but no more than five individuals. The chairman of a creditors committee should be the liquidator.

The creditors' committee ceases to exist on the termination of the insolvency proceeding in which it was appointed.

4.2.2 Functions

The functions of a creditors' committee are to:

- consult with the liquidator about matters relating to the insolvency proceeding;
- receive and consider reports of the liquidator; and
- assist the liquidator in discharging his functions.

A creditors' committee may also call a meeting of creditors; require the liquidator to provide the committee with such reports and information concerning the insolvency proceeding or request his attendance before the committee to provide it with such information and explanations concerning the insolvency proceeding as it reasonably requires. A creditors' committee cannot give directions to the liquidator.

Where a liquidator disposes of any assets of the company to a person connected with the company, he should notify the creditors' committee of such disposition.

4.2.3 Voting mechanisms

A meeting is quorate if notice of the meeting has been given to all members and a majority of its members are present at the meeting. Each member has one vote and a resolution is passed by a simple majority of those members who are present and vote.

The committee may agree procedures for the participation by members in meetings by telephone or other electronic means; and the passing of circular resolutions.

4.2.4 Remuneration of the member of the committee

The members of the creditors committee are entitled to reimbursement for their expenses. The 'reasonable' travelling expenses of members directly incurred in attending a meeting of the creditors' committee shall be paid by the liquidator out of the assets of the company, or as an expense of the insolvency proceeding. Where the liquidator is of the opinion that a meeting of the creditors' committee called by a member was unreasonably called he may refuse to pay members' expenses. The creditors may then pass a resolution that the expenses should be paid by the liquidator out of the assets of the company, or as an expense of the insolvency proceeding.

4.3 Other forms of direct creditors' participation

There are no other forms of direct creditors' participation outlined in the Act or Rules, although of course individual creditors may well have direct communications and dealings with the liquidator on any individual issues. There is also provision under the Act for any party who is dissatisfied with the acts or omissions of a liquidator to apply to Court for directions. We address this further below.

4.4 Rights related to reorganization plans and proceedings

Creditors' Arrangement

A creditors' arrangement is a procedure which enables a company to compromise liabilities with creditors. It is very flexible and can vary or cancel debts; it may provide for the whole or partial cancellation of a liability of the company in return for shares of any kind or for the issue by the company, or by any other person, of a debenture or a security interest; or relate to an amendment of the company's memorandum or articles that affects the likelihood of the company being able to pay a debt or satisfy a liability. An arrangement does not affect the rights of secured or preferential creditors without their written consent. There is no moratorium on creditor rights and no Court involvement.

A proposal for a creditors' arrangement may be made by the board on the basis that it believes the company is insolvent or likely to become insolvent or by the liquidator. If the company is being wound up, the liquidator may also make a proposal for a creditors' arrangement and appoint another eligible insolvency practitioner as the interim supervisor or as is usually done, act as the interim supervisor himself. The creditors nor members of a company do not have any standing to propose an arrangement.

The interim supervisor must call a creditors meeting to consider the arrangement within 28 days of his appointment. He must prepare a written report on the proposal, and send each creditor, member and director a copy of it, along with a copy of the proposal, and a copy of the company's statement of affairs.

If the creditors approve the arrangement by 75% in value of those present at the meeting, the arrangement takes effect. The arrangement then binds all creditors of the company (including dissenting creditors) and creditors who were not present at the meeting or who did not have notice of it.

After the approval of an arrangement the board or liquidator, puts the supervisor into possession of the assets included in the arrangement so that he may carry out his duties, which may include:

- promptly discharging any sums due to the liquidator under the Act or the Rules; or
- provide the administrator or liquidator with a written undertaking to discharge any such sums out of the assets as soon as practicable;
- discharge any sums due to the preferential creditors;
- discharge all guarantees properly given, or obligations properly entered into, by the liquidator for the benefit of the company or in the course of his duties;
- pay the liquidator's outstanding remuneration.

The supervisor should also keep accounting records, recording and explaining the receipts, expenditure and other transactions relating to his acts and dealings in and in connection with the arrangement, and prepare reports concerning the progress and efficacy of the arrangement.

If a creditor believes that an approved or modified arrangement unfairly prejudices him he may make an application to the court to revoke or suspend any decision made approving or modifying the arrangement.

Some of the drawbacks of this arrangement and factors that limit its utility is that the arrangement does not affect the rights of secured or preferential creditors without their written consent and there is no moratorium on creditor rights. There is little to no court involvement in a judicial capacity unless some difficulty or disagreement arises.

The arrangement will terminate upon completion of the arrangement, at which point notice is given to the company, the members, the creditors and the Registrar of Corporate Affairs, together with a report summarising the receipts and payments.

4.5 Cross-border and specific country rights

Any creditor resident or not in the BVI may be appointed as members of the creditors committee.

QUESTION 5

5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

A liquidator, whether appointed by resolution of the members or by the Court, acts as an officer of the Court, not of the creditors. He is the agent of the company in liquidation.

Any person who is aggrieved by an act, omission or decision of the liquidator may apply to the Court on that bases and the Court may confirm, reverse or modify the act, omission or decision of the liquidator.

5.2 Substitution of the insolvency representative

5.2.1 Creditors' meeting

At the first creditors' meeting, the creditors may appoint a liquidator in the place of the liquidator appointed by the members. An application must then be made to the Court to sanction this decision.

5.2.2 Court removal

On application by a creditor, or creditors' committee, the Court may remove a liquidator from office if the liquidator:

- is not eligible to act as an insolvency practitioner in relation to the company;
- breaches any duty or obligation imposed on him by or owed by him under this Act or the Rules; or
- fails to comply with any direction or order of the Court made in relation to the liquidation of the company; or

the Court is satisfied that:

- the liquidator's conduct of the liquidation is below the standard that may be expected of a reasonably competent liquidator; or
- the liquidator has an interest that conflicts with his role as liquidator.

5.2.3 Death or resignation

Where the liquidator of a company dies or resigns, an application may be made by the creditors committee to the court to appoint an eligible insolvency practitioner in his place.

5.2.4 Official Receiver

Where the Official Receiver has been appointed to act the liquidator in any of the situations addressed above, he may call a meeting of the creditors to have them resolve that an eligible insolvency practitioner may be appointed in his place.

5.3 Cross-border and specific country rights (entitlements)

Foreign creditors have the same entitlements as local creditors. The exercise of their controlling rights is not prohibited by their being out of the jurisdiction as many of them may appoint legal representatives to act on their behalf and keep them informed of the liquidators' actions.

QUESTION 6

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6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

Where a liquidator of a company is appointed and, at the date that the application was filed, an arrangement was being supervised by a supervisor, the remuneration of the supervisor is a first charge on the assets of the company.

The remuneration of a liquidator is fixed by the creditors' committee, if any exists or by the Court after the conclusion of the insolvency proceeding, though interim payments may be arranged.

If a creditor believes that the sum fixed by the creditors' committee is excessive, he may with the concurrence of at least 25% in value of the creditors apply to the Court for an order reducing the remuneration fixed. In the event that the creditors' committee fails to fix the liquidator's remuneration, or the liquidator considers that the remuneration, or an interim payment, fixed is insufficient or unacceptable he may make the same application to the court or no committee exists, he may make an application to the Court to fix his remuneration, or to fix an interim payment.

The members of the creditors' committee or, the creditors given notice of the hearing, may appear and be heard at the hearing of the application.

6.2 Funding special activities of the insolvency representative *(liquidator)*

The creditors do not usually fund the insolvency proceedings. However in the event that the debtor company has insufficient assts to cover the costs of the insolvency proceedings, the applicant/creditor will frequently be called upon to do so, pursuant to the terms of any indemnity that it has provided to the liquidator upon his appointment.

6.3 Specific country entitlements

There is no provision under the Act or Rules for the State to fund to insolvency proceedings.

CANADA

Introduction

Insolvency law in Canada provides a mechanism for the orderly liquidation of the assets of an insolvent person, and the structure for restructuring an insolvent person's business. Canada is a federal state in which governance is constitutionally divided between national (federal) jurisdiction and provincial jurisdiction. Insolvency law falls under the sphere of federal jurisdiction. The two main statutes governing insolvency law in Canada are the *Bankruptcy and Insolvency Act* ("BIA") and the *Companies' Creditors Arrangement Act* ("CCAA"). In addition to these two statutes, there is a third, less frequently used statute, the *Winding-Up and Restructuring Act*, which governs the winding-up of federally-incorporated banks or insurance companies. As all three statutes are federal, they apply across Canada. However, given the interplay with varying provincial property law statutes, and prevailing interpretive views of the provincial judiciary, there is some variation in how these three statutes actually operate in each province.

The most pronounced variation in provincial law is found in the Province of Québec, which is a civil law jurisdiction. Federally, and in all other Canadian Provinces, common law applies.

Canada's insolvency legislation offers a high level of flexibility in a corporate restructuring. Generally speaking, and in restructuring (as opposed to liquidation) proceedings in particular, the court has broad statutory discretion and inherent jurisdiction to make such orders it deems necessary and appropriate in an insolvency proceeding. However, amendments to Canada's insolvency legislation which came into effect in 2009 have placed certain limits on judicial discretion and have created certain "super-priority" priority rights in respect of employment claims.

The BIA provides a framework for the liquidation of a bankrupt entity's assets, and the fair and orderly distribution of the proceeds of liquidation among the bankrupt's unsecured creditors. The BIA also permits a debtor to file for protection from its creditors and to submit to them a proposal (a "BIA Proposal") with respect to the restructuring of its affairs. The CCAA is most commonly used for more complex corporate restructurings (a debtor cannot qualify for relief under the CCAA unless it has aggregate indebtedness in excess of CDN$5,000,000.) It allows corporations to obtain court-ordered protection against some or all of its creditors while it attempts to restructure its business and affairs. The object of both BIA Proposal proceedings and CCAA proceedings is to facilitate a compromise between the debtor and its creditors that is approved by both the creditors and the court. Given that this publication primarily deals with small to medium sized businesses, this chapter will focus more on the BIA than the CCAA.

Question 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

Under the BIA, an "insolvent person" may be any person, including a corporation (excluding banks, insurance companies, trust companies, loan companies or railway companies), a partnership, a cooperative society, an individual, or an unincorporated association, who is not bankrupt[1] and who resides or carries on business or owns property in Canada, whose liabilities exceed CDN$1,000 and who is unable to meet its obligations as they come due or the aggregate of whose property is insufficient to meet all of its obligations.

The most common forms of insolvency proceedings are: (i) BIA liquidation; (ii) BIA reorganization; (iii) CCAA reorganization; and (iv) court-appointed or private receivership (receiverships do not necessarily involve the insolvency of the debtor, but as a practical matter this is usually the case). In the Province of Quebec, private receiverships are not available; however, a secured creditor may apply to the court for the appointment of a person to be designated by the Court to proceed with the sale of assets charged with the creditor's security, in accordance with the *Civil Code of Quebec*.

Outside of insolvency proceedings, unsecured creditors generally must obtain a judgment and execute on the judgment in order to make recovery on their claims against the debtor. In some cases, unpaid suppliers may seize goods for a limited period of time.

Also prior to insolvency proceedings, secured creditors may attempt to enforce and realize their security interest in the collateral. The BIA requires a secured creditor to send a notice of intention to enforce security to the debtor, giving the debtor ten calendar days to effect payment. In enforcing its security, a secured party must comply with the applicable provincial laws with respect to both personal and real property, including statutory notices in many cases.

In a BIA Proposal scenario, the debtor attempts to restructure its debt by way of a Proposal made to its creditors. In most cases, this is initiated by the debtor filing a notice of intention ("NOI") to make a proposal with the Superintendent of Bankruptcy (a federal governmental entity that oversees the operation of Canadian bankruptcy and insolvency proceedings). After the NOI is filed, both secured and unsecured creditors are stayed from commencing or continuing proceedings against the debtor for the recovery of claims for 30 days. The debtor may apply to the court for extensions of the stay of proceedings for up to 45 days at a time, subject to an aggregate limit of six months. Before the stay of proceedings expires, the debtor must file its Proposal and present it at

[1] The BIA defines a "bankrupt" as a person who has made an assignment into bankruptcy or against whom a bankruptcy order has been made or the legal status of that person. Furthermore, while an insolvent person can become a bankrupt, the definition of an "insolvent person" specifies that an insolvent person cannot concurrently be a bankrupt.

a meeting of creditors; if no Proposal is filed, the debtor is automatically bankrupt. The Proposal must identify the specific classes of creditors who will vote on its acceptance; generally speaking, creditors who are in the same or a similar legal position with respect to claims on the debtor's assets will be placed in the same class.

In order to be approved by creditors, the BIA Proposal requires the support of the majority in number and two-thirds majority in dollar value of claims for each class of creditors that are voted in person or by proxy at the meeting of creditors. If the requisite statutory majority is obtained, then the Proposal is presented to the Court for approval. If a class of secured creditors does not support the Proposal, then a successful Proposal is not binding on that class of secured creditors. On the other hand, if a class of unsecured creditors or the court rejects the Proposal, then the debtor is deemed to have made an assignment into bankruptcy. In practice, the support of secured creditors is very important. Secured creditors often hold security over all of the debtor's assets so, without their support, the insolvent person is unable to effect a restructuring.

While a BIA Proposal is initiated by the debtor, there are certain tools that creditors can employ in order to initiate a BIA liquidation process. As stated above, unsecured creditors may reject a Proposal which leads to the debtor becoming a bankrupt as it is thereby deemed to have made an assignment in bankruptcy. Under the BIA, unsecured creditors may also petition the Court to issue a bankruptcy order against a debtor. Secured creditors may not petition the Court for a bankruptcy order unless they first release their security or if they are unsecured for a portion of the debt owing by the debtor; consequently, secured creditors usually proceed by way of receivership in order to recover their claims.

CCAA proceedings are almost invariably initiated by the insolvent entity filing a Petition with the Court seeking an Initial Order that, *inter alia*, creates a stay of proceedings. Similar to a BIA Proposal, in CCAA proceedings the debtor attempts to make a plan of compromise or arrangement (a "CCAA Plan") with its creditors, under a process which is similar in many ways to the BIA Proposal process, including with respect to statutory voting thresholds and Court approval once creditor approval is obtained.

1.2 Choice of the insolvency representative

The most common form of insolvency proceeding is a liquidation bankruptcy under the BIA. An individual, sole proprietor, a partner or a corporation can become bankrupt as follows by:

- making a voluntary assignment into bankruptcy;
- the failure of Proposal proceedings, either because a Proposal is not filed before the stay of proceedings expires, or the creditors or the Court do not approve the Proposal; or
- creditors, or creditors petitioning the Court to make a Bankruptcy Order declaring the insolvent person bankrupt.

Once an insolvent person is bankrupt, all of the property of the bankrupt vests in a licensed trustee in bankruptcy (a "Trustee") who is charged with the administration of the bankrupt's estate. The Trustee is responsible for liquidating the bankrupt's assets, subject to the rights of secured creditors. The appointment of a Trustee does not affect the ability of secured parties to enforce their security. When an insolvent person makes a voluntary assignment into bankruptcy, they usually select their own Trustee. In an involuntary bankruptcy scenario, the Trustee is either appointed by the Court (often on the recommendation of the creditor that is petitioning the debtor into bankruptcy) or is appointed by the official receiver, who is a federally appointed civil servant under the office of the Superintendent of Bankruptcy.

The Trustee, after accepting an appointment, must perform its required statutory duties until discharged or replaced. The BIA provides that the Trustee should not act as a trustee in bankruptcy in certain circumstances, including: (i) if the Trustee was an officer or director of the debtor, or was in a employment relationship with the debtor or any of its officers or directors; (ii) the Trustee was an auditor, accountant, solicitor, or partner or employee of such parties of the debtor during the past two years; (iii) the Trustee is also the trustee under any trust indenture issued by the debtor or a person related to the debtor or is related to the Trustee under a trust indenture; and (iv) the Trustee is also acting as Trustee, receiver or liquidator for another party that is related to the debtor. Despite the foregoing, the Trustee may be permitted to act in certain of the above scenario if approval of the Court is obtained, or if there is full disclosure prior to appointment.

If a secured party wishes to enforce its security and realize upon the collateral, the secured party may appoint a private receiver (also called an instrument appointed receiver) if such appointment is permitted under the terms of the security agreement. As mentioned above, privately receivers are not available in the Province of Quebec, but a secured creditor may apply for the appointment of an officer in order for it to enforce its security and have the assets subject to such security sold by judicial authority. The secured party may also apply to court for a court-appointed receiver. The receiver takes possession of, and sells, the assets charged by the security agreement. Proceeds of the sale are distributed by the receiver, after paying the costs of the receivership, to the secured creditors in accordance with their priorities, with the remaining balance (if any) paid into Court or to unsecured creditors on a *pari passu* basis. Except in the Province of Quebec, a private receiver may be converted into a court-appointed receiver upon application to the Court.

In CCAA proceedings, it is mandatory under the legislation that the Court appoints a Monitor as the Court's officer to supervise, assist with, and report to the court and creditors on the restructuring proceedings. The Monitor must be a licensed bankruptcy Trustee. Similarly, in Proposal proceedings under the BIA, the debtor appoints a Proposal Trustee which is the Court's officer in the proceeds; unlike a bankruptcy Trustee, the debtor's assets typically do not vest in a Proposal Trustee. In both CCAA and BIA Proposal proceedings, the debtor is a "debtor in possession" and maintains possession and control of its assets and undertaking.

1.3 Packaged insolvencies

Packaged insolvencies, or "pre-packaged" insolvencies are relatively common in Canada. These usually arise when an otherwise viable business finds itself burdened by too much debt, or when a formal insolvency process will provide certain benefits for a pre-arranged sale or restructuring of a debtor's assets or business. In pre-packaged insolvency proceedings, whether receivership, bankruptcy, BIA Proposal or CCAA proceedings, the goal is to enter the proceedings with the end goal already formulated and the necessary transaction terms already settled, with a view to completing the transaction as quickly as possible, within the context of the insolvency proceeding. Common reasons for a pre-packaged insolvency include: taking advantage of tax benefits provided in the relevant insolvency process; using the statutory voting process to "cram down" on minority creditors; restructuring the debtor's balance sheet; taking the benefit of a vesting order made by the Court to avoid third party claims to assets; and taking advantage of certain reversals of creditor priority rankings provided by the BIA.

1.4 Cross-border insolvencies and specific country rights

Under the BIA, the definition of an insolvent person provides that they must either reside, carry on business, or own property in Canada. However, Canadian insolvency law covers all assets of an insolvent person, not just those situated in Canada. Furthermore, Canadian insolvency law does not make any legal distinction between Canadian and non-Canadian creditors. Therefore, foreign creditors are not excluded and are full participants in Canadian insolvency proceedings.

Canadian insolvency law has taken account of cross-border issues and the BIA and CCAA have both been amended to include many features of the UNCITRAL Model Law on cross-border insolvencies. The CCAA is available to companies incorporated in Canada, and to companies incorporated or formed outside of Canada but who carry on business in Canada. Specifically, the BIA will recognize that foreign proceedings will operate in conjunction and concurrently with Canadian proceedings. Moreover, the BIA permits the court to restrict the application of Canadian proceedings to Canadian assets, if foreign proceedings have already been initiated.

Given Canada's proximity and close economic ties to the United States, insolvency proceedings often occur with businesses that operate or own assets in both Canada and the United States. As with other countries, issues arising for Canadian insolvency proceedings include the recognition of Canadian Courts' decisions in jurisdictions were the assets are situated, and the choice of law as determined by the Courts. Generally, speaking, there is a highly cooperative attitude as between Courts in the United States and Canada, and recognition of one another's proceedings is common, as are joint hearings and coordinated, cross-border restructuring plans, particularly in CCAA proceedings.

Question 2

2. Creditors' rights aimed to meet claims

Under Canadian insolvency law, a distinction is made between those who have proprietary rights against assets held by the debtor and those who have personal rights (debt claims) against the debtor. Those with proprietary rights, such as secured creditors, may operate outside of the BIA regime, but those with debt claims only, such as unsecured creditors and unpaid workers, must operate within the BIA regime in the event of insolvency.

Secured creditors need to take account of the notice requirements in the insolvency statutes and comply with the applicable provincial laws with respect to personal and real property when enforcing their security and realizing upon their collateral security. As discussed further below, unsecured creditors must also establish their claim prior to participating in any liquidation process.

Both the BIA and the CCAA provide for claims processes in which both secured and unsecured creditors may prove their claims with the applicable insolvency representative.

2.1 Filing a claim

In a liquidation bankruptcy, an unsecured creditor must file a proof of claim with the Trustee if it wishes to participate in the division of assets of the bankrupt. Without filing a proof of claim, the creditor will not be able to participate in the liquidation proceedings nor vote in any meeting of creditors. Creditors typically file their claims as early as possible as distribution of assets may take place on a rolling basis with "interim dividends" paid as assets are liquidated, and late filing creditors will not be able to retroactively participate in earlier distributions. Secured creditors who are "undersecured" may prove the unsecured portion of their claim in the bankruptcy, in order to participate in any dividends made to unsecured creditors.

In a bankruptcy, the bankrupt submits a statement of affairs to the Trustee. In the statement of affairs, all of the bankrupt's creditors are listed. The Trustee mails claims forms to the creditors listed in the statement of affairs. Concurrently, the Trustee places a notice of bankruptcy in a local newspaper and mails claim forms to creditors who respond directly to the advertisement. It is not necessary for creditors who are outside of Canada to have a Canadian domicile as the Trustee will mail claims forms directly to any foreign address listed in the statement of affairs. After a completed proof of claim form has been submitted to the Trustee, the Trustee reviews it and either allows the claim, requests further information, or rejects it in whole or in part. Claims which are allowed by the Trustee can be challenged by the bankrupt or by another creditor through an application to the court. In such application, the applicant may ask the court to either reduce the amount of the claim or reject the entire claim. As well, for creditors whose claims were reduced or rejected by the Trustee, the BIA provides a streamlined process for resolving disputed claims on a summary basis by application to the Court.

If a creditor's claim is rejected by the Trustee through a notice of disallowance, the creditor may challenge such notice to the court within 30 days of receiving the notice. If a claim is partially accepted by the Trustee, but the creditor feels that the valuation of the claim is too low, the creditor may also challenge the notice of valuation to the court within 30 days of receiving the notice. In BIA Proposal and CCAA proceedings, creditors have similar rights to challenge partial or full disallowances of their claims, as discussed in more detail above.

Under Canadian insolvency law, the time that a claim originates is of utmost importance, as only claims that are in existence at the date of bankruptcy or the filing of the NOI (including contingent, future or unliquidated claims) are provable claims. For the reason noted above, a claim does not need to be filed by the creditor prior to the first creditors' meeting, but it is advisable to do so.

In a BIA Proposal proceeding, creditors file their claim with the Proposal Trustee under a process similar to that followed in a liquidation bankruptcy. Similarly, in a CCAA proceeding the Court typically makes a Claims Process Order under which a similar process for proving claims is followed. The main conceptual difference in BIA Proposal and CCAA Proceedings (as opposed to bankruptcy proceedings) is that it is the debtor that reviews and either accepts or rejects claims, not the Proposal Trustee or Monitor, who generally provide only an administrative function with respect to collecting and processing claims.

2.2 Privileges of secured claims

Secured creditors are not affected by a liquidation bankruptcy, and generally may enforce their security without impediment. The assets secured as collateral are not included in the pool of assets under the control of the Trustee, except to the extent that there is equity in those assets. As noted above, a secured party may still elect to participate in the bankruptcy as an unsecured creditor if, and to the extent that, it is not fully secured. The secured party may decide to participate in the BIA proceedings either before or after enforcing its own security.

Given the interplay between the federal insolvency statutes and provincial personal and real property laws, secured creditors may find themselves ranking subsequent in priority to certain other parties, such as the Crown, employees or landlords in certain circumstances. One common benefit to secured creditors of a bankruptcy is that upon bankruptcy, the scheme of priority as outlined in the BIA takes effect, which will often result in certain claims that outside of bankruptcy would have super-priority under provincial law, being subordinated to the claims of secured creditors.

In CCAA proceedings, secured creditors are generally stayed from enforcing their security. In BIA Proposal proceedings, secured creditors are initially stayed, but if the debtor chooses to make a Proposal only to unsecured creditors, then the stay is lifted with respect to secured creditors.

2.3 Continuation of contracts entered into with the debtor

When an insolvent person attempts a reorganization by commencing BIA Proposal proceedings, creditors who have an agreement with the debtor to provide goods, services or use of leased property to the insolvent person are

stayed from terminating their agreement with the debtor, even where the agreement, by its terms, provides that insolvency proceedings or other pre-filing defaults trigger a right to termination of contracts. Creditors cannot, however, be forced to extend further credit to the debtor after the filing date, and will usually require that the debtor pay for goods and services on a COD basis during the post-filing period. Furthermore, if the debtor defaults under an agreement with the third party during the post-filing period, the third party can apply to the court for permission to terminate the agreement.

In CCAA proceedings, suppliers of goods and services are subject to similar restrictions on their ability to terminate agreements on account of pre-filing defaults by the debtor.

In both CCAA and BIA Proposal proceedings, third parties who do not have existing agreements with the debtor on the filing date generally are not required to continue to supply goods and services.

In a liquidation bankruptcy, although the Trustee takes title to all of the bankrupt's assets, including its contracts, the Trustee is subject to the rights of contractual counterparties to terminate, in accordance with the terms of such contracts. There is no stay of proceedings with respect to terminate. There is one exception to this rule: the Trustee has the right to assign commercial leases of the bankrupt (where the bankrupt is the tenant), subject to certain rights of the landlord to object to the assignment by application to the Court.

2.4 Cross-border and specific country entitlements

Canadian insolvency legislation is considered to be universal in application, in that its reach is not restricted to Canada. As long as the debtor qualifies for the definition of "insolvent person" under the BIA, foreign creditors may apply for relief under the BIA even if the obligations owing are governed by foreign law and even if there are no defaults on obligations owing to Canadian creditors.

While the Court will apply Canadian insolvency law with respect to the insolvency process after proceedings have been commenced in Canada, the Court may also apply the laws of another jurisdiction when faced with certain issues. The most prominent issue relates to the establishment of a claim. For example, the Court may need to apply the laws of another jurisdiction in order to confirm the validity of a contract which purports to create the obligation. The BIA and CCAA do not contain provisions with respect to the application of foreign laws. Therefore, the Court will look to the common law on conflict of laws. As well, the choice of law rules of private international law will be of assistance.

While Canadian insolvency legislation is universal in application, the Court may decline to exercise jurisdiction in certain situations. If the Court determines that the proceedings have limited connection to Canada while concurrent foreign proceedings have already commenced, the Court *may* decline jurisdiction. However, Canadian proceedings have operated concurrently with foreign proceedings in many matters, and the Court will only decline jurisdiction where concurrent proceedings will create inefficiency in the overall administration of the insolvency.

Question 3

3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

The Canadian insolvency regime gives creditors certain control over insolvency proceedings through voting mechanisms and other powers. However, Canadian insolvency law balances creditors' control with that of the Trustee, who is a quasi-governmental official. In BIA Proposal and CCAA proceedings, the interests of the debtor and other stakeholders (including employees, the community, customers, etc.) are also balanced against the interests of the creditors.

The government controls the education, licensing and supervision of bankruptcy trustees, and through this, the insolvency regime manages and counterbalances potentially excessive creditor control of insolvency proceedings. All of that said, there are many cases where it is clear that the creditors, and particularly secured creditors, are the only party with any economic interest in the debtor and its assets, and in those cases the balancing of interests will generally reflect that fact.

3.2 Specific rights of information during the proceeding

Under Canadian insolvency law, creditors are entitled to receive information from the Trustee pertaining to the bankrupt person's assets. At the first meeting of creditors (discussed further below), the Trustee must report to the creditors as to (i) the condition of the assets, (ii) the money on hand, and (iii) the particulars of any assets of the bankrupt. In addition, creditors may require the Trustee to provide a report at any time. The Trustee is charged with certain record keeping duties, and must allow creditors the opportunity to examine such records.

Upon completion of bankruptcy proceedings, the Trustee must tender a final report in the form of a final statement of receipts and disbursements. This report must contain the following information:

(i) all moneys received by the Trustee out of the property of the bankrupt;

(ii) the amount of interest received;

(iii) all moneys disbursed and expenses incurred;

(iv) the remuneration claimed by the Trustee; and

(v) the particulars of all property of the bankrupt that has not been sold and the reasons why it was not sold.

In CCAA and BIA Proposal proceedings, creditors have a general right to make enquiries of, and seek information from, the debtor and the Monitor or Proposal

Trustee, as the case may be. The Monitor or Proposal Trustee, as the officer of the court, has a general duty to assist creditors with specific information requests, where the request is fair and reasonable. The debtor, Monitor, Proposal Trustee or any creditor may also, if necessary, apply to the Court for directions, an Order, or a declaration with respect to whether and in what manner the information sought should be provided.

In addition to the foregoing, the BIA sets out specific duties of the Proposal Trustee, including certain mandatory reporting and filing matters in connection with the debtor's BIA Proposal and the BIA Proposal proceedings generally. In CCAA proceedings the Initial Order made by the Court will impose certain obligations on the Monitor to report to the Court on the proceedings generally, review and approve sales of assets and other actions by the debtor, and assist generally with the formulation and implementation of the debtor's CCAA Plan.

3.3 Approval rights not delegated to a creditors' committee

In Canada, the practice of appointing a creditors' committee is uncommon. There have been some creditors' committees appointed in the context of CCAA proceedings, but this is a matter of judicial discretion as there is no statutory provision for creditors' committees in the Canadian legislation. However, in a liquidation bankruptcy, the creditors may appoint inspectors of the bankrupt estate, who represent the creditors and are given certain approval rights with respect to actions proposed and taken by the Trustee. See below for further discussion of the appointment and role of inspectors.

3.4 Cross-border and specific country rights (*entitlements*)

Canadian insolvency legislation does not discriminate between Canadian and foreign creditors. As such, it is not necessary for foreign creditors to establish or maintain a Canadian presence in order to participate in the insolvency proceeding or be entitled to receive materials or notices relating to the proceeding.

Question 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

In a liquidation bankruptcy, within five days of its appointment, the Trustee must call a first meeting of creditors by distributing a notice of meeting. The meeting itself must be held within 21 days of the appointment of the Trustee.

The chair of the first meeting of the creditors is the official receiver from the Superintendent of Bankruptcy, or its designate (usually the Trustee). Under a directive of the office of the Superintendent of Bankruptcy, the Trustee tenders a preliminary report on the status of the bankrupt estate.

At the first meeting of creditors, the creditors may confirm the appointment of the Trustee and may also appoint up to five inspectors of the bankrupt estate. The inspectors supervise the Trustee's administration of the estate. Certain decisions to be made by the Trustee must first receive the approval of the board of inspectors. Inspectors may be creditors or non-creditors; however, a party cannot be an inspector if it is a party to an contested action by or against the estate of the bankrupt.

Although the Trustee may call a meeting of creditors at any time, there are usually no additional meetings after the first meeting of creditors. However, the Trustee must call a meeting of creditors upon direction from the Court, by a request from a majority of the inspectors or by creditors who represent 25% of the number of creditors and who hold at least 25% of the value of the proven claims.

In a CCAA or BIA Proposal context, creditors usually do not formally meet until they are required to vote on the CCAA Plan, or the BIA Proposal. Once the CCAA Plan or BIA Proposal has been prepared and filed with the Court, the Monitor or Proposal Trustee, as the case may be, sends a copy of it to the creditors along with certain information regarding the particulars of the creditors' meeting to vote upon it. It is common, and usually prudent, for the debtor to discuss the terms of the CCAA Plan or BIA Proposal, as the case may be, with key and major creditors before it is filed.

4.2 Creditors' committee

As noted in Section 3.3 above, in Canada, the practice of appointing a creditors' committee in the CCAA context is uncommon. In the United States, the appointment of an official creditors' committee is authorized by Chapter 11 of Title 11 of the U.S. Bankruptcy Code ("Chapter 11"); however, the CCAA is silent on the appointment of such a committee in Canadian proceedings. Where such a committee is appointed in CCAA proceedings, this is done under the Courts' inherent jurisdiction and statutory discretion.

While inspectors in a BIA context may perform duties that are similar to what creditors' committees perform in a Chapter 11 context (or might perform in a CCAA context), they are actors in different regimes. Moreover, while inspectors may in essence be a "committee of creditors" in a BIA context, there are instances where non-creditors are appointed as inspectors. In such situations, the inspectors would not be a "committee of creditors".

4.3 Other forms of direct creditors' participation

In CCAA proceedings, creditors have an effectively unlimited right to come back to the Court to ask for any specific relief, or for changes to any Order made by the Court in the proceedings, particularly with respect to the provisions of the Initial Order, which is almost always made on an *ex parte* application.

Through the appointment of the inspectors, the creditors in a bankruptcy liquidation context, have a significant role in the liquidation process. Many of the decisions required in a bankruptcy liquidation must be approved by the inspectors, including any decision to:

(i) sell or otherwise dispose of for such price or other consideration as the inspectors may approve all or any part of the property of the bankrupt, including the goodwill of the business, if any, and the book debts due or growing due to the bankrupt, by tender, public auction or private contract, with power to transfer the whole thereof to any person or company, or to sell the same in parcels;

(ii) lease any real property or immovable;

iii) carry on the business of the bankrupt, in so far as may be necessary for the beneficial administration of the estate of the bankrupt;

(iv) bring, institute or defend any action or other legal proceeding relating to the property of the bankrupt;

(v) employ a barrister or solicitor or, in the Province of Quebec, an advocate, or employ any other representative, to take any proceedings or do any business that may be sanctioned by the inspectors;

(vi) accept as the consideration for the sale of any property of the bankrupt a sum of money payable at a future time, subject to such stipulations as to security and otherwise as the inspectors think fit;

(vii) incur obligations, borrow money and give security on any property of the bankrupt by mortgage, hypothec, charge, lien, assignment, pledge or otherwise, such obligations and money borrowed to be discharged or repaid with interest out of the property of the bankrupt in priority to the claims of the creditors;

(viii) compromise and settle any debts owing to the bankrupt;

(ix) compromise any claim made by or against the estate;

(x) divide in its existing form among the creditors, according to its estimated value, any property that from its peculiar nature or other special circumstances cannot be readily or advantageously sold;

(xi) elect to retain for the whole part of its unexpired term, or to assign, surrender, disclaim or resiliate any lease of, or other temporary interest or right in, any property of the bankrupt; and

(xii) appoint the bankrupt to aid in administering the estate of the bankrupt in such manner and on such terms as the inspectors may direct.

4.4 Rights related to reorganization plans and proceedings

Under the BIA, an insolvent person may file for creditor protection by filing with the Superintendent of Bankruptcy a Notice of Intention to Make a Proposal. As noted above, in order to be successful a BIA Proposal requires the support of the majority in number and two-thirds majority in dollar value of the claims voted for each class of creditors at the creditors' meeting, as well as court approval (subsequent to approval by the creditors). If a class of secured creditors does not support the BIA Proposal, then it is not binding on that class

of secured creditors. On the other hand, if a class of unsecured creditors or the court rejects the BIA Proposal, then the debtor is deemed to have made an assignment into bankruptcy. A BIA Proposal is usually, but not always, relatively quick and inexpensive as compared to proceedings under the CCAA. In particular, the BIA provides smaller companies with less complicated business structures a relatively inexpensive and predictable mechanism to restructure their business. However, the BIA is more specific in its provisions governing BIA Proposals, as compared with the CCAA which grants the Court and the debtor more flexibility and discretion.

Under the CCAA, a debtor files for creditor protection by filing a Petition with the Court seeking an Initial Order which, among other things, creates an initial 30-day stay of proceedings as against creditors and other third parties and appoints the Monitor to supervise the process for the Court and the creditors. Various Canadian provinces have standard "model orders" for initial CCAA applications, which may be altered as required in the circumstances, and with the specific approval of the Court. This "initial application" may be *ex parte* but as a practical matter the debtor usually gives key creditors and stakeholders some notice of the application. The debtor may apply for additional extensions to the stay of proceedings, and unlike in BIA Proposal proceedings, there is no statutory limit on the total length of the stay. Within the CCAA proceedings, the debtor may file a CCAA Plan with its creditors, which the designated classes of creditors vote on at a meeting of creditors that is ordered by the Court. The statutory voting thresholds are the same as in a BIA Proposal: a majority in number and two-thirds majority in dollar value of the claims voted for each class of creditors at the creditors' meeting. As with a BIA Proposal, a CCAA Plan requires court approval by way of a Sanction Order.

While creditors in a liquidation bankruptcy can appoint inspectors, the supervisory functions in CCAA or BIA Proposal proceedings are carried out by the Monitor or Proposal Trustee, as the case may be, and by the Court. Creditors in restructuring proceedings have several bargaining tools at their disposal: they may vote against the proposed compromise, and they may ask the court to terminate the restructuring proceedings on the basis that the proceedings are, in whole or in part, unfair, in bad faith, doomed to fail, or otherwise not calculated or likely to benefit the creditors as a whole.

As noted above, CCAA proceedings are more flexible than BIA Proposal proceedings. However, this flexibility comes with a price tag. During CCAA proceedings, not only does the corporate debtor have to pay for its own counsel, it must also pay for the fees of the Monitor, the Monitor's counsel, and (in some cases) counsel for the secured parties.

During the course of CCAA and BIA Proposal proceedings, a debtor may be able to arrange debtor-in-possession ("DIP") financing, which provides working capital to the corporate debtor to allow it to keep operating while in the process of restructuring. Usually, the Court will approve of the granting of first ranking security priority to DIP financiers. Creditors may object to the DIP financing on the basis that it is prejudicial to their security position or prospects for recovery, but generally speaking, the Courts will allow DIP financing if it is satisfied that the benefit of the DIP financing (in terms of preserving or facilitating the creation of going concern value) is likely to outweigh the costs of the financing.

4.5 Cross-border and specific country rights

As noted above, Canadian insolvency legislation does not discriminate between Canadian and foreign creditors. If a foreign creditor cannot attend the first or subsequent meeting of creditors in person, it may appoint a representative to attend on its behalf. Creditors may vote in person or by proxy form. A foreign creditor should furnish its representative with the necessary proxy. Such proxy may be in paper form transmitted by any form or mode of telecommunication. It may be addressed to the representative holding the proxy or to the chair of the meeting.

Question 5

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5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

In a liquidation bankruptcy, the Trustee must seek approval from the board of inspectors prior to taking certain actions. Furthermore, creditors can exercise some indirect control over the Trustee through the appointment and control of the inspectors, or by calling a meeting of creditors.

The bankrupt company and its creditors have the statutory ability to apply to the Court if they have been aggrieved by any act or decision of the Trustee, and the Court may confirm, reverse or modify the act or decision complained of and make such order in the premises as it thinks just.

If the bankrupt estate has a claim against a third party that the Trustee is unable or unwilling to pursue, a creditor may apply to the Court for an Order allowing the creditor to pursue the claim itself, at its own cost, but without the requirement to share any proceeds or recoveries with other creditors.

5.2 Substitution of the insolvency representative

At the first meeting of creditors, the creditors are required to vote on whether to approve the appointment of the Trustee. This approval is obtained by ordinary resolution. However, if the creditors wish to replace the Trustee, a special resolution is required. Under the BIA, a special resolution is where there is both a majority in the number of creditors and three-quarters majority of the value of the proven claims. The creditors may also decide to replace the Trustee at a later stage. They may do so by special resolution at a subsequent creditors' meeting.

In CCAA proceedings, the Monitor may be replaced by Court Order on the application of a creditor or other stakeholder, but this is seldom done. In BIA Proposal proceedings, the Proposal Trustee may be replaced at a meeting of creditors or by Court Order.

Question 6

6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

In a liquidation bankruptcy, the Trustee deducts its remuneration from the proceeds of liquidation of the bankrupt's estate. Therefore, in essence, the Trustee is paid by the unsecured creditors through the funds that are otherwise available to be distributed among them.

In BIA Proposal proceedings, the Proposal Trustee is paid by the debtor out of cash flow, which effectively means that the creditors pay the Proposal Trustee, since where the debtor is insolvent, by definition its assets are beneficially owned by its creditors.

In a CCAA proceeding, although the Monitor is a court appointed officer, its remuneration is approved by the Court and funded by the debtor. The debtor is also responsible for paying the Monitor's legal fees. To the extent that cash flow is unavailable to make such payments, the Monitor and its counsel will usually be granted an "Administrative Charge" by Court Order, giving them a super-priority charge on the assets of the debtor, up to a specified amount which is determined by the Court according to the particular facts of the case.

6.2 Funding special activities of the insolvency representative *(liquidator)*

In a liquidation bankruptcy, there are sometime insufficient assets readily available to pay the Trustee's fees and costs. Where the creditors wish the Trustee to exercise its investigative and other powers to, for example, investigate or take steps in relation to the conduct of the bankrupt, suspicious or reviewable transactions, or claims that the bankrupt may have against third parties, the creditors will sometimes fund the Trustee to do that.

China

Introduction

China followed planned economic policies for a long time and consequently there was no need for insolvency law. Once the country introduced market economy reforms, state owned companies were encouraged to make their own management decisions and take full responsibility for their own profits and losses. It was for this purpose that the "Enterprises Insolvency Law of the People's Republic of China (Trial)" came into force in December 1986. This trial law was applicable to state owned companies only. The trial law was supposed to be replaced with formal law shortly. However, at that time, there was still debate on whether a full market economy should be followed and it was not clear how an enterprise should be declared insolvent and what should be an enterprise's social responsibility. It was only after 20 years, in August 2006, a new "Enterprise Insolvency Law of the People's Republic of China" (hereinafter referred to as the "Insolvency Law") was promulgated and it came into force in June 2007. It replaced completely the old trial law. This Insolvency Law forms the whole insolvency regime of the PRC.

The new Act applies to all enterprise legal entities (except for individuals, sole practitioners, non-legal person enterprises and public authorities). The main feature of the new law is that it includes three insolvency proceedings: reorganisation, settlement and liquidation.

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

A declaration of a debtor's insolvency can only be made by an insolvency court, after an unsuccessful reorganisation or settlement proceeding and before the liquidation proceeding.

As far as filing for such a declaration is concerned, a debtor can apply to a court for entering into reorganisation or settlement proceedings if any of the circumstances stated in of Art. 2 of the Insolvency law is seen. They are as follows:

(a) it is unable to pay its debts when due;

(b) its assets cannot discharge in full its debts or it is obvious that it cannot repay in full its debt; or

(c) it is obvious that it is unlikely that it can repay its debts in full when due.

However, a creditor can only apply for reorganisation if the debtor cannot pay its debts when due. In other words, the existence of the settlement proceeding is largely for the benefit of the debtor who wishes to settle with its creditors. On filing for an insolvency proceeding, an applicant (either a creditor or a debtor) must submit an application form and the relevant evidence to a competent court.

The application form should contain:

- basic situations of the applicant and the party against whom an application is filed;
- the purpose of the application;
- reasons and grounds of the application; and
- information required by the court.

Where an an application is filed by the debtor, it shall submit a description of its financial conditions, a detailed list of debts, a detailed list of credits and the relevant financial reports, and the payment details of the salaries and social security expenses of the employees.

1.2 Choice of the insolvency representative

Under the Insolvency Law, upon receiving an insolvency application from a creditor or a debtor, if a relevant court decides to accept such an application, the court must immediately appoint an administrator. Therefore, only an insolvency court may appoint an administrator from its own list of administrators. According to a Supreme Court rule on appointing administrators issued in June 2007, each insolvency court must have its own list of administrators for its jurisdiction. Qualified institutions and individuals may apply for being on the list subject to the court's approval. Neither a creditor nor a debtor has any say or can make any suggestions as to who should be appointed as the administrator. An administrator appointed by an insolvency court reports to the court and is monitored by the creditors' meetings and creditors' committee.

A creditors' meeting may apply to the relevant insolvency court to replace the administrator if the meeting considers that the appointed administrator does not carry out its duty in a fair manner and does not comply with the laws, or if there are other issues which may render the administrator unqualified.

The administrator can be a liquidation team composed of experts from relevant authorities and institutions or a law firm, a certified public accountants firm or an insolvency liquidation firm and other relevant intermediary agencies established according to laws.

An insolvency court may, after collecting the opinions from relevant intermediary agencies, appoint suitable personnel from such agencies who have good expertise and qualifications to act as an administrator.

1.3 Pre-packaged insolvencies

Insolvency proceedings must be done through the courts in China. As mentioned, before liquidation, courts often go through reorganisation proceedings and settlement proceedings.

1.4 Cross-border insolvencies and specific country rights

The Insolvency Law does not differentiate proceedings brought up by foreign or domestic creditors. If a foreign creditor applies for insolvency of a domestic entity to determine the insolvency status of a debtor, an insolvency court will often apply PRC law as governing law.

The Insolvency Law provides that any insolvency proceeding commenced in accordance with the Insolvency Law in the PRC given shall bind the relevant debtor's assets outside the PRC.

If a foreign court has given an insolvency judgment or an insolvency order involving a debtor's assets in the PRC which require to be enforced against, and the relevant creditor applies for acknowledgement of such a foreign judgment or order and enforcement, to the relevant Chinese court. The court will take due consideration of the PRC Insolvency Law, and relevant international treatise to which the PRC is a party and also the reciprocal rules, and then acknowledge and enforce such a judgment or order.

QUESTION 2

2. Creditors' rights aimed to meet claims

2.1 Filing a claim

Once a court receives an insolvency application from a creditor or a debtor and decides to accept such an application, within 25 days after the decision, the court must notify the creditors and make a public announcement of its decision.

Once the decision is announced, any creditor at that time may make a filing of its claim to the administrator.

For any debt which is not due yet, once the insolvency filing is accepted by the court, the debt will be deemed to be due immediately, and no interest can be accrued from the moment the insolvency filing is accepted by the court.

A creditor must file its claims within the time limit set by the court which accepts the filing. Such a period must be a minimum of 30 days and a maximum of 3 months from the date of the public announcement by the court of acceptance of the insolvency filing.

When a creditor files its claim, it must state in writing the details of the debt such as the amount of the unpaid debt, whether the debt is secured and whether the debt is a joint liability.

If a creditor fails to file its claims within the time limit set by the court, it may still file its claims before the final distribution of insolvency assets. However, the creditor will not be able to share any previous distributions.

2.2 Privileges for secured claims

Privilege for secured claims arise when the assets of the insolvent debtor will need to be distributed among creditors. Articles 109 and 110 of the Insolvency Law provide that a creditor who has a security over certain assets of an insolvent debtor enjoys a priority in claims against the particular assets. If the particular assets are not sufficient enough to pay off the secured creditor, then the outstanding debt shall rank equally with unsecured debtors. The order of priority to settle claims after paying the secured creditors is as follows:

i) Insolvency fees and debts for common benefit (debt incurred after the filing of insolvency is accepted by the court);

ii) Employees salaries, medical allowances, disability allowances, condolence allowances, pensions, basic medical insurances and other compensations to employees required by laws;

iii) Taxes;

iv) Unsecured ordinary debts.

Within the same class, distribution will be on a pro rata basis.

One exception to the above order is that, for money owing to the employees listed above in item ii) incurred before 27 August 2006, if they cannot be satisfied from the debtor's insolvent assets (not including those subject to security arrangements), then the short fall can be met in priority to secured creditors against the secured assets.

It should be noted that a secured creditor may not enforce its security during the reorganisation proceeding, although if the security holder considers that the value of the security is decreasing and its rights as a security holder may be affected, the security holder may apply to the relevant court asking to enforce it security rights.

The Insolvency Law also provides the following:

- Security to be set aside

  Article 31 of the Insolvency Law provides that once an insolvency filing is accepted by a court, an administrator has the right to request the court to set aside any security granted for a debt previously without security within one year before the acceptance of the filing by the court;

- Secured creditors voting on a reorganisation plan

  During the reorganisation period, creditors are divided into different groups to vote for a reorganisation plan according to the following:

  - secured creditors;

  - employees with credits regarding salaries, medical allowance, disability allowance, pension fund, medical insurance and other allowance;

- authorities for taxes;

- unsecured creditors.

If creditors of a group have voted for the reorganisation plan, with a simple majority and the credits represented by these creditors exceed 2/3 of the total credits of this group, then that plan is considered as passed by this group.

As far as secured creditors are concerned, if the group does not vote for the reorganisation plan, the company or the administrator can apply for the court to approve the plan if they consider that after the plan, the secured creditors will be paid in full, all losses incurred as a result of delays in discharging of debts will have been compensated and the security has not been damaged in substance.

2.3 Continuation of contracts entered into with the debtor

Once an insolvency proceeding commences and an administrator is appointed, it is the administrator who may decide whether to terminate or continue to perform a contract entered into by the debtor before the insolvency proceeding commences but has not completed the process yet and then notify the counterparty of its decision.

If the administrator fails to notify the counterparty within 2 months after the commencement of the insolvency proceeding, or it fails to respond to the counterparty's chaser within 30 days after it has received the counterparty's chaser, then the relevant contract shall be deemed to be terminated.

If the administrator decides to continue the performance of the contracts, the counterparties concerned shall continue to perform such contracts. However, they are entitled to request the administrator to provide security for such a performance, and if the administrator fails to provide such security, then the relevant contract shall be deemed to be terminated.

QUESTION 3

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3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

General Creditors' rights aimed to monitor the insolvency proceeding are carried out through creditors' meetings and creditors committees.

All creditors who have filed their claims can attend the creditors' meeting and vote.

If a creditor considers that the decision of a creditors' meeting is contrary to the laws and is to its disadvantage, it may, within 15 days after the decision, apply to the relevant court to invalidate the decision and request for a new order.

A creditors committee is set up by creditors' meetings but subject to written acknowledgement of the relevant court. It also must include a representative from the employees.

3.2 Specific rights of information during the proceeding

In addition to what has been mentioned below on what a creditors' meeting may do to monitor the insolvency proceedings, an administrator must attend the creditors' meetings and answer any questions creditors may have.

In the meantime, an administrator must report to the creditors' committee in respect of the following actions:

- any transfer involving land and real property;
- any transfer involving property rights such as mining rights, intellectual property rights;
- transfer of all stocks or the whole business;
- loans;
- security that has been granted;
- transfer of creditor's rights and securities;
- details of contracts under which both the debtor and its counterparty have not discharged their obligations in full;
- waiver of rights;
- return of secured properties;
- any other disposal of assets which may cause adverse effects to the creditors' interests.

Please note that in the event that creditors' meetings do not set up a creditors committee, the administrator will only report the above to the relevant insolvency court which appoints him.

3.3 Approval rights not delegated to a creditors' committee

The function of a creditors' committee is indicated in paragraph 3.1 above. Approval rights are given to the creditors' meetings.

QUESTION 4

4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

As mentioned above, every creditor that has filed its claim legally has the right to become a member of the creditors' meeting and may vote. All resolutions of a creditors' meeting may be passed by simple majority of the members present, and that the aggregate amount of liabilities these votes represent must exceed half of the total outstanding debts.

The relevant court that accepts the insolvency application must appoint a chairman among the creditors who will host the creditors' meeting.

A creditor may ask its proxy to attend a creditors' meeting and that person present must produce evidence of such proxy at the meeting. In the meantime, there must be union members or representatives of the employees of the debtor attending the creditors' meeting.

The administrator must notify each creditor 15 days before a creditors' meeting.

The following are the major rights reserved to be discussed at creditors' meetings:

- Right to replace the administrator

  Once an insolvency filing is accepted by a relevant court and an administrator is appointed by the court, the creditors may, through these meetings, replace the administrator if they consider the appointed person cannot carry out its duty in a fair manner and in compliance with laws. All creditors may attend the creditors' meetings. The creditors' meeting may also question how the administrator is paid once the remuneration of the administrator is decided by the relevant court;

- Right to monitor the administrator's work

  If an administrator is appointed, its work is monitored by the creditor's meetings and creditors committees (although the administrator has the right to decide whether to continue or discontinue the business operation before the first creditors' meeting is convened).

- Who can motion the creditors' meeting

  The first creditors' meeting is organised by the relevant court and must be convened within 15 days after the expiry of the period within which the creditors' must file their claims. Thereafter, the administrator, the creditors' committee or creditors who have more than one fourth of the total outstanding debts may motion a creditors' meeting.

- What a creditors' meeting may decide

  The creditors' meetings monitor the whole insolvency proceedings as follows:

  - auditing the debts;
  - applying for replacement of the administrator, reviewing the expenses and remuneration of the administrator;
  - the administrator;
  - electing or replacing the members of the creditors committee;
  - deciding whether to continue or suspend the business operation of the company;
  - approving the reorganisation plan;
  - approving the settlement agreement;
  - approving the administration plan of the assets;
  - approving the sale plan of the assets;
  - approving the distribution plan of the assets;
  - others subject to the relevant court's discretion.

4.2 Creditors' committee

In addition to what is mentioned above relating to who can be members of a creditors committee, there should be no more than 9 members in a creditors committee.

A creditors committee has the following functions:

- monitoring the administration and disposition of the company's assets;
- monitoring the distribution of the proceeds realised out of the assets of the insolvent company;
- motioning creditors' meetings;
- other functions given by the creditors' meetings.

4.3 Other forms of creditors' direct participation

There is none in the Insolvency Law.

4.4 Rights related to reorganisation plans and proceedings

It is the creditors' meeting that approves the reorganisation plans.

4.4.1 Application for reorganisation

Either the debtor or the creditors may apply to the court directly for reorganisation of the debtor. In case the creditors apply for an order for insolvent liquidation, and after the court accepts the application for insolvency but before the debtor is declared insolvent, the debtor, or the investors who holds more than one-tenth of the debtor's registered capital, may apply to the court for reorganisation.

4.4.2 Security rights

During the period of reorganisation, the security rights against the particular property of the debtor shall be suspended. If however, such a property is damaged or its value is apparently threatened to be decreased so that they will adversely affect the rights of the secured creditors, such a creditor is entitled to ask for resumption of exercising the security rights.

During the period of reorganisation, if the debtor or the administrator raises a loan in order to carry on with the business operation, they are permitted to establish a security for such loan.

4.4.3 Other related parties' rights

During the reorganisation period the owner whose property is possessed by the debtor under reorganisation may take back the property according to the requirements as agreed.

The debtor's investor shall not ask for the distribution of the return of the investments made. Further, the directors, supervisors or senior officers of the debtor will not transfer their equity in the debtor to a third party, unless otherwise consented by the court.

4.4.4 Termination right of reorganisation procedure

Upon the request of the administrator or the interested parties, the court shall terminate the reorganisation procedure and declare the debtor insolvent in any of the following circumstances:

- where the management and financial conditions of the debtor continue to be deteriorating and are impossible to get recovered;

- if the debtor acts fraudulently and in bad faith that results in the decrease of the property of the debtor, or other behaviors that apparently have adverse effects on the creditors; or

- the administrator is unable to perform its functions due to the behavior of the debtor.

4.4.5 Voting right to reorganisation plan

Within 30 days after receiving the draft plan of reorganisation, the court shall convene the creditors' meeting to vote on the draft reorganisation plan. The creditors attending the meeting shall be divided into different groups for voting according to PRC Insolvency Law.

If over half of the creditors of the same voting group attending the meeting give consent to the draft reorganisation plan, and if they hold over two-thirds of the total amount of the creditor's right in the same group, the draft reorganisation plan shall be deemed as being passed by this group.

4.4.6 Approval of reorganisation plan

If all the groups (Please refer to paragraph 2.2 above for the creditors' grouping for the purpose of voting) pass the draft reorganisation plan, it shall be deemed as being adopted.

Within 10 days after approving the reorganisation plan, the debtor or the administrator shall apply to the court for approval of the reorganisation plan. The court shall approve such plan within 30 days if it meets the relevant requirements.

QUESTION 5

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5. Creditors' rights aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

As mentioned above, a creditors' meeting may request to replace an administrator appointed by the court and also monitor the administrator's work. The administrator must attend creditors' meetings to answer questions during which creditors may challenge the decisions and acts of the administrator.

Therefore, the current Insolvency Law does not provide means for an individual creditor to challenge the acts or decisions of an administrator; and it must always do so through the creditors' meetings.

5.2 Substitution of the insolvency representative

An administrator is appointed by the relevant court. The resignation or replacement of an administrator must go through the court.

If the creditors' meeting considers that the administrator is unable to perform its functions legally, or is otherwise not competent at the task, it may apply to the court to have a replacement administrator appointed. The new administrator must also be appointed by the court.

QUESTION 6

6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

The remuneration of the administrator shall be decided by the court and will be deducted from the debtor's assets in priority. A creditors' meeting may question the remuneration of an administrator once it is decided by the relevant court.

If the administrator helps to manage the maintenance, conversion, and delivery of the assets subject to security, the administrator shall have the right to receive a certain amount of remuneration for such management. If the secured creditor cannot reach agreement with the administrator on the amount to be paid, the court may decide it subject to the limitations provided by the relevant laws.

6.2 Funding special activities of the insolvency representative (liquidator)

Liquidation activity is carried out by the administrator, fees are included in the remuneration of the administrator, no additional funding is required.

FRANCE

Introduction

The insolvency proceedings are governed by the Commerce Code and also controlled by the Insolvency Court. The persons involved in the process are an entitled judge to the case "*Juge Commissaire*", and insolvency practitioners that are solely entitled to be administrators "*Administrateurs Judiciaires,*" and liquidators – receiver "*Mandataires judiciaires*". This is a court driven system.

There is a wide range of solutions offered to a debtor by law:

- The Safeguard proceeding "*Procédure de Sauvegarde*" or the brand new Accelerated Safeguard *"Procédure de Sauvegarde Financière Accélérée"* (2010). The debtor can file forthis if it is facing an imminent insolvency, with the aim of restructuring and rescheduling its debt;
- The *Redressement Judiciaire* can be opened in case of insolvency; and
- Liquidation.

Except in case of liquidation, the aim of the proceedings is to keep the business running with fewer redundant employees as the pay back of creditors is taken into consideration too. This is both a cause and the consequence of the strong rights of the employees that have a super privilege, and also the ability to have most of their unpaid wages taken into account by a National Fund.

As a general overview, the foreign creditors rights are similar to that of French creditors rights but foreign creditors have an advantage of having an extra two months to file a claim. There is no restriction for foreign creditors except that all documents produced by the creditors have to be in the French language.

QUESTION 1

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1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

All registered companies, tradesmen, craftsmen, independent professionals, farmers and associations can file for insolvency. Depending on the legal basis of the debtor, the Commerce Court insolvency division or the Civil Court will be competent. There is no insolvency proceeding available in case of consumer insolvency; only the professional debts could generate an insolvency proceeding.

With respect to an insolvency proceeding or judicial liquidation, a creditor can submit a petition to the Court in case of an unsuccessful execution of an enforceable title. The Court can then decide whether to commence an insolvency proceeding after giving a hearing to the debtor.

In practice, there are only a few cases where insolvency proceedings can be commenced by petitions submitted by trade creditors, banks, and in some instances by tax and social insurance authorities.

1.2 Choice of the insolvency representative

The appointment of all the judicial representatives (administrator, liquidator, creditors representative "Représentant des créanciers", delegated judge "Juge Commissaire") is made solely by the insolvency court.

In case of filling for safeguard proceedings, the debtor can request for a specific administrator, to be appointed.

In other insolvency cases, the creditors are involved in choosing the administrator or the liquidator.

1.3 Packaged insolvencies

As the Court has a strong control of the proceedings and appoints the persons involved, the pre-packaged insolvencies that would require at the same time the opening of the insolvency proceeding and adopting resolutions do not take place in practice.

However, in limited situations insolvency proceedings may be commenced. These situations are:

- work that could be done in pre-insolvency proceedings in finding a way out under an insolvent scheme;
- accelerated safeguard proceeding where the plan can be set up within one month;
- opening of a *Redressement Judiciaire*, or a liquidation. This will apply for asset sale deals only.

These practical solutions may offer an alternative to the existence of a pre-packaged insolvency.

1.4 Cross-border insolvencies and specific country rights

According to French insolvency law, when compared to the rights of creditors who do reside in France, no restrictions exist on the rights of creditors that are not resident in France.

French insolvency proceedings with connections to other European countries are conducted in accordance with the European Insolvency Regulation (Reg. 1346 / 2000 / EG of 29.05.2000) if cross-border matters are involved. In accordance with this Regulation, creditors have the opportunity to petition for the opening of so-called secondary (or territorial) insolvency proceedings in respect of those assets of the debtor located in France.

France has not adopted the framework of the UNCITRAL Model Law. Insolvency proceedings can also be initiated in respect of the assets belonging to foreign companies, who carry out commercial activities by means of a dependant subsidiary in France.

All foreign (EU or non EU) creditors are granted an extra 2 months time to file their claims with the receiver, which means that the time limit is 4 months from the date the insolvency judgment is published. Generally the publication of the judgment takes place after a few days of the judgment being given. After 4 months, the creditor ‘s debt will not be included in the dividends paid by the insolvency proceeding (see 2.1)

QUESTION 2

2. Creditors’ rights aimed to meet claims

The French law separates the debts that have occurred or have been generated before the opening of a proceeding from the debts or expenses that have been incurred after it.

For unsecured creditors, the rules that determine the existence of the proof of debt is governed by the Commerce Code and can be proved by many means.

For the secured creditors, the privilege is granted by following the entitlement rules that apply to each kind of privilege (i.e.: a leasing or a warrant have to be registered to the commerce court). These general conditions apply in the same way in case of claiming for the privilege facing an insolvent debtor. A debt will be secured only if the creditor has followed the formal rules applicable for each type of securization. If the formal conditions for the securisation of the debt has not been properly fulfilled, the claim will be considered as unsecured.

For secured creditors, the privilege is granted by following the entitlement rules that apply to each kind of privileges, a lease. In order for a secured creditor to make a claim it is important to prove that the formal conditions for the securitisation of the debt has been completed. If not the claim will be considered as unsecured.

Unsecured creditors are governed by the Commerce Code.

2.1 Filing a claim

In all cases of insolvency (including the two safeguard proceedings) the court appoints a receiver to gather the creditors’ claims and determine they are in order. It is essential that all claims are filed with the receiver in order to get satisfaction from the assets.

The claims have to be submitted to the receiver no later than two months after the official publication of the court decision in the BODACC. (The official publication for registered companies) with an extra two months for foreign creditors. Generally, the publication in the BODACC happens two or three weeks after the insolvency courts decision.

Usually the claim is prepared by using the CERFA N°10021*01 form or by a lawyer. There is no compulsory need for a creditor to have a location or a representative in France, even if this may be convenient.

The claim shows whether the amounts due and whether such claims are privilege or not, and whether it is overdue or not. The claim if not already having an enforceable entitlement has to be certified. The claim can be sent by the creditor (i.e. the CEO) or a lawyer, or any other person (employee of the debtor or accountant) with a written authorisation. The claim has to contain the proof of the existence of the amount claimed (invoices, contracts). In case of pending litigation on the amount of the debt, that had commenced prior to the insolvency proceeding, the claim must state the maximum amount that the creditor intends to request, and information of the court in charge of the litigation (date of first judgments in the litigation, and location of the court, hearing or appeal pending).

In case of a debt in a foreign currency (non euro), the amount has to be converted to euros using the exchange rate of the day of the judgment opening the insolvency proceeding.

In case of a late filing of a claim, the creditor has a final chance of making a request to the judge, within six months (one year if the creditors didn't know at this moment that they were a creditor) from the date of the publication of the insolvency decision by the court. This happens when secured creditors have not been personally informed of the insolvency proceeding by the receiver, or for unsecured creditors if they were not on the list of creditors given by the debtor to the receiver for information.

If the claim has not been sent in time, the creditor shall not qualify, not have the benefit of the dividends paid by the liquidator or the insolvent company, and can recover its rights only if the plan fails. When the reimbursement plan has been fulfilled by the debtor, all the debts not claimed are cancelled.

Depending on the kind of proceeding and the final outcome, the receiver will record and check the claims or just gather them. For example, in a direct liquidation where the assets will not be sufficient to cover the super privileged creditors and liquidation costs, the liquidator (acting as receiver) will not record the unsecured creditors.

Only secured creditors with a privilege published in the Commerce Court files (applies to leases of equipments, some pledges.) have to be individually informed by a registered letter by the receiver.

With regard to all other creditors, the receiver or the liquidator has no obligation to send a registered letter informing them of the insolvency proceeding and; publication of the court decision in the BODACC is adequate. In practice, the receivers write to the creditors based on the debtors' list of creditors in respect of larger liquidations, *redressement judiciaire,* and safeguard proceedings.

Except for the tax administration and social insurances that are allowed to claim a tentative amount that does not have to be calculated when filing the claim, all other creditors have to determine a fixed amount that cannot be increased afterwards. In case of litigation, contracts such as leases (this includes amounts arising from the possible termination of the debtor's contracts with creditors by the insolvency representative after the opening of proceedings), of services not already known (eg some maintenance or royalties) or sales for unknown amounts (eg concealment stocks), the creditors have to determine the maximum amount of the claim they may have. The claim could be reduced by the receiver or by the judge after filing but never increased.

There is no exception for shareholders loans or intercompany accounts: they also have to claim in the same way.

Payments by compensation between account receivables and account payables have to be carefully studied before filing the claim in order to not reveal clawback possibilities.

When the receiver is challenging the claims, he will send a letter to the creditor. The creditor has 30 days to disagree with the proposal of the receiver; and if no answer is made, the claim will be adjusted according to the proposal of the receiver.

2.2 Privileges for secured claims

2.2.1 Different privileges

Privileges that are granted correspond to a priority of payment in case of liquidation or an asset sale of the business. The main privileged claims are:

- salaries or the national fund for salaries that are granted a super privilege for most of their claims;

- general privilege of the tax administration and social insurances, and the "new money" lenders if a pre-insolvency *Conciliation* has been used prior to insolvency;

- secured creditors with an asset based guarantee.

There is another kind of privilege granted by law to some creditors, even if they are classified as unsecured creditors in the order of repayment by the liquidator. (see 2.2.3)

Before all creditors are paid there is a super privilege granted to salaries or the National Fund for salaries. This debt has the highest rank.

2.2.2 Secured creditors with asset based guarantee

This is classified as "*créancier privilegié"* in the debt listing and includes all claims with the enforcement of an asset based guarantee. This covers pledges on the goodwill "*fonds de commerce*" of the business, the equipment and fixed assets. (Generally for bank loans, leases or mortgages). For such securization on fixed assets, the creditor has to obtain a public disclosed entitlement of the privilege.

These guarantees have, under general business regulation, to be recorded by the Commerce Court or the real estate administration. By filling a claim with these privileges, the creditor will be classified as "*créancier privilégié".* In addition, secured creditors can have an asset-based guarantee without public disclosure. This covers mainly the pledge on financial assets, and on stocks and trade debtors (Bank financing under "Loi Dailly" securization on account receivables or factoring). These guarantees only require private contracts so the proof of the privilege has to be provided when filing for a secured claim.

Creditors secured by mortgages or by right of lien can satisfy themselves out of the charged assets even in the case of insolvency on a priority basis due to these securities.

Creditors with claims against the insolvency mass itself (this includes claims arising from the continuation of the debtor's contracts with creditors by the insolvency representative after the opening of proceedings) receive satisfaction out of the insolvency mass, whereby only the surplus of the realisation of such goods secured by mortgages or rights of lien after the satisfaction of creditors secured is added to the insolvency mass.

2.2.3 Other privileges and guarantees for creditors

Some creditors can only claim against the insolvency mass due to the nature of their claim. But for some of them, certain rights can be granted by the business rules and the general Commerce Code. These rights are:

- The sales under retention of title (*réserve de propriété*) for which the creditor has to claim for the full amount and then request for the ownership of the goods sold (therefore the claim will be reduced by the value of the goods taken back) are privileged. The request for the ownership of unpaid goods has to be done last and usually 3 months after the insolvency judgment. The identification of the goods under the retention of title can be easier as the insolvency judgment has to appoint a professional in charge of doing the inventory and valuation of all tangible assets of the debtor. Therefore, the existing goods at the opening of the insolvency proceeding can be identified by the administrator for restitution or payment. If the identified goods have been used or sold by the debtor after the opening of the insolvency proceeding, the purchase price has to be paid to the creditor.

- Sub contractors indicated in the main contract of the debtor and his clients for which the subcontractor has to claim for the full amount and act in payment directly to the final client (most of the cases in the building industry).

- Transport suppliers where the creditor has a retention right of the transported goods at the time of the insolvency decision (the *1998 loi Gayssot*). In case of unpaid services, the supplier can sell the transported goods to offset the debt of the transport.

- Special privilege of the landlord, that covers the debt up to 24 months before the opening of the insolvency proceeding. In the case of a cancellation of the lease by the administrator, an additional amount of up to 12 months of the lease to cover the cancellation indemnity. Claims exceeding these amounts are unsecured.

2.2.4 Personal guarantee of the CEO (*caution*)

It is commonly required by banks to have a personal guarantee of the CEO in small and medium companies. This personal guarantee stays at a standstill during the safeguard proceeding and the *redressement judiciaire* proceeding; nevertheless the bank keeps the personal guarantee until the end of the proceeding and will have the right to enforce it in case of liquidation.

2.3 Continuation of contracts entered into with the debtor

2.3.1 In case of liquidation, the contracts are automatically terminated. An exception is made for the employees contract for which the liquidator has to set up a redundancy plan. Another exception is made if the courts decide on a liquidation procedure with a short period to run the operations of the business. In this case, creditors will claim for both the unpaid invoices before insolvency and the consequences of the anticipated termination of the contract by the liquidation proceeding.

2.3.2 For *Redressement judiciaire* and *Safeguard*, the decision of the court to open an insolvency proceeding has no effect on the validity and the fulfilment of contracts. Even if a contract includes a clause of termination in case of insolvency, such a clause has no effect in law. Therefore, all contracts are taken as continuing if they have not been specifically cancelled by a court decision during the insolvency process.

The decision of fulfilling the existing contracts lies with the administrator who solely has the ability to make such a request to the insolvency judge. Therefore, the administrator can ask a reluctant contractor to fulfil the contract or to stop it, either by purchasing the contract or by selling the contract. The decision of the administrator should not to be explained to the contractor; in practice, cancellation by the administrator is used to reduce current costs or from a cash perspective if the contract would generate a cash deficit (clients that paid by provision before insolvency). There is no time frame for the administrator to decide and inform the contractor. If the administrator has not taken a position, the contract can force him by registered letter to choose. In the absence of a response within one month, the contractor is automatically cancelled.

During the insolvency proceedings, the terms and conditions of the contract have to be fulfilled by both parties. If not, the contractor can enforce the fulfilment of the debtor in front of the court. If the fulfilment of the obligation is a payment, the contract will be automatically cancelled if payments are not made.

There is a specific way for the lessor of the premises to request the insolvency judge to cancel the contract if the rent remains unpaid, but the lessor can't make the request to the judge earlier than 3 months after the opening of the insolvency proceeding.

The termination for employees is subject to the rules of the Social Code and the time scale is dependent on the size of the company and the number of employees involved, the existence or not of employee representatives and unions. The major part of the redundancy plan in *Redressement Judiciaire* allows a payment by the national employment fund and this amount comes as a super privilege in the insolvency mass.

In case of a cancellation of a contract during the insolvency proceeding, the contractor has one month after the end of the contract to file an additional claim to the receiver. This additional claim may include the indemnities and costs created by the early end of the contract.

2.4 Cross-border and specific country entitlements

The law applicable to the relevant contract is applicable as long as the content and the commitments are not contrary to French Insolvency law. Due to running business considerations and emergency situations during the insolvency, priority to insolvency regulation may apply.

Specific attention will be paid to the position of employees located in France but employed with contracts under foreign law. The payment by the French national employees fund is often an issue.

QUESTION 3

3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

The insolvency proceedings treat the global interest of creditors through the insolvency mass. The receiver appointed by the insolvency court is empowered to work in the interest of all the creditors. The receiver is in charge of gathering the claims, analysing them with the debtor and accepting or rejecting them.

The receiver (generally acting as liquidator) is the only one able to sue the directors for personal liabilities in an insolvency proceeding due to mismanagement or fraud. The administrator or the liquidator can also sue some creditors for the general benefit of all the creditors.

In the same way, claw back actions can be initiated by the administrator or the receiver / liquidator and not by individual creditors.

Except the rights granted to creditors committees, the receiver defends the position of all the creditors in the proceeding. In case of a reimbursement plan from the debtor, the receiver will send the reimbursement proposal to the creditors with his opinion on it, gather the opinions of each creditor and then form a final opinion to submit to the court. The Court considers firstly the employees situation, secondly the continuity of the business and at last the creditor's dividends. The insolvency court has the final decision.

3.2 Specific rights of information during the proceeding

A creditor can make a request to the judge to become controller *(contrôleur)* of the proceeding. Therefore the controller will be informed of each report made by the administrator and receiver / liquidator and participate in the court hearing where the creditors can be involved.

By having this information, the controller is able to check that each of the parties of the proceeding has followed a normal process and that the interest of the creditors have correctly been taken into account. The controller however is not allowed to disclose the "non public" information to other creditors.

These controllers are appointed by the *Juge-Commissaire* on request from creditors to become the controller. The creditor who applies to become a controller has to make a request to the Insolvency Court (*Greffe du Tribunal*) of the amount owed to him and indicating of the privilege. If several indicating controllers are appointed, the judge has to choose one from the secured creditors and one from the unsecured creditors. The controller must be independent from the debtor, shareholders and family members.

A controller has to be provided with the following information:

- profits and losses made by the debtor after the opening of the insolvency proceeding;
- purchase offers for asset deals; (i.e. assets sales plan);
- reports done by the administrator to the court.

For each hearing in the insolvency court, the controller has to be summoned and he / she can give an opinion to the insolvency court. This also includes hearings for changes during the plan.

A controller can request the court, to liquidate the debtor in the event it cannot pay the Continental contacts.

The advantage of being a controller, is to be informed “from inside” of all the steps and details of the proceeding. By monitoring it in such a way the proceeding and being able to give his position to the court, the creditor will be able to ensure that everything possible has been done in the creditors’ favour, but not only to its own advantage.

Being a controller must not be used by a creditor for its own personal advantage. To ensure that a controller will not take personal advantage of this position, the law forbids the controllers to take over the debtor, to purchase the assets, or to take part in such a plan for the following five years.

3.3 Approval rights not delegated to a creditors’ committee

In case of a reimbursement plan, each creditor is informed individually and can make a choice (if the plan offers one) and accept or refuse the proposal. Individual consensus is necessary if the plan requires a discount from creditors. No discount on the claims can be decided without the formal approval of the creditor.

The receiver makes a report on the votes by creditors and the court decides. Except in the case of a nomination of a creditors committee, the court does not have the right to enforce a discount but the court is allowed to spread the dividends to the mass up to 10 years. If the Court approves a plan with a creditors committee majority in favour of a discount, some creditors may suffer a discount.

In case of asset sale plans, creditors’ interests are supervised by the Receiver; the creditors with contracts can participate in the hearing of the insolvency court. In practice, only the main contractors or creditors with guarantees come to the hearing if they have a special interest (ie a transfer of their contract or a sale of the asset on which the guarantee is based).

3.4 Cross-border and specific country rights *(entitlements)*

Foreign creditors have the same entitlements as local creditors.

Foreign creditors can monitor the proceeding in detail by requesting for an appointment of a controller. This allows the foreign creditors more information on the different steps of the proceeding and the financial situation. Everything is held under secrecy.

A creditor acting as a controller has a great advantage, whereby it has information on the financial situation of the debtor, and the ability to challenge it, if an inaccurate analysis of the financial interest of the creditors is done. In order to do so, the controller has to be able to read and understand French documents.

QUESTION 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

Except in the case where a creditors' committee exists, there is no creditor meeting. The representativeness of all the creditors is assumed by a sole receiver.

Information from the creditors as well as to them are communicated by mail or by public information available from the Insolvency Court.

4.2 Creditors' committee

Since changes were introduced to the French insolvency law in 2006, the law allows for a creditors' committees to be set up in safeguard proceedings. The rules of the creditors' committee that applies for safeguard proceedings and *Redressement Judiciaire* proceeding are the same.

By law creditors' committees can be found by companies that have over 150 employees and 20 million euros of sales, and by option for companies below these thresholds. This option for smaller companies is granted to the debtor, the administrator or the judge. The creditors may not request for a creditor's committee.

4.2.1 Nomination

There are two separate committees: one consisting of banking creditors and the other consisting of supplier creditors. The committees are organized by the administrator.

- Banking creditors committee: all creditors of this kind are members

- Supplier creditors committee: all suppliers and trade creditors representing more than 3% of the supplier debt are members of the committee. Smaller creditors can be members upon request of the administrator and agreement of the supplier.

These two separate committees act independently.

If the company has issued bonds (*obligations*), there is a specific committee for the bondholders' mass. The rules of the bondholders' committee are the same as the two main committees. Insolvency rules exceed the rules of the bonds.

4.2.2 Competence

A creditors' committee's aim is to discuss the reorganization plan of the company, with the ability for each member of a committee to propose another scheme. The reorganization plan proposed can include:

- rescheduling of the debt;
- discounts on the debt;
- swap debt to equity;
- consider different proposals to creditors if the company can motivate the proposal.

4.2.3 Voting mechanisms

The creditors committee can approve a resolution by a 2/3 majority of the debt held by the voting members.

The vote has to take place between 20 to 30 days after the proposal was sent by both the company and the administrator. Upon request of the administrator, the insolvency judge can modify the time scale, but not less than 15 days.

4.2.4 Remuneration of the members of the committee

No remuneration applies.

4.3 Other forms of direct creditors' participation

Other forms of direct involvement of creditors are not arranged. Only creditors that have been appointed as controller may play a role and participate in the courts' hearings.

4.4 Rights related to reorganization plans and proceedings

As indicated below, each creditor is requested to approve or not the reorganization plan, either individually or within the creditors' committee framework.

No creditor can be given a discount without individual approval, except when the creditors committee has approved such a discount under the majority rules defined by law.

In a reorganization plan, the entitled creditor will have the right to receive dividends. These dividends will be paid globally by the debtor to the administrator in charge to enforce the plan (*Commissaire à l'exécution du plan*) who will pay individually each creditor.

A creditor will receive dividends as stated in the plan. By law, the dividends are payable after the final judgment of the court in the following manner:

- immediately for smaller debts (lower than 300 euros) for a global amount not higher than 5% of the mass;
- payment of dividends by installments cannot exceed a period of 10 years;
- first dividend is at last one year after the judgment;
- after the second year, each dividend must be at a minimum of 5%.

4.5 Cross-border and specific country rights

There is no specific advantage or restriction for creditors at this stage.

Foreign creditors can become members of the creditors' committees as well as French creditors. Some discussions and topics can be treated between the creditors, the committee, the administrator and in foreign languages but the final official documents for the court have to be in French.

QUESTION 5

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5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

There are few decisions that a creditor can challenge. In the most often seen oppositions we can notice the ability to appeal the opening of the insolvency proceeding (eg in 2006 challenge of the Court's judgement has been done through appeal (*tierce opposition)* of a decision of opening a Safeguard proceeding; this could apply if the court has not sufficiently motivated its judgment but will be very rare in practice) or the final judgement (eg the judgment for Eurotunnel has received several *tierce opposition*).

If directly concerned by a decision of the receiver or the insolvency judge the creditor involved can appeal the decision.

5.2 Substitution of the insolvency representative

The substitution of the insolvency representative is extremely rare in practice (eg. for decease, retirement, etc.) and the ability to request any change is not offered by law to creditors.

5.3 Cross-border and specific country rights (entitlements)

There is no specific advantage or restrictions for creditors at this stage.

The monitoring of the proceeding is done by the receiver (also creditors representative) who is in charge of the interest of the mass; the receiver is appointed by the court without the possibility of a request from the creditors.

Creditors involved with a contract and with the debtor will be requested to give their individual opinion in case of asset sales as they may be individually concerned.

Creditors can also have details and continuous information and attend each hearing from the court by being appointed controller (upon request from the creditor).

These two kinds of involvement in the insolvency proceeding have been discussed previously.

QUESTION 6

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6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

There is no responsibility for the creditors to pay any remuneration to the insolvency representative.

Creditors will only have to support their own costs (advisors, lawyers..) but none of the costs of the debtor.

The liquidator's costs, as well as the administrators' fees, are paid by the debtor. If the assets are insufficient to meet the fees of the liquidator, there is a state fund that allows a minimum fee for each liquidator.

6.2 Funding special activities of the insolvency representative *(liquidator)*

Except in clawback actions against a creditor or if the insolvency representative sues a creditor for responsibility in the insolvency, there is no compulsory funding from the creditors. If the creditor is found guilty it will have to refund or pay indemnity to the mass.

Except in clawback actions against a creditor or if the insolvency representative sues a creditor for responsibility in the insolvency, there is no compulsory funding from the creditors. In this case, the guilty creditor will have to refund or pay indemnity to the mass. In case of failure of the clawback actions, the costs are charged to the debtor.

The costs of the litigation process are paid out of the assets of the debtor. There are only a few cases, when fraud occur or criminal responsibilities are involved, and in those circumstances that part of these costs will be paid by the ministry of justice budget.

6.3 Specific country entitlements

There is no specific advantage or restriction for creditors at this stage.
No specific obligation applies for foreign creditors.

Basic forms

CERFA N°10021*01 form – as referred to under 2.1.

GERMANY

Introduction

Germany has a civil law system. German insolvency law is codified in an insolvency code – *"Insolvenzordnung"* (InsO) – which came into force in 1999 and has since been subject to a number of amendments.

One of the main characteristics of the German system is that there is only one kind of insolvency proceeding which applies to all legal entities - including individuals and deceased persons' estates - with only some simplification in respect of consumer insolvencies. The aim of the proceeding is to satisfy the creditors of an insolvent entity equally and in the best way possible through liquidation or restructuring, depending on which of those processes leads to the best result for the creditors. The InsO includes the possibility of a plan proceeding (*"Insolvenzplanverfahren"*) which can be commenced at any time within an insolvency proceeding, especially, but not only, for the restructuring of a business. As the legislature sought to make insolvency proceedings more attractive as a restructuring tool, a specific reform, intended to be brought into force in 2011 is supposed to bring some changes in order to promote restructuring; nonetheless restructuring and the saving of jobs are not considered as ends in themselves.

There is the possibility that the debtor can stay in possession, and that an individual debtor can get a discharge.

The key party in an insolvency proceeding is the administrator; his title is *"Insolvenzverwalter"* in regular proceedings or *"Sachwalter"* (i.e. custodian), if the debtor is in possession, and it is *"Treuhänder"* (i.e. trustee) in consumer insolvency proceedings. The court only supervises the proceeding, and the judge's competence normally ends with opening of the proceedings; during ongoing proceedings a registrar of the court is in charge. The reform due for 2011 is intended to change that insofar as plan-proceedings are to be handled by the judge in the future.

QUESTION 1

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1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for an insolvency proceeding

In principle every private law company, individual or other legal entity that can be subject to rights and obligations qualifies for an insolvency proceeding. Starting a proceeding requires the filing of a petition to the insolvency court where the debtor is domiciled. The petition has to be in written form and can be filed by a creditor or by the debtor.

A creditor's petition requires a legal interest and due substantiation that the debtor is insolvent. If the debtor files the petition himself, he at least has to present the facts that demonstrate his insolvency.

The directors (and *de-facto* directors) of any legal entity with limited liability are obliged to file a petition for an insolvency proceeding without undue delay in the

case of insolvency. If a company is without leadership, this obligation applies for the shareholders. A breach of that duty leads to personal liability. Delaying the petition for more than three weeks is also a criminal offence.

A debtor is technically insolvent, if he is not able to pay his debts when they fall due (illiquidity). In addition, legal entities with limited liability and a deceased person's estate are technically insolvent in the case of overindebtedness. In the case of imminent illiquidity only the debtor is entitled to file a petition.

According to the German Federal Supreme Court's jurisdiction, a debtor is considered illiquid, if he cannot satisfy a liquidity gap of more than 10 per cent for more than three weeks.

In general a corporate body or a deceased person's estate are over-indebted as soon as the value of the total assets no longer covers the total liabilities. Liabilities for which the creditors agree to rank behind all other creditors need not be taken into consideration – shareholders regularly use this possibility with regard of their claims in order to avoid overindebtedness.

1.2 Choosing the administrator

After a petition for an insolvency proceeding is filed and the court is satisfied regarding the formal requirements, the judge has to check whether the debtor is technically insolvent and whether there are sufficient assets to cover the costs of an insolvency proceeding.

The court usually appoints an external expert to answer these questions. If necessary – and regularly in the case of a going concern – the court will order security measures and appoint the expert as provisional administrator (see below 1.3). When the insolvency proceeding is opened later, the provisional administrator almost always will be appointed as the administrator. Only at the first meeting of the creditors' assembly can the creditors appoint their own nominee as administrator with a double majority representing the heads and claims of the creditors who participate in the meeting. The first creditors' meeting should take place within the first six weeks after the opening of the insolvency proceeding, but the final deadline is three months. At that time it might already be too late to influence the course of the proceedings by replacing the administrator, because naturally the crucial time for proper action to be taken is right at the beginning of the proceeding, during the provisional administration, which often takes two to three months. Thus even given the - hardly ever used – possibility that after opening of the proceeding a group of creditors forces an extraordinary meeting of the creditors' assembly within a maximum of three weeks to replace the administrator, this eventuality will only have limited effectiveness.

This of course raises the question whether there are informal ways to influence the court's decision about who is appointed as (provisional) administrator. There is no generally satisfying answer. The actual statutory provisions specify only that the administrator has to be an individual who is experienced in business, qualified for the case and independent of the creditors and the debtor. So far in Germany there is no regime of licensing insolvency practitioners and mostly it will be specialized lawyers who work as administrators. Usually the court chooses from a list of local administrators.

It depends on the applicants diplomatic skills and on the particular judge whether an attempt to influence his choice is successful or triggers the very opposite effect.

As both the regularly involved parties and the legislature are not too happy with the unpredictability of whom the courts choose as administrators – especially in prominent cases – there are plans to codify a right for the main creditors to make recommendations the court will have to consider.

Additionally there is currently a discussion under way as to whether according to European Community Law corporate bodies have to be admitted as administrators in insolvency proceedings, too. It is not yet clear whether that will lead to changes of the law.

1.3 Preliminary proceedings

Between the application for an insolvency proceeding and its opening there can be – and in the case of a going concern there regularly is – a preliminary proceeding (*"vorläufiges Insolvenzverfahren"*) for which the court (judge) appoints a provisional administrator (*"vorläufiger Insolvenzverwalter"*) and defines his powers and all necessary security measures.

These security measures regularly include a stay of all enforcement measures regarding non-immoveable assets together with an order that the provisional administrator may collect the debtor's receivables and that the debtor can no longer dispose of assets without the provisional administrator's consent.

Creditors who continue or enter into business with a debtor during preliminary insolvency proceedings need to ensure that their claims from that period get paid in full and that the payment cannot be annulled by the later administrator. The best way to ensure this is that either the court has granted the sole power of disposal over the debtor's assets to the provisional administrator or has made a specific order regarding the deal in question. In that case the creditor's status will be creditor of the estate (*"Massegläubiger"*, see below 2).

1.4 Cross-border insolvencies and specific country rights

For cross-border issues in connection with insolvency cases there are two main statutory regimes in German international insolvency law.

Cross-border cases within the EU (except Denmark) are covered by the EU Regulation on insolvency proceedings ("EIR" - Reg. 1346/2000 / EG of 29 May 2000), which became effective on 20 March 2003.

For all other cross-border cases the German insolvency code (InsO) provides regulations in its sections 335-358, the concept of which mainly reflects the provisions under the EIR. As these regulations are already quite specific and in parts more detailed going beyond those in the UNCITRAL Model Law on Cross-Border Insolvency, Germany has not adopted the latter provision.

Generally insolvency proceedings can be opened in Germany, if the debtor is domiciled in Germany or has its center of main interests (COMI) in Germany. Corporations in a legal form of another EU member state can be subject to a

German insolvency proceeding, if the corporation law of the state of their incorporation allows an insolvency proceeding. Regardless of the legal form and the debtor's origin, a territorial insolvency proceeding can be opened over a branch or assets of the debtor in Germany.

With regard to creditors, German insolvency law does not establish any different treatment of domestic and foreign creditors.

QUESTION 2

2. Creditors' rights aimed to meet claims

German insolvency law knows mainly three types of claims, irrespective of whether claims are secured or not: Claims against the estate (*"Masseforderungen"*), insolvency claims (*"Insolvenzforderungen"*) and subordinated insolvency claims (*"nachrangige Insolvenzforderungen"*). German legal terminology does not include the expression 'priority claims' or 'preferential claims' or any similar concept, even though one type of claim has to be paid out prior to the other and even though other jurisdictions would speak of a priority claim structure in such a case. German legal thinking and terminology do not focus on the order in which the claims get paid, but on their legal status.

Claims against the estate have to be paid in full out of the insolvency estate. In principle, claims against the estate are claims that originate from a time after the opening of the insolvency proceeding, like the costs of the proceeding (administrator's fees and court fees), obligations created by the administrator or inevitable obligations (e.g. due to continuing contracts). Claims that were constituted before the opening of the proceeding only acquire that status, if created by a provisional administrator with sole power of disposal over the debtor's assets or with a specific court order (see above 1.3). Creditors with claims against the estate are free to pursue their claims against the estate as they would outside an insolvency proceeding, except that the administrator declares there to be an insufficiency of the estate (*"Masseunzulänglichkeit"*).

All other claims originating from before the opening of the insolvency proceeding are insolvency claims. They can only be pursued by lodging with the administrator.

Some special claims are subordinated insolvency claims and can only be lodged if the court decides accordingly. Subordinated claims are:

- interest on insolvency claims for the period of the insolvency proceedings;
- creditors' costs for participation in the proceedings;
- fines;
- gifts owed;

- shareholder loans or economically similar claims;
- claims for which the creditor agreed to rank behind all other creditors.

2.1 Lodging and examination of claims

The opening of insolvency proceedings bars all insolvency creditors from pursuing their claims individually, regardless of whether they already have an enforcement order for their claim. Pending lawsuits are abated. The only admissible way to pursue an insolvency claim is to lodge it with the administrator.

The court publishes its adjudication order on a website for publications in insolvency proceedings (www.insolvenzbekanntmachungen.de). Additionally the administrator has to inform all known creditors and debtors of the debtor by mail. The notice for the creditors includes a copy of the adjudication order and, regularly, a (non-mandatory) form and instructions for the lodgment of claims.

The creditors need to lodge their claims in writing with the administrator, stating the basis and the amount of each single claim, and they should attach copies of proof documents that allow for the examination of the claim. Within the scope of the EIR creditors may lodge their claims in the official language of their state of residence, as long as they use the German headline *"Anmeldung einer Forderung"*. They can, however, be asked to provide a translation. All other foreign creditors have to lodge their claims in German in the first place.

The insolvency court's adjudication order contains a deadline (two weeks up to three months) for the creditors to lodge their claims. Failure to observe the time-limit does not however bar the creditors from lodging their claims. The disadvantages of lodging late are mainly that before lodging a claim there is no voting right in the creditors' assembly, and before the examination the claim does not participate in preliminary distributions.

At the first examination hearing (within one week to two months after the lodging-deadline) the administrator, each creditor and the debtor may dispute lodged claims. Only in such a case has the court to notify the creditor, but not if the claim is fully admitted. An objection by the administrator, the debtor in possession or a creditor will bar the disputed claim from distributions, unless the creditor of the disputed claim already had an executory title before the opening of the insolvency proceeding. In that case the disputing person has to pursue the objection by a special legal action; otherwise the creditor who wants to remove the objection has to pursue his claim in court. Before taking legal action against an administrator's objection, however, it is advisable for the creditor to contact him and ask for his grounds of objection, because mostly an objection is only due to calculation problems or to a lack of proper proof documents.

A creditor whose claim is secured by a right to separate satisfaction (see below 2.2.2) can only participate in distributions with the amount that remains after realization of the security. In this context it is important that the creditor notifies the administrator about his deficiency at the latest within two weeks after a distribution is announced (via internet only). Otherwise the claim will be fully ignored in the distribution.

2.2 Security rights

2.2.1 Right to separation *(Aussonderung)*

Creditors with proprietary rights with regard to assets which do not belong to the insolvency estate can claim for the return of these assets. Regardless of the creditor's respective entitlement outside an insolvency proceeding, he can, however, only collect the assets from where they are and does not have the right to delivery. Costs in this regard may constitute or add to a damage claim, and the creditor can only lodge such a claim as an insolvency claim (see above 2.1).

Creditors with the right to separation are commonly the landlord / lessor and the vendor with reservation of title, as long as the sold item has not been irreversibly mixed or converted or transferred to a third party. In Germany there are no formal requirements for a legally effective retention of title; it can be part of the vendor's general terms and conditions and only has to be agreed upon together with the sale at the latest. For the purpose of evidence, of course, the provision of documentation is advisable.

With regard to retention of title it has to be observed that only the original owner has the right to separation. Assignment of the reserved title to a third party will be treated as fiduciary security and only grant a right to separate satisfaction.

2.2.2 Right to separate satisfaction *(Absonderung)*

If the creditor only has a security right in regard of an asset that belongs to the debtor, he only has the right to separate satisfaction. This means that he cannot claim the asset itself but is only entitled to get the proceeds from the sale of the asset or realization of the security respectively. In most instances the administrator is entitled to manage and effect the sale/realization. He can then deduct VAT (if applicable) and a portion for the insolvency estate from the proceeds. That portion is a fixed rate of four per cent and the costs of the realization, at least another five per cent. As for the sale of real property there is no legally fixed portion for the insolvency estate, its participation is subject to negotiation.

The right to separate satisfaction is in most cases based on a mortgage, or a statutory or contractual lien. Examples are the landlord's statutory lien over all of the debtor's assets on the landlord's premises, securities of asset-based lenders with an assignment on plant, equipment, inventory or accounts receivables, and an assignment based on extended retention of title.

Creditors with the right to separate satisfaction have a voting right in the creditors' assembly in the full amount of their claim. If the secured claim is not aimed against the insolvent debtor, the voting right is reduced to the estimated deficiency.

2.3 Continuation of contracts with the debtor

For contractual relationships there are several special provisions. The most important are the following:

2.3.1 In case neither the debtor nor the other party has fully fulfilled the obligations of a mutual contract at the time insolvency proceedings are opened, the administrator can choose whether he wants to fulfill the contract or not. On the making of a request the administrator is obliged to issue a statement; if he fails to react in due course, he loses his right to opt for performance of the contract.

The administrator's right to chose or refuse performance applies to continuing obligations such as chattel leasing, insurance contracts and license agreements.

2.3.2 Contracts concluded by the debtor for the lease and tenancy of immovables are not directly affected by the opening of insolvency proceedings. The same applies to loan agreements with the debtor being the lender.

Only if the debtor is the tenant and the rental object is not his dwelling, will the administrator have the possibility to terminate the contract within a cancellation period of three months.

2.3.3 Service and labour contracts are also not automatically terminated by opening of insolvency proceedings. But if the debtor is the employer, the administrator has a termination right, too, with a cancellation period of three months.

2.3.4 Agency agreements and mandate orders by the debtor referring to assets involved in the insolvency proceedings automatically expire together with any power of attorney, when an insolvency proceeding is opened.

2.3.5 If a community, another ownership in common or a company without legal personality exists between the debtor and third parties, the insolvency of the debtor will trigger liquidation. Companies can, however, arrange in their statutes that the company is continued in case of the insolvency of a shareholder and will only have to pay out the partnership interest.

2.4 Cross-border and specific country rights

With regard to the pursuit of claims there is no differentiation between domestic and foreign creditors. In particular, all insolvency creditors may lodge their claims in German insolvency proceedings, no matter whether they are main or secondary (territorial) proceedings. The only difference within the scope of the EIR is that creditors may lodge their claims in the official language of their state of residence (see above 2.1).

The effectiveness of security rights is principally judged according to German insolvency law as the *lex concursus*. This, however, does not answer the questions whether a security right was established properly and what happened to it, if the asset in question crossed borders. Furthermore there are exceptions from the *lex concursus* principle, particularly in the case where the asset involved is not located in the state where insolvency proceedings are opened at the time they are opened. Thus it can be quite difficult to determine

whether a security right is valid or not. Generally speaking the validity of rights *in rem* is governed by the *lex rei sitae* within the scope of the EIR. For other cross-border cases German international insolvency law provides the same at least for rights *in rem* in immovable objects. As for security rights in chattels or claims of the debtor German law has the advantage that there are no specific formal requirements. Therefore under certain circumstances a security right can be valid in Germany even if it did not meet the formal requirements of the state in which it was agreed upon.

For contracts with a cross-border impact the basic rule is again that the *lex concursus* applies. Both the EIR and the German international insolvency law make an exemption in the case of contracts of employment, which are governed by the law applicable to the contract.

In connection with contracts it is also of interest to note that both according to the EIR and German international insolvency law, the opening of insolvency proceedings does in principle not affect the possibility of set-off. In practical terms a creditor is not deprived of an existing right to demand the set-off of his claims against the claims of the debtor, where such set-off is permitted by the law applicable to the insolvent debtor's claim.

A creditor, who, after opening of a main proceeding, obtains by any means total or partial satisfaction of his claim on the assets belonging to the debtor situated outside the state of the main proceeding, has to return what he has obtained to the administrator, unless he obtains satisfaction in insolvency proceedings opened in another state. His satisfaction will, however, be taken into account in distributions in the German proceedings.

QUESTION 3

3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

In theory creditors have numerous possibilities and rights to participate in and influence the course of insolvency proceedings. German insolvency proceedings are quite creditor friendly and, in principle, creditor driven. The practical problem is that in most of the cases creditors do not or cannot make use of these possibilities – either, because it does not pay or benefit them to invest time and money in active participation, or, because the situation does not offer alternatives which entail a need to make such decisions.

As for rights that allow monitoring of the proceedings, the situation can be explained as stated below.

3.2 Specific individual creditor's rights to information during the proceeding

Neither the insolvency court nor the administrator is obliged to answer individual creditors' requests for specific information. Nevertheless it represents

best practice not to ignore creditors' queries – especially queries coming from important creditors. It is customary to receive the administrator's periodical (normally twice a year) reports to the court directly from the administrator. Many administrators provide an information system for creditors on their website. In any case each participant in the proceedings has the right to view the court file. The review, however, has to be done in the court building, because the court will not allow the removal of the file during proceedings. Even third parties may view court files, if they show a legitimate legal interest. The court file in particular contains the administrator's reports, the record of assets involved in the proceedings, the record of creditors and a survey of property; furthermore all lodged claims can be viewed in the court file.

Apart from viewing the court file, individual creditors or shareholders of an insolvent debtor company do not have the right to view the administrator's files or the debtor's business documents. Shareholders may be granted the right, though, to view the company's business records in regard of business transactions before opening of proceedings.

Creditors with the right to separate satisfaction do have individual rights to information with regard to the asset in question, if the administrator is entitled to realize the security. In that case the administrator on request has to inform the secured creditor about the condition of the asset; alternatively he can allow the creditor to inspect the object or, in case of a claim, inspect the debtor's books and business documents respectively.

3.3 Specific rights of information of the creditors' assembly

Legally the best opportunity for a creditor (who is not a member of the creditors' committee) to obtain information is the creditors' assembly.

Together with the opening order, the court fixes the date for two regular creditors' assemblies: the report meeting (administrator's first report) and the meeting for examination of the claims. The latter can take place immediately after the report meeting. There is a third compulsory meeting of the creditors' assembly at the end of the proceedings. Apart from those, the court may call extraordinary meetings and the court is obliged to call such meetings within three weeks on the application of the administrator, the creditors' committee or a specific quorum of creditors or secured creditors.

The creditors' assembly may – by majority decision (of total claims) – require the administrator to give specific information and a report on the progress of the proceedings and on the management. If a creditors' committee has not been installed, the creditors' assembly may also have the administrator's monetary transactions and the available cash verified.

On the insolvency court's order the debtor has to provide all information concerning the proceedings towards the creditors' assembly.

Before the administrator engages in transactions which are of particular importance to the insolvency proceeding (including sale of the business to an insider or sale below value) he shall obtain the consent of the creditors' committee or, if a committee has not been installed, of the creditors' assembly. A contravention of the administrator will normally not make his legal acts invalid, but increase his risk of personal liability.

3.4 Additional rights of information of the creditors' committee

If a creditors' committee is appointed, it exercises most of the rights the creditors' assembly otherwise has, unless the latter chooses to exercise a right itself. There are rights, however, only the creditors' committee has these rights. The reason is that the creditors' committee is more flexible, its members are sworn to secrecy and are personally liable for breaches of duty.

The members of the creditors' committee shall support and monitor the insolvency administrator's execution of his office. They must demand information on the progress of business affairs, they can have the books and business documents inspected, and the monetary transactions and the available cash verified. Accordingly every member of the creditors' committee has the right to information regarding every aspect of the proceedings. The administrator and the debtor are obliged to provide all requested information or provide access to documents accordingly.

There are, however, exceptions; for instance in a case where a member of the creditors' committee is in a position where there is a conflict of interest or pursues objectives beyond the proceedings.

3.5 Cross-border and specific country rights

With regard to creditors' rights to information there is no differentiation between domestic and foreign creditors. Creditors domiciled outside Germany have the same rights as German creditors.

QUESTION 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' assembly

In its meetings, the creditors' assembly has extensive possibilities to influence the course of the proceedings – at least if the actual situation still allows this and offers alternatives. Decisions are taken by the majority of claimed sums of the creditors present in a meeting; the replacement of the administrator is the only decision which requires a majority of heads additionally. The most important decisions the creditors' assembly can take are:

- In the first meeting subsequent to the appointment of the administrator the creditors' assembly may replace the administrator by electing a new one. At any time later in the proceedings the assembly may apply to the court to dismiss the administrator for an important reason.

- The creditors' assembly decides whether to establish a creditors' committee or maintain court appointed members in office. Later on the assembly may apply to the court for the dismissal of a committee member for an important reason during the whole proceedings.

- At the report meeting it is up to the creditors' assembly to decide whether the debtors business shall be closed down or continued. The assembly may commission the administrator or, if so, the debtor in possession to draw up an insolvency plan and determine the plan's objective for him. In subsequent meetings the assembly may modify its decisions.

- If the debtor is an individual the creditors' assembly may determine whether and to what extent the debtor and his family are to be granted support using the assets involved in the proceedings.

- If the court granted the debtor the right to stay in possession, it has to repeal that order on the creditors' assembly's demand.

4.2 Creditors' committee

4.2.1 Nomination

It is the common opinion, that even during preliminary proceedings a provisional creditors' committee can be installed. In that case the court appoints the members of the committee – usually on recommendation of the (provisional) administrator.

The court is supposed to have three groups of creditors represented in the committee: the creditors with a right to separate satisfaction, the creditors holding the highest claims and the small sum creditors. The committee should also include a representative of the debtor's employees, if they are involved as creditors holding considerable claims.

Members of the creditors' committee neither need to be creditors themselves, nor need they be individuals. Often external insolvency specialists or representatives of credit insurers or agencies are appointed as committee members.

4.2.2 Competence

Besides the rights mentioned above (3.4 and end of 4.1) the creditors' committee's most important rights are:

- On the committee's request the court has to call a creditors' assembly within three weeks.

- The committee can ask the court to dismiss the administrator for an important reason. The request is not binding on the court but the committee can appeal against a negative decision.

- If the administrator wants to close down the debtor's business prior to the first regular meeting of the creditors' assembly (report meeting), he must obtain the committee's consent.

- The administrator must also obtain the committee's consent if he intends to make distributions to the creditors, and the committee may determine the fraction to be paid in advance distributions.

- In plan proceedings, the committee has the right to comment on the plan, before it is sent to the creditors.

4.2.3 Voting mechanisms

The creditors' committee has to consist of at least two members. In practice three members or another odd number are common.

If not agreed upon otherwise there are no formalities for decisions of the committee. A decision is valid if the majority of the members participated in the voting and backed the decision with the majority of voting members.

4.2.4 Duties / responsibilities of the creditors' committee members

As already mentioned (see above 3.4) both the administrator and the debtor are obliged to provide information to every single committee member, unless the request is based on dishonest motives.

The other side of this information privilege is that the committee members are obliged to seek information and monitor both the proceedings and the administrator; furthermore they are sworn to secrecy. In practical terms the latter means that a creditor or his representative who becomes a member of the committee may be in a position to get all confidential information available to satisfy his inquisitiveness, but he is not allowed to make use of it outside the proceedings. A creditor's representative may be in a situation in which he cannot even inform his client about what he learned as a committee member.

Misconduct or neglect of duty can have severe consequences. Apart from the danger of dismissal through the court the committee members are personally liable for any damage they cause culpably to the creditors. German courts have become quite strict with regard to that liability: in a case where the administrator embezzled money, the committee members were held liable, because they had failed properly to monitor the administrator.

Committee members without sufficient expert knowledge are entitled to hire experts who support them, e.g. for verifying the monetary transactions and the available cash.

4.2.5 Remuneration of the creditors' committee members

The committee members are entitled to the reimbursement of their documented reasonable expenses and to remuneration.

The expenses for hiring an expert to support the committee member can constitute reimbursable expenses, as well as the costs for a personal liability insurance.

The statutory remuneration is an hourly fee of 35 to 95 Euros. The court, however, is relatively free to exceed that rate in order to attain an adequate fee for experts, and even small percentages of the administrator's fee are sometimes accepted, depending on the complexity of the committee's work.

4.3 Other forms of direct creditors' participation

Like the creditors' committee specific groups of creditors may ask the court to call a creditors' assembly within three weeks: one or more secured or unsecured creditor whose securities or claims represent two fifth of all securities or claims, or at least five secured or unsecured creditors whose securities or claims represent one fifth of all securities or claims.

The one fifth quorum of creditors can also apply to the court for the provisional prohibition of transactions for which the administrator requires but has not yet received the creditors' committee's or assembly's consent.

Additionally at the request of the one fifth quorum of creditors, the court may order that an envisaged sale of the business shall require the approval of the creditors' assembly. For an application like this, however, the creditor quorum has to present proof that there exists a better sales opportunity.

Apart from that, individual creditors have a number of possibilities to appeal against decisions of the creditors' assembly and of the court.

4.4 Rights related to insolvency plan proceedings

Creditors cannot present their own insolvency plan. Only the debtor and the administrator have that right. But the creditors' assembly can take the initiative to start a plan proceeding by commissioning the administrator to draw up an insolvency plan for which the assembly can determine the plan's objective.

In an insolvency plan, groups shall be formed where creditors with different legal status are concerned, such as secured and unsecured creditors. The author of the plan can form groups too, within creditors of the same legal status, if they have different economic interests. Each group of creditors with voting rights votes on the plan separately. Creditors whose claims are not impaired by the plan have no voting right. Acceptance of the plan requires that, in each group, the majority of the voting creditors in headcount and claim sums backs the plan. If the majority of groups backs the plan, a dissenting group may be deemed to have consented (*cram down*), given that the creditors forming that group suffer no loss compared to the situation without the plan and that they participate to a reasonable extent in the economic value devolving on the parties under the plan.

An individual creditor who opposes the plan in the voting meeting can apply to the court to reject the plan, if the plan puts him at disadvantage compared to the situation without the plan. The court's decision confirming the plan or refusing its confirmation can be challenged, too, by the creditors. The reform of the law expected in 2011 aims, among other things, to limit the possibilities of mounting a challenge to an insolvency plan.

4.5 Cross-border and specific country rights

German law does not draw a distinction between domestic and foreign creditors in regard of participation rights.

QUESTION 5

5. Creditors' rights aimed at controlling the activities of the administrator

5.1 Means to challenge decisions and acts of the administrator

The administrator is under the supervision of the court and is monitored by the creditors' committee. Due to its lack of flexibility the creditors' assembly in practice hardly ever plays an active role in regard of monitoring the administrator.

Even if the administrator ignores participation rights of the creditors his actions are in principle valid and cannot be annulled. Apart from the possibility mentioned above of having the court provisionally prohibit transactions (see above 4.3) only acts that obviously contradict the aim of the proceedings are invalid in the first place.

The court can impose an administrative fine on the administrator, if he does not fulfill his duties. It is not within the court's competence, however, to check and decide upon the expediency of the administrator's actions. The best motivation for the administrator to meet his duties is his personal liability towards all parties within the proceedings. The court can appoint another administrator who has to pursue damage claims against the (first) administrator.

5.2 Replacement of the administrator

As already described (1.2, 4.1 and 4.2.2), the creditors have the possibility to replace the administrator in the first meeting of the creditors' assembly after the administrator has been appointed by the court. If the court granted the debtor the right to stay in possession, the creditors' assembly can exchange the custodian in the same way as an administrator and it can appoint an administrator in exchange for the debtor as well by demanding that the court repeals its decision to leave the debtor in possession.

Dismissal of the administrator is only possible for an important reason. Such a dismissal may be ordered by the court ex officio or at the request of the administrator, or of the creditors' assembly, or of the creditors' committee. Such a request is not binding on the court, though.

The court's decision to dismiss or not to dismiss the administrator is subject to appeal.

5.3 Cross-border and specific country rights

Foreign creditors have the same rights as domestic creditors.

QUESTION 6

6. Creditors' obligations

6.1 Responsibility for the costs of the proceeding

If insolvency proceedings are opened, creditors are not responsible for the costs of the proceedings. It is one of the preconditions to the opening of proceedings in the first place that these costs are covered by the insolvency estate. If nevertheless it turns out that the costs are not covered the court fee and the administrator's remuneration are only paid pro rata.

A creditor may only be held responsible for costs, if he filed the petition to open insolvency proceedings and his petition was inadmissible or if the proceedings cannot be opened and the money cannot be collected from the debtor. The costs, which the creditor may have to pay, do not include the remuneration of a provisional administrator.

6.2 Funding special activities of the administrator

Just as creditors do not have to fund the costs of an opened insolvency proceeding they are not obliged to fund any activities of the administrator. In practice, though, individual creditors sometimes agree to provide the administrator with necessary funds, especially in two cases.

If the administrator wants to litigate to pursue a claim of the insolvency estate, but these costs are not covered by the estate, the administrator can only receive legal aid in regard of the litigation costs, if funding is unacceptable for the creditors. The latter is only the case, if the creditors cannot expect a considerable benefit in case the administrator wins the lawsuit. Consequently, if they can expect considerable benefit, the creditors only have the choice to fund litigation or to abandon pursuit of the claim.

In an ongoing business creditors with security rights in the current assets – especially in the accounts receivables – often will allow the (provisional) administrator to use the securities or the proceeds respectively to finance the continuation of the business, in order to avoid devaluation of the business and of their securities. In that case the creditors of course get other securities in exchange, like the new accounts receivables.

Basic forms

In the case of a debtor's application for consumer insolvency proceedings only, there is a mandatory standard form. Forms for the application of a non-consumer are available from each insolvency court, but these forms differ more or less and their use is not compulsory.

Every administrator provides his own form for the lodgment of claims. Claims can be lodged validly without using the form, but it makes sense to use it, because that avoids the danger of missing to submit necessary information, and it makes the administrator's work easier.

GHANA

Introduction

Corporate insolvencies in Ghana are regulated by the Bodies Corporate (Official Liquidations) Act which was passed into law in 1963. The law has remained in its original state without a single amendment despite several attempts in the past to amend or completely replace it.

Given that the law has been in existence for almost half a century, it should not come as a great surprise to find that it is silent on some of the key features of a modern insolvency law. The most significant omission relates to provisions on reorganisations. The Registrar of Companies, who is a public servant is the liquidator in all insolvencies. The law is also completely silent on cross-border issues in a liquidation.

The law does not make special provision for small and medium sized businesses. The information provided in this chapter is applicable to all businesses in Ghana.

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

A creditor may file for a debtor to be placed into liquidation where the latter is unable to pay its debts. A debtor company would be deemed to be unable to pay his debts if a debt not less than approximately US$6,500 remains outstanding 21 days after a written demand has been issued. A debtor would also be deemed to be unable to pay its debts if an execution of a judgment debt levied by a creditor is returned unsatisfied in whole or in part. In addition to these two grounds, a creditor may, by any other means, prove that a debtor is unable to pay its debts. The prospective and contingent liabilities of a debtor may be taken into consideration in determining whether it is unable to pay its debts. The balance sheet insolvency test is effectively made applicable in Ghana by reason of this provision. There is as yet no judicial decision on the application of the balance sheet insolvency test in Ghana.

An application by a contingent or prospective creditor to place a debtor into liquidation will only be considered where a *prima facie* case is first established and security for costs is provided by the applicant. A secured creditor may apply to place a debtor into liquidation but only after establishing that its security is insufficient to fully settle the debtor's indebtedness.

A creditor may apply to the Registrar of Companies to place a debtor into liquidation. A copy of the application must be submitted to the debtor on or before the day on which it is presented to the Registrar of Companies. The Registrar of Companies may only exercise its power to place a debtor into liquidation if sufficient proof is provided that it is unable to pay its debts.

A creditor may also apply to the High Court to place a debtor into liquidation. In addition to the ground that a debtor is unable to pay its debts, the High Court may place a debtor into liquidation if it is satisfied that it is just and equitable to do so.

1.2 Choice of the insolvency representative

The Registrar of Companies is by law the liquidator in all insolvent liquidations.

1.3 Packaged insolvencies

A packaged insolvency may be effected by the liquidator with the consent of the debtor and creditors. At least three-quarters of votes cast at a creditor's meeting is required to give effect to a packaged insolvency which involves an arrangement with creditors.

1.4 Cross-border insolvencies and specific country rights

The current law on liquidations is silent on cross-border insolvencies. The law does not discriminate between the rights of resident and non resident creditors. Ghana has not entered into bilateral agreements with other countries which may have application for insolvency proceedings or the rights of the residents of those countries.

A creditor may petition for an external company to be placed into liquidation. An external company is defined as a body corporate formed outside Ghana but which has a branch or some other fixed place of business in Ghana.

QUESTION 2

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2. Creditors' rights aimed to meet claims (credit, titles, contracts etc.)

2.1 Filing a claim

Upon commencement of a liquidation, the liquidator may by notice in the *official gazette* fix a time within which creditors are to submit their claims. A creditor who fails to comply with such a notice will forfeit its right to participate in the benefits of distributions made before its claim is submitted.

A creditor puts in a claim by submitting a proof of debt to the liquidator. The proof of debt is in two parts. The first part contains brief particulars of the following:

- the debts owed to the creditor by the debtor;
- obligations owed to the debtor by the creditor; and
- securities held by the creditor, if any.

The second part contains details of the transactions from which debts and obligations mentioned in the first part arose.

The liquidator must forward copies of the first part of the proof of debt to the company and all known creditors. The liquidator must be informed as soon as practicable of any material falsehood in the proof of debt known to a creditor or the company.

The liquidator may invite a creditor to amend incorrect items in the proof of debt within a timeframe he specifies. The liquidator is required to inform the creditor of his decision to either accept or reject the proof of debt in a timely manner.

All admitted proofs of debt must be verified by the liquidator, who may at this stage set off claims owed by the creditor to the debtor against debts owed by the debtor to the creditor. The liquidator must be notified of all changes in the value of a debt or security included in an admitted proof of debt except where the change has arisen as a result of accumulation of interest.

2.2 Privileges for secured claims

Notwithstanding the commencement of insolvency proceedings, a secured creditor may take steps to realise its security and to that end may commence or continue legal proceedings against a debtor. The liquidator may request a secured creditor to realise its security within a specified time (not less than six months). A secured creditor who fails to comply with such a request would be deemed to have forfeited its security.

Preferential claims have priority over the claims of floating charge holders and may be paid out of the property comprised in or subject to the charge. Preferential claims comprise employee remuneration not exceeding approximately US$4,500 during the whole or any part of the 4 months preceding the commencement of liquidation and taxes, rates and similar payments owed to the Republic or a local authority which have become due and payable the year preceding the liquidation.

A creditor may enforce a retention of title claim in a liquidation. A retention of title claim can not be enforced if the goods are not identifiable.

2.3 Continuation of contracts entered into with the debtor

The law on liquidations is silent on how the pre-liquidation contractual obligations of a debtor must be treated. The courts have also not had the opportunity to clarify or provide guidance on this subject. In practice, the liquidator has often taken the view, based largely on experience from other jurisdictions, that unless adopted on the commencement of a liquidation, all pre-liquidation contracts are deemed to have been terminated.

2.4 Cross-border and specific country entitlements

The law is silent on cross-border issues. In practice, although not under any specific legal duty to do so, the liquidator may give notice directly to non-resident creditors listed in the statement of affairs.

QUESTION 3

3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

A creditor has a right to be fully informed on the progress of a liquidation particularly on matters relating to the realisation and distribution of assets. A creditor also has a right to receive details of claims by other creditors and where necessary to raise an objection.

A creditor has a right as far as is practicable to an early declaration and distribution of dividends. A creditor aggrieved by the acts and omissions of the liquidator may appeal to the High Court for redress. A creditor may obtain an order from the High Court to inspect the books and papers of a debtor.

3.2 Specific rights of information during the proceeding

A creditor has a right to attend and vote at the first creditors' meeting which must be held not later than six weeks after notice of the liquidation has been published in the *official gazette*. Creditors are entitled to receive copies of the company's statement of affairs and proposals for an arrangement, if any, prior to the creditors' meeting.

The liquidator is required to report to the creditors at intervals of not more than six months on the progress of the liquidation. In addition, the liquidator must consult the creditors on any matter which substantially affects their interest and as far as practicable give effect to their views in relation to the realisation and distribution of the company's assets.

3.3 Approval rights not delegated to a creditors' committee

The law does not make provision for creditors' committees. Consequently, the creditors' meeting is the forum for obtaining approval from creditors.

3.4 Cross-border and specific country rights *(entitlements)*

The law is silent on cross-border issues. A non-resident creditor has the same rights to information as its resident counterpart. The law enjoins the liquidator to give notice of the first creditors' meeting in a practicable way to each creditor listed in the statement of affairs or who has lodged a proof of debt. In practice, the liquidator has interpreted this to mean contacting non-resident creditors directly or publishing notices in international publications.

QUESTION 4

4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

The liquidator is required to hold the first creditors meeting not later than six weeks after gazette notification of the liquidation. Creditors are entitled to a copy of the company's statement of affairs and proposals for an arrangement with creditors. After the first creditors meeting, the liquidator is required to report to the creditors at intervals of not more than six months on the progress of the liquidation. In addition, the liquidator must consult the creditors on any matter which substantially affects their interest and as far as practicable give effect to their views in relation to the realisation and distribution of the company's assets.

4.2 Creditors' committee

As previously indicated, the law does not make provision for a creditors' committee in a liquidation.

4.3 Other forms of direct creditors' participation

Other forms of direct involvement of creditors are not provided for under Ghanaian law.

4.4 Rights related to reorganization plans and proceedings

The law as it currently stands does not make provision for reorganisations but provides for schemes of arrangement. A creditor has a right to attend and vote at the meeting to approve the proposed arrangement and also to be heard in court when the arrangement is confirmed. In practice, schemes of arrangement are not frequently utilised largely because of the absence of an automatic moratorium on the enforcement of creditor claims.

4.5 Cross-border and specific country rights

The law is silent on cross-border issues. A non-resident creditor has the same rights of participation as does its resident counterpart.

QUESTION 5

5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

An aggrieved creditor may challenge the acts and omissions of the liquidator in the High Court. The law gives the High Court wide powers on such an application to make any order that it deems fit in the circumstances.

5.2 Substitution of the insolvency representative

The Registrar of Companies is the liquidator in all liquidations and by law cannot be substituted.

5.3 Cross-border and specific country rights (entitlements)

A non-resident creditor has the same rights as does its resident counterpart.

QUESTION 6

6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

A liquidator is required to create an account known as the "liquidation fund" for the purposes of the liquidation. The liquidator's fees may be drawn from the "fees account" which is an account within the liquidation account. Creditors have no obligation for the payment of the liquidator's fees.

6.2 Funding special activities of the insolvency representative *(liquidator)*

Creditors are not under obligation to fund the activities of the liquidator. In practice, however, it is not uncommon to find creditors advancing monies to the liquidator, particularly at the beginning of the liquidation. Monies advanced to the liquidator must be refunded as soon as realisations are made.

6.3 Specific country entitlements

The law provides that the Minister of Justice may by legislative instrument prescribe the fees to be paid to the liquidator under the Act. The Minister is yet to prescribe the liquidator's fees notwithstanding the fact that the Act has been in force since 1963.

HONG KONG PRC

Introduction

Types of winding-up

Hong Kong corporate insolvency law aims to achieve an equal distribution of the company's assets to all creditors, subject to priority claims by preferential and secured creditors as provided for in the Hong Kong Companies Ordinance.

In Hong Kong, a company may be wound up voluntarily by the passing of a resolution of the company's members irrespective of whether the company is insolvent. Where the company is solvent, a voluntary winding-up is commenced by the passing of a special resolution by the members of the company, and is referred to as a "*Members Voluntary Liquidation*". The involvement of creditors in this type of liquidation is limited since the company is solvent and the creditors will be paid in full. Where the company is insolvent, a voluntary winding-up is commenced by the passing of a members' special resolution. However, a meeting of the creditors will be called at the same time and the creditors will thereafter continue to participate in the liquidation, assisting with and overseeing the conduct of the liquidation. This type of liquidation is generally referred to as a "*Creditors' Voluntary Liquidation*".

A company may also be wound up compulsorily under a Court order on grounds including, but not limited to, that the company is unable to pay its debts (i.e. is insolvent). This type of liquidation is referred to as a "*Compulsory Liquidation*".

This chapter focuses on creditors' rights in relation to insolvent liquidations only, being Creditors' Voluntary Liquidations and Compulsory Liquidations.

Jurisdiction

The types of companies that may be wound up in Hong Kong include those companies incorporated and registered in Hong Kong under the Companies Ordinance, foreign incorporated companies registered as "overseas" companies in Hong Kong, and foreign incorporated companies that are not registered as "overseas" companies in Hong Kong but have sufficient connection with Hong Kong. Readers should note that financial institutions such as banks and insurance companies may be subject to additional regulations under the laws of Hong Kong and are not covered in the information provided below.

Corporate insolvency matters are dealt with exclusively by the Court of First Instance (subject to appeals to higher Courts), and are normally overseen by a designated Companies Judge.

In addition to case law, the statutory provisions regulating the various corporate winding up procedures are primarily contained in the Companies Ordinance (Chapter 32) and the Winding Up Rules (Chapter 32H) of the Laws of the Hong Kong Special Administrative Region. As bankruptcy law was developed prior to corporate insolvency law, the Companies Ordinance incorporated several references to the provisions of the Bankruptcy Ordinance as corporate insolvency law developed over the years.

Corporate insolvency law in Hong Kong has been under recent review and it is being proposed that substantial amendments to the law be enacted and consolidated into a separate corporate insolvency ordinance, rather than being dealt with in the Companies Ordinance, as is currently the case.

QUESTION 1

1. Creditor's rights before an insolvency proceeding is opened

1.1 Filing of a winding up petition

The Court may order that a company be compulsorily wound up on various grounds, one of them being that the company is unable to pay its debts.

Under the Companies Ordinance, a company is deemed to be unable to pay its debts if it is indebted in a sum equal to or exceeding HK$10,000, has been served with a statutory demand for the debt to be paid, and has for 21 days thereafter neglected to pay, secure or compound for it to the reasonable satisfaction of the creditor. In such circumstances, a creditor has the right to present a winding up petition to the Court for the debtor company to be wound up.

At the hearing of the winding up petition before the Court, creditors other than the petitioning creditor may support or oppose the petition. If the petitioning creditor has for any reason decided not to proceed with the petition, other creditors may be substituted for the original petitioner and continue with the winding up proceedings.

1.2 Appointment of liquidator

Liquidators are normally qualified accountants or legal or other professionals experienced in insolvency practice. Whilst there is no licensing regime in Hong Kong for liquidators, the Hong Kong Institute of Certified Public Accountants has recently introduced specialist accreditations for insolvency professionals.

Liquidators are normally appointed after insolvency proceedings have commenced. In a creditors' voluntary liquidation, creditors have the right to vote for the appointment of a liquidator at a creditors meeting after considering the qualifications, experience and remuneration of the proposed liquidator. In a compulsory liquidation, the Official Receiver normally becomes the provisional liquidator following a winding-up order being made. The provisional liquidator will then call meetings of the creditors and contributories (i.e. those persons liable to contribute to the assets of the company, usually the company's shareholders or members) to decide on the appointment of a private sector liquidator. The proposed appointment needs to be sanctioned by the Court. In circumstances where the meetings of creditors appoints a different liquidator than the meeting of contributories, the Court is more likely to sanction the appointment of the liquidator voted by the creditors, as the interests of creditors override those of the contributories in an insolvent liquidation. It should be noted however, that the appointment of the liquidators (usually appointed jointly and severally) is at the discretion of the Court and it is not bound by either the creditors' or contributories' nomination. The Court may make such other appointment as it considers appropriate in the circumstances.

Notwithstanding the above, there are circumstances where a provisional liquidator may be appointed prior to the commencement of a winding up. A creditor may apply to the Court for the appointment of a provisional liquidator if it can prove to the Court that, pending the determination of the winding-up petition, the assets of the company are in jeopardy and that there is a real risk that the assets of the company will not be available for *pari passu* distribution amongst the creditors unless a provisional liquidator is appointed. If a provisional liquidator is appointed and a winding-up order subsequently made, then the provisional liquidator will remain as such until the Court has sanctioned the appointment of a liquidator. More often than not, the provisional liquidator will be sanctioned as liquidator.

1.3 Packaged insolvencies

Unlike many other jurisdictions, there are no statutory provisions on pre-packaged insolvencies in Hong Kong, or any arrangement whereby the business of the company is carried on under a new and separate special corporate vehicle. That being said, it is nevertheless not uncommon for companies to be restructured under a pre-pack arrangement. See also section 4.4 below in relation to restructuring of insolvent companies.

1.4 Cross-broader insolvency and specific country rights

Any creditor can petition in Hong Kong for the winding up of a Hong Kong registered company or a foreign company registered in Hong Kong under the Companies Ordinance. The Court also has jurisdiction to wind-up an unregistered foreign company having a sufficiently close connection with Hong Kong, determined by the criteria set out in case law.

The UNCITRAL Model Law on Cross-Border Insolvency has not been adopted in Hong Kong. While foreign insolvencies may be recognised in Hong Kong, such recognition is subject to rules of common law.

QUESTION 2

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2. Creditors' rights aimed to meet claims

2.1 Filing a claim

After a liquidation has commenced, the liquidator will identify a list of the creditors of the company and notify them of the requirement to submit proofs of their claims (known as proofs of debt).

Pursuant to the provisions of the Winding Up Rules, the liquidator in any type of winding up may issue a notice to all known and suspected creditors requiring them to submit proofs of debt not less than 14 days from the date of the notice. The liquidator must also advertise such notice in local newspapers. In a Compulsory Winding-up, the Court may fix a date on or before which creditors must submit a proof of the debt owing by the company to them.

The failure of a creditor to submit a proof of debt on time does not bar their claim, although the creditor will be excluded from the benefit of the distribution made next after that date and from the benefit of any previous distribution.

Formal proof of debt forms are not required in voluntary liquidations, although the liquidators, as a matter of practice, will usually follow the procedures outlined above and invite proofs of debt from creditors.

The proofs of debt are in prescribed forms. The creditor is required to state, with supporting documents, the creditor's name and address, the amount of its claim (and the amount of any claim for interest) as at the date of the winding up of the company, and the particulars of any security held by the creditor. The proof of debt form should be signed by an authorised representative of the creditor and state the name and authority of the signatory. Foreign creditors do not need a domicile in Hong Kong for the purpose of filing a claim.

There is no fixed period within which a liquidator must complete the adjudication of claims and declare a dividend. It is a matter of the liquidator's professional judgment, having regard to the particular facts of the liquidation, whether to continue waiting for claims to be submitted or to start to adjudicate the claims already submitted for the assessment of any dividend payment.

It is also worth noting that, for the purpose of the first meeting of creditors, proofs of debt are submitted by creditors of the company for voting purposes only. Separate proofs of debt will need to be subsequently lodged by creditors for the purpose of distribution, as outlined above.

2.2 Privileges for secured claims

2.2.1 Secured creditors

Secured creditors are generally paid out of the proceeds of their securities before any other claims, save for claims secured by a floating charge. A claim based on a floating charge will rank after the claims of "preferential creditors" as defined in the Companies Ordinance.

Floating charges are securities created over a class of assets of a company which may be changing and the value of which is not fixed, such as the company's book debts and receivables. A claim secured by a floating charge ranks below the claims of preferential creditors. Preferential claims include, for example, the fees and expenses of the liquidator, claims made by the company's employees and any debt due to the government for unpaid taxes, as provided for in the Companies Ordinance.

Secured creditors should note that they must state clearly, in their proof of debt, the security held, and provide supporting documents in respect of such security. Failing to do so may result in the security not been recognised by the liquidators and the secured creditor's claim being treated as an unsecured claim. Secured creditors must also ensure that the document creating the security, together with the particulars of the charge, has been properly registered with the Companies Registrar within 5 weeks after the date of the creation of the document. Failing to do so will render the security void as against the liquidator.

Where a company is in liquidation, a floating charge created within 12 months of the commencement of the winding up shall be invalid except to the amount of any cash paid to the company at the time of or subsequent to its creation, in consideration for the charge. The exception to this rule is where the company was solvent at the time of the creation of the charge.

2.2.2 Priority

Secured claims aside, the expenses of the liquidation, including the expenses used in the preservation and realisation of the company's assets and the liquidator's remuneration, will be paid first out of the company's assets.

Thereafter, the assets of the company will be used to satisfy preferential claims. The Companies Ordinance sets out detailed provisions on the priority to which preferential claims are paid.

Examples of preferential claims include those brought by the employees of the company in respect of unpaid wages and entitlements, and unpaid taxes due to the government. Where the company's assets are insufficient to satisfy all the preferential claims, the employees' preferential claims take priority over the government's claims, and, on the basis that there is insufficient funds to meet such preferential claims, these claims shall be paid out of any assets that are subject to floating charges. Ranking after the preferential claims of employees and of the government are any claims brought upon the distrained goods and property of the debtor company within 3 months before the date of a winding-up order. Thereafter, the assets of the company will be distributed in accordance with the *pari passu principle*, i.e. that the assets of the company are to be distributed equally among unsecured creditors. In practice, situations may arise whereby the company has insufficient assets to pay preferential and / or unsecured creditors. On the other hand, if any assets remain after the distribution to preferential and unsecured creditors, the surplus will go to the members of the company in accordance with their respective rights and interests.

2.3 Continuation of contracts entered into with the debtor

Contracts entered into by the company terminate upon its liquidation. The law does not provide specifically for how contracts should be dealt with after a company's liquidation. However, with the approval of the creditors or the Court, the liquidator may continue to operate the business of the company to complete the particular contract if doing so is beneficial to the general body of creditors. Otherwise, the other party to the contract has a claim against the company for damages arising from the company's failure to perform the contract.

QUESTION 3

3. Creditors' rights aimed to monitor the insolvency proceeding

Before discussing creditors' rights in insolvency proceedings, it should be noted that in compulsory liquidations, where the property of the company is not likely to exceed HK$200,000 in value, the Court may make an order that the company be wound up in a summary manner. In this case, no creditors meeting will be held and no committee of inspection will be formed. The liquidator appointed by the Court may do all things which may be done with the sanction of a committee of inspection as if one was appointed. The appointment and role of the committee of inspection will be further explained below.

3.1 General creditors' rights

Creditors have the right and duty to prove their claims against the company. All debts and liabilities, present or future, certain or contingent, to which the company is subject at the date of the liquidation are provable by the creditor.

Where the liquidator considers the creditor's claim to be invalid or unenforceable, the liquidator has the power to reject the relevant proof of debt in whole or in part, and the creditor will be entitled to written reasons from the liquidator as to the grounds of rejection. The creditor also has the right to appeal to the Court to have the rejection reversed.

A creditor may also apply to the Court to expunge the proof of debt of another creditor if it considers that the liquidator has wrongly admitted the proof.

3.2 Specific rights of information during the proceeding

3.2.1 The first meeting

In both creditors' voluntary liquidations and compulsory liquidations, the creditors will be summoned to a meeting shortly after the winding up of the company to decide on whether to appoint liquidators and a committee of inspection. A committee of inspection comprises a group of 2 to 5 creditors having the power to approve certain decisions of the liquidator during the liquidation.

At the first creditors' meeting, creditors are entitled to a summary statement of the company's affairs prepared by the director of the company or the provisional liquidator appointed by the Court, together with an explanation of its contents. Creditors will be provided with the details of the proposed liquidator, including his / her experience, charges and any prior involvement with the company, for the purpose of considering whether the proposed liquidator should be appointed. The creditors will also receive a brief report on the company's trading history, including the directors' reasons for the failure of the company, coupled with the audited or draft accounts prior to the company's liquidation.

3.2.2 Right to receive periodic general reports

Where the liquidation of a company continues for more than 1 year, the liquidator has the duty (subject to the approval of the Official Receiver) to summon a general meeting of the company at the end of the first year after the commencement of the winding up, and of each subsequent year, or at the first convenient date within 3 months from the end of the year.

At the annual creditors' meeting, the liquidators will provide an account of his / her acts and dealings and of the conduct of the winding up in the relevant year. Further, many liquidators have developed a practice of sending regular written reports to the committee of inspection or to the creditors in general.

3.2.3 Right to be individually informed by the liquidator

There is no provision giving a creditor the right to be kept informed by the liquidator individually. In fact, the liquidator may require the sanction of the Court to disclose certain information to a creditor (such as information and documents obtained by the liquidator through private or public examinations). Whereas liquidators may respond to creditors' queries generally (subject to any requirement to obtain sanction), information is usually available to the creditors through meetings of the committee of inspection (see paragraph 3.3 below), annual creditors meetings held by the liquidators, and any written reports prepared by the liquidators.

3.3 Approval rights delegated to a creditors' committee

A committee of inspection is normally formed to assist and supervise the liquidator in the liquidation proceedings. Certain decisions of the liquidator cannot be exercised without the sanction of the committee of inspection. They include the power to pay creditors in full, to make compromises or arrangements with creditors or to compromise claims against contributories or debtors of the company.

In cases where no committee of inspection is appointed, or the committee has neglected or refused to provide sanction, the sanction of the Court is required before the liquidator can exercise these powers. Matters in relation to the conduct of a committee of inspection are further explained in section 4 below.

3.4 Cross-border and specific country rights

There is no distinction between the rights of a local creditor and a foreign creditor in relation to obtaining information from the company.

QUESTION 4

4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

Creditors meetings will be held by the liquidator except in cases where the summary procedure is applicable (see paragraph 1.3 above). Whereas creditors who are members of the committee of inspection will meet regularly in such period as they may agree with the liquidators, creditors generally will meet at the creditors' meeting held by the liquidator annually.

4.2 Creditors' committee

Creditors' participation in a winding-up is mainly delegated to the members of the committee of inspection.

4.2.1 Nomination

The members of the committee of inspection are elected at the first creditors' meeting after the winding up of the company. They are nominated by a simple majority based on the creditors' claims admitted to vote at that meeting.

A member of the committee may resign by notice in writing signed by that member and delivered to the liquidator.

A committee member may also be removed by an ordinary resolution at a meeting of creditors (if that member represents creditors) or a meeting of contributories (if that member represents contributories) convened with 7 days notice which states the object of the meeting. In addition, where a committee member becomes bankrupt, or is absent from 5 consecutive committee meetings without the leave of the other members, that person shall be automatically vacate from office.

On a vacancy occurring in the committee, the liquidator shall immediately summon a meeting of creditors or of contributories (as appropriate) to fill the vacancy by ordinary resolution, either re-appointing the same member or appointing an alternative member. However, where the liquidator is of the opinion that it is unnecessary for the vacancy to be filled, that member may apply to the Court for an order to that effect.

The rest of the members of the committee may continue to act if there are not less than 2 members remaining.

The maximum number of creditors on the committee is 5. In practice, it is preferable to have an odd number of committee members to prevent the situation where there is a deadlock on voting.

4.2.2 Competence / Powers

In a compulsory liquidation, the approval of the committee of inspection or of the Court is required before the liquidator can exercise the following powers to:

- tapprove and decide on the liquidator's remuneration;
- bring or defend any action or other legal proceeding in the name and on behalf of the company;
- carry on the business of the company, so far as may be necessary for the beneficial winding-up thereof;
- appoint a solicitor to assist that member in the performance of his / her duties;
- pay any class of creditors in full;
- make any compromise or arrangement with creditors or persons claiming to be creditors, or having or alleging themselves to have any claim, present or future, certain or contingent, ascertained or sounding only in damages against the company, or whereby the company may be rendered liable; and
- compromise all calls, claims between the company and a contributory, all questions in any way relating to or affecting the assets or the winding up of the company, take any security for the discharge of any such call, and give a complete discharge in respect thereof.

In a voluntary liquidation, the approval of the committee of inspection is required for the liquidators to do only the last three matters listed above, and the liquidator may summon meetings of the committee to determine any other affairs of the company in the liquidation proceedings as he / she thinks fit.

4.2.3 Voting mechanism

The affairs of the company which require the approval of the committee of inspection will be decided by the members of the committee by a majority of votes. For the meeting of the committee of inspection to take place, the quorum, being a majority of the creditors on the committee, must be present. Provided that quorum is met, the committee of inspection can vote on matters by a majority of votes.

4.2.4 Rights and duties / responsibilities of the members of the committee

The function of the committee of inspection is to assist and supervise the liquidator in the liquidation process. Any rights and duties available to the committee are exercisable by the committee only and cannot be assigned or delegated to other creditors or any third parties. Where a committee member wishes to resign, he / she must resign by written notice delivered to the liquidator.

Members of the committee of inspection cannot, directly or indirectly, make any profit from any transaction arising out of the winding up, receive any payment

for goods supplied to the liquidator, or purchase the assets of the company without the leave of the Court.

4.2.5 Remuneration of the members of the committee of inspection

The members of the committee of inspection do not receive any payment for their services rendered, and they cannot claim against the company for any expenses they incur in attending meetings of the committee.

4.3 Other forms of direct creditors' participation

In a compulsory liquidation, any resolution or direction of the creditors given at a general meeting shall be taken into consideration by the liquidator in administering and realising the assets of the company and in the distribution of such assets among the creditors. Any directions given by the creditors or contributories at a general meeting shall, in the case of a conflict, be deemed to override any directions given by the committee of inspection.

The liquidator may summon general meetings of the creditors or contributories for the purpose of ascertaining their wishes, and that member is under a duty to summon meetings at such times as the creditors or contributories request by resolution at the meeting appointing the liquidator, or whenever one-tenth in value of the creditors or contributories so request.

4.4 Rights related to reorganisation plans and proceedings

There is currently no satisfactory statutory provision in Hong Kong providing or regulating the reorganisation of an insolvent company. Any such arrangements have been done by way of private arrangements entered into between all the interested parties in the company. Such private arrangements are capable of being sanctioned by the Court, in which case they are known as "schemes of arrangements" under the Companies Ordinance. The scheme of arrangement provisions are thought to be unsatisfactory due to the lack of any moratorium or standstill.

Schemes of arrangement operate to bind all or a specific class of the creditors of a company to the arrangement, even if some creditors may not agree with the same. The proposed arrangement must be voted on and approved by three quarters of the class of creditors concerned, voting either by proxy or in person at a meeting of the creditors, and the scheme must subsequently be sanctioned by the Court.

It should be noted that even with the Court's sanction, a scheme of arrangement does not take effect until the order allowing the scheme has been registered with the Companies Registry.

Prior to the creditors' meeting called to vote on a proposed scheme of arrangement, the creditors will be provided with a set of documents, which is usually prepared by the company's solicitors and accountants, containing the following information:

- background to the company's failures and the difficulties faced by it;

- past accounting data; and

- proposals on how the arrangement is intended to operate and how it is designed to solve the financial difficulties of the company.

Such information will assist the creditors in considering their voting options, and will be considered in detail when the scheme is later being considered by the Court.

4.5 Cross-border and specific country rights

Foreign creditors may be appointed as members of the committee of inspection. It is up to the creditor as to whether it attends the committee's meeting in person or by proxy from overseas.

QUESTION 5

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5. Creditors' entitlements aimed at controlling the activities of the liquidator

5.1 Means creditors have to challenge decisions and acts of the liquidator

Creditors may make proposals at a general meeting or, one-tenth in value of the creditors may request that a creditor's meeting be convened by the liquidator, at which a proposal for the removal of the liquidator may be discussed and an ordinary resolution to the same effect be passed.

Alternatively, the Court has the power to remove liquidators in both voluntary and compulsory liquidations. Any aggrieved creditor may apply to the Court for the removal of the liquidator if he / she is dissatisfied with the liquidator's performance of his / her duties or considers for any reason that the liquidator is not qualified to hold such position, provided that the creditor is able to provide evidence to support his / her concerns.

The Court will order the removal of a liquidator only if it considers it appropriate to do so having regard to the evidence available to it. Accordingly, there is no guarantee that such an application will succeed, and creditors should note that any such application to the Court may be expensive and not recoverable from the assets of the company. Further, an unsuccessful creditor may be ordered to pay the liquidators' costs of defending an application for removal.

5.2 Substitution of the liquidator

5.2.1 Procedure

The application to the Court to remove the liquidator is usually made by way of Summons to be heard before the Companies Judge, supported by an affidavit sworn by the applying creditor. There is no time limit within which the creditor must make the application.

Where an order is granted for the liquidator to be removed, the Court will appoint the Official Receiver or another liquidator nominated by the creditors in place of the original liquidator.

5.3 Cross-border and specific country rights (entitlements)

The rights available to creditors are the same irrespective of the jurisdiction in which they reside or operate. Foreign creditors may attend meetings convened by the liquidator by proxy, although they will be required to either attend the Court in person or appoint a legal representative in Hong Kong if any application to the Court needs to be made by them.

QUESTION 6

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6. Creditors' obligations

6.1 Responsibility for the remuneration of the liquidator

The responsibility of the creditors in respect of the remuneration of the liquidator only goes so far as to fixing and approving the remuneration of the liquidator. The actual remuneration will be paid out of the assets of the Company, in priority to the claims of preferential and general creditors. If the assets of the company are insufficient to cover the remuneration of the liquidator, then the liquidator will be paid whatever is available, leaving the creditors with nothing. There have been circumstances where liquidators have agreed to take a reduction on their remuneration to ensure the creditors do receive a distribution (even if it is only a small one).

Where the remuneration of a liquidator is determined by the committee of inspection, it may be in the nature of a commission or percentage of which one part shall be payable on the amount realised, after deducting the sums paid to secured creditors (other than debenture holders) out of the proceeds of their securities, and the other part on the amount distributed in dividend. In practice, however, liquidators usually apply their time costs.

In the case of a compulsory winding-up where there is no committee of inspection, the liquidator's remuneration will be fixed by the scale of fees and percentages for the time being payable on realisations and distributions by the Official Receiver as liquidator.

6.2 Funding special activities of the liquidator (liquidator)

There is no obligation on the part of the creditors to provide funding to the liquidators to recover the assets of the company, although in practice the creditors are generally identified by liquidators as persons who may be willing to provide such funding given their interest in the outcome of such recoveries. The legislation does give credit to those creditors who provide funding to the liquidator in protecting, realizing or preserving the company's assets. Subject to the sanction of the Court, a creditor may obtain a larger distribution from those assets recovered with the assistance of that creditor's funding.

Recently, the Hong Kong Courts have approved of third party litigation funding in insolvency proceedings. Causes of action vested in the company are assets of the company which are capable of being sold or assigned to the funder if the liquidators are (subject to the Court's sanction) of the opinion that the sale would benefit the creditors of the company in general.

INDIA

Introduction

Corporate insolvency

There is no comprehensive insolvency law in India which provides for a systematic and cohesive system for rehabilitation and liquidation of companies and individuals. A number of laws comprise the insolvency system. The revival and rehabilitation of industrial companies which fall within the definition of a sick company as set out under the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) is governed by that Act. A body of experts namely, the Board for Industrial and Financial Reconstruction (BIFR) set up under SICA considers references made by distressed industrial units or creditors of such distressed companies for adopting measures for their revival and rehabilitation. The winding up of companies is carried out under the Companies Act, 1956 (1956 Act). The High Court of each state is vested with the jurisdiction to supervise the liquidation of companies. The official liquidators (OL), who are government officers under the Ministry of Corporate Affairs, are responsible for carrying out the liquidation of companies under the court supervision.

Reorganization

The re-organization or rehabilitation of companies is carried out under the provisions of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) and the relevant regulations.[1]

SICA requires that when an industrial company has become a sick industrial company, the Board of Directors of the said company shall, within sixty days from the date of finalising of the audited accounts of the company for the financial year as at the end of which a company has become a sick industrial company, make a reference to Board for Industrial and Financial Reconstruction (BIFR), comprising of a chairman and members, for determination of the measures for its revival and rehabilitation. However, if the Board of Directors has sufficient reasons even before finalization of accounts to form an opinion that the company has become a sick industrial company, it shall, within sixty days after it has formed such an opinion, make a reference to the BIFR[2].

Non-bankruptcy workouts and restructuring

There is no statute governing the non-judicial rehabilitation, workouts and restructuring of companies. However, such workouts are quite prevalent in financing. The RBI introduced the corporate debt restructuring (CDR) mechanism for restructuring of debt in multiple banking consortium accounts with exposure above Rs. 10 crore in the year 2001. The objective of the CDR mechanism is to ensure timely and transparent process for restructuring of the corporate debts of viable entities facing problems, outside the purview of legal proceedings, for the benefit of all concerned. The legal basis to the CDR Mechanism is provided by the Debtor-Creditor Agreement (DCA) and the Inter-Creditor Agreement. The debtors have to accede to the DCA at the time of loan documentation or at the time of reference to CDR. Similarly, all participants in the CDR Mechanism are required to enter into a legally binding agreement, with necessary enforcement and penal clauses, to operate the System through laid-down policies and guidelines. One of the most important elements of Debtor-Creditor Agreement is 'stand still' agreement binding for 90 days, or 180 days by both sides.

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1 Board for Industrial and Financial Reconstruction Regulations, 1987

2 Section 15(1) of the Sick Industrial Companies (Special Provisions) Act, 1985.

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filling for the declaration of debtor's insolvency

The 1956 Act provides for law relating to corporate insolvency and *inter alia* contains the provisions for winding up of companies. The Companies (Court) Rules, 1959 provide *inter alia* the procedure to be followed in the winding up proceedings. All over India, the liquidation of companies is carried out under the provisions of the 1956 Act and the Rules framed there under. The winding up of a company under the 1956 Act can be by an order of court or voluntary. A company may be ordered to be wound up by Court on petition *inter alia* on the ground that the "*Company is unable to pay its debts*". A company shall be deemed to be unable to pay its debts - if a creditor to whom the company is indebted in a sum exceeding five hundred rupees, has served on the company a demand by registered post at its registered office requiring it to pay the sum so due and the company has for three weeks thereafter neglected to pay the sum; or if execution or other process issued on a decree or order of any court in favour of a creditor of the company is returned unsatisfied; or if it is proved to the satisfaction of the court that the company is unable to pay its debt.

An application to the court for the winding up of a company, can be made by way of a petition presented by the following:

- The company;
- Any creditor or creditors including contingent or prospective;
- Any contributory or contributories;
- Registrar of Companies;
- In a case falling under Section 243 of the 1956 Act, by any person authorized by the central government in that behalf.

Generally, the liquidation proceedings are triggered by creditors and on the recommendations made by Board for Industrial and Financial Reconstruction BIFR under Sick Industrial Companies (Special Provisions) Act, 1985 (SICA).

Similarly under the Presidency Towns Insolvency Act, 1909, and the Provincial Insolvency Act, 1920 a creditor, who has a decree or an award of recovery of a certain amount, can also file a petition against a debtor in case his assets are not enough to pay off the debts. A creditor is not entitled to present an insolvency petition against a debtor unless the debt owed by him to the creditor, or, if two or more creditors join in the petition, the aggregate amount of debts owing to such creditors, amounts to 500 Rupees and the debt is a liquidated sum payable either immediately or at some certain future time. Also, the act of insolvency on which the petition is grounded should have occurred within three months before the presentation of the petition.

1.2 Choice of the insolvency representative

The Companies Act which deals with the law relating to corporate insolvency does not afford an opportunity to the creditor or any other person presenting the winding up petition before court to choose or have any say in the choice of the insolvency representative.

On hearing a petition, the court may dismiss it or adjourn it conditionally / unconditionally or make any order of winding up or pass any interim order or make any other order as it may deem fit, including appointment of Provisional Liquidator (PL).

An Official Liquidator (OL) appointed by the Central Government is attached to each High Court who is a whole time officer. Where a winding up order has been made or where a PL has been appointed, the liquidator takes into his custody or under his control all the property, effects and actionable claims to which the company is or appears to be entitled. All the property and effects of the company are deemed to be in the custody of the court as from the date of the order for the winding up of the company.

Likewise the legislations dealing with personal insolvency do not afford an opportunity to creditor to choose the insolvency representative. The power to appoint insolvency representative is vested with court and court is not put under an obligation to consult any one including creditor. The Court is empowered under the Provincial Act and Presidency Act to appoint an interim receiver after admitting the petition and before the order of adjudication to take possession of the property of the debtor. Consequent to the order of adjudication, the whole of the property of insolvent vests in Court or with a receiver.

1.3 Packaged insolvencies

Pre-packaged deals, where a company facing bankruptcy finds a buyer first, negotiates and agrees on a price and seeks the approval of the bankruptcy court for the sale of assets is not dealt in any of the statute dealing with insolvency law and the concept is non-existent in India. There is no fast-track process or procedure available. However, if a company, on its approaching the BIFR, presents a scheme of reorganization and does not seek any sanction of a formal scheme, and assures the BIFR that it is capable to regaining its net worth within a reasonable time on its own, the BIFR can issue directions without entering into the stage of formation and sanction of scheme.

Besides a scheme of arrangement may also be presented before the Company Court. Sections 389 to 396 A of the 1956 Act deal with the procedure of compromises, arrangement, reconstruction of a company liable to be wound up under the 1956 Act. The Company Court has the power to sanction a scheme envisaging (a) compromise or arrangements with creditors; and (b) enforce such compromises / arrangements.

The Company Court may, on an application made by creditor(s) or member(s) in case of a compromise or arrangement proposed between the Company (which is liable to be wound up) and its creditor(s) / member(s), order a meeting of the creditors / members in a manner it directs. If 3/4 of the value

of creditor(s) / member(s) present and voting agree to any compromise, then they shall be bound by such arrangement or compromise subject to its sanction by Court.

1.4 Cross-border insolvencies and specific country rights

The 1956 Act does not make any distinction between a foreign creditor or claim and the domestic creditor or claim. All the claims against the company are admissible to proof against the company in the winding up, even though the claims are filed by a foreign or a domestic creditor but subject to the tests laid under Section 13 and 44A of Civil Procedure Code, 1908 (CPC) being satisfied.

The CPC also does not contain any provision, which would create any distinction between a foreign creditor, and an Indian creditor or their claims as long as the tests laid under CPC are satisfied.

Under common law and as a general concept, insolvency law has followed the principle of situs of the assets of the debtor. The following observations made by the Supreme Court of India, in the case of *Rajah of Vizianagaram v. Official Receiver*, clearly bring out the legal position of international insolvencies in India. The question before the Supreme Court of India was whether in a winding-up proceeding initiated in India in respect of the business of a foreign company in India, the foreign creditors of that company could prove their claim. The Indian Supreme Court, after examining various precedents under English Law, held that under the provisions of theIndian Companies Act and the general principles, foreign creditors canprove their claims in the winding-up of unregistered companies in India.

The Indian laws concerning insolvency and winding-up closely follow the principles of English common law. The Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 are substantially along the lines of Bankruptcy Act 1914 (repealed). Neither of these two Indian Acts makes any reference to cross-border insolvencies. Indian insolvencies laws do not have any extra-territorial jurisdiction, nor do they recognize the jurisdiction of foreign courts in respect of the branches of foreign banks operating in India. Therefore, if a foreign company is taken into liquidation outside India, its Indian business will be treated as a separate matter and will not be automatically affected unless an application is field before an insolvency court for the winding-up of its branches in India.

QUESTION 2

2. Creditor's rights aimed to meet claims

2.1 Filling a claim

Creditors may file the proof of debt as soon as the company is wound up. If any creditor fails to file proof of his debt with the liquidator within the time specified in the advertisement, such creditor may apply to the Court for relief, and the Court may, adjudicate upon the debt or direct the liquidator to do so. Every creditor has to prove his debt, unless the Company Court in any particular case directs that any creditors or class of creditors shall be admitted without proof. A debt is proved by delivering to the liquidator, an affidavit verifying the debt made by the creditor or by some person authorized by him. An affidavit[3] proving a debt shall include the following:

- contain or refer to a statement of account showing the particulars of the debt;
- specify the vouchers, if any, by which the same can be substantiated;
- whether the creditor is a secured creditor, or a preferential creditor;
- set out the particulars of the security or of the preferential claim.

In case of numerous claims by workmen, all claims shall be substituted by one proof which may be filed by the foreman or any other person on behalf of such creditors. However such proof shall have the effect of separate proofs filed by each of the said workmen.

In case the security is in the form of a bill of exchange or a promissory note or a negotiable instrument, then the same may be produced before the OL and be marked by him before the debt is submitted.

The value of all debts and claims against the company shall, be estimated according to the value thereof at the date of the order of the winding-up of the company or where before the presentation of the petition for winding-up, the company for voluntary wining-up has passed a resolution, at the date of the passing of such resolution.

The liquidator may call for the production of the vouchers, if any, referred to in the affidavit of proof or require further evidence in support of the debt.

In a winding-up by the Court, the OL shall file a certificate containing a list of the creditors who submitted to him proofs of their claims in pursuance of the advertisement and the notices. The proofs, with the memorandum of admission or rejection of the same in whole or in part as the case may be endorsed thereon, shall be filed in Court along with the certificate.

[3] If the affidavit is made by a person authorized by the creditor, it shall state the authority and means of knowledge of the deponent.

After investigation, the liquidator may admit or reject the proof in whole or in part. Every such decision has to be communicated to the creditor. Where the liquidator rejects a proof, wholly or in part, he shall state the grounds of the rejection to the creditor.

If a creditor is dissatisfied with the decision of the liquidator, within 21 days from the date of service of the notice upon him of the decision of the liquidator the creditor may appeal to the court against the decision.

With respect to filling of claim by creditors personal insolvency laws require the court to publish the matter of insolvency in the official gazette of the Government and local papers so that all creditors have a chance to claim their dues. If they do not come forward to claim their share and once the insolvent is discharged, the insolvent is under no obligation to pay any of such creditors. Only those debts that a creditor can prove on the basis of books of accounts and banking transactions to the satisfaction of the official receiver or assignee are taken into account. Court scrutinises the claims on the basis of their genuineness.

2.2 Privilege of secured claims

The secured creditors have an option to remain outside the winding up proceedings conducted under the 1956 Act and enforce their claim under SARFAESI and DRT Act. The banks and financial institutions in order to enforce their claims are required to initiate proceedings under DRT Act by filing an application for recovery of their dues before the DRT. However, for claims below Rupees Ten Lakh (One Million Rupees), the banks and financial institutions are required to go to the civil court, which could either be the District Court or the High Court depending upon the pecuniary and territorial jurisdiction.

For recovery of amount less then rupees one million, a secured creditor can initiate a suit for foreclosure[4] under section 67 of the Transfer of Property Act, 1882. This provision vests in the secured creditors, in the absence of a contract to the contrary, at any time after the mortgage-money has become due to him, and before a decree has been made for the redemption of the mortgaged property, or the mortgaged-money has been paid or deposited, a right to obtain from the court a decree that the mortgagor shall be absolutely debarred of his right to redeem the property, or a decree that the property be sold.

Under SARFAESI, the banks and financial institutions can enforce their security without the intervention of the court. SARFAESI provides that where any borrower makes any default in repayment of secured debt or any installment thereof, and his account in respect of such debt has been classified by the secured creditor as non-performing asset, then, the secured creditor may call upon the borrower by way of a written statutory notice to discharge in full, his liabilities within sixty days from the date of the notice failing which the secured creditor would be entitled to exercise all or any of the rights set out in sub section 4 of Section 13 of SARFAESI. The provisions of SARFAESI relating to security of interest can be invoked by:

- Any banks;

[4] A suit for foreclosure is a suit to obtain a decree that a mortgagor shall be absolutely debarred of his right to redeem the mortgaged property.

- Public financial institution under Section 4A of the 1956 Act;
- Institution specified by Central Government under sub clause (ii) of clause (h) of section 2 of the DRT Act;
- Any other institution or non banking financial company as specified by Central Government;
- International Finance Corporation or a consortium thereof.

The provisions of SARFAESI *inter alia* do not apply in cases where the amount due is less than twenty per cent of the principal amount and interest thereon.

On the expiry of sixty days statutory notice period if the debt is not fully paid by the borrower, the officer(s) so authorized by the secured creditor can enter the premises where the secured asset is lying and take its possession. If there is resistance or there is likely to be resistance, the assistance of the Chief Metropolitan Magistrate or the District Magistrate in whose jurisdiction such secured asset is situate may be sought by the officer to take possession.

Another option available under SARFAESI is to take over the management of the business of the borrower. While in possession of borrowers business, the secured asset can be sold simultaneously to recover the dues.

In case of financial assets by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor is entitled to exercise any of the rights conferred on him unless exercise of such rights is agreed upon by the secured creditors representing not less than three fourth in value of the amount outstanding as on record date and such action shall be binding on all secured creditors

Any person (including borrower) aggrieved by any of the above measures taken by the secured creditor may prefer an appeal to the DRT[5] having jurisdiction in the matter within forty-five days from the date on which such measures had been taken. Any person aggrieved by any order by the DRT under section 17 may prefer an appeal to an Appellate Tribunal.

No suit, prosecution or other legal proceedings shall lie against any secured creditor or any of his officers or manager exercising any of the rights of the secured creditor or borrower for anything done or omitted to be done in good faith under SARFAESI. However, any offence by the company during the time the directors of the secured creditor are holding appointment, would be treated as an offence committed by a company in a normal case is treated.

The secured creditors have an option to enforce their security outside the liquidation proceedings, if any such proceedings are pending.

The secured creditors, other than banks and financial institutions have to approach the civil court for enforcement of security by way of an ordinary suit for recovery or by filing a mortgage suit.

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[5] Debt Recovery Tribunals have been set up in almost all states in India under Recovery of Debts Due to Banks and Financial Institutions Act, 1993 for expeditious recovery of debts due to banks and financial institutions.

In the winding up of a company under the 1956 Act claims entitled to priority or preference in distribution are (a) costs of administering estate, including professional fees, the costs of administering the estate including professional fees are priority dues though they are generally paid by secured creditors, and recovered from the assets; (b) workmen's dues; and (c) debts due to secured creditors to the extent such debts rank under clause (c) of the proviso to sub-section (1) of section 529 of the 1956 Act *pari passu* with such dues, are paid in priority to all other debts. The debts payable to workmen shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

Personal Insolvency laws lay down that in distribution of property of the insolvent, following debts shall be paid in priority to all other debts:

- Debts due to the government;
- Salaries and wages not exceeding the limit specified in the Provincial and Presidency Acts;
- Rent due to the landlord from the insolvent. Clause (c) mentions only the Presidency Act and not the Provincial Act.

The privilege provided to secured creditor is only limited to the extent that a secured creditor has an option to realize his security outside insolvency proceeding. In case a secured creditor opts to join the insolvency proceeding, he shall be required to relinquish his security for the general benefit of the creditors. Where however a secured creditor does not either realize or relinquish his security he shall have to put a value to his security as per his own assessment in which case secured creditor shall be liable to receive a dividend only in respect of the balance due to him after deducting the value so assessed by him.

2.3 Continuation of contracts entered into with the debtor

Upon appointment of an official liquidator in winding up, the official liquidator has the power to disclaim onerous or unprofitable contracts. The official liquidator can disclaim such contracts at any time in the first twelve (12) months of the winding up or within further time granted by the court. The court may then make an order as it sees fit terminating the contract and allowing the contractor to have a claim for a debt based on damages for the termination of the contract which must be proved as part of the winding up. The court may also transfer property as compensation for such liability of the company. The court's power is limited to only being able to cancel onerous or unprofitable contracts and as such, counter-parties can argue whether their contract is onerous. There is no exception for swaps or other contracts.

In rehabilitation under Section 22 of SICA, the BIFR can during the course of a scheme, suspend rights and obligations under contracts or the BIFR can adapt the conditions as it sees fit. This includes Actions taken to enforce rights. These suspensions can only be valid for two (2) years initially followed by extensive of one (1) year up to a maximum of seven (7) years in total. This stay applies irrespective of the terms of any laws or corporate documents that indicate otherwise. When the stay expires the claim and rights become enforceable as if the declaration had never been made and any claim continues on the

same basis. Due to rampant abuse of this provision by unscrupulous debtors, the Second Amendment to CA, 1956 has removed this automatic statutory stay completely. The National Company Law Tribunal (NCLT) to be constituted under the Second Amendment to the 1956 Act however will have the powers to stay pending proceedings against a sick company.

The insolvency system provides only for rejection of such contracts in case of winding up.

As a general rule, liquidation of a company, whether voluntary or compulsory, does not automatically terminate existing contracts unless special provisions to that effect are embodied in such contracts or, by necessary implication, such contracts cannot survive the liquidation. In case a contract is continued then the counterpart has the same status which is available to the principle. No specific exceptions to the general rules have been provided under the legal framework in India.

Provincial and Presidency Acts grant protection to *bona fide* transaction and state that nothing in these legislations shall invalidate the following *bona fide* transaction in the case of insolvency:

- payment by the insolvent to any of his creditors;
- payment or delivery to the insolvent;
- transfer by the insolvent for valuable consideration; or
- contract or dealing by or with the insolvent for valuable consideration.

Provided that any such transaction takes place before the date of the order of adjudication and that such person with whom such transaction takes place does not have notice at the time such transaction takes place of the presentation of any insolvency petition by or against the debtor.

2.4 Cross-border and specific country entitlements

No distinction is made between a domestic and a foreign creditor.

QUESTION 3

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3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditor's rights

The 1956 Act provides for constitution and appointment of a committee of inspection by a liquidator upon direction by the court or by the creditors themselves in some situations. Such committee of inspection is to be constituted either by the creditors themselves or in consultation with creditors of the company and comprises of among others creditors as its members

having power to inspect the accounts of the liquidator at all reasonable times. Under the personal insolvency laws creditors have the following general rights with respect to monitoring the insolvency proceedings:

- A creditor is entitled to appear and oppose the grant of protection whenever an insolvent against whom an order of adjudication is made applies to court for protection from arrest or detention;
- Creditors are entitled to approve or disapprove the proposal for schemes and arrangement presented by debtor;
- Court may authorize the creditors who have proved their debts to appoint a committee of inspection for the purpose of superintending the administration of the insolvent's property by the receiver.

3.2 Specific rights of information during the proceeding

Creditors under the 1956 Act have been granted the following rights with respect to receiving information during the insolvency proceeding:

- Notice of commencement of proceedings

  No notice of commencement of proceedings is issued to the creditors except when a winding up petition is being initiated on the basis of the opinion formulated by the BIFR. However, when the petition is admitted, a citation is issued in the newspapers informing the public at large and creditors in particular, of the admission of the petition. By way of the said public notice, affidavits in support or objection to the winding up are invited from all parties including the creditors. Sometimes, the court issues notice to secured creditors even prior to this stage if it is considered necessary in view of the peculiar facts and circumstances of a case.

- Notice of specific actions by liquidator

  The liquidator does not issue notice to creditors of all actions to be taken by it. However, on certain important issues, the creditors are issued notice like for instance, in the case of the invitation of claims and settlement thereof, and the sale of the asset if the asset under sale is charged to the creditor.

- Notice of date by which claims must be filed

  After the company is ordered to be wound up, the OL, pursuant to the directions issued by the Company Court on administrative side, invites claims from all the creditors and other parties. A notice to file proof of debt is sent to all creditors disclosed in the Statement of Affairs who have not filed their claims against the company.

The OL may fix a certain day, where the creditors of the company are to prove their debts or claims and to establish any title they may have to priority under section 530 of the 1956 Act, or to be excluded from the benefit of any distribution made before such debts or claims are proved. This date shall be not less than 14 days from the date of the notice given to the creditor to prove their debts on or before.

The notice to creditors to prove their debts is advertised in one issue of a daily newspaper in the English language and one issue of a daily newspaper in the regional language circulating in the State or Union Territory. The advertisement contains the date before which the proof of debt is required to be sent to the OL of the Court.

Notice is sent, in case there is a statement of affairs, to every person mentioned in the statement of affairs as a creditor, who has not proved his debt and to every person mentioned in the statement of affairs as a preferential creditor, whose claim to be a preferential creditor has not been established or is not admitted. In case there is no statement of affairs, notice shall be sent to the creditors as ascertained from the books of the company

Notice is sent, to each person who, to the knowledge of the liquidator, claims to be a creditor or preferential creditor of the company and whose claim has not been admitted.

Under the personal insolvency laws, court is obligated to serve a notice of the order admitting the insolvency petition and date of the next hearing on the creditors. Further the notice of an order of adjudication stating the name, address and description of the insolvent, the date of adjudication, the period within which the debtor shall apply for his discharge and the court by which the adjudication is made is also required to be published in the official gazette. The creditors are also entitled to receive notice of date fixed by court for consideration of the proposal of scheme of arrangement made by debtor.

3.3 Approval rights not delegated to a creditor's committee

Under the 1956 Act, there is no committee of creditors. The creditors are not necessary parties at the time of the initiation of the liquidation proceedings. If the winding up petition is admitted, a public notice is issued inviting affidavits in support or objecting to the winding up. The secured creditors and some unsecured creditors join the proceedings at this stage. However, the court can summon the creditors at any stage. The Company Court can also summon the contributories at any stage.

Personal Insolvency laws also do not provide for the establishment of a committee of creditors.

3.4 Cross border and specific country rights (entitlements)

Since Indian insolvency laws do not make any distinction between a domestic and a foreign creditor, all rights available to creditors in general are also available to foreign creditors.

QUESTION 4

4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditor's meetings

There are several provisions in the 1956 Act requiring meeting of creditors to be held on various occasions. A liquidator is obligated to give regard to any directions given by resolutions of creditors and he is also empowered to summon general meetings of the creditors for the purpose of ascertaining their wishes. Further, a liquidator is under an obligation to summon meetings of creditors upon receiving directions by resolution or written request from not less than one tenth in value of creditors.

Committee of inspection constituted from amongst the creditors is also entitled to organise its meetings from time to time.

In the event when voluntary winding up proceedings initiated by the members of the company are being regulated by creditors due to inability of members to submit a solvency certificate, the company is obligated to organise a meeting of creditors coinciding with the general meeting in which resolution for winding up is to be proposed. The Company is under further obligation to notify all the creditors and advertise the notice of meeting of creditors in the official gazette and in two newspapers in the district where the registered office of the company is situated. Further, if such winding up proceeding continues for more than a year a liquidator is required to call a meeting of creditors at the end of each successive year within three months of the end of the year. A liquidator shall in such meetings present an account of his acts and dealings and of the conduct of the winding up during each preceding year.

At the conclusion of winding up proceedings, liquidator is obligated to call a meeting for the purpose of submitting the account of winding up before the meeting of creditors. Every such meeting is called by an advertisement published in official gazette at least one month before the date of meeting.

Meeting of creditors may be held under the Presidency Act after the order of adjudication is made under the direction of court given upon receiving application from a creditor or official assignee. The purpose of the said meeting is to consider the circumstances of the insolvency and the insolvent's schedule and explanation offered by insolvent thereon. Further the Presidency Act also provides for submission by the official assignee of the scheme of arrangement or composition proposed by the insolvent debtor. Furthermore, an official assignee is empowered to summon meeting of creditors from time to time for the purpose of ascertaining their wishes.

The provisions relating to meetings are not that elaborate in the Provincial Act. Similar provision with respect to the approval of the scheme of arrangement or composition proposed by insolvent in meeting of creditors is contained in the Provincial Act. Other than the above provision, the meeting of creditors is not directly dealt with in the Provincial Act. However the High Court is empowered to make rules *inter alia* 'for meeting of creditors'.

4.2 Creditors' committee

There are no provisions prescribing anything on the committee of creditors. The creditors are not necessary parties at the time of the initiation of the liquidation proceedings. The 1956 Act does however, provide for constitution of a committee of inspection from amongst the creditors having power to inspect the accounts of the liquidator at all reasonable times.

Similar to the provisions contained in the 1956 Act, personal insolvency law also in Provincial Act and Presidency Act provide for the constitution of a committee of inspection from amongst the creditors for the purpose of superintending the administration of the insolvent's property by the official assignee.

4.3 Other forms of direct creditor's participation

Besides, the right granted to creditors to hold meetings and constitute committee of inspections, creditors have also been granted some further rights empowering the creditors to oversee and participate in insolvency proceedings. The 1956 Act authorizes any creditor to inspect (a) the statement submitted by the insolvent company to official liquidator containing inter alia particulars about assets, debts & liabilities, details of creditors of the insolvent company; (b) the books kept by the liquidator: (c) audited accounts of receipts and payments of the liquidator.

Likewise, the law on personal insolvency also contains several provisions granting rights to creditors enabling them to participate in the insolvency proceedings. Both the Provincial and Presidency Acts empower the creditor to participate in examination of the insolvent by the court and question the creditor as to his conduct, dealings and property. In the event of an insolvent applying to court for an order of protection of insolvent from arrest or detention, creditor has right to appear before court and oppose the grant of such protection applied for by insolvent. The creditor is also entitled to raise objections against the granting of an order of discharge. Another right that vests with creditor, is to apply to court for an order of arrest of the insolvent after adjudication, if the insolvent has absconded or departed from the local limits of the jurisdiction of the relevant court.

4.4 Rights related to reorganization plans and proceedings

The formal reorganization process is explored under the provisions of SICA. However, a scheme of compromise and arrangement can be presented under the 1956 Act in case liquidation proceedings are pending before the Company Court.

Composition schemes

(a) Voluntary

A sick industrial company can present a voluntary scheme, which may contain provisions for reviving the company on its own. The BIFR, if satisfied, issues necessary directions and no consent of creditors may be required if the scheme had prior approval of creditors or if it does not

contain any provision involving any reliefs and concessions from creditors. It is for the BIFR to satisfy itself of the possibilities of the sick industrial company being able to make its net worth positive within a reasonable period, on its own and without taking any reliefs and concessions from creditors.

(b) Involuntary

In case the sick industrial company is not in a position to make its net worth positive on its own, BIFR appoints an Operating Agency (OA) which generally is the largest creditor and directs the OA to prepare a scheme for revival of a sick industrial company. Generally, the company is directed to prepare and submit a draft scheme to the OA which examines such a scheme and presents the scheme to BIFR after consulting the secured creditors and other concerned parties in the backdrop of the directions issued by the BIFR.

In case the scheme prepared by the OA is acceptable to all the secured creditors and statutory authorities expected to make sacrifices or grant assistance under the scheme, it is sanctioned by BIFR and it becomes binding on all the parties.

Schemes of arrangement

A scheme based on an OTS arrangement between the parties can be prepared, approved and sanctioned by BIFR if all the creditors approve the scheme. Such kind of scheme is based on an understanding reached between the parties of payment of dues on the basis of a schedule of payment of the dues of a creditor in an expedited manner provided some part of it is sacrificed by the creditor. In such a scheme, the debt is paid expeditiously and the accumulated losses come down resulting in restoration of the net worth.

A scheme of arrangement can also be presented before the Company Court. Sections 389 to 396 A of the 1956 Act deal with the procedure of compromises, arrangement, reconstruction of a company liable to be wound up under the 1956 Act. The Company Court has the power to sanction a scheme envisaging (a) compromise or arrangements with creditors; and (b) enforce such compromises / arrangements.

The Company Court may, on an application made by creditor(s) or member(s) in case of a compromise or arrangement proposed between the Company (which is liable to be wound up) and its creditor(s) / member(s), order a meeting of the creditors / members in a manner it directs. If 3/4th of the value of creditor(s) / member(s) present and voting agree to any compromise, then they shall be bound by such arrangement or compromise subject to its sanction by Court.

Creditors and claims

- **Notice of proceedings to creditors**

  - Notice of commencement of proceedings

    Notice of commencement of proceedings is given by the BIFR to the secured creditors, concerned statutory authorities and the appropriate government after the reference filed by a company has been registered and the matter has been assigned to the bench of the BIFR. Such notice invites the secured creditors to file their response including on the claim of the company of being a sick company so that they can be considered at the first meeting of the bench. However, no notice is required to be given to creditors before the registration of the reference.

  - Notice of specific actions by debtor or fiduciary

    There is no specific provision under SICA requiring debtor to give notice of specific action. However, such condition can be imposed by BIFR.

  - Notice of date by which claims must be filed

    There is no provision for filing of claim under SICA. However, the BIFR can set dates by which the creditors must inform of their dues so that they can be taken into consideration while preparing the scheme for reorganisation.

- **Submission of claim to court**

  There is no provision for submission of claim before BIFR. The BIFR only asks the secured creditors to inform about its dues for the purpose of preparing the scheme.

- **Allowance or disallowance of claim**

  The BIFR / AAIFR cannot allow / disallow claims of secured creditors. The BIFR can direct parties to reconcile the dues in case of dispute but cannot direct bank to accept the result of any such reconciliation. As regards the dues of unsecured creditors, the BIFR goes by the balance sheet of the company. The unsecured creditors can also submit their claims. If they are disputed by company and the company claims a different amount, the unsecured creditor is given an option to either take permission to file legal proceedings to get the debt determined or accept the amount being stated by the company and get paid as per the scheme being prepared. The BIFR has the power to waive some of the dues of unsecured creditors though if the amount is high, the unsecured creditor is heard by the BIFR. Normally, the BIFR does not reduce the amount and only approves spreading of payment of the entire amount.

- **Claims secured by real and personal property**

  During the reorganisation process, the enforcement rights of creditors are suspended and they cannot enforce their rights without consent of BIFR / AAIFR. Normally, consent to execute securities is not granted.

  Schemes for reorganisation based on sale of surplus assets are sanctioned by the BIFR if acceptable to secured creditors (if the asset is charged to them). In such a case, a scheme is prepared based on the approximate value of property to be sold. The secured creditors agree for payment of their dues on realisation of sale proceeds and the distribution is dealt by the schemes.

- **Claims entitled to priority or preference in distribution**

  Claims entitled to priority or preference in distribution are (a) costs of administering estate, including professional fees, costs of administering the estate including professional fees are priority dues though they are generally paid by secured creditors and recovered from the assets; (b) workmen's dues; and (c) debts due to secured creditors to the extent such debts rank under clause (c) of the proviso to sub-section (1) of section 529 of the 1956 Act *pari passu* with such dues, are paid in priority to all other debts. The debts payable to workmen shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

- **Claims of general creditors**

  The unsecured creditors do not have a right of hearing before the BIFR. Some unsecured credits submit their claim before the BIFR. If they are disputed by the company and the company claims a different amount, the unsecured creditor is given an option to either take permission to file legal proceedings to get the debt determined and, paid as per the scheme being prepared. The BIFR has the power to waive the dues of unsecured creditors though if the amount is high, the unsecured creditor is heard by the BIFR. Normally, the BIFR does not reduce the amount and only approves spreading of payment of the entire amount.

  Likewise, the Presidency and Provincial Acts also lay down similar provision as regards schemes of compromise or arrangement with respect to personal insolvency situations. Every such proposal of compromise or arrangement is required to be placed before meeting of creditors by official assignee. A notice is sent to each creditor along with a copy of the insolvent' s proposals with a report thereon. This proposal is required to be accepted by majority in number and three-fourths in value of all the creditors whose debts are proved.

4.5 Cross-border and specific country rights

No distinction is made between a domestic and a foreign creditor.

QUESTION 5

5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

With respect to corporate insolvency, in terms of the provisions of the 1956 Act any order made in matter of winding up of a company is appealable. Appeal against such order made by any court may be made to a court to which appeals in the usual course are made against the decisions and orders of the former court.

With respect to personal insolvency, if the creditor is aggrieved by the order or decision made in the insolvency jurisdiction by court subordinate to a district court may appeal to the district court against such decision or order. Order of the district court upon such appeal shall be final. High Court has been empowered to call for any case for the purpose of satisfying itself that the order in appeal made by the district court is according to law.

5.2 Substitution of the insolvency representative

The entitlement to substitute the insolvency representative with any other once the proceedings have been commenced is not available to any party to the insolvency proceeding under any of the statute dealing with insolvency.

5.3 Cross-border and specific country rights (entitlements)

All reliefs as available to a domestic litigant are available, to foreign litigants too.

QUESTION 6

6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

The fee of the court is always paid by and is the responsibility of the petitioner who files the petition in court and if the petition is filed by the creditor then the creditor will be responsible for all the costs associated with such a petition.

6.2 Funding special activities of the insolvency representative (liquidator)

All expenses incurred during liquidation including the liquidator's remuneration are paid out of the assets of the insolvent company.

6.3 Specific Country entitlements

The law does not make any distinction between foreign and domestic creditors and entail identical obligations on both.

Basic Documents

1. Chapter Vll of The Companies Act, 1956
2. The Companies (Court) Rules, 1959
3. The Sick Industrial Companies (Special Provisions) Act, 1985
4. The Provincial Insolvency Ac, 1920
5. The Presidency Town Act, 1909

INDONESIA

Introduction

Indonesia adopted the Bankruptcy Ordinance from the Netherlands Indies Government, first enacted in 1906. The Bankruptcy Ordinance was later amended by Bankruptcy Law Number 4 of 1998. This law was enacted as a result of the economic crisis that occured during the same year and based on IMF's encouragement. In the year 2004 the laws were amended again by Law Number 37 of 2004 on Bankruptcy and Suspension of Payment (the "Bankruptcy Law"). This chapter will focus on the regulatory framework as well as the implementation and practical aspect on corporate Insolvency in Indonesia from a creditor's point of view.

A company is deemed insolvent once a declaration of bankruptcy is made by court. Such an order will be made in the following circumstances: (i) no composition plan is submitted by the company to the creditors, (ii) a composition plan is submitted but subsequently rejected by the creditors, or (iii) a composition plan is submitted and subsequently approved by the creditors but is not ratified by the court. Insolvency can also lead to the liquidation of a company.

A company that is declared bankrupt is not automatically dissolved. It can be dissolved either upon a resolution of shareholders or upon application by a bankruptcy creditor to the court for a liquidation order.

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

Bankruptcy process can be initiated by both debtor and creditor, provided that the debtor must have two or more creditors and does not pay in full at least one debt which is due and payable.

The Bankruptcy Law also specifies the definition of "debt which is due and payable" as obligation to pay a debt that is due, either because it has been agreed (in writing), because of accelaration of payment as agreed, resulting from the improvement of penalty or sanction by the authorized party, or because of court decision, or decision of arbitrator / board of arbitrator.

The Bankruptcy Law limits the procedure to file bankruptcy petition for the following legal entities:

- Bank Indonesia will be the only institution that may file a bankruptcy petition on a bank;
- Capital Market Supervisory Board, will be the only institution that may file bankruptcy petition on: (i) Security Company, (ii) Stock Exchange, (iii) Clearing Guarantee Institution, and (iv) Central Securities Depository;

- Minister of Finance will be the only institution that may file bankruptcy petition on: (i) Insurance and/or Re-insurance companies, (ii) Pension Funds, and (iii) State Owned Enterprises those are involved in public interest; and

- Public prosecutor may also submit bankruptcy petition for the sake of public interest in the event that a debtor has two or more creditors and fails to repay at least one mature and payable debt, and no bankruptcy petition has been filed against the debtor.

The Bankruptcy Law does not provide specifically for voluntary liquidations, although a debtor is entitled to present a petition for its own bankruptcy. However, there is scope under the general Company Law (Law Number 40 of 2007) and the Articles of Association for a debtor that is a limited liability company to commence a voluntary liquidation of its business. This may be initiated by a resolution adopted by shareholders in a general meeting, and followed with notification to all creditors and the related government agencies.

Once a resolution for liquidation has been passed, the company is not able to conduct any legal action except for that necessary to realize the Company's assets as a part of the liquidation process and distribute proceeds to creditors.

1.2 Choice of the insolvency representative

The applicant of a bankruptcy proceeding may propose an independent insolvency representative known as "receiver" to be approved by the Commercial Court through its bankruptcy decision.

The receiver must be independent and free of conflict of interest with the debtor and creditors. In practice, a receiver is either a solicitor or an accountant. To become a receiver, an individual must be registered at the Department of Law and Human Rights.

1.3 Packaged insolvencies

The Bankruptcy Law provides suspension of payments (moratorium) as a formal corporate rescue proceeding that is available. Suspension of payment is proposed by either the debtor or creditor and followed by a composition plan. Suspension of payment will be declared by the court based on the approval from the unsecured as well as secured creditors based on the following quorum: (i) approval of more than 1/2 of the total number of unsecured creditors that are present and represent at least 2/3 of the total acknowledged or temporary acknowledged debt of the unsecured creditors or their authorized representatives that are present at such hearing; and (ii) approval of more than 1/2 of the total number of secured creditors that are present and represent more than 2/3 of the total amount of outstanding receivables payable to the creditor (both secured and unsecured) and who are present or being represented in such hearing. During a suspension of payment, an administrator is appointed by the court for the purpose of jointly running the company with the debtor.

Other than the suspension of payment, informal approach through out-of-court debt restructurings are implemented in the form of debt rescheduling, debt refinancing, conversion of debt into convertible notes, and debt to equity swaps.

1.4 Cross-border insolvencies and specific country rights

Indonesian Bankruptcy Law adopts the principle of universality, that is, a bankruptcy declared in Indonesia will include all assets owned by a debtor no matter where those assets are located. However this principle is limited by the principle of sovereignity, in which implementation of the law can only be implemented in a foreign country if it is allowed under the regulation of such country. It requires that a creditor who has enforced its rights over assets abroad of an Indonesian debtor, whilst the creditor is an unsecured creditor, to refund to the bankruptcy estate in the same amount of its claims. A receiver must investigate whether there are any assets of debtors located overseas, and can commence a lawsuit based on preferential transfer provisions. A receiver may request the co-operation of a debtor for the liquidation of its assets located offshore, so that the proceeds can be included into the bankruptcy estate.

On the other hand, a bankruptcy declared overseas, theoritically will not bring any impact to the assets of the offshore company that are located in Indonesia, unless there is a special international treaty between the two countries.

Pursuant to Indonesia's Civil Code, in the absence of any international agreements stipulating otherwise, decisions of foreign courts do not have direct effect in the territory of the Republic of Indonesia. New actions must be brought in Indonesian courts for determination by the court under local laws.

QUESTION 2

2. Creditors' rights aimed to meet claims

2.1 Filing a claim

Within a maximum of 5 days from a court order declaring the debtor bankrupt, the receiver appointed by the Commercial Court must issue public notification of bankruptcy. Such notice must be published in at least two newspapers and in the State Gazette of the Republic of Indonesia. In addition to that a receiver must also send notification to creditors that have been identified by the receiver.

Creditor's claims are submitted to the address as notified by the receiver in public announcements. The date and venue of the first creditors meeting will be determined by the Supervisory Judge, but must be conducted within 14 days from the date of the court order approving the petition.

2.2 Privileges for secured claims

Bankruptcy has no effect on secured creditors, except that secured creditors are stayed from enforcing their rights in bankruptcy. Pursuant to Article 55 of the Bankruptcy Law, secured creditors are creditors holding security rights over mortgage, pledge, and fiduciary securities.

The granting of a bankruptcy petition automatically triggers a moratorium on legal proceedings for enforcement of claims by secured creditors for a maximum period of 90 days commencing from the date of granting the order. Once the stay is lifted, secured creditors are free to enforce their security but must do so within two (2) months from the commencement of the state of insolvency or will, upon subsequent enforcement of their security, become liable to contribute to the costs of the bankruptcy. The state of insolvency is stipulated in Article 178 paragraph 1 of the Bankruptcy Law, and will immediately commence once: (i) no composition has been offered, (ii) the composition plan has been rejected, or (iii) its ratification has been refused by the Commercial Court. Following the state of insolvency, the receiver will distribute the bankrupt estate to creditors.

Article 56 paragraph 3 of the Bankruptcy Law stipulates that adequate protection required to protect the interests of the secured creditors may consist of: (a) compensation for the diminution in value of the bankrupt estate; (b) the net proceeds of a sale; (c) replacement of real security rights (i.e. pledge, mortgage, or fiduciary security rights); (d) fair and reasonable remuneration and other cash payments.

2.3 Continuation of contracts entered into with the debtor

Upon declaration of a Bankruptcy decision: (a) execution / sale of debtor's assets will stop; (b) attachments will be cancelled, except for: (i) secured creditors, (ii) auction which date has been determined, in such case the sale can proceed with the approval of the supervisory judge. The sale proceed will become a part of the bankruptcy estate.

Once the bankruptcy was declared, contracts to transfer assets, security documents, mortgage, fiduciary security, may not be implemented, contracts for sale of goods, is also terminated. Consequently any party who suffer loss may become unsecured creditors. On the other hand if the bankruptcy estate suffer loss due to the cancellation of contracts, then the counter part to the contract must pay compensation to the bankruptcy estate. Rent / lease, can be stopped provided that prior termination notice must be issued based on ordinary practice (at least 90 days). However termination of rent / lease cannot be implemented during a period where the rental has been paid upfront. Continuation of other contracts will depend on the decision of the receiver. In the event that a receiver refuses to continue the contract, the counter part who suffer loss may also become an unsecured creditor.

2.4 Cross-border and specific country entitlements

Under the laws of the Republic of Indonesia, any party may enter into a contract which is governed by and interpreted in accordance with foreign law, provided that the law chosen has some relationship with the contract or the parties to the contract and that it is not contrary to public order in the Republic of Indonesia and provided that, based on the statements of expert witnesses, the courts will be in a position to determine the applicability of the foreign law as the governing law of the contract.

The submission to and a judgment of a foreign (non-Indonesian) court as referred to in a contract will not be enforceable by the courts in the Republic of Indonesia, unless there is a bilateral treaty between the Republic of Indonesia

and the country in which the judgment was rendered. A non-Indonesian judgment may, however, be given such evidentiary weight as an Indonesian court considers appropriate and re-examination of the issues would be required before an Indonesian court in order to enforce the claim on the subject of the foreign judgment in the Republic of Indonesia.

QUESTION 3

3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

In general all creditors have the rights to receive repayment of their claims, as this is governed by Article 1131 of Indonesian Civil Code.

However Article 1133 of Indonesian Civil Code and the Bankruptcy Law classified the following creditors with preferential rights:

a) Secured Creditors who has privilege rights in accordance with Article 1134 of Indonesian Civil Code that consist of creditors holding the following security rights: (i) pledge, (ii) mortgage, and (iii) fiduciary rights.

b) Receivables with particular privileges that consist of: (i) court proceeding fee for the enforcement of security; (ii) rental fee of immovable goods; (iii) unpaid purchase price of movable goods; (iv) expenses incurred to secure respective goods; (v) fees owing to a skilled labour for the performance of a certain task; (vi) transportation expenses; (vii) accommodation expenses; (viii) compensation to be borne by employees for any duties misconduct.

c) The following receivables have preferential rights over immovable and movable assets and will be repaid from the proceed of the sale of such immovable and movable assets: (i) court proceeding fees for the enforcement and settlement of legacy (such fees shall have preferential rights than mortgage right and pledge); (ii) expenses for interment; (iii) medical expenses; (iv) employee's wages; (v) receivables arising for the delivery of foods to the debtors during the last six months period; (vi) receivables arising from the dormitory entrepreneur; (vii) receivables to be paid to children (for daily and educational expenses).

Upon the declaration of bankruptcy, in addition to its rights to receive payment a creditor is entitled to:

- submit claims, attend creditors' meeting and cast votes in such meeting; and
- file an objection letter against the receiver to the supervisory judge in relation to the actions of the receiver.

3.2 Specific rights of information during the proceeding

3.2.1 The rights to be notified

A creditor has the right to be notified on: (i) the bankruptcy of its debtor, (ii) the schedule of creditors' meeting, (iii) deadline of submission of claims, and (iv) deadline of tax verification, either through a newspaper publication or based on a written notice issued by a receiver addressed to the creditor. Such newspaper publication will be deemed to allow all creditors to be aware of the bankruptcy of the debtor. Creditors who domicile outside Indonesia and face difficulties to comply with the deadline of claim submissions are allowed by Article 133 paragraph 3 of the Bankruptcy Law to deviate from such deadlines and may still submit their claims upon the lapse of the deadline. Even though the law does not stipulate the expiration of such extension date, however filing of such claim should be done before the completion of the entire bankruptcy process.

3.2.2 The rights to view the General Register

Creditors as well as other individuals are entitled to view the General Register maintained by the Court Registrar which contains the following information by indicating the date of each item:

- summary of bankruptcy decision or decision cancelling the bankruptcy;
- brief description of the composition plan and the ratification of the composition plan;
- deletion of composition plan;
- amount of distribution in settlement;
- rrevocation of bankruptcy; and
- rehabilitation of debtor.

3.2.3 The rights to view the Claim Verification Report

A receiver must make available minutes of claim verification and the verification report upon the completion of claim verification. These documents are made available at the Court Registrar as well as the office of the receiver and can be accessed by creditors.

3.3 Approval rights not delegated to a creditors' committee

The following rights of creditors in a bankruptcy proceeding are not delegated to a creditor's committee:

- attend claims verification meetings and submit claims to be verified;
- request a receiver to explain each receivable and their placement in the list, or to object to claims, preferential rights, retention rights, or to approve objections by a receiver;

- giving oath about the accuracy of its receivable;
- cast votes in acreditors' meeting;
- request for the cancellation of a composition which has been ratified if it appears that the debtor has failed to comply with the terms of the composition plan;
- request the business of the company to be ceased.

3.4 Cross-border and specific country rights *(entitlements)*

Foreign creditors have the same rights as local creditors.

QUESTION 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

A creditors meeting is chaired by a supervisory judge. The receiver must be present in the meeting. The day, date, time and place of the first creditors meeting will be determined by supervisory judge and has to be convened within the latest of 30 days from the date the bankruptcy decision is declared.

Following that, the supervisory judge will conduct other meetings if it is deemed necessary by: (a) the creditors commitee, and (b) at least 5 creditors who represent 1/5 of the total receivables acknowledged or accepted with a condition.

The creditors meeting will be announced through newspapers and will be notified through registered mail or by courier, to those creditors who have registered.

Resolution in creditors meetings are past based on approving votes of more than 1/2 of the total votes (by number of creditors) cast by the creditor and / or its proxy who attend the meeting.

In the event that a creditor will attend creditors meeting and does not use its voting rights, the creditor will be deemed as casting rejecting votes.

Assignment of receivables following to the bankruptcy declaration will not result in any voting rights for the new creditor.

4.2 Creditors' committee

A committee of creditors can be formed on the request of creditors and subsequently appointed by the court. The committee is also entitled to examine all books, statements and documentation relating to the bankruptcy proceedings.

A creditors' commmittee is formed with the objective to give advice to the receiver, including to propose amicable settlement to end an ongoing court dispute or to prevent any court dispute, as well as to give written opinions on the composition plan in a claim verification meeting.

A creditors'commitee is formed by the court from 3 creditors who have registered their claims to be verified. Once the claim verification is completed, the creditors'committee will be formally appointed by supervisory judge as permanent creditors' commitee.

4.3 Other forms of direct creditors' participation

There are no other forms of direct creditors' participation other than what is described above.

4.4 Rights related to reorganization plans and proceedings

Reorganization plans can only become effective if it is approved by the creditors and the Commercial Court. Reorganization as a result of a voluntary suspension of payments will be applied to both secured as well as unsecured creditors. Upon receipt of a petition for voluntary suspension of payments submitted by either a debtor or creditor, the Commercial Court will immediately issue an order for the temporary suspension of payments by the debtor. Following to that, the administrator will convene a creditors' meeting to vote on: (i) a proposed composition plan; or (ii) the conversion of the temporary suspension of payments into a permanent suspension of payments and the duration of the suspension.

The meeting of creditors must be held within 45 days from the date that the Commercial Court approved the temporary suspension of payments. The creditors may supervise the implementation of the court decision by granting a permanent suspension of payments for a period that shall not exceed 270 days from the date of the court decision.

The plan must be approved by:

a) more than 50% of unsecured creditors present at the meeting who represent at least 2/3 of the total unsecured debts of the creditors who attend the meeting; and

b) more than 50% of secured creditors present at the meeting who represent at least 2/3 of the total secured debts of the creditors who attend the meeting.

4.5 Cross-border and specific country rights

Foreign creditors are treated in the same manner as local creditors.

QUESTION 5

5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

Any creditor, the creditors committee and the debtor may submit a letter of objection to the supervisory judge to object to any legal action by the receiver or request the supervisory judge to issue an order instructing the receiver to carry out or not to carry out certain planned legal action.

5.2 Substitution of the insolvency representative

The court may at any time approve a proposal for the replacement of the receiver, after having summoned and heard the receiver concerned, and may appoint another receiver and / or appoint an additional receiver based on the request of:

- the receiver himself;
- another receiver if any;
- the supervisory judge; or
- the bankrupt debtor.

The court must dismiss or appoint a receiver at the request or at the proposal from concurrent creditor based on the resolution of the creditors' meeting, provided that such a decision is taken on the basis of an affirmative vote of more than 1/2 of the total concurrent creditors or their proxy who are present at the meeting, and who represent more than 1/2 of the total claims of the concurrent creditors or their proxy who are present at such meeting.

5.3 Cross-border and specific country rights (entitlements)

The Bankruptcy Law does not provide legal basis to treat foreign creditors differently from local creditors.

QUESTION 6

6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

In the event that a bankruptcy petition has been approved, then the remuneration of a receiver will be determined by the first creditors meeting. Receiver's remuneration will be paid from the bankrupt estate. The Minister of Law and Human Rights has issued regulations governing the amount of such remuneration.

6.2 Funding special activities of the insolvency representative (liquidator)

All expenses incurred in relation to the bankruptcy process will be borne by the bankruptcy estate. A creditor does not have any obligation to finance the bankruptcy process.

6.3 Specific country entitlements

There are no specific country entitlements in relation to the bankruptcy expenses. In the event that the value of the bankruptcy estate is not sufficient to cover the bankruptcy expenses, the Commercial Court based on a request to the supervisory judge is entitled to request for the court to revoke the bankruptcy status of the debtor.

Basic forms

The Bankruptcy Law does not provide basic forms for the bankruptcy proceeding. Applicants are free to use their own forms of bankruptcy application as well as all relevant documents.

ITALY

Introduction

Italian insolvency proceedings are designed to equally satisfy all creditors of a company that is unable to meet all of its liabilities in full. Traditionally, this goal was achieved through a liquidation / disbandment of the debtor company.

Since the reforms that were introduced to the Italian insolvency law during 2006 / 2007, there are more opportunities for reconstructions which can be dealt under the freedom of contract between the creditors and the debtor and courts and "administrators" only assume a supervisory role. In practice however the reconstruction with the creditors involved is somewhat still limited. In the majority of insolvency cases, the company is still liquidated and the liquidation proceeds are distributed to secured and unsecured creditors, consequently long drawn out proceedings have to be expected.

At the same time, the new reforms that were introduced have strengthened the creditor's rights.

This chapter primarily deals with small to medium businesses. The Italian insolvency proceedings pertaining especially to large companies and for example insurance companies, such as "*amministrazione straordinaria delle grandi imprese in crisi"* and *"Liquidazione coatta amministrativa"* are therefore not dealt with here.

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

Only companies of a certain size are eligible for liquidation through an insolvency proceeding, i.e. the assets of consumers, small companies and tradesmen cannot fall under insolvency proceedings, even if these people are insolvent. Further, in order for insolvency proceedings to be applicable a debtor otherwise subject to insolvency would have to have accumulated liabilities of at least € 30.000.

The petition for bankruptcy may be prevented by one or more creditors. The only requirement is that the creditor proves his claim and the absence of payment by the debtor. It is legally not required that an enforceable title exists. In practice, petitions are only filed after the unsuccessful execution of an enforceable title.

1.2 Choice of the insolvency representative

The choice of the administrator (insolvency representative) *"curatore fallimentare"* is made solely by the insolvency court. Nominations of an insolvency representative based on a creditor's or a majority of creditor's suggestion is, at least in smaller proceedings, unthinkable, because otherwise there would be concerns as to the insolvency representative's impartial ability to represent all creditor's interests equally. In special large proceedings of

national importance, the nomination of the insolvency representative is made on recommendation of the *Ministero dell'Industria*.

In practice it is often the case that younger tax advisers or solicitors are appointed as insolvency representatives in smaller proceedings, who often possess neither adequate experience nor structures. So far, they either receive only an inadequate consideration or none at all due to the absence of funds in the insolvency mass. Although a decision was passed by the Italian Constitutional Court in 2006 the State was supposed to take care of the insolvency representative's consideration in such cases.

1.3 Packaged insolvencies

In cases of insolvency of small and medium sized businesses a practice has developed to structure insolvent companies as *packaged insolvencies*. In such situations the insolvent company is wholly leased to a new-co *(affitto d'azienda*), where this new-co is often administered by the owners of the insolvent company or persons close to them. The profits go to the insolvent company and are used – within the framework of a liquidation even without formal insolvency proceedings – to partially satisfy creditors of the old-co.

This procedure is often unsatisfactory to smaller creditors because they often have only unsecured claims and generally receive minimal dividends, if any. Although lower dividends are to be expected in such insolvency proceedings regarding the assets of the old-co (due to higher costs of proceedings, which are paid preferentially) this type of "reconstruction proceedings" is often the lesser of two evils for the creditors.

(Please see 4.4 below regarding the reconstruction proceedings introduced within the reform of Italian insolvency law and the special creditors' rights within these proceedings).

1.4 Cross-border insolvencies and specific country rights

According to Italian insolvency law, when compared to the rights of creditors who do reside in Italy no restrictions exist on the rights of creditors not residing in Italy.

Italian insolvency proceedings with relations to other European countries are conducted in accordance with the European Insolvency Regulation (Reg. 1346/2000 / EG of 29.05.2000) if cross-border matters are affected. In accordance with this Regulation creditors have the opportunity to petition for the opening of so-called secondary (or territorial) insolvency proceedings in respect of those assets of the debtor located in Italy. Experience has shown however that this opportunity is seldom taken up.

Italy has not entered into any bilateral agreements with third party states that could be applicable to insolvency proceedings having regard to countries outside Europe.

Insolvency proceedings can also be petitioned in respect of the assets belonging to foreign companies, who carry out commercial activities by means of a dependant subsidiary in Italy.

QUESTION 2

2. Creditors' rights aimed to meet claims

In accordance with Italian law, agreements entered into by the debtor can only oppose the insolvency representative under strict formal conditions. Evidence has to be submitted that the agreement was entered into before the commencement of insolvency proceedings. This is usually done by registering the appropriate contract in the official register or when it arises out of an official document. Should neither be the case, the application of a "secured date" (*data certa*) can, for example, be used as evidence that the agreement was entered into before the opening of insolvency procedures. In such cases where insolvency risks exist regarding one contract party creditors should be advised to make the agreement "insolvency protected" by the application of a "secure date" in any agreements entered into with the debtor. This can be done by affixing a simple stamp to the relevant document. The Italian postal service provides a special service for this.

2.1 Filing a claim

In proceedings where it is expected that the insolvency mass will be available to satisfy creditors, the appointed insolvency representative will inform the creditors (or rather those who are identifiable from the debtor's accounts) regarding the time frame during which claims in the insolvency can be registered. In smaller proceedings, where it is expected that no payment of dividends will be possible to creditors, the liquidator can decide not to send this information.

The registration of claims into the insolvency mass is made by filing of the appropriate application at the relevant insolvency court. Use of specific forms has so far not been used in Italy. Some courts accept filing of the application by electronically certified means. Within the framework of application of European Insolvency Regulation the application can be made in the creditor's own language and it has to be visible in the Italian language within the text of the application that this concerns registration of a claim, that is to say a *"Insinuazione di Credito".* In practice, this method cannot be recommended because substantial insecurities exist in Italy regarding the application of the European Insolvency Regulations and the insolvency court can demand from the creditor a translation of the registration of the claim into the Italian language.

The application for registering the claim has to be received by the applicable court at least 30 days before the date for examination of registered claims, and has to be signed by the creditor or by a solicitor in possession of a Power of Attorney (in the case of electronic transmission the signature has to be certified appropriately). Late applications are possible under certain circumstances, but the creditor who registers claims belatedly does not participate in the payout of those dividends however which were carried out before his claim was recognised or approved.

The registration of the claim has to accurately define the claim according to reasons and amount, apart from some formal requirements (description of the applicable court, details regarding the creditor's identity, signatures) and should also state any possible priority rights. The creditor also has to nominate someone within the insolvency court's jurisdiction to accept service. The last requirement, although it is legally binding, is not always applied by all courts and insolvency representatives with the consequence that in such cases information regarding the state of the proceedings is sent also to addresses that are outside the insolvency court's jurisdiction.

2.2 Privileges for secured claims

2.2.1 Separation of assets (*rivendicazione e restituzione*)

Creditors who can claim secured and / or personal rights to items in the debtor's ownership or possession can register these claims in the same format and under the same arrangements as creditors who register claims against the insolvency mass. The decisive factor for the enforcement of such claims is that the creditor defines such items (stationery or moveable) that he claims accurately and distinctively. This is especially important in the case of a sale under retention of title *(vendita con riserva di proprietà)* or in the case of leasing arrangements for the production of goods on the debtor's order.

2.2.2 Object of security rights - satisfaction out of assets (*privilegi*)

The basic principle of *par condition creditorum* in its strictest interpretation is breached by numerous general priority claims regarding any of the debtor's assets or claims regarding specific separate assets *(privilegi)*.

General priority claims are held by employees, sales agents, workmen, social security providers, fiscal authorities as well as generally the State.

Priority claims restricted to certain goods can, under certain formal conditions, be awarded to the conditional vendor of machinery in respect of the machinery sold as well as to the State regarding any outstanding taxes in connection with the moveable goods of commercial companies.

In practice, these priority claims often result in situations where unsecured creditors cannot expect any payment of dividends on their claims or only very small ones.

Creditors secured by mortgages or by right of lien can satisfy themselves out of the charged assets even in the case of insolvency on a priority basis due to these securities.

Creditors with claims against the insolvency mass itself (this includes claims arising from the continuation of the debtor's contracts with creditors by the insolvency representative after the opening of proceedings) receive satisfaction out of the insolvency mass, whereby only the surplus of the realisation of such goods secured by mortgages, or right of lien after the satisfaction of creditors secured is added to the insolvency mass.

2.3 Continuation of contracts entered into with the debtor

If no legal provisions exist to the contrary, the continuing fulfilment of those contracts not already fulfilled by both parties is initially suspended by the opening of insolvency proceedings. This is in order to afford the insolvency representative the opportunity to decide autonomously (but with agreement of an appointed creditors' committee if appropriate) about the performance / fulfilment of these contracts. Practically, this rule very often leads to drawn out insecurities regarding the continuation of contractual relationships. The creditor involved (i.e. contractual partner of the insolvency debtor) is however able to involve the court in setting a time frame for the insolvency representative, during which he has to decide whether he wants to fulfil the suspended contract or not. The time frame can be 60 days at most. If the liquidator does not make a decision during the time frame set, the contract is deemed to have been annulled.

It is a basic principle that, if the order to open insolvency proceedings includes an order for the continuation of the business, all contracts not completely fulfilled at the date of the opening of proceedings will be continued by the insolvency representative.

The law provides separate provisions for certain types of contracts. They are explained below.

2.3.1 Contracts where the subject is a company lease (*affitto d'azienda*) are continued in the event of the lessee's insolvency as well as in the event of the lessor's insolvency. Both contractual parties (this means not only the appropriate insolvency representative) have a special right to terminate, which has to be exercised within 60 days after the opening of the insolvency proceedings and is only binding for payment of "appropriate compensation" (*equo indennizzo*). Should the insolvency representative decide to terminate the contract, the compensation payable by him represents a liability payable in advance out of the insolvency mass.

2.3.2 Contracts for services however are categorically annulled as a point of law at the point of opening of insolvency proceedings, unless the insolvency representative specifically decides within 60 days (with the creditors committee's agreement) on fulfilment. In this event any liabilities arising from the date of such decision are deemed insolvency liabilities.

2.3.3 Employment contracts can be terminated by the insolvency representative at the point of opening of the insolvency proceedings in an orderly fashion (i.e. keeping to the notice period and payment of the legal compensation *(trattamento di fine rapporto)*) insofar as the employees are not required for the continuation of the business. Special provisions apply to cases of multiple discharges (5 or more within 120 days, if the company has more than 15 employees), it is compulsory in these cases to involve the appropriate unions.

2.3.4 Cross-border purchase contracts (especially sales with retention of title)
If the goods have already been passed on or the purchase price paid (in advance) before the opening of insolvency proceedings, the purchaser's insolvency representative can demand the handover of the goods from the vendor and the vendor's insolvency representative can demand payment

of the purchase price. If the relevant insolvent party has not already complied, the other side can only pursue its claim by filing an appropriate claim in the insolvency proceeding of the counterpart.

Should a purchase contract not have been completely performed by either party (i.e. the goods have not been passed on or the purchase price has not been paid) the following applies: In the event of the purchaser's insolvency the insolvency representative can, according to the general rules, chose the commitment to the purchase contract and settle the purchase price out of the insolvency mass as a priority.

In the event of the vendor's becoming insolvent, the insolvency representative is obliged to deliver the goods (on payment of the purchase price), when ownership has already been transferred by means of a contract (which is generally the case in accordance with the consensual principle applicable in Italy). If change of ownership has not taken place (for example in the case of sale of goods yet to be produced) the insolvency representative can, with the creditors committee's agreement and in accordance with general rules, chose to perform the contract or to decline it.

Special provisions apply to sales under retention of title. In the event of the purchaser becomes insolvent the purchase contract is usually suspended The insolvency representative can, with the creditor committee's agreement, chose to enter into the contract. He would achieve a claim to the transfer of ownership of the goods sold at the point of payment of the (remaining) purchase price. If the insolvency representative declines performance of the contract, he is obliged to hand over the goods and the vendor is obliged to repay all instalments already received (after deduction of appropriate consideration for the expected wear and tear of the goods). In this case it is essential that the vendor is able to identify the goods sold individually and correctly and that he can evidence the fact that the purchase contract was entered into before the opening of insolvency proceedings. Special provisions apply for the sale of machinery under retention of title.

The performance of the contract is not affected by the vendor's insolvency.

2.3.5 Current account agreements with banks - These are annulled at the point of commencing of insolvency proceedings regarding the account holder's assets. The bank is not entitled to use any payments received after the opening of insolvency proceedings to offset the debtor's liabilities that existed at the point of the opening of insolvency proceedings.

Banks cannot be subject to insolvency proceedings; specific "administrative compulsory winding up proceedings" are available instead.

2.4 Cross-border and specific country entitlements

Where contractual parties reside in two different jurisdictions, a major problem arises as to which jurisdictions laws should be applied to the contract. Keeping in mind the provisions of the European Insolvency Regulations, national Italian regulations regarding the performance of pending business relationships take priority over the law applicable to the relevant contract. Exceptions apply. For example, to employment contracts, and contracts relating to property not located in Italy.

Under Italian law there are specific priorities given to preferred creditors. For example specific priorities of preferred creditors in the event of insolvencies such as sales representatives. This preferred creditor could claim such specific priority even if the contract falls under the laws of a jurisdiction that does not have such provisions.

QUESTION 3

3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

The entitlements of creditors involved in Italian insolvency proceedings have been strengthened by the reforms introduced in 2006 / 2007. This applies especially to the field of reconstruction proceedings that are aimed at the avoidance of insolvency proceedings.

Creditors are entitled to have any claims filed and to submit written comments and objections to these before the oral hearing, during which decisions will be made regarding these filed claims.

After the list of claims has been agreed, creditors who have filed claims in the insolvency are entitled to view this list and can, in the event that their own registered claims have not or have only partially been recognised, raise objections against this or the acceptance of other claims.

3.2 Specific rights of information during the proceeding

3.2.1 Right to examine the files (in court)

Italian law does not have general provisions in favour of a creditor that would entitle him to have sight of the files regarding the insolvency proceedings.

Creditors can apply for permission to view the files if they can evidence a specific legal interest. This perusal is granted only rarely in exceptional cases by a decision of the appropriate insolvency judge (after hearing of the insolvency representative) and can be restricted to specific sections of the file.

Creditors can view such documents – in the court and increasingly by electronic means after receipt of the applicable access data – which the court has declared to be not private, such as the order which opened the insolvency proceedings, the insolvency representative's final report, the registered claims, the agreed list of claims and the distribution plan. Bi-annual intermediate reports to be filed in court by the insolvency representative can in individual cases be made available for perusal by creditors by the appointed judge (either completely or in parts).

3.2.2 Right to receive periodic general reports

Creditors involved in Italian insolvency proceedings are not granted such entitlement. The biannual reports to be filed at court by the insolvency representative are partially made available for perusal by some creditors. Members of the creditors committee have an entitlement to perusal (also) these reports.

3.2.3 Right to be individually informed by the administrator

There is no entitlement for a single creditor to be kept informed individually by the insolvency representative. The insolvency representative is obliged to inform the creditor about the results of any examination of a claim registered in the insolvency.

In practice however the insolvency representative does provide information, at least in response to enquiries by telephone, regarding the general status of the proceedings, but very often written enquiries do not get answered.

3.3 Approval rights not delegated to a creditors' committee

All creditors as a whole are obliged, in the court-led reconstruction proceedings (*concordato preventivo*), to vote on the acceptance of the reconstruction proceedings. A majority vote is necessary for the acceptance of the compromise agreement (calculated on the basis of the claims entitled to vote). If the compromise agreement includes the formation of different creditor groups, a majority of these groups is also necessary. Preferential creditors, whose claims in accordance with the compromise agreement are to be satisfied in their entirety, do not have a voting right unless they surrender their preference all together or in part.

Within the insolvency proceedings one or several creditors can submit a compromise agreement *(proposta di concordato)*. The acceptance of such a compromise agreement is subject to the same majorities as the *concordato preventivo.*

3.4 Cross-border and specific country rights *(entitlements)*

Foreign creditors have the same entitlements as local creditors.

QUESTION 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

For smaller insolvency proceedings, (*procedura di fallimento*), in practice creditor meetings will not be held but they are entitled to attend the oral hearing for the examination of registered debts.

However, in the event of a compulsory settlement in the course of insolvency proceedings (*concordato fallimentare*), in judicial composition proceedings for the avoidance of insolvency proceedings (*concordato preventivo*), as well as in out-of-court recovery proceedings (see below at paragraph 4.4) creditors meetings will be held and the creditors can discuss and resolve on the proposed settlement and recovery proposals.

4.2 Creditors' committee

As part of the reform of the Italian insolvency legislation, the indirect influence of creditors' rights represented by the creditors committee was strengthened instead of granting the creditors direct rights of participation.

4.2.1 Nomination

In principle, it is the responsible insolvency judge (*giudice delegato*) who nominates the members of the creditors committee. The creditors committee has at least three but no more than five members. The members appoint a chairman (*presidente*).

The creditors may use the oral hearing for the examination of registered debts to apply for replacing of some or all members of the creditors committee. Such application requires the majority of votes of the creditors (voting rights being calculate in proportion to the amount of the acknowledged claim). The majority has to be present at the hearing and the poll either in person or be represented by a proxy with due power of attorney.

4.2.2 Competence

The creditors committee is in charge of controlling the insolvency representative's activities. In addition, the creditors committee has to authorise certain activities of the insolvency representative. From time to time the creditors committee is merely given the opportunity to make a statement prior to decisions.

A non-complete number of specific competences of the creditors committee can be listed as follows:

- The creditors committee is entitled to initiate the dismissal of the insolvency representative and is also entitled to appeal decisions given by the insolvency judge.

- In case of a continuation of the insolvent business being ordered by the insolvency court, the creditors committee may request the cessation of the continuation if this is not in the creditors' interest (any more). For this reason the insolvency representative also has to inform the creditors committee at least every three months on the progress of the continuation of the business.

- In case of a compulsory settlement, the creditors committee controls that the terms and obligations of the settlement are duly performed and adhered to.

- The creditors committee authorises the liquidation scheme proposed by the insolvency representative or suggests amendments to it. The creditors committee may also block by application to the insolvency judge, realisation of assets which are being subject to the insolvency proceedings. For example, if the proposed realisation is to achieve a price below market value.

- Furthermore, the creditors committee's approval is necessary, for example, in the following situations:

  - entering into a settlement;

  - acknowledgement of third party rights;

  - reduction of claims;

  - entering into contracts which at the time of opening of the insolvency proceedings are still pending (i.e. are not discharged by both parties);

  - waiving to continue pending court proceedings;

  - deregistration of mortgages and release of pleadged assets;

  - raising of claims for compensation of damages against dismissed insolvency representative;

  - discharge of debts of the insolvent's estate outside the final distribution of assets of the estate.

- In the following cases the creditors committee has to be given the opportunity to make a statement before the insolvency representative takes the relevant steps:

  - termination of company lease agreements against payment of compensation;

  - raising liability claims against administrative and controlling bodies or shareholders of the debtor's business.

- The insolvency court has to ask for the creditors committee's statement in respect of the following:

  - continuation of the debtor's business, unless continuation was already ordered as part of the judgment on the opening of the insolvency proceedings, as well as cessation of the business activities;

  - leasing of the debtor's business to third parties;

  - dismissal of the insolvency representative

  - suspension of the insolvency proceedings due to insufficiency of assets.

Moreover, the insolvency judge may ask the creditors committee at any time for statements in respect of individual questions.

The creditors committee has to produce, for the court's disposition, its comments on the semi-annual reports of the insolvency representative as well as on any compulsory settlement proposals of the insolvency representative.

Finally, the creditors committee has the right to be informed by the insolvency representative of all circumstances that may influence the continuance of the debtor's business.

4.2.3 Voting mechanisms

The creditors committee makes its resolutions as a collegial body by a majority of the votes cast. Resolutions are to be made within 15 days of the request for decision making being received by the chairman; resolutions may be made in meetings or by other means

4.2.4 Rights and duties / responsibilities of the members of the committee

The creditors committee and each of its members has a full right of access to the insolvency court files as well as to the insolvency representative's books and records and may also claim disclosure of information from the insolvency representative or the insolvency debtor. The members of the creditors committee may assign their rights in total or partially to third parties but must communicate any such assignment to the insolvency judge.

The members of the creditors committee have to officiate with due diligence and care. They are also under a special duty of confidentiality.

Liability claims against members of the creditors committee may only be initiated by the insolvency representative (with leave of the insolvency judge).

4.2.5 Remuneration of the members of the committee

The members of the creditors committee are entitled to reimbursement of their expenses. Remuneration for their activities is only payable upon prior approval of the majority of the creditors involved in the proceedings, provided these made a corresponding resolution to this effect after holding an oral hearing for the examination of registered debts but before formal acknowledgement of the insolvency schedule. The remuneration may by no means be higher than 10% of the remuneration receivable by the insolvency representative.

4.3 Other forms of direct creditors' participation

Other forms of direct involvement of creditors are not arranged for in Italy.

4.4 Rights related to reorganization plans and proceedings

4.4.1 *Piano attestato di risanamento*

This is an out-of-court recovery plan for businesses in financial difficulties that, need not necessarily to be insolvent (unable to pay). The plan has to be attested by an independent expert in relation to the correctness of the facts relied upon and its practicability. The consequence of such attestation, which also serves for the protection of creditors affected, is that any activities, which were carried out as part of the realisation of the plan, cannot, if recovery fails, be challenged in the subsequent insolvency proceedings.

Participation of the creditors in such proceedings is not required; but, in practice, it is useful to get at least the strategically most important creditors. This form of recovery procedure does not stop individual creditors to initiate individual means of compulsory execution.

4.4.2 *Accordo di ristrutturazione dei debiti*

The recovery plan illustrated above is often accompanied by a plan for settlement of debts involving the creditors. At least 60% of the creditors (calculated in proportion to the total sum of debts) have to co-operate with such a plan. A discrimination of creditors or groups of creditors may be agreed; the general rule of *par conditio creditorum* need not to be adhered to therefore it is possible to enter into individual and separate arrangements with each creditor. For a period of 60 days following publication of the plan in the commercial register means of compulsory execution by individual creditors are not admissible. If realisation of the plan for settlement of debts fails and if subsequently insolvency proceedings over the debtor's assets are opened, any legal acts (such as payments and granting of securities) which were performed as part of the realisation of the plan are not subject to challenge actions. Creditors who do not co-operate with the plan for settlement of debts have to be satisfied to the full amount and in accordance with the contractual agreements. The practicability of the plan for settlement of debts (in particular with regard to the total satisfaction of creditors who did not co-operate) has to be attested by an independent expert and must be approved by the competent court. Creditors who did not approve the plan or who did not co-operate with it may, within a period of 30 days following registration in the commercial register, file an opposition against approval of the plan with the responsible court.

4.5 Cross-border and specific country rights

Creditors who are not resident in Italy may be appointed as members of the creditors committee.

QUESTION 5

5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

The insolvency representative acts under the supervision of the insolvency judge and the insolvency court. The creditor's committee takes on an additional supervisory role. This supervision is achieved by a number of legal provisions regarding agreements and approvals as well as those regarding information and hearing requirements.

The single creditor only has the opportunity to complain against actions or omissions by way of appeal (*reclamo*). This has to be directed to the insolvency judge (*giudice delegato*) within 8 days from publication of the action. Appeals against the reasoned judgment of the *giudice delegato* to the insolvency court are also permitted within 8 days.

In practice appeals brought by individual creditors usually play a subordinate role.

5.2 Substitution of the insolvency representative

5.2.1 Procedure

The insolvency representative's substitution (*sostituzione*) is only permissible after the date of the approval of all registered claims and before the declaration of enforceability of the list of registered claims. This requires the submission of an application to the insolvency court, which should also include the specification of a new insolvency representative. The application has to include reasons. The court is required to check the application and is not obliged to appoint the suggested new insolvency representative. Appeals are permissible against the insolvency court's decision. It is the clear and declared objective of the Italian lawmakers to ensure the retention of an insolvency representative who is independent of the majority of creditors.

5.2.2 Majorities required

The application for the substitution of an appointed insolvency representative has to be supported by the majority of creditors, whose claims were admitted into the list of claims at the date of consideration (majority based in claims).

5.3 Cross-border and specific country rights (entitlements)

Italian law does not include provisions for the different handling of national or foreign creditors. The exercising of their controlling rights by foreign creditors are severely restricted by the extremely short time scales and the practical impossibility of being kept informed about the insolvency representative's actions (or omissions).

QUESTION 6

6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

The insolvency representative's remuneration is defined by the court on the basis of scales.

Initially, the insolvency representative's claims (including the reimbursement of expenses) are to be satisfied in advance out of the insolvency mass. Should the active mass be insufficient for this purpose, the insolvency court can define that remuneration to be payable by the State.

Creditors would only be liable for the insolvency representative's remuneration and expenses when the application for the opening of insolvency proceedings had been brought by that creditor and that application been rejected retrospectively (for example because of relief granted to the debtor) and the proceedings had then been dismissed after the appointment of a insolvency representative, or if the application had been rejected altogether. In such cases the court is obliged to charge these costs to the applying creditor and additionally to order him to pay compensation in the event of a flawed application. In the latter case the creditor is also liable for payment of the remuneration of an insolvency representative already appointed.

6.2 Funding special activities of the insolvency representative *(liquidator)*

From a legal point of view, creditors (or a part of them) are not obliged to finance any actions (especially proceedings) intended by the insolvency representative. Practically, however, it is not excluded that this takes place, especially in smaller proceedings with a small insolvency mass, mostly in the format that one or more creditors carry the costs of proceedings, if these cannot be realised by any other means.

6.3 Specific country entitlements

Under special circumstances, to conduct court proceedings by charging the State (*patrocinio a spese dello stato*). One of the prerequisites is amongst others that the claimant or the defendant is not in a position to pay the costs of the proceedings. In cases where the insolvency is small the appointed insolvency judge can formally define that the insolvency mass is insufficient to carry the costs of the proceedings. If the further required prerequisites exist, the insolvency representative can receive the permission for the costs of the proceedings to be allocated to the State. In such an event, creditors are not made liable for the provision of the costs of the proceedings. The State however has the right of priority reimbursement of the expenditure on proceedings.

JAPAN

Introduction

Japanese insolvency law is compiled of various different laws to cater for different crisises, financial situations and prospective outcomes of the proceedings, as well as the size of a company. Separate laws exist for all those different proceedings. Japanese insolvency law is a compilation of the old German Bankruptcy Code that has been in force since the end of the 19th Century and has been adapted likewise in Japan. After World War II Japan amended its insolvency law by including reorganization laws and procedures that were inspired by the American Chapter 11 proceeding.

Finally during the nineties Japan started to revise and renew its insolvency laws again as it realized that the laws were very rarely used, the procedure was not transparent and the stigma of an insolvency in Japan was so dramatic that directors and the upper management of a company were very reluctant to enter formal insolvency proceedings as such. During the revision of the insolvency laws in the nineties and the beginning of 2000 one of the goals of the legislator was to enact a law that helps companies to reorganize and that makes the insolvency and reorganization procedures attractive so that companies would in fact participate in the procedures and utilize their effects. The legislator promoted the new proceedings and the new law in a way that bankruptcy or insolvency is no longer the death of the company, rather a hospital visit even if it is to the emergency room.

This chapter on the Japanese insolvency laws, therefore focuses and limits itself to the law that has been made for the broadest application. The so-called Civil Rehabilitation Law ('Minjisaisei-ho') is a reorganization procedure meant for individuals as well as companies of all sizes, and is designed to rescue companies as opposed to winding them down.

As for individuals, there is a simplified process available under the code that will not be discussed in detail in this article. We will focus on the rescue procedure for companies under the Civil Rehabilitation Law that came into force on 1st April 2000.

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

The idea and the objective of the Civil Rehabilitation Law was to provide the company with a rescue procedure and, therefore, a mechanism that allows it to enter into formal proceedings earlier than that of the usual winding-down bankruptcy proceedings. Therefore, under the Civil Rehabilitation Law it is not necessary to wait for illiquidity or over-indebtedness. Reasons to file a petition for a Civil Rehabilitation procedure are the threat of illiquidity or over-indebtedness and, therefore, the reasons to enter winding-down bankruptcy proceedings are present; and secondly the company is not capable of paying debts and, therefore, the continuation of the business would be endangered. Creditors are allowed to file a petition to open Civil Rehabilitation procedures

for the first reason, the threat of illiquidity or over-indebtedness. There is no additional requirement in relation to the amount of the creditor's claim or the portion of the creditor's claim other than the company reorganisation procedures. There is also no requirement to obtain a final court decision prior to the petition, but the claim must be undisputed.

1.2 Choice of the insolvency representative

The Civil Rehabilitation Law provides for four different office holders. However, it is not necessary to appoint any of them. This is based on the idea that a rescue scheme that is flexible should be provided. All four of them will be appointed by court upon motion by a creditor or likewise ex officio. The legislator has, therefore, listed four different persons or options in order to be flexible. The first is the so-called 'kantoku-iin', a sort of supervisor whose task is to supervise the continuation of the business, the disposal of assets or to review certain other transactions of the debtor company. The second is the so-called 'chosa-iin', an examiner who is appointed by the court. The examiner's task typically is to assess and analyze the financial and business circumstances of the company, to examine the reasons for insolvency and entering into proceedings as well as the implementation of the proposed rehabilitation plan and creditors' rights. Upon motion, the court can also appoint an administrator who takes on powers of the company to administer and possess and dispose of all assets. With the appointment of a so-called 'kanzai-nin', an administrator, the directors will be deprived of their powers. Finally upon petition of any party to the rehabilitation proceedings a security officer ('hozen kanri-nin') can be appointed if the "debtor in possession"- format of the regular case is inappropriate or if the rehabilitation procedure is handled in an incorrect or even fraudulent way by the management. This security officer can also be appointed in order to take care of the continuation of the business. The appointment is rendered by the court, and creditors have no right to suggest or choose the office holder. A creditor can only file a motion asking for the appointment of a security officer.

1.3 Packaged insolvencies

The rehabilitation process is focused on the rescue and restructuring of the business and the company. Therefore, the goal and main part of the rehabilitation process is the rehabilitation plan. Typically the court announces a date when the debtor or the office holder has to file and submit the suggested rehabilitation plan to the court. Also creditors who have filed their proof of claim are allowed to file a rehabilitation plan. Typically the period set by the court to submit a plan is about three months. However, the legislation allows the rehabilitation plan to be submitted together with the petition to open rehabilitation proceedings, and this is actually preferred.

It is possible to draft a pre-arranged or pre-agreed plan to show the court that a rehabilitation or rescue concept has already been agreed upon and pre-discussed with various parties and stakeholders. This is also of particular importance as it speeds up the opening of the proceedings and simplifies the rehabilitation process. This finally enables the fast approval process of the plan.

According to the Japanese Rehabilitation Law it is permissible to have and submit more than one rehabilitation plan proposal, so even creditors and the debtor can submit a suggestion to the court.

A short-cut procedure, a so-called 'agreed procedure' is a specific form of the rehabilitation proceedings in which all creditors agree on the rehabilitation plan before it is filed in court. The plan deals with the claims and creditors agree not to omit any specific proof of claims process. Claims are accepted and approved as the pre-agreed rehabilitation plan stipulates. The court can order the commencement of the so-called agreed procedure meaning that the pre-agreed rehabilitation plan deemed approved. Such form of pre-packaged plan and pre-agreed proceedings is used for smaller cases and smaller and medium-sized companies in practice.

1.4 Cross-border insolvencies and specific country rights

Japanese insolvencies treat all creditors equally and there is no specific priority or preference to any Japanese involved party. However, due to language and other issues, there is often in reality a difference in how creditors are treated or there can be discrimination.

QUESTION 2

2. Creditors' rights aimed to meet claims

2.1 Filing a claim

In the commencement order the Court stabilizes a time limit within which creditors have to file proof of their claim. This proof of claim application shall give the reason for the claim including the supporting documents and amount that is sought. These proceedings are only applicable for unsecured claims. This means that the duration of the proceedings is significantly reduced. Creditors who do not file their proof of claim forms within the deadline will no longer be regarded as entitled to their claim. The debtor is then deemed not to have any obligations towards this creditor. Secured claims, privileged claims or claims arising from shareholding do not form part of the proceeding and can be asserted without the formal proof of claim process.

After the commencement of the rehabilitation proceedings no unsecured claim can be processed outside the formal filing procedure and no civil proceedings or any enforcement procedures are admissible. However, there is an exemption for small and medium-sized companies: In the case where the debtor is the main business partner of the creditor the court can order that a claim must be settled before the approval of the rehabilitation plan. This is meant to help small and medium-sized companies in situations where the business partners can avoid any sort of domino insolvencies. The court assesses the financial situation of the creditor and also the trade relationship with such a creditor.

Filed proof of claims will be entered into a creditor's register. Creditors do have the possibility to check and reconfirm filed claims, and likewise to file and submit their objections against other creditor's claims. Furthermore the debtor will also certainly submit and file his written objections. Finally the court would decide on a dispute about an objected filed claim in a simplified estimation process.

2.2 Privileges for secured claims

Creditors with a secured claim like pledges or liens, mortgages or other pledges are not affected by the stay - one of the measures ordered by the court to secure the estate and freeze all unsecured claims to be asserted in court against the debtor. Secured creditors can, therefore, enforce their rights in court. However, the court upon petition or ex officio can postpone the enforcement action if it would significantly harm other creditors or if the secured creditor would be sufficiently satisfied otherwise. In the case where the assets of the estate are subject to secured creditor's security rights but are necessary for the debtor's business, the debtor may apply to the court to seek the removal of the security right in order to relieve these assets. In this case the secured creditor will obtain payment of the fair market value of the assets burdened with the security right and not the face value of its claim. The creditor will obtain not more than his claim, but would have to file a proof of claim in case the fair market value does not suffice to satisfy his interests. This provision has been included in the law to assure the rescue of the company.

2.3 Continuation of contracts entered into with the debtor

As foreseen in many other jurisdictions, contracts still not fulfilled by both parties are to the disposition of the debtor. Contracts that have not been fulfilled by a party can either be performed or rejected by the debtor. If the debtor chooses performance, the other party also has to perform. Should the debtor choose to not fulfill the contract the other party has a claim for damages which it could file as an unsecured creditor.

2.4 Cross-border and specific country entitlements

The governing law of the contract does not affect certain rights of a rehabilitation debtor discussed under 2.3 or the rights for unsecured or even secured creditors discussed under 2.1 and 2.2. The rehabilitation law is mandatory and prevailing any obligatory agreed contractual provisions. Foreign creditors are treated equally to domestic creditors. Rights and obligations of creditors of a debtor in rehabilitation are dealt with by the Civil Rehabilitation Law to the extent the code provides a rule.

QUESTION 3

3. Creditors' rights to monitor the insolvency proceeding

3.1 General creditors' rights

Creditors are in principle entitled to receive information and to get access to review books, balance sheets, cash flows, statements, etc. The reason behind this is to enable the creditors to decide whether to vote in favor of or against the rehabilitation plan.

3.2 Specific rights to receive information during the proceedings

During the proceedings creditors are entitled to be informed about the financial affairs of the debtor as well as the status and situation of the business. Those information rights are usually fulfilled at the creditors meeting in which the debtor or any of the office holders presents the report and explains it to the creditors. However, in the case where a creditor's meeting is not called as it is optional to do so, a written report should be provided so that creditors can review written statements. In the case where a creditors committee is called, the committee represents the creditors before the court. The debtor as well as the office holders are entitled and obliged to participate in any creditors committee meeting and discussion. Likewise the creditors committee is entitled to express its opinion to the court, the debtor or the office holders.

3.3 Approval rights not delegated to a creditors committee

The rights of the creditors to approve the rehabilitation plan cannot be delegated to the creditors committee. Creditors are entitled to vote on the suggested insolvency plan. Typically the creditors' approval is sought in a creditors meeting, however, it is possible to order a written approval process so that the creditors vote in writing and send their votes to the court.

In the case of a pre-packaged plan, creditors are supposed to vote on the plan before the petition to open rehabilitation proceedings and before submitting the suggested rehabilitation plan to the court.

3.4 Cross-border and specific country rights *(entitlements)*

The same rights exist likewise for foreign creditors. There are no differentiations between Japanese and foreign creditors.

QUESTION 4

4. Creditors' rights to actively participate in the proceedings

4.1 Creditors' meetings

The creditors meeting is not a necessity but a typically invoked institute. Debtors, office holders, the creditors committee or creditors with at least 10 percent of the total claim sum are entitled to call creditors meetings. In so-called simplified proceedings, no creditor's meetings take place and the decision and approval on the rehabilitation plan is done in writing.

4.2 Creditors' committee

The creditors committee is likewise a voluntary institution and aims to facilitate flexible and fast proceedings. As mentioned above the creditor's committee represents the creditors and if the creditors committee is appointed it is entitled to participate in meetings and provide statements to make its opinion heard. In the case of the sale of the business the creditors committee is entitled to issue a statement that the court would take into consideration when deciding to approve such a business sale or that creditors could refer to. It can also invoke a creditors meeting and it is entitled to supervise and oversee the implementation of the rehabilitation plan. The creditors committee, however, is not entitled to submit an insolvency plan though single creditors are allowed to do so. The creditors committee however, might provide its own opinion on the matter.

4.3 Other forms of direct creditor participation

Creditors in the rehabilitation proceedings have much fewer possibilities to participate and to express their opinion than in other proceedings. The rehabilitation proceedings are meant to be a quick and a very flexible solution that would enable a distressed company to rescue its business in the shortest and easiest way. All sorts of group participations such as information meetings for the creditors, creditors meetings or any other meetings concerning proof of claims etc. can be substituted by written procedures. Creditors do, therefore, often not even see or meet other creditors and have considerably fewer possibilities to exchange views with other creditors in those sorts of meetings. These written procedures for approvals and proof of claim are meant to speed up the process.

4.4 Rights related to reorganization plans and proceedings

The aim of the rehabilitation proceedings is to submit and approve a rehabilitation plan that should reorganize the business of the debtor's company and rescue that undertaking. It is mandatory that creditors have the chance to vote and participate in the approval process of a rehabilitation plan. Creditors also have their own right to submit a rehabilitation plan and can do so even if the debtor does so at the same time. It is not necessary for the creditors to wait until another plan is provided by the debtor or the office holder. When there is

a contest between the possible rehabilitation plans and what the legislator expressly wanted, the creditors in a creditors meeting would then vote on two or even more plans.

In the case of a sale of the business outside of a rehabilitation plan the creditors committee is allowed to issue a statement and participate in the sales process. Such a sale outside of a plan does not require the approval of the creditors meeting in order to facilitate a very quick sale when it is necessary to protect the business' value. Creditors are heard through the creditors committee or otherwise when the court decides on the necessity and appropriateness of the sale for the continuation of the business, the concept, the settlement of claims, protection of employees and the purchase price. The legislator will rely heavily on the statement of the creditors committee because it cannot form a sufficiently balanced opinion on all aspects for rendering the decision.

4.5 Cross-border and specific country rights

The creditors committee is established voluntarily and outside of the proceedings and it must apply for its participation in the proceedings and shall consists of 3 to 10 members and represent all creditors. This makes it rather difficult for foreign creditors to participate or nominate a member to the committee as there is no formal process or timeline to form such a body, unless it is the biggest customer.

QUESTION 5

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5. Creditors' entitlements to control the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

Insolvency office holders are supervised and observed by the court. The creditors have less means to challenge decisions and even if they do, those decisions would rarely become invalid. It is the purpose of the rehabilitation proceedings to limit and restrict creditors participation to an absolute minimum to push the case through the process without any disturbance. The typical remedy against important decisions like the sale of the business or a capital reduction is a immediate appeal to the court, available *after* the decision is made final. This might, if at all, give creditors some sort of compensation. Individual creditor rights are not of high importance. What counts is the rehabilitation of the business and the survival of the entity. Any decision by the debtor in possession or the office holder which is arguably necessary and appropriate to achieve that will be upheld.

5.2 Substitution of the insolvency representative

If for any reason the office holder cannot manage his business or the business of the debtor or the estate appropriately a creditor or any other involved party is entitled to file a petition with the court in order to dismiss the office holder. There is no quorum required. However, the court would take its own decision and evaluate the facts and allegations. The court then replaces the office holder for good cause if necessary.

5.3 Cross-border and specific country rights (entitlements)

An office holder is not required and the court would appoint such a person for a certain case on its own discretion. Even a legal entity could be appointed if circumstances would require this. The code does not exclude anybody from being appointed and is very flexible. Under the law, a foreign office holder would not be impossible. However, language skills and legal and business cultural difference would make this rather unlikely. There is no licence to be an office holder, but typically lawyers and accountant or auditors are chosen. Finally, the courts keep lists of suitable persons to be appointed, so that foreigners would face another hurdle of being admitted.

QUESTION 6

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6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

The court determines and approves the fees for the office holders. These fees are administrative expenses and the creditors are not responsible for the remuneration of the office holders and are borne by the estate. For various office holders the court holds serveral lists of fees schemes. Remuneration is in principle based on the value.

A report from 2008 shows a schedule of fees that can be charged. For example an auditor appointed as examiner in the Tokyo district would receive for a case with a debt volume of under 50 million JPY a fee of about 2 million JPY. Similarly, for a case with a debt volume of 5 to 10 billion JPY a fee of about 7 million JPY may be charged.

MEXICO

Introduction

Paving the way for the enactment of the Mexican Bankruptcy Law (*Ley de Concursos Mercantiles* "LCM") resulted in substantial social and economic changes in Mexico since enactment of the *Ley de Quiebras y Suspensión de Pagos* " ("LQSP") in 1943. Mexican companies entered the international marketplace and began to list on stock exchanges abroad in the following 58 years. Moreover, Mexico's economy opened to foreign companies through entry into numerous free trade agreements (e.g., NAFTA). As a result, the previous Mexican Bankruptcy Law simply became too antiquated to deal with Mexico's modern reality and the expectations of institutional investors. The LQSP did not allow efficient reorganization of profitable businesses and artificially propped up loss-making enterprises at the expense of the public and otherwise healthy competitors. In addition, Mexican authorities began to realize the importance of business for sustaining Mexico's economy and recognized the need to safeguard these businesses from outright liquidation.

Recognizing the deficiencies in the LQSP, in November 1999, a group of senators proposed the LCM. After a few modifications by the House of Representatives in April 2000, the LCM became effective upon being published in the Federal Official Gazette (*Diario Oficial de la Federación*) on 12 May, 2000.

In a shift away from the old adversarial system embodied in the LQSP, the LCM is designed to foster co-operation and agreement. Whereas under the LQSP the inevitable result was a lengthy suspension of payments or liquidation process. The LCM focuses more on reorganization and involves court-appointed officials in that process from the beginning. Only if this process – called the "Conciliation" (*Conciliación*) — fails does the debtor enter into liquidation.

Under the LQSP, each case was assigned to a local or federal judge and in most cases was not specialized in or even familiar with bankruptcy matters. Under the LCM, each case is assigned to a federal judge, but in contrast with the procedure under the LQSP, this judge will be assisted by specialists appointed by the Federal Institute of Reorganization Specialists (*Instituto Federal de Especialistas de Concursos Mercantiles* "IFECOM").

In general, a case under the LCM has three phases: (i) "Bankruptcy Trial" (*Juicio de Concurso*); (ii) "Reorganization" and, if no Reorganization is implemented, (iii) "Liquidation." A civil judge (with guidance from specialists appointed by IFECOM) oversees these three phases from the beginning.

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

The debtor

A case under the LCM may be commenced by (i) the debtor, (ii) a creditor or (iii) the Attorney General (*Ministerio Público*). Under the LCM, a debtor is deemed to have "generally defaulted on its payment obligations" if:

(a) a payment default has occurred with respect to the claims of at least two creditors;

(b) payments are due for more than 30 days and represent 35% or more of all the debtor's payment obligations as of the date of the filing; and / or

(c) the debtor does not have liquid assets (e.g., cash deposits, short-term securities, and accounts receivable) to pay at least 80% of the obligations past due as of the date of the filing.

A debtor may commence a voluntary reorganization proceeding under the LCM if it satisfies condition (1) and either (2) or (3). A creditor, whether unsecured or privileged, or the Attorney General can file an involuntary reorganization proceeding under the LCM only if *all three* conditions are satisfied. Nevertheless, if a creditor commences an involuntary proceeding and is unable to demonstrate that all three conditions have been fulfilled, it must pay all attorneys' fees and other expenses incurred by the debtor in accordance with the court's discretionary ruling.

Under the LCM, eligibility is presumed when the debtor does not have sufficient assets to attach after a default, there are no persons with authority present, or where the court determines that the debtor is fraudulently conveying its assets to avoid the payment of obligations.

Generally, only "merchants" are eligible to file for reorganization. Article 3 of the Commercial Code defines merchants as: (i) persons with legal capacity to engage in commerce; (ii) corporations incorporated in accordance with the commercial laws; and (iii) foreign corporations, and their agencies or branches that engage in commerce within a Mexican territory. In addition, a trust whose main purpose is the conduct or facilitation of business may also be eligible for reorganization. The partners of general partnerships and general partners of limited partnerships can also be subject to reorganization proceedings. Limited partners of a limited partnership cannot be forced into a bankruptcy of the partnership.

1.2 Choice of the insolvency representative

A case under the LCM will be assigned to a district judge, a federal judge, at the debtor's domicile or where its principal place of business is located. This judge will oversee the reorganization and bankruptcy proceedings. IFECOM, however, trains and randomly (with no participation of creditors) appoints specialists to assist the judge throughout the process.

IFECOM

IFECOM is an arm of the judicial branch of the federal government and maintains lists of people approved to act as specialists — Auditors, Conciliators or Trustees — in reorganization proceedings. IFECOM sets the fees to be paid to specialists and monitors their work. IFECOM also provides continuing education to specialists, judges and lawyers, publishes relevant statistics, issues rules and forms, and acts as mediator between a debtor and its creditors when asked. Recent amendments to the LCM (enacted in December 2007) have increased IFECOM's powers by allowing it to, for instance, respond directly to questions posed by judicial authorities.

Under the LCM, potential debtors can mediate disputes with its creditors through IFECOM before filing for bankruptcy. Likewise, any creditor with a claim against a debtor may also seek mediation through IFECOM.

Specialists (*Especialistas*)

There are three types of specialists in bankruptcy proceedings under the LCM.

- Auditor - After a district judge has approved a valid request for reorganization, the judge gives notice to IFECOM, which then appoints an "Auditor" (*visitador*) to review the debtor's books to determine whether the debtor is eligible for reorganization.

- Conciliato - The Conciliator (*conciliador*) is appointed by IFECOM after a district judge gives notice that the conciliation phase of the proceeding has begun. The Conciliator acts as mediator between the debtor and its creditors and is responsible for preparing a reorganization plan. In addition, the Conciliator monitors the administration of the company and presents the list of creditors to the judge. The Conciliator may also be authorized to operate the business under certain circumstances, much like an operating trustee in the United States.

- Trustee - The Trustee (*síndico*) is appointed in the same manner as the other two specialists when the judge gives notice to IFECOM that the liquidation phase has begun.

  The Trustee is entrusted with selling the assets of the estate in the event conciliation fails and the case proceeds to liquidation. It is not uncommon for the Trustee to be the same person designated as Conciliator.

Specialists in Mexican proceedings must be bonded to guarantee their performance in an amount determined by IFECOM. To date, according to IFECOM, no claims have ever been filed against specialists by any party and, as a result, their bonds have never been called upon.

In addition, specialists are required to keep information they obtain during their tenure confidential and are liable for any damages caused by unlawful disclosure .

1.3 Packaged insolvencies

Before the amendments to the LCM (enacted in December 2007) a reorganization plan could not be filed at the same time as the petition for relief. In other words, there was no provision for "pre-packaged" plans. Interested parties, however, were free to negotiate outside of the proceeding at all times and the reorganization plan could be filed as soon as the order of recognition, ranking and preference of claims was entered.

The amendments, however, now include a new Title XIV which allows a debtor to file, simultaneously with its petition, a prenegotiated plan of reorganization signed by creditors holding at least 40% of its total debt. Under those circumstances, (i) the judge will issue an Order for Relief without the appointment of an Auditor, thereby expediting the effectiveness of the stay enjoining creditors' actions, and (ii) the Conciliator must consider the prenegotiated plan before negotiating any other plan.

However, under the LCM, the votes solicited and obtained prior to the bankruptcy filing will not be binding and the debtor will be required to re-solicit the votes during the bankruptcy. Thus, while "prenegotiated plans" are possible under the LCM, "pre-packaged plans" are not.

1.4 Cross-border insolvencies and specific country rights

In general, foreign companies may not be subject to bankruptcy proceedings in Mexico. The LCM, however, does allow for the reorganization of branches and subsidiaries of foreign companies.

The LCM also permits the recognition of foreign proceedings under "*Título XII*," which is based on the UNCITRAL Model Law on Cross-Border Insolvency. Mexico was one of the first countries to adopt the Model Law.

A representative of a foreign creditor is empowered to request the commencement of a reorganization proceeding under the LCM, if the conditions for the commencement of such proceeding are otherwise complied with.

Foreign creditors have the same rights as Mexican creditors as to the commencement of reorganization proceedings, filing proof of claims, voting rights, ranking of claims, etc.

QUESTION 2

2. Creditors' rights aimed to meet claims

In order to determine the amount of claims against the debtor, all debts are accelerated and, if the claims are subject to a condition, the condition is considered satisfied. If necessary, claims are converted to present value and obligations that are not expressed by the payment of money are assigned a monetary value.

All unsecured claims cease to accrue interest and are converted into UDIs[1] as of the date of the Order for Relief, provided that an unsecured claim denominated in foreign currency is first converted to pesos and then to UDIs. Claims denominated in UDIs are protected against Mexican inflation.

In general, a secured claim will remain denominated in the original currency or unit of measure and will continue to accrue interest to the extent the collateral is sufficient to satisfy the secured claim. A plan under the LCM may provide for distributions in other currencies.

2.1 Filing a claim

A creditor with a claim against a debtor has three opportunities to file a proof of claim:

(i) within 20 days following the date of the publication of the Order for Relief;

(ii) within five days of the filing of a provisional list of creditors by the Conciliator; or

(iii) within nine days of issuance of the Order of Recognition and, Ranking and Preference of Claims. Failure to file a proof of claim within these deadlines, or to otherwise ensure that a claim is identified in the Order of Recognition, Ranking and Preference of Claims, results in the permanent loss of the claim.

Foreign creditors have 45 calendar days to file their proof of claim either (i) after the publication of the Order for Relief in the Federal Official Gazette or, if the court orders different, (ii) after the notice to the creditor of the Order for Relief made by other means. This process can be served by courier and does not require Letters Rogatory or other formalities.

A proof of claim must contain basic information, including the name and address of the creditor, the amount of the claim, a description of any collateral, as well as a description of the claim generally (e.g., the types of documents and the relationship that gives rise to the claim). The proof of claim must also state whether the claim is entitled to preferential or priority status. It must be filed using the form approved by IFECOM and must be accompanied by any

[1] UDI's are *Unidades de Inversion*, a measuring unit of constant value. Starting in April 1995, the Central Bank *Banco de México*) publishes the value of the UDI for each day of the month in the Federal Official Gazette. The DI's value increases or decreases depending on Mexican inflation rates.

original documents (or copies certified by a notary public) and the necessary translations. Additionally, the creditor shall state a domicile within the jurisdiction of the court or provide an alternative communication media like a facsimile number or an e-mail to receive further notices.

Provisional list

After the first deadline to file proofs of claim, the Conciliator is required to submit to the court a provisional list of claims against the debtor using the information gathered from the debtor, the data included in the Auditor's report, and filed proofs of claims. The filing of the provisional list commences a five-day period for creditors and other interested parties in interest to file objections to the recognized claims on the provisional list, including the validity of, or the proposed amount or priority assigned to, those credits.

Final list and order of recognition, ranking and preference of claims

Once the five-day period to object to the provisional list has elapsed, the court sends copies of all objections received to the Conciliator, who then has up to ten business days in which to revise the provisional list of claims based upon the objections and to prepare the proposed final list of claims for submission to the court. Once the proposed final list is submitted, the district judge decides whether to accept the list and, if so, enters an order declaring the final list received from the Conciliator as the list of "recognized claims" against the debtor. That order is called the Order of Recognition, Ranking and Preference of Claims.

The final list will rank the claims as follows:

- Qualified labor claims. Salaries earned within the two year period prior to the entry of the Order for Relief, plus any severance pay;

- Claims related to the administration of the estate. Expenses incurred in the administration of the proceeding including attorneys' fees;

- Specialists' fees and expenses. The fees and expenses charged by the Auditor, Conciliator, Trustee and their assistants in the performance of their duties;

- Singularly privileged creditors. Funeral expenses and medical expenses incurred with respect to illness leading to death, when the debtor is a natural person;

- Secured creditors. Creditors with a mortgage, pledge or other security agreement covering property of the debtor. Under Mexican law, security interests must be properly registered or they will be avoided. Secured creditors' claims are satisfied out of the collateral to the extent of the collateral's value. If the claim is greater than the value of the collateral, the resulting deficiency claim is considered an unsecured claim;

- Labor and unsecured tax claims. Claims that do not fall into any of the previous categories, (i.e., unsecured tax claims or labor claims which are not qualified labor claims);

- Creditors with a special privilege. Certain creditors have a special statutory privilege and have a "right to withhold." These creditors have rights that are similar to those of secured creditors; and

- General unsecured creditors. Finally, any creditor that does not fit into one of the foregoing categories is considered an unsecured creditor. Unsecured creditors come last in line and are paid only if all senior classes of creditors are paid in full.

The debtor, any creditor (regardless of whether it has participated in the proceedings), the Controller (see below for more detail), the Conciliator, the Trustee or the Attorney General may appeal the Order of Recognition, Ranking, and Preference of Claims within nine days of its entry. If a creditor did not file a claim, it has an opportunity to do so no later than nine days after the final list of creditors is published.

2.2 Privileges for secured claims

In general, a secured claim will remain denominated in the original currency or unit of measure and will continue to accrue interest to the extent the collateral is sufficient to satisfy the secured claim. A plan under the LCM may provide for distributions in other currencies.

Any recognized holder of a secured claim that did not approve of the reorganization plan may commence or continue to foreclose on the collateral securing the claim, unless the plan provides for the repayment of their claims, or the payment of the value of their collateral. If the amount to be paid for the value of the collateral does not satisfy the entire claim, the deficiency will be treated as an unsecured claim.

2.3 Continuation of contracts entered into with the debtor

Executory contracts

The general rule is that executory contracts must be honored by the debtor, unless the Conciliator rejects them. Even if the debtor or its management remains in control of the business, the Conciliator is empowered to accept or reject executory contracts, incur new indebtedness, substitute collateral and sell assets outside the regular course of business. If the Conciliator decides to terminate a lease under which the debtor is the lessee, the lessor is entitled to three months' rent.

A non-debtor party to a contract may ask the Conciliator to decide if it will reject the contract. If the Conciliator responds that it will not, then the debtor must honor the contract. If the Conciliator states that it will reject the contract, or does not respond, the non-debtor party to the contract may terminate it by giving notice to the Conciliator.

The LCM provides certain protections to sale contracts. Specifically, a seller is not bound to deliver the goods or the real estate if the price has not been paid or a guarantee that it will be paid has not been provided. Moreover, in the case of movable property that has not been paid for, when the debtor / buyer commences a bankruptcy case prior to the delivery of goods, the seller may refuse to deliver unless the purchase price has been paid in full.

Notwithstanding the general rule, the following contracts are automatically terminated on the date the Order for Relief is issued: agreements to repurchase stock, stock loan agreements, and agreements regarding futures, or financial derivative operations that become due after the Order for Relief. Construction agreements (*obra a precio alzado*) will be also automatically terminated by the bankruptcy of one of the parties, unless the parties and the Conciliator agree to assume it.

Use, sale or lease of property of the estate in the ordinary course of business

While the debtor generally remains in control of the company, the Conciliator supervises the accounting and operations of the debtor. The Conciliator, in consultation with any Controllers, must consent to the execution of any loan agreement or the sale of assets outside of the ordinary course of business. The Conciliator may not sell assets outside the ordinary course of business. The Conciliator must inform the district judge of any new loans or the sale of property. Creditors and the Attorney General may object.

Treatment of financial contracts

Under Mexican law, financial contracts are treated like any other contract and are not entitled to any special treatment.

QUESTION 3

3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

The entitlements of creditors in Mexico were strengthened by the reforms introduced 2007.

Creditors are entitled to file proofs of claims to have their credits recognized and to actively participate in the drafting of the reorganization plan; also, as explained below, certain percentages of creditors have different options to protect their interests.

Creditors have the right to examine the court files and to request copies of it. Since all of the debtor's activities are reported to the court by the Conciliator, creditors have a fairly good grasp of what is happening by following the court file.

Controllers

Controllers (*Interventores*) represent the interests of creditors in a proceeding under the LCM and act much like an official committee of unsecured creditors in a United States bankruptcy case.

They act as “watchdogs” and oversee the Conciliator and the Trustee to ensure they perform their duties properly. A Controller may be appointed by the court only upon the request of a creditor or group of creditors representing at least ten percent of the total amount of the debtor’s indebtedness. Accordingly, there may be up to ten Controllers.

The interested creditors have the right to submit a proposal regarding the person to be nominated as Controller by the court. There is no need to be a creditor to be nominated as Controller.

Controllers have the authority to request information from the Conciliator relating to the debtor and the management of its business and estate. Their fees are paid by the appointing creditor or group of creditors, which reflects a significant departure from the United States system, where the fees of creditors’ committee and their professional advisors are paid by the debtor’s estate.

The Controllers may be replaced or removed by whoever appointed them.

QUESTION 4

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4. Creditors’ rights aimed to participate actively in the proceeding

4.1 Creditors’ meetings

Creditors are allowed to take any decision regarding the proceedings; however, no formal legal treatment is established in the law.

Foreign creditors have the same rights as Mexican creditors.

4.2 Creditors’ committee

Creditors’ committees are not allowed according to Mexican bankruptcy law.

4.3 Other forms of direct creditors’ participation

There are no other forms of direct participation of creditors. They do not have any voting rights regarding any decision inherent to the proceeding with the exception of what is stated under the following sections 4.4 and 4.5.

4.4 Rights related to reorganization plans and proceedings

Reorganization plan

Once the Court publishes the list of recognized claims, the Conciliator is required to attempt to reach an agreement with the debtor and holders of recognized claims on a plan of reorganization. If the Conciliator believes that the debtor and a majority of holders of recognized claims support a plan of reorganization for the debtor, it must circulate the plan to all holders of recognized claims. Such holders will have ten business days to comment on the plan.

Plan

The plan must provide for the payment of the list set forth in Section 2.2 above.

A reorganization plan may provide for the sale of the debtor company as an ongoing business.

If the plan provides for an increase in capital stock, the Conciliator must give notice to existing shareholders so they can exercise any preemptive rights they may have. If existing shareholders waive such preemptive rights, any person, including the claim holders may participate in the capital stock increase. As part of the reorganization plan, the claim holders and the debtor can agree to capitalize debt.

Approval of the reorganization plan by the creditors

If the Conciliator believes that an adequte number of creditors will vote in favor of the plan, he will submit it to the holders of recognized claims for a ten-day period so that they may comment on or execute it.

The Conciliator must attach to the plan a clear summary of its terms. Both the proposed plan and the summary must be submitted using the form provided by IFECOM.

In order for a plan to be approved by the court, it must be agreed to by (i) the debtor and (ii) holders of recognized claims holding more than 50% of the sum of (a) the total recognized amount of unsecured claims, and (b) the amount of the secured claims and claims having a special privilege under Mexican law that undersign the plan.

On the other hand, a plan would not be approved if it is rejected (*vetado*) by a simple majority of recognized unsecured creditors, or by any number of them whose claims equal or exceed 50% of the total amount of recognized unsecured claims.

In general, a plan will be deemed accepted by all unsecured claim holders if it provides for the payment of the entire amount of their claims, converted into UDIs.

With respect to creditors that do not agree to the terms of the plan, the plan must provide for minimum protections with respect to the discount and payment period of claims. In particular, the LCM provides that a dissenting creditor should be treated no worse than any 30% of the recognized unsecured creditors that did sign the plan.

Within seven days after the expiration of the ten-day period, the Conciliator must submit the plan to the judge, signed by the debtor and by the required majority of recognized claim holders.

The judge then must make the plan and the summary available to all recognized claim holders for five days, so that they may file any objections.

Dissenting secured creditors

Any recognized holder of a secured claim that did not approve the reorganization plan may commence or continue to foreclose on the collateral securing the claim, unless the plan provides for the repayment of their claims, or the payment of the value of their collateral. If the amount to be paid for the value of the collateral does not satisfy the entire claim, the difference will be treated as an unsecured claim.

Discretion of the judge

Under the LCM, the district judge controls the bankruptcy proceeding but the judge's discretion is limited to approval or disapproval of the reorganization plan filed by the Conciliator and signed by the necessary majority of the claim holders. The judge may not unilaterally modify the plan.

4.5 Creditors' right to request a longer look-back period

Under the LCM, the issuance of the Order for Relief effectively sets a "look-back" period of 270 calendar days before the entry of the Order for Relief during which suspect transfers may have occurred. The Conciliator, the Controller or any creditor can request the court to fix a longer look-back period in appropriate circumstances.

According to the LCM, a fraudulent conveyance is any transfer by the debtor designed to defraud its creditors if the transferee had knowledge of the fraudulent purpose, or if the transfer was made at no cost to the transferee like the absence of "reasonably equivalent value" rule under United States law. The LCM lists transactions that are presumed to be fraudulent conveyances, including insider transactions with board members, family members, shareholders or affiliates and subsidiaries.

QUESTION 5

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5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

The debtor, the auditor, the creditors and the attorney general may appeal the order denying relief. Such appeal shall stay the reorganization proceedings. An appeal may be filed against the order for relief. Such appeal shall not stay the reorganization proceedings unless it is declared valid.

The order of recognition, ranking and preference of claims may be appealed as well. Such appeal will not stay the reorganization proceedings.

The debtor, any creditor, the Controller, the Conciliator or the Trustee, if any, or the Attorney General, directly or through his representatives, may appeal the order of recognition, ranking and preference of claims.

If the Trustee proposes a sale proceeding of the estate (through a procedure other than the one provided under the LCM, if he believes that in so doing a higher price will be obtained), it may only be objected by: (a) one half of the recognized creditors; (b) recognized creditors who jointly represent at least 50 percent of the total amount of the recognized claims; and (c) the Controllers who jointly account for at least 50 percent of the total amount of the recognized claims.

The order for liquidation may be appealed by the debtor, any recognized creditor and the attorney general as well as by the Auditor, the Conciliator or the Trustee in the same terms that the order for relief may be appealed. Also, the debtor, any recognized creditor and the Conciliator may appeal the order for liquidation in the same terms that the order for relief may be appealed.

5.2 Substitution of the insolvency representative

The Auditor's, Conciliator's or Trustee's appointment may be challenged by the debtor and by any creditor. Such a challenge will be allowed only in any of the following instances:

- The spouse, female or male concubine or blood relative within the fourth degree or within the second degree by affinity, of the (i) debtor under reorganization proceeding, of any of his creditors or of the judge; (ii) members of the managing bodies, if the debtor is a legal entity, or of any stockholders who are liable without limitation;

- The lawyer, attorney in fact or authorized person of the debtor or of any of its creditors, in any pending lawsuit;

- To have or have had in the six months immediately preceding his appointment, a labor relation with the debtor or any of the creditors, or to render or have rendered, independent professional services;

- To be a stockholder, landlord or lessee of the debtor or of any of his creditors, in the proceeding to which he is appointed; or

- To have a direct or indirect interest in the reorganization proceeding or to be a close friend or an open enemy of the debtor or any of its creditors.

The challenge will be processed through ancillary proceedings.

The judge may refuse the appointment made by the IFECOM in any of the above events, and must report such rejection to the IFECOM so that the latter makes a new appointment.

The challenge to the Auditor's, Conciliator's or Trustee's appointment will not prevent him from taking office and will not stay the inspection visit, the conciliation or the bankruptcy.

QUESTION 6

6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

Specialists are paid an hourly fee based on schedules prepared by IFECOM. Payment of the specialists' fees and expenses are provided for in the reorganization plan as ordinary company expenses. If a reorganization proceeding winds up in liquidation, the specialist's fees and expenses are paid from the estate at the end of the liquidation proceeding.

Prior to the amendments of December 2007, the fees of the specialists were paid from the debtor's estate. Such fees were entitled to a priority, but were only paid after labor claims.

Indeed, specialists had to initiate ancillary proceedings (*Incidente de liquidación de honorarios*) by which they filed a report detailing the hourly activities performed by the specialists and their assistants. The parties then had the opportunity to object to the report, after which the judge determined the amount to be paid.

6.2 Funding special activities of the insolvency representative *(liquidator)*

Creditors do not have to fund insolvency proceedings activities; however, they have to bear the burden of their own expenses while taking part in insolvency proceedings.

6.3 Specific country entitlements

There are no special rules in this regard according to Mexican bankruptcy law that apply differently to foreign creditors.

Basic forms

The forms approved by IFECOM must be accompanied by any original documents (or copies certified by a notary public) and the necessary translations and *apostille* if applicable. All forms created by IFECOM can be found at www.ifecom.cjf.gob.mx

NEW ZEALAND

Introduction

Personal bankruptcies and Company liquidations are the most common form of insolvency in New Zealand. Other options include compromises with creditors; arrangements, amalgamations and compromises by the Court; voluntary administration; or receiverships. All procedures have the aim of repaying creditors the maximum possible, following the priorities afforded secured and preferential creditors, followed by unsecured creditors and lastly shareholders. The main relevant legislation involved is:

- Insolvency Act 2006
- Insolvency (Personal Bankruptcy) Regulations 2007
- Companies Act 1993
- Companies Act 1993 Regulations 1994
- Companies (Voluntary Administration) Regulations 2007
- High Court Rules
- Insolvency (Cross-Border) Act 2006
- Receiverships Act 1993

QUESTION 1

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1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

In the case of personal insolvency a creditor may apply for a debtor to be adjudicated bankrupt if the debt due is $1,000 or more and the debtor has committed an act of bankruptcy within 3 months before filing the application. A secured creditor must establish the debt exceeds the value of the charge by at least $1,000. An application for bankruptcy by a creditor or the debtor themselves, must be on the prescribed form and lodged with the Official Assignee in accordance with the prescribed procedure. The Official Assignee is a Government official with the authority to administer the Insolvency Act 2006 (personal bankruptcies) the Companies Act 1993 (company liquidations) and the Proceeds of Crime Act 1991. He or she administers all bankruptcies, No Asset Procedures, Summary Instalment Orders and some Court appointed liquidations.

Once the Court has adjudicated the debtor bankrupt, the bankruptcy commences and the Official Assignee nominates an Assignee to be the Assignee of the debtor's property. The Assignee must advertise the adjudication and call a meeting of the bankrupt's creditors, although after consideration of the likely outcome of the bankruptcy the meeting may

be dispensed with provided information regarding the debtors affairs is sent to all creditors.

For companies, the initial step is the filing of a statutory demand (Section 289, Companies Act 1993) on the debtor company. This gives the debtor company 15 days (or such longer period as the Court may order) to pay the debt, or enter into a compromise arrangement, or give a charge over its property to secure payment of the debt. The Court may, on the application of the debtor company set aside a statutory demand if it is satisfied there is a substantial dispute or it has a counter-claim, set-off or cross-demand or ought to be set aside for other grounds.

An application to the Court for the appointment of a Liquidator follows and the Court will appoint if it is satisfied that the company is unable to pay its debts; or the company has consistently failed to comply with the Companies Act 1993; or it is just and equitable that the debtor company be put into liquidation.

1.2 Choice of the insolvency representative

There is no choice in the case of personal bankruptcy, whereby the Assignee in the area the application for adjudication is made, is appointed. No private insolvency practitioners undertake personal bankruptcy work, unless appointed as an Agent for the Assignee.

The proposed Liquidator must certify in writing that he or she is not disqualified from acting. Accordingly the choice of insolvency representative rests with the appointer in the case of receivership, or the shareholders or the Court in the case of liquidations. Administrators of compromises are appointed by the creditors and confirmed by the Court. Voluntary Administrators are appointed by the company (by resolution of directors) or a Liquidator or Interim Liquidator, if the company is in liquidation, or a secured creditor, or the Court.

Therefore, experience, reputation and geographical location play a large part in the appointment of insolvency representative. If no Liquidator has given consent to act in proceedings for a Court appointed Liquidator then the appointment will go to the Official Assignee operating in the region of that Court.

1.3 Packaged insolvencies

New provisions in the Companies Act 1993 included the regulation of director involvement in what is known as Phoenix Companies (creating and transferring assets to a new company and generally leaving creditors behind) came into force on 1 November 2007. These rules came about due to bad publicity arising from directors of failed companies restarting under a new entity with the same business and business contact details, trade or company name. Accordingly the new rules prohibit being a director of a Phoenix Company or being directly or indirectly concerned in or taking part in the promotion, formation or management of a Phoenix Company or being directly or indirectly concerned in or taking part in the carrying on of a business that has the same name as the failed company's pre-liquidation or similar name. A person who contravenes these rules may become personally liable to a creditor of the company for a debt to that creditor incurred by the company.

However there are certain exceptions to this where the permission of the Court is obtained; where a successor notice is issued or the Phoenix Company has been non-dormant for the previous 12 months.

These rules make hive-downs to newly created companies more difficult but are still possible if managed correctly.

1.4 Cross-border insolvencies and specific country rights

The Model Law on Cross-Border Insolvency adopted by the United Nations Commission on International Trade Law on 30 May 1997 was accepted in New Zealand in 2006. The Insolvency (Cross-Border) Act 2006 provides a framework for facilitating insolvency proceedings when a person is subject to insolvency administration (whether personal or corporate) in one country, but has assets or debts in another country; or more than one insolvency administration has commenced in more than one country.

Generally overseas insolvency practitioners have no restrictions on dealing with assets of an individual or a company in New Zealand, with assistance from the New Zealand Courts. As a consequence it may not be necessary to appoint a New Zealand practitioner. There is no specific restriction on a foreign practitioner being appointed as the New Zealand appointee but practically it is unlikely the Court will allow it.

However, a foreign judgment order cannot be enforced without pursuing in the New Zealand High Court. If the application is successful then the judgement can be enforced as a local judgement against the debtor company and its New Zealand property.

Case law indicates it is desirable for any New Zealand liquidation of assets to be concurrent with and ancillary to the overseas liquidation with protection to the various classes of creditors; i.e. the secured and preferential creditors but the unsecured creditors would not enjoy any special protection and rank equally.

QUESTION 2

2. Creditors' rights aimed to meet claims

2.1 Filing a claim

With personal bankruptcy the creditor must submit a claim form to the Official Assignee within the specified time, which is specified in the notice to creditors and in the advertising. The creditor must submit the claim form in accordance with the prescribed procedure and they may amend or withdraw the claim but any amended claim form must also comply with the same formalities prescribed for in the original claim form. The Official Assignee examines each creditors claim form, unless he considers it is likely no dividend will be possible. The claim may be admitted or rejected in whole or part or

further evidence to support the claim may be required. If a claim is rejected by the Official Assignee, he or she must give notice, as soon as practicable, of the grounds for the rejection. A creditor whose claim has been rejected may apply to the Court, within 15 working days of receiving the notice, for an order modifying or reversing the Official Assignee's decision. The Court may make an order cancelling an admitted claim or reducing it if it considers the claim was improperly admitted.

In the case of Receiverships the Receiver normally requests creditors of all classes to file a claim, by correspondence or by completing a confirmation of amount owing form. Attached to the form will be evidence (copy invoices usually) of the debt being claimed. There is no prescribed timeframe for these to be filed. The Receiver must ensure secured and preferential claims are correctly dealt with but has no duty to settle unsecured claims.

Following the appointment of a liquidator, (within 5 days if a voluntary appointment or 25 days if a Court appointment) he or she must prepare a list of every known creditor of the company with each creditor's address (if known). The first report is then sent to all creditors which normally includes a date by which claims need to lodged with the liquidator. Public notice of the date is also given, by advertising in the New Zealand Gazette and in one newspaper circulating in the area in which is situated the company's principal place of business.

A claim needs to be made in the prescribed form and contain full particulars of the claim and attach evidence to support the claim (usually copy invoices). The Liquidator must, as soon as practicable, admit or reject the claim in whole or in part and if the liquidator subsequently considers that a claim has been wrongly admitted or rejected in whole or in part, may revoke or amend that decision. If a claim is rejected in whole or part, notice in writing must be given to the creditor.

Where there have been mutual credits, mutual debts, or other mutual dealings between the company and a creditor, those amounts may be offset and only the balance of the account may be claimed in the liquidation, or is payable to the company, as the case may be. The amount of a claim may include interest up to the date of the liquidator's appointment at the rate specified in any contract that provided for interest to be payable or in the case of a judgment debt, at such rate as is payable on the judgement debt.

If a liquidator rejects a creditor's claim the creditor may make an application to the Court to have the liquidators decision reversed. The Court may allow costs to be added to the creditors claim; or, allow costs of any party to be paid out of the assets of the company, such costs being deemed to be expenses of the liquidator or order any costs to be paid by any party to the proceedings other than the liquidator.

Dividends are paid on accepted claims and in the correct order of priority.

2.2 Privileges for secured claims

The Personal Property Securities Act 1999 reformed the law relating to security interests and provided for the creation and enforceability of security interests along with the determination of priority between security interests in the same property and the creation of a register of security interests in property.

A secured creditor may realise property subject to their charge, if entitled to do so; or, value the secured property and claim in the liquidation as an unsecured creditor for the balance due; or, surrender the charge to the liquidator for the general benefit of creditors and claim as an unsecured creditor for the whole debt. A claim needs to be made in the prescribed form and contain full particulars of the valuation and any claim along with full particulars of the charge and any supporting documents to substantiate the claim. The liquidator must accept or reject in whole or part the valuation and claim but where it is rejected the creditor may make a revised valuation and claim within 10 working days of receiving the notice of rejection. Furthermore the liquidator may, if he or she subsequently considers that a valuation and claim was wrongly rejected in whole or part, revoke or amend that decision.

The liquidator may at any time, by notice in writing, require a secured creditor, within 20 working days after receipt of the notice, to elect to realise property subject to a charge, or value the property, or surrender the charge. If the secured creditor fails to comply then it will be taken as having surrendered the charge to the liquidator for the general benefit of creditors. A secured creditor who surrenders a charge but before the liquidator realised the property, may with the leave of the Court or the liquidator withdraw the surrender and rely on the charge or submit a new claim.

2.3 Continuation of contracts entered into with the debtor

Contracts and agreements entered into prior to the date of appointment are generally not binding on the insolvency representative, unless they are accompanied with security documentation and registered on the Personal Properties Security Register set in place by the Personal Property Securities Act 1999.

The appointment of a receiver does not automatically bring a pre receivership contract to an end. The receiver may enforce it if it is likely to be beneficial to the company and the other party cannot terminate it unless the contract specifically allows for termination on the appointment of a receiver. Generally though, the receiver will not be interested in continuing pre receivership contracts. However, the receiver does not have a statutory right to disclaim a contract and the other party is able to claim as an unsecured creditor for any loss. There is a priority afforded in the case of lay-by sales whereby the buyer is entitled, on payment of the balance outstanding, to obtain the goods.

Liquidators have the ability to disclaim onerous contracts, being an unprofitable contract; or property that is unsaleable or may give rise to a liability or a litigation right that the liquidator believes has no reasonable prospect of success. A creditor so affected may claim as a creditor of the company for the amount of the loss or damage and apply to the Court for an order that the disclaimed property be delivered to or vested in the creditor. A creditor whose rights would be affected by the disclaimer of onerous property may give the

liquidator notice in writing requiring the Liquidator to elect whether to disclaim the property not less than 20 days after service of the notice.

A creditor is not entitled to retain the benefit of any execution process, distress or attachment over or against property of a company in liquidation unless the process was completed prior to the liquidation appointment.

Many contracts provide for the automatic termination upon the appointment of a liquidator and generally that does not concern him or her; however if the liquidator wishes to retain the benefit of a particular contract he or she may negotiate new arrangements relating to the contract.

2.4 Cross-border and specific country entitlements

Whenever notice is given under a New Zealand insolvency proceeding to creditors in New Zealand, such notification shall also be given to known overseas creditors. No letters rogatory or other similar formality is required. The notification to foreign creditors shall indicate a reasonable time period for filing claims and specify the place for their filing and indicate whether secured creditors need to file their secured claims.

In the case of a foreign representative who successfully applied to the High Court for recognition of the foreign proceeding in which the foreign representative has been appointed, the Court may entrust the distribution of all or part of the debtor company's assets located in New Zealand to the foreign representative or another person designated by the Court, provided the Court is satisfied that the interests of creditors in New Zealand are adequately protected. The foreign representative has standing to initiate any action that an insolvency representative may take in respect of a New Zealand insolvency proceeding that relates to a transaction, security or charge that is voidable or may be set aside or altered. The foreign representative may, provided the requirements of New Zealand law are met, intervene in any proceeding in which the debtor company is a party.

QUESTION 3

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3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

3.1.1 Personal bankruptcy

The role of creditors in a bankruptcy is to attend meetings of the creditors and to submit proofs of debts due by the bankrupt. A secured creditor may realise property subject to their charge; or value the property subject to the charge and prove in the bankruptcy as an unsecured creditor for the balance due, or surrender the charge to the Official Assignee for the general benefit of creditors and prove in the bankruptcy as an unsecured creditor. The secured creditor, with the leave of the Court or the Official Assignee, may withdraw the surrender and rely on the charge, or submit a new creditor's claim form.

If there have been mutual credits, mutual debts or other mutual dealings between a bankrupt and a creditor prior to adjudication, the amounts may be set-off.

A creditor who considers their interests are detrimentally affected by any other decision made by the Official Assignee may also apply to the Court to reverse or modify the act or decision, within 15 days of the act or decision.

A creditors meeting may appoint an expert or a committee of any persons to assist the Official Assignee in the administration of the bankrupt's estate. The Court must approve any remuneration for those people however.

A creditor or their lawyer, may at any reasonable time, inspect the record of an examination on oath in regard to the bankrupt's property, conduct or dealings by a District Court Judge or by the Court. They also have the right to inspect and take extracts or copies of the bankrupt's accounting records, statement of affairs, proofs of debts and minutes of creditors meetings.

A creditor may object to the automatic discharge, after 3 years, of a bankrupt. If that occurs the Official Assignee must summon the bankrupt to be publicly examined by the Court. The Court may, on application of a creditor, reverse the discharge of a bankrupt any time before 2 years after the discharge.

3.1.2 Receiverships

Receivers have a duty to exercise their powers in good faith and for a proper purpose. They must have reasonable regard to the interests of secured and unsecured creditors of the debtor company and also sureties who may be called upon to fulfil obligations of the debtor company. Also, when selling property the receiver owes a duty to obtain the best price reasonably obtainable as at the time of sale.

Unsecured creditors have a right to request in writing a copy of any statutory report (6 monthly) to be received within 21 days after the notice being received. In any event these reports are filed at the Companies Office and can be downloaded by anyone searching.

An unsecured creditor may make an application to Court to review or fix remuneration of a receiver at a level which is reasonable in the circumstances and to order the receiver to refund any amount found to be unreasonable. The Court may also declare whether or not a Receiver was validly appointed or validly entered into possession or assumed control of the company.

Despite the receivership, a creditor still has the right to apply to the Court for the winding up of the company and the appointment of a liquidator.

3.1.3 Voluntary administration

At the initial meeting creditors vote on whether to retain the existing Administrator or whether to appoint a replacement Administrator. They also decide whether to appoint a creditors' committee and if so, to appoint its members. The next "watershed" meeting of creditors decides the future of the company and in particular whether the company and the Deed Administrator should execute a deed of company arrangement.

A secured creditor has a decision period of 10 working days from the appointment of Administrator to appoint a Receiver; or assume control of the charged property; or to exercise any right conferred on it by the security. The Court may limit the powers of a secured creditor in relation to a charge. If no action is taken during the decision period the charge becomes unenforceable except for a charge over perishable property.

The Court may adjourn an application for liquidation or interim liquidation, if it is satisfied that it is in the interests of the company's creditors to continue in administration rather than be placed in liquidation.

If a deed of company arrangement (DOCA) is entered into it binds all creditors in respect of claims that arise on or before the cut-off day, being not later than the day when the administration began. Creditors may amend, vary or terminate the DOCA by resolution at a meeting called to consider a proposed variation or termination of the DOCA.

The Court may make any order that it thinks necessary to protect the interests of the company's creditors while the company is in administration. Furthermore a creditor may make an application for the Court to rule on the validity of the Administrator's appointment. A creditor may also apply for a Court order for supervision where it is believed the management of the company's business, property or affairs are prejudicial to the interests of some or all of the company's creditors and the Court may also order the Administrator or Deed Administrator to remedy any default.

The Court, on the application of a creditor, must make a prohibition order in relation to a person who is unfit to act as Administrator or Deed Administrator by reason of persistent failures to comply or the seriousness of a failure to comply.

3.1.4 Liquidations

Liquidators owe a duty of care to the company and to act impartially between the interested parties in the liquidation. If an appointment is made which the creditors object to they may call for a creditors meeting to seek the appointment of a replacement liquidator. If the appointment was via the Court an application can be made to Court to make an alternative Court appointment. Creditors no longer have a right to receive a list of creditors prior to the first meeting so it is difficult for them to ensure they have voting strength prior to the meeting.

An application could be made to the Court to terminate the liquidation and then immediately put the company back into liquidation with a new liquidator. The Court would need to be satisfied though that the creditors would gain some benefit from this approach.

Liquidators have a duty to have regard to the views of creditors and shareholders. If there is no initial meeting then there is no resolution to rely on to confirm that. The appointment of a liquidation committee can assist therefore. A creditor can request in writing that a creditors meeting be called to vote on the proposal to appoint a liquidation committee. Once appointed the liquidation committee is able to assist the liquidator in his duties, although he is not bound by directions from a liquidators committee.

Creditors who dislike any decision taken by a Liquidator may apply to the Court for directions. This procedure can be used to enforce Liquidators' duties and obligations.

3.2 Specific rights of information during the proceeding

3.2.1 Personal bankruptcy

A creditor may ask questions about the bankrupts affairs at the first and any subsequent creditors meetings; however, the Official Assignee may dispense with the meeting after considering the bankrupt's assets and liabilities, the likely result of the bankruptcy and any other matters. If a meeting is called, along with the notice of meeting the Official Assignee must send a summary of the bankrupt's assets and liabilities, extracts from or a summary of the bankrupt's explanation of the causes of the bankruptcy and any comments on the bankruptcy the Official Assignee wishes to make. A creditor or their representative, may question the bankrupt as to his or her property, conduct or dealings and the questioning may be on oath.

A creditor, or their representative, who has lodged a creditor's claim, has a right to at any reasonable time, inspect and take extracts or copies of:

- the bankrupt's accounting records;
- the bankrupt's answers to questions;
- the bankrupt's statement of affairs;
- all proofs of debt;
- the minutes of any creditors meeting.

A creditor, or their representative also has a right to at any reasonable time, inspect the record of an examination of the bankrupt by a District Court Judge or the Court.

Every Official Assignee must keep proper accounting records for each bankruptcy, in the prescribed form; and verify those records by statutory declaration, when required by the Court. A creditor, or any person who has an interest may inspect the Assignee's accounting records for a particular bankruptcy.

The Official Assignee must prepare a final statement of receipts and payments at the conclusion of the bankruptcy and this is able to be inspected without fee by any creditor or other person who has an interest. The Official Assignee must publish the final receipts and payments in the prescribed manner and advertise in the prescribed manner that it has been published.

3.2.2 Receiverships

Not later than two months after the receivers appointment, he or she must prepare a report on the state of affairs with respect to the property in receivership. Not later than two months after the end of each six months after his or her appointment and the date on which the receivership ends, a Receiver

must prepare a further report summarising the state of affairs for the company to that point. A copy of every report must be sent to the company and every person in whose interests the Receiver was appointed and a copy to the Registrar, within 7 days after it is prepared. Not later than 21 days after receiving a written request for a copy of the report from a creditor, director or surety of the company, or any other person with an interest in the receivership or the authorised agent of any of them, a Receiver must send a copy of it to the person requesting it. A person to whom a report must be sent is entitled to inspect the report during normal business hours at the office of the person required to send it.

A receiver may provide information to the directors of a company in receivership in addition to the normal reports, but he or she must take care to ensure that is not contrary to the interests of the appointing secured creditor or likely to have commercial consequences.

3.2.3 Voluntary administrations

Administrators must file an account with the Registrar for the period of 6 months (or shorter as the administrator decides) after the date of appointment and each subsequent period of 6 months during which he or she holds office and finally for the period between the last report and the date on which he or she vacates the office. These must be filed within 20 working days after the end of the period in question. A creditor may apply to the Court to order an administrator to remedy any default; such as, failing to file any return.

If an administrator reports a matter of misconduct to the Registrar, he or she must provide information, access to documents and facilities for inspecting and copying documents.

3.2.4 Liquidations

Liquidators have a specific duty to keep accounts and records of the liquidation and to permit those accounts and records and the accounts and records of the company to be inspected by a liquidation committee, unless the liquidator believes such inspection would be prejudicial to the liquidation and if the Court so orders, inspection by a creditor or shareholder. The records must be retained for not less than one year after the end of the liquidation. The Registrar may, whether before or after the completion of the liquidation, authorise the disposal of any accounts and records and require any accounts or records to be retained for longer than one year after the completion of the liquidation.

A liquidator appointed following a shareholders resolution, must, within 5 working days prepare and send to every known creditor, every shareholder and the Registrar for registration a report containing a statement of the company's affairs, proposals for conducting the liquidation, a listing of creditors and if practicable, the estimated date of its completion. A notice must also be sent advising the right of a creditor or shareholder to call a meeting of creditors. In the case of a Court liquidation, the liquidator must complete this within 25 working days, after appointment. At the completion of the liquidation a final report and a statement of realisations and distributions must also be sent, along with a summary of the applicable grounds on which a creditor or shareholder may object to the removal of the company from the New Zealand register.

On the application of a liquidation committee, or, with the leave of the Court, a creditor, shareholder, director or other entitled person, may seek an order for an audit of the accounts of the liquidation or make an order for the retention or disposal of the accounts and records of the liquidation of the company.

3.3 Approval rights not delegated to a creditors' committee

In all forms of insolvency, the requirements to produce regular reports remain, regardless of whether a creditors' committee exists. Creditors retain their rights to information, legal redress and the ability to contact the insolvency representative over any matter. The creditors committee, however, can call for extra reports or call a meeting of creditors or of shareholders easier than a normal creditor.

3.4 Cross-border and specific country rights

Foreign creditors have the same entitlements as local creditors.

QUESTION 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

4.1.1 Receiverships

Receivers are not required to call meetings of creditors and the receiver is not the agent of the creditors. The only effective right creditors have is to apply for the Liquidation of the company. This does not prevent the Receiver continuing his duties but can provide a watchdog for the creditors.

4.1.2 Voluntary administration

In these proceedings creditors have a far greater say. The administrator must follow a strict timetable of events, which includes creditor meetings. The first meeting must be called not less than 5 working days before the meeting, which must be held within 8 working days after the date on which the administration began. The purpose of this meeting is to determine whether the creditors wish to appoint someone else as administrator and to appoint a creditors committee. The administrator must then convene a "water-shed" meeting. Notice must be given no less than 5 working days before the meeting and must be held within 5 days after the end of the convening period of 20 working days after appointment, being a total of 25 days after commencement. This meeting decides one of three outcomes; i.e. the administration should end and control reverts to the directors; or, a resolution is passed to liquidate the company; or, a resolution is passed that the company executes a Deed of Company Arrangement (DOCA).

The administrator must call other creditors' meetings as required; e.g. because an administrator has resigned or the DOCA requires amendment.

The administrators of related companies may call meetings of creditors of their respective companies to be held at the same time and place, but only with the consent of all the creditors.

4.1.3 Liquidations

A liquidator is required to summon a meeting of creditors for the purpose of resolving whether to appoint another liquidator or confirm the existing appointment and to have regard to the views of creditors or shareholders set out in a resolution at the meeting. Notice in writing of a meeting of creditors must be given in the liquidator's first report. Public notice of the meeting must also be given not less than 5 working days before the meeting.

In the case of a solvent liquidation, if the liquidator determines the company in fact cannot pay its debts then he or she must call a meeting of creditors for the same purposes as above.

However, a liquidator is not required to call a meeting of creditors if he or she considers that having regard to the assets and liabilities of the company, the likely result of the liquidation of the company and any other relevant matters, that no such meeting should be held and notice is given of that. A creditor may give notice in writing, within 10 working days after receiving the notice that no meeting will be held, that a meeting is required in which case the liquidator must give notice in writing of a meeting of creditors to be held within 15 working days after the Liquidator receives the notice, although he can still refuse the request for the reasons given above.

Furthermore a creditor or shareholder may request the liquidator to call a meeting of creditors or shareholders at any time in the course of the liquidation to vote on a proposal that a liquidation Committee be appointed to act with the liquidator. The Liquidator may decline this request if the request is frivolous or vexatious; or, was not made in good faith; or the costs of calling the meeting would be out of proportion to the value of the company's assets. This decision may be reviewed by the Court on the application of any creditor or shareholder.

If a meeting is held and a resolution is determined because of the voting strength of a related entity, the Court may on the application of the liquidator or a creditor - order that the resolution be set aside, order that a new meeting be held to consider and vote on the resolution, order that a specified related creditor must not vote on the resolution, or make any other orders the Court thinks necessary.

Practically though, in the majority of small business insolvencies, no meetings are held.

4.2 Creditors' committee

4.2.1 Voluntary administration

The creditors resolve at the first meeting whether to appoint a creditors committee and if so who the members are to be. A person may be a member of the creditors' committee only if that person is:

- a creditor of the company; or
- the agent of a creditor under a general power of attorney; or
- authorised in writing by a creditor to be a member.

The functions of the creditors committee of a company in administration are:

- to consult with the administrator about matters relating to the administration and;
- to receive and consider reports by the administrator.

The committee must not give directions to the administrator but the administrator must report to the committee about matters pertaining to the administration as and when the committee reasonably requires.

4.2.2 Liquidation committees

These can assist a liquidator in the performance of his or her duties. Because few meetings are held however, there are few liquidation committees appointed. The committee must consist of not less than 3 persons who are creditors or shareholders.

The Liquidation committee has the power to:

- call for reports from the Liquidator on the progress of the liquidation;
- call a meeting of creditors or shareholders;
- apply to the Court for Court supervision of the Liquidator or orders to enforce the Liquidators duties;
- assist the liquidator as appropriate in the conduct of the liquidation.

Committee members are not paid for their services, although they can receive out-of-pocket expenses incurred, as a preferential payment. The committee meet as it from time to time decides and the liquidator or a member of the committee may also call a meeting of the committee as and when necessary.

Committee members are nominated and voted for at a meeting of creditors and shareholders. In practice few committees are appointed although sometimes the Liquidator uses an informal group of creditors to assist him or her on the liquidation.

4.3 Other forms of direct creditors' participation

The only other form of direct creditors' participation is via Court proceedings for the supervision of receivers, administrators or liquidators. Informally, creditors may telephone, email, correspond with or visit the insolvency representative to discuss the proceedings, but this involves the insolvency representative's time and thus increases the cost of the proceedings thereby reducing the funds available for distribution.

4.4 Rights related to reorganisation plans and proceedings

4.4.1 Bankruptcy compromise

An insolvent person may make informal arrangements with creditors but this does not affect those creditors' rights to take enforcement action or proceed to bankrupt the individual.

The creditors of an individual who is already bankrupt may accept a composition in satisfaction of the debts due to them by passing a special resolution (the preliminary resolution) that contains the terms of the composition. To be effective the composition is confirmed at a creditors meeting by passing a special resolution (the confirming resolution) which may vary the terms of the preliminary resolution, if the final terms are at least as favourable to the creditors as the terms set out in the preliminary resolution. For it to be binding, the Court must approve the composition, which then binds all creditors in respect of provable debts due to them by the bankrupt. The Court may refuse to approve the composition if its terms are not reasonable or not calculated to benefit the general body of creditors. The Court may also, on the application of an aggrieved person, order that any default in payment of any composition approved by the Court, be remedied or enforce the provisions of the composition.

4.4.2 Informal compromise

Any debtor company can make informal compromise arrangements with one or more of their creditors. These arrangements are completely informal and are not binding on creditors (unless separate individual contracts are entered into, which is unlikely) and creditor rights of execution, distress or attachment remain. Any creditor may proceed to petition the Court to wind up the company if they decide the proposal is not in their interests or is not working. These arrangements are only effective with the good grace of the creditors involved and the confidence they have in the company to settle the debt as arranged in the compromise.

4.4.3 Part 14 compromise

The proponent of a compromise must compile, in relation to each class of creditors of the company, a list of creditors with the amount owing and forward a notice of intention to hold a meeting of creditors and a statement setting out the terms of the proposed compromise with the foreseeable consequences if the proposal is accepted and a copy of the list of creditors. The creditors have the right to approve or vary the proposal, at a meeting of creditors which then becomes binding on the company and its creditors. A secured creditor retains the right, during a period beginning not earlier than the date on which notice was given of the proposed compromise and ending not later than 10 working days after the date on which notice was given of the result of the voting on it, to take poseession of, realise or otherwise deal with property of the company over which it holds a charge.

With the leave of the Court, a creditor may seek an order from the Court that the compromise will, if the company is put into liquidation, continue in effect and be binding on the Liquidator.

4.4.4 Part 15 arrangement, amalgamation, compromise by the court

An arrangement includes a reorganisation of the share capital of a company by the consolidation of shares of different classes, or by the division of shares of different classes. The Court may, on the application of a company, or any shareholder or creditor of the company, order that an arrangement, amalgamation or compromise shall be binding on the company and other persons the Court specifies. The Court may also order the holding of a meeting of creditors to consider and approve, in such manner as the Court may specify, the proposed arrangement or amalgamation or compromise.

A creditor may also seek an order requiring that a report on the proposed arrangement or amalgamation or compromise be prepared and if the Court sees fit, supplied to the shareholders or creditors or any class of creditors or to any other person who appears to the Court to be interested. They may make an additional order providing for and prescribing terms and conditions for persons who voted against the arrangement, amalgamation or compromise at any meeting or appeared before the Court in opposition to the application.

4.4.5 Voluntary administrations

Creditor rights in regards to these have been covered in the other sections.

4.5 Cross-border and specific country rights

Foreign creditors have the same rights regarding the commencement of and participation in a New Zealand insolvency proceeding as creditors in New Zealand. This does not affect the ranking of claims in a New Zealand insolvency proceeding or the exclusion of foreign tax and social security claims from such a proceeding.

A foreign representative may apply to the High Court for recognition of the foreign proceeding in which the foreign representative has been appointed. Upon recognition of the foreign main or non-main proceeding the Court may grant any appropriate relief. The right to request the commencement of a New Zealand insolvency proceeding or the right to file claims in such a proceeding is not affected. The foreign representative has standing to initiate any action that an insolvency administrator may take in respect of a New Zealand insolvency proceeding.

QUESTION 5

5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

The insolvency representative has a duty to have regard to the views of creditors and shareholders. He or she must not act in a way which unreasonably prejudices the interests of the company and other creditors of the company. Should the insolvency representative fail to do so a creditor, of any class may seek legal redress. In a Receivership, a creditor may make an application for an order for the Receiver to comply with Receivers duties. If the Court is satisfied the person is unfit to act as a Receiver due to persistent failures to comply then the Court may make a prohibition order against that person for a period not exceeding 5 years. Alternatively the creditor could make an application for the winding up of the company and once the Liquidator was appointed endeavour to have the Liquidator examine the actions of the Receiver and if necessary take appropriate legal action.

In the case of liquidator a creditor owed not less than 10 per cent of the total amount owed to all creditors of the company may request a meeting of creditors. At the meeting the creditor could make their views known and seek the appointment of a liquidation Committee. If the liquidator has refused a meeting or ignores the creditor's requests an application may be made for Court supervision of the liquidation whereby the Court may give directions in relation to any matter arising in connection with the liquidation; confirm, reverse or modify an act or decision of the liquidator; order an audit of the accounts of the liquidation; order the liquidator to produce the accounts and records of the liquidation for audit; review or fix remuneration of the iquidator or order a refund; declare whether or not the liquidator was validly appointed or validly assumed custody or control of property; or make an order concerning the retention or the disposition of the accounts and records of the liquidation.

Alternatively an application for an order to enforce liquidators duties may be made. If the liquidator fails to comply with this the Court may remove the liquidator from office and may also make a prohibition order for an indefinite period.

In practice most creditors complain direct to the insolvency representative who then endeavours to resolve the matter amicably rather than ending in legal action and in many cases once the decisions have been made and acted upon, it is too late to change the outcome. Legal challenges are rare, but are available.

5.2 Substitution of the insolvency representative

5.2.1 Personal insolvency

An Assignee must vacate office if he or she is adjudicated bankrupt. An Assignee is disqualified from acting in a bankrupt estate if he or she is a creditor of the estate and the creditors resolve that he or she must not act as Assignee.

5.2.2 Receiverships

A receiver may be removed by the appointer and another receiver appointed in which case the first receiver must pay out preferential claims before accounting to the second receiver. On removal the powers of the Receiver ceases and until the new receiver is appointed the debtor company is out of receivership.

An application may also be made for orders to enforce receiver's duties or remove the receiver from office. In the case of persistent failures to comply the Court may order a prohibition of that person from acting as receiver or liquidator for a period not exceeding 5 years.

A receivership under a security agreement is displaced if the Court appoints its own receiver although these circumstances are very rare. Furthermore the Court may remove a receiver where it is established he or she were acting dishonestly or recklessly.

5.2.3 Voluntary administration

The administrator may be removed by the Court following an application of a creditor or by a resolution of creditors passed at the first meeting or a resolution of creditors at a meeting convened to consider whether to remove a replacement administrator. The creditors may not remove the administrator by a resolution passed at a creditors meeting unless the same resolution also appoints as administrator another person who is not disqualified and the person named in the resolution as the new administrator has, before the resolution is considered, tabled at the meeting a signed written consent to act as administrator and an interests statement.

5.2.4 Liquidation

In the case of liquidation, the first meeting of creditors may resolve that a replacement Liquidator be appointed. This is done by resolution of the creditors and requires a majority in number and value of the creditors or class of creditors voting in person or by proxy or postal vote. In the event of a vote for a compromise proposal the resolution is adopted if a majority in number representing 75 per cent in value of the creditors or class of creditors voting in person or by proxy or postal vote. The Court may set aside a resolution on application by a creditor if the outcome is determined by the voting strength of related entities. They may order a new meeting to be held to consider and vote on the resolution.

5.3 Cross-border and specific country rights (entitlements)

Upon recognition by the High Court of a foreign proceeding, the foreign representative, has standing to initiate any action that an insolvency administrator may take in respect of a New Zealand insolvency proceeding. When the foreign proceeding is a foreign non-main proceeding, the Court must be satisfied that the action relates to assets that, under the law of New Zealand, should be administered in the foreign non-main proceeding.

However, recognition of a foreign proceeding does not prevent the Court, on the application of any creditor or interested person, from making an order, subject to such conditions as the Court thinks fit, that the stay or suspension against the debtor company's assets does not apply in respect of any particular action or proceeding, execution, or disposal of assets. The right exists to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor. It also does not affect the right to request the commencement of a New Zealand insolvency proceeding or the right to file claims in such a proceeding.

QUESTION 6

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6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

6.1.1 Receiverships

The Receiverships Act 1993 at Section 30 confirms preferential status for the receivers expenses and remuneration but only in relation to proceeds from accounts receivable and inventory. Proceeds from security interests excluding accounts receivable and inventory must be paid to the security interest holder. Most receivers endeavour to obtain an indemnity from their appointer to cover expenses and remuneration in the event asset realisations are insufficient to cover this. In recent times there has been a trend for banks and finance companies to tighten up on the indemnities, limiting them in some cases to just appointment defects rather than any trading losses or reduced realisations.

6.1.2 Voluntary administration

The administrator is entitled to charge reasonable remuneration for carrying out his or her duties and exercising their powers. This is further enshrined in the Seventh Schedule of the Companies Act 1993 where it is listed as second after Liquidator's expenses and remuneration in the list of priority of payments to preferential creditors. The Court may, on the application of the Administrator, a director or officer of the company, or a creditor, or a shareholder, review or fix the administrator's remuneration at a level that is reasonable in the circumstances.

6.1.3 Liquidation

The expenses and remuneration of the liquidator are payable out of the assets of the company. The Seventh Schedule of the Companies Act 1993 lists as number one priority the fees and expenses properly incurred by the liquidator in carrying out his or her duties and exercising their powers.

In some cases a liquidator will seek an indemnity from a shareholder or director of a voluntary appointment where it appears there are unlikely to be sufficient assets to cover costs, but the shareholder or director still wishes to proceed with the liquidation. With voluntary liquidations, market forces can impact on rates of remuneration charged with different firms charging different amounts, often dictated by their size or overhead structure.

The Official Assignees' who are appointed liquidators charge remuneration at an amount fixed by the Companies Act 1993 Liquidation Regulations 1994. Liquidators accepting Court appointments must also charge at these prescribed rates or apply to the Court for approval to charge the rates normally charged by their firm for the personnel involved.

6.2 Funding special activities of the Insolvency representative

Creditors have no obligation to fund actions by the insolvency representative. However occasionally creditors are sufficiently aggrieved to agree to funding for some particular action where the insolvency representative has insufficient funds to do so. That would become an arrangement between the creditor and liquidator although any payment received should be recorded in the liquidators accounts as a receipt and payment. A common situation where this applies is when a creditor requires extensive research into director liability issues and the liquidator lacks the funds in the liquidation to comply. If the action is successful the costs contributed are refunded but not the creditors original debt which is dealt with under the normal priority rules.

Liquidators may apply to private funders for assistance or to the Government's liquidation surplus account, but generally these services require watertight cases and a high percentage of any proceeds.

6.3 Specific country entitlements

A priority exists for a creditor who protects, preserves the value of or recovers assets of the company for the benefit of the company's creditors by the payment of money or the giving of an indemnity; being the amount received by the Liquidator by the realisation of those assets, up to the value of that creditor's unsecured debt; and the amount of the costs incurred by that creditor in protecting, preserving the value of, or recovering those assets.

Basic forms

Proof of Debt form (Insolvency and Trustee Service website – Forms)
Statutory demand (Example)

Form C1 - Statement of claim in proceeding for putting company into liquidation (High Court Rules Schedule 1 Forms)

Form C3 – Notice of proceeding for putting company into liquidation
(High Court Rules Schedule 1 Forms)

Form 1 – Unsecured creditors claim (Companies Act 1993 Liquidation Regulations 1994 Schedule Forms)

Form 2 – Secured creditor's valuation and claim (Companies Act 1993 Liquidation Regulations 1994 Schedule Forms)

Form – Accounts of company in administration (Companies (Voluntary Administration) Regulations 2007 Schedule 2 Prescribed form for administrator's accounts)

POLAND

Introduction

Polish bankruptcy law was the subject of wide ranging reforms in 2009. The sweeping changes led to the adoption of amendments which aimed at a general modernization of the system. Even if the Polish Bankruptcy Act itself is very young, from 2003, reforms were introduced in 2009, in order to guarantee a procedure which takes into account the fulfillment of the creditor's claims to the maximum extent. The reform of 2009 modified the bankruptcy law in particular by increasing the powers and tasks granted to the relevant judge during the procedure, especially with reference to the supervision over the operations for the liquidation of the bankrupt's assets.

Moreover, 2009 also saw the introduction into the Polish system the "consumer bankruptcy law", principally derived from American regulation but also extracted from several other European legal orders. Consequently, it is possible now for individuals to file a motion for bankruptcy and prepare a repayment plan in accordance with the creditors.

The bankruptcy law provisions are applied for debtors who have the status of "entrepreneurs", which means an individual or legal person, or organization with legal personality which conducts a business or professional activity on its own behalf.

The provisions of the bankruptcy law are also applied to the following legal subjects:

- Joint-stock companies and limited liability companies which do not conduct any business activity;
- Partners in Polish partnerships, who are personally liable for the obligations of the partnership with all their personal assets, and
- Partners in professional partnerships where it is not possible to apply for bankruptcy such as:
    - the Treasury (*Skarb Pa stwa*);
    - the commons and other units of local government;
    - institutions responsible for public health; individuals conducting an agricultural activity; and universities.

QUESTION 1

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1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of a debtor's insolvency

Both the debtor and one (or more) creditors are entitled to file a motion for the declaration of the debtor's insolvency. If the petition to declare bankruptcy is filed by a creditor, this creditor should provide evidence to support its claim and additionally, if the creditor applies for a declaration of bankruptcy with the possibility to make an agreement with the creditors, it should provide a preliminary agreement proposal.

The decision concerning this declaration of insolvency is given by the relevant court. It may be appealed against only by the bankrupt, whereas the decision dismissing the petition to declare bankruptcy may be appealed against only by the petitioner.

If the Court ascertains that the debtor's assets are encumbered with secured claims such as mortgage, pledge, registered pledge, tax lien or maritime mortgage to such a degree that the debtor's remaining assets are not sufficient to satisfy the cost of the proceedings, it rejects the petition.

In case a creditor files for bankruptcy of a debtor, the *favor creditoris* is also given by the provision concerning the possibility to activate the insolvency procedure even when there is a legislative basis not to declare it (i.e. when a debtor's delay in performing the obligations does not exceed three months and the amount of unperformed obligations does not exceed 10% of the balance sheet value of the debtor's enterprise), if the non declaration of the insolvency would be in detriment to the creditor.

The creditor also has the general right to be exempt from court fees, unless he filed the petition for bankruptcy in bad faith.

1.2 Choice of the insolvency representative

In the event of a declaration of bankruptcy, the court shall issue a judgment acknowledging bankruptcy, in which it should among other things, appoint the so-called judge-commissioner (*s dzia komisarz)* and the trustee (*Syndyk,* the insolvency representative) or court supervisor (*nadzorc s dowego*) or administrator (*zarz dcy)*, also based on the opinion released by the preliminary meeting of the creditors.

The trustee is appointed in the event the insolvency proceeding will be carried on by means of liquidation of the debtor's assets, while the court supervisor shall be appointed in the case of a declaration of bankruptcy with the possibility to make an agreement with the creditors ("restructuring plan"). The administrator shall be appointed in the case of a declaration of bankruptcy with the possibility to make an arrangement, when the bankrupt has been deprived of the right to administer his assets.

There is an exception regarding the appointment of a natural person as an insolvency representative, considering that it is possible also for a commercial partnership or a company to be appointed as a trustee, court supervisor or administrator, but only if partners that are personally liable without any limitation for the partnership's obligations or members of the board representing the company have an appropriate license.

1.3 Packaged insolvencies

Packaged insolvencies are currently not common in Poland to date. Such insolvencies may be developed by Polish praxis in the future due to the fact that more and more small or medium- sized enterprises apply for declarations of insolvency.

1.4 Cross – border insolvencies and specific countries entitlements

The Polish law incorporated into its system the Regulation (EC) No 1346 / 2000 (OJ of 29 May 2000), concerning the cross-border insolvency within Member States of the EU.

The law states that the provisions concerning the cross-border bankruptcy proceedings given in the Polish insolvency law cannot be applied if an International Agreement to which the Republic of Poland is a party, or the law of an international organization of which the Republic of Poland is a member states otherwise.

In accordance with the Community law, Polish law expressly guarantees and does not discriminate the rights of a creditor having a domicile or registered office abroad.

The Polish insolvency law defines specific criteria as for the jurisdiction of its territorial courts in the event of a cross-border insolvency proceeding. Moreover, it uses the criterium of the "centre of interest", according to which Polish courts shall have exclusive jurisdiction in bankruptcy cases if the debtor has the centre of its main interests in the Republic of Poland. However, it has to be said that Polish legislation applies a broad interpretation to the term "centre of interest", in the event of a cross-border insolvency. In fact, it considers the Polish Court to hold jurisdiction also in cases where the debtor has an establishment, domicile, registered office or assets in the Republic of Poland.

QUESTION 2

2. Creditors' rights to participate actively in the proceeding

2.1 Filing a claim

Polish bankruptcy law is quite creditor-orientated, in the sense that the creditor's rights and the maximum satisfaction of their claims are a top priority. Further, in the case where the petition to declare bankruptcy is filed by the debtor, such petition should contain a list of all creditors, including addresses and the amount of their respective claims and dates of payment, as well as a list of securities established by the creditors on the assets of the debtor including the dates of their establishment.

In accordance with the basic principle that it is feasible to carry out the satisfaction of claims of the various creditors only after such claims (and other patrimonial rights towards the debtor) have been assessed and ascertained, under the new law is it possible to evaluate only the claims submitted to the so – called judge commissioner (*S dzia Komisarz).*

Accordingly, the claims of the employees of the debtor, as well as the claims for reparation of damages arising from illness, inability to work, or death, plus the claims assessed by means of a judiciary decision are inserted *ex officio* into

the list of claims. However, the Polish legislator considered that such a rule was contrary to the general principles of Polish bankruptcy law. The new provisions therefore state that only the claims of workers towards the debtor may be included *ex officio* in the list of claims while all others require a formal submission to the relevant judge.

Once the court allows the petitioner to declare bankruptcy, it shall issue a decision, and summon the creditors of the bankrupt to file their claims within a specified period of time not before one month and not after three months.

The creditor possesses the status of a person "entitled to satisfaction from the bankruptcy assets", even if no requirement to file the claim exists. According to the proceeding, each creditor has to file its claim with the judge – commissioner within the deadline provided in the decision declaring bankruptcy. The judge – commissioner examines whether the filing of the claim satisfies formal requirements. If this examination is satisfied, he forwards the filing to the trustee, court supervisor or the administrator. Their function is to check whether the claims filed are justified. The claim may be disallowed if it is unenforceable e.g. because of non – validity of the contract on which it is based.

A claim shall be filed in writing and two copies have to be filed. The entity filing the claim shall attach to the filing the original or a copy of the document justifying the claim, authenticated by a notary. The copies may also be authenticated by a legal adviser or an attorney at law representing the creditor filing the claim.

The filing of a claim shall include: i) first name and surname or the name or business name of the creditor, and, respectively, place of residence or registered office; ii) the identification of the claim along with any accessory claims (e.g. interest) and the value of the in-kind claim; iii) proof of the claim; iv) the class in which the claim shall be included; v) the security connected with the claim and the sum of the security; vi) current stage of affairs if the claim is subject to civil or administrative proceedings.

A foreign creditor is not required to have its domicile / registered office in Poland to file its claim. In practice, foreign creditors appoint Polish attorneys at law as their representative to file claims because the filing claim procedure within insolvency is very formalized. However, within cross-border insolvency, a foreign creditor is obliged to appoint a person who will be empowered to receive any correspondence on behalf of the creditor within the insolvency case.

2.2 Privileges for secured claims

Polish bankruptcy law places great emphasis on the creditor's secured claims.

The Polish law expressly states that all claims that are secured by means of a mortgage, pledge, registered pledge, tax lien, maritime mortgage or by any other entry in the land and mortgage register or in the register of vessels,will be taken as valid secured claims. Failing that, such claims wil be considered *ex officio*.

For the purposes of the bankruptcy law, it is also possible to consider the employee's claims as "privileged claims". As a consequence, once the trustee is appointed he shall without delay perform all duties set out in the provisions on the protection of employees' claims in the event of the employer's insolvency.

The debtor while filing for bankruptcy is obliged to insert in the relevant petition a list of all claims that are secured, in a way to guarantee that they will be prioritized.

Another privilege given by Polish law to the secured claims concerns the second option with which it is possible to carry out the insolvency proceeding (i.e., the agreement between the creditors and the debtor). In such a case, the agreement shall not include a claim arising from an employment relationship or a claim secured on the bankrupt's assets by a mortgage, pledge, registered pledge, tax lien or maritime mortgage, unless the creditor consented to the inclusion of such a claim in the agreement.

Specific provisions are provided in the case of that pledge being registered may seek satisfaction from the object of the pledge by seizing it in accordance with the procedure set forth in the Law on the Registered Pledge and the Register of Pledges.

During the phase of distribution of the bankruptcy asset funds, the proceeds of the items and rights being encumbered with a mortgage, pledge, registered pledge, tax lien and maritime mortgage shall be assigned for the satisfaction of the creditors whose claims were secured on these items or rights. Then, the amounts remaining shall be allocated to the bankruptcy estate funds.

The Polish legislator, despite the general *favor* given to holders of secured claims, foresees some disposition in order to avoid a misuse of such encumbrances. Thus, the judge-commissioner shall *ex officio* or upon a motion of the trustee, court supervisor or administrator, declare the ineffectiveness towards the bankruptcy estate of any mortgage, pledge, registered pledge, tax lien or any other encumbrance which is formed on the bankrupt's properties, if the bankrupt was not a personal debtor. This is to avoid any agreement between the debtor and other persons (usually members of the family) before the bankruptcy is declared. That is why, in order for this rule to apply it shall be necessary that: i) the encumbrance was established one year prior to the filing of the petition to declare bankruptcy; ii) the bankrupt did not receive any consideration for the creation of that security; iii) if a consideration was received, the rule is anyway applied if this was of a significantly lower value than the value of the created security; iv) in any case (i.e. regardless of the amount received as a consideration to secure the claim), the encumbrance will be annulated by the judge – commissioner if this is done with persons who have particular connections with the debtor (for instance such as the spouse, a relative by blood or marriage).

2.3 Continuation of contracts entered into with the debtor

Polish law is structured in a way to deal with all the different effects of the opening of bankruptcy proceedings toward the parties involved. Thus, it dedicates a specific Chapter as to the effects of the bankruptcy declaration toward the obligations of the debtor.

In order to protect the interests of future business partners, the bankruptcy law provides that in any case after the declaration of bankruptcy, the company / enterprise bankrupt shall insert into its business name the additional words "in bankruptcy with liquidation" ("*w upadło ci likwidacyjnej*"), or "in bankruptcy with restructuring plan" ("*w upadło ci układowej*"). In this way the counterparts have the possibility to better assess the risks involved in the stipulation of contracts / agreements with the bankrupt. Moreover, because of this new provision the legislator guarantees an opportunity for entities in bankruptcy to participate in trade.

Furthermore any kind of provision / clause of a contract (to which the debtor is a party), stipulating that the respective legal relationship is to be modified or expire in the case of a declaration of bankruptcy, has to be considered null and void.

Additionally, the law respects the principle of conservation of the legal relationships (when this is possible and convenient for the contractual parties) entered into by the debtor, as after the bankruptcy is declared it is not possible to bring any further modification or expiry of the legal relationship to which the debtor is a party, unless it is carried out in accordance with the bankruptcy law.

As for the obligations of the debtor, the aforementioned principle of conservation of the legal relationships, states that the trustee takes the place of the debtor as for the performance of the contractual obligations which on the date bankruptcy is to be performed are still to be satisfied (in part or in full). Moreover, the trustee shall decide whether to terminate / rescind the contract or continue it, by requesting that the other party render the reciprocal performance.

The law, also allows to terminate specific contracts when bankruptcy is declared (agency agreement; mandate or commission agreement; loan agreements; etc.).

It is interesting to consider some specific provisions of Polish bankruptcy law, concerning the so – called framework agreements to which the debtor is a party. If such agreements stipulate that specific agreements concerning the sale and purchase of securities are to be concluded in order to fulfill framework agreements and the termination of these framework agreement result in the termination of all specific agreements, so is the trustee not empowered to terminate these framework agreements.

2.4 Cross-border and specific country entitlements

Polish insolvency law fully respects the principles of the EC Regulation on Insolvency Proceedings (Insolvency Regulation) which was adopted by the Council of the European Union on 29 May 2000, and came into force on 31 May 2002. Therefore and pursuant to Article 16 of the Insolvency Regulation, any judgment on opening of insolvency proceedings issued by a court of a Member State shall be recognized in all other member states excluding Denmark. In addition, the law applicable to such insolvency proceedings shall be that of the Member State in which such proceedings have been opened (Article 4 of the Insolvency Regulation).

With respect to non – European Union Member states and Denmark, Polish Insolvency law provides regulation on the acknowledgment of such insolvency proceedings. Such proceedings shall be initiated on the motion of the foreign administrator and are acknowledged if these refer to matters for which Polish courts do not have exclusive jurisdiction and the acknowledgment complies with the basic principles of the Polish legal system. After the recognition of foreign bankruptcy proceedings the foreign representative may bring an action to declare as ineffective any legal acts performed to the creditors' detriment. The foreign representative may also bring actions to declare null and void or to invalidate legal acts of the bankrupt which have been performed in breach of the law, principles of community life or which were intended to evade the law. In general, it is expressly provided that if the foreign bankruptcy proceedings have been recognised, the ineffectiveness of and challenging of the bankrupt's acts related to the assets located in the Republic of Poland included in the bankruptcy estate shall be determined by Polish law.

QUESTION 3

3. Creditors' rights to monitor the insolvency proceeding

3.1 General creditors' rights

The right of the creditors to preserve the bankruptcy assets in order to satisfy their claims is reflected in the provisions in the law. The court may apply measures to secure the assets of the debtor, in particular it may order mandatory administration of the debtor's assets, if reason exists to fear that the debtor may conceal its assets or otherwise act to the detriment of the creditors, or if the debtor does not comply with the instructions of the interim court supervisor.

The rights of the creditor in Polish bankruptcy proceedings encompass also the possibility to authorize the conduct of specific activities under certain circumstances. For instance, a restructuring plan (instead of the liquidation of the debtor's assets) is chosen, the creditors have to give their consent for the possibility to carry out performances resulting from the obligations which arose prior to the declaration of bankruptcy, if it is indispensable to continue the economic activity of the bankrupt or to improve the effectiveness of his enterprise.

3.2 Specific rights of information during the proceeding

Creditors under Polish law are entitled to be regularly informed about the state of affairs of the proceeding. Upon the declaration of bankruptcy, the trustee shall notify those creditors whose addresses are known on the basis of the bankrupt's books. However, apart from the information concerning the content of the petition for bankruptcy (in the case of its filing by the debtor), each creditor has the right to be informed.

It has to be stressed that Polish law does not provide any specific provisions allowing creditors to examine the files concerning the bankruptcy proceeding. However, files regarding the bankruptcy proceedings are in general accessible to the participants of the proceedings (debtor, creditors).

3.3 Approval rights not delegated to a creditors' committee

Polish insolvency law is based on extended rights of the creditor's committee. However, there are some approval rights granted by law to creditors within the so – called "preliminary creditor's meeting" before a judgment on insolvency is handed down. Such a preliminary creditor's meeting may be called by the court in order to take a decision as to the issue if the proceedings should be aimed at liquidating a debtor's assets or at the conclusion of a restructuring plan. At such a meeting, creditors may also approve a restructuring plan if at least a half of the creditors attend such a meeting and they represent 75% of all undisputable claims. Such a meeting is handed by a judge from the court appropriate to examine the motion for the opening of an insolvency case.

The reason why Polish law does not delegate separate approval rights to creditors is partially caused by the structure of Polish insolvency law, the function of the judge and persons involved in the entire insolvency proceedings. The information given below provides a brief outline of these characteristics.

Following the information of bankruptcy, the court maintains the possibility to allow the debtor to act as its own administrator of its assets, however, for acts exceeding the scope of regular administration the court supervisor's approval should be sought.

The judge – commissioner is a key figure of the insolvency proceedings in Poland, especially after the reforms of 2009. Accordingly, he directs the course of the proceedings, supervises the acts of the trustee, court supervisor and administrator, specifies the acts which the trustee, court supervisor or administrator may not perform without his approval or without the consent of the creditors' committee.

The judge – commissioner is also entitled to approve the final list of claims submitted by the creditors. In the case of a liquidation proceeding via the sale of an enterprise or its organized unit, effected by way of tender, the judge – commissioner should approve the winning offer, which was in precedence chosen by the trustee. Only after this approval, does the offer become legally binding. Finally, in the proceedings on the distribution of the bankruptcy estate funds, the judge – commissioner is entitled to approve the distribution plan.

During proceedings, the court has the right to approve the final reports written by the trustee, court supervisor or administrator. It also decides the final amount of their remuneration, taking into account the results and scope of their respective activities. On the other hand, the judge commissioner has the right of approval of the financial report submitted by the trustee, court supervisor or administrator at the end of their activities.

3.4 Cross-border and specific country rights (entitlements)

Foreign creditors have the same rights as local creditors.

QUESTION 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

Creditor's meetings are particularly important under Polish law, allowing creditors to actively participate in the insolvency proceeding in order to strengthen the pursuit of their rights. A preliminary meeting of creditors is convened by the court before bankruptcy is officially declared.

The debtor, interim court supervisor or mandatory administrator (nominated during the proceeding to secure the debtor's assets) has the right to participate in the preliminary meeting of creditors. Moreover, such a right shall be vested upon the creditors whose claims have been confirmed by enforcement titles. However, Polish law also allows for the participation of creditors that have been admitted by the court and whose claims are not challenged or have been shown to be "probable". The presumption of probability shows the discretion given to the court to evaluate the claims.

There are certain instances that are codified in which the preliminary meeting of creditors cannot be convened, namely: i) when from the facts of the case it appears that such proceedings would involve excessive costs (the court decides in this case); ii) when the sum of the challenged claims exceeds 15% of the total sum of claims; iii) when it is evident that further proceedings may be conducted only in order to liquidate the bankrupt's assets.

In particular this last option is linked with the prerogatives and tasks of the preliminary meeting, which has to deal especially with the possibility to adopt resolutions as for the choice of the insolvency proceeding to be held (liquidation of the debtor's assets or possibility to make a restructuring plan). Other tasks of the preliminary meeting refer to the possibility of election of a creditors' committee, and the possibility to issue an opinion on the appointment of the trustee, court supervisor or administrator (such opinion being not legally mandatory).

The preliminary meeting shall be chaired by a judge, and it is generally not adjourned. In fact, the reconvening of the meeting is possible only in "particularly justified" cases.

The resolutions of the preliminary meeting may be taken even in the case of a justified absence of the debtor.

The court however retains a certain degree of power upon the resolution issued by the preliminary meeting of creditors, considering that it may state, by means of a judiciary decision, when a resolution "contradicts the law".

As for the proper meeting of creditors, this is also convened by the judge – commissioner. He has to convene the meeting not only when he deems it necessary or when a resolution that is mandatory for the prosecution of the proceeding according to the law has to be taken, but also upon a motion filed by at least two creditors who hold not less than one third of the total sum of the acknowledged claims.

The judge-commissioner shall chair the meeting of creditors without the right to vote. The resolutions in general shall be adopted irrespective of the number of the persons present, by the majority of votes cast by the creditors holding at least one fifth of the total sum of the claims vested in the creditors entitled to participate in the meeting.

In the event of a vote on an exemption from the bankruptcy estate, the adoption of a resolution shall require the majority of the votes cast by the creditors holding at least two thirds of the total sum of acknowledged claims.

The judge – commissioner is also able to annul a resolution of the meeting of creditors if it is illegal, contrary to good practices, or if it flagrantly violates the interest of a creditor who voted against the resolution.

4.2 Creditors' committee

Generally speaking, the judge-commissioner has the task to establish, (but only if he deems it necessary) a creditors' committee and appoint its members. However, the judge-commissioner shall establish the creditors' committee upon a motion of the creditors who are vested with at least one fifth of the total sum of the claims, which have been acknowledged or shown to be probable. The creditor's committee is an optional organ of the insolvency proceedings and is established rather rarely in practice.

A creditors' committee shall consist of three to five members and one or two deputies, appointed by the creditors, whose claims have been acknowledged or shown to be probable.

The range of the creditor's committee's tasks and powers in insolvency proceeding relies ultimately on the decisions given by the judge – commissioner. The office holder has to specify the acts which the trustee, court supervisor or administrator may not perform without his approval or without the consent of the creditors' committee.

The nature of the activities performed by the creditor's committee is two fold. On the one hand, the law acknowledges to the creditor's committee a simple role of "support" to the other participants of the insolvency procedure (in terms of assistance to the trustee, court supervisor or administrator, expression of comments and opinions concerning their activities, supervision of their activities, monitoring the bankruptcy estate funds). In relation to the supervisory activities of the committee, then, the law admits that such activities are exercised also individually by the members of the committee (in any case upon authorization granted by the committee itself).

On the other hand, the law provides for a list of acts and activities which cannot be performed without the consent of the creditor's committee, namely: i) further

operation of the enterprise by the trustee, if the enterprise is to be operated for longer than three months from the date bankruptcy is declared; ii) resignation from the sale of the bankrupt's enterprise as a whole; iii) unrestricted sale of the real property or a sea vessel recorded in the register of vessels; iv) the sale of rights and claims; v) taking loans and bank credits and encumbering the bankrupt's assets with limited rights in rem; vi) the performance of a reciprocal agreement entered into by the bankrupt or the rescinding of such a agreement, as well as the performance or rescinding of an agreement entered into by the bankrupt; vii) the acknowledgement, waiver and conclusion of a settlement, concerning challenged claims, as well as submitting a dispute to a court of arbitration for settlement.

These activities require the approval of the creditor's committee in the case of insolvency aimed at the liquidation of the debtor's assets. In the event of insolvency proceedings resulting in a restructuring plan, the consent of the creditor's committee is in general foreseen in the following matters: i) encumbering of the debtor's assets with and ii) the taking of bank credits and loans.

All the resolutions of the creditor's committee must be taken by a majority of votes granting one vote to each member.

4.3 Other forms of direct creditors' participation

Such forms are not available under Polish insolvency law.

4.4 Rights related to reorganization plans and proceedings

4.4.1 The restructuring plan (*układ)*

Polish law provides for the possibility to operate a restructuring plan of the entity risking the insolvency (*układ)* in the form of an agreement between the debtor and its creditors, when it will achieve a higher value of the creditor's claims in comparison with the "ordinary" procedure consisting of the liquidation of the debtor's assets.

The reform of 2009 extensively modified the discipline of the restructuring plan which has repercussions also on the creditor's rights connected to the performance of such procedure.

Furthermore, since the reform it is the debtor who is normally charged with the management of its assets during the bankruptcy proceedings, while the administrator takes its place only in the case when the Court recognizes that this is necessary in order to guarantee a sound and legal management of the assets.

As for the rights of the creditors in a restructuring plan, the Bankruptcy law oversees certain creditors who do not have any right to vote in the matters concerning the restructuring plan. Among them, are the spouse of the debtor, his relatives and relatives in law. Moreover, in the event the debtor is a commercial company the creditors representing companies being with the debtor / company in relationships of dominance or dependence, pursuant to the provisions of the Polish Commercial Companies Code (CCC) do not have voting rights.

Since 2009 according to the new provisions in the matters related to the restructuring plan, if the debtor is a commercial company, the creditors being physical persons and representing more than 25% of the share capital of the insolvent company cannot exercise voting rights.

The new provisions also give the possibility for a better and simplified procedure as for the approval of the restructuring plan by the meeting of creditors. In fact, it is now possible to approve such a plan not only orally, but also in written form what is expected becoming the preferred form in practice.

With reference to the procedure for the approval of the restructuring plan, Polish law states that it depends on the decision of the judge – commissioner if he approves the plan by means of a group of creditors, each of them representing a certain field of interest. In this sense, the discretion granted to the judge – commissioner is wide, and what is more important, his decision on this issue cannot be objected to by the creditors. Any objections launched by the parties involved in the proceedings concerning the presence of mistakes that have arisen in the formation of groups, may be submitted exclusively while objecting to the restructuring plan.

According to Polish law a restructuring plan may contain not only monetary claims, but also claims of another nature. These ones may be turned into monetary claims only if the creditor expressly refuses the restructuring of non-monetary claims.

Following the legal reforms in 2009, the parties / creditors who intend to file objections or opposition to the restructuring plan to be approved may express their objections to the plan during the meeting of the creditors. The objections submitted are registered in the minutes of the assembly. Moreover, objections that are submitted after more than one week from the drawing of the restructuring plan are not taken into consideration.

Irrespective of the active involvement of creditors in their meeting during the proceeding for the adoption of the restructuring plan, creditor's participation is limited by the wide powers given to the other organs within the procedure. Accordingly, while the restructuring plan shall be adopted at the meeting of creditors by the majority of creditors from each of the lists of creditors comprising the classes of the creditors' interests, jointly holding not less than two thirds of the total sum of the claims, it shall be approved also by the court in a proper hearing. The decision concerning the approval or disapproval by the court of the restructuring plan is subject to appeal from the parties involved.

The court can refuse to approve the arrangement if the arrangement is in breach of the law or if it is "evident" that the arrangement will not be performed. Moreover, the court may refuse to approve the arrangement if the terms and conditions of the arrangement are "grossly detrimental" to the creditors who voted against the arrangement and have filed objections.

After the restructuring plan is in force, this binds all creditors whose claims are included in the plan, even if not recorded in the list. Exceptions are made for those creditors, whose existence the bankrupt intentionally did not disclose and who have not participated in the proceedings.

4.5 Cross-border and specific country rights

Creditors who are not resident in Poland may be appointed as members of the creditor's committee as well.

QUESTION 5

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5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

According to the Polish procedure, the creditors throughout the procedure have the right to object to the decisions coming from the organisms of the procedure, in this way exercising a sort of supervision over their discretionary powers. By way of example, the following are acts that can be objected to by the creditors during the procedure:

- While it is recognized that the judge-commissioner has the power to annul a resolution adopted at the meeting of creditors (in the cases when it is illegal, contrary to good practices or if it "flagrantly" violates the interest of the creditor who voted against the resolution), at the same time it is possible for them to appeal against (*za alenie)* the decision of the judge-commissioner;

- When the restructuring plan is approved, the creditors also have the right to appeal against the decision of the court concerning the approval or disapproval of the plan itself; moreover, the creditors of the bankrupt who voted against the arrangement may file an appeal against the decision approving the arrangement within two weeks of the date of the approval of the arrangement being announced in the Court Publication (*Monitor S dowy i Gospodarczy*). In this way the minority of creditors are also protected;

- The creditors may appeal against the decision of the court to change the decision declaring bankruptcy with the possibility to make an arrangement instead of a decision declaring bankruptcy by liquidation of the debtor's assets;

- An appeal may be brought against the decision of the court ending the proceedings. However, in this case the decision of the court of the second instance shall not be subject to appeal to the Supreme Court;

- An appeal may be filed also against the type of security that was decided on by the administrator to secure the assets of the debtor.

For the creditors, the time limit to file an appeal shall commence on the day the decision is notified, while with respect to creditors, to whom the decision has not been pronounced, the time limit shall begin on the date the decision was made public by way of an announcement.

An appeal launched by the creditor shall be served on the bankrupt and on the trustee, court supervisor or administrator.

5.2 Substitution of the insolvency representative

The trustee, court supervisor or administrator may be replaced if they do not fulfill their obligations orderly or for any other reasons. The insolvency court is empowered to decide on such a replacement. However, in the case of the insolvency representative not fulfilling his obligations properly, the decision of the court must by justified by evidence. In addition, the insolvency representative may also be replaced by a motion of the creditor's committee, a member of the creditor's committee or through his own motion.

QUESTION 6

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6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

Polish bankruptcy law provides for several dispositions with regard to the remuneration of the organisms of the insolvency procedure, and delegates carefully the obligations of the creditors in these senses.

The trustee, court supervisor and administrator obtain a remuneration that must be calculated in proportion to the work carried out. However, the total amount of remuneration may not exceed 5 per cent of the bankruptcy estate funds. Alternatively, the remuneration will be fixed at a level not exceeding 40 times the average monthly salary in the enterprise sector (excluding payments from profit).

The court determines the amount of both the preliminary remuneration of the trustee, court supervisor and administrator and the final one, after approval of the report of their activities.

As the organs of the insolvency procedure may also obtain advance payments for the performance of their activities (such amount not being higher than ¾ of the preliminary remuneration), the court shall impose upon the trustee, court supervisor and administrator the obligation to return to the bankruptcy estate such advance payments, after the determination of the final remuneration.

The remuneration for the trustee, court supervisor and administrator are considered by the law as costs for the bankruptcy proceeding. This implies that such remunerations shall be paid out by the bankruptcy estate, proportionally to the value of the bankruptcy estates of each of the bankrupts.

Considering the involvement of creditors in the remuneration of the organisms of the insolvency procedure, the judge – commissioner, if he deems it necessary (again this provision confirms the high degree of discretionary power conceded to the judge commissioner by the law) shall convene a

meeting of the creditors, so that he adopts a resolution on the allowance by the creditors of a prepayment to cover the costs of the proceedings. Moreover, the judge-commissioner may oblige the creditors who possess the highest claims (the sum of which amounts to at least 30% of the total amount of the claims vested in the creditors authorized to participate in the meeting) to make an advance payment to cover the costs of the proceedings.

As for the costs of the proceedings, if a creditor files a claim after the relevant deadline elapsed, he is obliged to cover the costs resulting from the late filing. This also applies in the case when the delay was not the fault of the creditor. The judge – commissioner can oblige the creditor to issue an advance payment for the costs related to the late filing of a claim. In such a case, if the creditor does not meet such an obligation, his claim shall be rejected.

6.2 Funding special activities of the insolvency representative (liquidator)

There are no special provisions providing for certain obligations served upon the creditor in order to fund the activities of the organs of the insolvency procedure.

However, the law considers the possibility, in justified cases of increased workload, that the court may decide to augment the remuneration of the trustee, court supervisor or administrator, in an amount not exceeding 25% of the amount settled. Moreover, if the trustee or administrator administers the bankrupt's enterprise, in cases justified by extraordinary work input, the trustee may receive additional remuneration therefore, such remuneration may not exceed 10 per cent of the earned annual income.

6.3 Specific country entitlements

In order to facilitate the formation of the bankruptcy estate, and for a situation in which there are obstacles to take possession of the bankrupt's assets, the trustee may use the bailiff, to seize such assets. In this case the State Treasury shall temporarily finance the costs of the seizure, and then such costs will be charged to the persons who have obstructed the trustee from taking possession of the assets. Should this prove impossible, the costs shall be covered by the bankruptcy estate.

RUSSIA

Introduction

Russian bankruptcy legislation emerged less than twenty years ago and is still in the process of being fully developed. As in most other jurisdictions, Russian insolvency procedure is designed to properly satisfy the creditors of a company that is unable to meet its liabilities in full.

The main laws concerning bankruptcy in Russia are:

- Russian Civil Code of 30 November 1994, as amended;
- Law on Bankruptcy (Insolvency) of 26 October 2002, as amended;
- Law on Bankruptcy (Insolvency) of Credit Organizations of 25 February 1999, as amended.

This publication deals with the standard bankruptcy procedure applied to a regular company. The specific procedures that are followed in other circumstances, such as for individuals, financial institutions, strategic companies, companies entering bankruptcy proceedings during liquidation, dormant companies and others, are not discussed herein.

QUESTION 1

1. Creditors' rights before insolvency proceedings are initiated

1.1 Filing a declaration of debtor's insolvency

Insolvency proceedings can be initiated either by the debtor itself or by the debtor's creditor(s). If a debtor has outstanding obligations to the state budget, an insolvency petition can also be filed by the state authorities as creditor.

Bankruptcy law stipulates that different court requirements be met by the petitioner depending on whether the petitioner is a debtor, a commercial creditor or the state authorities. However, the procedure by which the court considers a bankruptcy petition is the same for all categories of petitioner. Moreover, multiple creditors can submit a joint petition regarding the debtor's bankruptcy if they so desire.

A commercial creditor (i.e. other than a state authority) can initiate bankruptcy proceedings against a debtor only if its claim against the debtor meets all of the following criteria concurrently:

- the amount of the claim is not less than RUB 100,000 (approximately EUR 2.400 or USD 3.200);
- the claim has not been discharged within the three months immediately following its original due date;
- the claim has been confirmed by a court decision that is currently in force.

The following claims cannot *per se* serve as grounds upon which to initiate bankruptcy proceedings, but they will be taken into account should bankruptcy proceedings be commenced on proper grounds:

- claims of individuals to whom a debtor is liable for damage caused to life or health, or because of a moral harm;
- employee salaries and severance allowances;
- authors' royalties under relevant agreements;
- shareholder claims resulting from their participation in the debtor's share capital;
- fines and penalties for non-fulfilment or improper fulfilment of an obligation;
- interest on late payments;
- losses in the form of lost profit that are reimbursable for non-fulfilment or improper fulfilment of an obligation; and
- other material and / or financial sanctions, including for failure to discharge liabilities with respect to tax or other payments to the state budget.

1.2 Choice of the insolvency representative

Only a Russian citizen who is a member of a self-regulating organization of bankruptcy managers can act as bankruptcy manager during insolvency proceedings.

A bankruptcy petition that is filed with the court must designate a nominee for the position of bankruptcy manager or indicate the self-regulating organization of bankruptcy managers that will nominate the individual from among its members.

In the event that the court receives several bankruptcy petitions (e.g. from multiple creditors or from a creditor and the debtor), the court appoints the nominee who is designated in the petition that is first to be delivered to the court, or the nominee selected by the self-regulating organization of bankruptcy managers indicated in the petition. Therefore, filing a bankruptcy petition early gives a petitioner the advantage of nominating the bankruptcy manager, which is crucial from a practical standpoint. However, the bankruptcy manager is obligated to act both reasonably and in good faith for the interests of the debtor, creditors and general public, regardless of the petitioning party that appointed him / her.

A bankruptcy manager is reappointed for each new phase of the bankruptcy proceedings. Selection of a nominee for the subsequent phase of bankruptcy proceedings, or selection of the self-regulating organization of bankruptcy managers that will nominate the bankruptcy manager, is conducted by the creditors' meeting.

1.3 Packaged insolvencies

Russian bankruptcy law does not know the concept of pre-packaged insolvency existing in some other jurisdictions. Any official discussion between the debtor and creditors (i.e. creditors' meeting or committee) as to the restructuring of debt, debtor's business operations, sale of assets, etc can take place only in the course of bankruptcy proceedings within the frameworks established by bankruptcy law.

1.4 Cross-border insolvency and specific country rights

In cases where creditors from other jurisdictions participate in the bankruptcy proceedings against a Russian debtor, the provisions of Russian bankruptcy law will be applied to the proceedings unless an international treaty requires otherwise.

Russian bankruptcy law cannot be applied against debtors situated in other jurisdictions as well as their branches and representative offices in Russia (this does not apply to subsidiary companies as they are regarded as Russian legal entities).

In case of insolvency of a foreign company the decision of the foreign court regarding a property of such company in Russia can be enforceable in Russia only if there is respective international treaty or such foreign country recognises respective decisions of Russian courts (reciprocity principle).

QUESTION 2

2. Creditors' rights aimed at fulfilling claims

Upon considering a bankruptcy petition, a court will either reject the petition if there are not sufficient grounds to begin bankruptcy proceedings or issue a decision to begin the proceedings. As a rule, the bankruptcy proceeding begins with the monitoring phase.

Once the bankruptcy proceedings are commenced, all of the debtor's creditors can demand that their claims be included in the register of creditors' claims. This register is maintained either by the bankruptcy manager or an independent registrar.

2.1 Filing a claim

Current law does not obligate the bankruptcy manager to notify each particular creditor of the initiation of bankruptcy proceedings against the debtor. The creditors should file their claims within 30 days of the date of publication of an announcement on commencement of the monitoring phase.

Failure to submit a claim within the deadline noted will prevent the creditor from participating in the first creditors' meeting, and claims filed after the deadline shall only be considered by the court during the subsequent phase of bankruptcy proceedings. Given that the bankruptcy manager must notify the creditors that filed their claims in time about the late claims, a creditor filing a late claim is obligated to reimburse the bankruptcy managers for the expenses of such notification.

Creditors may file their claims until the register of creditors' claims has been declared closed. Generally, the register of creditors' claims shall be declared closed after a period of two months following publication of the notice that the debtor is bankrupt and that the final phase of bankruptcy proceedings – Insolvent Liquidation – has begun. Claims filed after the register of creditors' claims is closed can be satisfied only after satisfaction of all of the claims that were timely registered (with an exception for first and second-priority claims).

A creditor's claim should be filed with the court, the bankruptcy manager and the debtor, together with the requisite supporting documentation (e.g. a contract, court decision, etc).

The creditor's claim can be challenged in court by the debtor, bankruptcy manager, other creditors or a representative of the debtor's shareholders. Creditors' claims shall be examined by the court and can be included in the register of creditors' claims only upon its decision. Any claims rejected by the court are not taken into account during the actual bankruptcy proceedings. Furthermore, actions that are taken by the court during bankruptcy proceedings can be challenged in superior courts.

2.2 Privileges for secured claims

2.2.1 Secured claims

Only a pledge of debtor's property can bestow "secured" status upon a creditor during bankruptcy proceedings.

A secured creditor receives 70 percent (80 percent under a credit agreement) of the proceeds (capped at the total amount of secured indebtedness plus accrued interest) that are released from the bankruptcy sale of the debtor's property that is secured in favor of that creditor.

The remaining proceeds that are released from the sale of pledged property are allocated as follows:

(i) 20 percent (15 percent under a credit agreement) for discharging first and second-priority claims, where the debtor's other property is insufficient to cover them; and

(ii) 10 percent (5 percent under a credit agreement) for discharging claims that originated with the court, bankruptcy manager or the latter's advisors.

Should 70 percent (80 percent) be insufficient to cover a secured creditor's claim, the exceeding part of the 20 percent (15 percent) that is allocated to first and second-priority claims, remaining after their full discharge will be used to satisfy the secured creditor's claim.

A secured creditor's claim that has not been satisfied by proceeds from the sale of property that is secured in its favor shall be satisfied as the claim of a third-priority creditor.

2.2.2 Claims arising during bankruptcy proceedings

The law establishes a different approach to satisfying the claims that existed before the date that the bankruptcy petition against a debtor was accepted by the court and the claims that arise after that date ("Current Claims").

Current Claims are prioritized for discharge against the claims that existed before bankruptcy proceedings on the following basis:

(i) court expenses, publication costs, bankruptcy manager's remuneration, remuneration of other individuals / legal entities involved in the bankruptcy proceedings;

(ii) remuneration of employees and other individuals who are engaged by the bankruptcy manager;

(iii) current utilities and operational expenses of the debtor; and

(iv) other current payments, including environmental and safety expenses.

2.2.3 Satisfaction of creditors' claims

Creditors' claims are satisfied from the debtor's property that is included in the bankruptcy mass. As a rule, property included in the bankruptcy mass is sold at auction.

Creditors' claims arising before the bankruptcy petition is accepted are satisfied on the following basis and only after the Current Claims have been satisfied:

- *First-priority claims*: debtor's obligations to individuals to whom a debtor is liable for damage caused to life or health, or because of a moral harm;

- *Second-priority claims*: debtor's obligations to pay salaries and severance allowances to employees, and authors' royalties under relevant agreements;

- *Third-priority claims*: debtor's obligations to other creditors, including tax debts and other state obligations.

Creditors' claims at each priority level should be discharged only after the creditors' claims on the preceding level have been fully satisfied. If debtor's assets are insufficient to satisfy the claims of creditors on one priority level, the assets shall be distributed among the creditors in proportion to the amount of their claims.

2.3 Continuation of contracts entered into by the debtor

2.3.1 Refusal to execute contracts

During the External Management and Insolvent Liquidation phases of bankruptcy proceedings, the bankruptcy manager is entitled to refuse to execute the debtor's transactions that have not been fully performed.

Such refusal is possible only if (i) the execution of the contract would impede restoration of the debtor's solvency; or (ii) the debtor would incur losses from performance, as calculated by comparison with similar transactions that were concluded in comparable circumstances.

A decision to refuse to execute a contract may be adopted at the bankruptcy manager's sole discretion, and no approval of the court or creditors' meeting is required.

2.3.2 Challenging contracts

During the External Management and Insolvent Liquidation phases of bankruptcy proceedings, the bankruptcy manager has the right to challenge:

(i) transactions made by the debtor during the three years preceding the court's acceptance of the bankruptcy petition, or after such acceptance; and

(ii) any of debtor's actions aimed at discharging obligations under the debtor's agreements, or as resulted on other grounds (e.g. state authorities' orders, court decisions, etc.), for the three years preceding the court's acceptance of the bankruptcy petition, or after such acceptance.

Essentially, the bankruptcy manager can challenge so-called "suspicious transactions" (non-market transactions and / or those that would harm the creditor by decreasing debtor's assets or increasing its liabilities) and those that give preference to any particular creditor. General grounds for challenging these transactions (sham, illegality, etc.) can also be pursued by the bankruptcy manager.

The bankruptcy manager can seek to invalidate a debtor's transactions at the manager's own discretion or upon request of the creditors' meeting or committee. A decision to invalidate such transactions is made by the court.

QUESTION 3

3. Creditors' rights to monitor insolvency procedure

3.1 General creditors' rights

Information about the insolvency of a debtor is divided into two classes. The first class includes information that is publicly available, and the second class includes information that is available only to creditors of the debtor.

In 2009, a new Unified Federal Register on Bankruptcy Proceedings was formed, and the data contained therein is available to the public. This includes information regarding:

- initiation of any bankruptcy proceedings in relation to a particular debtor (observation, financial rehabilitation, external management or winding up)
- termination of any bankruptcy proceedings;
- appointment or termination of an external manager;
- court satisfaction with the applications made by third parties to settle debtor liabilities;
- tenders to sell the debtor's property and the results of such tenders;
- any other information that the creditors' meeting or committee decides should be documented.

The publicly available information is published on the website www.kommersant.ru/bancruptcy and is announced in the newspaper Kommersant.

Creditors are also entitled to receive more detailed information from the debtors and external manager. Such information includes a copy of the debtor's court motion to declare insolvency, information on any change to the debtor's registered address, information on the creditors' meetings and results thereof, an extract from the register of claims, information on the existence of grounds for deliberate insolvency and the grounds for administrative or criminal offences that have been revealed, information on debtor transactions that may be challenged or may entail third-party liability (controlling members of the company or management), the expenses incurred in the course of insolvency, the results of appraisal of the debtor's property, and other information that external management reports to the creditors' meeting.

3.2 Specific rights to information during proceedings

A creditor is entitled to receive an extract from the register of claims in relation to its claims only, though a creditor whose claims are equal or exceed one percent of the aggregate amount of claims may obtain access to the entire register.

3.3 Approval rights not delegated to creditors' committee

The creditors' committee supervises the activities of the external manager and makes decisions on low-level issues. Its authority to make decisions on behalf of the creditors is limited, and the following matters can be resolved only by a creditors' meeting:

- initiation of financial rehabilitation and external management (such as a change in the duration of such proceedings);
- approval or amendment of the terms (*the plan*) of external management;
- approval or amendment of the plan of financial rehabilitation or the schedule for discharging debtor's debt;
- selection of the external manager and approval of the terms regarding his /her additional fees;
- approval of an increase in the external manager's fixed fee;
- selection of the registrar to maintain the register of claims;
- approval of voluntary arrangements with the creditors;
- approval of the court motion to wind up the debtor;
- formation of creditors' committee and termination of a committee member's term in office;
- determination of the authority of the creditors' committee; and
- appointment of the creditors' meeting representative to represent the meeting during court proceedings.

QUESTION 4

4. Creditors' rights focused on active participation in proceedings

4.1 Creditors' meeting

A right to attend and vote in the creditors' meeting is provided to the bankruptcy creditors and tax authorities (insofar as they have claims against the debtor). Certain other people who do not have voting rights are also entitled to attend the meeting. This group includes a representative of the employees, a representative of the shareholders of the debtor and a representative of any self-regulated organization whose member functions as the debtor's external manager. They each have one voice in the agenda but cannot vote.

Those bankruptcy creditors whose claims are secured by a pledge of the debtor's property may only vote during the observation stage and financial rehabilitation / external management. In the latter case, they may vote only if it has been decided that the object of the pledge securing their claims will not be sold.

The exclusive competence of the creditors' meeting is described in Section 3.3 above.

The creditors' meeting can be convened by the external manager, creditors' committee, a bankruptcy creditor / tax authority if the claim of such creditor / tax authority exceeds 10 percent of the aggregate amount of claims, or a group of bankruptcy creditors representing one-third of the total number of creditors.

As a general rule, the creditors' meeting is convened at the location of the debtor. During the meeting, a bankruptcy creditor has a number of votes proportional to the amount of its claims with relation to the aggregate amount of debtor's claims.

The creditors' meeting is deemed to have established a quorum when creditors representing more than 50 percent of votes are present. If there is no quorum, then a second meeting is valid when creditors with more 30 percent of votes are present.

Generally, a decision of the creditors' meeting is adopted by majority vote of the creditors present at the meeting, but a decision that falls within the exclusive competence of the creditors' meeting can only be adopted if a majority of the votes of all creditors are in favor of the decision. There are several types of decisions for which adoption requires the consent of all creditors whose rights are secured by a pledge on debtor's assets (e.g. the formation of several subsidiaries of the debtor and the contribution of assets into their share capital).

A decision of the creditors' meeting can be challenged by a person who has attended the meeting within 20 days of the date of the meeting. If a creditor was not duly notified of the date and location of the meeting, he can challenge the decision within 20 days of the date on which he learns of the meeting's occurrence, but in any event this can be no later than six months after the date of the meeting.

4.2 Creditors' committee

The creditors' committee supervises the activities of the external manager and makes decisions on low-level issues. It has the right to request reports and information from the external manager, to challenge the external manager's decisions, to convene the creditors' meeting, to make recommendations to the meeting for replacement of the external manager, and to perform other duties as delegated by the creditors' meeting.

Formation of a creditors' committee is mandatory if the number of bankruptcy creditors exceeds 50. The creditors' committee must have at least three members, but the number of its members cannot exceed 11. The competence and composition of the creditors' committee is determined by the creditors' meeting.

The election of members to the creditors' committee is performed through cumulative voting, which means that, with respect to this matter in the agenda of the creditors' meeting, each bankruptcy creditor has a number of votes that is equal to the amount of its claims multiplied by the number of creditors' committee members to be elected. A bankruptcy creditor may give all of his votes to one nominee, or he may distribute them among several candidates. Candidates with the highest number of votes are elected.

Within the creditors' committee, each member has only one vote, and the transfer of such vote to any other person (including another member of the committee) is not allowed.

4.3 Other forms of participation in proceedings

As a general rule, creditors' involvement is limited to attending the creditors' meeting and standing for election to the creditors' committee.

4.4 Rights related to reorganization plans and proceedings

Once a company is declared insolvent, it can be reorganized only by the decision of either the creditors' meeting or the creditors' committee.

During the liquidation stage, the law allows for a *quasi* spin-off to be conducted for the debtor wherein the debtor incorporates 100 percent subsidiary (such subsidiary can only be in the form of a public company) and transfers to such subsidiary some or all of the debtor's assets, licenses and employment contracts. Such a subsidiary must be sold by open tender.

This type of the restructuring is unique and only permissible during bankruptcy proceedings.

QUESTION 5

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5. Creditors' entitlements aimed at controlling insolvency representative activities

5.1 Creditors' rights to challenge insolvency representative acts and decisions

As a general rule, the creditors have the right to require termination of the external manager's tenure and seek compensation for the losses incurred by the debtor or a creditor due to the external manager's failure to act reasonably and in good faith when performing his duties as external manager or to follow the decisions of the creditors' committee and / or creditors' meeting. The losses must be verified by a court decision.

5.2 Substitution of external manager

The external manager can be substituted by a court in the event that:

- a decision of the creditor's meeting to replace the manager is made by reason of his / her failure to perform the duties in a proper manner;
- a motion from a creditor is filed stating that the external manager did not duly perform his / her duties, and the interests of an applicant are breached, and the external manager's actions caused actual damage to the applicant;
- the court becomes aware that the external manager:
  - is not independent with relation to the debtor or creditors;
  - has outstanding liabilities to the creditors of another debtor for which he / she performed the role of external manager;
  - has terminated his / her membership in a self-regulated organization of external managers;
  - does not maintain professional insurance; or
  - is subject to disqualification as an external manager.

QUESTION 6

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6. Creditors' obligations

6.1 Responsibility to remunerate the bankruptcy manager

The bankruptcy manager's remuneration consists of a fixed amount established by law and a variable amount that depends on the extent of debtor's assets. Simply stated, the bankruptcy manager's remuneration is paid from the bankruptcy mass. If the debtor's funds are insufficient to fulfill this purpose, the creditor(s) that filed the petition for debtor's bankruptcy shall pay the fixed amount of the bankruptcy manager's remuneration. Such creditor(s) may seek compensation for this from the bankruptcy mass on a priority basis.

The insufficiency of the bankruptcy mass to cover the manager's remuneration and other costs associated with the bankruptcy proceedings is valid ground upon which the court can terminate the proceedings.

6.2 Funding the special activities of the bankruptcy manager

Like the bankruptcy manager's remuneration, the other expenses related to bankruptcy proceedings (state duties, publication costs, remuneration of the individuals / legal entities that are involved in bankruptcy proceedings by the bankruptcy manager) are paid from the bankruptcy mass.

The creditor(s) that filed the bankruptcy petition are liable for the expenses related to the bankruptcy proceedings when the petition for debtor's bankruptcy is not satisfied by the court. This will not apply when the claims of the creditor(s) that applied for the bankruptcy proceedings are satisfied by the debtor before the court decides on the merits of the petition.

The creditors, debtor and other people participating in the bankruptcy proceedings can challenge the amount of remuneration paid to the individuals / legal entities involved by the bankruptcy manager.

6.3 Specific country entitlements

Russian bankruptcy law does not envisage situations wherein the expenses related to bankruptcy proceedings are imposed on the state budget.

SOUTH AFRICA

Introduction[i]

The history of the South African Laws of Insolvency may be traced back to the Roman Law and the period of the Twelve Tables and the Roman Dutch Law when the *cessio bonorum* was introduced into Holland.

The modern South African Laws of Insolvency are not unified in a single piece of legislation. The Insolvency Act 24 of 1936 ("Insolvency Act") is the basis for the laws of insolvency in general and governs the administration of an insolvent estate and the relationship between a natural person ("consumer") and his / her creditors. Where companies are insolvent or in liquidation the provisions of the Insolvency Act must however be read with provisions of the Companies Act 61 of 1973 ("Companies Act") which contain specific provisions relating to the liquidation of a company.

The Companies Act does not deal with a specific set of circumstances in the winding up of a company, the provisions of the Insolvency Act apply *mutatis mutandis*. Furthermore, the Close Corporations Act 69 of 1984 ("Close Corporations Act") provides for the liquidation of an entity known as a close corporation which is an entity where the membership interest is held by a few individuals or family members and where liability is limited.

The Close Corporations Act does not deal with a specific set of circumstances in the winding up of the Close Corporation the provisions of the Companies Act may apply *mutatis mutandis,* and insofar as the Companies Act does not apply provisions of the Insolvency Act apply. It is therefore clear that South African laws of insolvency need reform.

In 1987 the South African Law Reform Commission commenced with the investigation into the insolvency laws of South Africa and this led to a variety of reports and a draft Bill in 2000. The present position is that the Law Commission is still in the process of drafting a uniformed Insolvency Bill which is in its latest draft form and was again circularised during the course of 2010.

Further recent developments that effect the position of consumers include the promulgation of the National Credit Act 34 of 2005 which addresses and prevents over indebtedness of consumers and provides a mechanism for resolving over indebtedness. What is dealt with herein is an attempt to provide a guide for small to medium businesses. What must however be understood is that the provisions of the Insolvency Act and the Laws of Insolvency in South Africa apply across the board and the size of the matter is in fact irrelevant.

The *concursus creditorum* is one of the key concepts of the South African Law of Insolvency in that it entails that the rights of creditors of a group are preferred to the rights of individual creditors. The *concursus creditorum* ensures that the insolvent's position be crystallised upon the granting of a sequestration Order by the Court and that the hand of the law is laid upon the affairs of the consumer or entity and that the rights of the general body of creditors have as at that date have to be taken into consideration.

Although what is contained herein is aimed at proceedings relating to medium and small businesses being conducted under the auspices of a sole proprietorship,

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[i] The major source of information contained in this publication is Mars; The Law of Insolvency in South Africa, 9th ed., JUTA Law Publishers

a partnership, a company or a close corporation, the principles applicable are exactly the same in large businesses.

In the case of an insolvent consumer, the insolvency practitioner is referred to as a "trustee" whereas in the case of a company or close corporation the practitioner is referred to as a "liquidator". (hereinafter referred to as "insolvency practitioner")

QUESTION 1

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1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

A consumer may file an application for "a voluntary surrender" of his / her estate in terms of the provisions of the Insolvency Act.

Once a consumer is of the view that a person is unable to pay his / her debts or is insolvent, that debtor may file an application for voluntary surrender. The debtor must demonstrate that they have sufficient assets which are unencumbered, or not fully encumbered to ensure that the benefit to creditors will not be negligible. The major consideration here is that the filing of a voluntary surrender must be to the advantage of creditors. The Courts have set different criteria in the various jurisdictions in South Africa but it is generally a rule that in the estate of a consumer that an unsecured or "concurrent creditor" should at least receive 10 to 15 percent of its claim. (10 to 15 cents in the Rand).

In terms of the provisions of the Companies Act a company of any size may adopt a Special Resolution placing the company in creditors' voluntary winding up in terms of which the company is laid in the hands of the Master of the High Court and whereupon the Master of the High Court will appoint an insolvency practitioner nominated by creditors.

The provisions of the Close Corporations Act are similar in that a resolution may be filed for a creditor's voluntary winding up.

There is no legal requirement that there should be an advantage to creditors in the liquidation of a company or close corporation.

Compulsory sequestration is the term used upon the launching of a hostile application by a creditor in the High Court of South Africa for a provisional sequestration order of a consumer's estate. A rule *nisi* is granted under such circumstances with a return date on which date the consumer or an interested party such as a creditor should show cause why a final order should not be granted.

Companies and close corporations may also be liquidated pursuant to an application launched in the High Court. A creditor, shareholder or any combination of them and the company itself on an *ex parte* basis may apply for an order of liquidation. Similar provisions apply to a close corporation where

the Court may, upon the application of creditor, member or the close corporation itself grant an order of liquidation.

1.2 Choice of the insolvency representative

In the case of an individual estate of a consumer, a company or a close corporation the appointment of the insolvency practitioner is determined by the wishes of the creditors.

Upon the filing of an application for voluntary surrender in the High Court or a creditors' voluntary winding up in the case of a company or close corporation with the Registrar of Companies and Close Corporations and upon receipt of the Order of Court sequestrating the estate of the consumer or the resolution in terms of which the company or close corporation is voluntarily liquidated, the Master of the High Court opens a file and creditors with claims of more than R1 000,00 vote for the appointment of an insolvency practitioner. The votes of creditors are reckoned in number and value and that in certain instances joint appointees may be made based on number and value of creditors' votes.

Since approximately 2001 the South African Government, through regulation, instituted a system in terms which a person from the previously disadvantaged community (PDI appointee) is appointed in each and every matter. The administration of the insolvency is thereafter in the hands of the joint insolvency practitioners who are then duty bound to report to the Master of the High Court through the process as it is provided for in law.

1.3 Packaged insolvencies

The concept of the "packaged insolvency" in the case of a consumer may be also described as a so-called "friendly sequestration". Section 8 of the Insolvency Act provides for a number of instances where, through an insolvent's conduct, an "act of insolvency" may be committed by, for example, stating in writing that a debtor is not able to pay their debt. In such circumstances the creditor may apply for the insolvency of the debtor.

In so called friendly sequestrations the debtor arranges with a creditor; who, is normally connected to the debtor, to commit a pre-arranged act of Insolvency, such as to state in writing that they are unable to pay an amount due to the creditor. The creditor then applies to Court for the sequestration of the consumer's estate and under those circumstances an insolvency practitioner of the parties' choice is normally provided with all the information beforehand with a view to ensuring that the creditors in number and value vote for such an insolvency practitioner's appointment.

This process is also from time to time embarked upon in the liquidation process of companies and close corporations under circumstances where the company itself applies for its own liquidation in terms of the provisions of the Companies Act on an ex parte basis and where prior arrangements are made with the insolvency practitioner to be nominated by the general body of creditors in number and value with a view to ensuring the appointment of the insolvency practitioner.

The process may be abused in the sense that certain role players who are conflicted may get involved and under circumstances where investigations into the affairs of the insolvent person or entity are not properly investigated.

1.4 Cross-border insolvencies and specific country rights

South Africa is not a party to any treaty on international convention or treaty on cross-border insolvency that might be found in Europe or Northern America. The rights of creditors outside South Africa are not different to the rights of South African creditors.

South Africa, being a fairly isolated society, is not as affected by cross-border insolvency issues as would be the case in Europe. The Cross Border Insolvency Act 42 of 2000 was assented to in December 2000 and came into effect on 28 November 2003 and adapts the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency, adopted in Vienna on 30 May 1997.

An inward bound request for assistance whereby recognition is given to a foreign trustee to administer assets in South Africa is possible according to South African law as though they were in a relevant foreign jurisdiction from where that foreign trustee derives. The foreign trustee seeking recognition in South Africa would have to apply to the relevant division of the High Court and that Court would initially direct a rule *nisi* to issue an order which is then published to enable all persons concerned to show cause, if any, against the granting of the application. This would however in the interim prevent the debtor from disposing of any of its property. The Court has the jurisdiction to grant the final order.

The outward bound request for assistance in terms of which the South African insolvency practitioner wishes to retrieve assets in a foreign state involves the application for letters of request in a local division of the High Court in South Africa, requesting the aid of courts on the foreign jurisdiction in recognising the South African insolvency practitioner and allowing them to bring proceedings necessary for the proper and effective winding up of the estate in such a foreign jurisdiction.

QUESTION 2

2. Creditors' rights aimed to meet claims

2.1 Filing a claim

As a general rule a creditor who wishes to share in the distribution of the assets in an insolvency of a consumer, a company or a close corporation must file proof of his claim against the entity or estate of the debtor at a meeting of creditors to the satisfaction of the Officer presiding at such a meeting.

Only a creditor who has proved it's claim has the necessary *locus standi* to challenge the insolvency practitioner's administration of the matter and once a claim has been admitted by the presiding officer the insolvency practitioner has the right, after having investigated the affairs and books and records of the insolvent entity, to expunge a claim where it turns out that such a claim is in fact not valid.

There is no time frame for filing of a claim except under the provisions of Section 366 of the Companies Act where the insolvency practitioner, upon having applied for a date to the Master of the High Court may set a final date for claims to be proved.

The formalities for the proof of claims are that a claim must be proved by an affidavit substantially in a prescribed form and that such a claim must be administered under oath accompanied by the necessary supporting documents. There is no requirement in terms of which a foreign creditor is required to appoint a South African agent for purposes of establishing a domicilium in South Africa. The foreign creditor is entitled to correspond and communicate with the insolvency practitioner directly if the creditor chooses to do so. Any claim which is expunged by a insolvency practitioner, is subject to the High Court's powers of review and any aggrieved creditor may approach the court for an order enforcing its claim.

2.2 Privileges for secured claims

2.2.1 Secured creditors

The South African Insolvency Laws make provision for the definition of "security" and "preference". There is however no definition for the expression of a "secured creditor". A creditor may, when filing a claim, rely on certain security that it holds and must state the nature of such security.

Security is nothing more than a preferential right over the property of the insolvent.

Security is conferred by virtue of a special mortgage over an immovable property, a landlord's legal hypothec over movable assets, an instalment sale agreement hypothec, a pledge or a right of retention. Legislation also makes provision for a special notarial bond over specifically described movable assets which confers security in favour of the holder of the notarial bond.

The secured creditor is entitled to a specific vote and to give specific directions with regard to the realisation of its security.

2.2.2 Preferential creditors

A preferent creditor is a creditor who is not secured but who enjoys a preference to other claims out of the free residue (the proceeds of unencumbered assets) and who ranks above concurrent creditors (also known as unsecured creditors).

After the deduction of costs from the proceeds of the free residue any balance remaining is applied to paying certain preferential amounts in respect of any arrear salary or wages, leave pay and severance pay due to employees up to maximum amounts determined by the Minister from time to time.

Any balance then remaining shall be applied to amounts owing to the Compensation Commissioner, the South African Revenue Services (SARS) in respect of Income Tax owing to SARS, Pay as you earn (PAYE) deducted and not paid over to SARS and any Value Added Tax (VAT) owing to SARS.

2.2.3 Only upon payment in full of the amounts owing in respect of the statutory preferences does any balance still remaining in the free residue become available to concurrent creditors.

2.3 Continuation of contracts entered into with the debtor

Contracts between the debtor and third parties are not automatically terminated by the insolvency of one of the parties.

The major effect is that the insolvency practitioner, who steps into the shoes of the debtor, cannot be compelled to render a specific performance as he has to act in the interest of the general body of creditors.

It therefore follows that the insolvency practitioner must, within a reasonable time, decide whether he will perform in terms of a contract or not.

It is often referred to as an "election" that needs to be made by the insolvency practitioner whether to abide by a contract or terminate it. The real effect of this is, however, that the right of the creditor to demand specific performance is terminated and the insolvency practitioner must within a reasonable period make his election to abide by a contract or not.

2.3.1 Contracts for the acquisition of property

The purchaser's insolvency practitioner has the option to either adopt or repudiate such a contract.

When the seller's become insolvent the contract falls to be dealt with in terms of common law and in terms thereof property sold and not transferred passes to the insolvent's insolvency practitioner. There are certain statutory provisions for a purchaser who bought land in terms of a written contract where the purchase price is paid by way of instalments over a period of more than one year.

2.3.2 Instalment sale agreements of movables

Where the seller becomes insolvent and has reserved ownership, the insolvency practitioner of the seller must elect within a reasonable time whether to perform in terms of the contract or not.

Where the purchaser becomes insolvent, the effect of such a transaction is that where ownership has been reserved it creates, upon the insolvency of the purchaser, a hypothec over the property in favour of the seller in terms of which the seller becomes a secured creditor in respect of the proceeds of such an asset.

2.3.3 Effect on leases

The insolvency of a lessee does not automatically terminate a lease but the insolvency practitioner may choose to terminate a lease subject to the necessary powers being conferred upon the insolvency practitioner. Once the insolvency practitioner has made a decision he is bound by that decision.

The insolvency of the lessor does not automatically terminate the lease. The common law principle of "huur gaat voor koop" dictates that an insolvency practitioner of a insolvent estate of the lessor of immovable property must always sell the property subject to the lease. There is an exception insofar as the rights of a person enjoying a prior real right over the property, such as a mortgage bond is concerned.

2.3.4 Effect on contracts of service

The insolvency of an employer only suspends contracts of service. Upon insolvency, the employees are not required to render services and they are not entitled to remuneration. The insolvency practitioner finally appointed may enter into discussions with the employees to reach consensus on appropriate measures to rescue the whole or part of the insolvent's business. Creditors may upon the request of the insolvency practitioner also participate in these discussions.

Unless the insolvency practitioner has made specific arrangements with an employee with regard to continued services, all contracts of employment automatically terminate 45 days after the final appointment of the insolvency practitioner.

2.4 Cross-border and specific country entitlements

South African Law has no specific cross-border and specific country entitlements insofar as creditors' rights are concerned and to meet claims are concerned.

QUESTION 3

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3. Creditors' rights aimed to monitor the insolvency proceedings

3.1 General creditors' rights

The right to monitor insolvency proceedings in South Africa arises when the creditor obtains the necessary *locus standi* to participate in the process and in order to do so the creditor must become a proved creditor. The powers of insolvency practitioners are normally derived at a second statutory "general" meeting of creditors where resolutions are adopted in terms of which the powers of the insolvency practitioner are determined. The insolvency practitioner lodges a report and documents at a second meeting of creditors which is then considered by creditors and creditors may give directions relating to any matter reported to creditors or as to the administration or realisation of the insolvent's assets as they may deem fit.

The insolvency practitioner is duty bound to act in terms of the directions by creditors unless such directions are illegal by reason of it being in conflict with either the letter or the spirit of the insolvency laws.

3.2 Specific rights of information during the proceeding

The creditors' rights to information during the proceedings are limited to the receipt of a report at the second "general" meeting of creditors. In extraordinary circumstances supplementary reports are submitted and correspondence may be addressed to the insolvency practitioner at any given time to which the insolvency practitioner would be duty bound to respond. Other than the duty to submit a report there is no specific duty upon the insolvency practitioner to provide information.

3.3 Approval rights not delegated to a creditors' committee

There is no provision for the notion of a "creditor's committee" in South African law. However, all proved creditors are deemed to be the "general body of creditors" and they may adopt resolutions to provide directions to the insolvency practitioner.

Under certain circumstances the debtor may submit to creditors an offer of composition in the case of the insolvency of a consumer or a compromise or scheme of arrangement in the case of a company subject to the majorities of votes stated in 4.4 below.

3.4 Cross-border and specific country rights (entitlements)

There are no specific provisions in this regard as the rights of all creditors are the same whether from inside or outside of the South African borders.

QUESTION 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

The first meeting of creditors is normally held shortly after a final liquidation or sequestration order has been granted.

This meeting of creditors is convened by publication in the Government Gazette, a weekly publication where all Government Notices and Publications are published. The sole purpose of the first meeting is to proof claims of creditors and to vote for the appointment of a final insolvency practitioner.

After the first meeting of creditors the insolvency practitioner receives his final certificate of appointment and upon receipt of such a certificate of appointment the insolvency practitioner must convene a second meeting of creditors at which a report is filed and resolutions are adopted which enables those creditors to obtain the extended powers to finalise the process such as to sell assets, proceed with litigation, convene enquiries etc.

Subsequent to the second meeting of creditors, further special meetings of creditors may be convened for the purpose of proving further claims and the interrogation of witnesses in order to investigate the affairs of the insolvent.

Further general meetings may also be convened to adopt specific additional resolutions based on these requests by creditors in the estate who have already proved their claims. These requests must be made by creditors who have a certain percentage value of the claims already submitted for proof.

4.2 Creditors' committee

Save for the notion of a general body of creditors, there is no such concept in South African Law.

4.3 Other forms of direct creditors' participation

Creditors may only participate through formal directions and may not direct a insolvency practitioner to do anything which is contrary to the law.

4.4 Rights related to reorganization plans and proceedings

With respect to the estate of an insolvent consumer, a composition may be entered into between a consumer and his / her creditors as is provided for in terms of the Insolvency Act. It must be accepted by at least 75% of the proved creditors in number and value.

The South African Companies Act provides for schemes of arrangement in terms of Section 311 of the Companies Act in order to rearrange the affairs of a company by virtue of a scheme of arrangement between the company and its creditors. The voting at a meeting of creditors takes place after a plan of reorganisation has been submitted to the High Court and leave to convene meetings with creditors have been granted.

Creditors present and voting at such a meeting of creditors may vote in favour of a scheme of arrangement by majority of more than 75% in value and more than 50% of those attending the meeting.

4.5 Cross-border and specific country rights

There are no such specific provisions in South African Law and all foreign creditors have the same rights as is provided for in South African Law.

QUESTION 5

5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

An insolvency practitioner is duty bound to act in terms of South African Law and any action by the insolvency practitioner that disregards the views of the general body of creditors may lead to an application for his removal.

The Master of the High Court governs the conduct of insolvency practitioners and any creditor aggrieved by the actions of an insolvency practitioner may submit a complaint to the Master of the High Court.

5.2 Substitution of the insolvency representative

The Insolvency and Companies Acts provide for the grounds upon which an insolvency practitioner may be removed and be disqualified.

The Master of the High Court may remove an insolvency practitioner where he was not qualified for election, he has failed to perform satisfactorily any duty imposed upon him in terms of the Insolvency Act or to comply with the lawful demand of the Master, where he is mentally or physically incapable of performing his work satisfactorily, where the majority of creditors entitled to vote at a meeting of creditors has requested the Master to remove the insolvency practitioner or, the Master is of the opinion that the insolvency practitioner is no longer suitable to be the insolvency practitioner of the estate concerned.

5.3 Cross-border and specific country rights (entitlements)

The rights of foreign creditors are no different to South African creditors.

QUESTION 6

6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

Under circumstances where there is a shortfall, i.e. not adequate assets to cover the costs of the liquidation proceeding, creditors may be requested to contribute, pro rata to the value of their claims, to the costs of such proceedings.

Insolvency practitioners in South Africa are remunerated on a percentage based system and in the event where there are no assets, the insolvency practitioner''s minimum remuneration is R2 500, 00.

The remuneration is provided for by Tariff in terms of the Insolvency Act and is calculated as follows:

- On the gross proceeds of movable property (other than shares or similar securities) sold, or on the gross amount collected under promissory notes or book debts, or as rent, interest or other income: - 10 per cent.

- On the gross proceeds of immovable property, shares or similar securities sold, life insurance policies and mortgage bonds recovered and the balance recovered in respect of immovable property sold prior to sequestration: - 3 per cent.

- On money found in the estate and the gross proceeds of cheques and postal orders payable to the insolvent, found in the estate; and on the gross proceeds of amounts standing to the credit of the insolvent in current, savings and other accounts and of fixed deposits and other deposits at banking institutions, building societies or other financial institutions. - 1 per cent.

- On sales by the insolvency practitioner in carrying on the business of the insolvent, or any part thereof: - 6 per cent.

- On the amount distributed in terms of a composition: - 2 per cent.

- On the value at which movable property in respect of which a creditor has a preferent right:- 5 per cent.

6.2 Funding special activities of the insolvency representative (liquidator)

The creditors of an insolvent estate may by resolution authorise the insolvency practitioner to enter into certain legal proceedings and may contribute towards such costs on an ad hoc basis. There is no specific procedure set down for this.

6.3 Specific country entitlements

The position of international creditors is no different to South African creditors.

SPAIN

Introduction

Insolvency proceedings in Spain, in relation to company insolvency and individual bankruptcy, are exclusively regulated by the Insolvency Act of 2003 (recently amended by Royal Decree-Law 3/2009, of 27 March – *Ley Concursal*). Out-of court insolvency proceedings where the court only has a supervisory function do not exist in Spain.

The Insolvency Act distinguishes between voluntary and compulsory insolvency. A proceeding is considered to be voluntary when the debtor himself filed for insolvency and compulsory in the remaining cases. In the first case the debtor conserves his right to administer and dispose of his assets, being the exercise of this right subject to supervision of the insolvency representative, the administrator (*administrador concursal).* In the second case, only the administrator has the right to administer and dispose of the debtor's assets.

The general structure of an insolvency proceeding consists of two consecutive main stages: the first stage, which is called the "common stage" (*fase común)* and the second stage which can be the "arrangement stage" (*fase de convenio)* or the "liquidation stage" *(fase de liquidación)*. The insolvency proceeding therefore can conclude either with the approval of an arrangement between debtor and his creditors or with the liquidation of the company. The aim of the Insolvency Act of 2003 was to maximize the return of the creditor by, amongst other measures, providing the debtor with a legal instrument which supports and ensures the continuity of its activity and reduces liquidation of insolvent companies. In practice however, a large part of iinsolvency proceedings are concluded with the liquidation of the debtor company. For this reason one of the purposes of the recent amendment of the Insolvency Act was to improve the legal possibilities for insolvent companies to continue with their activity.

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for declaration of a debtor's insolvency

Not only is the debtor himself but also one or more of his creditors entitled to file for declaration of debtor's insolvency, provided that the legal requirements are met. According to these the creditor may justify the petition by giving evidence that either the enforcement of a title was unsuccessful due to a lack of sufficient enforceable goods to cover the whole debt, or by proving existence of one of the following facts:

- Cessation of current payments, or
- Existence of attachment orders that will affect the debtor's assets as a whole, or
- Liquidation or alienation of all the debtor's goods in a detrimental manner, or

- General non-fulfillment of the debtor's obligations as payment of tax related debts or contribution to social security which are demandable during the three months prior to the petition for insolvency, or payment of salary and dismissal wages or any other payments arising from employment corresponding to the last three months. Evidence must be given of the motive, kind, amount, date on which it arose and maturity of the claim by attaching the corresponding documents.

Nevertheless, these creditors who within six months prior to the petition have acquired the claim after its maturity date by virtue of acquisition *inter vivos* are not entitled to file for declaration of debtor's insolvency.

Since it may occur that between the petition and definite opening of the insolvency proceeding a long period of time (weeks or even months) elapses, the filing creditor can ask the insolvency court for preliminary measures in order to ensure integrity of the insolvency estate. These measures e.g. may be requested with the objective to prevent the debtor from actions taken in that period to the detriment of his creditors.

1.2 Choice of the insolvency representative (*administrador concursal)*

The administrator will be appointed exclusively by the insolvency court. The court will appoint one or more administrators who in the latter case will act jointly. There is no possibility for the creditors to make suggestions to the Court for appointment of the administrator.

One administrator is appointed if an abbreviated insolvency proceeding (*procedimiento abreviado)* is opened. This kind of proceeding is more simplified. It must be opened if the debtor is authorized to present an abridged balance and its liabilities, according to an initial estimation, do not exceed the amount of 10 million Euros. If these requirements are not met, the court opens an ordinary insolvency proceeding (*procedimiento ordinario)* and three administrators will be appointed.

In case of an abbreviated proceeding a lawyer, accountant, or economist can be appointed as administrator whereas in an ordinary proceeding the board of administrators must be composed of one lawyer (with 5 years of practice), one accountant or auditor (with 5 years of practice) and one ordinary or general or preferential creditor who also will be appointed by the court. If the appointed creditor is a company it will have to designate an accountant or an auditor as its legal representative.

1.3 Packaged insolvencies

A similar structure to packaged insolvencies is provided in the Insolvency Act in relation with the liquidation of the debtor's company. The debtor can make a proposal for the sale of its assets or of the company as an ongoing business (*propuesta anticipada de liquidación* or *plan de liquidación)* to a third party. The purchase price will be used by the administrators to satisfy the creditors according to the ranking of claims (vide 2). In practice the proceeds of such a sale, above all if the debtor is a small sized company, are often not satisfactory to unsecured creditors who sometimes receive only a partial payment or even

no payment at all. This structure can solely be used within a court governed insolvency proceeding. An out-of court proceeding, before insolvency proceeding is opened, in order to restructure a company or to liquidate it would neither be subject to the Insolvency nor supervised by the court.

1.4 Cross-border insolvencies and specific country rights

Creditors resident abroad are treated in the same manner as those residing in Spain. Both have the same rights.

In cross-border insolvencies between member states of the European Union, with exception of Denmark, the Council regulation (EC) Nº 1346/2000 of May 29 on insolvency proceedings (EC Regulation) is applicable. According to this regulation creditors can request the opening of a secondary insolvency proceeding in Spain which only has effects to the debtor's assets situated in Spain.

Furthermore, according to the Insolvency Act creditors can request opening of a territorial insolvency proceeding in Spain, if the debtor operates in Spain by the use of an establishment. The Insolvency Act adopted the same definition for establishment as used in the EC Regulation, i.e. any place of operations where the debtor carries out a non-transitory economic activity with human means and goods as is defined. The effects of such territorial proceeding are restricted to the establishments' assets.

There exist no bilateral agreements with Non-EU-Member States. The Insolvency Act has adopted the UNCITRAL Model Law which applies to creditors of Non-EU-Member States.

QUESTION 2

2. Creditors' rights aimed to meet claims

Procedure rules

In several articles regarding rules of insolvency procedure, the Insolvency Act refers to those contained in the Civil Procedure Act (*Ley Enjuiciamiento Civil*) which shall be additionally applicable. Of special interest is the figure of the *procurador,* a mandatory court agent, who represents the creditor before the insolvency court. The creditor is obliged to be represented by such a court agent and by a lawyer if he wishes to participate in the insolvency proceeding by way of *personación* or if he files for declaration of a debtor's insolvency. The consequences of such a *personación* are described below under 3. However, for the lodgment of claims the creditor must not be represented by a court agent and / or a lawyer.

Ranking of claims

The creditor's claims do not necessarily rank equally but may have different rankings. The Insolvency Act distinguishes between special and general preferential claims, ordinary and subordinated claims.

- The categories of special and general preferential claims include mainly secured claims, in the first case, and in the latter, amongst others, debts due to Inland Revenue, Social Security contributions, employees and up to 25% of the creditor's claim who filed for declaration of insolvency. Payment of special preferential claims is described below (2.2.). General preferential claims shall be paid out of the non-secured assets, once the debts payable out of the insolvency estate are satisfied, following the order of the claims established in the Insolvency Act.

- Ordinary claims are those which are not legally defined as preferential or subordinated claims and can only be paid in full if the remaining assets, after payment of the above described claims, are sufficient to meet them. Otherwise, they are paid in equal proportions.

- Finally, subordinated claims are, amongst others, those regarding interests, which are due to a person specially related with the debtor or those which were lodged late. These claims will only be satisfied if the ordinary claims were paid in full.

2.1 Filing a claim

2.1.1 Lodgment of a claim

Once the administrator is appointed, he shall send a notice to all the creditors of the debtor and require them to lodge their claim (*comunicar el crédito)* before the insolvency court. The administrator may send this notice in Spanish. The claims must be received by the court within one month, in an ordinary proceeding, or within fifteen days, in an abbreviated proceeding, after the following day of advertisement of the insolvency proceeding in the Official Gazette (*Boletin Oficial de Estado*). If the creditor does not lodge its claim on time, this may be subordinated due to late filing.

Relevant information regarding the debtor's creditors either is contained in the statement to be submitted by the debtor to the court (*lista de acreedores)* or has become known to the administrator otherwise, e.g. after revising the accounts. This statement shall show relevant information regarding the creditors and their claims. Moreover, if a creditor has already taken legal actions against the debtor the statement must also inform about the respective court proceeding and its *status quo.*

The creditor shall lodge his claim in writing and state, apart from general information (such as name, address, characteristics of the claim), nature of the claim, amount, date on which it arose, maturity date, and, if a preferential claim is alleged, what assets are covered by the guarantee or security he is invoking. Furthermore the letter to the court must be signed by the creditor or by any authorized representative and must be sent by post, in particular there is no need to be represented by a court agent or a lawyer. Originals or certified copies of supporting documents and, where required, the power of attorney must be attached. In national insolvency proceedings the letter shall be written in Spanish or in the official language of the respective autonomous region of the opening of proceeding, otherwise the creditor may be required to provide a translation. A translation of the documentation attesting the claim is not legally required but may be requested by the administrator. Whereas in a cross-

border proceeding between Member States according to the EC Regulation the creditor can lodge the claim in its own language. Although in practice it is always recommendable to use Spanish or any other official language.

In practice, the court can waive the above mentioned formalities and agree an alternative method for lodging the claim, e.g. via electronic transmission directly to the administrators.

The administrator verifies the claims and decides about their admission in the insolvency proceeding. Admission consists of integration of the claims into a creditor list (*lista de acreedores*) which the administrator, at the end of the insolvency proceeding, will take as a basis for the distribution of the proceeds. The administrator shall decide if he admits the claim totally, partially, in a different way than it was requested by the creditor or if he excludes it and also shall decide about the ranking of the claim. If the creditor does not challenge this decision within 10 days after its public announcement or after personal notification (in case of 3.2.), the claim is deemed to be definitely admitted in the way as it is stated in the creditor list.

2.1.2 Proceedings brought by creditors

After the opening of an insolvency proceeding, the insolvency court is exclusively competent for such claims brought against the debtor and which will have an effect on its assets or on the employment contracts subscribed by him as an employer. If such a claim was brought before another court this court must abstain from deciding about the claim and refer the plaintiff to the insolvency court.

2.1.3 Lawsuits and arbitration proceedings pending

Lawsuits or arbitration proceedings where the debtor is one of the parties and which are pending at the moment of opening of the insolvency proceeding will be continued until the final judgment or award is passed. The insolvency court and the administrator are bound by these final resolutions and must take it into account in the insolvency proceeding, e.g. by including the awarded amount in the credit list. The administrators or those creditors, who participate in the insolvency proceeding by way of *personación* (vide 2.) may request the insolvency court accumulation to the insolvency proceeding of such lawsuits for which the insolvency court is exclusively competent (vide 2.1.2.).

2.1.4 Enforcement after opening of insolvency proceeding

Once the insolvency proceeding is opened no enforcement proceeding over the debtor's assets can be initiated. The proceedings which were already initiated are suspended and cannot be continued until the debtor enters into liquidation. Exception from this rule constitutes enforcement proceedings initiated by the proprietor of a right *in rem*. If this right *in rem* refers to assets not necessary for the debtor's commercial or professional activity the enforcement can be initiated. Otherwise, the possibility to enforce is suspended until an arrangement (*convenio)* has been approved or more than one year since opening of the insolvency proceeding has passed without opening of the liquidation stage.

2.2 Privileges for secured claims

Formalities regarding secured claims

Claims regarding outstanding amounts for installment payments agreed in a financial lease agreement or claims which are secured by securities as voluntary or legal mortgage, pledges, antichresis, lien, retention of title, etc. in respect of assets of the debtor are deemed to be special preferential claims. Nevertheless the administrator will only admit such ranking if the security was granted under observance of the requirements and formalities applicable to the respective security. Otherwise, the claim will be included in the creditor list as ordinary claim. If Spanish law applies it must be noted e.g. that mortgages must be enshrined in the Land Register, pledges must be granted in public deed, retention of title regarding a moveable asset must be registered in the Moveable Assets Register, etc. Therefore, in the latter case the creditor who has a right of retention of title is only able to assert his right to segregation of the moveable asset if the retention of title was duly registered before opening of the insolvency proceeding. Nevertheless, the right of segregation only gives the creditor the right to obtain a declaration from the administrator according to which the asset covered by the retention of title will be separated from the others assets of the debtor.

Furthermore, the accrued mortgage interests, as well as those which may accrue in a future are also ranked as special preferential claims up to the amount of the given guarantee, unlike ordinary interests which are subordinated claims.

Satisfaction out of assets

The special preferential claims shall be paid out of the asset given as security whereas the surplus on sale or public auction of this asset must be paid to the insolvency estate. If the asset is insufficient to cover the whole amount of the claim the remaining amount will be included in the creditor list as an ordinary claim.

The administrator, in the interest of the insolvency proceeding, can also decide to pay the claim as an estate liability in order to avoid alienation of the asset. In this case, the administrator must pay at once the outstanding amount of the claim, the interests due, and must undertake the obligation to assume the successive payments. This decision can only be taken until an arrangement has been approved or more than one year since opening of the insolvency proceeding has passed without opening of the liquidation stage.

2.3 Continuation of contracts entered into with the debtor

2.3.1 Current contracts

As a general rule, current contracts with reciprocal obligations pending maintain their validity after an insolvency proceeding has been opened. Contractual clauses which establish a right to terminate the contract in case one of the parties is declared insolvent are deemed to be null and void according to the Insolvency Act. Notwithstanding the general continuity of the contracts, the administrators or the debtor can ask the court for termination of the contract if they consider it necessary for the benefit of the insolvency proceeding.

2.3.2 Set-off

Once an insolvency proceeding has been opened the creditors are no longer allowed to demand the set-off of their claims against the claims of the debtor, unless requirements for such a set-off were already met prior to the opening of the insolvency proceeding. An exception to this general rule is established in the Royal Decree Law 5/2005 (*Real Decreto-Ley 5/2005, de 11 de marzo, de reformas urgentes para el impulso a la productividad y para la mejora de la contratación pública)* which permits financial institutions, under certain circumstances, to set-off their claims against the claims of the debtor.

2.3.3 Reinstatement of bank agreements or purchase agreements with deferred payment

The administrators upon their own decision or upon debtor's request may revive such agreements as credit contracts or purchase agreements where payment in installments was agreed, which were terminated due to default within three months prior to the opening of the insolvency proceeding. In return for such reinstatement the outstanding amounts must be fully paid out of the insolvency estate and the obligation to assume payment of the successive amounts, which will be due in the future, must be undertaken. The creditor can challenge this reinstatement, provided that, prior to the opening of the insolvency proceeding, he had initiated legal actions in order to claim payment.

2.3.4 Lease agreements

In case, prior to the opening of an insolvency proceeding, an action for eviction was filed against the debtor as lessee the administrator may also revive the lease agreement and pay out of the insolvency estate the outstanding amounts and assume payment of the successive amounts due in the future.

2.3.5 Employment contracts

The general rule that contracts with reciprocal obligations maintain their validity is also applicable to employment contracts. Nevertheless due to a debtor's economic crisis, in the majority of cases it becomes necessary to adopt measures in order to reorganize the personnel. For this purpose the Insolvency Act contains provisions for collective or single measures. Collective measures, understood as substantial modifications of working conditions and collective termination or suspension of employment contracts can be adopted at the request of the administrator, the debtor or the employees. Single measures can be taken by the administrator regarding management contracts which can be terminated or suspended, subject to payment of dismissal pay and judicial review of these measures.

2.4 Cross-border and specific country entitlements

The EC Regulation is applicable to cross-border proceedings according to which Spanish law determines the effects of insolvency proceedings on current contracts to which the debtor is party. Nevertheless, according to the Insolvency Act some exceptions apply, e.g. regarding set-off rights or employment contracts.

QUESTION 3

3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

Creditor's general rights are limited to few rights. Once the claims have been lodged (vide 2.1.1.) the creditors only have the right that these claims are revised by the administrator and finally are included in the creditor list, provided that all the requirements for such lodgment were met. The creditors may challenge the decision regarding the inclusion or exclusion. According to the Insolvency Act however, they have no right to be individually informed by the administrator or to receive the creditor list. Therefore further information regarding the claim can only be obtained by contacting the administrator directly or by *personación* (vide 2.), i.e. participating in the insolvency proceeding.

Moreover, creditors have no right to ask for access to the insolvency proceeding records. Only in case of *personación* creditors receive personally all the documents submitted to the court, as e.g. the reports issued by the administrator. Nevertheless several judicial resolutions regarding insolvency proceeding and regarding submission of administrator's report are publicly announced on the court's notice-board and in the Public Registry of Insolvency Resolutions (https://www.publicidadconcursal.es) which is open to the public and free.

Creditors who assist the creditors' assembly (vide 4.1.) may request further information regarding the administrator's report, his activities and the proposal for arrangement with creditors (*propuesta de convenio*).

Furthermore, creditors have the possibility to participate and be a party, via *personación,* exclusively in that stage of the insolvency proceeding which analyses if debtor's insolvency was caused or aggravated by willful misconduct (*mens rea*) on the part of the debtor or his legal representatives (*fase de calificación).* The creditor must prove a legitimate interest and allege in writing what he considers relevant. Moreover, the creditor may appeal the judgment which was passed at that stage.

3.2 Specific rights of information during the proceeding

As already stated above (vide 2) only the creditor who participates in the insolvency proceeding receives all the documents, reports and information which are filed during the proceeding. In practice the insolvency court delivers the court agent copy of all the documents issued in the proceeding and he hereupon passes this information to the creditor.

The court agent only delivers the documents and does not give further explanations regarding their content. Therefore it could be recommendable to choose a Spanish lawyer, who must be commissioned additionally, who is able to sum up the relevant information in creditor's language and to give more explanations regarding the legal situation and the current state of the insolvency proceeding.

3.3 Approval rights not delegated to a creditors' committee

The ordinary and preferential creditors have the right to vote on the acceptance of the proposal regarding arrangement with creditors (*propuesta de convenio*), vide 4.

3.4 Cross-border and specific country rights (*entitlements)*

There is no distinction between local and foreign creditors. Both have the same rights. Foreign creditors who wish to be a party of the proceeding should query with the court agent if he also delivers the documents issued in the proceeding abroad. Otherwise an address in Spain for notification should be made available.

QUESTION 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

Arrangement stage (*fase de convenio)*

Creditors' assembly (*junta de acreedores*) is held within the arrangement stage. The purpose of this stage is to reach an agreement for settlement of the claims between the debtor and its creditors. Prior to (*propuesta anticipada de convenio)* or following (*propuesta de convenio)* the resolution in which the insolvency court has opened the arrangement stage, the debtor or the creditors may present a proposal for an arrangement with the creditors. But only those creditors, who represent at least 20% of the total amount of the debtor's liabilities, as stated in the creditor list, are allowed to submit a proposal. If the insolvency judge considers that the proposal meets the mandatory requirements he will deliver it to the administrator.

The proposal must include a payment plan, indicating the financial resources which shall be used in order to comply with this plan. If in addition the proceeds obtained by debtor's activity shall be used to fulfill the proposed arrangement, the proposal must contain a viability plan which specifies the possibilities to obtain the necessary proceeds. The Insolvency Act limits the content of the proposal as it allows only a debt release of maximum 50% of the ordinary claims and a stay for maximum five years, with some exceptional cases. The administrator must analyze the content of the proposal and evaluate the payment plan and, if it exists, the plan regarding the feasibility.

Prior to the creditors' assembly the creditors, who are included in the creditor list, may accept the proposal by signing the corresponding document before the insolvency court or before a notary public. In addition, creditors may also approve the proposal by voting in favor during the creditors' assembly. The proposal may only be accepted without modifications. Creditors who only have a subordinated claim are not allowed to vote.

The proposal of arrangement is considered to be validly accepted by the creditors' assembly when at least 50% of the ordinary creditors (by value of credits) have voted in favor. Acceptance of the proposal is subject to the final approval by the insolvency judge. The administrator, any creditor not attending to the assembly, creditors who have voted against the proposal or administrator and creditors who, jointly or separately, represent 5% of the total amount of the ordinary claims if they consider that fulfillment of the proposal is objectively impossible are entitled to oppose the judicial resolution which approves the proposal.

4.2 Creditors' committee

The Insolvency Act does not provide the possibility of representation of the creditors by a creditors' committee. Every creditor acts in its own name or by means of a designated representative. Only in case of an abbreviated proceeding the insolvency judge will appoint, out of the existing ordinary or general preferential creditors, a creditor as third administrator. This administrator has the same rights and obligations as the other ones.

4.3 Other forms of direct creditors' participation

Forms of direct participation other than those already stated do not exist according to the Insolvency Act.

4.4 Rights related to reorganization plans and proceedings

Rights other than those already stated do not exist according to the Insolvency Act.

4.5 Cross-border and specific country rights

There is no distinction between local and foreign creditors. Both have the same rights.

QUESTION 5

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5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

The creditors have only limited possibilities to challenge decisions or acts of the administrator.

Liability of the administrators

The administrator is liable for damages caused to the insolvency estate due to acts or omissions which have infringed a law or which were realized without diligence required. In this case the debtor or a creditor may initiate an action against the administrator before the insolvency judge. Furthermore, the debtor, a creditor or a third party is authorized to initiate a claim against the administrator if his acts or omissions caused them direct damages.

Subsidiary entitlement for litigation

In certain cases only the administrator is entitled to initiate legal actions in the interest of the insolvency estate. In case those legal actions are not taken, the creditor may request the administrator in writing to initiate a court proceeding, indicating the legal grounds on which such claim shall be based. Only if the administrator, within two months after this request, does not take legal actions the creditor has also standing to sue, although on a subsidiary basis. The creditor must sue at his own expense but have the right of reimbursement of the expenses and legal costs in case the claim was successful, up to the maximum limit of the result of the judgment.

This right is granted to the creditor in case of legal actions which have effects on the debtor's assets and which are initiated with the objective to rescind detrimental acts of the debtor. In the latter case only those acts which were carried out within the two years prior to the opening of the insolvency proceeding can be rescinded.

5.2 Substitution of the insolvency representative

The insolvency judge ex officio or upon request of a creditor or any member of the board of administrators may dismiss the administrator, provided that a reasonable cause is alleged.

Furthermore, any interested party may request the insolvency judge the dismissal of the administrator and appointment of another one, if the liquidation stage has not finished within one year since its opening. The insolvency judge will hear the administrator and decide the dismissal, provided that there exists no cause which would justify the delay.

5.3 Cross-border and specific country rights (entitlements)

National and foreign creditors have the same rights.

QUESTION 6

6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

The remuneration is calculated on the basis of a scale and must be paid out of the insolvency estate. Should the estate be insufficient to cover these costs the administrator would not get paid. Currently enactment of a national regulation is pending which will derogate the current scale and establish basic rules for the remuneration of the administrators. In particular, a maximum amount of remuneration for the whole insolvency proceeding shall be established and a minimum amount for those proceedings where the insolvency estate is insufficient. The minimum amount shall be paid out of an account. The fund for this account shall be raised by mandatory contributions which will be deducted from the administrators' remuneration. The creditors are not responsible for the administrator's remuneration.

6.2 Funding special activities of the insolvency representative

Special activities are also paid out of the insolvency estate. If the administrator for the exercise of his duty needs the help of an expert, he must pay that persons fees out of the received remuneration.

6.3 Specific country entitlements

There exist no specific country entitlements.

Basic forms

Form for lodgment of claims.

UNITED ARAB EMIRATES

Introduction

It is a common misconception that the UAE does not have its own insolvency legislation. Despite the relative youth of the UAE, there does exist a set of insolvency laws. However, due to the fact that the UAE has not experienced until recently an economic downturn, there has been a lack of substantive insolvency cases to test the legislation.

The primary set of laws governing the liquidation of companies is contained within Federal Law No. 8 of 1984 ("the Companies Law") whilst provisions for bankruptcy and reorganisation proceedings are contained within the Law No. 18 of 1993 ("the Commercial Code"). Commercial Bankruptcy is set out in Articles 645 to 900 of the Commercial Code. Typically, liquidations provide for the termination of a corporate entity whereas bankruptcies are primarily aimed towards discharging a debtor from its debts and liabilities, therefore preserving its ongoing business activities. Examples of each procedure are discussed in this article but with a primary focus on bankruptcy proceedings, as this is the main form of insolvency procedure that is implemented in the UAE.

In circumstances where a trading entity does not fall within the definition of a "trader" under Article 11 of the Commercial Code, bankruptcy will proceed under Federal Law No. 5 of 1985 as amended (the "Civil Code") more specifically according to Articles 678, 679, 680, 681 and 682.

Relevant sections of the Commercial Code (in relation to commercial bankruptcy) and the Civil Code (in relation to personal bankruptcy) are quoted for reference throughout this article.

Due to the increasing number of Free Trade Zones within the UAE, there is also some overlap in relation to the applicability of the insolvency regulations that are specific to each of the Free Trade Zones, and the Federal Insolvency Laws.

Advice should be sought on a case-by-case basis to determine which legislation applies, as there is no standard position.

QUESTION 1

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1. Creditors' rights before an insolvency proceedings is opened

1.1 Filing for the declaration of debtor's insolvency

Article 647 of the Commercial Code states, a trader may declare his own bankruptcy or it may be declared at the request of any one of his creditors. The court also has jurisdiction to initiate a bankruptcy proceeding upon the request of the public prosecution or with its own accord.

By contrast to bankruptcy, liquidation proceedings provide for the termination of a company's corporate existence. The relevant procedures are set out in the Companies Law and they only apply to Companies. If a liquidation is commenced, the words 'under liquidation' must follow the company's name.

1.1.1 Application for bankruptcy by the "trader"

Where a trader's financial position "*becomes unstable and he suspends payment of his debts*" he may apply for bankruptcy. He will then be required to apply for bankruptcy after 30 days have lapsed since the suspension. Should the trader fail to request bankruptcy at that time, he will be considered to have committed the crime of bankruptcy, which is an offence under Federal Law No. 3 of 1987 as amended (the "Penal Code").

An application for bankruptcy must be submitted to the court stating the reason for the suspension of payments and submitting a signed report. The report must include prescribed documentation including details of assets and liabilities.

If the managing director of a company intends to apply for bankruptcy he must first obtain permission to do so from a majority of the partners (in the case of general and limited partnerships), or from an extraordinary general meeting of shareholders (in the case of other companies). A company creditor, including a partner of the company who is also a creditor, may apply for a declaration of its bankruptcy.

The company must submit a signed report setting out the reasons for the company's insolvency and attaching the same documents as outlined above in its application to the court.

The court may, on its own or at the request of the company, postpone the declaration of the bankruptcy for a period not exceeding a year, if its financial position is likely to be enhanced or if it is in the interest of the national economy.

1.1.2 Application for bankruptcy by a creditor

A creditor of a trader may apply for a declaration of bankruptcy in respect of any trader that fails to pay its debts when due. In order to do so, the creditor must demonstrate to the court that the trader has suspended payment of its commercial debt.

A creditor with a deferred conditional commercial or civil debt may file a petition for bankruptcy if the debtor has no place of domicile, absconds and winds up the business provided that a proof of debt is submitted by the creditor stating that the debtor has suspended payments of his outstanding debt.

After the application is submitted, the court may make certain interim orders to secure the assets of the debtor. This may include securing the trading premises, fixing a provisional date for the suspension of payments and appointing a trustee to administer the bankruptcy. The court may also appoint an expert to investigate a debtor's financial position and submit a report. Any objections to the bankruptcy will be heard by the court prior to rendering

judgment. After satisfying all the necessary internal procedures and resolving all disputes and applications concerning the case, the court will decide whether to make the declaration of bankruptcy.

Although a creditor may initiate liquidation proceedings, against a company (known as 'involuntary' liquidation), the principal method for involuntary winding-up of a debtor is through bankruptcy proceedings.

1.2 Choice of the insolvency representative

In the UAE, the law provides for the appointment of a "trustee in bankruptcy" who is appointed by the courts. The extent to which the creditors are able to influence the choice of trustee is difficult to ascertain because of the limited number of bankruptcies so far in the UAE.

1.2.1 The trustee in bankruptcy

In accordance with Article 668 of the Commercial Code the court appoints a paid person as a trustee in bankruptcy to administer the same. The number of trustees may at the volition of the bankruptcy judge, the controller, or the bankrupt be increased provided that the number appointed does not at any time exceed three persons.

During the adjudication of the bankruptcy the trustee shall administer and preserve the property of the bankruptcy. After the adjudication of bankruptcy any rights in respect of and / or commercial claims will vest in the trustee rather than the bankrupt.

The fees and expenses of the trustee in bankruptcy shall be determined by the bankruptcy judge.

1.2.2 The controller

The laws of the UAE also provide for the appointment of a "controller", who is the representative of the body of creditors. The formation of the body of creditors is discussed in more detail below.

1.3 Packaged insolvencies

No provisions exist under UAE law which facilitate "packaged" insolvencies.

1.4 Cross-border insolvencies and specific country rights

1.4.1 Sovereign immunity

A creditor's right to recover money that it may be owed by a sovereign entity needs to be considered both from the perspective of UAE Federal Laws, and from the perspective of the laws applicable to each Emirate.

The (Federal) UAE Civil Procedure Code states that there is an overall prohibition on seizing "public property owned by the state or one of the Emirates" for the purposes of enforcement.

Difficulties often arise in determining what constitutes "public property" and therefore which individuals / entities benefit from sovereign immunity.

Similarly, it is not entirely clear whether the Civil Code should apply in relation to the enforcement of contractual debts in a commercial transaction where the "state" debtor is a commercial corporate entity benefiting from its own separate legal entity.

1.4.2 Bounced cheques

In the UAE, providing a cheque that is dishonoured is both a civil, and a criminal offence that could lead to a period of imprisonment. This means that the person that presented the cheque is entitled to notify the police who will then seek to arrest the party (or parties) who signed the bounced cheque(s).

1.4.3 The Penal Code

A declaration of bankruptcy may result in the imposition of a term of imprisonment and a fine. The extent of any punishment will depend on whether, and to what extent, the debtor contributed to the bankruptcy by their own negligent acts or committed fraudulent acts in an attempt to conceal the bankruptcy. Article 419 of the Penal Code provides, in relation to simple bankruptcies (ie. without questions of fraud arising), that:

"*Any merchant, who is declared bankrupt by a final adjudication order, shall be considered a negligently bankrupt and shall be punishable by imprisonment for a period not exceeding one year and by a fine not exceeding ten thousand Dirhams, when it is established that he committed any of the following acts.*

- *Undertook, for the interest of another and without any compensation, obligations which constitute a too heavy burden for his financial situation at the time of contract.*

- *Failed to keep account books or kept incomplete or disorderly account books which are not sufficient to clearly indicate the debits and credits pertaining to his trade, or failed to keep stock-taking books as is required by the law.*

- *Failed to comply with the rules set for the Commercial Register.*

- *Refrained from filing the declaration of stopping of payment within the time limit specified therefore by the law, or failed to submit the balance sheet, or if it is established after stopping of payment that he submitted incorrect statements.*

- *Refrained from submitting the statements required by the competent Court or wilfully submitted incorrect statements.*

- *If, after stopping of payment, he granted any special privileges to a creditor in preference to the others with the intention of obtaining a scheme of composition.*

- *If he is declared bankrupt once again before he performs the obligations arising from a previous scheme of composition*".

Typically, more stringent penalties may be imposed in cases where fraud or negligence can be proven in bankruptcies.

These circumstances may be described as follows:

- Deliberately becomes bankrupt in order to cause loss to his creditors and an order is made against that trader by the court for the performance of his obligations;

- Following judgment against that trader, conceals property in order to avoid execution against it, or fabricates debts with the intention of causing loss to creditors; or

- Fraudulently changes its address with the result that its creditors suffer loss, he will be liable to be punished for fraud.

QUESTION 2

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2. Creditors' rights aimed to meet claims

2.1 Filing a claim

As a general principle, the UAE courts have jurisdiction to hear bankruptcy cases relating to any commercial entity that trades within the UAE. This may relate to any debtor who is a 'trader' conducting its principle activity in the UAE, or that has its central management in the UAE as defined in the Commercial Code. Although the Commercial Code makes reference to a 'specialised court' for bankruptcy, no such distinct judicial system exists in the UAE legal system.

The bankruptcy provisions apply equally to foreign 'traders' conducting their principle activity in the UAE or which have their central management in the UAE. This is the case even where a declaration of bankruptcy has not been issued in a foreign country.

2.1.1 What happens following the declaration of bankruptcy?

The court will send the public prosecutor, the trustee of the bankruptcy, the Ministry of Economy, Chamber of Commerce and the Central Bank, a transcript of the bankruptcy judgment. It shall also be displayed at the court house for a period of 30 days. The bankruptcy trustee will publish an extract of the judgment in one or more daily newspapers specified by the court within 15 days of the date of issue, which sets out various details of the bankrupt and his business. Creditors will through the publication of the judgment in newspapers be invited to submit their debts and prove these to be owing. Foreign creditors will ordinarily be given an extended period to file a proof of debt. The Court will compile a list of the unsecured creditors. Any creditor holding security shall not be included within the list of unsecured creditors as they have recourse to their security.

There is no requirement for foreign creditors to be domiciled within the UAE in order to file a claim.

Once all submitted debts have been fully investigated and evidenced, the judge will invite the creditors whose debts have been accepted to attend a hearing in order to consider whether a compromise referred to as a 'composition' (discussed below) is feasible. A composition will not be final without the approval of the majority of the creditors holding two thirds of the debt that has been accepted by the court. It is crucial that "general" creditors (see paragraph 2.2) submit details of their debt and participate in the bankruptcy process. Creditors should consider whether from a commercial perspective it is preferable to accept the proposal set out in the composition rather than rejecting the same.

2.2 Privileges for secured claims

The Civil Code categorises creditor priority rights into "general" or "particular". General priority rights apply in relation to all assets of the debtor. Particular priority rights relate to specific real or movable property of the debtor, over which a creditor has a claim.

In this way the law differentiates between ordinary creditors (described as unsecured creditors) and creditors with secured debt by mortgage or special liens (described as secured creditors).

Following a declaration of bankruptcy unsecured creditors will not be allowed to commence proceedings against the debtor, or continue proceedings commenced prior to the declaration of bankruptcy, or to take enforcement proceedings against the assets of the bankrupt.

The position with respect to secured creditors is different. Those creditors have the right to bring and continue actions against the bankrupt represented by the trustee in bankruptcy or continue enforcement in respect of those assets over which they have a charge, unless they have agreed to be bound by a voluntary arrangement with the debtor.

In addition, specific articles of the Commercial Code (from articles 711 to 720) apply in respect of holders of debts secured by mortgage or lien on moveable property and real estate. For example, article 717 prescribes that the bankruptcy judge may order to use the first money that comes into the bankruptcy for payment of the claims of the creditors who have a lien upon the bankrupt's movables.

If a creditor with the benefit of security and / or any other priority creditor receives less than the value of the debt owed to them from the proceeds of the sale of any properties over which they have a charge, they will be deemed ordinary creditors for the balance of their debt.

"Priority rights", which rank following debts secured by mortgage or lien and above 'ordinary' claims, would include:

- wages and salaries due to workers and staff;
- any debts paid made by the trustee from their own funds or those paid by another person;

- rental payments for any property leased by the bankrupt;
- court fees; and
- money due to the government.

2.3 Continuation of contracts entered into with the debtor

Following a declaration of bankruptcy, all monetary debts owed by the bankrupt become payable whether the debts are ordinary or secured. According to Article 721 of the Commercial Code, a declaration of bankruptcy shall not automatically lead to the termination of a contract that is binding on both sides (and of which the bankrupt is a party).

However, the trustee in bankruptcy may choose not to implement contracts or to discontinue contracts to which the bankrupt is a party, in which case the contracting party is entitled to prove in the bankruptcy proceedings for compensation as an unsecured creditor. Permission of the bankruptcy judge must be obtained before the trustee can discontinue any contracts.

In relation to leases of premises, if a bankrupt is a holder of a lease of the premises from which he practises a business, a declaration of bankruptcy shall not automatically terminate the tenancy or cause the balance of rent due for the remaining period of the tenancy to become due.

2.4 Cross-border and specific country entitlements

Although the position is not clear cut, the wording of Article 650 of the Commercial Code suggests that where contractual parties reside in two different jurisdictions, the UAE law permits the creditor to file for a petition for bankruptcy in the UAE courts against the other party. The reason for reaching this conclusion is that article 650 of the Commercial Code provides that *"any creditor with a commercial or civil debt that has become due"* may file a petition for adjudication of bankruptcy.

It should be noted that the UAE legal system contains laws restricting foreign ownership in UAE companies, which may cause issues for foreigners when attempting to enforce pledges over company shares. In general, 51 percent of UAE companies must be owned by UAE or GCC nationals.

2.4.1 Commercial Code

The court can detain a bankrupt or place them under supervision in circumstances where they have intentionally concealed property or books or not followed an order of the bankruptcy court. The court can also use precautionary measures to protect the interests of creditors. Such measures could include, amongst others, the granting of interim freezing orders to protect the assets of a debtor.

A bankrupt may, by permission of the court, engage in a new trade with money other than that of the bankruptcy and creditors whose debts arise from such trade shall have priority to receive their due from that trade.

2.4.2 Civil Code

The type of restrictions which can be placed on a civil bankrupt include an order that deferred obligations are immediately due for performance and orders preventing the obligor from incurring additional debt (i.e. any obligations made by the obligor to another person will be held ineffective from the time that the order is registered).

A creditor may obtain an attachment over the property of the obligor during the time that the restriction is in place. The property of the obligor under restriction will then be sold and "*divided among the creditors by way of pro rata sharing in accordance with the procedures laid down by law*". The obligor will be left with enough money to maintain himself and any dependants.

2.4.3 Interest

The accrual of interest on a debt will cease for ordinary creditors when the bankruptcy judgment is pronounced, however, there is a limited scope for post-bankruptcy interest to be paid on debts secured by mortgage or lien. Interest in these circumstances may be claimed on the proceeds of the sale of the secured asset / assets.

2.4.4 Interlocutory relief

A creditor should send formal notice of default to the defaulting party and insist upon due performance.

If the defaulting party has provided some sort of commercial instrument of payment (i.e. a cheque, or bill of exchange) which is due but has not been paid, it may be possible to seek an order for payment, on an 'ex parte' basis, against the debtor. It will be at the judge's discretion as to whether such an order will be granted, or whether a trial must be held. Additionally, as described above, there may be criminal consequences for a debtor who fails to honour payments by cheque.

In all circumstances, an innocent party may file a civil claim seeking payment of the debt. An application for a precautionary attachment, being an order of the court "freezing" identifiable assets of the debtor, may be made by a creditor prior to filing the substantive action and on an 'ex parte' basis.

QUESTION 3

3. Creditors' rights aimed to monitor the insolvency proceeding

3.1 General creditors' rights

3.1.1 Commercial Code

If a debtor requests a declaration of bankruptcy and the court rejects the application, it can impose a fine if it has found that he has intentionally fabricated the bankruptcy. Similarly, a creditor should be wary that if he requests the declaration and this is rejected the court will also impose a fine and will order that the judgment be published at the creditor's expense in a newspaper of its choice, if it finds that he has intended to discredit the commercial reputation of the debtor. The debtor may also be able to claim compensation.

3.2 Specific rights of information during the proceeding

Article 670 of the Commercial Transactions Law provides that the trustee in bankruptcy shall make a daily record of all matters related to the administration of the bankruptcy, in a special book whose pages shall be numbered. The court, the judge of bankruptcy and the controller may have access to such book at any time. Likewise, the bankrupt may have access to it, with permission from the judge of bankruptcy.

Creditors may be able to obtain information relating to the bankruptcy form the 'controller' (see below).

3.3 Approval rights not delegated to a creditors' committee

As discussed in other sections of this chapter, a creditors' committee will be formed after creditors have been invited to prove their debts in the bankruptcy or winding-up.

3.4 Cross-border and specific country rights (entitlements)

Foreign creditors have the same rights as local creditors. In addition, both the Commercial and Civil Codes recognises a creditor's right to set-off but certain requirements must be met before set-off or netting will be enforceable on an insolvency. Set-off is likely to be an available remedy where the obligations of the parties could be said to be 'connected'. In general, set-off can be imposed by law or pursuant to an agreement between the parties or by order of the court. The timing and procedure for set-off will depend upon the circumstances of the particular case.

3.4.1 The Penal Code

It is important to note that the provisions of the Penal Code apply to all crimes committed within the State of the UAE, regardless of whether such crimes are committed within one of the Emirates, or within a Free Trade Zone. Chapter 7

of the Penal Code relates to bankruptcy and more specifically crimes related to bankruptcy.

Article 1 of the Penal Code provides that:

"The Code (law) attached hereto shall apply to all crimes and punishments, and any text contradicting its provisions shall become null and void."

Article 16 provides that:

"The provisions of this Law shall apply to all crimes perpetrated or committed on the territory of the State. The States territory includes its lands and any place governed by the States sovereignty, including the territorial waters and the atmospheric layer which covers them. A crime shall be deemed committed on the States territory if one of the acts constituting it has been committed thereon or if its results have been or were intended to be produced thereon."

QUESTION 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

As set out in more detail later in this chapter, a creditors' committee may be formed that will be able to approve or reject protective or judicial 'compositions'. In respect of any proposed judicial composition the composition meeting will, typically, be chaired by the bankruptcy judge.

4.2 Creditors' committee

Although there is provision for the creditors to meet to deliberate any proposal of a 'composition', no provision exists under UAE law for the appointment of a creditors' committee (in the sense that one might be familiar with in other jurisdictions such as the UK). Instead, the bankruptcy judge will appoint a 'controller' who represents the body of creditors.

4.2.1 "Controller" - Article 690 of the Commercial Code

The controller is appointed by the bankruptcy judge from among the creditors who offer themselves as candidates for the role. In addition to other authorities, the controller shall examine the balance sheet and the reports submitted by debtors and shall assist the bankruptcy judge, in exercising control over the activities that are to be performed by the trustee in bankruptcy. As part of this process, the controller may request that the trustee in bankruptcy provides clarification in relation to the progress of the bankruptcy proceedings, for example, by way of a report which incorporates a progress report in relation to the status of the insolvency. The controller does not receive a fee in consideration of his work.

4.3 Other forms of direct creditors' participation

No further forms of participation exist under UAE law.

4.4 Rights related to reorganization plans and proceedings

Upon the filing of a claim, in order to try and avoid bankruptcy or winding up a debtor may attempt to instigate a 'protective composition'.

The Commercial Code provides that a trader, whose financial state is such that he may not be able to pay his debts, may within the 20 days following his suspension of payment apply for a voluntary arrangement (known as a 'protective composition') preventing the instigation of bankruptcy. Such an arrangement will not be granted to a company that is already in liquidation. Any application for a preventative composition must be submitted to the court and must set out the reasons for the disruption of the business, details of the proposed arrangements and guarantees as to its implementation. The proposed settlement cannot be for less than 50% of the debt owed and the payment period cannot exceed three years. The supervising judge will issue a decision opening the composition proceedings and this will be published, along with an invitation to creditors to attend a meeting of creditors. Creditors will be required to submit documentation showing the level of the debts that they are owed for consideration (and acceptance or rejection) by the court. Every creditor whose level of owed debt has been accepted will have the right to attend the deliberations meetings in relation to the composition. An arrangement will not be reached without approval of the majority of the creditors who hold two-thirds of the debt that has been accepted.

In addition to the above, it is open to the parties (debtor and creditors) to reach an arrangement amongst themselves (outside of the formal insolvency legislative framework) in circumstances where the debtor has not yet suspended payments, but is in financial difficulties. Under UAE law, the validity of these agreements, as with any contract, will be subject to the provisions of the Civil Code. The consent of all creditors will be required.

A creditor may seek to reach an arrangement with the debtor to re-schedule or restructure the debt, or, request additional security and/or protection by way of a guarantee or collateral. However, such transaction may be susceptible to an antecedent transaction challenge (as more particularly considered below). In circumstances where an application for bankruptcy is being heard, the bankruptcy court may make an order to safeguard the assets of the debtor until such time as the proceedings are complete.

Upon filing of the composition, the court will appoint a trustee who publishes an invitation to creditors to attend a creditors' meeting in two daily newspapers. Local creditors must submit details of their debts within 10 days of publication of the notice, whilst foreign creditors have 30 days to do so.

Once details of the debts have been received by the trustee, he must lodge the details with the court, publish a list of the debts in a local newspaper and send a statement to each creditor. The debtor and creditor have 10 days in which to object to the published debts. A judge will then verify the debts and a creditors meeting is held where the trustee will submit a report on the financial state of the debtor's situation.

If a debtor does not apply for a protective composition after bankruptcy proceedings have been commenced then the judge must commence a 'judicial composition', which follows a similar procedure to that of a protective composition.

Pursuant to the Commercial Code, following the declaration of bankruptcy and the acceptance or provisional acceptance of creditor's claims, the judge supervising the bankrupt's estate will invite the creditors whose debts have been accepted, to attend a deliberation meeting with the aim of formulating an appropriate arrangement.

At this meeting, the trustee will submit its report on the bankruptcy. An arrangement will not be made *"except if it is approved by a number of the creditors, representing the numerical majority and holding two-thirds of the debts that have been finally or provisionally accepted."* The arrangement might involve delays for the insolvent to pay its debts or a waiver by the creditors of some parts of the debts.

Any creditor not attending the meeting shall be considered as dissenting to the arrangement. A decision will be issued by the judge declaring the arrangement and this will be published in the newspaper.

4.4.1 Antecedent transactions

Article 696 of the Commercial Code provides that certain dispositions including settlement of debts prior to maturity, donations, and settlement of debts other than in the manner contractually agreed may be challengeable by the creditors, to the extent that such transactions take place after suspension of payments and prior to adjudication of the bankruptcy.

Article 697 of the Commercial Code suggests that the transaction is liable to be void if the act was harmful to the general body of creditors and the recipient was aware at the time of receipt that the bankrupt had stopped making payment. Article 700 of the Commercial Code provides that in the event a disposition is deemed invalid the recipient is obliged to re-instate the bankrupt estate either with the property or the monetary equivalent. Article 702 imposes a two year limitation from the date of the bankruptcy upon taking any action in relation to articles 696-701 inclusive.

Creditors should consider whether they believe that any transaction completed by the defaulting party could be challenged as an antecedent transaction.

4.5 Cross-border and specific country rights

Not applicable in the UAE.

QUESTION 5

5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the Court)

5.1 Means creditors have to challenge decisions and acts of the insolvency representative

Once a judgment of bankruptcy has been delivered, it may be challenged by an interested third party within 10 days of the last publication of the judgment in the newspapers. A challenge to any of the claims arising under the bankruptcy must be made within 10 days either after the issue of the judgment or after its publication.

If the debtor becomes capable of honouring all debts due to him, prior to the issuance of the judgment, the court must nullify the judgment and the debtor must pay all expenses of the case.

5.2 Substitution of the insolvency representative

Article 673 of the Commercial Transactions Law sets out the procedure for removing a "trustee in bankruptcy". The bankruptcy judge, with his own accord or at the request of the bankrupt or the controller, may decide to remove the trustee or reduce the number of trustees appointed. The judge's decision in this respect shall be incapable of challenge, however. If the bankruptcy judge has not decided the issue within the period of 10 days from the date of any submission by the bankrupt or controller, then the request may be submitted directly to the court for a decision.

The bankruptcy judge does have an obligation (under Article 788) to consult with the creditors to see whether they are content to keep the trustee or to change him. If it transpires that the majority of the creditors who are present at that consultation meeting decide to change the trustee, then the judge of the bankruptcy shall immediately appoint a replacement. The new trustee shall be called *"the trustee of the creditors' union".*

5.3 Cross-border and specific country rights (entitlements)

The insolvency laws of the UAE do not include provisions which differentiate between the handling of national and foreign creditors. In practice, however, unless the creditor is fully aware of the debtor's position and follows them closely, the ability of foreign creditors to apply for bankruptcy against a debtor in the UAE is likely to be constrained due to the (usually) short time periods involved in the process.

QUESTION 6

6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

As a general rule, the expense of making a declaration of bankruptcy shall be paid out of the estate of the bankrupt. If no money is available in the bankruptcy at the time of its declaration to meet any of the expenses of the process, including payment of the trustee, then such expenses shall be paid from the public treasury upon an order from the bankruptcy judge. The public treasury shall recover the amounts it has paid as a lien over all creditors from the first money received into the bankruptcy.

6.2 Funding special activities of the insolvency representative

Not applicable in the UAE.

6.3 Specific country entitlements

Article 800 of the Commercial Code states that, if it appears that the value of the bankrupt's estate does not exceed Dhs. 50,000, the judge of the bankruptcy may order that the periods provided for within articles 753 - 757 and 770 of the Commercial Code may be reduced by half.

Conclusion

Although the UAE does have an insolvency regime, the legislation is often unique and not straight-forward. There are often jurisdictional issues that mean that creditors would be well advised to seek advice on a case-by-case basis
to establish which provisions are relevant and in order to determine the appropriate course of action.

More often than not, in a situation where a commercial entity has become bankrupt, creditors will be better off negotiating settlement terms that are
as favourable as possible, rather than relying on a court judgment. This is particularly the case where a creditor is not "particular".

UNITED KINGDOM

Introduction

The UK's insolvency procedures are considered by some to be the most liberal and flexible in Europe. The legislation, which governs the use of any procedure, is the Insolvency Act 1986 and The Insolvency Rules 1986, modernised by the Enterprise Act 2002. The DNA of UK legislation can be traced back to the Debtors Act 1869 and earlier.

There are differences in the detail between the procedures in England and Wales, Scotland and Northern Ireland; however they essentially follow the same philosophy in dealing with the winding up of a company.

Any insolvency procedure must be supervised by a Licensed Insolvency Practitioner (IP) of which there are approximately 2000 in the UK, regulated by the accountancy and legal bodies of each jurisdiction; in addition the Insolvency Practitioners Association and the Insolvency Service regulate IPs across all jurisdictions. The primary functions of the IP are to realise assets, agree claims, investigate the affairs of the company and distribute funds to creditors in accordance with their class rights as prescribed by legislation.

There is a wide range of procedures available to save the company, the business of the company or if all else fails wind the company up.

The principal procedures available to a company are:

- Company Voluntary Arrangement (CVA)
- Administrative Receivership (now rarely used)
- Administration
- Liquidation (Creditors Voluntary Liquidation (CVL))
- Compulsory Winding Up (CWU)

Each procedure is not mutually exclusive and companies can and do move from one procedure to another depending on the outcome of any business rescue.

This guide will only deal in detail with insolvency procedures in England and Wales. All of the procedures listed above are available to small and medium sized companies in the UK, but their use is dependent on whether the entry requirements are met and the value of the assets realised to cover the costs of the procedure used.

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Filing for the declaration of debtor's insolvency

The directors of the company usually instigate insolvency proceedings when they realise that the company is insolvent.

An insolvent company is usually defined as one whose assets are less than its liabilities (balance sheet test) or one who cannot pay its creditors as and when they fall due for payment (cash flow test). In such cases, creditors are advised of the insolvency after the decision to enter into some type of insolvency procedure has been taken by the directors.

However, a creditor can also instigate insolvency proceedings in a number of ways. A secured creditor, on default of payment of its debt, can appoint an administrator by applying to the court or can make its own out-of-court appointment; in addition a secured creditor may in limited circumstances appoint an administrative receiver if the security document allows for it and predates 15th September 2003.

Unsecured creditors can also petition the court to place the company into compulsory liquidation or less frequently administration. When a winding up order is granted (CWU), the affairs of the company will be passed to the Official Receiver to administer.

1.2 Choice of the insolvency representative

In the majority of voluntary insolvency procedures, the directors of the company choose the IP, often after consulting the company's advisors and bankers. Only in the cases of an administrative receivership, a qualifying floating charge holder or creditor appointed administration or compulsory liquidation does the creditor have a direct input into the appointment process.

The calling of an early creditors meeting in a CVL, and the calling of an initial meeting of creditors or report to creditors within 8 weeks of appointment in an administration, overcome this apparent initial disregard of creditors' interests.

At these meetings, the wishes of creditors will be taken into account and a majority in value of creditors (based on the sums owed) can overturn the directors' choice of IP.

1.3 Packaged insolvencies

With the introduction of the Enterprise Act 2002, the process of placing a company into administration was simplified and this made it a more cost effective solution to save smaller businesses and companies. This simplification of the procedure led to the development of the pre-packed sale of a business from the insolvent company to another legal entity, which was

often but not always controlled by the management of the failed company. In a pre-packaged sale the terms of the sale are negotiated prior to the appointment of the administrator and the sale is completed immediately after the appointment takes place. The process has become known as a 'prepack' and in some circles is much maligned as unsecured creditors usually have no input into the decision to sell and competitors in the same industry see the new business as unfair debt-free competition. In addition, further controversy has arisen over the position of retention of title creditors who find it difficult to enforce their terms and conditions upon the new company.

A prepack sale is no different to any other sale of a business, except that the company is insolvent, however the number of complaints and the degree of public concern was so great that further guidance on best practice was introduced to improve transparency in the use of prepacks.

Academic research has shown that prepack sales do save both businesses and jobs and tend to provide a better return to creditors overall; however, it is sometimes only the secured creditors who feel the benefit. IPs are now required to advise creditors of pre-packed companies in administration of the insolvency and provide an explanation of why the business was pre-packed within 14 days of appointment.

1.4 Cross-border insolvencies and specific country rights

In general, a foreign creditor can make use of the UK insolvency procedures in the same way as a UK creditor, to either appoint an administrator or wind up a company.

UK insolvency legislation is subject to both the EC Regulations 2000 (the EC Regulation) and the UNCITRAL Model Law. In addition, there is recognition of insolvency proceedings with other Commonwealth countries pursuant to section 426 of the Insolvency Act 1986.

The Cross-Border Insolvency Regulations 2006 set out how the above are to be applied in the UK.

The UNCITRAL Model Law applies to foreign proceedings globally without reciprocation. The EC regulation applies to dealings with EU countries, except for Denmark. If there is conflict with UK legislation, it is the international regulations that take precedence.

Foreign creditors can claim in UK proceedings in the same manner as a UK creditor.

The conversion into sterling of any claim in foreign currency is as at the date of the commencement of the insolvency proceedings, and is at "the official exchange rate" which is the middle exchange rate on the London Foreign Exchange Market at that day.

QUESTION 2

2. Creditors' rights aimed to meet claims

UK insolvency legislation recognises the following three classes of creditors: secured, preferential, non-preferential (often referred to as the unsecured creditors).

Secured creditors, as the name suggests are creditors whose debt is secured against the assets of the company. Preferential creditors are defined by the insolvency legislation and the most common preferential creditors are employees for unpaid wages and holiday pay.

Non preferential creditors are all other creditors including trade creditors, directors and other unsecured loans and any deficiency to secured creditors arising from the sale of assets subject to security.

2.1 Filing a claim

The Insolvency Practitioner appointed over the failed company will invite creditors to provide details of their claims in the proceedings, either when calling a meeting in the case of a liquidation or Company Voluntary Arrangement, or shortly after appointment in the case of administration.

There are often creditors who only come to light after the commencement of the insolvency procedure. As soon as the IP has knowledge of the existence of additional creditors he should notify them of the insolvency procedure, if they are unhappy with the actions of the IP, they can seek the remedy of the court. A specific proof of debt form is available to creditors to do this, which will be sent to the creditors at the appropriate time.

A creditor will be unable to participate in the decision making process in the insolvency procedure unless a claim has been submitted.

Creditors' claims are unlikely to be agreed by an administrator unless they are secured or preferential because an administrator does not have the power to pay a dividend to non preferential creditors without the permission of the court. As a result non preferential claims will be dealt with by a subsequent liquidator who prior to paying a dividend will invite creditors to submit their claim within a minimum period of 21 clear days or the creditor will be excluded from the distribution of funds. If the liquidator rejects the claim, the creditor can refer the matter to court for adjudication.

2.2 Privileges for secured claims

In general secured creditors are entitled to both take control of their security and realise the asset themselves, or allow the IP to realise the assets and after the deduction of any agreed fee, account to the secured creditor for the proceeds (but see below).

In the case of administration, following the filing of a notice of intention to appoint an administrator or submission of an application to the court for an administration order a moratorium takes effect which protects the company and its assets from its creditors including secured creditors. The Secured creditors can only enforce their rights with the approval of the court.

Where a secured creditor has a debenture over the assets of the company which was created on or after the 15th September 2003, a sum known as the 'prescribed part' is put to one side from the net floating charge realisations for non-preferential unsecured preferential creditors. The IP need not set aside the prescribed part if the company's net property is worth less than £10,000. Otherwise, it is calculated at 50% of the first £10,000 and 20% of any remaining assets to a maximum sum of £600,000.

2.3 Continuation of contracts entered into with the debtor

Contracts can be, and are usually, terminated on insolvency unless there is mutual advantage in not doing so.

IPs have a right to the supply of essential services (heat, light and power), but they may be on less favourable terms than were offered to the company.

Contracts of employment are not terminated automatically except in the case of companies wound up by the court. When dismissing employees the IP must follow current employment legislation on consultation if he is to avoid additional claims from employees for unfair dismissal.

Claims for breach of contract can form the basis of a claim in the insolvency; it is likely that these will be unsecured non-preferential claims.

Retention of title over goods supplied and in the UK is not generally recognised, any retention of title claim will be decided on its own merits under UK law. Art 7 EC regulations will apply if the goods supplied are situated in a member state other than the UK.

2.4 Cross-border and specific country entitlements

Unless EC regulations apply, or there are specific provisions in the contract, UK law will apply to all contracts entered into with foreign creditors by the insolvent company.

Foreign creditors do not need a UK domicile to receive communications etc, the UK IP will write to the creditors usual trading address.

QUESTION 3

3. Creditors' rights aimed to monitor the insolvency proceedings

3.1 General creditors' rights

The UK insolvency legislation details the rights of creditors in any insolvency procedure. In general (as ever there are exceptions) all creditors have a right to participate in the insolvency process, this includes the submission of claims, being advised of the commencement of the insolvency, approving the appointment of the IP and his actions in relation to the company, agreeing the fees of the IP, and to be kept informed of progress in the insolvency procedure.

Some of these rights can be delegated to a creditors committee consisting of between three and five creditors or shareholders who are appointed by the general body of creditors.

3.2 Specific rights of information during the proceeding

In a creditors voluntary liquidation it is the shareholders who place the company into liquidation and the general body of creditors must be informed of the insolvency proceedings to allow them to participate in the creditors meeting, to receive a report explaining why the company has failed, and to approve the appointment of the liquidator.

The minimum notice period is 7 clear days, although 14 days is usually given. It is usual at the first meeting for the directors to be present and answer questions put by creditors as to their conduct in relation to the failure of the company. This first meeting is also the opportunity for creditors to appoint a committee to whom the liquidators can report and seek guidance and approval of their actions and fees.

In administration, creditors are advised of the appointment after the event. The IP must communicate with creditors as soon as practicable, 3 days is considered good practice, and issue a report and/or call a creditors meeting to approve the administrators proposals within 8 weeks of appointment (the meeting must be held within 10 weeks of appointment). A creditors' committee can be appointed. In administration, approval of the administrators' proposals can also be achieved by way of a postal vote unless creditors that represent at least 10% of debts in value demand a meeting.

In a Company Voluntary Arrangement, the creditors must receive details of the proposal and be invited to attend a meeting so that they can approve the same. Creditors are also entitled to receive annual and final reports.

Regardless of the procedure, creditors always have the right to receive a report on the outcome of any creditors meeting held, and in the case of liquidation receive an annual progress report, whilst in administration the IP must issue a progress report every 6 months.

On completion of the insolvency procedure, the IP must issue a final report, and in liquidation call a final meeting of creditors at which the final report is approved.

It is considered best practice to keep creditors informed of progress in the insolvency procedure; individual creditor enquiries by telephone and in writing will be responded to promptly by the IP and their staff.

3.3 Approval rights not delegated to a creditors' committee

Creditors must approve the appointment of any creditors' committee, and if a committee is not appointed the IP must seek approval from the general body of creditors for his fees and certain actions.

It is for the general body of creditors to approve the appointment of a liquidator, approve the administrators' proposals and approve the IP's release from office once the insolvency procedure is completed.

The creditors can delegate to the creditors' committee the powers to approve fees, the payment of dividends to creditors, the use of valuers and solicitors, along with a number of other matters laid down in legislation.

A member of a committee is entitled to receive a booklet explaining their rights and responsibilities.

3.4 Cross-border and specific country rights (entitlements)

Foreign creditors are entitled to claim in the insolvency procedure in the same way as UK creditors, the amount of the claim in pounds sterling will be calculated using the official exchange rate.

Creditors claiming retention of title need to be aware that UK IPs regularly defend such claims.

QUESTION 4

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4. Creditors' rights aimed to participate actively in the proceeding

4.1 Creditors' meetings

All creditors are entitled to receive notice of any creditors' meeting called. The location of any meeting is to be at the convenience of the general body of creditors and is usually held in the area where the company traded. However it is possible for meetings to be held remotely such as by way of telephone conference call. It is anticipated in future many more meetings will be held remotely and by electronic means.

In liquidations, creditors will receive a notice calling the meeting, a proof of debt form and a proxy form to nominate a representative at the meeting. That

person can be the chairperson of the meeting and in a creditors voluntary liquidation at the first meeting that would be the director of the failed company.

In administrations and in CVAs the information sent to creditors will be similar to that sent in a liquidation. In addition, there will also be the IP's (in administration) or the company's (in a CVA) proposals to consider. The chairperson in these two procedures will be the IP or a member of his staff experienced in insolvency matters.

When a liquidation is completed, the IP will call a final meeting of creditors to approve the final account and to seek his release from the appointment.

Creditors can also require the IP to call a meeting at the request of 10% by value of creditors' claims.

In administrations and liquidations, resolutions that are passed at meetings can also be dealt with by post.

4.2 Creditors' committee

Creditors may appoint a committee at the first meeting.

The committee is made up of between three and five creditors or shareholders, usually the larger creditors and often non preferential unsecured trade creditors; it would be very unusual for either a director or shareholder to be present on a committee.

There are detailed rules surrounding the conduct of the committee. Its purpose is to monitor the actions of the IP and is a body to which he can turn for guidance and approval of a number of matters.

A committee member must be an individual appointed by a creditor whose claim has not been rejected and that person must not be an undischarged bankrupt. A committee member is entitled to recover their expenses but not to receive any remuneration.

4.3 Other forms of direct creditors' participation

Creditors participate in the insolvency procedure either through the collective processes of the creditors' meeting or through a creditors' committee. Creditors' rights are set out in detail in the insolvency legislation. In general IPs will respond promptly to creditor enquiries and welcome creditor participation in the insolvency process.

4.4 Rights related to reorganisation plans and proceedings

Schemes of Arrangement are not part of UK insolvency law; they are a feature of company law, although it is possible for them to be used in conjunction with an insolvency procedure.

The Scheme is a mechanism by which a company can enter into a compromise or arrangement with its creditors. It can also be used as a restructuring or reorganisation tool. Where a Scheme is proposed, the court on the application of the company, the creditors or members can order a meeting of creditors generally or for any class of creditor.

For a Scheme to receive sanction and be binding, a 75% majority of either creditors or each class of creditors voting must be achieved.

When sanctioned the Scheme binds all creditors. In addition the sanction of the court is required.

The controversies surrounding Schemes relate to the composition of each class of creditor and the classes of creditor excluded from voting. Creditors in a class must have a common interest in the Scheme, and those creditors who are excluded from voting are likely to be those who are 'out of the money' when it comes to payment.

4.5 Cross-border and specific country rights

Foreign creditors in general have the same rights as UK creditors.

QUESTION 5

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5. Creditors' entitlements aimed at controlling the activities of the insolvency representative (the court)

In general the creditors control the activities of the IP through both the creditors' meetings and the creditors' committee.

Ultimately, matters can be referred to the court for adjudication.

5.1 The means by which creditors have to challenge decisions and acts of the insolvency representative

The IP requires a majority of creditors who vote, to approve his proposals and actions. The majority required is determined by the value of creditors voting, and whose claims are admitted for voting purposes.

In creditors' committees each member of the committee has one vote; again a majority is required to approve the IP's actions.

If a creditor is unhappy with the outcome of a meeting he can request a further meeting of creditors, but this must be supported by at least 10% by value of creditors.

If the creditor is still dissatisfied with the outcome of any meeting the matter can be referred to court for adjudication.

5.2 Substitution of the insolvency representative

In the case of **liquidation** a majority of creditors voting by value appoint the liquidator; accordingly it would be unusual for an IP to be replaced as liquidator after the first meeting unless creditors were dissatisfied with his actions.
In addition the court has the power to replace the liquidator.

In an administration the IP's proposals can be rejected by the creditors and this could include the replacement of the IP by one chosen by the creditors, if a majority by value of claims chose to do so.

A creditor in a CVL with the support of at least 25% by value of creditors can requisition a creditors meeting in an attempt to replace the office holder at anytime.

Creditors can also make use of the courts if all else fails and they still feel dissatisfied.

The IP will be replaced if he retires, ceases to be qualified as an IP, or dies.

5.3 Cross-border and specific country rights (entitlements)

Foreign creditors have the same rights as UK creditors.

QUESTION 6

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6. Creditors' obligations

6.1 Responsibility for the remuneration of the insolvency representative

The IP's remuneration is approved by the creditors' committee, if there is no committee or if the committee does not reach a decision approval can be provided at a general meeting of the company's creditors.

Remuneration is traditionally calculated by reference to the IP's time costs in dealing with the matter, or as a percentage of realisations and distributions. The default position if agreement is not reached over the level of fees is by reference to the Official Receiver's scale of fees, which is a percentage of assets realised and funds distributed. In addition to the traditional bases for remuneration, IPs can now agree with creditors either a fixed fee or any special basis for the remuneration they wish to propose.

If the IP and creditors cannot agree a basis for remuneration in a CVL or Administration, the matter can be referred to the courts for adjudication.

The IP's remuneration is usually paid in priority to creditors' claims. In Administration where asset realisations are only sufficient to pay secured and preferential creditors, it is these creditors who determine the amount of the remuneration paid to the IP.

6.2 Funding special activities of the insolvency representative (liquidator)

Creditors are not responsible for payment of the costs and fees of the IP, but subject to approval the costs of the procedure will be paid in priority to any distribution to creditors.

In special cases, where creditors have concerns regarding the management of the company, and want the IP to conduct a detailed investigation into the affairs of the company and where there are insufficient assets to meet the costs, creditors may contribute to a fighting fund.

In some rare occasions the state through HM Revenue and Customs will provide funds to an IP to investigate the affairs of the company, in the hope that additional monies can be recovered.

In addition the IP can enter into conditional fee agreements with solicitors and also insure costs where litigation is proposed and the outcome is uncertain.

6.3 Specific country entitlements

Where the company is wound up by the court, the creditor issuing the proceedings can recover the cost of obtaining the winding up order from the proceeds of the assets realised, in priority to the IP's remuneration and the payment of creditors' claims.

Basic forms

Useful forms and more detailed information can be found here:
www.insolvency.gov.uk/forms/forms.htm

UNITED STATES OF AMERICA

Introduction

The United States Bankruptcy Code (the "Code") is codified as Title 11 of the United States Code ("U.S.C."), and is designed to achieve three fundamental goals. The first is to provide the debtor with a fresh start. The second is to maximize the value of the debtor's property either on a liquidation (Chapter 7) or on a going-concern basis (Chapter 11). The third goal is to afford fair treatment of creditors, shareholders and others with rights and interests in the debtor or debtor's property.

The Bankruptcy Code of 1978, which supplanted the Bankruptcy Act of 1898, has been amended several times over the years. Most recently, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), which made major changes to consumer bankruptcies including the introduction of a "means test" limiting the availability of a discharge of indebtedness in a Chapter 7 consumer liquidation case to individual consumer debtors who earn less than "median income." However, BAPCPA also made significant changes to many aspects of business bankruptcies, in the treatment of executory contracts, in small business reorganization cases and in so-called "single asset real estate" reorganization cases.

Chapter 7 contains the substantive provisions relating to liquidation cases under the Code and provides for appointment of a Bankruptcy trustee. Chapter 9 provides exclusively for the adjustment of debts of a municipality, and Chapter 11 is the general business reorganization statute of the Bankruptcy Code. Chapter 12 is a special reorganization chapter reserved for use by "family farmers", i.e. by small agricultural operations. Chapter 13 is a reorganization chapter of the Code that is only available to individuals with regular income and secured debts of less than $1,010,650 and unsecured debts of less than $336,900.

Bankruptcy petitions are filed in the bankruptcy court in the federal judicial district where the debtor or its principal assets in the United States are located. The bankruptcy court is a "unit" of the United States District Court of the judicial district where the bankruptcy case is filed.

QUESTION 1

1. Creditors' rights before an insolvency proceeding is opened

1.1 Voluntary petitions

A bankruptcy case may be commenced by the debtor (a voluntary case) or by a petitioning creditor or creditors of the debtor (an involuntary case). The vast majority of cases are voluntarily filed by the debtor.

1.2 Involuntary petitions

Creditors may seek to commence an involuntary Chapter 7 or 11 case against any debtor eligible to file a voluntary petition except a farmer or a nonprofit corporation. An involuntary petition must be in the form of a complaint, which must allege that the debtor is generally not paying its debts as they come due

or that a receiver has been appointed to take charge of substantially all of the debtor's assets within the prior 120 days. The petition must be brought on behalf of at least three creditors holding a total of more than $13,475 in non-contingent claims, unless the debtor has less than twelve such creditors, in which case only one creditor will suffice. Creditors contemplating commencement of an involuntary suit should be aware that they may be subject to judgment for costs, attorneys' fees and damages if the petition is dismissed.

1.3 Property of the estate

The filing of the bankruptcy petition creates a "bankruptcy estate" comprised of all legal and equitable interests of the debtor in property as of the date of the bankruptcy filing, including intangible property rights such as intellectual property and causes of action.

1.4 Automatic stay

The filing of a Title 11 bankruptcy case automatically creates a stay, i.e. injunction, prohibiting the commencement or continuation of legal actions against the debtor, property of the debtor, or property of the bankruptcy estate on account of a debt incurred before the commencement of a case. The stay affects pending litigation, informal collection efforts, foreclosures in progress, and virtually all other acts to liquidate or enforce rights against property of the debtor. Generally, the automatic stay does not bar collection action by the creditor against third parties such as non-debtor, co-obligors, guarantors, partners, or sureties.

The bankruptcy court may terminate or modify the automatic stay for "cause", including lack of "adequate protection" or, with respect to an act against property, if (1) the debtor does not have equity in the property, and (2) the property is not necessary to an effective reorganization. If the property is in severe danger of suffering irreparable damage, the court may grant relief to the extent necessary to prevent such damage with or without a hearing.

The bankruptcy court has inherent power to sanction abusive actions by creditors, including violations of the automatic stay, but the court may only award compensable damages under its inherent power to sanction. However, if the debtor is an individual, the bankruptcy court has statutory authority to assess punitive damages in favor of that individual debtor injured by a creditor's willful violation of the automatic stay.

QUESTION 2

2. Creditors' rights aimed to meet claims

2.1 Filing of claims

Under the Code, a "claim" is defined as to be a "right to payment", whether or not it has been "reduced to judgment, is liquidated or un-liquidated, fixed, contingent, matured, un-matured, disputed, undisputed, legal, equitable, secured, or unsecured". A claim also includes the right to an "equitable remedy for breach of [the debtor's contractual] performance", as long as the debtor's breach gives rise to a right to payment.

Sections 501 and 502 of the Code describe how a creditor's pre-bankruptcy ("prepetition") claims are asserted and how they should be treated under the Code. Section 501 requires that claims be filed with the bankruptcy court on a timely basis and limits who can file a prepetition claim. Section 502 describes the process for filing and allowance of claims and, in certain instances, how the amount of the claim is determined. Generally speaking, a creditor asserts a claim against a debtor's bankruptcy estate by filing a "proof of claim" with the bankruptcy court, which states the amount and nature of the claim, and to which the creditor attaches a breakdown or accounting of the claim and relevant contractual documents.

2.2 Secured claims

A "secured claim" is a right to payment that can be enforced either against property in which the debtor has an interest or against a claim of the debtor that is subject to set-off. A secured claim is a creditor's claim that is secured or backed by a lien on real or personal property of the debtor that is perfected, i.e. properly recorded with the appropriate filing officer or office in accordance with the requirements of non-bankruptcy law before a bankruptcy case is commenced. A creditor is entitled to secured status only to the extent of the actual value of its collateral. Thus, the under-secured creditor has two claims: (1) A secured claim to the extent of collateral value, and (2) an unsecured claim for that portion of a pre-petition debt exceeding the value of the collateral securing the claim. A secured creditor is entitled to either recover it collateral by repossession or to foreclose its lien in the collateral after the bankruptcy court has granted the creditor relief from the automatic stay, or, alternatively, is entitled in a debtor's chapter 11 reorganization case, to be paid or to otherwise realize the value of the collateral in accordance with the so-called "confirmation standards" specifying how a chapter 11 debtor's plan must treat the holder of a secured claim.

2.2.1 Survival of secured claim

Secured claims are not discharged and survive the bankruptcy case. Valid prepetition (i.e., pre-bankruptcy) liens securing creditors' prepetition claims survive the bankruptcy case, and are not extinguished by the debtor's discharge of liability in bankruptcy. Secured claims remain enforceable *in rem* after discharge.

2.2.2 Post-bankruptcy interest

An over-secured creditor is entitled to post-petition interest and also, if the underlying debt instrument so provides, to attorney fees and other post-petition contractual charges even if they are not permitted by state law.

2.2.3 Proof of claim

A secured creditor in Chapter 7 must either to be paid the amount of its claim or else retain its right to proceed against the property. Nothing in the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure makes these results depend on the filing of proof of the secured claim. Therefore, the principal reason for any creditor filing proof of a secured claim would be for the creditor to obtain the benefit of an unsecured claim in the amount of any deficiency in the collateral.

2.2.4 Treatment of secured claims

Unless a secured creditor in a Chapter 7 case agrees to different treatment, it is likely either that the trustee will be required to pay the creditor in full, or that the creditor will be allowed to pursue claims against the collateral outside of bankruptcy. Thus, in a Chapter 7 case, the creditor can require more than the value of the collateral in exchange for allowing the debtor to retain it. (See discussion of "lien-stripping", *infra*.). Under a confirmed reorganization plan under Chapters 11 or 12, however, a debtor need only pay the secured creditor the present value of its collateral; the deficiency balance of the secured creditor's claim is treated under the plan as an unsecured claim.

2.2.5 Adequate protection of secured claims

Adequate protection is the Bankruptcy Code's term for the secured creditor's right to preserve and protect the value of its collateral. It delimits the debtor's power to continue the automatic stay against the creditor; to use, sell or lease the creditor's security or to demote the secured creditor's lien. It is the fundamental conceptual underpinning of the preservation of secured creditor's rights in bankruptcy proceedings. A creditor may not be prevented from foreclosing or otherwise realizing upon its security if its value is not adequately protected. Section 361 of the Bankruptcy Code describes three nonexclusive methods, originating under pre-Code law, by which a debtor can provide the secured creditor with adequate protection, including periodic cash payments to compensate for the decrease in value of the collateral; granting the secured creditor additional security or replacement liens; granting the secured creditor other relief (other than administrative priority) that the court determines will give the secured creditor the "indubitable equivalent" of its interest in the property under the bankruptcy estate's control. If the property against which the creditor has a lien is worth more than the indebtedness, there may be a sufficient "equity cushion" to permit post-petition interest to continue to accrue. An "equity cushion" in collateral can therefore constitute adequate protection. A guaranty may be offered as adequate protection, but there must be some reasonable basis to show it will be adequate to the indebtedness. A second mortgage on the debtor's real property discounted by costs of foreclosure, conveyance and delay during the redemption period could also provide a form of adequate protection.

2.2.6 Post-petition status of prepetition security interests (Liens)

Prepetition security interests (liens) in a debtor's personal property do not extend to personal property acquired by the debtor after its bankruptcy filing. For example, a creditor's security interests in a debtor's pre-bankruptcy inventory, equipment, and accounts receivable granted by the debtor before its bankruptcy filing to secure the creditor's claim do not extend to a Chapter 11 debtor's inventory, equipment, and accounts receivable which are acquired post-petition. Before bankruptcy, the creditor's liens "float" continuously to new inventory and equipment acquisitions by the debtor and to new accounts acquired by the debtor. Those liens stop "floating" as of the date of the debtor's bankruptcy filing, and will not attach to the same classifications of property which the debtor acquires post-petition. Often, however, the bankruptcy court will approve a stipulation between a secured creditor and the debtor granting continuing post-petition security interests in same classes of property in which that creditor enjoys prepetition security interests in consideration of the creditor's agreement to permit the debtor use its "cash collateral" in consideration of a new post-bankruptcy loan by the creditor to the debtor for operating expenses. (See "Cash Collateral"*, infra)*.

2.2.7 "Lien-stripping"

The most important point about secured claims in Chapter 7 is the limited extent to which these claims can be affected by the bankruptcy. Chapter 7 debtors occasionally seek to "strip down" secured debts, that is, to keep the collateral securing the debt while paying the secured creditor only the value of the collateral, which may be much less than the debt. In this way, any post-petition appreciation in the property would inure to the benefit of the debtor. However, this "stripping down" of liens is generally unavailable in Chapter 7.

2.2.8 Relief from the automatic stay

A secured creditor may move the bankruptcy court to terminate or modify the automatic stay for the following reasons for "cause", including the lack of adequate protection; or if the debtor does not have equity in the property and the property is not necessary for an effective reorganization under 11 U.S.C. § 362(d)(2). If the court grants the motion, then the secured creditor may proceed under non-bankruptcy law to liquidate its collateral.

2.2.8.1 Burden of proof

A secured creditor has the burden of proving the value of its collateral, but creditor moving for stay relief should not attempt to prove unrealistically low collateral values. Even though a low collateral valuation will aid in litigation regarding relief from the stay, establishing too low a value may rebound against the secured creditor in approaching a plan of reorganization where the secured creditor benefits from a high evaluation for the collateral.

2.2.8.2 "Superpriority" claim for lack of adequate protection of secured creditor's interest in debtor's property, and dangers of loss of lien priority

The aggressive creditor is rewarded. The secured creditor is entitled to a "superpriority" claim if adequate protection granted by the court proves

to be inadequate, but the creditor must have requested adequate protection from the court to be eligible. The diligent creditor is also aware of the continuing risks that the estate or another creditor can be boosted ahead of its secured position and monitors the case continually against those possibilities. Bankruptcy courts often grant a new, post-petition lender making a post-bankruptcy loan to a debtor-in-possession a "priming" lien, i.e. a first priority lien on the debtor's assets ahead of all other secured creditors.

2.2.8.3 Perishable collateral

Accounts receivable and inventory collateral are usually perishable and require prompt action to protect their values. The "floating lien" (*see* ¶ 2.2.6, *supra.)* stops floating as of the filing of the petition. Also for any accounts or inventory created during the 90 days before bankruptcy a preferential payment problem is likely to have arisen; certain payments to, or liens arising in favor of, creditors within 90 days before the debtor's bankruptcy filing while the debtor was insolvent can be reversed or recovered by a Chapter 11 debtor. If the secured creditor wants the debtor to operate and to maintain its secured position in the receivables and inventory post-petition, the debtor must execute and the creditor must perfect a new security agreement with court permission and with notice to all affected creditors.

2.2.8.4 Enforceability of court-approved stipulations

2.3 Administrative expenses

An "administrative expense" is a priority claim that is attractive to creditors because it enjoys an especially high ranking in the priority of claims that are paid from assets of the bankruptcy estate. "Administrative expenses" are paid by the bankruptcy estate (i.e., by a bankruptcy trustee or chapter 11 debtor-in-possession) before either "priority claims" or general unsecured claims are paid. Generally speaking, administrative expenses are claims incurred post-petition (i.e. after the commencement of a case) by the bankruptcy estate. They include the necessary and reasonable costs of post-petition operation of a Chapter 11 debtor-in-possession's business, such as wages, salaries and commissions for services rendered after the commencement of a bankruptcy case; taxes incurred by the trustee or debtor-in-possession after the commencement of the case; rental payments for the debtor's post-petition use of real estate or equipment, as well as court-approved compensation of professionals hired by a chapter 11 debtor-in-possession or trustee.

2.3.1 Reclamation of goods claims

Section 503(b)(9) of the Bankruptcy Codes is one of only a few instances where a claim that arises prepetition is treated as an administrative claim. Rarely has Congress authorized a prepetition expense to be elevated to treatment under §503(b). Other instances include the actual and necessary expenses incurred by a petitioning creditor that files an involuntary bankruptcy petition against a debtor, and the reasonable compensation for professional services rendered by an attorney or an accountant to a petitioning creditor. In 2005, Congress added a new category of administrative expense claims - claims allowable by sellers and deliverers of goods delivered during the last 20 days before a bankruptcy filing. These new administrative claims are very

common and often have a much higher dollar value than other administrative claims. It is quite common that any retail, health care or manufacturing debtor on the verge of bankruptcy orders and receives goods in the weeks immediately before it files a Chapter 11 case in an effort to keep the business operating.

2.4 Priority claims

Priority claims are paid before all other claims. This group of claims includes, most significantly, "administrative expenses"; various tax claims; family support claims in the nature of alimony, for maintenance, or support of a spouse, former spouse or child; wages, salaries and commissions earned within 180 days before the commencement of the bankruptcy case not exceeding $10,950.

2.5 General unsecured claims

At the lowest level of priority to be paid from the assets of the bankruptcy estate are general unsecured claims, which are claims not backed by a lien and which are not entitled to priority. They are the last claims to be paid. In liquidation cases under either Chapter 7 or under a Chapter 11 liquidating plan, these claims often go unpaid, or are paid only in part on a *pro rata* basis.

2.6 Executory contracts and unexpired leases

Creditors' claims under either so-called "executory contracts" (i.e., pre-bankruptcy contracts that have not been substantially performed by both contracting parties before a debtor's bankruptcy filing) or unexpired leases are entitled to special treatment under the Bankruptcy Code. A bankruptcy trustee or chapter 11 debtor must decide whether to "assume" or to "reject" the executory contract or unexpired lease. Assumption entails curing all defaults and continuing to pay the creditor or lessor, according to the terms of the executory contract or unexpired lease. Rejection of an executory lease of equipment or other personal property lease entitles the creditor to assert an unsecured claim for his damages against the bankruptcy estate as of the date of the debtor's bankruptcy filing. Rejection of an unexpired real estate lease gives the creditor a priority claim.

2.6.1 Time for assumption or rejection

In a Chapter 7 case an unexpired lease of residential real property or of personal property must be assumed by a trustee within 60 days after the commencement of the case, or prior to one extended date that the court can grant and establish for cause shown within the 60-day period. If the lease is not assumed, it is deemed to have been rejected as of the date of the debtor's bankruptcy petition filing. For cases under Chapters 9, 11, 12 and 13 the trustee or the debtor-in-possession may assume or reject an executory lease of residential real property or personal property at any time before plan confirmation. However, the lessor may request and obtain an order of the court fixing the date by which the trustee or the debtor must make the decision whether the lease is to be assumed or rejected. A single rule governs treatment of leases of nonresidential real property under all chapters of the Code (Chapters 7, 9, 11, 12 and 13): The trustee or debtor must assume

nonresidential real property leases within 120 days after the date of the filing of the debtor's bankruptcy petition or, alternatively, the debtor or the trustee must move within that 120-day period for an extension of time period for assuming or rejecting a lease of nonresidential real property. Otherwise, the lease is deemed to have been rejected as of the date of the commencement of the bankruptcy case.

2.7 Abuse of the bankruptcy process: Bad faith filings

Bankruptcy courts are courts of equity and may draw upon their residual equitable powers to dismiss cases found to have been filed by debtors in bad faith. A determination that a case has been filed in bad faith may also constitute "cause" for granting a creditor relief from the automatic stay. A good faith determination depends upon the bankruptcy court's evaluation of debtor's financial condition, motives and the prevailing financial realities. The court states that the indicia of bad faith include factors such as a single encumbered asset, few employees, little cash flow, few unsecured creditors, pending foreclosure, and the so-called "new debtor syndrome" (*see, infra*). Where there is no going concern to preserve, no employees to protect and little hope of rehabilitation, neither the court nor the creditors should be subjected to the costs and delays of a bankruptcy case.

2.7.1 Frequent filings

One particularly troublesome manifestation of the bad faith filing problem is found in the so-called "new debtor syndrome." This affliction is characterized by a debtor which is an entity created on the eve of the bankruptcy filing. It appears with some frequency among real estate developer bankruptcies. It has been held that a transfer of distressed property to a newly-formed entity shortly before that entity's Chapter 11 filing creates a presumption of bad faith.

2.8 Treatment of creditors' claims in cross-border insolvency cases

A new Chapter 15 to the Bankruptcy Code has been enacted based upon the Model Law on Cross-Border Insolvency promulgated by UNCITRAL (the United Nations Commission for International Trade Law), and provides for the recognition of foreign insolvency proceedings by United States bankruptcy courts. Chapter 15 includes several provisions which are designed to protect foreign creditors and to ensure that they are treated fairly.

2.8.1 Nondiscriminatory treatment of foreign claims

Code § 1513 explicitly provides that "[f]oreign creditors have the same rights regarding the commencement of, and participation in, a case under this title as domestic creditors." The meaning of a foreign creditor's rights "regarding the commencement" of a Chapter 15 case is not clear. There is no provision in Chapter 15 for the involuntary commencement by creditors, whether domestic or foreign, of a Chapter 15 case. The entire text of Bankruptcy Code § 1513 appears to relate principally to distributive issues, ensuring that foreign and domestic creditors are treated equally. Section1513 mandates nondiscriminatory or "national" treatment for foreign creditors.

2.8.2 Priority of foreign claims

Nevertheless, the law as to priority for foreign claims that would apparently fit within a class given priority treatment the Bankruptcy Code (for example, claims of foreign employees or spouses) is unsettled. Section 1513 permits the continued development of case law on that subject and its general principle of nondiscriminatory treatment should be a cardinal principle to be considered. At a minimum, foreign claims must receive the treatment given to general unsecured claims without priority, unless they are in a class of claims in which domestic creditors would also be subordinated.

2.8.3 Proofs of claims and notice of commencement of Chapter 15 cases

Foreign creditors have the right to file proofs of claim when a Chapter 15 case is commenced "recognizing" a foreign insolvency proceeding. Code § 1514(a) requires that whenever notice is required to be given to either general classes of creditors or to categories of creditors, the notice must also be given to known creditors without addresses in the United States, and the court "may order that appropriate steps be taken with a view to notifying any creditors whose address is not yet known." The notice is required to be given individually, unless the court orders otherwise. The notification given to foreign creditors of the commencement of a Chapter 15 must indicate when claims must be filed and whether secured claimants need to file a claim. It must also contain all other information that a notice under the Bankruptcy Code would normally include. Finally, the court is required to provide reasonable additional time to serve foreign creditors.

QUESTION 3

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3. Creditors' rights aimed to monitor insolvency proceeding

The Bankruptcy Code and Federal Rules of Bankruptcy Procedures give creditors ample opportunity to monitor and participate actively in asserting their rights in bankruptcy proceedings as well as to reporting from Trustees, debtors and Creditors' Committees.

3.1 Duty of a bankruptcy trustee or debtor-in-possession to provide information

Both a bankruptcy trustee and a Chapter 11 debtor-in-possession have fiduciary duties to creditors, and are required by the Code and by the Rules to give creditors information requested by creditors.

3.2 Creditors' access to filings with bankruptcy court

A creditor may inspect the bankruptcy court's files and docket on any particular case either in person at the office of the bankruptcy clerk, or electronically by registering for use of the so-called "PACER" service which provides on-line access to the court's dockets and files. In addition, a creditor can file a "request

for notice" requiring the court and other parties to serve the creditor with all pleadings, orders and reports filed in the bankruptcy case. In most judicial districts, pleadings and reports are filed electronically, and any creditor who has registered with the court and consents to be served electronically is sent an e-mail with a link to that document as soon as it is filed with the court. Similarly, a creditor has instant access to the electronically filed "claims register" showing all filed creditors' claims filed in any bankruptcy case. Creditors can also monitor the Chapter 11debtor's on-going reorganization efforts by examining on-line a Chapter 11 debtor's monthly operating reports which include comparative income statements and balance sheets and which are required to be filed with the court.

3.3 Duty of the creditors' committee to provide information

Creditors Committees are obligated to provide access to information to non-Committee members - this may raise issues including related to confidentiality, privilege, trade secrets and claims trading. Creditors' committees are formed to represent creditors in Chapter 11 cases. The committees are appointed by the United States Trustee as soon as practicable after the Chapter 11 bankruptcy is filed. Their role is to be the principal overseers and negotiators for the creditors with respect to the operation of the debtor-in-possession, the formulation of the debtor's plan of reorganization, and other matters such as the potential conversion of the case from a Chapter 11 reorganization to a Chapter 7 liquidation.

3.4 Hearings

Shortly after the commencement of every bankruptcy case, a so-called "§341 hearing" or "first meeting of creditors" is convened and is presided over by the appointed trustee in a case filed under Chapter 7, 12, or 13, or by a representative of the Office of the United States Trustee in a Chapter 11 case. Creditors are free to attend, monitor, and ask questions of the debtors.

3.5 2004 Examinations

A creditor may file a motion with the bankruptcy court seeking the court's order requiring the debtor or any other person affiliated with the debtor to submit to an examination under oath about any aspect of the debtor's business operations, debts, assets, and finances and to produce financial records. The scope of the examination is very broad, and it provides an excellent opportunity for the creditor to acquire whatever information and documents the creditor requires in order to represent its interests in the debtor's bankruptcy case.

3.6 Chapter 11 disclosure statement

Another good source of financial information about a Chapter 11 debtor for creditors is the Chapter 11 disclosure statement that a Chapter 11 debtor must file at the time it proposes a plan of reorganization or of liquidation. A proposed Chapter 11 plan of reorganization or of liquidation must be accompanied by a disclosure statement when it is filed. The disclosure statement must provide those creditors entitled to vote on the plan with "adequate information" reasonably necessary to make an informed decision when voting for or against the proposed chapter 11 plan. Any creditor in the Chapter 11 case may request a copy of the

disclosure statement. Changes in a plan are often negotiated in the days just prior to the hearing on the disclosure statement. No one may solicit votes on the plan until an approved disclosure statement is distributed to creditors.

QUESTION 4

4. Creditors' right to participate actively in the proceedings

4.1 Discovery of information and production of documents

Creditors may obtain information and documents relating to a debtor's bankruptcy case from the case trustee or debtor-in-possession, at the § 341 hearing, through a 2004 examination, and by reading a plan proponent's disclosure statement accompanying the filing of a Chapter 11 plan. Under certain circumstances, a creditor also has the right to take depositions of witnesses or to require other parties to produce documents with respect to issues raised in "contested matters" initiated by motions or in "adversary proceedings" initiated by complaints filed with the bankruptcy court in order to prepare for hearings or trials before the court.

Secured creditors should reduce stipulations regarding adequate protection and relief of stay to writing. In "settling" stay litigation, creditors are well-advised to try to include automatic termination of stay for noncompliance with the settlement agreement. Courts will enforce such stipulations.

4.2 Debtor-in-possession's use, sale or lease of property of bankruptcy estate

A debtor-in-possession or trustee authorized to operate a business may generally use, sell or lease property of the bankruptcy estate (except cash collateral) in the ordinary course of business without obtaining court approval. Creditors and creditors' committees should be vigilant to ensure that the bankruptcy estate is not dissipated by the debtor's mismanagement, sale or use of those assets by the debtor out of the ordinary course of business. Secured creditors who fear that their collateral is threatened by the debtor's continued possession or use should move the court for adequate protection and seek an order from the court prohibiting or conditioning the debtor's use of the collateral. A secured creditor may bid its lien claim at a sale by the trustee or debtor-in-possession and offset its claim against the purchase price. If the debtor-in-possession or trustee proposes to use, sell or lease property out of the ordinary course of business, the debtor must first obtain court approval following notice and hearing.

4.3 Cash collateral

The debtor-in-possession may not use "cash collateral" without either secured creditor approval or authorization of the bankruptcy court. The Bankruptcy Code defines cash collateral as "cash, negotiable instruments, documents of title, securities, deposit accounts or other cash equivalents and includes the proceeds, products, offspring, rents or profits of property" subject to a

prepetition security interest, whether such property was converted to cash prior to or after the commencement of the case. The debtor-in-possession or the trustee may not use cash collateral unless (1) each entity with an interest therein consents, or (2) the court authorizes the use after notice and hearing. A creditor with a lien in cash collateral may file a motion to prohibit the debtor's use of cash collateral unless the creditor is granted appropriate adequate protection. The result is usually a negotiated adequate protection agreement which obligates the debtor to protect the creditor's interest by, e.g., maintaining a stipulated inventory level; submitting periodic financial reports regarding sales volume and cash receipts and disbursements; making period cash or an adequate protection payment to offset ongoing depreciation of tangible personal property collateral; or insuring the maintenance of a specified amount of insurance on the collateral.

QUESTION 5

5. Creditors' entitlements aimed at controlling the activities of the insolvency representative

5.1 Creditors' power to control the administration and disposition of the bankruptcy process

The Bankruptcy Code grants creditors ample rights to protect their interest and to influence the disposition and administration of a bankruptcy case. Creditors have the right to be heard by the court on essentially any aspect of a bankruptcy case affecting the creditors' interest in property of the estate, in the Chapter 11 debtor's post-petition operating of its business, in a trustee's administration of the estate. The United States Trustee's office, a division of the United States Department of Justice, appoints an unsecured creditors committee in Chapter 11 case from the twenty largest unsecured creditors. The U.S. Trustee may also appoint other committees of creditors or equity holders as the circumstances warrant.

5.2 Conversion to Chapter 7 or dismissal of a Chapter 11 case

A creditor, the U.S. Trustee, a creditors' committee or any other "party in interest" with a stake in a Chapter 11 case can request the bankruptcy court to convert a Chapter 11 case to a liquidation case under Chapter 7 administered by an independent bankruptcy trustee. The 2005 amendments to the Bankruptcy Code have made the grounds for conversion or dismissal of a Chapter 11 case more favorable to creditors. Unless the court identifies unusual circumstances establishing that conversion or dismissal is not in the best interests of creditors, the court must convert or dismiss for cause. Thus, the burden appears to have shifted in favor of the creditor. The historical, statutory factors that constituted cause for conversion or dismissal (e.g., gross mismanagement, continuing loss or diminution to the estate and lack of a reasonable likelihood of rehabilitation) remain as part of the amended statute. The debtor can establish unusual circumstances if it can establish that there is a reasonable likelihood of confirming a plan within certain statutory time

periods. In addition, if cause to convert or dismiss exists because of some act or omission, the debtor can establish reasonable justification and demonstrate that it will be cured within a reasonable time fixed by the court.

5.3 Appointment of an examiner or of an Independent Trustee in a Chapter 11 case

Creditors may file a motion with the court to replace a Chapter 11 debtor-in-possession with an independent bankruptcy trustee, or, alternatively, to request the court to appoint an examiner to investigate the financial affairs of the debtor. The court will grant that relief upon a showing of "cause, including fraud, dishonesty, incompetence, gross mismanagement of the affairs of the debtor by current management", either before or after the filing of the Chapter 11 case, if such appointment is in the interest of creditors and other stakeholders in the Chapter 11 case.

5.4 Creditor authorization to exercise the avoidance powers of the debtor-in-possession

If a Chapter 11 debtor-in-possession fails or refuses to bring an action to set aside preferential payments or to recover a fraudulent transfer or otherwise to exercise the foregoing powers of the debtor-in-possession to augment the bankruptcy estate, then on a motion by a creditor or the unsecured creditors' committee, the bankruptcy court, after notice and a hearing, may authorize that creditor or the creditors' committee to take legal action to set aside or to recover those transfers if it is shown to be in the best interest of creditors to do so.

QUESTION 6

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6. Creditors' obligations

6.1 Honesty and good faith

A secured creditor has no obligation to the bankruptcy estate other than honesty in filing claims and obeying court orders and refraining from violating the automatic stay.

6.2 Costs of administration

Secured creditors are not responsible for paying the costs of administration of a bankruptcy case. The costs of administration of a bankruptcy case, including the compensation of a bankruptcy trustee, and professionals retained by a trustee or by a debtor-in-possession are administrative expenses that are paid from the unencumbered assets of the estate prior to distribution of payments to priority or unsecured creditors. Generally, a secured creditor's collateral may not be looked to as a source of payment of costs of administration of a bankruptcy case. Only with the consent of a secured creditor may a trustee or debtor-in-possession surcharge the property securing the creditor's claim with the costs of specifically preserving that collateral.

Basic forms

Forms used by secured creditors are prescribed by local bankruptcy court rules or by the customs of local practice. A standardized proof of claim form must be used for filing proofs of claims with the bankruptcy court. Since the proof of claim form has been revised frequently, creditors should download the most current version from the website of the bankruptcy court in which they intend to file a claim, and consult with competent bankruptcy counsel.

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