INSOL INTERNATIONAL

MSMEs – PRACTICAL CHALLENGES AND RISK MITIGATION POST COVID-19

INSOL INTERNATIONAL

International Association of Restructuring,
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PRESIDENT'S INTRODUCTION

The World Bank has estimated that micro, small and medium sized enterprises (MSMEs) represent over 95% of enterprises and account for more than 60% of employment worldwide. With limitations regarding their ability to self-protect against insolvency risk, their susceptibility to systemic demand and supply shocks, their limited capital reserves and their level of debt overhang, MSMEs are in a vulnerable predicament as government fiscal and insolvency relief measures are wound back and the world endures difficult economic circumstances and tightened monetary policy measures.

This new publication from INSOL International, *MSMEs – Practical Challenges and Risk Mitigation Post Covid-19*, provides a timely overview of the informal, hybrid and formal restructuring and insolvency options available to MSMEs in the event of financial distress in 29 jurisdictions across the world. It also outlines the interim measures adopted by governments in those jurisdictions during the pandemic, and assesses the success of those measures in preserving the financial stability of MSMEs and maximising the prospect of a successful restructuring.

Each of the 29 chapters also provides an update on the latest insolvency reform measures either introduced or contemplated to provide streamlined restructuring and insolvency alternatives for MSMEs. This is especially important, with INSOL, the World Bank and UNCITRAL having identified the need for bespoke MSME processes beyond the "one size fits all" formal insolvency alternatives that are generally suited for larger enterprises.

Ultimately, given MSMEs' contribution to domestic, regional and global GDP and employment, creating flexible, efficient and cost-effective restructuring and insolvency alternatives for MSMEs is critical to ensure broader economic and financial stability, job maintenance, innovation and growth in our global economy.

Following the introduction of MSME restructuring and insolvency alternatives in the United States, Myanmar, Singapore, India and Australia in the last several years, it is hoped that similar measures will be introduced in other regions as we continue to navigate current economic conditions.

This book will provide a valuable contribution to our members worldwide, and will serve as a foundation to support ongoing law and policy reform and capacity building in coming years.

INSOL thanks each of the contributors from the 29 jurisdictions covered in this book, as well as the leader of this project, Rocky Gupta, INSOL Fellow, of UNITEDJURIS, India for committing their time, energy and expertise to ensure the completion of this book.

I hope you enjoy reading this excellent resource.

Scott Atkins
INSOL Fellow & President
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December 2022

FOREWORD

This is a special INSOL International publication which explores the insolvency frameworks and special insolvency procedures that exist for MSMEs in 29 jurisdictions worldwide. The publication also provides an overview of the interim fiscal stimulus and insolvency relief measures that were introduced during COVID-19 and the systemic challenges that MSMEs face – such as access to new money and the stigma associated with insolvency – in attempting to restructure their affairs.

Across these 29 jurisdictions, this book concentrates on the diverse tools available to facilitate the reorganisation and restructuring of MSMEs and the possible best solutions and strategies for economic distress alleviation. One of those tools, mediation, is a particular focus point and this book assesses the effectiveness of mediation as a viable restructuring tool.

For each jurisdiction, the book also includes feedback from experienced practitioners on what they see as being the best way to safeguard the interests of MSMEs and whether simplified processes exclusively for MSMEs would enhance the likelihood of a successful restructuring.

The idea of this project came in mid-2020 when the pandemic was at its peak and many businesses and companies had started getting into financial and operational distress. This was not a local phenomenon, but a global one. MSMEs, being one of the major contributors to GDP and collectively constituting almost 90% of the businesses in most jurisdictions, were facing the full impact of the pandemic.

I hope that this book will be a valuable tool for practitioners, academics and the judiciary across the world and may serve as the basis for future law reform locally, regionally and globally.

This project would not have been possible without the help and support of a team of professionals associated with this project. The initial acknowledgement must however go to the Technical Research Committee of INSOL International and Dr Sonali Abeyratne, Dr Kai Luck and Ms Waheeda Lafir in particular for all their assistance throughout the completion of the project, and of course to all the chapter contributors to the book globally for their time, expertise and commitment.

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ARGENTINA

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

Argentine insolvency law is governed by Act No 24.522 of 20 July 1995, as amended in 2002 (Act 25.589), 2006 (Act 26.086) and 2011 (Act 26.684), constituting the Argentine Insolvency Law (AIL).

The AIL outlines three statutory types of court-supervised proceedings that may voluntarily be commenced by a distressed company:

- a reorganisation proceeding, referred to as a *concurso preventivo*;
- an *acuerdo preventivo extrajudicial*, or APE restructuring proceeding, which is similar to a United States "pre-packaged" Chapter 11 proceeding; and
- a *quiebra*, or liquidation proceeding, comparable in goals to a United States Chapter 7 proceeding, performed under court control and supervision, seeking to liquidate the bankrupt company's assets and distribute the proceeds among its creditors in proportion to their respective claims and / or credits.

A concurso preventivo is similar to a reorganisation under Chapter 11 of the United States Bankruptcy Code (nowadays more similar to a Subchapter V) in that its main purposes are: (i) the reorganisation of a debtor's business in order to avoid liquidation; (ii) the development of a plan for the payment of creditor claims; and (iii) the emergence of the company from the proceedings as a viable entity.

Throughout a *concurso preventivo*, a debtor continues in the possession and maintenance of its properties and the operation of its business, under the supervision of a court-appointed supervisor or trustee (*síndico*) and a creditors' committee (*comité de control*, which also includes a representative of the employees), while it develops a plan of reorganisation or *acuerdo preventive,* which means the financial terms of the restructuring process.

1.2 Specific insolvency legislation

There is no specific insolvency legislation for MSMEs in Argentina.

Nonetheless, sections 288 and 289 of the AIL regulate what the AIL refers to as "Of Small Restructurings and Liquidations", but within those two sections there is no special insolvency regulation for MSMEs.

Section 288 only defines what qualifies as a "small restructuring and / or liquidation":

- the overall debt should be less than 300 minimum wages (*salario mínimo vital y móvil*);[1]

[1] By January 2022, the minimum wage wass AR $33.000. Therefore, the legal standard in section 388.1 would be AR $9.900.000, which expressed in US dollars (at the current official rate) would mean a total debt under US $95,000.

- there should not be more than 20 unsecured creditors; and
- the debtor should not have more than 20 employees.

Finally, section 289 only provides those few features of the general proceeding that are not applicable to MSMEs:

- two requirements for the *concurso preventivo* filing: (i) a detailed statement of assets and liabilities (section 11.3 of the AIL); and (ii) a list of creditors, indicating amounts of their claims, the grounds (or basis) for the claims, the dates on which the obligations became due and whether there are mortgages or pledges (referred to as privileges) relating to the claims (section 11.5 of the AIL) do not need to be adjoined with a CPA certification;[2]
- there is no need to create the creditors' committee;[3]
- section 48 of the AIL (competing reorganisation plans from third parties when the debtor fails to obtain the approval for its plan) is not applicable; and;
- the trustee (*síndico*) will oversee the fulfilment of the restructuring plan in case a creditors' committee is not created.

As can be seen, there are no legal provisions in the AIL that make it easier, less costly, quicker or in any other way more advantageous for MSMEs compared to the general / common proceedings.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

In Argentina, Law 24.522 in 1995 introduced the *acuerdo preventivo extrajudicial* or APE. As explained above, it is similar to a "pre-pack" proceeding under the United States Bankruptcy Code.

After being significantly improved with Law 25.589 in 2002, now the AIL provides for two different types of APEs, one regulated and the other unregulated.

The unregulated APE is simply a full out of court restructuring between the debtor and its creditors which is only enforceable against those creditors that effectively accept the plan. The legal framework of unregulated APEs is mostly the Civil and Commercial Code.

On the other hand, in the regulated APE, although the plan is negotiated out of court, if the debtor obtains the same majorities established in section 45 of the AIL for the approval of a plan within a *concurso preventivo*, the debtor may file the APE for confirmation (*homologación*) to be granted by a competent court.

In the regulated APE, certain specified majorities of creditors must consent to the terms of the plan of reorganisation on a class-by-class basis: (i) more than 50% of

[2] Nevertheless, some courts do ask for those CPA certifications even in small *concursos preventivos*.
[3] Again, most courts do organise the *comité de control* in small *concursos preventivos*.

all unsecured creditors, determined on a headcount basis, regardless of the principal amount of the unsecured debt held (headcount majority); and (ii) at least 2/3 of the aggregate principal amount (plus accrued but unpaid interest) of the unsecured debt (principal majority).

The 2002 AIL amendment provided that the approval of an APE by a competent Argentine court would make it binding on all unsecured creditors that: (i) were creditors prior to the date of the filing of the APE petition; and (ii) are included in the APE, whether or not those creditors consented to the APE. This binding effect on all affected unsecured creditors subject to the terms of the restructuring agreement, while avoiding certain expenses and lengthy procedural stages usually involved in a *concurso preventivo*, converted the APE proceeding into a very useful restructuring tool.

Unfortunately, the experience during the last 20 years clearly shows that the regulated APE proceeding is not used by MSMEs, mainly because this type of out of court restructuring proceeding demands high levels of sophistication both from the debtor and creditors and, therefore, the regulated APE has only been a superlative restructuring instrument for debtors of considerable size.

During pandemic times, there have been several projects attempting to amend the AIL which introduce features aiming to facilitate the use of the APEs for MSMEs, for example conciliation, mediation or other alternative dispute resolution (ADR) tools. None of those projects have yet been enacted into law.

1.3.2 Informal framework

As explained above, other than the formal (regulated) out of court proceeding, debtors can seek the assistance of financial institutions to get concessions in their loans and credit pursuant to the internal rules and regulations of the financial institutions.

1.4 Accelerated restructuring or liquidation of MSMEs

A regulated APE provides for an accelerated restructuring framework. However, as noted, very few MSMEs have used regulated APEs for accelerated restructuring in practice.

1.5 Discharge of debts for natural persons

Section 68 of the AIL provides a legal framework for those natural persons that, being guarantors of the main debtor (generally a company related to the natural person), face the need to file a personal restructuring proceeding associated with the main proceeding.

Regarding specifically the discharge of debts for natural persons, according to the AIL there are two ways to effect a discharge: the first one within a restructuring proceeding (whether a *concurso preventivo* or an APE), and the second one within a liquidation proceeding (*quiebra*).

As extensively explained below, the "classical" discharge of debts for natural persons can only be found in a *quiebra*.

But within a restructuring proceeding of a debtor (natural person or not), after a restructuring plan is confirmed by the court, unless it is afterwards declared null and void,[4] according to section 55 of the AIL all the pre-filing claims affected by the confirmed plan are extinguished and replaced (novated, or *novación*) by the new debts arising from the plan. The old debt is "discharged".

Nonetheless, the "classical" scope of the discharge of debts for natural persons comes as a result of sections 107 and 236 of the AIL, in a liquidation proceeding.

Specifically, automatically with the bankruptcy / liquidation decree, the debtor is dispossessed of all his or her assets (except for those specifically excluded in section 108 of the AIL) and is also disabled (*inhabilitación*) from engaging in commerce for the term of one year and cannot be a shareholder, member, director or proxy of any company.[5]

This *inhabilitación* lasts initially for one year,[6] and unless it is reduced and or prolonged (both situations associated with the debtor not being or being subject to criminal investigations), it ceases *ipso facto* after that one year period.

After the *inhabilitation* ceases, all the assets that the bankrupt debtor acquires will be free and clear of the still ongoing liquidation proceeding. In other words, those new assets acquired by the debtor after his or her *inhabilitation* will not be part of the insolvency estate.

All the debts that are not satisfied within the proceedings of the full liquidation of the insolvency estate are definitely discharged.

Scholars have heavily criticised the amplitude of this discharge of debts for natural persons on the basis of:

- subjectivity – only good faith debtors should be granted the discharge (currently, being subject to a criminal investigation under section 236 of the AIL does not exclude other bad faith debtors);

- objectivity – multiple types of claims should be excluded from discharge (such as alimony and other liabilities to pay maintenance to any person under family law, liability to pay fines imposed by a court or tribunal, and liability to pay extra contractual damages for wilful misconduct or gross negligence); and

- timing – there should be a minimum number of years between one discharge and the next one.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

During the pandemic, there were no amendments made to the AIL regarding the simplification of insolvency proceedings for MSMEs in particular, and / or to all debtors in general.

[4] AIL, s 60.
[5] *Idem*, s 238.
[6] *Idem*, s 236.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

There were no suspensions to the requirement to initiate insolvency or liquidation proceedings. Nonetheless, during 2020 and 2021, very few insolvency and liquidation proceedings were in fact initiated, mostly due to the position taken by the financial creditors and the Federal Tax Authority (*Administración Federal de Ingresos Públicos* or AFIP) in Argentina to *de facto* extend the deadlines for the payments of the corresponding credits and taxes.[7]

In the absence of legislative reform, due to political short-sightedness, it was the judges who courageously adopted numerous decisions which in practice resulted in fruitful and concrete solutions for the development of bankruptcy proceedings that were already developing.

In order to understand debt restructuring proceedings under the AIL, a brief description of the so-called "exclusivity period" and the timetable for reorganisation proceedings is necessary.

Pursuant to article 14 of the Argentine Bankruptcy Law (LCQ) (24.522), the court decision that decrees reorganisation proceedings are to be opened must set several procedural dates on which certain relevant legal acts should take place during bankruptcy proceedings. Determining the bankruptcy timetable means, in practice, adapting the deadlines generically determined in the LCQ to each specific case. The final segment of such proceedings is the so-called "exclusivity period", within which the bankrupt debtor has the exclusive power to formulate proposals for a scheme of arrangement to the creditors and the latter can choose to accept or reject them.

This exclusivity period is expected by legislation to last 90 working days.[8] It is appropriate to recall here that the LCQ itself has provided for the possibility of extending the exclusivity period by a further 30 judicial working days, depending on the number of creditors, the categories proposed and their location in different jurisdictions, among other considerations.

In the face of the global crisis caused by COVID-19, the vast majority of debtors that were going through debt restructuring proceedings have tirelessly and emphatically requested that the end of the exclusivity period should be set taking into account the socio-economic crisis that has hit Argentina and the world, and paying particular attention to the harmful consequences suffered by the debtor company and the economy as a whole. Depending on the case, the extension of the exclusivity periods that were in progress and those affected by the onset of the pandemic and the provisions of the National Executive's ASPO and DISPO measures should be extended. On the other hand, debtors that had just started bankruptcy proceedings requested that the COVID-19 factor be taken into account so that the exclusivity period would be longer than in ordinary times.

[7] Besides two tax and social security debts moratoria approved by the Congress in 2020 and 2021, specifically the AFIP passed certain resolutions suspending tax and social security debts for MSMEs.
[8] AIL, s 43.

Thus, we observe three types of central decisions adopted by the judges:

- the decision to order reorganisation proceedings to be opened while suspending the determination of dates of the bankruptcy calendar or timetable;
- many decisions providing for the extension of the exclusivity period in progress; and
- several pronouncements providing for the postponement of the due date for payment of bankruptcy instalments already due or about to fall due.

In each of these cases, as a general rule, there is a softening and extension of the deadlines originally ruled, all under the premise of guaranteeing the scheme of arrangement solution and, in effect, the survival of the companies and the sources of employment they supported.

MSMEs in Argentina had (and still are having) a hard time surviving the crisis due to COVID-19 and lockdown periods. For example, during 2020, more than 60% of the MSMEs in Buenos Aires had to get into debt to avoid the company's closure or liquidation. In addition, more than 75% of the MSMEs in the province of Buenos Aires ceased paying all of their taxes.[9]

2.3 Insolvency procedural deadlines

See section 2.2 above in relation to judge-initiated extensions in relevant insolvency procedural deadlines.

2.4 Minimum debt requirements to initiate insolvency proceedings

The AIL does not have a minimum debt requirement. To initiate, whether a voluntary or an involuntary insolvency proceeding, the debtor must prove that it is in a status of "*cesación de pagos*" (literally translated as suspension of payments but equivalent to insolvent) and a creditor must prove that there are revealing facts (*hechos reveladores*) that the debtor is in *cesación de pagos*.

2.5 Suspending specific creditors' rights

No specific measures were introduced in this regard.

2.6 Mediation and / or debt counselling

Mediation is a mandatory procedure for most of the civil and commercial disputes in Argentina, and the procedure is fulfilled before initiating the proceedings.

Being a federal nation, all the procedural rules in Argentina are dictated by each province (state). As such, each province has their own rules regarding pre-judicial mediation.

The AIL does not determine any mediation or debt counselling procedure for insolvency or liquidation proceedings.

[9] https://www.redcame.org.ar/estadisticas-pyme/77/analisis-de-impacto-del-covid-19

Moreover, article 5 of the Argentinian Mediation Law (applicable in the City of Buenos Aires) expressly prohibits a mediation procedure in the case of insolvency or liquidation proceedings. Similar prohibitions are established in other jurisdictions (for example, the Province of Buenos Aires, the Province of Córdoba and the Province of Santa Fe).

Making mediation or debt counselling mandatory in an insolvency matter could potentially avoid a longer proceeding and could lower costs, while also allowing for confidential agreements (which could appeal to some debtors and creditors). On the other hand, mandatory mediation may not be apt to solve the complexity of insolvency issues. It is also unlikely to result in a successful outcome among disparate creditors, and could just lead to wasted time.

3. Challenges Faced

3.1 Stigma associated with insolvency

In Argentina, the stigma associated with insolvency has diminished during the last 20 to 30 years. Nowadays, many business owners consider that filing for insolvency is a good business decision to protect their business, shareholders, employees and creditors. Obviously, companies that go through the insolvency process have a harder time getting access to new money (as will be explained in section 3.3 below). But in terms of social punishment, business owners are much less fearful to file for insolvency nowadays.

3.2 Availability of financial information

In Argentina, there are several databases. Some of them are public and others are private, requiring a subscription in order to access the information regarding the situation of the debtor's estate.

On the one hand, in any Public Registration Office, through several requests of reports, on a prompt basis and with minimum costs, accurate information regarding goods, attachments and particular circumstances of the debtor can be obtained (for example, from the Land Records Office, the Vehicles Registration Office and the Trademark and Patent Office).

On the other hand, in order to measure credit risk, some companies gather detailed information of financial and credit records or statements. By paying a monthly membership, it is possible to access some reports per month (for example, NOSIS and VERAZ, among others).

3.3 Access to new money

Access to new money is quite a difficult task for MSMEs in Argentina. Statistics show that almost 50% of MSMEs consider that the requirements are too demanding and the conditions are unfavourable to access financing.[10] Also, 27.9% of MSMEs consider that the requirements by the financial institutions are too onerous to be

[10] http://redcame.org.ar/novedades/10907/casi-el-50-de-las-pymes-considera-que-los-requisitos-son-demasiado-exigentes-y-las-condiciones-no-favorables-para-acceder-al-financiamiento

fulfilled and 21.3% of MSMEs do not consider credit conditions as favourable to them.[11]

Moreover, companies that are going through insolvency proceedings have almost no access to new money, depending entirely on capital contributions from their shareholders.

Therefore, access to new money is limited to certain companies that can meet the compliance and risk requirements that the financial institutions require.

3.4 Secured creditors *vis-a-vis* unsecured creditors

In the Argentinian insolvency regime, creditors are divided depending on whether they are secured or not.

Those who have their credits secured (special preferred, as explained below) have the right to accrue and collect interest until the day their credit is paid (in contrast to non-secured or "general preferred" creditors, whose interest stops accruing the day on which the insolvency proceeding is filed) and to pursue foreclosure (for example, if the credit is secured by a mortgage or pledge) independently of the insolvency proceeding. Secured creditors are mostly financial institutions that tend to be much more demanding before making loans than the rest of the creditors. On the other hand, unsecured creditors tend to be operational creditors such as vendors and suppliers of the debtor.

The AIL recognises three types of priority claims.

"Special preferred" (*privilegios especiales*) claims are the most senior of the priority claims.[12] They consist of certain statutory priority and secured creditor claims. The statutory priority claims include: (i) expenses for construction, improvement or conservation of a thing; (ii) claims for wages or salary for six months prior to the filing and those arising from indemnities for work-related accidents or dismissal; and (iii) taxes. The secured claims are "privileged" claims, being those secured by a mortgage or pledge.

Next among the priority claims are the *gastos de administración y justicia*, or administrative claims.[13] Those are claims that arise during the *concurso preventivo* (voluntary restructuring) or the *quiebra* (liquidation).

Finally, there are the so-called "general preferred" (*privilegios generales*) claims consisting of other labour claims, tax claims andsocial securities claims.[14]

The key difference between "special preferred" claims and "general preferred" claims is that special preferred claims have affected certain asset or assets as a specific collateral, while general preferred claims give preference over the total remaining assets of the debtor after full satisfaction of the special preferred claims and administrative expenses.

[11] https://www.redcame.org.ar/estadisticas-pyme/85/acceso-al-financiamiento
[12] AIL, s 241.
[13] *Idem*, s 240.
[14] *Idem*, s 246.

Labour claims are the sole type of claims in the AIL that enjoy a double priority: such claims are special preferred[15] and general preferred.[16]

The AIL double priority for labour claims includes not only the principal of such claims but also the accrued interest for two years.[17]

According to a quite new ruling of the Argentine Supreme Court (*In re Pinturas y Revestimientos*), and due to the precedence of an international treatise (Convention Nº 173 of the International Labour Organisation) over national laws (the AIL), general preferred labour claims have priority over other general preferred claims, more specifically, over tax and social security claims.

As to the order of satisfaction of several special preferred claims, and only when those different claims with the same special priority have the same asset or assets as collateral, the precedence among them order of satisfaction would be:

- maintenance costs of the assets or assets affected to the preference;
- claims secured by a mortgage or pledge;
- labour claims; and
- tax claims that affect a particular asset or assets.

3.5 Insufficient asset base

Most commonly, MSMEs do not have a sufficient asset base to provide as collateral for secured lenders and, as such, personal guarantees are required to be given from administrators, equity holders and relatives.

3.6 Personal guarantees (PGs)

As noted above, section 68 of the AIL provides for the reorganisation proceeding or *concurso preventivo* of the guarantors of the main debtor, so that both proceedings are handled simultaneously. When a company files for reorganisation, the issuance of a public notice in a national newspaper is required. The AIL provides 30 days counted from the publication of that notice to the guarantors to request their reorganisation proceedings. Financial institutions tend to request PGs when they provide access to credit to companies.

3.7 Further challenges

There are no additional challenges to be identified.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

Softening lending lines of credit, from private and public financial institutions,

[15] *Idem*, s 241, para 2.
[16] *Idem*, s 246, para 1.
[17] *Idem*, s 242, para 1 and s 246, para 1.

would be the best way to assist MSMEs. It would also be ideal to facilitate MSMEs' access to the capital market in a "secondary" tier, and to put in place MSME-specific restructuring and liquidation proceedings that are shorter, less costly and less burdensome.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

In Argentina, the majority of debtors undertaking formal insolvency proceedings are MSMEs. Therefore, although certain legislative enhancements are required, the AIL has helped MSMEs to date.

4.3 Simplified insolvency proceedings

Experts concur on the absolute necessity of a simplified restructuring, liquidation and discharge mechanism to enable a quick resolution for financially distressed MSMEs, as compared to the three formal mechanisms already in existence.

Experts also primarily concur in the major features that such a simplified process for MSMEs should have – specifically, it should:

- be shorter;
- be less costly;
- operate as a debtor in possession model;
- provide for statutory or automatic discharge for pre-petition claims (subject to the limitations noted in section 1.5 above); and
- provide for the expeditious liquidation of remaining assets.

AUSTRALIA

1. Insolvency Framework - General Overview

In Australia, there is no agreed or uniform definition of MSMEs.

Various definitions of "small business" and "micro-business" have emerged over the years which rely on different indicators of the business. For instance, the definition adopted by the Australian Taxation Office hinges on the aggregated turnover of the business.[1] The Australian Bureau of Statistics (ABS) defines micro businesses as businesses employing between zero and four people and "small businesses" as those that employ five to 19 employees.[2]

Commonwealth laws do not provide for a consistent definition of "small businesses" either.

The common approach adopted in the relevant definitions seems to rely on setting a threshold on the number of employees (though the threshold varies across different legislative frameworks).[3]

In practical terms, MSMEs are often referred to in Australia simply as "small and medium enterprises" (SMEs). In this chapter, any reference to SMEs is intended to also capture micro businesses.

According to the ABS, the vast majority of businesses employ either no or fewer than 20 employees. As of June 2021, there were approximately 2.3 million businesses with fewer than 20 employees. This represents over 97% of all businesses operating at the end of the financial year 2020/2021, with micro businesses (i.e. those with zero to four employees as defined by the ABS) accounting for over 87%.[4]

1.1 Formal insolvency legislation

MSMEs may be constituted in various ways, including as a sole trader, partnership or a company. The law that applies to regulate and resolve business failures of MSMEs depends on the legal structure – where it is a sole trader or partnership, the bankruptcy regime for natural persons applies; where it is a corporation, the corporate insolvency provisions apply. These two frameworks are discussed in more detail below.

1.1.1 Corporate insolvency

The Australian corporate insolvency regime is principally governed by federal instruments, including the Corporations Act 2001 (Cth) (Corporations Act), the Insolvency Practice Schedule (Corporations) (which appears in Schedule 2 of the Corporations Act), the Corporations Regulations 2001 (Cth) (Corporations

[1] Australian Taxation Office, "Small Business Entity Concessions" (last modified 2 June 2021).
[2] Australian Bureau of Statistics, "Australian Industry Presents Estimates Derived using a Combination of Data from the Economic Activity Survey and Business Tax Data Sourced from the Australian Tax Office", 28 May 2021.
[3] For instance, ss 12BC and 12BF of the Australian Securities and Investments Commission Act 2001 (Cth); s 761G of the Corporations Act 2001 (Cth); s 5 of the Australian Small Business and Family Enterprise Ombudsman Act 2015 (Cth); and s 328-110 of the Income Tax Assessment Act 1997 (Cth).
[4] Australian Bureau of Statistics, "Counts of Australian Businesses", 24 August 2021.

Regulations) and the Insolvency Practice Rules (Corporations) 2016 (Cth). These rules set out the framework by which an Australian company enters into a formal insolvency process and how its assets are to be distributed to creditors.

The main formal procedures available under the Corporations Act include receivership, voluntary administration, winding up (solvent and insolvent), deeds of company arrangement, and schemes of arrangement. The corporate insolvency regime is regulated by the Australian Securities and Investments Commission (ASIC).

1.1.2 Personal insolvency

With respect to the insolvency of natural persons, including sole traders, a separate system exists. In contrast to some jurisdictions, the term "bankruptcy" in Australia refers only to the insolvency of individuals. The insolvency of individuals is governed by the Bankruptcy Act 1966 (Cth) (Bankruptcy Act), the Insolvency Practice Schedule (Bankruptcy) (which appears in Schedule 2 of the Bankruptcy Act), the Bankruptcy Regulations 1996 (Cth) (Bankruptcy Regulations) and the Insolvency Practice Rules (Bankruptcy) 2016 (Cth). The Bankruptcy Act and associated legislation underpin the framework by which individuals in severe financial stress discharge their debts, while providing for the realisation of a debtor's available assets for distribution to creditors.

Under this regime, insolvent individuals are provided with formal options to resolve their personal insolvency through bankruptcy, Personal Insolvency Agreements (PIA) and Debt Agreements (DA). The Australian Financial Security Authority (AFSA) is responsible for the administration and regulation of Australia's bankruptcy system.[5]

1.1.3 Recent reforms

The divided system of insolvency regulation for corporate and personal insolvencies has historically been far from ideal. Reforms that are designed to harmonise terms and concepts between these regimes came into effect in 2017.[6] Under the reforms, substantial changes to insolvency law and practice have been introduced, including the alignment of a range of specific rules relating to the handling of personal bankruptcies and corporate external administrations.

While bankruptcy law predominantly covers consumer debtors, corporate insolvency is more focused on small to medium businesses across a wide range of industries. Arguably, the "one size fits all" system regulating corporate insolvency lacked the flexibility to accommodate small businesses, raising concerns as to whether it was suited to and practical for those entities.[7] It has been observed that distressed small businesses may be discouraged from engaging with the insolvency framework early due to reasons such as high cost and complex processes.[8] This in turn is likely to affect their chances of survival, particularly in

[5] For further information, please refer to AFSA's website at: https://www.afsa.gov.au/.
[6] See the Insolvency Law Reform Act 2016 (Cth); Explanatory Memorandum, Insolvency Law Reform Bill 2015 (Cth).
[7] J Black and T Mornane, "Insolvency Law Reform in Australia: Big Benefit for Small and Medium Enterprises?", Norton Rose Fulbright, 2021.
[8] *Ibid.*

light of adverse economic impacts, such as those arising from the COVID-19 pandemic.[9]

In this context, the Australian Government introduced a package of reforms to the corporate insolvency regime in late 2020 designed to meet the needs of small businesses and support them to overcome the economic, financial and operational challenges caused by the pandemic.[10] These changes are arguably the most significant reform to Australia's corporate insolvency regime in almost three decades. Acknowledging the significant role that small businesses play in the Australian economy, the reforms focus on the introduction of two new restructuring and insolvency processes that are designed to address the needs of small businesses – a streamlined debt restructuring process and a simplified liquidation pathway.[11] The new measures are particularly relevant in the context of MSMEs, given one of the eligibility criteria is that the total liabilities of the business must be less than AUD $1 million. Further details on these two processes are set out below in section 1.4.

1.2 Specific insolvency legislation

There is no specific insolvency legislation for MSMEs. However, certain bespoke MSME processes are provided for, which are explained in further detail in section 1.4.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

- *Corporate insolvency framework*

  In Australia, there are no formal legal structures to implement out of court workouts. However, with respect to companies, standstill agreements are often deployed to provide the debtor company with some "breathing space" to formulate a restructuring plan by restraining creditor enforcement action. Standstill agreements may involve heightened information, reporting and payment deferrals.

  The primary formal mechanisms for corporate restructuring include voluntary administration followed by a deed of company arrangement (DOCA), and schemes of arrangement. Voluntary administration resulting in a DOCA (i.e. a binding agreement between the company and its creditors governing the company's affairs) is currently the main formal statutory tool relied on by Australian companies to restructure their debts. Concurrent receivership is sometimes deployed by secured creditors in a restructuring taking place under a DOCA.

  Voluntary administration was introduced in 1993 as an alternative mechanism to rescue corporations in financial distress. It was designed to provide a more flexible mechanism that did not depend on court approvals (which are often costly). This mechanism imposes short timeframes within which the

[9] Explanatory Memorandum, Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (Cth).
[10] *Ibid.*
[11] See above, n 7.

administrator investigates and reports to creditors about the company's business, property, affairs and financial circumstances. The administrator is also required to form an opinion about the options available to the company, giving due consideration to the best interests of creditors. [12]

Both DOCAs and schemes of arrangement provide a degree of flexibility that may include altering the terms of payment and compromising the company's debts and liabilities. However, as compared with schemes of arrangement, DOCAs are considered less expensive, quicker to initiate and more flexible than a scheme (which requires two court approvals that can lengthen, and add cost to, the restructuring process).

- *Personal insolvency framework*

MSMEs that do not utilise corporate structures may consider alternatives to bankruptcy that are available under the Bankruptcy Act, including PIAs[13] and DAs.[14]

(a) Personal Insolvency Agreements

A debtor who is insolvent may enter into a PIA (which is a legally binding agreement) with creditors as an alternative to bankruptcy.[15] Under this framework, a trustee is appointed to take control of the debtor's property.[16] The debtor must submit a statement of affairs and a proposal for the treatment of his or her affairs (which must include a draft PIA), and the creditors will then approve or oppose the proposal by special resolution.[17]

Where the debtor's proposal for a PIA is accepted by the creditors, the agreement terms bind all unsecured creditors, even if they did not vote in favour of the proposal.[18] Secured creditors may choose to rely on their respective securities and claim any shortfall as an unsecured creditor in accordance with the terms of the agreement.[19] Where the terms of the PIA have been carried out, there may be a release of provable debts (subject to the actual terms of the PIA).[20] While a PIA remains in force, all proceedings or actions against a debtor in respect of a provable debt under the PIA are stayed.[21]

A PIA enables the debtor to avoid the stigma of bankruptcy, while providing creditors with an avenue to recover their debts. Debtors are given the flexibility to introduce a broad scope of terms into the PIA as appropriate to their circumstances, provided the prescribed content requirements of PIAs are met.[22] This is particularly relevant in the context of MSMEs, given the

[12] Corporations Act, s 438A.
[13] Bankruptcy Act, pt X.
[14] *Idem,* pt IX.
[15] *Idem,* s 188.
[16] *Idem,* ss 188-189.
[17] *Idem,* ss 188(2C), 188(2E), 204.
[18] *Idem,* s 229(1).
[19] *Idem,* s 229(3).
[20] *Idem,* s 230.
[21] *Idem,* s 229(2).
[22] *Idem,* s 188A.

intertwining nature of the debtor's personal and business assets, and where there is often a strong sense of personal attachment to the performance of the business. However, the debtor's details will appear on the National Personal Insolvency Index (NPII) permanently.

(b) Debt Agreements

Being another alternative to bankruptcy, DAs provide insolvent debtors with an avenue to reach a compromise with their creditors through the use of legally binding agreements. DAs are considered less expensive and not as formal as PIAs. They are primarily intended to be used by debtors with lower levels of income and debt, coupled with fewer assets.[23]

Similar to PIAs, the terms of a DA can be flexible and may include terms providing for deferred payments or periodic payments out of income.[24] Under this regime, the debtor may give the Official Receiver a written proposal for a DA that contains all the specific requirements together with a statement of affairs,[25] and authorise a debt administrator to administer the proposal.[26] Each affected creditor known to the Official Receiver will be asked to indicate their acceptance of the proposal within a specified timeframe.[27] A simple majority by value of claims is required for the acceptance.[28] Once the proposal is accepted, a DA is made in the terms of the proposal when its details are entered on the NPII.[29]

A limited moratorium is imposed after the acceptance of a debt agreement proposal for processing is recorded in the NPII, and remains in place until the occurrence of certain events.[30] Additionally, while the DA is in force and its details are on the NPII, various restrictions are imposed on the actions of creditors (for instance, they are restricted from presenting a creditor's petition against the debtor).[31] However, secured creditors are permitted to realise or otherwise deal with their security.[32]

A DA generally comes to an end when all obligations created under it are fulfilled,[33] after which the debtor is released from provable debts from which he or she would have been released in a discharge from bankruptcy.[34] The debtor's name appears on the NPII for a limited time.

[23] Bankruptcy Legislation Amendment (Debt Agreements) Bill 2007 (Cth).
[24] Commonwealth, Parliamentary Debates, House of Representatives, 26 June 1996, 2827 (The Hon Daryl Williams MP, Attorney General and Minister for Justice).
[25] Bankruptcy Act 1966, s 185C-D.
[26] *Idem,* s 185C(2).
[27] *Idem,* s 185EA.
[28] *Idem,* s 185EC.
[29] *Idem,* s 185H.
[30] *Idem,* s 185F.
[31] *Idem,* s 185K.
[32] *Idem,* s 185XA.
[33] *Idem,* s 185N.
[34] *Idem,* s 185NA.

1.3.2 Informal framework

- *Corporate insolvency*

  In Australia, informal restructuring or workouts are available to companies. They may involve a privately negotiated agreement between the debtor company and a select group of its creditors (for instance, a major creditor) to vary contractual payment terms so as to allow the debtor company to improve its financial position and return to solvency.

  The main goal of informal restructuring or workouts is to address the financial challenges encountered by the debtor company on a temporary basis, while the entity develops a long-term strategy to return to a viable status. Informal workouts proceed on the basis that, if the debtor company is still viable despite its current financial challenges, it is in the interests of creditors to collaborate with the debtor company by refraining from immediate enforcement action and supporting a restructuring plan that will hopefully return the debtor to profitability.[35] This focuses on the long-term benefits of an ongoing trading relationship with the company. The key elements of a successful informal workout include the extensive creditor consultation and cooperation which results in an agreement and, more importantly, the ability to keep the stakeholders and / or creditors in the negotiated deal as opposed to them taking enforcement action.

  It can be said that informal rescue processes are rather under-developed in Australia and remain the exception rather than the norm. This may be explained by the fact that there is a strong individualist creditor enforcement culture – in contrast to the generally more debtor-friendly framework in the United States and the more developed creditor cooperation system in the United Kingdom.[36] The recent "safe harbour" reforms in Australia designed to protect directors from incurring personal liability against insolvent trading is arguably a positive step to encourage distressed businesses to explore this informal workout option with the guidance of expert practitioners.[37] However, creditors arguably need to be incentivised as well to support informal workouts, given they are still permitted to enforce their claims during an informal workout.

  Where successful, informal workouts allow the debtor company to continue trading and for its directors to retain control of the company. In comparison to formal processes, informal workouts provide increased flexibility and confidentiality. They are also a less expensive and quicker option than the formal alternatives. These advantages are particularly relevant in the context of MSMEs, given the varied nature of the business, a low asset base and what is often an intertwining of personal and business assets and liabilities associated with family-run businesses.

  However, a major drawback is that debtor companies are unable to benefit from a legal and enforceable framework and a moratorium against claims that

[35] S Atkins and Dr K Luck, "The Value of Informal Workouts and the Framework to Guide their Development in the Asia-Pacific", Centre for Commercial Law in Asia, 19 August 2020.
[36] *Ibid*.
[37] For how "safe harbour" applies: see Corporations Act, s 588GA.

are generally available under formal processes. In particular, "hold out" creditors are not bound by this informal process. Creditors can also change their minds and abandon the deal at any time, asserting their rights to recover their debt by way of legal proceedings. To encourage the use of informal workouts, a mandatory enforcement moratorium should ideally be in place. While there are restrictions on the operation of *ipso facto* clauses in Australia, their application is limited to formal restructuring processes (such as voluntary administration).[38]

- *Personal insolvency*

  Similar to the informal alternatives available to companies, MSMEs that are not corporate structures may enter into informal, private agreements with their creditors to avoid the consequences of bankruptcy. These private agreements will be governed by contractual principles. However, informal arrangements may not bind dissenting creditors who may choose to initiate bankruptcy proceedings.

1.4 Accelerated restructuring or liquidation of MSMEs

From January 2021, MSMEs that meet specific eligibility criteria are able to access two new processes, namely the streamlined debt restructuring process and the simplified liquidation mechanism. As noted above, to be eligible, the total liabilities of the company must be less than AUD $1 million.

1.4.1 Streamlined debt restructuring process

The legislative intention for introducing the streamlined framework is to provide an alternative to the "one size fits all" voluntary administration process to better address the needs of small businesses with non-complex liabilities.[39] Where the company is insolvent or likely become insolvent at some future time, the new debt restructuring process enables the debtor company to develop a restructuring plan with the assistance of an independent professional known as a "small business restructuring practitioner". The reduced complexities and costs of this new process encourage small businesses facing financial distress to adopt debt restructuring at an earlier stage in order to maximise their opportunity for survival.[40]

The new restructuring mechanism shares many features of the voluntary administration framework. It is designed to be a debtor in possession model. During the restructuring, the directors remain in control of the business and are able to continue trading in the ordinary course of business.

In summary, the company has 20 business days from the commencement of the restructuring process to put forward a restructuring plan (accompanied by a restructuring proposal statement that contains a schedule of debts and claims) to its creditors.[41] The plan can provide for the company to make payments in respect

[38] See above, n 35. See also N McCoy and L Johns, "Ipso Facto Law Reform", Norton Rose Fulbright, July 2018.
[39] Explanatory Memorandum, Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (Cth).
[40] *Ibid*.
[41] Corporations Regulations, regs 5.3B.14-5.3B.17.

of an admissible debt or claim for up to three years.[42] The creditors will typically be given 15 days to vote on the plan.[43] The plan will be accepted if more than 50% of creditors by value agree.[44] Once the plan is accepted, it binds the company, its officers, members and creditors to the extent of their admissible debts or claims (subject to limited exceptions).[45] The company must then make payments according to the terms of the plan. When the company pays off its obligations under the plan, it is released from all admissible debts or claims that it had under the plan.[46]

In addition to the liabilities threshold, the company must meet certain pre-requisites before being able to present the restructuring plan to creditors, including the requirement to be in substantial compliance with its obligations concerning employee entitlements and tax lodgements.[47]

Intended to provide "breathing space" for the company concerned, the rights of key stakeholders are affected while the company is in the process of restructuring. In particular:

- a moratorium is applied to the enforcement of claims by unsecured creditors and some secured creditors;[48]
- personal guarantees from the company's director(s) or their relatives cannot be enforced without the court's consent;[49] and
- *ipso facto* clauses are stayed for some contracts.[50]

This new restructuring framework is only available for companies. MSMEs which are not companies may consider processes under the Bankruptcy Act which bear similarities to this new regime. The mechanisms with respect to PIAs and DAs are outlined in section 1.3 above.

1.4.2 Simplified liquidation

Simplified liquidation enables eligible companies in a creditors' voluntary liquidation to access a cost-effective option that is specifically designed to address the needs of small businesses. It is intended to reduce the time and costs involved in navigating what is otherwise a complex and lengthy liquidation process, which in turn increases returns for both creditors and employees. The simplified framework is characterised by reduced investigations as well as meeting and reporting requirements. There is no ability to form a committee of inspection under this framework.[51] In addition to the liabilities threshold, there are a number

[42] *Idem*, reg 5.3B.15.
[43] *Idem*, reg 5.3B.21.
[44] *Idem*, reg 5.3B.25.
[45] *Idem*, reg 5.3B.29.
[46] *Idem*, reg 5.3B.31.
[47] *Idem*, regs 5.3B.14(1)(e), 5.3B.24.
[48] Corporations Act, ss 453R-453T.
[49] *Idem*, s 453W.
[50] *Idem*, s 454N-454R. See also Australian Government, "Simplified Debt Restructuring: A Factsheet for Small Business", December 2020.
[51] Corporations Act, s 500AE.

of eligibility criteria including that the company must be up to date with its tax lodgments.[52]

This simplified process adopts most of the framework applicable to ordinary creditors' voluntary liquidations, and introduces amendments that facilitate a more "fit for purpose and efficient process".[53] A significant difference, however, relates to the reduced circumstances where the liquidator may recover unfair preference payments from creditors that are unrelated to the company.[54]

1.4.3 Uptake of the new processes

Empirical studies are likely to inform how effective these new mechanisms are in achieving their legislative objectives. These new tools have, to date, not been widely adopted by MSMEs. Discussions on the conservative uptake suggest that the current emphasis should, perhaps, be on educating MSME owners and directors to ensure they have a good level of understanding of what their obligations are, and what options they have when their business is in distress. There are also suggestions that the AUD $1 million threshold is too low, and that the relevant legislation is fairly difficult to navigate – a factor that may inhibit MSMEs from using these mechanisms.

1.5 Discharge of debts for natural persons

In the absence of an objection, discharge from bankruptcy normally occurs automatically after the effluxion of three years from the date of filing of the debtor's statement of affairs.[55] However, the bankrupt will not be automatically discharged from bankruptcy if the trustee objects to the discharge. Depending on the ground of the objection, the discharge may not take effect until five years, or in some cases eight years, after filing the statement of affairs.[56]

The effect of discharge from bankruptcy is generally to release the bankrupt from all provable debts (including secured debts).[57] In the case of secured debts, this is regardless of whether the secured creditor has surrendered its security for the benefit of creditors generally. However, this does not affect the rights of a secured creditor, or successor in title, to realise or otherwise deal with the security to the extent that the secured creditor has not proved in the bankruptcy.[58]

The discharge from bankruptcy does not, however, release the bankrupt from certain debts, such as a debt incurred by means of fraud or a fraudulent breach of trust, or forbearance of a debt obtained by fraud.[59] A discharged bankrupt also remains liable for debts where those debts are not provable in bankruptcy. These

[52] *Idem*, s 500AA. See also ASIC, "Insolvency for Directors", Information Sheet 42, reissued in August 2020.
[53] Explanatory Memorandum, Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (Cth).
[54] Corporations Regulations, reg 5.5.04.
[55] Bankruptcy Act, s 149.
[56] *Idem*, s 149A.
[57] *Idem*, s 153.
[58] *Idem*, s 153(3).
[59] *Idem*, s 153(2)(b).

include debts in respect of pecuniary penalty orders[60] and orders made under a proceeds of crime law.[61]

Despite the general discharge of debts, a bankrupt's name stays on the NPII.[62] The NPII is a publicly available electronic record which provides information about individuals who have been subject to proceedings under the Bankruptcy Act. It contains details of the bankruptcy, including the bankrupt's name and whether the bankruptcy has been discharged.

A Bill was introduced in late 2017 to reduce the default bankruptcy period from three years to one year. The amendments were designed to boost commercial behaviour and reduce the stigma associated with bankruptcy.[63] However, the Bill lapsed due to the 2019 federal election being called. In early 2021, consultation was undertaken with respect to the reduction of the default period to one year – this time as an ongoing response to the impacts of COVID-19.[64] As at the time of writing, it is yet to be seen whether this will become law.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

There is no doubt that MSMEs play a significant role in the Australian economy. MSMEs have been central to the Australian Government's COVID-19 economic support measures.

On 30 March 2020, it was announced by the Australian Banking Association (ABA) that its member banks had voluntarily agreed to allow businesses with total business loan facilities of up to AUD $10 million to defer their loan repayments for up to six months. At the time, banks also agreed to not take enforcement action on business loans for non-financial breaches of the loan contract (such as changes in valuations). It was estimated that the support would extend to 98% of all businesses with a loan from an Australian bank and would cover up to AUD $250 billion worth of loans.[65]

Upon the expiry of the deferral period on 30 September 2020, customers who were able to resume paying their loans were required to do so, while those with ongoing financial difficulties as a result of the pandemic were offered the option to restructure or vary their loans. Where consensus could not been reached, customers were eligible for an extension of deferral for up to four months.[66]

Data released by the ABA in November 2020 suggests that these deferral arrangements assisted small businesses to weather the effects of the pandemic, enabling them to bounce back towards the latter part of the year. In June 2020, there had been 228,070 business loan deferrals, of which over 85% (198,262) were SME deferrals. By November 2020, the number of business loan deferrals had

[60] *Idem*, s 82(3AA).
[61] *Idem*, s 82(3A).
[62] Australian Financial Security Authority, "National Personal Insolvency Index", last updated 25 May 2021.
[63] Bankruptcy Amendment (Enterprise Incentives) Bill 2017 (Cth).
[64] Attorney-General's Department, "The Bankruptcy System and the Impacts of Coronavirus", January 2021.
[65] Australian Banking Association, "Banks to Help Commercial Landlords who Help Tenants through Covid 19", 30 March 2020.
[66] Australian Banking Association, "Banks Enter Phase Two on Covid-19 Deferred Loans", 8 July 2020.

reduced by almost 70% to just over 72,000, while SME loan deferrals had diminished by a similar proportion to just over 65,000.[67]

The new pandemic wave in mid-2021 brought about another round of nation-wide lockdowns across Australia. In July 2021, banks again offered deferrals of up to three months on business loans to support small businesses through the challenging period.[68] By September 2021, there had been more than 3,500 business loan deferrals, the majority of which came from states that were significantly impacted by the lockdowns.[69]

Further details on the specific measures implemented as a result of the pandemic are set out in section 2 below.

2. Special Measures

On 22 March 2020, the Australian Government announced the introduction of a number of new measures to provide flexibility and temporary relief for financially distressed individuals and businesses, with a particular focus on the MSME sector. These temporary reforms were contained in Schedule 12 of the Coronavirus Economic Response Package Omnibus Act 2020 (CERP Legislation) and are discussed in more detail in sections 2.3 and 2.4 below. On 22 September 2020, the Australian Government extended the temporary insolvency relief measures in Schedule 12 of the CERP Legislation to 31 December 2020. These temporary changes ceased on 31 December 2020.

As a result of the pandemic, many MSMEs were forced to restructure both operationally and financially and others ceased to exist entirely. The CERP Legislation, in addition to other measures such as government stimulus packages, provided MSMEs under temporary distress with much needed relief, and gave businesses every chance to recover. Arguably, these measures have ceased at an appropriate time and have struck the right balance between the need for ongoing support for MSMEs and the protection of future generations from substantial cost.

2.1 Procedural insolvency measures with respect to MSMEs

Please refer to section 1.4 above.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

No specific measures were introduced in this regard for MSMEs.

2.3 Insolvency procedural deadlines

2.3.1 Corporate insolvency framework

In the normal course, a creditor can issue a statutory demand against a company demanding payment of a debt of at least AUD $2,000 that is currently due and payable. The company then has 21 days after being served with the statutory

[67] Australian Banking Association, "Majority of Deferred Loans Back on Track", 17 November 2020.
[68] Australian Banking Association, "Australian Banks Offer Covid-19 Customer Relief", 8 July 2021.
[69] Australian Banking Association, "Hardship Assistance Triples as Deferrals Continue to Rise", 15 September 2021.

demand to pay the demanded amount, reach an agreement with the creditor about the debt to the creditor's satisfaction, or apply to a relevant court to have the statutory demand set aside. If a company fails to respond to the statutory demand within 21 days, it will be presumed to be insolvent and the creditor can make an application to a court for the company to be wound up in insolvency and a liquidator to be appointed to the company.[70]

In order to reduce the instances of companies being liquidated as a result of the COVID-19 pandemic, the Australian Government, through introduction of the CERP Legislation, temporarily extended the time for a company to respond to a statutory demand from 21 days to six months. This provided businesses with a longer period of time to deal with the statutory demand, and thereby reduced the pressure for a quick response.

2.3.2 Personal Insolvency framework

Mirroring the amendments in relation to the winding up of companies, the CERP Legislation temporarily extended the time a debtor had to respond to a bankruptcy notice from 21 days to six months.

The CERP Legislation also temporarily increased the temporary debt protection period available to individual debtors from 21 days to six months. Ordinarily, if an individual intends to voluntarily become bankrupt, they can present a declaration to the Official Receiver (an officer of the court). If the declaration is accepted by the Official Receiver, the debtor is afforded a 21 day protection period or "stay" in which unsecured creditors are prevented from taking enforcement action to recover money owed.[71]

This extension of protection gave individuals "breathing space" to seek professional advice, negotiate a payment plan or consider formal insolvency options. These reforms were particularly relevant for MSMEs, given personal assets are often intertwined with the business operations of a MSME.

2.4 Minimum debt requirements to initiate insolvency proceedings

2.4.1 Corporate insolvency framework

In addition to extending the time for a company to respond to a statutory demand, the CERP Legislation increased the statutory minimum for a creditor to issue a statutory demand against a company for a debt owed, from AUD $2,000 to AUD $20,000. This meant that a creditor must have had a much larger debt owing to it by the company before it could issue a statutory demand.

Although these temporary changes ceased on 31 December 2020, on 1 July 2021 the Australian Government permanently raised the minimum debt required to serve a statutory demand from AUD $2,000 to AUD $4,000.[72]

[70] Corporations Act, s 459E.
[71] Bankruptcy Act, ss 54A and 55.
[72] Corporations Amendment (Statutory Minimum) Regulations 2021 (Cth).

2.4.2 Personal insolvency framework

Similarly, the CERP Legislation increased the level of debt required before a creditor could apply for a bankruptcy notice against an individual from AUD $5,000 to AUD $20,000.

Although these temporary bankruptcy changes ceased on 31 December 2020, on 1 January 2021 the monetary threshold for a creditor wishing to initiate a bankruptcy process permanently increased from AUD $5,000 to AUD $10,000.[73]

Australia has not yet seen the wave of business closures predicted when the CERP Legislation and Government stimulus packages (for example, JobKeeper) ended. On the contrary, the 2020-2021 financial year saw a lower number of businesses entering external administration compared with the previous financial year. ASIC recently reported that in the 2020-2021 financial year, 4235 companies entered external administration. This was after 7362 in 2019-20, and 8105 in 2018-19.

These numbers may at least partly be explained by MSME business owners who have simply walked away rather than entering any formal insolvency process, or "zombie businesses" being kept afloat by Government stimulus packages. Some experts have predicted that a significant number of zombie businesses will soon succumb to external administration, now that protective measures have been removed.

Notwithstanding, these challenges may be alleviated by the January 2021 law reforms which allow for streamlined liquidation and restructuring processes for businesses with total debts of less than AUD $1 million (for further detail, refer to section 1.4 above).

2.5 Suspending specific creditors' rights

No measures suspending specific creditors' rights to initiate insolvency procedures were introduced during COVID-19 in Australia.

2.6 Mediation and / or debt counselling

2.6.1 Corporate insolvency framework

In Australia, mediation is available to companies as an alternative to formal insolvency proceedings. Further information regarding informal restructuring or workouts is discussed in section 1.3 above.

2.6.2 Personal insolvency framework

AFCA provides individuals in financial difficulty with free financial counselling to help them get back on track and discuss their options for dealing with unmanageable debt. Formal alternatives to bankruptcy such as DAs and PIAs (discussed in section 1.3 above) generally involve some form of mediation between the debtor and creditor.

[73] Bankruptcy Regulations 2021 (Cth), reg 10A.

Presently, there is no overarching mandatory requirement to initiate mediation or debt counselling or financial education for rescue, restructuring or rehabilitation, prior to formal insolvency in Australia.

However, in most parts of Australia, a primary producer with a dispute over a farm debt can seek resolution under a Farm Debt Mediation (FDM) scheme. In New South Wales, Victoria and Queensland, it is compulsory for banks and other creditors to offer mediation to primary producers before commencing debt recovery proceedings on farm mortgages. The FDM scheme has been praised as a valuable tool that assists in partially addressing the power imbalance between primary producers and banks, as well as facilitating access to justice. The Australian Government has indicated support for the creation of a nationally consistent FDM scheme.

In terms of the merits of making debt counselling or mediation mandatory in a pre-insolvency context:

- *Debt counselling*

  It is arguable that merely removing a debtor's liabilities will not provide a meaningful "fresh start" or "new opportunity" without additional measures designed to address the underlying causes of indebtedness. Debtor education or compulsory financial counselling could be undertaken both before problems arise in terms of personal over-indebtedness and post-bankruptcy discharge to help reduce the risk of a second bankruptcy.

- *Mediation*

  There are a number of well-established advantages to mediation generally. Relevantly to MSMEs, mediation is more cost effective than formal processes and it often allows for a faster resolution which reduces legal costs – which is particularly important for MSMEs. Further, unlike in court, mediation is completely confidential, and thereby protects the reputation of the debtor. Mediation can also allow for creative solutions as opposed to going to court where a judgment is passed on the case and leaves little room for negotiation. Bringing about a mutually satisfactory outcome by attending mediation also helps preserve current business relations between the creditor and debtor. Litigation, on the other hand, usually results in strained relations that may ruin any chance of future business transactions between the two parties.

However, it is important to note that the basic premise of alternative dispute resolution is that it should be voluntary. Mediation provides a forum for parties to freely and willingly discuss their dispute with a view to resolution on their own terms, as they see fit. Conversely, "mandatory" implies compulsion and it is arguably antithetical to the purpose of mediation. Further, conceptual difficulties arise where the mediation involves more than one creditor. For mediation to be effective, it must bind all creditors. Often, not all creditors participate in the mediation and any settlement reached has no effect over the creditors who are not parties to the agreement. Even where all creditors do participate in the mediation, there is a dilemma of how mediation can reconcile the interests of all creditors. Conversely, formal insolvency procedures capture and thereby bind all creditors.

3. Challenges Faced

3.1 Stigma associated with insolvency

Insolvency has often been a source of significant stigma in Australia for many MSMEs. Individuals are often hesitant to enter into insolvency or liquidation due, in part, to the negative perceptions of doing so, and the fear of embarrassment and failure. While stigma associated with insolvency proceedings affects a variety of organisations and institutions, it is perhaps more evident in the context of MSMEs due to the often smaller business model and close association of shareholders and managers within the business. This is because, as a business owner, success or failure of the MSME is directly attributable to them and consequently there is often a feeling that they would lose their place in society and be labelled a failure should the business become insolvent.

This stigma associated with insolvency therefore can have significant ramifications across MSMEs, ranging from deterring business owners from talking about their company's financial circumstances with trusted advisors to delaying actionable solutions for early intervention procedures that could save their businesses. This stigma surrounding insolvency presents large barriers and can deter business owners from admitting the truth about the status of their companies and gathering relevant information to take the necessary steps to remedy and restructure their business in time.

In order to reduce to impacts of stigma for MSMEs in instances of insolvency across Australia, it is important that business owners appreciate that many businesses go into liquidation due to no fault of their own and that entering into an insolvency process does not necessarily equate to the end of the business. To shift people's mindsets so that the perceptions of insolvency on an MSME does not attach with it any sense of shame or stigma, it is important to promote and increase discussion so the subject becomes less taboo as well as increase training modules so that business owners have a greater understanding of their options in dealing with instances of insolvency moving forward.

3.2 Availability of financial information

The ABS provides data sets on the number of businesses in Australia, regardless of the legal form, by size of employment.[74] This includes financial information on sole proprietors, companies, partnerships and trusts. For statistical purposes, the ABS defines an entity employing less than 20 employees as a MSME, and a medium-sized business as a business employing between 20 and 199 employees. It is worth noting that, when compiling its data sets, the ABS only includes entities that are actively trading in goods and services in a given period of time.

In 2017-2018, Australia had around 2.4 million MSMEs which accounted for 99.8% of all enterprises and more than 7.6 million people. Sole traders make up the majority of all businesses, followed by businesses which employ one to four people. Irrespective of the type of legal entity in which a business is carried out, many MSMEs depend on the personal finances of their owners as security to

[74] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Background Paper 12: Financial Services and Small and Medium-Sized Enterprises (SMEs), 2018.

obtain access to finance.[75] To date, banks remain the main source of lending to MSMEs in Australia.[76] This means that banks therefore have significant financial information in relation to MSMEs across Australia which, if shared, could be an important reference point and provide an additional source of data.

While there is some data on the size and composition of the MSME sector in Australia, it remains rather limited. Indeed, most MSMEs are sole traders who may not have enough funds to retain professional advisers to assist them on the running of their business. Instead it is often the case that MSME business owners rely significantly on family and friends. This follows that access to financial information is, in part, based on the individual circumstances of MSMEs.

3.3 Access to new money

Access to finance for MSMEs has been a longstanding challenge in Australia.[77] MSMEs, predominantly less established ones, tend to be riskier than large, established entities with a history of profitability.[78] As a result, lenders reject a greater proportion of loan applications from smaller businesses.[79] They also charge more to take on additional risk associated with the loans they provide, And the terms of the loans for MSMEs may also be more restrictive.[80] Indeed, around 95% of loans to SMEs are secured, as contrasted with approximately 70% of large business loans.[81] About half of small business loans are secured by residential property which, for many MSME business owners who are not in a position to provide sufficient home equity to secure a suitable loan, can be very challenging.[82]

These enduring challenges are further exacerbated in circumstances where MSMEs are undergoing the formal process of insolvency. Indeed, there are a variety of reasons why financially distressed MSMEs often face more problems gaining access to new financing. These factors include low bargaining power, lack of advice, reduced size and lack of viability. The under-investment issues often created through a situation of insolvency can be worsened in the context of MSMEs, where generally they have few viable substitutes for external finance outside of traditional intermediated finance.[83] Interim or new finance is therefore not readily available to MSMEs, particularly when a MSME is going through the formal process of insolvency.

3.4 Secured creditors *vis-à-vis* unsecured creditors

Whether it is an individual or a company that enters insolvency, the status of a secured or unsecured creditor will affect legal rights concerning the steps that can be taken to recover the debt. A creditor is an entity (individual or company) that extends credit by giving another entity permission to borrow money intended to

[75] *Ibid*.
[76] *Ibid.*
[77] C Kent, "Small Businesses Finance in the Pandemic", Speech, Address to the Australian Finance Industry Association, 17 March 2021.
[78] *Ibid.*
[79] *Ibid.*
[80] *Ibid.*
[81] *Ibid.*
[82] *Ibid.*
[83] *Ibid.*

be repaid in the future. A defined hierarchy of creditors exists when a MSME enters insolvency, with secured creditors being at the top.

This hierarchy is significant as it will dictate a creditor's priority in receiving payment. A secured creditor is a creditor that holds a security interest in some or all the company's assets to secure a debt owed by the company.[84] On the other hand, an unsecured creditor is a creditor who does not hold a security interest in the company's assets.

The liquidation of an insolvent company provides for an independent registered liquidator to take control of the company so its affairs can be wound up in an orderly and fair way to benefit creditors. There are two types of insolvent liquidation – a creditors' voluntary liquidation and court liquidation. A creditors' voluntary liquidation is one which begins when creditors vote for liquidation following a voluntary administration or a terminated DOCA, whereas in a court liquidation, a liquidator is appointed by a court to wind up a company following an application (often by a creditor). Unless the court provides its consent, after a company goes into liquidation, unsecured creditors cannot commence or continue legal proceedings against the company.

Secured creditors may enforce their rights in every form of external administration. If a company fails to meet its obligations under a security interest, a secured creditor can appoint an independent qualified individual (receiver) to take control of and realise part or all of the secured assets in order to repay the secured creditor's debt. The secured creditor can also ask the liquidator to deal with the secured assets for them and account to them for the proceeds and costs of collecting and selling those assets.

A secured creditor can vote at creditors' meetings for the amount the company owes them less the amount they are likely to receive from the realisation of the secured assets. If a voluntary administration otherwise terminates, a secured creditor may also commence steps to enforce its security interest upon termination. The secured creditor can take part in any dividend to unsecured creditors for their shortfall.

3.5 Insufficient asset base

Many insolvent MSMEs in Australia have little to no assets. The lack of assets often makes it more difficult to gain financial and legal advice needed to implement a timely and effective strategy in a situation of financial distress. MSMEs that have a low asset base often cannot afford the costs associated in funding the formal process of insolvency or liquidation.

Among other implications, MSMEs that have a low asset base are at greater risk that creditors will push for liquidation rather than keep the debtor as a going concern. This is because there is a greater level of uncertainty that the debtor will be able to repay the debts that are owed. It is also faster and much simpler for creditors to take this approach.

[84] Corporations Act, s 51E.

3.6 Personal guarantees (PGs)

Generally, a PG is provided by shareholders or directors of a company to personally guarantee the payment of money or obligations on behalf of their company. A PG is a written promise to guarantee the liability of one party for the debts of another party. It is prevalent in Australia for directors of a company, particularly in the MSME sector, to provide PGs on the basis of which banks and other financial institutions lend money to the company.

If a company is liquidated, directors can have guarantees enforced against them. Sections 440J and 453W of the Corporations Act provide that a creditor is required to obtain leave of the court to enforce director guarantees and, often, they will not be given permission to proceed. The justification being that directors would be hesitant to appoint an administrator if there was a risk that the creditor holding the guarantee would proceed against them.

Sections 440J and 453W work to protect the directors' assets and not directly the company's assets. The court, when deciding whether to grant leave, must be positively satisfied that there would be no prejudice to the voluntary administration. Similarly, under the new debt restructuring regime that came into force in January 2021, the requirement to obtain leave to enforce personal guarantees begins on the date of the company's appointment of the small business restructuring practitioner.

At the end of the voluntary administration, if creditors vote for a DOCA proposal, the creditor holding the PG can take enforcement proceedings under the guarantee once the DOCA is executed. If creditors vote for the company to enter liquidation, the creditor can begin enforcement proceedings under the PG against the guarantor.

4. Moving Ahead

For this section, we interviewed *Kathy Sozou (Partner, McGrathNicol), Phil Quinlan (Partner, KPMG), and John Winter (CEO, Australian Restructuring Insolvency and Turnaround Association).*

The industry experts shared with us practical insights in the context of MSMEs. A common theme is that enhanced focus should be placed on educating business owners and / or directors on their obligations and available options, as one of the best ways to safeguard the interests of MSMEs. Having a robust framework itself is not sufficient – the experts pointed out that the education aspect is significant, given MSMEs delay seeking professional assistance (if at all) in most instances.

The complexities of the mechanisms available to MSMEs in distress, including the new restructuring and simplified liquidation processes discussed in section 1.4, may also deter MSMEs from adopting these processes in the Australian context.

To watch the interviews, please click the links below:

Interview with Kathy Sozou:

- https://cdn2.webdamdb.com/md_kJYy7lPBT2K65wmR.mp4?1638095432

Interview with John Winter:

- https://cdn2.webdamdb.com/md_Ewv0xBMQ8g402QfG.mp4?1637798625

Interview with Phil Quinlan:

- https://cdn2.webdamdb.com/md_oKlF5e28AvM01sBX.mp4?1637543090

4.1 Best way to safeguard the interests of MSMEs

MSMEs face a number of structural challenges when going through restructurings and formal insolvencies. Often MSME directors have no or very little understanding of their obligations, including the duty to prevent insolvent trading. Presently in Australia, there is no requirement to undertake any formal training to become a director. If directors are educated about the restructuring and insolvency processes and particularly around what their options are, they are more likely to seek professional advice early on when the company is in distress. If directors seek advice too late in the process, there is often too little that can be saved in the business.

Further, MSMEs often have low or no assets and their personal assets are intertwined with the business. As a result, they do not have available cash flow to pay for financial advisers when the business is struggling. This issue is further complicated by the enormous cost of Australia's insolvency regime, which is largely due to the regime's complex nature. A one size fits all model that applies across entities of different sizes has traditionally been considered as appropriate. Upon appointment, an insolvency professional is required to investigate the cause of the collapse of the business, report to the corporate regulator and make recommendations around potential prosecutions. One way to reduce costs may be to take out these stringent requirements for MSMEs, although there may be difficulties in defining the eligibility criteria.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

As noted, Australia's insolvency regime is cumbersome and complex. It is often considered unapproachable even by accountants or lawyers who are not specialists in the area. This complexity translates to costs, lack of understanding and reduced attractiveness to businesses who may otherwise have benefitted from it. Additionally, it may create personal stress on owners of MSMEs if they are not aware of the level of control that is taken away from them through these formal processes.

To address the issue around complexity, the Australian Restructuring and Turnaround Association (ARITA) has been calling for a review of Australia's insolvency regime for some time. The last major review of Australia's corporate insolvency laws was the Harmer enquiry which was undertaken in 1988 by the Australian Law Reform Commission (ALRC).

On the other hand, for some owners and operators of MSMEs, the appointment of an administrator or liquidator may relieve stress by preventing the situation from getting worse, giving them breathing space and helping them to understand what their options are to resuscitate the business to some extent.

Various measures introduced by the Australian Government during the pandemic have benefitted MSMEs. In particular, the Government stimulus that was largely directed at providing support for businesses to enable them to keep their employees prevented mass unemployment. Other temporary measures such as the moratorium on insolvent trading and the moratorium on landlord evictions gave breathing space to directors of MSMEs in distress.

These changes were appropriate at the time and they achieved their purpose of avoiding a tsunami of corporate failures. However, the timing of these measures tapering off is appropriate because the overwhelming majority of businesses have been able to recover. In particular, measures that stalled creditors' abilities to recover funds are incompatible with a continuing capitalist environment.

4.3 Simplified insolvency proceedings

As discussed in section 1.4 above, from January 2021, MSMEs that meet specific eligibility criteria are able to access two new processes, namely the streamlined debt restructuring process and the simplified liquidation mechanism. To be eligible, the total liabilities of the company must be less than AUD $1 million.

Unfortunately, these reforms have not had the desired effect. Many MSMEs the reforms were designed to help have been prevented from accessing the streamlined process due to not meeting the stringent eligibility criteria. For example, due to the design of the Australian tax framework, many MSMEs utilise trusts for tax planning purposes. However, regardless of how simple the business is, businesses with trusts or those businesses that have assets placed in trusts are excluded from this regime.

AUSTRIA

1. Insolvency Framework – General Overview

MSMEs are the backbone of the Austrian economy. In Austria, MSMEs are categorised as:

- medium sized enterprises with less than 250 employees, an annual turnover less than EUR 50 million and an annual balance sheet total of less than EUR 43 million;
- small enterprises with less than 50 employees, an annual turnover less than EUR 10 million and an annual balance sheet total of less than EUR 10 million; and
- micro enterprises with less than 10 employees, an annual turnover of less than EUR 2 million and an annual balance sheet total of less than EUR 2 million.[1]

According to the Austrian Institute for SME Research, approximately 99.6% of all companies in Austria are MSMEs. In 2019, there were 358,400 MSMEs employing 2,072,800 million persons.

1.1 Formal insolvency legislation

In Austria, the following proceedings are available for MSMEs regarding their restructuring or insolvency: restructuring proceedings (*restrukturierungsverfahren*), reorganisation proceedings with / without debtor in possession (*sanierungsverfahren mit / ohne eigenverwaltung*) and liquidation (bankruptcy) proceedings for entrepreneurs (*konkursverfahren*) or natural persons (*schuldenregulierungsverfahren*).

1.1.1 Restructuring proceedings based on a "likelihood of insolvency"

MSMEs are able to restructure in a preventive restructuring framework regulated by the Austrian Restructuring Act. Debtors, even though they are in financial difficulties, are able to continue their business or parts thereof within these restructuring proceedings. These proceedings are aimed at avoiding insolvency. Therefore, companies have access to the restructuring regime in the event of "likelihood of insolvency".[2] Likelihood of insolvency means: (i) imminent illiquidity; or (ii) the equity ratio falls below 8% and the notional debt repayment period exceeds 15 years.

Only the debtor can initiate the restructuring mechanism to avert insolvency and ensure the viability of the company. Creditors and other third parties cannot file for restructuring. During the proceedings, the court monitors the debtor and, if it becomes necessary, appoints a restructuring administrator. The discharge of debt is achieved based on a restructuring plan (*restrukturierungsplan*) without a mandatory minimum quota.

[1] https://www.kmuforschung.ac.at/facts-and-figures/kmu-daten/?lang=en
[2] Austrian Restructuring Act, s 6.

1.1.2 Reorganisation and liquidation proceedings based on "illiquidity" or "over-indebtedness"

The proceedings regulated by the Austrian Insolvency Act (further outlined below) are available to MSMEs that are deemed to be "illiquid". Over-indebtedness is a reason to declare bankruptcy only for MSMEs having limited liability.

To discharge its debts and continue its business, the debtor can choose a reorganisation proceeding with or without debtor in possession. The main focus of these proceedings lies in: (i) the discharge of debt with a reorganisation plan (*Sanierungsplan*); (ii) paying creditors a quota of 20% (in reorganisation proceedings without debtor in possession) or 30% (in reorganisation proceedings with debtor in possession) within two years; and (iii) in the continuation of the debtor's business or parts thereof. Apart from the quota, the difference between these two forms of insolvency proceedings is whether the debtor retains, generally and subject to certain restrictions, control over its assets, and whether an insolvency administrator acts as either a monitor or takes control of the debtor and its affairs.

Liquidation (bankruptcy) proceedings are for non-viable businesses. A court-appointed insolvency administrator takes control of the debtor and sells the estate's assets at a maximum value, with the proceeds being paid out to creditors without any minimum quota.

For natural persons, the Austrian Insolvency Act provides a special form of liquidation (bankruptcy) proceeding to discharge debt. The debtor can discharge debt with a repayment plan (*zahlungsplan*) with a quota that results from the individual situation of the entrepreneur (the selling of assets and the leviable income in the next three / five years). If the debtor is not able to pay the quota, the debtor has to supply its leviable income for the next three / five years (*abschöpfungsverfahren*).

1.2 Specific insolvency legislation

In Austria, there is no specific insolvency legislation for MSMEs.

MSMEs can therefore choose between all restructuring and insolvency proceedings, limited however insofar as liquidation (bankruptcy) proceedings for natural persons are only applicable to micro enterprises with one person.[3]

As mentioned above, most companies in Austria are MSMEs. The Austrian legislator therefore considers the interests of MSMEs in legislation. The formal insolvency legislation is applicable and for the most part suitable to MSMEs as well as large companies.

The European legislator confirmed this insolvency legislation for MSMEs in Austria with the EU Directive on Restructuring and Insolvency (EU Directive) as it ensures that the period after which insolvent entrepreneurs are able to be fully discharged from their debts is no longer than three years.

[3] Austrian Insolvency Act, s 193.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

Austrian law does not provide a formal legal framework for purely out-of-court restructuring proceedings or for preliminary mandatory and consensual restructuring negotiations.

These proceedings within the Austrian Restructuring Act are a hybrid of out-of-court and court monitored proceedings. The European legislator (transposed into national law by the Austrian legislator) tried to implement an early restructuring mechanism for companies facing a likelihood of insolvency. The debtor – comparable to reorganisation proceedings with debtor in possession – retains, generally, but subject to less restrictions than in reorganisation proceedings with debtor in possession, control over its assets. The most important thing is that the debtor can gain a discharge of debt without the consent of all creditors involved based on a restructuring plan. The adoption of the restructuring plan requires that a majority of the affected creditors present in each class approve the plan and the sum of the claims of the consenting creditors in each class is at least 75% of the total sum of the claims of the affected creditors present in that class. The restructuring plan[4] therefore must contain the proposed restructuring measures and their duration, the reduction and deferral of claims as well as any newly provided financial support.

In addition, the restructuring must describe the debtor's economic situation, in particular its assets, liabilities and the company. The affected creditors (including classification into creditor classes) as well as the unaffected creditors must be listed in the restructuring plan together with a factual justification for their inclusion / non-inclusion in the restructuring plan. The plan must also include a conditional forecast of the company's continued existence and a description of the necessary preconditions for the success of the plan. In the restructuring plan, it also should be argued why restructuring proceedings under the Restructuring Act are in the best interests of the creditors compared to insolvency proceedings.[5]

The European legislator decided that a discharge of debt needs the approval of the court. Therefore, these restructuring proceedings are monitored by court and the restructuring plan is binding on the parties only if it is confirmed by court.

During the implementation of the EU Directive in Austria, COVID-19 arose and the Austrian legislator (in relation to the new *ReO* process) as well as the German legislator (in relation to the new *unternehmensstabilisierungs- und –restrukturierungsgesetz – StaRUG* process) aligned as far as possible the new restructuring mechanism with the effects of the pandemic. Although the Restructuring Act came into force in July 2021, there up to now has been no relevant number of restructuring proceedings.

The "new" Austrian Restructuring Act is very similar to the Austrian Business Reorganisation Act, which came into force in 1997 but ended up as "dead law". In Germany, the "StaRUG" – comparable to the Austrian Restructuring Act – has been

[4] Austrian Restructuring Act, s 27.
[5] https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32019L1023&from=DE

in force since the beginning of 2021 and the relevant experience is limited to approximately 25 cases. The German Government has provided COVID-19 aid packages, which may be a reason why there is only this small number of "StaRUG-restructuring proceedings". The restructuring proceeding regarding eterna Mode Holding GmbH – one of the largest proceedings – led to a debt cut for the bond holders to 12.5% of the nominal value. Regarding MSMEs, there is also a lack of relevant experience.

The EU Directive itself has to be reviewed no later than 17 July 2026.[6] Due to the experience with the Austrian Business Reorganisation Act, it is very likely that modifications will be necessary to provide the restructuring level needed to cope with COVID-19.

In addition to the current out-of-court restructuring practice, the Austrian Restructuring Act presents an alternative for financial creditors in the context of the so-called simplified reorganisation proceedings or, perhaps, also in the case of financing structures that also include bondholders.

The post COVID-19 period will show if the provided restructuring and insolvency proceedings, especially the new restructuring mechanism, are able to minimise the negative economic impact of the pandemic.

1.3.2 Informal framework

The current out of court restructuring practice – as an informal framework – can be seen as restructuring on the basis of an out-of-court restructuring agreement providing for example a moratorium, haircuts and a sale of the business or parts thereof in a M&A transaction.

The first step Austrian MSMEs usually take is to enter into negotiations with their creditors on an out of court basis. Creditors have the choice between out of court restructuring and a formal insolvency proceeding.

In many cases, an out-of-court restructuring with a "voluntary" debt relief comes about as a result of a higher quota that can be reached than is the case with formal insolvency proceedings, which also has the possible negative effect in terms of public image and reputation, especially among customers and suppliers.

Out of court restructurings, on the other hand, aim at voluntary debt relief, including the subordination of loans, the injection of "new money" such as new loans or private equity, and economic reorganisation of the business, all in accordance with the provisions of private law based on a restructuring agreement. Therefore, unlike formal restructuring and insolvency proceedings with court involvement, an out of court restructuring demands the consent of all creditors involved. The lack of a restructuring or insolvency court being involved leads to less negative publicity, which helps the debtor because the last thing a debtor in financial difficulties needs is negative publicity. Regardless of this fact, the debtor has to inform at least its largest (usually financial) creditors.

[6] EU Directive, art 33.

An agreement concluded at a time when the debtor was already insolvent is at risk of being held void in insolvency proceedings. An advantage of out of court restructuring is that these proceedings are not registered in the insolvency database. Furthermore, out of court restructuring is potentially much faster, provided that all parties participate.

1.4 Accelerated restructuring or liquidation of MSMEs

The Austrian Restructuring Act provides for a special form of restructuring process if only financial creditors are involved.[7] The debtor needs a restructuring agreement with the same content as a restructuring plan, and the agreement needs to be signed by the financial creditors before the opening of the proceedings. The restructuring agreement is adopted, provided that at least 75% of the total sum of the claims of the creditors included agree.

However, an accelerated restructuring or liquidation process specifically in relation to MSMEs is not provided for by the Austrian Insolvency Act.

1.5 Discharge of debts for natural persons

In Austria, natural persons (as long as they are entrepreneurs) can discharge debt in all restructuring and insolvency proceedings. Liquidation (bankruptcy) proceedings for natural persons are – as mentioned above – only applicable to micro enterprises.[8] Natural persons who are no longer entrepreneurs are able to discharge debts with a reorganisation plan (*sanierungsplan*) or in a liquidation (bankruptcy) proceeding (*schuldenregulierungsverfahren*), which is a special form of insolvency proceeding especially for natural persons. Natural persons can discharge debts within three years and without a minimum quota.

2. Special Measures

Some of the special legal and at the same time economic measures provided by the Austrian Government during COVID-19 have led to a decrease in the insolvency rate. In 2020, there were only about 3,000 company insolvency proceedings opened, which meant an overall decline of almost 40% compared to the previous year. In the first half of 2021, the number of company insolvencies decreased by around 45% to 1059 company insolvencies compared with the first half of 2020. This means the lowest number of company bankruptcies in over 40 years. However, since the third quarter of 2021, the number of insolvency proceedings however has begun to increase again. In the first half of 2022, the number of insolvency proceedings is twice as high as in the first half of 2021. There have been around 2,300 company insolvencies in the first half of 2022.

2.1 Procedural insolvency measures with respect to MSME

To mitigate the effects of COVID-19, the Austrian Government provided – instead of a broad range of procedural insolvency measures – a number of financial measures to prevent an increase of insolvencies (including for MSMEs). These measures included the granting of short-time work and fixed-cost subsidies, the

[7] Austrian Restructuring Act, s 45.
[8] Austrian Insolvency Act, s 193.

assumption of liabilities and the suspension of tax liabilities. These measures were not applicable to companies which had already been in financial difficulties before the pandemic.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

To prevent a "wave" of insolvency proceedings, the Austrian legislator suspended the obligation to file for insolvency due to over-indebtedness until 30 June 2021, if the over-indebtedness occurred in the period between 1 March 2020 and 30 June 2021. The obligation to file for insolvency due to illiquidity was not suspended, but the broad range of financial measures provided by the Austrian Government (see above) prevented the illiquidity of many MSMEs.

2.3 Insolvency procedural deadlines

For reorganisation proceedings, a restructuring plan by the debtor must be submitted to the court with financial records of the past three years that show the debtor's ability to pay 20% of its debt to unsecured creditors within a period of two years.

Under the Austrian COVID-19 legislation, in relation to reorganisation proceedings with / without debtor in possession, the debtor was until 31 December 2021 allowed to pay the minimum quota within three years instead of two years.[9]

2.4 Minimum debt requirements to initiate insolvency proceedings

No measures were introduced in relation to minimum debt requirements for a creditor to initiate an insolvency proceeding.

2.5 Suspending specific creditors' rights

For creditors, the possibility to file for insolvency due to over-indebtedness was suspended until 30 June 2021, if the over-indebtedness occurred in the period between 1 March 2020 and 30 June 2021.

In Austria, a large number of insolvency applications are filed by the regional medical insurance company (*Österreichische Gesundheitskasse*) and the taxation office (*Finanzamt*). During COVID-19, these creditors – without a corresponding obligation – did not file for insolvency. Combined with the suspension of social insurance contributions and tax liabilities, this has led to the decrease in new insolvency proceedings during the pandemic (see above).

2.6 Mediation and / or debt counselling

There is no mediation and / or debt counselling for MSMEs in Austria. Based on the trend in recent years to strive for the earliest possible restructuring, a mandatory mediation and / or debt counselling should also be introduced. By doing so, out-of-court restructuring could be further promoted and the number of insolvency proceedings kept to a minimum. A central question that needs to be

[9] 2. COVID-19-JuBG, s 11a, ceased to be in force 1 January 2022.

clarified is who should be subject to this obligation. In addition to the debtor, not all creditors should be included immediately. It could be considered that only the financial creditors are included or only certain groups of creditors. Ultimately, such mandatory mediation and / or debt counselling would have to form the basis for an out of court restructuring (based on a restructuring agreement).

3. Challenges Faced

3.1 Stigma associated with insolvency

With a reform of the Austrian Insolvency Act in 2010, the Austrian legislator tried to change the view of the public on insolvency proceedings. However, more than a decade later, insolvency proceedings are still associated with the stigma that the entrepreneur has failed in his or her business.

3.2 Availability of financial information

Financial information is available before the opening of insolvency proceedings for the protection of creditors (*kreditschutzverband von 1870*). The financial information includes a credit rating of the business.

The national commercial register provides the annual accounts when there is a corresponding obligation for the MSME to issue annual accounts and to publish these accounts. MSMEs have to issue annual accounts when they have annual revenues of over EUR 700,000 or when they are a company with limited liability.

Additionally, after the opening of insolvency proceedings, financial information limited to the fact that an MSME is insolvent is provided by the insolvency register (*insolvenzdatei*).

3.3 Access to new money

Access to new money during insolvency proceedings is very difficult because of the rating provided by *kreditschutzverband von 1870*. Perhaps this is also a reason why MSMEs, before entering into insolvency proceedings, often try to restructure (or get access to new money) in out of court restructuring proceedings. This financial assistance is one of the most important factors for a successful restructuring plan. Therefore, it needs to be protected, especially from avoidance actions.

According to the European legislator, "financial assistance" should be understood broadly: provision of money, third-party guarantees and the supply of stock, as well as inventory, raw materials and utilities. This leads to a protection of two forms of financial assistance often used, namely financial measures both from private equity investors (with subordinated loans) and banks (with new bank loans).

There is a distinction between "new financing" and "interim financing". New financing means financial measures taken to implement a restructuring plan, whereas interim financing consists of financial measures necessary to continue the day-to-day business during the negotiations for a restructuring plan. Both new

financing and interim financing in restructuring proceedings under the Austrian Restructuring Act are protected from avoidance claims (*anfechtung*).[10]

3.4 Secured creditors *vis-á-vis* unsecured creditors

Security instruments over assets are pledges (*pfand*), transfers of securities (*sicherungsübereignungen*), assignments of securities (*sicherungszessionen*) and reservation of title (*eigentumsvorbehalte*). These security instruments in insolvency proceedings lead to claims of separation to receive assets (*aussonderungsanspruch*) and / or claims of separation to receive the proceeds of enforcement after sale (*absonderungsanspruch*).

Claims of separation can be divided into secured and unsecured parts based on the collateral valuation. The unsecured part is an insolvency claim. Claims of secured creditors are not affected by the commencement of insolvency proceedings, except for the restraint that no secured claim can be paid within six months from the commencement of insolvency proceedings in case such claims might jeopardise the business continuity of the debtor. Only if the enforcement is vital to prevent severe economic disadvantage to the secured creditor may this provision be disregarded. The secured creditor merely has to inform the administrator and, lacking acknowledgement of the claim, potentially file a lawsuit against the insolvency administrator in order to enforce the senior security. In addition, secured creditors are at risk of avoidance claims being commenced.

In contrast, unsecured creditors have insolvency claims (*insolvenzforderungen*). Insolvency claims may be filed with the competent court within a time period after the commencement of insolvency proceedings as fixed by the court. Those insolvency creditors that file a claim not contested by the insolvency administrator also share in such claims on a pro rata basis.

Subordinate claims may result from contractual provisions or from statutory provisions. Subordinate creditors do not participate in the insolvency proceedings in general, but rather only if a surplus for distribution is generated. However, in practice, high diligence is required in drafting subordination agreements to determine the extent (and scenarios) of full or partial subordination.

By comparison, the new Restructuring Act provides that debtors, except for MSMEs, are obliged to divide their creditors into specific classes and all creditors of the same class must be treated equally (if permissible and no classes are formed, all creditors must be treated equally). The categories of classes are mandatory and are as follows:

- secured creditors: creditors with claims for which a pledge or a comparable security has been granted from the debtor's assets. The claims of secured creditors are to be included in this class with the amount covered by the security (any unsecured part of the claims falls into the class of creditors with unsecured claims, which means, as a general principle, that one and the same creditor may, depending on the type of its claims, fall into more than one class);

- unsecured creditors;

[10] *Idem*, ss 36a, 36b.

- vulnerable creditors: this class includes in particular creditors whose claims do not exceed EUR 10,000. Unlike for the other classes, it is the intention of the law to cover in this class claims of creditors that do not have as a matter of fact or as a consequence of the nature of their business the possibility to spread their risk of insolvency (including, for example, a debtor's suppliers);

- bondholders (including holders of securitised title); and

- creditors of subordinated claims.

3.5 Insufficient asset base

A low asset base for MSMEs can push creditors to opt for restructuring (keeping the debtor as a going concern) rather than liquidation. For this decision, the creditor has to compare the quota it would receive in a going-concern scenario with the quota in a liquidation scenario. A low asset base usually leads to a higher quota in a going concern scenario.

3.6 Personal guarantees (PGs)

MSMEs with limited liability often have a lack of assets to have sufficient access to financing. Therefore, the shareholders and managing directors have to guarantee or pledge real estate for the liabilities of MSMEs. In insolvency proceedings, the collateral can be realised to reduce liabilities. The shareholders and the managing directors are often the same person, which leads to the situation that a PG is not recoverable because the shareholder-managing director has already helped his or her MSME out with all the assets (especially liquid funds) available to him or her. This is also the reason why it is not uncommon for the insolvency of the shareholder-managing director to follow the insolvency of the MSME.

3.7 Further challenges

Austrian MSMEs now have to cope with the ongoing impact of COVID-19 without further legal measures in the field of insolvency and restructuring. Some experts tend to predict a substantial increase of the insolvency rate primarily in relation to MSMEs going forward.

These circumstances lead to the question how to cope with imminent insolvency within the insolvency and restructuring legislation provided by the Austrian and European legislator, especially the new Austrian Restructuring Act, in order for MSMEs not to end up in liquidation (bankruptcy) proceedings.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

One of the most important factors is for the restructuring and insolvency legislation to fit the needs and requirements of MSMEs. On the one hand, in case of a "likelihood of insolvency" or insolvency (illiquidity, over-indebtedness) there are a lot of different types of proceedings to restructure or liquidate MSMEs. On the other hand, a formal framework for out of court restructuring still does not

exist. As noted below, it would be ideal for such a formal framework to be introduced.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Formal insolvency would have stressed MSMEs without the financial and legal measures taken by the Austrian Government during the pandemic. Most of these measures are no longer in force and the post COVID-19 era will show if the new restructuring proceedings and insolvency proceedings, especially the reorganisation proceedings, fit the needs of MSMEs in financial difficulties.

4.3 Simplified insolvency proceedings

The new Austrian Restructuring Act is another step towards a viable restructuring and insolvency culture. Nevertheless, there is a need for further simplification of both out of court restructuring as well as restructuring within insolvency proceedings. In order to counter negative developments as early as possible, a formal framework for out of court restructuring (based on restructuring agreements) is required. In principle, general standards have already been established in this area, but there are still no specific legal provisions.

One of the most important issues in out of court restructuring is the need for all creditors to agree to a haircut. The European legislator recently repeated this principle with the EU Directive on Restructuring and Insolvency (binding for the Austrian legislator). In restructuring proceedings under the Austrian Restructuring Act, approval of the insolvency court is always required in addition to the consent of the creditors by means of a majority decision.[11] Therefore, debtors will in practice need to negotiate with every creditor to get the necessary consent. If a creditor does not want to participate, a formal restructuring or reorganisation is an alternative, but the debtor has to cope also with the negative effects.

One of the biggest negative effects is the negative publicity of insolvency proceedings. Insolvency proceedings affect all of the company's stakeholders. It starts with the customers who lose trust in the company. The suppliers begin to consider whether they want to continue supplying the company. Even if they are willing to continue, suppliers often change the terms of payment and delivery. Employees who are important to the company leave the company. Regardless of these negative effects, Austrian insolvency law basically offers a viable proceeding for quick and targeted restructuring. The central element of a further simplification is, as is already the case in the pre-insolvency area, to in particular assess the individual facts from an economic point of view, especially when it comes to continuing the business or the sale process. Even if a formal procedure is required to protect the interests of the creditors, an economic perspective should always be applied.

[11] Austrian Restructuring Act, s 34.

BRAZIL

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

Federal Law No. 11,101/2005, recently modified by Law No. 14.112/2020 (Brazilian Bankruptcy Law) establishes three insolvency mechanisms: (i) judicial reorganisation; (ii) extrajudicial reorganisation; and (ii) liquidation. The mechanisms of judicial reorganisation and extrajudicial reorganisation aim to restructure a viable company and its debts to preserve the company's activities.

The liquidation proceeding shall apply when the company is no longer viable. In this case, the debtor is removed from the company's management and activities. The existing assets are gathered, appraised and sold by a judicial administrator appointed by the court, who will use the proceeds to pay the creditors of the bankruptcy state.

Regarding MSMEs, a short introduction is necessary. Brazilian MSMEs mainly take two forms: microenterprises (MEs) and small business enterprises (SBEs). Both can take on various corporate types, such as entrepreneurial companies, simple companies, individual limited liability companies and simple partnerships.

Several models of a corporate organisation may fit into the concept of MSMEs in Brazil, but they must comply with some pre-established parameters. In accordance with Federal Complementary Law n. 123/2006, the National Statute of the Micro and Small Businesses, MEs are companies that earn a gross revenue up to BRL 360,000.00, while SBEs are companies that earn a gross revenue higher than BRL 360,000.00 and up to BRL 4,800,000.00.

There is a section of the Brazilian Bankruptcy Law with particular provisions concerning the judicial reorganisation of micro and small companies through a more simplified and less burdensome procedure. However, such companies can still opt for the reorganisation through the general procedure available for all types of companies.

1.2 Specific insolvency legislation

1.2.1 Judicial reorganisation of micro and small companies

Section V of the Chapter III of the Brazilian Bankruptcy Law provides for the judicial reorganisation of micro and small companies.

A special judicial reorganisation proceeding begins with the filing of a petition with the court, and may only be voluntary (i.e. creditors cannot request a debtor's judicial reorganisation).

The debtor may opt to include certain specific creditors, which is a relevant difference from the ordinary judicial reorganisation proceeding. The special judicial reorganisation cannot affect credits with fiduciary liens (*alienação fiduciária*), advance of foreign exchange currency agreements or tax claims.

A rural producer holding an indebtedness up to BRL 4,800,000.00 may also file for the special judicial reorganisation request.

The judicial reorganisation request must be filed before a court with competent jurisdiction, where the main centre of interests of the company is located, which corresponds to the place where the debtor conducts the administration of its interests.

To be eligible to file the request, the debtor cannot: (i) be bankrupt; (ii) have had another judicial reorganisation request granted within the past five years; or (iii) have been convicted for a bankruptcy crime.

If all requirements for the judicial reorganisation are met (e.g. filing of the list of creditors and of all lawsuits filed against the debtor and recent financial statements), the court will grant the request.

The debtor must submit a judicial reorganisation plan within 60 days of the decision that granted the request to file the judicial reorganisation. The special judicial reorganisation plan shall provide for the following conditions: (i) payment in 36 equal and successive monthly instalments, plus interest according to the SELIC rate, and may contain a proposal for debt reduction; (ii) the grace period cannot exceed 180 days as of the filing date of the judicial reorganisation; and (iii) the court, after hearing the judicial administrator appointed by the court and the committee of creditors, shall authorise the debtor to increase expenses or hire new employees.

Despite the restrictions for the presentation of the special plan, there is a great advantage that makes the judicial reorganisation procedure for MEs and SBEs worthwhile: there is no need to convene a general meeting of creditors to vote on the plan.

If the plan is presented in compliance with the legal requirements, the court will ratify it automatically.

1.2.2 Liquidation

The liquidation proceeding, which is also applicable to micro and small companies, may be voluntary, filed by the debtor itself, or involuntary, filed by creditors. Creditors may request a company's liquidation when: (i) the debtor fails to pay a due debt that exceeds 40 minimum wages;[1] (ii) the debtor fails, during the legal period, to pay the debt or to appoint assets for seizure in a foreclosure proceeding; or (iii) the debtor engaged in acts such as fraud against creditors, fraudulent payments or failure to comply with obligations pursuant to a reorganisation plan.

As a response to the request filed by a creditor, the debtor may:

- pay the debt, causing the termination of the process;
- file a defence and post a bond with the Bankruptcy Court to avoid the liquidation decree. In case of rejection of the defence, the bond will be released to the creditor;

[1] A minimum wage in Brazil in January 2018 corresponded to BRL 1.212. 40 minimum wages would correspond to BRL 48.480 (approximately USD $ 9,696.00).

- only file a defence; or
- request its judicial reorganisation.

In case of a voluntary request, the debtor must disclose the reasons of the impossibility to carry on its activities along with some documents required by Bankruptcy Law, such as a creditors' list.

Unlike a judicial reorganisation proceeding, in a liquidation proceeding, all the managers and directors will be removed, and the court-appointed judicial administrator will manage the bankruptcy estate and represent it with the courts and in contracts.

Regarding bilateral contracts, the judicial administrator may opt to continue their fulfilment for a certain period to avoid debt increase or if it is necessary to preserve and maintain the bankruptcy estate's assets.

The judicial administrator must gather, appraise, and sell all the company's assets through competitive public proceedings. The valuation of the assets as well as the timing of the proceedings concerning the sale of the assets will depend on the judicial administrator.

The judicial administrator will use the proceeds to pay the creditors according to the preference order set forth by articles 83 and 84 of the Bankruptcy Law.

After the liquidation is decreed, the debtor company will be liquidated so that its assets can be seized and sold by the judicial administrator, and the amount obtained will be used to pay the creditors. Only after the termination of all obligations may the shareholders request the rehabilitation of the company, to explore its activity once again.

All the debtor company's obligations will be considered terminated if: (i) it is able to pay all its debts; (ii) it is able to pay up to 25% of its unsecured debts; or (iii) after three years of the bankruptcy decree, except for the use of previously collected assets, which shall be destined for liquidation to satisfy listed creditors or creditors that made an amount reservation request.

The liquidation proceeding is a case of total judicial dissolution of the company. If, after the sale of all assets and the payment of creditors, there is any amount left (which is very unlikely to occur), this amount will be given to the shareholders in proportion to their participation in the company's equity.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

- *Extrajudicial reorganisation*

  Extrajudicial reorganisation allows the debtor to restructure its debts with specific groups of creditors, for example, only financial institutions or secured creditors. In the extrajudicial reorganisation proceeding, the debtor negotiates a plan with its creditors (pre-package restructuring) and may request the

homologation of the plan by the court to become binding regarding other creditors included in the extrajudicial reorganisation.

The debtor negotiates the terms of the plan, and which companies are going to be part of the restructuring, before filing of the request with the court.

As Brazilian Bankruptcy Law determines a minimum quorum of adhesion, for the homologation, most creditors, per amount, will already be in accordance with the terms disposed.

Afterwards, if the legal requirements are met and the court homologates the extrajudicial plan, the non-adherent creditors will also be subject to the conditions agreed by the majority of creditors.

As the plan is previously negotiated between the debtor or debtors of the same economic group, and its creditors, the court cannot include *ex officio* another company in the extrajudicial reorganisation.

During the extrajudicial reorganisation proceeding, the debtor remains in possession and shareholders, officers and directors appointed by the shareholders keep control and management of the debtor company

Exempted creditors are not subject to extrajudicial reorganisation, and the subjection of labour and occupational accident claims requires collective bargaining with the labour union of the respective professional category.

The debtor must obtain the approval of creditors representing more than 50% of the claims, in amount, in each affected group or class of claims. If that threshold is met then, ursuant to the applicable law, the plan shall be confirmed by the court and become binding on holders of all impaired claims, including those who disagreed with it.

The request for confirmation of the extrajudicial reorganisation plan will also trigger the stay period, but only in relation to the credits included in the reorganisation. The ratification of the plan does not prevent the exempted creditors or creditors that were not included in the extrajudicial reorganisation from requesting the debtor's bankruptcy liquidation.

1.3.2 Informal framework

A company in economic and financial crisis is not forbidden to seek renegotiation of the payment terms with its creditors in an extrajudicial manner and without any homologation by the court.

In these cases, there is no standardised procedure, and renegotiations are made according to the particularities of each case. The debtor can approach banks directly to renegotiate loan payments and seek new credit to stabilise its operation.

1.4 Accelerated restructuring or liquidation of MSMEs

The Brazilian Bankruptcy Law's provision regarding the possibility of submitting a special plan by MSME debtors is a measure that aims to accelerate the

reorganisation procedure, making it simpler and cheaper.

Once the need for a general meeting of creditors to vote on the plan is dismissed, the most time-consuming part of the procedure – negotiating with creditors – is avoided.

The Center for Studies of Insolvency Processes – NEPI of the Pontifical Catholic University of São Paulo – analysed all judicial reorganisation processes in the State of São Paulo between the years 2011 and 2016, with data from ABJ – Brazilian Association of Jurisprudence – and found that the median time between granting of the reorganisation and the effective holding of the creditors' general meeting was 314 days for reorganisations processed in specialised courts and 433 days for reorganisations processed in common courts.

In other words, the average time from the moment the reorganisation processing is requested by the creditor to the moment the meeting that will vote on the plan is held is approximately one year.

Besides, holding the first general creditors' meeting does not necessarily mean that the plan will necessarily be voted on and approved. In practice, it is also common for the meeting to be suspended and resumed a few times, which only makes the whole process even more time-consuming.

Therefore, the legal provision for a specific judicial rehabilitation procedure for MSMEs sought precisely to speed up the process, considering the economic and financial particularities of these companies.

The slowness of the ordinary procedure was so great that the changes introduced by Law 14.112/2020 brought express provision about a deadline for the plan to be effectively voted on by creditors.

Currently, once the general creditors' meeting is held, the plan must necessarily be voted on by creditors within 90 days.

Another interesting fact to note is that, despite the existence of a special procedure for micro and small companies, many of them opt to seek restructuring through the ordinary procedure.

According to NEPI's analysis, in only 17.9% of the cases did MSMEs opt for the special route, which means that of all the judicial recoveries requested in the State of São Paulo from 2011 to 2016 by a MSME debtor, in 82.1% of the cases the company chose not to present a special plan meeting the legal requirements. The data reflecting the plan approvals in this same period is even more problematic, since of the 387 plans approved, only 1.8% of them were special plans submitted by MSMEs.

This statistical analysis confirms that, even though there is the evidently greater speed in the presentation of special judicial reorganisation plans, the limitations on the procedure imposed by law have kept MSMEs from opting for special judicial reorganisation.

1.5 Discharge of debts for natural persons

1.5.1 Civil insolvency

The Brazilian Bankruptcy Law is not applicable to natural persons.

The Brazilian Civil Code establishes civil insolvency for natural persons, but it is rarely applied in Brazil.

While the provisions of Law 11.101/2005 deal with the judicial rehabilitation of companies, the civil insolvency provided in the Civil Code aims to regulate the insolvency of individuals and legal entities with a non-business nature, such as cooperatives, associations and foundations.

Both the debtor and the creditor can request the debtor's civil insolvency whenever the debtor's debts, supported by an enforcement instrument, exceed the debtor's assets. Thus, the only requirement for declaring the debtor's civil insolvency is that the enforcement instrument that is sought to be collected exceeds the debtor's assets.

The aim of civil insolvency is to enable the rehabilitation of the debtor's civil life.

When a debtor is declared insolvent:

- all the enforceable titles held have their early maturity;
- all assets susceptible to attachment become part of the action;
- all pending or future executions against the debtor are redirected to the insolvency action; and
- the debtor loses the right to administer his / her assets, which remain under the administration of his / her major creditor.

The selected assets will then be auctioned, and the proceeds from the sales will be shared among the creditors. The debtor is only considered rehabilitated and free of any debt within five years after the final unappealable decision that closed the insolvency proceedings. During this lapse, any assets acquired by the debtor will be used to pay the remaining creditors.

1.5.2 Super-indebtedness Law

After nearly a decade under discussion in the National Congress, on 2 July 2021, Law nº 14.181/2021 took effect, called the Super-indebtedness Law.

This Law amends the Brazilian Consumer Protection Code (CDC) and the Elderly Statute and regulates, in an innovative way, the consumer credit regime. The focus is on combating over-indebtedness, a situation defined as the consumer's inability to pay their debts without compromising the “existential minimum”.

The legal text provides new rules on the offer and contracting of credit and innovates with the possibility of renegotiation of consumer debts in court.

The main goal of the Law is to combat social inequality brought about by the economic crisis in Brazil, observed by the increasing number of indebted people.

On the one hand, the Law is applicable to every individual consumer (natural person) subject to the offer of credit, or in a situation of over-indebtedness. On the other hand, it is applicable to any supplier and to financial institutions.

Over-indebted consumers may request the renegotiation of their debts both extrajudicially and judicially. The Law makes it optional for SNDC public agencies, such as state and municipal PROCONs and SENACON, to promote conciliation to combat over-indebtedness, in addition to other educational measures. The consumer may also request the judicial renegotiation of their debts, a procedure that will include a conciliation hearing with creditors and the creation of a compulsory payment plan.

However, the following debts cannot be included in the negotiation:

- debts contracted in bad faith or without payment intention;
- debts related to luxury goods and services (high value);
- secured claims;
- real estate financing; and
- rural credit.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

When it comes to the insolvency of MSMEs, the Brazilian Government has not implemented any special measures in response to COVID-19, which shows a large gap in the jurisdiction. The measures taken were directed to treat the pandemic in an extrajudicial manner, with the granting of credit and extension of payment terms.

Concerning individuals, a specific procedure for over-indebtedness was introduced (as discussed above). Although the Bill's project was first presented in 2015 (PL 3515/2015), with the pandemic and its financial consequences, the procedure was accelerated to enact the law.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

No measures have been implemented in Brazil suspending the application for judicial reorganisation and bankruptcy of micro and small companies.

2.3 Insolvency procedural deadlines

No measures extending the deadlines for insolvency proceedings for MSMEs during the COVID-19 pandemic were introduced in Brazil.

2.4 Minimum debt requirements to initiate insolvency proceedings

No minimum debt for filing for judicial reorganisation, especially for the period of the COVID-19 pandemic, was introduced in Brazil.

2.5 Suspending specific creditors' rights

There was also no provision for suspending the rights of specific creditors concerning filing for MSME bankruptcy during COVID-19.

2.6 Mediation and / or debt counselling

The debtor may file injunctive relief before the court to obtain a stay period of 60 days, during which the enforcement proceedings will be suspended to seek a settlement with the creditor in a mediation proceeding to be commenced with the Judiciary Center for Conflict Resolution and Citizenship of the competent court.

The stay period of 60 days will be deducted from the stay period of 180 days if the debtor files later for judicial reorganisation or extrajudicial reorganisation.

If the debtor files for judicial reorganisation or extrajudicial reorganisation within up to 360 days counted from the date of the settlement in the mediation, the creditor will have its rights and guarantees restored.

3. Challenges Faced

3.1 Stigma associated with insolvency

Regarding a small entrepreneur, there is a reduced business operation, with a reduced number of employees, reduced working capital, and, consequently, less opportunity to obtain credit directly linked to private financial institutions, associated with greater difficulty in offering guarantees to contracts intending to obtain credit.

In the case of a MSME that has experienced economic and financial difficulties that led to a recovery procedure, whether extrajudicial or judicial, either by the common or the special procedure, obtaining credit to resume activities after the end of the process is even more complicated.

Moreover, even the possibilities of financing during the recovery procedure for MSMEs, either by maintaining the supplier creditors or obtaining a DIP loan, is also more difficult when compared to the situation of a large company with a very high turnover.

A large and consolidated company that goes through a judicial rehabilitation process is seen more positively by its creditors and the financial market than a MSME that goes through the same situation.

The stigma relates to companies that have faced insolvency leads many companies in difficulty – which could easily get back on their feet by filing a reorganisation request – not to do so.

Going through an insolvency proceeding is commonly linked to representation weakness and mismanagement, preventing many companies from opting to negotiate their debts by a legal procedure.

3.2 Financial information

As mentioned above, MEs are companies that earn a gross revenue up to BRL 360,000.00, while SBEs are companies that earn a gross revenue higher than BRL 360,000.00 and up to BRL 4,800,000.00. As their composition involves few employees and managers, the level of organisation and required public financial information by law is simpler than medium and large companies.

MSMEs have the option to not keep balance sheets / books. MSMEs are exempted from presenting a balance sheet if they can adhere to the Simples Nacional, which is a tax collection and inspection regime.

With respect to the need to submit balance sheets for the filing of a judicial reorganisation, MSMEs can submit simplified books and accounting records (art 51, §2).

However, not keeping a balance sheet can create obstacles for MSMEs. For example, in order to participate in bidding processes, it is necessary to submit the company's balance sheet (the economic-financial qualification of the company must be proven, among other items, by the balance sheet and the financial statements for the last fiscal year).

3.3 Access to new money

The law did not foresee specific ways of financing MSMEs during a restructuring procedure.

Once the judicial reorganisation procedure is initiated, the debtor may seek to obtain DIP financing. The court may, after hearing the committee of creditors, authorise financing agreements to the debtor, guaranteed by a fiduciary lien over assets and rights owned by the debtor or third parties, in relation to the activities and expenses of restructuring or preserving the value of assets.

If the debtor has its judicial reorganisation converted to a liquidation, the DIP lender will have a super priority, and in the payment ranking preference will receive its payments only after labor claims that became due three months before the bankruptcy, limited to five minimum wages per employee, and essential expenses of the management of the bankruptcy estate.

However, the Federal Government has also approved Law n. 14.025/2020, which provides that the Brazilian Support Service to Micro and Small Companies (*Sebrae*) must allocate to the Endorsement Fund for Micro and Small Companies (*Fampe*) at least 50% of the resources that will be transferred to it from the proceeds of the collection of the additional contribution of social security rates related to the competencies of April, May and June 2020.

The Endorsement Fund for Micro and Small Companies in turn, is a Government fund that allows the Support Service to be a complementary guarantor of financing for small businesses.[2]

The Government has also instituted a program called GiroCAIXA PRONAMPE. The program is a credit line of the National Program of Support to Micro and Small Enterprises (PRONAMPE) to assist in developing and strengthening small businesses to face the impacts caused by COVID-19.[3]

The credit is subject to special payment conditions, which count on an 11 month grace period and 37 months for payment; annual interest rate corresponding to the Selic plus 6% aa; and a contracting limit of R $ 150,000.00.

3.4 Secured creditors vis-à-vis unsecured creditors

In the MSME special proceeding, there is no difference in between the treatment of secured and unsecured creditors (all creditors are treated equally, as special privilege creditors).

3.5 Insufficient asset base

The Brazilian Federal Constitution provides that the economic order would be based on the principle of favourable treatment for small businesses. This favourable treatment would be even more indispensable when these MSMEs are stricken by an economic-financial crisis that would compromise their already limited resources.

As already mentioned, due to the cost and complexity inherent in a judicial reorganisation proceeding, the LREF has provided micro and small businesses with a more simplified and less costly proceeding for judicial restructuring.

For instance, the judicial administrator's fees are limited to 2% of the amount payable to creditors (while in regular judicial reorganisation, this limit is 5%).

Despite the reduced financial capacity of MSMEs and the benefits of the special procedure for such companies, there are also provisions in the Brazilian Bankruptcy Law that seek to provide creditors with some kind of security, so that it is not more advantageous for them to file for bankruptcy of the company: (i) claims must be paid in a maximum of 36 equal and successive monthly instalments, plus interest; and (ii) the first instalment must be paid within 180 days from filing of the judicial reorganisation.

3.6 Personal guarantees (PGs)

The guarantee regime for MSMEs is the same as for other types of companies. In Brazil, personal guaranties can be granted to enforcement instruments (*aval*) or generally any obligation involving a claim (*fiança*). Such guarantees are available for any type of company, not only MSMEs. The *aval* has autonomy and can be enforced regardless of the debtor´s original obligation. The guarantor (*avalista*) is

[2] https://www.sebrae.com.br/sites/PortalSebrae/sebraeaz/fundo-de-aval-do-sebrae-oferece-garantia-para-os-pequenos-negocios,ac58742e7e294410VgnVCM2000003c74010aRCRD
[3] https://www.caixa.gov.br/empresa/credito-financiamento/capital-de-giro/pronampe/Paginas/default.aspx

jointly liable to pay the debit. The *fiança* is related to the underlying obligation and, as a rule, the creditor will only seek payment from the guarantor (*fiador*) provided the creditor already sought to collect / enforce the claim against the debtor, but the guarantor may waive such right, which is common in Brazil.

4. Moving Ahead

Interviews were conducted with the following senior practitioners in Brazil to address the questions posed in this section.

Practitioner 1: Camila Crespi – Associate of Frange Advogados

4.1 Best way to safeguard the interests of MSMEs

Micro and small businesses currently make up more than 98% of the Brazilian corporate system, which means that these companies characterise more than half of the labour income of the Brazilian population, currently estimated at 54%.[4] Nevertheless, these entities are still faced with a restructuring system that does not represent them. Even the recent amendments to Law No. 11,101/05, as incorporated in Section V, dealing with "the court-ordered restructuring plan for micro and small enterprises", did not result in significant changes on the topic, so that the previously established rules remain practically intact.

In this sense, the Brazilian entrepreneur finds it increasingly hard to exercise his / her labor activity, and to venture and fail. Unfortunately, in Brazilian reality, the smaller the company is, the more exposed it is to crisis. To safeguard the interests of MSMEs, therefore, legislative reform would be required that can really meet the demands of companies, taking into account, for example, their annual turnover and their cash flow, which are different from other companies. Currently, more flexible standards, longer payment terms – for the cash flow to be adjusted and the necessary breathing room for the company's working capital – and more lenient labour standards are required.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Under Brazilian legislation (Law No. 11,101/05), micro and small enterprises have a very simplified procedure for business recovery and restructuring, which is carried out through the presentation of a special court-ordered restructuring plan. This is still little used in practice because it contains some specific rules that must be observed for the success of the restructuring procedure. Still, as stated above, no significant changes have occurred regarding this topic, even with the recent changes in the law introduced by Law No. 14.112/20, Section V. The way it is currently presented, therefore, the restructuring legislation is restricted to the needs of the market and not the companies in crisis.

Thus, there are still few small businesses that choose to submit the special court-ordered restructuring plan provided for in the legislation, either because of the cost of the judicial process itself, or even because of the difficulty in accessing

[4] BRAZIL. Subsecretaria de Desenvolvimento das Micro e Pequenas Empresas, Empreendedorismo e Artesanato - SEMPE (Undersecretary's Office for the Development of Micro and Small Enterprises, Entrepreneurship and Crafts). Brasilia: Final Report: Proposal for the New Legal framework for the Court-ordered Restructuring of Micro and Small Enterprises. Brasília - DF: SEMPE, 2019, 26.

credit after the request for the court-ordered restructuring. The conclusion is that little help was provided for MSMEs with the recent changes in the law, with only 2.4% of the companies that presented the special court-ordered restructuring plan going on to participate in the second phase in the state of São Paulo (Brazil), according to a study carried out by the Insolvency Observatory.[5]

4.3 Simplified insolvency proceedings

Although the current legislation provides for a more simplified procedure in theory, the reality is that the level of indebtedness of MSMEs is high, so the special court-ordered restructuring plan, for example, becomes difficult to be fulfilled in alignment with the legal framework.

As noted, the special court-ordered recovery plan would ideally reflect the economic and financial reality of the company going through the crisis and not just the market itself.

Despite the law granting a special regime to MSMEs, which is now simplified and fast, practice has shown that this benefit is still little used because it is risky – either because of the procedural costs of the court-ordered restructuring itself, which must be borne by the small entrepreneur, or because of the difficulty in obtaining new credit on the market after the recovery request.

There is no doubt that a simplified restructuring mechanism is needed, but one that meets everyone's needs and, above all, that has an enforceable restructuring plan. Rather than only settling debts, it is undeniable that the law should provide means for MSMEs to go through a real revitalisation and reorganisation process of their businesses.

Practitioner 2: Renato Scardoa, Partner of Bumachar Advogados and Professor of INSPER.

4.1 Best way to safeguard the interests of MSMEs

In Brazil, there is no specific legislation or public policy that provides for the adoption of pre-insolvency mechanisms as in other jurisdictions.

Thus, it is up to the MSME to seek to initiate individualised negotiations with creditors in order to avoid the need to enter into restructuring and liquidation procedures. It would be optimal to have those pre-insolvency mechanisms included in the law.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

The current Brazilian system for micro-enterprises is very bad, as can be seen from the data recently collected.

According to SEBRAE data, more than 99% of Brazilian companies are MSMEs. However, another study carried out by the PUCSP Insolvency Studies Center, in the

[5] ABJ – Associação Brasileira de Jurimetria (Brazilian Association of Jurimetry). Insolvency Observatory: Second phase. Dec. 2018. Available at: https://abj.org.br/cases/2a-fase-observatorio-da-insolvencia/, accessed on 13 September 2021.

State of São Paulo (a state that concentrates 2/3 of all judicial reorganisation cases in Brazil), only 10% of the reorganisations were filed by MSMEs.

Of these judicial reorganisation cases, only four companies opted for the special proceedings for MSMEs.

In other words, the MSMEs that form the largest number of companies, being the most vulnerable group, do not access the current mechanisms, much less the one specially created for them – which already shows a big indication that our system is inefficient.

There are several reasons that make the current system inefficient, but we can highlight:

- our legislation provides only one remedy for MSMEs, which is the special judicial reorganisation in Law 11.101, but the group that forms MSMEs is heterogeneous (from small industries and businesses to service providers), with diverse needs;

- access to this remedy is late – it is only after two years that a MSME can seek renegotiation via a judicial reorganisation, either special or in the ordinary form. Note that these first two years are exactly the most difficult for the small entrepreneur. Sebrae data shows that 27% close their doors in the first year and 38% close their doors in the second year;

- bureaucratic. The current system is concentrated in the judiciary, and it is up to the judge to decide on possible new contracts or new expenses to be assumed by the entrepreneur in the course of the process. Imagine, a small restaurant having to ask the judge whether or not it can hire more servers, or if it can do a new painting. This does not make any sense;

- inflexible and inefficient. In addition to the restriction on new expenses, the current system establishes the payment limit in up to 36 monthly, equal and successive instalments, adjusted by SELIC, with the first instalment due within 180 days of the request.

  It is not possible for an entrepreneur, even if he / she obtains the agreement of creditors, to establish a payment plan with a longer grace period and longer instalment payments; and

- exclusion of the entrepreneur. The current system was created to cover only the company, but leaves the entrepreneur aside. In other words, it forgets that, as in other jurisdictions, the company and the entrepreneur are blended. And, especially in Brazil, there is practically no bank debt that is not personally guaranteed by the entrepreneur, who owns the company.

In addition, bankruptcy, a fully judicial process, is expensive, bureaucratic and time-consuming, and therefore inaccessible to MSMEs, which, for the most part, end up irregularly closing their activities, creating a large scenario of "zombie" companies.

Brazil only approved palliative measures to face the MSME crisis. They are PRONAMPE and the RELP.

The National Support Program for Micro and Small Businesses (PRONAMPE) is a Federal Government program that offers credit lines for MSMEs.

The Debt Payment Rescheduling Program in the Scope of Simples Nacional (RELP) was created with the aim of helping MSMEs affected by the COVID-19 pandemic, by granting discounts on interest, fines and charges related to unpaid federal taxes, proportionally to the drop in revenue in the period from March to December 2020, compared to the period from March to December 2019.

However, in the Federal Congress, there is a Bill, already unanimously approved in the Senate, but which is being debated in the Chamber of Deputies, which creates a new legal framework for MSMEs (PLP 33/20).

In addition, there are now MSME-specific permanent laws. For viable MSMEs, with less complex indebtedness, a special extrajudicial renegotiation has been established, a procedure without any judicial intervention that provides for the negotiation of MSMEs with their creditors, mediated by support entities such as SEBRAE, which may result in a payment plan registered in the Board of Trade, opposable even to dissenting or absent creditors. For more complex situations, which may cover MSMEs with debts already collected in court, a special judicial renegotiation was established, a form of reorganisation carried out in the judiciary, but with little intervention in a quick and simplified procedure.

For non-viable MSMEs, with less complex indebtedness, simplified extrajudicial liquidation was established, a procedure without any judicial intervention similar to that of closing a limited company and for more complex indebtedness. For more complex situations, which may cover MSMEs with debts already collected judicially, a form of judicial liquidation is established that is faster than bankruptcy. In both procedures, the entrepreneur is also allowed to liquidate his / her personal assets in order to guarantee the fresh start also for the individual.

All legal actions against the company and also against the entrepreneur are suspended during the special extrajudicial renegotiation process, the filing of the request for special judicial renegotiation, and the protocol of the request for registration of the special summary liquidation.

If a payment plan is renegotiated, the co-obligors (including the entrepreneur) remain guaranteeing the debt, however, under the new payment terms. In other words, there is no simple release of the guarantee, which would harm creditors and probably the granting of credit, nor the absurdity of the creditor accepting a payment condition in the plan and, on the other hand, charging the full debt from the guarantor, as occurs today.

4.3 Simplified insolvency proceedings

Although the current legislation provides for a more simplified procedure in theory, the reality is that the level of indebtedness of MSMEs is high, so the special court-ordered restructuring plan, for example, becomes difficult to be fulfilled in alignment with the legal framework.

As noted, the special court-ordered recovery plan would ideally reflect the economic and financial reality of the company going through the crisis and not just the market itself.

Despite the law granting a special regime to MSMEs, which is now simplified and fast, practice has shown that this benefit is still little used because it is risky – either because of the procedural costs of the court-ordered restructuring itself, which must be borne by the small entrepreneur, or because of the difficulty in obtaining new credit on the market after the recovery request.

There is no doubt that a simplified restructuring mechanism is needed, but one that meets everyone's needs and, above all, that has an enforceable restructuring plan. Rather than only settling debts, it is undeniable that the law should provide means for MSMEs to go through a real revitalisation and reorganisation process of their businesses.

Practitioner 3: Thomaz Luiz Sant'Ana, Partner of PGLaw

4.1 Best way to safeguard the interests of MSMEs

There is a lack of restructuring and formal insolvency proceedings in Brazil for MSME corporations. The proceedings available are better fitted to big corporations, involving a lot of cost and bureaucracy. In view of that, we need to think about a new model bringing faster and simpler proceedings. With less paperwork to file an insolvency proceeding, we will be able to decrease costs and accelerate the liquidation of assets, the payment of creditors and the company reorganisation.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

The Brazilian Insolvency Law has a specific section regulating the judicial reorganization of MSMEs. Nevertheless, as indicated above, those proceedings are not well suited for small corporations. For this reason, few small companies have adopted the regulated proceeding when facing financial problems. On the contrary, small businesses prefer simply to "close the door" without looking for a solution and / or negotiation with their creditors.

There is a whole new law (PLP 33/2020) in discussion by the Parliament with specific proceedings that are better fitted to small and medium companies. This new law is still pending discussion by the Parliament and could create a whole new system to reorganise MSMEs' debts.

4.3 Simplified insolvency proceedings

The present reorganisation law sets forth an inflexible proceeding with specific payment conditions in case of judicial reorganisation or with severe penalties to the businessperson in case of bankruptcy. New legislation is required to simplify the proceeding, bring flexible and negotiable payments conditions that should be discussed among the debtor and creditors and make possible a fast bankruptcy (in cases where a reorganisation is not possible) with the potential for a fresh start.

BULGARIA

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

Insolvency proceedings in Bulgaria are legally regulated in Part 4 of the Commerce Act (CA). Pursuant to article 607a of the CA, insolvency proceedings are opened for a merchant who is insolvent. Additionally, insolvency proceedings are opened in the case of over-indebtedness of a limited liability company, joint stock company or partnership limited by shares. A "merchant" is defined in article 1 to mean any natural or legal person who, by occupation, carries out transactions listed *numerus clausus* in the CA, as well as commercial companies and cooperatives with the exception of housing cooperatives. A merchant is also any person who has established an enterprise which, in accordance with its purpose and volume, requires that its business be conducted in a commercial manner, even if its activity is not listed in the CA. In Bulgaria, MSMEs are usually organised as limited liability companies or sole traders.

The insolvency proceedings in Part 4 of the CA apply to all types of merchants (including but not limited to sole traders and limited liability companies) and the aim of those proceedings is to fairly satisfy creditors and to provide the possibility of rehabilitation of the debtor's enterprise.

1.2 Specific insolvency legislation

The insolvency proceedings rules applicable to all merchants apply to MSMEs irrespective of their legal form.

However, there are additional specific regulations that apply only to the insolvency proceedings of a sole trader or for a general partner in a general partnership, limited partnership or partnership limited by shares. Notably, under article 611, paragraph 1 of the CA, insolvency proceedings may be opened for a sole trader or a general partner, who is deceased or deregistered from the Commercial Register, if before the date of the death or the date of the deregistration the sole trader or the general partner was insolvent. In such a case, the opening of insolvency proceedings may be applied for within one year after the date of the death or the date of the deregistration from the Commercial Register of the relevant sole trader or general partner.

In relation to sole traders or general partners who are married in community of property, the insolvency estate of the insolvent sole traders or general partners shall include one half of the assets, rights on assets and cash deposits which are included in the matrimonial community of property.[1] In accordance with article 27, paragraph 5 of the Family Code, the matrimonial community of property for a sole trader or general partner shall be terminated upon the entry in force of the judgment for opening the insolvency proceedings.

[1] CA, art 614, paras 2 and 3.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

Chapter 48 (articles 740 to 741a) of the CA provides the possibility for an out of court settlement. At any stage of the insolvency proceedings, the debtor may enter into a written contract with all creditors with admitted receivables to settle the payment of the monetary liabilities of the debtor. In such a case, the insolvency trustee shall not represent the debtor as a party to the out of court settlement. If the agreement so executed meets the requirements of the law, the court shall terminate the insolvency proceedings with a judgment, provided that no requests under article 694, paragraph 1 of the CA have been lodged for declaring an admitted receivable non-existing.

The court judgment for termination of the insolvency proceedings is subject to appeal within seven days of its registration in the Commercial Register. If the debtor fails to fulfil its obligations under the out of court settlement, the creditors whose receivables represent not less than 15% of the total receivables may request the insolvency proceedings to be resumed without proving new insolvency or over-indebtedness. In the resumed insolvency proceedings, no rehabilitation proceedings shall be permissible.

1.3.2 Informal framework

Previously, as a common practice, MSMEs were considered by the credit and non-banking financial institutions in Bulgaria as potential borrowers with a higher risk in comparison with large companies. This risk assessment was based mainly on MSMEs' asset base, sales revenue and EBITDA.

However, during the pandemic, the credit institutions in Bulgaria developed more flexible practices. For example, on 3 April 2020, the Bulgarian National Bank (BNB) adopted a resolution for the implementation of the guidelines endorsed by the European Banking Authority (EBA) on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02). On 10 April 2020, the BNB affirmed the procedure for deferral and settlement of liabilities payable to banks and their subsidiaries – financial institutions, as proposed by the Association of the Banks in Bulgaria. That procedure was subsequently amended and supplemented and approved by the BNB on 9 July 2020 and on 10 December 2020. For more details, please refer to section 1.5 below. The procedure for deferral and settlement represents a non-legislative moratorium in terms of the guidelines of the EBA (EBA/GL/2020/02), which is subject to an agreement between the borrower and the respective bank or financial institution.

In addition, deferral and settlement may be agreed between the parties to a credit facility agreement or to a commercial agreement on the basis of their willingness to provide the debtor with a possibility and time sufficient for payment of its liabilities. Normally, agreements of this nature relate to payment of an initial minimum amount, potential establishment and perfection of certain security interests in favour of the creditor, rescheduling the final maturity dates for payment and other terms and conditions.

1.4 Accelerated restructuring or liquidation of MSMEs

The mechanisms for restructuring and liquidation for all merchants are regulated in the CA and there are no special regulations for their accelerated implementation in relation to MSMEs.

There are two available mechanisms for restructuring the debts of merchants (including MSMEs).

The first mechanism is regulated in Part 5 of the CA, "merchant stabilisation proceedings". The purpose of these proceedings is to prevent the initiation of formal insolvency proceedings by reaching an agreement between the merchant and its creditors on the manner of performance of its obligations, which would lead to the continuation of the merchant's activity. Stabilisation proceedings may be opened for a merchant who is not insolvent but is in imminent danger of insolvency. An imminent risk of insolvency is present when the merchant, in view of the forthcoming maturities of its monetary obligations in the next six months from the submission of the application for stabilisation, will be unable to fulfil the required monetary obligations or may suspend payments.

All creditors of the merchant participate in these proceedings, including the creditors the merchant has granted securities to for third party obligations. The proceedings are initiated upon written application submitted by the merchant, which is addressed to the District Court at its seat. The application is considered by the Court immediately in closed session and the Court makes a ruling on the merits. If stabilisation proceedings are initiated, a procedure for preparation, consideration and voting on a stabilisation plan is initiated. The stabilisation plan also needs to be approved by the court. The approved stabilisation plan is binding for the merchant and for the creditors whose receivables arose before the date of the decision for approving the plan, including those who did not take part in the proceedings or those who voted against the plan.

However, in practice, there are difficulties in the application of stabilisation proceedings in Bulgaria, so that it does not fulfil its function of a preventive procedure for the restructuring of merchants' debts. In particular:

- the use preventive restructuring mechanisms by merchants is not a common practice in Bulgaria;
- merchants initiate stabilisation at a very late stage – when they are already insolvent and the preconditions for initiating insolvency proceedings against them are present;
- merchants encounter difficulties in submitting the application for initiation of stabilisation proceedings, given its numerous contents, as well as due to the many annexes the application must contain (see article 770 of the CA);
- no interim financing is provided for financially distressed merchants. The current legislation related to insolvency proceedings provides for the possibility to revoke transactions performed after the initial date of insolvency, which is determined by a court; and

- stabilisation requires an agreement between the merchant and all its creditors, which is difficult to achieve, including due to the presence of large claims of the National Revenue Agency in some cases.

The second mechanism is regulated in Chapter 44 of the CA, "rehabilitation of the enterprise". In this case, there is already an open insolvency proceeding for the debtor, and rehabilitation proceedings are a possible stage of its development. A recovery plan may be proposed only by the persons specified in the CA no later than one month after the announcement of the court ruling for approval of the list of admitted receivables in the Commercial Register. The recovery plan is adopted by the creditors' meeting, and once adopted, the plan needs to be approved by the court. With the decision for approval of the plan, the court terminates the insolvency proceedings, but if the debtor does not fulfil its obligations under the plan, the creditors whose receivables are transformed by the plan and represent not less than 15% of the total receivables may request the resumption of the insolvency proceedings without proving new insolvency or over-indebtedness. In this case, no rehabilitation proceedings shall be permissible in the reopened insolvency proceedings.

The liquidation (voluntary winding up) of a merchant is regulated in Chapter 17 of the CA and it is applicable to all merchants, whether they are MSMEs or not. After the termination of the merchant, liquidation is carried out. The term in which the liquidation must be completed is determined by the general meeting of the shareholders in a limited liability company and a joint stock company, and for the other commercial companies by unanimous decision of the general partners. The minimum term may not be shorter than six months after the announcement in the Commercial Register of the invitation of the liquidator to the creditors for submission of their claims to the merchant. In practice, the minimum term is usually not shorter than eight months, taking into consideration that the notification of the National Revenue Agency for the intended liquidation is a prerequisite for the initiation of the liquidation procedure and the National Revenue Agency has a statutory term of two months to respond to the notification. Such a term shall also be determined by the registration official at the Registry Agency when he / she appoints liquidators. If necessary, the specified period may be extended.

The liquidators are obliged, by announcing the termination of the merchant, to invite creditors to present their claims. The invitation must be sent in writing to the known creditors and is announced in the Commercial Register. As identified above, the property of the company is distributed only if six months have passed since the day on which the invitation to the creditors was announced in the Commercial Register. The liquidators are obliged to complete the current transactions, to collect the receivables, to convert the remaining property into money and to satisfy the creditors. They may enter into new transactions only if required by the liquidation. When all liabilities have been settled and the remainder of the property has been distributed, the liquidators request the deregistration of the merchant form the Commercial Register.

1.5 Discharge of debts for natural persons

The current insolvency regime in Bulgaria applies only to natural persons who are engaged in commercial activities as sole traders registered in accordance with article 56 of the CA or as general partners in general partnership, limited

partnership or partnership limited by shares. On the legal grounds of article 625 of the CA, insolvency proceedings shall be initiated against an indebted merchant (irrespective of its legal form) upon written application lodged with the court by the debtor or, respectively, by the liquidator or by a creditor of the debtor under a commercial transaction, by the National Revenue Agency for a public liability due to the State or to the municipalities in relation to the commercial activity of the debtor or for a private State liability, or by the General Labour Inspectorate in the event of wages due and unpaid for more than two months to at least one third of the employees of the debtor.

In accordance with article 739, paragraph 1 of the CA, all claims which have not been submitted and the rights that have not been exercised within the insolvency proceedings shall be discharged. As per article 739, paragraph 2 of the CA, the claims that are not paid within the insolvency proceedings shall be discharged.

Resumption of the insolvency proceedings within one year of their termination shall be possible pursuant to article 744, paragraph 1 of the CA in the following cases:

- when amounts reserved for contested receivables are released; or
- when new assets of the debtor, which have been unknown as of the termination of the insolvency proceedings, are identified.

In accordance with Interpretative Judgment of the General Assembly of the Commercial Collegium of the Supreme Court of Cassation under case No 2/ 2018, the provisions of article 739, paragraph 1 of the CA shall apply also in cases when the insolvency proceedings are terminated under article 632, paragraph 4 of the CA due to lack of sufficient assets of the debtor to cover the initial expenses under the proceedings and where the creditors have not advanced an amount determined by the court for covering those expenses.

In the same Interpretative Judgment, the Supreme Court of Cassation accepts the position that article 739, paragraph 1 of the CA shall apply to sole traders (natural persons) with the same effect as other legal entities. This confirms that natural persons engaged in commercial activities as sole traders are discharged of their debts after the completion of the insolvency proceedings. The Supreme Court of Cassation justified its conclusion on the basis that, unlike companies (as legal entities) for which termination of insolvency proceedings means deregistration from the Commercial Register and the end of their existence (hence they cannot acquire new assets), a natural person who has acted as a sole trader shall continue his / her existence as an individual after deregistration as a sole trader. Any differentiation in the application of the discharge of claims under article 739, paragraph 1 of the CA may result in denial of the universal nature of the insolvency proceedings and may give grounds for creditors' claims which should have been discharged due to termination of insolvency to be directed to assets of the natural person which are newly acquired after the termination. According to the Supreme Court of Cassation, that differentiation shall not be justifiable, and it shall not be applicable. For avoidance of doubt, the interpretative judgments of the Supreme Court of Cassation are mandatory case law for all courts in Bulgaria.

The Bulgarian legislation does not provide for a personal insolvency regime for all natural persons (other than the classes considered above). Since 2015, the adoption

of a new legislative Act governing so-called "personal bankruptcy" has been under discussion and several proposed Bills have been lodged with the Bulgarian National Assembly, the most recent of them being the Bill for Insolvency of Natural Persons lodged under number 46-154-01-28 on 6 August 2021. However, none of those Bills have been submitted for discussion and voting in plenary session of the Parliament.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

On 13 March 2020, a State of Emergency was declared by the Bulgarian Parliament due to the COVID-19 pandemic. The term of the State of Emergency expired on 13 May 2020. Thereafter, pursuant to resolutions of the Council of Ministers, an "extraordinary epidemic situation" was declared. In accordance with the most recent Resolution of the Council of Ministers No 629/ 26 August 2021, the term of the "extraordinary epidemic situation" was prolonged from 1 September until 30 November 2021.

On 24 March 2020, the Bulgarian Parliament adopted the Act on the Measures and Actions During the State of Emergency Declared by a Resolution of the National Assembly on 13 March 2020 (effective as from 13 March 2020). The title of the new legislative Act was amended on 14 May 2020 to "Act on the Measures and Actions During the State of Emergency Declared by a Resolution of the National Assembly on 13 March 2020 and on Overcoming the Consequences" (State of Emergency Act).

In accordance with article 5 of the State of Emergency Act, all public sales and coercive entries into possession of assets against natural persons, announced by public or private bailiffs (enforcement agents), were suspended for a period of two months after the cancellation of the State of Emergency. Thereafter, the public sales and coercive entries into possession were to be scheduled again without levying additional fees and costs. Further, during the State of Emergency and for a period of two months after its cancellation, no injunctions on bank account receivables of natural persons were permissible.

As per article 6 of the State of Emergency Act, for a period of up to two months after the cancellation of the State of Emergency, upon delay of payment of liabilities of private persons under credit facility agreements or pursuant to other forms of finance provided by financial institutions under article 3 of the Credit Institutions Act, with exception to the subsidiaries of the banks, did not result in accrual of default interest or penalties, those liabilities were not subject to acceleration and enforcement and the relevant agreements were not subject to termination due to non-payment, including in the cases where the liabilities were acquired by banks, financial institutions or third parties.

Further, as specified above in section 1.3 above, on 10 April 2020, the BNB affirmed the Procedure for deferral and settlement of liabilities payable to banks and their subsidiaries – financial institutions, as proposed by the Association of the Banks in Bulgaria.

In summary, the Procedure provided borrowers with the possibilities for:

- deferral of liabilities for a period of up to nine months, expiring not later than 31 December 2021;

- deferral of liabilities to cover all due payables or only the principal amounts and the period of deferral to be defined as a "grace period";

- the amounts outstanding on the initially agreed maturity dates to be paid in instalments after the expiry of the grace period in accordance with the deferral mechanism agreed; and

- eligible borrowers to apply for deferral not later than 23 March 2021 and the respective creditor to decide on the application not later than 31 March 2021.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

No special insolvency rules or specific procedural insolvency measures were implemented in Bulgaria with respect to MSMEs in relation to the COVID-19 pandemic.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

No explicit rules for suspension of the requirement to initiate insolvency / liquidation proceedings were adopted in Bulgaria in relation to the COVID-19 pandemic. The measures specified in section 1.5 above with regard to the non-accrual of default interest and acceleration of debts and the procedure for deferral and settlement of liabilities payable to banks may be treated as measures which allowed MSMEs to take steps for improving their solvency and therefore not to be subject to the mandatory legal requirements to initiate insolvency proceedings.

2.3 Insolvency procedural deadlines

The insolvency procedural deadlines under Bulgarian law are to be treated as indicative and instructive rather than mandatory. The duration of insolvency proceedings depends on the number of creditors and their classes, on the availability of liquid assets of the debtor and the process of their realisation, and on the presence of additional court cases which relate to the insolvency proceedings (e.g. claw-back claims or court proceedings for non-admittance of certain creditors' receivables).

2.4 Minimum debt requirements to initiate insolvency proceedings

In Bulgaria, no additional debt requirements were introduced for creditors to initiate insolvency proceedings. Pursuant to article 608, paragraph 1 of the CA, an insolvent is a merchant who is unable to fulfil a due monetary obligation arising from or relating to a commercial transaction, including its validity, performance, non-performance, termination, destruction and cancellation, or the consequences of its termination. A merchant is also insolvent if it is unable to fulfill a public law obligation to the State and municipalities related to its commercial activity, an obligation under private State receivables (such as receivables of the State under contractual agreements) or an obligation to pay wages to at least one third of the workers and employees, which has not been discharged for more than two months. This regulation remained unchanged during the COVID-19 pandemic.

2.5 Suspending specific creditors' rights

The measures specified in section 1.5 above in relation to non-accrual of default interest and acceleration of debts and the procedure for deferral and settlement of liabilities payable to banks are examples of the suspension of creditors' rights which contributed to keeping MSMEs as a going concern.

2.6 Mediation and / or debt counselling

The Mediation Act governs mediation as an alternative and confidential procedure for the out of court settlement of disputes, during which a third party mediator assists the disputing parties to reach an agreement. Only natural persons who comply with the statutory requirements under the Mediation Act and are registered in the Register of Mediators kept by the Ministry of Justice may act as mediators. Mediation is also applicable to commercial disputes and the Bulgarian courts have been willing to instruct the parties to insolvency proceedings that their dispute may be resolved by mediation. However, it is not mandatory for the parties to undertake mediation as a prerequisite for initiating insolvency proceedings.

The merits of making mediation and / or debt counselling mandatory in a pre-insolvency scenario may be seen in the possibility for the debtor to improve its solvency status and to continue its operations as a going concern and for creditors to collect their receivables instead of waiting for distribution of the proceeds from the realisation of the debtor's assets (which are to be treated as distressed assets). In addition, mediation and / or debt counselling may be cost effective in comparison to the expenses relating to formal insolvency proceedings. A disadvantage is the possibility for a debtor acting in bad faith (irrespective of its statutory liabilities and of potential claw-back claims) to use the period of mediation to the detriment of its creditors by diminishing its assets and impeding the possibility of the creditors to collect their receivables.

3. Challenges Faced

3.1 Stigma associated with insolvency

There is no social or economic stigma towards merchants that are declared insolvent. However, there are important legal consequences that can be detrimental.

In accordance with article 57 of the CA, a natural person, who:

- is under insolvency proceedings;
- is an insolvent who is unrestored in his / her rights;
- is convicted for bankruptcy; or
- has been a managing director or a member of a managing or controlling body of a company dissolved due to insolvency in the last two years prior to the date of the judgment declaring the insolvency, if there were unpaid creditors;

shall not be entitled to be a sole trader.

Further, pursuant to article 141, paragraph 8 of the CA, a natural person who has been declared insolvent or has been a managing director or a member of a managing or controlling body of a company dissolved due to insolvency in the last two years prior to the date of the judgment declaring the insolvency, shall not be eligible to be a managing director of a limited liability company.

According to article 234, paragraph 2 of the CA, a natural person who has been a member of a managing or controlling body of a company dissolved due to insolvency in the last two years prior to the date of the judgment declaring insolvency, shall not be eligible as a member of a managing or controlling body of a joint-stock company.

3.2 Availability of financial information

As a general rule, merchants in Bulgaria are under the obligation to file their annual financial statements in the Commercial Register, which is publicly accessible.

However, in accordance with article 38, paragraph 9, item 1 of the Accountancy Act, natural persons who act as sole traders and are not subject to mandatory independent financial audits are not obliged to file their annual financial statements with the Commercial Register. In accordance with article 37, paragraph 1, item 1 of the Accountancy Act, the annual financial statements of small enterprises shall be subject to filing with the Commercial Register if the relevant small enterprise exceeds as of 31 December of the relevant reporting period two of the following three criteria:

- book value of the assets: N $2,000,000;
- net sales revenue: N $4,000,000; and
- average number of the personnel: 50 employees.

If a natural person who acts a sole trader is not obliged to publish his / her annual financial statements, the access to financial information by his / her creditors under commercial transactions may be impeded. As a common practice, banks and financial institutions in Bulgaria require their customers to present periodic financial information for the purposes of allowing the bank to assess the financial status and the credibility of the relevant customer. Such access to financial information is not so easy for the counterparties (suppliers) of the sole trader under commercial agreements for the supply of goods or services.

3.3 Access to new money

There is no practice in Bulgaria for the institutional granting of loans to merchants post-filing or post-commencement of insolvency. The information in relation to the initiation of insolvency proceedings of a merchant is publicly available in the Commercial Register and anyone can check whether insolvency proceedings have been initiated against a particular merchant. It is possible to grant a loan to a merchant after the initiation of insolvency proceedings, but from local creditors and not from a financial institution.

Pursuant to article 639 of the CA, creditors whose receivables have arisen after the date of the decision for opening the insolvency proceedings receive payment at maturity, and when they have not received payment at maturity, article 722, paragraph 1 of the CA provides that the receivables are satisfied in the seventh line. This includes the State for its new public receivables, including VAT, which is charged in the course of insolvency proceedings. Unsecured receivables arising before the date of the decision to open insolvency proceedings shall be satisfied in the eighth line.

Thus, the legislature separates the receivables of the creditors who have financed the continuation of the activity of the merchant after the initiation of the insolvency proceedings. By including these creditors ahead of the other unsecured creditors, the aim is to provide an incentive for the usual suppliers or customers of the merchant to continue their transactions with a merchant for whom insolvency proceedings have already been initiated. These creditors directly support both the possibility of rehabilitation of the enterprise and the interests of other creditors, as the the ability to generate new income increases while maintaining the dynamics of ordinary transactions, especially with the guaranteed trade supervision by the insolvency trustee. The allocation of funds to receivables from this line is in principle an exception, as it is assumed that the enterprise can still generate income from continuing activity and that they cover maturity payments after a special authorisation to dispose of available amounts.

3.4 Secured creditors *vis-a-vis* unsecured creditors

There are no regulations governing the powers of secured creditors over unsecured creditors in insolvency proceedings of the MSME specifically. The powers of secured creditors over unsecured creditors are the same, regardless of whether the trader is a MSME or not. Pursuant to article 722, paragraph 1 of the CA, secured creditors are satisfied with privilege in the first row, while unsecured creditors are satisfied in the eighth row. Also, according to article 638, paragraph 3 of the CA, which provides for suspension of enforcement proceedings against the debtor with the opening of insolvency proceedings, if actions are taken in favor of a secured creditor for the realisation of the security, the court may authorise the proceedings to continue to protect the interests of the secured creditor. The amount received above the amount of the security shall be deposited in the insolvency estate.

3.5 Insufficient asset base

A common problem facing MSMEs remains that the debtor's asset base is insufficient to cover the initial expenses of the proceedings. In these cases, the insolvency court must determine an amount to be prepared by a creditor in order for the court to initiate the insolvency processes. Usually, creditors make a rough estimation of the debtor's assets and decide whether there is a sufficient asset base to cover the costs of a formal insolvency process. In case the expenses are not prepaid, the court declares the insolvency and suspends the proceedings. The insolvency proceedings may be resumed within one year from the entry of the suspension decision upon an application of the debtor or a creditor. During the suspension period, the debtor may not request stabilisation or restructuring of the enterprise. Resuming the proceedings is allowed only if the applicant certifies that sufficient property is available or if an amount necessary to prepay the initial

expenses is deposited with the court. If the resumption of the proceedings is not requested within the one year term, the court shall terminate the insolvency proceedings and order deletion of the debtor from the Commercial Register.

3.6 Personal guarantees (PGs)

PGs for MSMEs may be provided in different forms. In accordance with the common practice, the natural persons who are shareholders in the respective MSME may be required to:

- enter into the relevant finance agreement as co-debtors jointly liable with the MSME as a borrower;
- execute a suretyship agreement, pursuant to which the surety shall be jointly liable with the MSME as principal debtor under the finance agreement; and / or
- provide personal collateral by executing a promissory note in favour of the creditor or to sign as a guarantor an "aval" to a promissory note executed by the MSME as principal debtor.

The PGs may be enforced by the creditor following the procedures governed by the Bulgarian Civil Procedure Code.

In case the creditor is a bank, it shall be entitled to apply to the court to issue an immediate enforcement order and writ of execution on the legal grounds of article 417, item 2 and article 418, paragraph 1 of the Civil Procedure Code. An immediate enforcement order and writ of execution may be issued to the creditor also on the basis of an agreement with a notarial certification of the signatures of the parties – in accordance with article 417, item 3 and article 418, paragraph 1 of the Civil Procedure Code. The potential objection of the debtor to the immediate enforcement order shall suspend the enforcement and the creditor shall be entitled to apply to a bailiff (private enforcement agent) for initiation of enforcement proceedings and collection of the receivables from the debtor.

Under article 417, item 10 of the Civil Procedure Code, a promissory note is also a document providing the creditor with the right to apply for an immediate enforcement order and writ of execution. However, in such a case, the objection of the debtor to the enforcement order shall result in suspending the enforcement and the creditor must lodge a claim with the court for establishing and ascertaining its receivables.

In all other cases, the enforcement of a PG may be applied for by the creditor on the legal grounds of article 410, paragraph 1, item 1 of the Civil Procedure Code. Subject to such application, the court shall issue an enforcement order, which may be objected by the debtor and such an objection shall result in suspension of the enforcement.

For the avoidance of doubt, the objection from the debtor need not contain any justification. It shall be sufficient for the debtor to file a written statement that the receivables claimed by the creditor are not due. In all cases, where the debtor has filed such an objection, the creditor must file a claim with the court for establishing and ascertaining its receivables.

3.7 Further challenges

After the parliamentary elections on 4 April 2021 and on 11 July 2021, the 45th and the 46th Bulgarian Parliaments did not succeed to elect a new Council of Ministers and at present Bulgaria is governed by provisional Governments appointed by the President. The majority of the Bulgarian society expects a new regular Council of Ministers to be elected and to take measures, among others, for implementing the National Strategy for SME's for 2021 – 2027, while the 47th Bulgarian Parliament to discuss and adopt new legislative acts, e.g. the legislation for personal insolvency, the implementation of the Directive (EU) 2019/1023 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, etc.

On 26 July 2022, pursuant to a Resolution of the Council of Ministers, a Bill for amendments and supplements to the Commerce Act was submitted to the Bulgarian Parliament for the purposes of implementation of Directive (EU) 2019/1023 into the Bulgarian national legislation. However, the Parliament was dissolved by the President on 2 August 2022 and the parliamentary elections are scheduled on 2 October 2022. Therefore, only after the new Parliament is constituted will there be more clarity on the implementation of the Directive in Bulgaria.

4. Moving Ahead

The information in this section is based on the discussion held with Ms Hristina Kirilova in her capacity as a registered insolvency trustee (insolvency practitioner) in Bulgaria. Her views are summarised below.

4.1 Best way to safeguard the interests of MSMEs

The best way to safeguard the interests of MSMEs to promote their effective restructuring is to stimulate the use of the stabilisation proceedings referred to in section 1.4 above. For that purpose, some changes need to be introduced, in particular:

- to assure merchants that stabilisation proceedings are an effective restructuring mechanism;
- to simplify the procedure for opening of the stabilisation proceedings;
- to develop early warning mechanisms and merchants' access to one or more clearly defined and transparent early warning tools that can identify the circumstances leading to the likelihood of insolvency;
- to provide additional obligations for management bodies to take all necessary actions to avoid insolvency of the merchant. The law should be amended to introduce a modern regime defining management bodies' obligations in the period approaching insolvency and liabilities for breach of those obligations; and
- to provide possibilities for post-commencement financing with protection from additional transaction avoidance claims.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Generally, the formal insolvency system creates more stress for MSMEs that suffer financial difficulties. In particular:

- the insolvency regime is not recognised by creditors as an effective collection mechanism but is often used as a tool to impede and squeeze the debtor's viable business; and

- on the other hand, debtors often file for insolvency at a very late stage as they do not consider insolvency as an opportunity for rescue and recovery, but as a tool to evade the payment of obligations – in many cases, fraudulently. The significant mistrust between debtors and creditors prevents the proper and timely use of insolvency proceedings in Bulgaria. These problems were noted by the World Bank in 2016[2] but this has not led to any significant changes at present.

4.3 Simplified insolvency proceedings

Liquidation[3] and restructuring[4] in Bulgaria are regulated as separate stages of the insolvency proceedings, following the court decision for the opening of proceedings. Despite the fact that the insolvency regime is simplified and the terms are relatively short, the insolvency proceedings are found to be very expensive, time consuming and ineffective both by the debtor and creditors. This is because the procedural terms are not mandatory for the court and it takes too long for the insolvency proceedings to be opened. Further, insolvency in practice is not recognised as an effective restructuring or universal collection mechanism by creditors. Currently, creditors often elect to take individual enforcement measures instead of choosing to initiate collective insolvency proceedings. Insolvency is generally used for completely dead businesses which have little prospect of being rehabilitated. Therefore, state policy should be focused on providing and encouraging restructuring opportunities outside insolvency (such as stabilisation proceedings), while also taking measures to speed up the sale of assets and to increase the effectiveness and efficiency of creditors' satisfaction through insolvency proceedings.

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[2] World Bank, "Bulgaria: Report on the Observance of Standards and Codes – Insolvency and Creditor or Debtor Regimes" (2016). Available at: https://documents.worldbank.org/en/publication/documents-reports/documentdetail/627841500888030145/bulgaria-report-on-the-observance-of-standards-and-codes-rosc-insolvency-and-creditor-or-debtor-regimes

[3] The CA uses the term "liquidation" for a voluntary termination of a company which is not insolvent / overindebted. For the purpose of the insolvency, instead of "liquidation" the legislator uses the term "sale of assets". For the purpose of the present answer, the term "liquidation" is used in the context of the "sale of assets".

[4] Instead of "restructuring", the Bulgarian legislator uses the term "rehabilitation". For the purpose of the present answer, the term "restructuring" is used in the context of a "rehabilitation" – i.e. termination of the insolvency proceedings with the adoption of a rehabilitation plan.

CANADA

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

The Bankruptcy and Insolvency Act of Canada (BIA) is the main insolvency legislation that addresses financial difficulties and insolvency in Canada. Other legislation exists that addresses specific insolvency-related issues, but the BIA is the general legislation accessible to individuals,[1] partnerships and corporations, small and large.

The BIA is a comprehensive piece of legislation that addresses both bankruptcy and restructuring of insolvent debtors to avoid bankruptcy. The legislation has objectives that aim at balancing the rights and interests of debtors and creditors, favouring restructuring over bankruptcy, and enhancing confidence in the credit granting system.

The BIA allows for a framework for restructuring which is accessible to MSMEs, through its consumer proposal provisions (available only for individuals) and commercial proposals (available for individuals and businesses). It should be noted, however, that while the commercial proposal relief is accessible by MSMEs, the process can be complex and involves administrative burdens, which substantially reduce its usefulness for smaller businesses in practice.

1.2 Specific insolvency legislation

Some provisions of the BIA apply exclusively to smaller individual debtors and allow relief from an unmanageable debt load, either through a consumer proposal or bankruptcy (a summary administration). Further details on these options are discussed below.

1.2.1 Consumer proposal

A consumer proposal is an agreement between the debtor and its creditors that allows the debtor to repay multiple debts with one monthly payment over a maximum period of five years. In most cases, the debtor pays less than the amount owed to their creditors.

To file a consumer proposal, a debtor must have between CAD $1,000 and CAD $250,000 of debt, excluding the mortgage on their principal residence. A joint consumer proposal can be filed by two or more people, with a limit of CAD $500,000 in combined debt, if their debts are similar and can be dealt with together due to their financial relationship (i.e. a married or common law couple).

A consumer proposal process is commenced by a debtor contacting a licensed insolvency trustee (LIT), who acts as the administrator of the consumer proposal and assists the debtor in preparing and filing certain specific information. In the context of a consumer proposal, the LIT acts as a court officer to administer the proposal proceedings under the BIA.

[1] In this text, we have attempted to maintain a gender-neutral style by using the pronouns "they" and "their" to describe an individual or natural person. The reader will understand the comments apply equally to male, female, or non-binary genders, and, depending on the context, may apply to a single person or several persons.

A consumer proposal streamlines the process for the individuals, creditors, the court and the LIT. Once the proposal is filed, the creditors have 45 days to review the proposal and vote for or against it. The creditors can also choose to abstain from voting and simply file a claim for the amount owed. During the 45-day period, the debtor is not required to make payments on any of their unsecured debts, all interest charges are frozen and legal action is stayed.

The proposal is deemed approved by the creditors if they do not request a meeting of creditors to be held within 45 days after the consumer proposal has been filed.

If 25% of the creditors, based on dollar value, request that a meeting of creditors be held,[2] the LIT calls a meeting of creditors, to be held within 21 days. This meeting will allow creditors to vote for or against the proposal. The proposal will be deemed accepted if the meeting is not held because of a lack of quorum, or if there is a majority (over 50% in dollar value) of creditors that vote in favour of it.

A proposal that is approved or is deemed to be approved by the creditors is also deemed to be approved by the court, except in unusual circumstances.[2] If a court hearing is required, the court has discretion to approve or refuse to approve the consumer proposal.

If the proposal is rejected by the creditors or is not approved by the court, the debtor can consider other options available under the BIA or another alternative.

A proposal can provide for monthly or other periodic payments for a maximum of five years, be a lump sum payment, or some other arrangement. Payments are made to the LIT and typically distributed to creditors annually. The fee charged by the LIT is set out in the BIA rules and is deducted from the debtor's payments. The LIT (administrator of the consumer proposal) will prepare and submit to all known creditors a report which will detail the calculation of the LIT's fees, the estimated net dividend to the creditors and a comparison of a bankruptcy scenario realisation for the creditors.

The BIA provides some flexibility post-filing if a default occurs in the performance of the consumer proposal, or if the debtor realises that they will be unable to meet the terms of the consumer proposal as originally submitted. In certain cases, the debtor may withdraw the consumer proposal, amend the consumer proposal (subject to approval by the creditors), cure a default or revive a consumer proposal that has been annulled. In each of these cases, the failure to complete the consumer proposal as originally filed will not result in the consumer debtor automatically becoming bankrupt,[3] although the failure could have an impact on the stay of proceedings or on the ability to formulate a subsequent consumer proposal.

The debtor is required to attend two insolvency counselling sessions during the consumer proposal.[4] The purpose of these sessions is to help the debtor understand the cause(s) of their financial difficulties, provide the debtor with the necessary skills

[2] The process could be different in specific circumstances that are beyond the scope of this text.
[3] Except in the circumstance where the consumer proposal had been filed by a person who was a bankrupt.
[4] While the debtor is required and expected to attend counselling sessions, there is no provision in the BIA that compels the debtor to do so. Rather, there are consequences under the BIA if the debtor does not attend the required counselling sessions.

set to prepare and maintain a reasonable budget, establish reasonable financial goals, and generally provide information to help manage their future finances.

If the terms of the consumer proposal are met and the debtor has attended the counselling sessions, the debtor is discharged from all debts addressed by the consumer proposal that would be dischargeable debts in a bankruptcy.[5]

1.2.2 Summary administration bankruptcy

Alternatively, a debtor can file an assignment in bankruptcy. The process will cause the debtor to have the legal status of a bankrupt, which means that the person must turn over all their assets (other than exempt assets, discussed below) to the LIT and must contribute to the estate based on their available surplus income, while they remain a bankrupt. The inception of the bankruptcy process itself is considered a request for relief from the bankruptcy, and when the discharge becomes operative, the debtor is discharged from all debts that are susceptible to be discharged in a bankruptcy.

In cases where there are little or no assets (under CAD $15,000 in value), the bankruptcy will be administered as a summary administration.

As mentioned above, the bankruptcy process requires that the bankrupt must turn over all of their assets to the LIT, except for assets that are exempt from seizure in the province in which the bankrupt resides, and the assets are located. Each province and territory in Canada has different rules regarding assets that would be exempt from seizure. For example, in Alberta:

- enough food for the individual and their dependents for the next 12 months;
- clothing for the individual and / or their dependents up to CAD $4,000;
- household furnishings and appliances up to CAD $4,000;
- one motor vehicle up to CAD $5,000;
- tools of trade up to CAD $10,000;
- medical and dental aids;
- the individual's principal residence up to CAD $40,000. If the home is co-owned, this amount will be reduced based on how much of the home is owned;
- social allowance, handicap benefit or a widow's pension as long as the proceeds from the payment are separate from the individual's other funds;
- RRSPs (Registered Retirement Savings Plan), RESPs (Registered Education Savings Plan) and pensions; and
- certain life insurance policies.

[5] BIA, s 178(1). Note however that a consumer proposal could effect a compromise of some of these claims, if the proposal provides for it and the affected creditor votes in favour of the consumer proposal.

As well, the bankruptcy process requires that the bankrupt reasonably contribute to their estate, to enhance recovery for the creditors. The amount to be contributed is expected to be commensurate with the debtor's income, but without being overly onerous, so that the debtor can maintain an adequate standard of living and meet their family obligations. Surplus income is calculated based on a set formula which takes into account the Low Income Cutoffs (LICO) released by Statistics Canada. The individual is required to pay 50% of their surplus income, provided this amount exceeds CAD $200 per month.

Similar to the consumer proposal, a meeting of creditors is not typically required in a summary administration bankruptcy. This reduces administrative costs for the LIT and the debtor and may allow for an enhanced recovery for the creditors.

The debtor is required to attend two insolvency counselling sessions during the bankruptcy. The purpose of these sessions is to help the debtor understand the cause(s) of their financial difficulties, provide the debtor with the necessary skillsets to prepare and maintain a reasonable budget, establish reasonable financial goals and generally provide information to help manage their future finances.

One of the objectives of the BIA is to allow an honest but unfortunate debtor the opportunity of a fresh start unfettered by unmanageable debts. A bankruptcy will allow a debtor the opportunity to re-initiate the credit rating history after some time has elapsed following the discharge from the bankruptcy process.

The table below illustrates the typical time required to obtain a discharge from the debts for a bankrupt or a consumer debtor, and the time for requirement to re-initiate the credit rating history by eliminating the references to the financial difficulties, for a natural person:[6]

Type of filing	Minimum delay	Maximum delay	Credit rating impact
First time bankrupt	9 months (no surplus income)	21 months	R9 for 6 years after completion of the bankruptcy
Second time bankrupt	24 months (no surplus income)	36 months	R9 for 14 years after completion of the bankruptcy
Third time bankrupt	36 months	Determined by the court	Same as above
Consumer Proposal	Depends on terms of proposal, cash available, etc.	60 months (5 years)	R7 for 3 years after completion of the proposal payments
Division 1 proposal	Depends on terms of proposal	Depends on terms of proposal	Same as above

[6] Of note, the minimum and maximum delays referred to above are typical timelines where no specific special circumstance exists. In certain specific cases, it is possible to obtain an order of discharge before 9 months in a bankruptcy and it is possible that the delay be longer if there is an opposition to the discharge by a creditor, the LIT or the Office of the Superintendent in Bankruptcy (the regulator). An individual who is considered a high tax debtor is subjected to a court hearing and consequently, the period of their bankruptcy is undetermined. However, the explanations of such special circumstances are beyond the scope of this text.

Canada has two main credit bureaus, Equifax, and TransUnion. Equifax uses a simplified scale of R1 to R9, with R1 being a perfect score. TransUnion measures credit scores on a scale of 300 to 900, with 650 being the dividing line between good or poor credit.

1.3 Framework for out of court assistance or workouts

For both corporations and individuals, an enhanced workout system is available, but only in respect of a specific industry (farmers, under the Farm Debt Mediation Act).

Otherwise, out of court workouts can and do occur occasionally, but when they do it is the result of a consensual arrangement between parties willing to modify the terms of their agreements or to settle, not a statutory framework. When these are negotiated and completed, they are enforceable as any other contractual agreement.

1.4 Accelerated restructuring or liquidation of MSMEs

There is no special rule, mechanism or method that is specific to MSMEs in respect of accelerating the restructuring or liquidation of these businesses.

1.5 Discharge of debts for natural persons

The BIA allows for the effective discharge of debts for a natural person. The debts that are discharged are all debts that are provable in proceedings under the BIA, save for a few specific exceptions, listed in section 178(1) of the BIA. The exceptions pertain to debts that are considered to be non-dischargeable for public policy reasons, such as debts (by way of example only and without limitation) arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity, or debts or liabilities resulting from obtaining property or services by false pretenses or fraudulent misrepresentations.

As the non-dischargeable debts represent an exception to the general rehabilitation objective of the BIA, a creditor has to demonstrate that their claim falls specifically within the category of debts that are not subject to discharge.

Except for the debts that are non-dischargeable, an order of discharge from a bankruptcy or a certificate of completion of a proposal discharges the debtor from all debts that would be provable claims under the BIA. These claims include all debts and liabilities due on the relevant date (date of the bankruptcy or date of the proposal, as the case may be) and all amounts that may become due before the discharge in respect of an obligation incurred before the relevant date.

For an outline of the time requirement to obtain a discharge, see the table in section *1.2.2* above. Note however that the timelines indicated in the table are typical timelines where no specific special circumstance exists. In certain cases, it is possible that the delay could be longer in a bankruptcy if there is opposition to the discharge by a creditor, the LIT or the Superintendent of Bankruptcy (the regulator). An individual who is considered a high tax debtor will be subjected to a court hearing and consequently, the period of their bankruptcy is undetermined.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

No formal measure was adopted by Canada or the provinces to suspend repayment terms on loans (including interest) or periodic debt service obligation. The majority of banks in Canada did give individuals a six-month deferral on mortgage payments on approved credit, and major lenders have generally been more tolerant of defaults or delays in payment during the pandemic, but these measures were voluntary measures adopted by the banks and lenders for practical reasons.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

No special insolvency measures or specific insolvency rules have yet been introduced for the simplification of proceedings for MSMEs during COVID-19 in Canada.

While many programs were put in place to assist enterprises with the COVID pandemic, there is no known program that is systematically designed to support the restructuring of debt of companies in distress because of COVID-19.

Programs were put in place to provide relief for employees who were furloughed during the pandemic, and to subsidise some salaries for employers who retained employees while their revenues fell, and to subsidise businesses who had to pay rent while their revenues fell. As well, during the pandemic certain relief measures were put in place by various government departments to provide additional credit by postponing the payment and / or reporting deadlines. Several measures were put in place to assist individuals and businesses generally, but these were not specifically designed to assist in the restructuring of debt.

As well, various programs were put in place to provide financial support and loans and assist with access to credit during the pandemic. These programs were designed to provide liquidity to businesses affected by the pandemic, and the financial support depended on the industry, sector, or size of the business. The assistance took the form of loans and loan guarantees and different programs were available from the federal and provincial governments.[7]

While no special insolvency measure has been implemented to address the needs of MSMEs during the COVID-19 pandemic, discussions have been commenced between various stakeholders with a view to enhance the restructuring tools available through the BIA, so as to better serve the needs of MSMEs. The pandemic has emphasised the need for tools designed to avoid bankruptcy, that are more streamlined and are less administratively burdensome than the tools currently available in the BIA to restructure larger corporations. These discussions are continuing but at the time of drafting this text, the timeline for implementation of rules specific for MSMEs or the specific content of these rules is unknown.

[7] For the programs available for individuals, see Canada's COVID-19 Economic Response Plan - Canada.ca. For the programs available for businesses, see Canada's COVID-19 Economic Response Plan - Canada.ca.

2.2 Suspending the requirement to initiate liquidation proceedings

There was no specific measure taken to suspend the requirements to initiate liquidation proceedings.

2.3 Insolvency procedural deadlines

No such measures were introduced in Canada.

2.4 Minimum debt requirements to initiate insolvency proceedings

No such adjustments were made in Canada.

2.5 Suspending specific creditors' rights

Creditors' rights were not suspended in Canada during COVID-19.

2.6 Mediation and / or debt counselling

Apart from the Farm Debt Mediation Scheme for financially distressed farmers (noted in section 1.3 above), there is no specific mediation pre-requisite as part of the insolvency process in Canada.

As noted in section 1.2, insolvency counselling – which is distinct to mediation – is an important component of both the bankruptcy and consumer proposal provisions of the BIA, for individuals.

The insolvency counselling process contemplated by the BIA is targeted to individuals only and is not a precondition or precursor to the insolvency proceedings, but rather a process that is undertaken after a formal filing has occurred under the BIA. As such, the process is not intended as a tool to avoid bankruptcy or consider alternatives, but rather a preventative process to avoid *reoccurrence* of financial difficulties, if possible.

The debtor is required to attend two credit counselling sessions during the bankruptcy or the consumer proposal, as the case may be. The purpose of these sessions is to help the debtor understand the causes of their financial difficulties and provide information to help manage their future finances.

It should be noted, however, that in the case of individuals, there is an assessment process that must be undertaken in collaboration with the LIT before any proceeding is filed, which aims principally at identifying the financial difficulties and choosing a path to deal with these. This process is undertaken before a decision is made regarding an insolvency proceeding, but it is not an in-depth exercise.

A more in-depth counselling or mediation process, if made compulsory before the inception of any insolvency proceeding, could have the following advantages:

- there are no permanent records of having undergone insolvency counselling or mediation, such that the debtor's credit history might not be adversely affected, or if so, may not be affected to the same extent, if the process leads to an arrangement that avoids an insolvency proceeding;

- the process may provide for a better education of the debtor about personal finances and budgeting, which may lead to better decisions and potentially avoid insolvency. For example, a debt counsellor may suggest ways of cutting costs and saving money, the debtor may learn about the various risks associated with different sources of credit, and the debtor may be able to better choose the source of credit and negotiate a better interest rate on their existing debt; and

- the process may reduce stress for debtors, by making them more competent to deal with their financial difficulties and take greater control of their financial affairs.

On the other hand, the disadvantages of a compulsory process would be:

- the process costs money, which may be in limited supply;

- the process needs to be regulated, monitored, and controlled to ensure that the persons responsible to deliver mediation or counselling services abide by the highest possible standards, and have the individual's best interests in mind;

- a counselling or mediation process that is required to be undertaken before initiating insolvency proceedings may be doomed to fail, unless there exists a possibility to stay proceedings by creditors while the counselling or mediation progresses. However, if a stay of proceedings is imposed, this would likely frustrate the first advantage above, by immediately causing a downgrade in the debtor's credit rating;

- a counselling or mediation process as a prerequisite to an insolvency proceeding can only be successful if it is possible to identify the need to undertake this process very early. It is likely that, in most cases, the process will be undertaken when it is already too late to implement measures that will correct the financial problems; and

- a mediation process that resolves issues with creditors is likely to be ineffective, unless a settlement can be made obligatory on all creditors, or at least on most creditors. In the absence of the potential to compel a minority of creditors to follow the wishes of a majority, the settlement made with individual creditors is not likely to fully resolve the debtor's financial difficulties.

There is no counselling process contemplated by the BIA for corporations. As such, is not mandatory for mediation / debt counselling to occur prior to a formal insolvency.

As mentioned in section 2.1 above, discussions have been commenced between various stakeholders with a view to enhance the restructuring tools available through the BIA, so as to better serve the needs of MSMEs. In the context of such discussions, it is likely that the restructuring provisions for MSMEs would incorporate a need for counselling, in cases where the LIT believes that the MSME could benefit from such counselling, but only once an insolvency procedure is filed.

Regarding the advisability of making a counselling or mediation process a prerequisite before the inception of any insolvency proceeding, we expect that the advantages and disadvantages would be the same as those identified for individuals above.

While the BIA does not provide for a mandatory insolvency counselling or mediation process prior to the inception of insolvency proceedings, it does provide that any proceeding thereunder, whether it is a bankruptcy or a restructuring proceeding, requires the participation of a LIT, who acts in the proceedings as a court officer. The LIT is not a representative of the debtor, nor a representative or agent of the creditors. The LIT is an officer of the court charged with ensuring that the objectives of the BIA are met.

The LIT is a professional who is subject to very high ethical standards, and must meet a stringent qualification process before they are authorised to practice, through a license granted and monitored through a rigorous regulatory process.

As a seasoned insolvency professional, the LIT can analyse the debtor's financial affairs, presenting alternatives and assist in their implementation, all with a timeline that is responsive to the debtor's particular circumstances. This provides a safeguard that alternatives are presented and discussed before an insolvency process is undertaken.

The essential components for an efficient restructuring process are that it must provide for: (i) a stay of proceedings to avoid a "race of the swiftest" while discussions progress, which would deplete the debtor's resources; and (ii) a means to compel a minority of creditors to accept the wishes of the majority.

As noted above, there is concern that these essential components may not exist during a compulsory counselling or mediation process, which would render the process inefficient and may exacerbate the problems.

As such, we do not believe that an insolvency counselling or mediation prerequisite would cut time or costs, at least not for the majority of MSMEs. The majority of MSMEs have limited assets and typically the amount of the loans or other credit obtained from creditors would not justify the time or the resources required to initiate and complete mediation. Finally, mediation may be seen by some creditors as nothing more than a delay tactic and a cost rather than a benefit to them.

In general, we believe that the system as it exists in Canada, which provides for the participation of a seasoned insolvency professional before proceedings are undertaken, but that does not impose an insolvency counselling or mediation process as a prerequisite, is the appropriate standard.

3. Challenges Faced

3.1 Stigma associated with insolvency

In Canada, it is difficult to determine what, if any, stigma is associated with insolvency. One of the main reasons for this is that many small businesses shut their doors without ever filing for insolvency. The business owner(s) may have

personal guarantees, directors' liabilities, or other personal debt obligations to the small business, but the business still ceases operations.

If a stigma does exist, it is from the owner wanting to ensure that they satisfy all their creditors because they always have, they believe that it would be dishonest to not repay the amount, and / or they have personal beliefs that encourage them to deal with their obligations.

Another time a stigma exists is when services were paid for by a customer but are not provided by the debtor, or alternatively goods were not shipped by the debtor. However, this usually only affects a small portion of the population.

3.2 Availability of financial information

In cases where the individual is a sole proprietor, or an unincorporated business that is owned by one individual, financial information is available if they maintain monthly bookkeeping records either personally or hire a third party. It is not unusual for a sole proprietor to only have annual statements prepared by their accountant for personal income tax purposes.

LITs usually do not have difficulty obtaining whatever information is available about the debtor with whom they work. Occasionally, that information is fragmented or incomplete, likely because of administrative shortcomings at the debtor's level, but rarely because of a lack of cooperation.

For access to other MSMEs' financial information, the information would be limited – the main reason being privacy. Most private businesses do not readily share financial information for some of the following reasons:

- they do not want their competitors knowing how they are doing financially, as this may cause issues obtaining credit from suppliers;
- new competitors may enter the market;
- customers may use the information for negotiating better prices; and
- the information may not accurately reflect the business.

To deal with some of the concerns above, any financial information would likely need to be limited to similar like businesses and averages, with highs and lows. An entrepreneur would likely not gain valuable insight. A better option would be a meeting of the minds, where entrepreneurs could share challenges and potential solutions to overcome these challenges.

3.3 Access to new money

The commercial proposal provisions of the BIA (Division 1 of Part III) allow for the debtor to obtain interim financing, possibly secured by a court-ordered charge that has priority over other creditors. To obtain the financing, the debtor must make a court application and put on notice the secured creditors who are likely to be affected by the interim financing on notice of the application.

The issue with MSMEs is that typically the process is expensive and cumbersome, in particular if the required borrowings are not very high. For MSMEs, the borrowing requirements are usually under CAD $1 million, and hence it is difficult to find funding for these amounts in Canada. If it is found, the costs are prohibitive as they usually have significant fees and interest rates.

3.4 Secured creditors *vis-a-vis* unsecured creditors

Secured creditors are treated differently from ordinary unsecured creditors, both for a restructuring and a liquidation, and the rules are the same whether or not the debtor is an individual, partnership or corporation, or if the debtor is a MSME or a larger business.

In a restructuring process, unsecured creditors are automatically subject to a stay of proceedings, while secured creditors may or may not be subject to a stay, depending on specific circumstances. For example (and without limitation), there is no stay of proceedings that affects a secured creditor in a consumer proposal unless the court orders one. As a result, a secured creditor is not prevented from realising the property if it took possession of the assets before a notice of intention to make a proposal was filed, nor if the notice of intention to enforce the security had expired before the notice of intention to make a proposal was filed, or if the debtor consents to the enforcement of the security. Also, he stay terminates if a proposal is not made to the secured creditor class or if the secured creditors of a particular class vote against or are deemed to vote against a proposal.

Further, in a restructuring process, the voting on the proposal is by class. The proposal made to unsecured creditors is only accepted if a specific majority of unsecured creditors who vote on the proposal accept it. If the proposal is addressed to secured creditors, the proposal is deemed rejected if none of the secured creditors in the class accept it and is accepted if a specific majority of the secured creditors to whom it is addressed vote to accept it.[8]

In liquidation proceedings in a bankruptcy context, unsecured creditors are automatically subject to a stay of proceedings, while secured creditors are not subject to a stay of proceedings, unless the court orders a stay. In the case of a bankruptcy of an individual, there may be restrictions regarding the ability to realise the security notwithstanding the fact that there is no stay of proceedings, if the only default or breach is that the person is insolvent or bankrupt.

In both restructuring and liquidation proceedings under the BIA, secured creditors have a greater right to distribution of proceeds, ahead of ordinary unsecured creditors, subject however to some statutory priority rights that can affect the

[8] In a consumer proposal, there is only one class, and the proposal is accepted if a majority of creditors (in dollar value of claims) vote in favour of the proposal, or in certain cases if the creditors are deemed to have voted in favour of the proposal. In an ordinary proposal (Division I of Part III of the BIA), the ordinary unsecured creditors generally form a single class, and the secured creditors may form one or more classes, depending on the circumstances. A proposal is accepted by a class of creditors if a majority in number of creditors holding more than 2/3 in value of the claims in that class accept it. If none of the creditors of a class of secured creditors vote on the proposal, that class is deemed to have voted against the proposal. Other than in this circumstance, the absence of a vote in an ordinary proposal process is not interpreted as a vote against the proposal, but rather the results are compiled based on the creditors who have actually voted on the proposal.

contractual security rights of the secured creditors and thus affect their ability to fully access their security.

The more significant rights provided by statute that could affect the security held by secured creditors are the following:[9]

- deemed trust claims of the Crown for payroll source withholdings;
- claims of creditors who that delivered merchandise in the 30 days before a bankruptcy or receivership, if the claim is made within a specified delay and the merchandise is still in the possession of the debtor and in the same condition;
- claims of farmers, fishermen or aquaculturists for products sold and delivered in the 15 days before a bankruptcy or receivership, if the claim is made within a specified delay;
- claims of employees for unpaid wages, salaries for work performed in the six months before the inception of proceedings under the BIA, to a maximum amount of CAD $2,000 per person, and claims of a travelling salesperson for expenses incurred to a maximum of CAD $1,000 each; and
- claims of a pension plan for certain specific amounts (such amounts would not include special payments and the actuarial deficit, for example).

Subject to the prior ranking claims as outlined above, the secured creditors would be entitled to the first proceeds of realisation on the assets pledged to them and encumbered by their security, after which the proceeds, to the extent any remain, would be distributed in the following order:[10]

- funeral and testamentary expenses of the legal representatives, successor, or heirs of a deceased bankrupt;
- costs of administration of the bankruptcy estate;
- levy payable to the Office of Superintendent of Bankruptcy;
- wages and salaries to the extent that they were not paid by the trustee or receiver through the priority of wages claims found in sections 81.3 and 81.4 of the BIA;
- the amount equal to the difference a secured creditor would have received but for the operation of sections 81.3 and 81.4 and the amount received by the secured creditors;

[9] These may apply in both in a restructuring and liquidation in bankruptcy or may be limited to a liquidation in bankruptcy context, and the order of priority among these "statutory" priority claims may vary, depending on the circumstances. A complete explanation of the priority claims and their relative ranking is beyond the scope of this text.

[10] This list is an outline of the provision only, and only applies in the context of a distribution under the BIA. Each of the categories is subject to specific rules, circumstances, and limitations, that are beyond the scope of this text. The reader should refer to sections 136 to 141 of the BIA for a more accurate description of the scheme of distribution under the BIA.

- the shortfall suffered by a secured creditor directly attributable to the encroachment of the secured creditor's security due to the priority for pension plan claims found in sections 81.5 and 81.6 of the BIA;
- alimony or alimentary pensions;
- municipal taxes;
- rents;
- costs incurred by the creditor who first attached or seized the assets of the debtor;
- physical injuries to employees that are not covered by a worker's compensation program, but limited to the amount paid by a person who has guaranteed the debtor against damages resulting from those injuries;
- ordinary unsecured claims that are not deferred; and
- certain claims that are considered deferred, such as equity claims (claims for dividends and amounts due for share repurchases), claims resulting from certain non-arm's length transactions and silent partners.

3.5 Insufficient asset base

A low asset base does not bar an enterprise from undertaking a restructuring process. The creditors make a decision regarding the merit or lack of merit of a restructuring process based on a variety of factors, one of which is a comparison of expected repayment in a restructuring process versus a liquidation, but other factors can also influence the decision, such as (without limitation) confidence in the management, preserving a supply chain and preserving employment or economic activity in a community.

A low asset base may affect access to the insolvency process, since the costs of a restructuring or liquidation are typically paid from the enterprise's own resources. A low asset base may mean that the enterprise will not be able to access the relief, except if a third party (such as a guarantor, shareholder or director) provides funds to pay the costs of the proceedings.

The majority of MSMEs typically do not have sufficient assets, nor loan value in Canada, to justify working with the entity to effect a restructuring completely as a going concern. In addition, the Canadian Government has Canadian small business loans, which are "guaranteed" by the Government. This means that, upon realisation of the assets of the MSME, the lender can also apply to the Government to recover the shortfall on the loan.

3.6 Personal guarantees (PGs)

Based on experience and knowledge, it is common to have PGs in place for MSME loans from secured creditors.

In Canada, a PG is a separate legal matter from the MSME, and pursuit requires specific steps taken by the creditor, often through a court process. It typically starts with a demand letter for repayment and may end in a court judgment ordering the guarantor to pay and / or an execution against the assets of the guarantor by way of garnishment or seizure of assets, and sometimes by the bankruptcy of the guarantor.

3.7 Further challenges

The primary challenges relate to the absence of a specific insolvency process for MSMEs, as discussed in further detail in section 4 below.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

A specific insolvency process designed for MSMEs would be the most optimal way to safeguard the interests of those entities. This is discussed in further detail below.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

We believe that Canada's insolvency system is efficient, well designed and generally serves the needs of the stakeholders well. However, we note that the system could be improved for MSMEs. The restructuring and bankruptcy process is accessible by MSMEs, but the system is not optimal, as the restructuring process as contemplated by the BIA is either reserved for individuals with a very low debt threshold or is overly expensive and administratively burdensome for a small enterprise.

4.3 Simplified insolvency proceedings

The current challenge is to design a streamlined, efficient, and inexpensive mechanism to enhance the restructuring opportunities for MSMEs as part of the BIA.

As noted in section 2.1 above, discussions on possible law reform options in this regard are continuing.

CHILE

1. Insolvency Framework - General Overview

1.1 Formal insolvency legislation

In order to understand bankruptcy law in Chile, it is first necessary to contextualise the ups and downs experienced by the country's bankruptcy legislation. A serious banking crisis, in the context of a political-military dictatorship in the 1980s, deeply affected the Chilean economy. The exponential closure of companies, including banking institutions, required the Government of the day to respond quickly and effectively.

Thus, Law 18.175 of 1982, known as the "Bankruptcy Law", came into force. The main objective of this legislation was to quickly resolve the insolvency of companies and traders by means of a rapid procedure that sought to realise the assets of the bankrupt. During the period it was in force, the bankruptcy system was characterised by a low number of bankruptcy proceedings and a practically non-existent use of agreements. One of the biggest problems was that it resulted in very long trials. As a result, the Bankruptcy Law became an underutilised institution, with long proceedings, whose main and most recognised effect was to create a stigma on the bankrupt – constituting, in fact, a real social, commercial and financial castration.

Thus, and in view of Chile's entry into the OECD in 2010, a new statute for entrepreneurship and re-entrepreneurship, in line with the times and the new business challenges, became imperative. In 2014, Law No 20.720 came into force, replacing the current insolvency regime with a Law on the Reorganisation of Companies and Individuals, a regulation whose main objective is to "provide responsible and collaborative legislation, in line with the current times in which globalisation demands full respect for certain principles and standards that, in time, will lead us to be considered as an even more serious, thorough and reliable country".

This Law aims to strengthen viable companies through their reorganisation, leaving the liquidation procedure (bankruptcy) as a subsidiary alternative for resolving insolvency. The Law also establishes an insolvency regime for natural persons as one of its main novelties, creating, in this case, a new institutional framework and much more accessible procedures.

On the other hand, the new Law also seeks to overcome the dogma prevailing to date, which prevented bankruptcy justice from serving in its full scope as a solution to the insolvency of the collective, and to erect business failure as a situation to which all sectors must give help and understanding. Eight years after its entry into force, insolvency justice has reached groups that had been historically neglected under previous laws. Thus, employees, students, retirees and independent workers, among others, have been able to make use of the tools that the reform contemplates, and this is reflected in the significant increase in the number of processes being substantiated.

Finally, it is important to note that a Bill is currently being processed that seeks to reform and modernise the current insolvency law, as well as to include simplified procedures for MSMEs which, in accordance with article 2 of Law 20.416, are those

whose income and services and other business activities have not exceeded UF 25.000.

1.2 Specific insolvency legislation

In Chile, MSMEs have their own statute, which is regulated by Law 20.416. Thus, those MSMEs that are in a state of insolvency have the possibility of voluntarily requesting an "economic insolvency advisor", whose main function is to carry out a study of the financial situation of the MSME in order to take the necessary steps before the corresponding body to reorganise it and overcome its state of insolvency, or, if necessary, to proceed to its closure. In these cases, the insolvency economic advisor can issue a certificate of the MSME's situation, which allows him / her to suspend actions such as seizures, liquidation requests, tax lawsuits, and any other legal proceedings resulting from non-compliance with obligations (except for the payment of salaries and contributions), for a maximum non-extendable period of 90 days.

1.3 Framework for out of court assistance or workouts

Chapter III, Title 3° of the Law on the Reorganisation of Companies and Individuals regulates the extrajudicial reorganisation procedure, which allows any debtor company to enter into an extrajudicial simplified reorganisation agreement with its creditors and submit it for judicial approval before the Civil Court of its domicile.

The object of this agreement is the restructuring of the debtor's assets and liabilities.

In order for the agreement to be approved, it must be filed with the court by the debtor, already have been approved by two or more creditors representing at least 75% of the liabilities, and be filed together with a background similar to that of a reorganisation agreement.

Upon the court issuing a streamlined reorganisation resolution, the debtor will enjoy a form of insolvency financial protection, which prohibits the initiation of compulsory liquidation proceedings or enforcement proceedings against the debtor.

Within 10 days of the publication of the agreement, the court may summon all creditors affected by the agreement for acceptance before the court. The acceptance must include at least three quarters of the liabilities. Once the agreement has been accepted, the competent court, after verification of the legal requirements, will declare the simplified agreement approved, and it must be published in the Insolvency Gazette. The same applies in the event that the court has not called a meeting of creditors within the aforementioned period and there is no dispute, or the dispute has been resolved, regarding the reported liabilities.

Once the agreement has been approved, the credits included therein shall be deemed to have been remitted, novated or rescheduled, as the case may be, for all legal purposes.

Outside of the court process, Law No. 20.416 establishes in its article 4, paragraph 4 that every debtor company shall have the right to choose the advisor it deems convenient from the list that the Superintendency will have for this purpose.

However, the advisor may also be appointed by the Bankruptcy Office *(Superintendencia de Insolvencia y Reemprendimiento* – SUPERIR) at the request of the debtor, in which case a lottery mechanism must be used that ensures the impartiality of the appointment.

The advisor of choice is presented with a request accompanied by one or more antecedents that prove the insolvency situation. The advisor must formally accept the nomination and communicate it to the SUPERIR, and a certificate is then granted. This certificate allows the debtor to be declared suspended by the judicial or administrative body from:

- any kind of claims arising from non-fulfilment of pecuniary obligations, with the exception of those related to remuneration and social security contributions, acquired in the course of business activities;
- acts which are a direct consequence of the protest of commercial documents of the applicant for the certificate;
- judicial acts involving attachments, precautionary measures of any kind, restitutions in lease proceedings and applications for the opening of bankruptcy liquidation proceedings;
- tax proceedings or lawsuits; and
- any other measure of an administrative or judicial nature, including before local police courts, which it is appropriate to pursue against the natural or legal person in whose name the certificate has been issued, on the grounds of any obligation relating to the debtor's business.

During the period of suspension, the advisor shall carry out a study of the debtor's economic, financial and accounting situation, establishing the nature and amount of its obligations, both due and to become due, whatever their term, condition or mode, the assets it owns and whether they are its property and the encumbrances, modes or conditions to which the assets are subject. The advisor must summon the creditors and the debtor to one or more meetings to be held with those who attend, at which the advisor must explain the debtor's situation and suggest the measures that would be necessary to resolve the difficulties that gave rise to the advisor's request.

1.4 Accelerated restructuring or liquidation of MSMEs

In Chile, there is no accelerated restructuring or liquidation procedure.

Notwithstanding the fact that the law still in force does not contemplate procedures for smaller companies, Bulletin 13802-03 of 2020, which contemplates the project to modernise Chilean insolvency law, considers procedures for MSMEs, with an emphasis on simplification. Among the measures that would allow for shorter processing times is, for example, the elimination of ordinary or extraordinary creditors' meetings.

1.5 Discharge of debts for natural persons

Natural persons receive the same discharge treatment as companies according to articles 281 and 255 of Law No 20.720.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

To date, there has been no regulation in Chile that favours MSMEs in particular.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

In Chile, there is no obligation to initiate insolvency proceedings under any circumstances. During the pandemic this rule has not been modified.

2.3 Insolvency procedural deadlines

No laws were introduced in this respect during COVID-19.

2.4 Minimum debt requirements to initiate insolvency proceedings

There is only a minimum amount required in the case of a debtor's renegotiation procedure, as article 260 of Law No 20.720 requires at least 90 *unidades de foment*, or USD $3,398. This has not been modified during COVID-19.

2.5 Suspending specific creditors' rights

In reorganisation proceedings, the issuance of the reorganisation resolution suspends certain rights of creditors during the period of bankruptcy financial protection. This consists mainly in the fact that creditors may not initiate liquidation or enforcement proceedings of any kind against the debtor. In addition, the contracts in force at the time will remain in force and their conditions will be maintained. This is set out in article 57 of Law No 20.720.

With regard to winding up proceedings, article 135 *et seq* establishes similar suspensions or limitations to the rights of creditors. It provides for the suspension of a creditor's right to individually execute against the debtor, and also states that the creditor may not exercise the legal right of retention once the liquidation resolution has been issued. Likewise, those attachments and precautionary measures decreed in the lawsuits filed against the debtor and that affect assets that must be realised or entered into the insolvency liquidation proceedings will be rendered ineffective once the liquidation resolution has been issued.

2.6 Mediation and / or debt counselling

About any instance of mediation, neither the current law nor the Draft Reform Bill considers this type of procedure.

The only stage that considers a kind of mediation is the renegotiation hearing in the debtor renegotiation procedure, as article 266 states that the "Superintendent shall facilitate the adoption of an agreement between the parties".

Mandatory mediation would be desirable as a pre-insolvency process, at least for MSMEs, since the debt structure of MSMEs is conducive to collaborative resolutions. This would also assist in relieving congestion in the courts and mitigating creditor and debtor costs alike.

3. Challenges Faced

3.1 Stigma associated with insolvency

On this point, progress has been made with regard to the elimination, modification or blocking of the debtor's data in the Insolvency Bulletin and other registers or personal data banks referring to economic, financial, banking or commercial obligations, as appropriate. However, the challenge lies in reincorporating insolvent companies and individuals into the credit market and, in this way, being able to effectively start up again.

3.2 Availability of financial information

Simplified insolvency procedures allow information to be obtained which is centralised and managed by the Commission for the Financial Market. Regarding tax information, there are easy access mechanisms through the website of the Internal Revenue Service.

3.3 Access to new money

There are mechanisms that encourage access to financing during the procedure under articles 72 to 74 of Law No 20.720. However, regarding smaller companies, the Law should establish additional benefits for their owners, since they are usually the ones who inject resources in critical stages.

3.4 Secured creditors vis-à-vis unsecured creditors

Under articles 94 and 95 of Law No 20.720, secured creditors have the option of executing their real guarantees outside of the insolvency proceedings and not subject to its terms, unless the security exists over assets declared essential.

3.5 Insufficient asset base

Statistics indicate that companies with assets of little value usually initiate liquidation procedures, since the law does not require a minimum value. In the case of reorganisation procedures, the little liquidity that MSMEs have prevents them from being able to afford this type of procedure. The Bill currently being proposed (see section 1.1 above) incorporates a simplified procedure for MSMEs that attempts to reduce these costs.

3.6 Personal guarantees (PGs)

Regarding PGs, Law No 20.720 allows the creditor to retain a PG, as long as it votes against the reorganisation proposal or does not attend the meeting. In such a case, the creditor may make a demand to enforce its rights against a third party, without the need to submit to the terms of the agreement. On the other hand, in the case of liquidation procedures, the extension of the discharge of debts, under

article 255 of Law No 20.720, does not reach third parties, who may pursue their payment after the bankruptcy of the main debtor has ended.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

The best way to achieve this is to establish low-cost and simplified procedures, as MSMEs generally do not have sufficient liquidity to face sophisticated lawsuits, nor to be properly advised. These circumstances deter smaller companies from opting for insolvency proceedings, which is substantially detrimental to the interests of creditors.

It would also be helpful to establish public policies for training, capitalisation and development of small businessmen and entrepreneurs. Tax exemptions and a simplified taxation system would also be useful.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

The formal insolvency system has created more stress, as the current procedures are proving to be very complex and expensive for smaller companies. Hopefully, the intended reforms will overcome this problem.

4.3 Simplified insolvency proceedings

The Bill project, Bulletin 13802-03 of 2020, currently being debated in the Chilean Parliament, highlights the implementation of new simplified liquidation and reorganisation procedures, whose design seeks to adapt to the physiognomy of smaller companies (96% of companies in Chile are considered to be MSMEs) and to the economic circumstances of natural persons subject to credit.

One of its main characteristics is the deregulation of the financial background necessary for the presentation of the application (the review of external auditors is not necessary and only a sworn statement is sufficient), which results in a notable reduction of the costs associated with it and, with the aim of favouring the chances of success, the applicant will have direct supervision and assistance from the overseer (insolvency administrator).

On the other hand, in the case of liquidation proceedings, the new simplified procedure sets new requirements for the admissibility of the application while also requiring reliable and traceable information to avoid abuse of the insolvency proceedings. Moreover, already in the context of bankruptcy, the rules on creditors' meetings and asset sales have been relaxed, so as not to delay the process due to a lack of quorums at the meetings called by law for this purpose, a situation that commonly occurs in liquidations with low-value realisable assets and which is often repeated in processes involving individuals and smaller companies.

CROATIA

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

Croatia bankruptcy law addresses insolvency procedures for companies. Procedures are divided in general into pre-insolvency proceedings (restructuring) and insolvency proceedings with a bankruptcy plan (which may enable continuation of the business as a going concern).

Consumer bankruptcy law provides a personal insolvency framework and is applied to natural persons.

Insolvency proceedings for MSMEs fall into the provisions of the bankruptcy law.

1.2 Specific insolvency legislation

Croatia does not have a distinct insolvency legislative framework specifically for MSMEs.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

Croatia does not have a formal framework for out of court assistance or workouts.

1.3.2 Informal framework

Croatia does not have an informal framework for out of court assistance or workouts. A workout is only possible when all creditors are willing to participate in negotiations with the debtor on possible solutions.

1.4 Accelerated restructuring or liquidation of MSMEs

There is no specific mechanism for accelerated restructuring or liquidations of MSMEs in Croatia.

1.5 Discharge of debts for natural persons

The personal insolvency regime provides for effective discharge of debts for natural persons. Discharge is provided after a period of probation that can be ordered to apply for up to three years, after which if the debtor was honest during the procedure, discharge of the remaining debts is ordered by the court.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

Croatia has not introduced measures extending or suspending the repayment terms of loans (including interest or penal interest) or periodic debt service obligations during COVID-19 for MSMEs.

In 2020, an Act on Emergency Measures in Enforcement and Bankruptcy Procedures during Special Circumstances regulated that reasons for bankruptcy stated by the Bankruptcy Law (insolvency lasting for 60 days or indebtedness) that

occurred during the time stated Act was in force, were not considered to be a prerequisite for the opening of a bankruptcy procedure. These provisions also put a moratorium on the initiation of mandatory bankruptcy proceedings that FINA[1] initiates at the Commercial Court after 120 days of continuous insolvency. The moratorium lasted for six months (until November 2020). The Act further proscribed a moratorium on all enforcement procedures by all creditors, with exceptions in procedures regarding alimony, unpaid salaries, wages or severance pay and in the case of criminal proceedings.

As it was applied on all companies, this reduced the number of opened proceedings to effectively none, and numbers further stayed low (in comparison to 2019) due to Government aid for employee compensations for businesses that demonstrated reduced income.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

There were no special insolvency measures introduced for the simplification of proceedings for MSMEs during COVID-19 in Croatia.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

Under the 2020 Act on Emergency Measures in Enforcement and Bankruptcy Procedures during Special Circumstances, insolvency lasting for 60 days or indebtedness could not be relied on to open a bankruptcy procedure. There was also a six month moratorium (ending in November 2020) on the initiation of mandatory bankruptcy proceedings following 120 days of continuous insolvency. The Act further placed a moratorium on all enforcement procedures by all creditors, save for procedures regarding alimony, unpaid salaries, wages or severance pay and in the case of criminal proceedings.

As it was applied to all companies, the Act reduced the number of opened proceedings to effectively none. Government aid for employee compensation for businesses that demonstrated reduced income also helped to keep businesses afloat.

These measures are now no longer in effect.

2.3 Insolvency procedural deadlines

As stated above, the biggest effect of 2020 Act on Emergency Measures in Enforcement and Bankruptcy Procedures during Special Circumstances was in no new insolvency procedures being able to be opened in that time. However, apart from the suspension on the opening of procedures, there were no measures introduced specifically relating to the extension of insolvency procedural deadlines.

[1] FINA – abr. For Financial Agency, a Government-owned legal entity that (among other things) aids Commercial and Municipal courts (technical and administrative) in insolvency and enforcement proceedings.

2.4 Minimum debt requirements to initiate insolvency proceedings

Croatia has not introduced any minimum debt requirements for creditors to initiate insolvency procedures during COVID-19.

2.5 Suspending specific creditors' rights

As noted, the 2020 Act on Emergency Measures in Enforcement and Bankruptcy Procedures during Special Circumstances effectively stopped all insolvency procedures. Therefore, all companies continued doing business as a going concern for the duration of the operation of the Act (six months). Combined with Government aid for employees' compensation, MSMEs and other companies were able to continue to trade in times when business activities were reduced due to lockdown and the negative economic impact of COVID-19.

2.6 Mediation and / or debt counselling

There is no debt counselling in Croatia. Mediation as a process is available in most court procedures, including pre-insolvency and insolvency proceedings, but in general it is still in the early stages of development.

Mediation, debt counselling or financial education for any type of rescue is not required prior to the initiation of formal insolvency proceedings.

Making mediation mandatory may not be optimal. Rather, additional education on the benefit of mediation could be pursued. If made mandatory, it could help dishonest parties to prolong the procedure.

Mediation is a welcome tool in the context of insolvency procedures and if all included parties are willing to approach it in good faith, it can cut the time and costs pertaining to restructuring and formal insolvency.

3. Challenges Faced

3.1 Stigma associated with insolvency

Insolvency usually brings certain stigma on entrepreneurs, although its effects mostly depend on the entrepreneurs' reaction to it. For honest serial entrepreneurs, that situation is considered in advance, and it does not come as something unexpected, but is accepted as part of the business.

3.2 Availability of financial information

Companies are required to submit yearly financial reports by 30 July for the past calendar year, and these are available through at least two public services which are online and free to use. Considering that the statements can be as much as six months old at the time of publishing, the relevance of the data is questionable. Reverting to the earlier solution of publishing yearly financial reports by 30 April (for MSMEs especially) would bring about an improvement to this situation.

3.3 Access to new money

Interim or new finance is usually not readily available to MSMEs post filing or post commencement of insolvency. This is mostly due to regulations of the Croatian National Bank, which provide that companies in a pre-insolvency procedure are already in default. That requires banks to classify loans to those companies as a 100% reservation, which leads to banks not being interested in providing financing in those cases.

The under-developed state of the distressed debt market in Croatia results in distressed companies not having many opportunities to acquire new finance.

There are provisions on the special priority status of new finance, but it is rarely (if ever) provided in practice.

3.4 Secured creditors *vis-a-vis* unsecured creditors

As in most jurisdictions, secured creditors have better chances of collection and usually receive a higher percentage of their claims. Additionally, for the amount not satisfied from the realisation of the assets subject to the creditor's security, the creditor can apply in insolvency proceedings as an unsecured creditor.

3.5 Insufficient asset base

The low asset base of MSMEs (which typically rely on the skills of the entrepreneur rather than established assets and business systems) has a bearing on funding formal insolvency processes. In the case of insolvency proceedings, this incentivises creditors to opt for a "liquidation sale" of the remaining assets, rather than trying to sell the "non-existent" business as going concern.

3.6 Personal guarantees (PGs)

PGs, together with a shareholder's private assets, are the primary source of collateral in MSME financing. There are also some PGs in support of MSMEs given by HAMAG BICRO (the Croatian Agency for SMEs, Innovations and Investments) with EU Funding projects.

There is no special protocol generally in relation to the enforcement of PGs and they are dealt with on individual basis. When HAMAG BICRO is involved, there is an internal procedure which at first aims to negotiate with debtors and try to reach a solution in pre-insolvency proceedings.

3.7 Further challenges

No other major challenges are relevant.

4. Moving Ahead

The last two years were an extraordinary time in Croatia. In the beginning, a wave of insolvencies was expected. That soon changed to a state of "stay", with no proceedings commenced, followed by a period of a very low number of proceedings and a large reduction in the number of insolvencies due to

Government aid and banks voluntarily agreeing on the deferment of payments and moratoriums on collection procedures. That period was followed by a tourist season (which is a major component of the national economy in Croatia) that exceeded even the most optimistic expectations. The economy now faces new challenges in the form of inflation and prolonged times for the delivery of goods due to global supply chain disturbances.

4.1 Best way to safeguard the interests of MSMEs

Additional education of entrepreneurs and subsequently directors of companies would best assist MSMEs to be aware of options to restructure their affairs at an early stage in the event of financial distress.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Formal insolvency proceedings create a certain amount of stress for companies regardless of their size. There are no benefits that have accrued to MSMEs in post-COVID 19 legislation or subordinate legislation.

4.3 Simplified insolvency proceedings

Simplified liquidation of companies is available in Croatia for all companies, regardless of their size. There is no mechanism for discharge of debts specifically for MSMEs, nor a special simplified restructuring framework for MSMEs. Reduction of obligations is available through the pre-insolvency procedure, and discharge is available through a bankruptcy plan.

A special regime for MSMEs may not be needed since the current legislation can be applied to MSMEs as well. The real issue is the moment in time when the procedure is requested, which in most cases is never, so there are limited opportunities for restructuring.

As noted, additional education for directors / management is required to inform them of possible solutions for distressed companies, and to ensure they have the knowledge to detect the early signs of the company going into a distressed situation and the need for immediate action.

FRANCE

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

France has formal and sophisticated insolvency legislation for corporate and individual persons integrated in several codes, but mainly the Commercial Code. Some of the legal provisions specially address the needs of MSMEs.

Companies are classified into four categories for the purpose of statistical analysis:[1] microenterprises, small and medium-sized enterprises (SMEs), intermediate-sized enterprises and large companies. The criteria for determining whether a company belongs to one of those categories are:

- a microenterprise is a company with fewer than 10 employees and annual sales or a balance sheet total not exceeding EUR 2 million;
- a SME is a company with a workforce of less than 250 people and an annual turnover not exceeding EUR 50 million or a balance sheet total not exceeding EUR 43 million;
- an intermediate-sized company is a company that does not belong to the SME category, with a workforce of less than 5,000 people and an annual turnover not exceeding EUR 1,500 million or a balance sheet total not exceeding EUR 2,000 million; and
- a large company is a company that cannot be classified in the previous categories.[2]

On 22 May 2019, a new category of business, the medium-sized business, was created in order to allow for simplified accounting presentation.[3] These companies do not exceed two of the following three thresholds: balance sheet total is set at EUR 20 million, net sales at EUR 40 million and the average number of persons employed during the financial year at 250.

We shall refer to microenterprises, SMEs and medium sized businesses hereafter as MSMEs.

MSMEs represent between 95% and 99% of European business activities. In France, MSMEs (of which 92% are very small businesses) account for approximately 99% of the 3.7 million French companies. MSMEs account for over 90% of insolvencies.

1.2 Specific insolvency legislation

Some of the insolvency rules respond to the legitimate concern to treat large companies and MSMEs differently in insolvency proceedings. Indeed, in the case of a MSME, there are often very strong reasons to protect the debtor, its managers and the holders of its capital (who may be one and the same person), because the business is only viable in the medium and long term if they remain in place (due to

[1] Law No 2008-776 of 4 August 2008, art 51.
[2] Decree No 2008-1354 of 18 December 2008.
[3] Law No 2019-486 of 22 May 2019, art 47.

their know-how, their network of contacts and their professional commitment), even if this means damaging the interests of creditors, at least in the short term.

Ordinance No 2021-1193 dated 15 September 2021 (Ordinance 2021), which transposes into French law Directive (EU) 2019/1023 of 20 June 2019 (EU Directive), also takes into account the specificity of SMEs by arranging the thresholds of the rules that apply to SMEs or to other businesses. These new preventive tools entered into force as of 1 October 2021. The reform does modify the purpose of French collective procedures: to ensure the maintenance of the company's activity, to protect jobs and to ensure the payment of creditors.

As a result of the efforts made for enterprises during the COVID-19 period, as of 27 September 2021, the volume of openings of procedures is down by 35% compared to September 2020. This evolution is due, to a large extent, to the fall in the number of direct judicial liquidations. The figures for the year 2021 indicate a further decrease in the number of insolvency proceedings opened: -3.8% compared to 2020. This represents a historically low level of insolvency openings. The decrease in the number of proceedings, compared to the years prior to the crisis, is even more significant: -41.3% compared to 2019 and -44.9% compared to 2018.[4] Tendencies for the year 2022 are slightly different as a result of the economic situation and due to the fact that the public aid measures have been reduced. As of 30 May 2022, the number of insolvency proceedings opened in May was up by 19.4% compared to May 2021. However, this level of openings of proceedings remains significantly lower than in 2019 and 2018 (4,281, i.e. -39.1% and 4,354, i.e. -40.2% respectively).[5]

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

France has implemented several confidential paths for restructuring. They are considered as out of court assistance, although the court is initially involved to appoint a third party, usually an insolvency practitioner (IP), to assist the debtor in possession.

These out of court measures consist of:

- *"Mandat ad hoc"*[6]

  More flexible than conciliation insofar as the debtor does not have to be in a state of cessation of payments, the *mandat ad hoc* is possible for any commercial, craft, agricultural or liberal enterprise (natural or legal person), but also associations, self-employed entrepreneurs and individual entrepreneurs with limited liability. *Mandat ad hoc* is requested to the President of the competent court by the debtor, which can choose the name of the IP (*mandataire ad hoc*) and define his / her mission.

[4] Source: Economic Data Observatory of the CNAJM (*Observatoire des Données Economiques du CNAJMJ*).
[5] *Ibid.*
[6] French Commercial Code, art L 611-3.

The aim of this process is to restore the company's situation before the cessation of payments. This may involve, for example, financial difficulties, failure to meet normal supplier payment deadlines, blocking situations and disputes between partners that can lead to the paralysis of the company.

- *Conciliation*[7]

  Conciliation is intended for all commercial, craft or liberal enterprises (natural or legal persons), as well as for associations, self-employed entrepreneurs and individual entrepreneurs with limited liability. It does not concern farmers, who benefit from a similar procedure organised by the rural code.[8] To use this procedure, the company must encounter existing or foreseeable legal, economic or financial difficulties, but must either not be in a state of cessation of payments,[9] or have been in such a state for less than 45 days.

  This procedure is only opened at the request of the debtor, which submits a request to the President of the competent court (commercial or civil) with supporting documents. The debtor can choose the name of the IP conciliator. In France, conciliators are registered on approved lists but are generally "*administrateurs judiciaires*".[10]

  The judicial administrator is a professional of the economy and finance agreed on a specific list. The conciliator's mission is to promote the conclusion of an amicable agreement between the debtor and its main creditors and partners, aimed at putting an end to the company's difficulties and ensuring its continuity.

  The conciliation procedure lasts for a maximum of four months (with a possible extension to five months). If concluded, the conciliation agreement should enable the debtor to obtain rescheduling or remission of debts, the credit necessary for the continuation of the business or to consider restructuring.

  The agreement is not, in principle, subject to any publicity. Only the signatories are aware of it, plus the President of the court. Creditors who have not signed the agreement are not bound by it and can sue their debtor, if necessary. During its execution, the creditors who have signed the agreement cannot pursue the recovery of their claims against the debtor.

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[7] *Idem*, art L 611-4 *et seq*.
[8] *Idem*, art L 611-5.
[9] An essential criterion in French law, cessation of payments is defined by article L631-1 of the French Commercial Code as "the impossibility of meeting current liabilities with available assets", it being specified that "a debtor who establishes that the credit reserves or moratoriums from which he benefits from his creditors allow him to meet current liabilities with his available assets is not in cessation of payments". In concrete terms, the cessation of payments is a cash flow concept: the company may or may not be able to pay today what it owes today.
[10] This IP is charged by a court decision to administer the assets of others or to exercise assistance or supervision in the management of those assets. The IP elaborates and presents to the court any solution tending to safeguard the company and the maintenance of its activity within the framework of a continuation plan. The IP receives and analyses possible offers to take over the business and submits them to the court with a view to transferring the business. The second type of professionals in charge of insolvencies in France are the "*mandataires judiciaires*" (liquidators). He / she is charged by court order with representing creditors, preserving the financial rights of employees and realising the assets of companies in judicial liquidation for the benefit of creditors.

In order to give greater force to the agreement, in particular in the event of new money, or to provide for the consequences of the agreement between the creditors if it is not respected, the debtor may request its homologation by the court if the following conditions are met: (i) the debtor is not in cessation of payments; (ii) the agreement is of such a nature as to ensure the continuity of the business; and (iii) the agreement does not adversely affect the interests of the creditors who are not signatories. The existence of the approved agreement is published, but not its content.

If, during the conciliation, a creditor does not accept a delay asked for by the conciliator, within certain limits and at the request of the conciliator, the President of the court may grant the debtor a period of grace and suspend the enforceability of the claim for the duration of the proceedings. Ordinance 2021 also clarifies the validity of clauses dealing with the lapse and resolution of amicable agreements and imposes a better anticipation of the foreseeable costs.

1.3.2 Informal framework

In each Department in France (administrative geographical area), a crisis advisor guides companies in a situation of financial fragility. This advisor respects a strict confidentiality framework, particularly about business and tax secrecy. He or she proposes a solution that is adapted and made operational for each company, depending on its situation. This advisor can mobilise the financial support tools put in place by the State: an adjustment of social security and tax debts, supplemented, if necessary, by a direct loan from the State to go along with ordinary bank financing. It can also call on the services of the Banque de France's credit mediation service or the business mediation service, or it can direct business leaders to the new crisis exit procedures implemented by the Commercial Courts (see section 1.4 below). The solutions put in place in France are based on four priorities: to accompany, detect weaknesses, guide and support the company. In total, nearly 20 measures are mobilised by the Departmental advisor to support companies according to their situation and needs.

The financial aid available for companies from 1 October 2021 is numerous, and includes:

- to relieve or strengthen cash flow: payment delays for tax and social debts, direct tax rebates, State-guaranteed loans (PGE), support measures for exporting companies, solidarity fund, assumption of fixed costs and partial activity for employees;

- to finance investments and strengthen working capital: exceptional loans to small businesses, subsidised loans and repayable advances, equity loans and stimulus bonds;

- to consolidate equity capital: the transition fund and mediation (credit mediation, mediation of companies);

- to benefit from a procedure before a Commercial Court (simplified amicable procedure): restructuring of company debt thanks to the crisis exit procedure; and

- the financing of the commissioners for restructuring and prevention of business difficulties.

The health crisis that has affected France since March 2020 has led to an unprecedented mobilisation of the State and its services to support weakened companies. This mobilisation has also resulted in exceptional financial support through various aid. As of October 2021, these measures were progressively decreased or disappeared altogether, and companies have started to reimburse tax and social security debt settlement plans as well as monthly payments on loans guaranteed by the State. MSMEs that have demonstrated difficulties in repaying their State-guaranteed loans (PGE) in 2022 have the opportunity to apply for an adjustment (the guarantee ended on 30 June 2022). However, a new state-guaranteed loan, called "PGE resilience", has been available starting 8 April 2022 to support businesses economically affected by the war in the Ukraine.

The action plan on exit support aims to provide each company that encounters difficulties during this period with a solution adapted to its situation. In each Department, a Departmental crisis exit advisor will be appointed for this purpose.

1.4 Accelerated restructuring or liquidation of MSME's

Some formal tools have been introduced for this purpose:

- *The "crisis exit treatment" after COVID-19 for MSMEs*

  For MSMEs that have ceased payments but were operating satisfactorily before COVID-19, the State has proposed a specific simplified collective procedure, for two years, to enable them to bounce back quickly by restructuring their debt: the crisis exit treatment to give an additional tool to the companies experiencing conjectural difficulties resulting from the health crisis or related to the financing of their activity. This procedure aims to deal with the debt problems of companies by allowing the restructuring of their liabilities without having to consider formal restructuring measures.

  The procedure of crisis exit treatment was created by the law of 31 May 2021.

  This procedure can only be opened at the request of the legal representative of the MSMEs. This procedure has a maximum duration of three months (observation period) and allows a company in a state of suspension of payments – but without wage claims – to benefit from the freezing of all its debts with a view to presenting a project for their repayment over a period of up to 10 years.

  Such provisions are of temporary implementation, ending on 1 June 2023, and are open at the sole initiative of the debtor with fewer than 20 employees and a balance sheet total of less than EUR 3 million in liabilities, excluding equity.

  As noted, the observation period lasts three months, with however an intermediate stage of two months during which the court decides whether or not to continue (generally on the basis of a report from the insolvency practitioner) if the debtor has sufficient financial capacity. During this period, the manager and the appointed insolvency practitioner work together to draw up a restructuring plan.

This plan only concerns the creditors indicated in the list drawn up by the debtor, prior to the opening judgment, and cannot affect claims arising from an employment contract, maintenance claims, tort claims and claims for an amount below a threshold set by decree. The amount of the annual instalments cannot be less than 8% (and not 5% as is the case for the safeguard or reorganisation plan) of the liabilities established by the debtor (and therefore not 8% of the actual liabilities as a result of updates or disputes).

The plan is adopted by the court, after consultation with the creditors (the court may authorise a period of 15 days to contest the plan). In the case of a plan adopted by the court, the company will benefit from a moratorium imposed on creditors.

In the absence of a plan within three months, the court opens a reorganisation or liquidation proceeding, at the request of the debtor, the insolvency practitioner or the Public Prosecutor.

- *Special MSME ad hoc mandate*

  To further facilitate the access of the smallest companies to the various procedures, the National Council of Judicial Administrators and Judicial Representatives (CNAJMJ) ruling French IPs has proposed a simplified amicable procedure, in the form of an *ad hoc mandate*, to exit the crisis. This mandate is intended for companies with no more than 10 employees that are experiencing financial difficulties due to the health crisis and its consequences. Its cost is capped at EUR 1,500, excluding tax for companies with less than five employees, and EUR 3,000, excluding tax for companies with five to 10 employees.

  This has been only a proposal from a professional organisation regarding a confidential proceeding. No public records are available to assess whether or not this proposal has been followed by insolvency practitioners and MSMEs.

- *The accelerated safeguard*[11]

  This procedure is part of the safeguard procedure.[12] It is available to all companies, with a quicker timeframe.

[11] French Commercial Code, art L 628-1 *et seq*.

[12] The safeguard procedure (art L 626 *et seq*. of the French Commercial Code) is reserved for companies that are experiencing difficulties that may compromise their long-term survival but are not in a state of suspension of payments. It is the "French Chapter 11". The purpose is to anticipate a foreseeable deterioration of the situation to allow the company to get out of these difficulties without being pressured by its creditors. The procedure is public. The judgment pronouncing the safeguard will also open a period of observation of six months, renewable once, which entails the suspension of the creditor's pursuits. A bankruptcy judge, a judicial administrator and a judicial representative are appointed. The company is treated as if it had started its activity on the day of the opening judgment of the procedure: it has no debts, starts its activity, and pays its debts after the judgment. The company director cannot use the "new" cash flow to pay debts incurred before the judgment. Creditors must declare their claims within a limited period. Such claims will be verified, accepted or rejected. The statistically most frequent solution of the safeguard procedure is the plan. The maximum repayment period for creditors is 10 years (15 years for farmers). The first repayment must be made at the latest one year after the judgment establishing the plan. Repayments can be made annually. It is the judicial representative who will consult the creditors: by letter (or meeting) he / she will ask them to take a position on these proposals and if there are several to decide between the different proposals. It is the court that approves or rejects the plan.

This accelerated safeguard is opened at the request of a debtor in conciliation proceedings and for companies whose accounts are drawn up by a chartered accountant or certified by an auditor. The debtor in conciliation may request the opening of this procedure to benefit from a necessary safeguard plan adopted by classes of affected parties.

Only the creditors having participated in the conciliation have the right to declare their claims, and the plan must be adopted within a period of two months, renewable once, failing which the procedure is terminated. The opening of the procedure is pronounced on the report of the conciliator and the hearing is held in the presence of the public prosecutor. The court appoints one or more judicial administrators. The debtor draws up a list of each "affected party" that participated in the conciliation procedure, which must be certified by its auditor or endorsed by its chartered accountant (with mention of the subordination agreements). The plan is adopted by the court.

In addition, to facilitate the financing of companies subject to a safeguard or receivership procedure or plan, Ordinance 2021 establishes the safeguard privilege, known as the "post-money" privilege, for the benefit of persons who make a new cash contribution to the debtor during the observation period with a view to ensuring the continuation of the company's activity and its durability. This privilege will not be available for contributions made by the debtor's shareholders and partners in the context of a capital increase.

1.5 Discharge of debts for natural persons

Pursuant to Article L 645-11 of the *French Commercial Code*, there is a "professional recovery proceeding" which, under certain conditions, allows at the end of the proceeding the cancellation of particular debts of the debtor (only for natural persons) towards creditors.

A professional recovery proceeding is opened by the court at the request of the debtor for a period of four months.[13]

The professional recovery procedure is open to any natural person debtor in cessation of payments and whose recovery is clearly impossible, provided that:

- it is not under a safeguard, judicial reorganisation or liquidation proceedings;
- it has not ceased its activity for more than one year;
- it has not employed any persons over the last six months; and
- its declared assets have a value of less than EUR 15,000.

The value of the main residence is expressly removed to determine the debtor's assets, as well as the value of assets that the law declares cannot be seized.

[13] French Commercial Code, arts L 645-1 to L 645-12 and R 645-1 to R 645-25.

This concerns claims, whether personal or professional, arising prior to the opening judgment, brought to the attention of the judge by the debtor, and having been the subject of an information of the creditors by the liquidator.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

During the COVID-19 period and (first) until 31 December 2021, the French Government introduced State-Guaranteed Loans (SGP). MSMEs represented 6.05% of the entities benefiting from SGP as of 1 October 2021, and very small enterprises represented 87.79%. For MSMEs, the guarantee covered by the State could extend to 90% of the amount borrowed.

These loans enabled MSMEs to navigate cashflow pressure and avoid financial difficulties during the COVID-19 economic downturn.

During the COVID-19 crisis, the French Government announced that all companies, including MSMEs, could obtain a deferment of an additional year to start repaying their SGP if they wished. For example, a company with a SGP in place in April 2020, which would not be able to start repaying it in April 2021, would be able to apply for a one year deferral and start repaying it from April 2022 instead.

The French Government has extended the possibility for companies to benefit from SGP relief from January to June 2022. Since 30 June 2022, this SGP relief is no longer available.

As from 8 April 2022, there is a new SGP which is intended to support companies economically affected by the war in the Ukraine. It has been extended until 31 December 2022 in the framework of the rectifying finance law.

There is also the exceptional small business loan, which was created to support the cash flow of very small and small businesses weakened by the COVID-19 crisis, particularly those that were unable to obtain a SGP. These specific loans were granted to companies with less than 50 employees, among others specific conditions.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

A MSME can be subject to a simplified judicial liquidation which is shorter and more flexible in relation to the verification of claims and the sale of assets.

Simplified judicial liquidation is mandatory when the following three conditions are met: (i) the company has no real estate; (ii) it does not employ more than one person; and (iii) its turnover excluding taxes is less than or equal to EUR 300,000. It is also mandatory for companies with up to five employees and a turnover of less than EUR 750,000.

In principle, the claims are not checked. Only wage claims and claims that can be settled with the available assets (depending on their rank) are checked.

In the case of a compulsory simplified liquidation, the IP liquidator does not need any authorisation from the insolvency judge (*juge-commissaire*) to sell the assets. The liquidator establishes a statement of claims filed with the court clerk's office, which can be contested by the creditors and the debtor within one month before the liquidator. The closing of the compulsory simplified judicial liquidation is pronounced at the latest within six months after the opening of the procedure. This deadline can only be extended by three months.

During the health crisis linked to COVID-19, the conditions of access to liquidation procedures are widened for natural persons whose situation does not allow them to consider a recovery plan. This rule applies to the procedure opened on 22 May 2020 until 17 July 2021.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

During the COVID-19 period and until 23 August 2020, the debtor's state of payments was assessed referring to the date of 12 March 2020. There was therefore a crystallisation of the date of cessation of payments, which effectively protected debtors from becoming subject to cessation of payments during the COVID-19 crisis.

The aim was to allow companies to benefit from preventive measures or procedures (in particular conciliation and safeguard procedures), even if after this date and during the COVID-19 crisis their financial situation worsened. For example, a company that became insolvent after 12 March 2020 was not obliged to apply for the opening of a judicial recovery or liquidation proceeding. Instead, it could apply for a conciliation or safeguard procedure.

2.3 Insolvency procedural deadlines

These measures are addressed in section 2.2 above.

2.4 Minimum debt requirements to initiate insolvency proceedings

In France, creditors cannot directly initiate proceedings against a debtor. There is no equivalent of the British receivership for example. Creditors that have a claim that is certain and due and that has not been paid by the debtor may, by a writ of summons, ask the court to order the debtor's reorganisation, judicial reorganisation or liquidation in the context of an adversarial proceeding, which may be appealed. There is no minimum debt requirement.

2.5 Suspending specific creditors' rights

In France, pre-insolvency and insolvency is generally favorable to the debtor acting in good faith, although Ordinance 2021 attempts to rebalance creditors' rights. During conciliation proceedings, if a creditor does not agree to suspend payment of its claim, the debtor may apply to the President of the court for the following actions: (i) the suspension or prohibition of any legal action seeking to obtain an order for the debtor to pay a sum of money or to rescind a contract for failure to pay a sum of money; (ii) the suspension or prohibition of any execution or distribution procedure; or (iii) the postponement or rescheduling of the payment of sums due. These

measures ordered by the President of the court are effective until the end of the conciliator's mission.

Before suing a creditor that has not agreed to suspend payment of its claim, the debtor may ask the judge who opened the procedure to rule on the debtor's situation. The judge can postpone or spread out the payment of the sums due, within a limit of two years, considering the situation of the debtor and of the creditor.[14] The judge may also order that the deferred payments bear interest at a reduced rate at least equal to the legal rate. The judge's decision suspends the enforcement procedures. In addition, interest increases or penalties for late payment are not due during the period set by the judge.

Especially because of COVID-19, conciliation proceedings initiated on or after 24 August 2020 but before 1 January 2022 benefit from an extension. The conciliator can ask the President of the court to extend the duration of the proceedings up to 10 months. These provisions were applicable until 31 December 2021.

2.6 Mediation and / or debt counselling

As mentioned in section 1.3 above, *ad hoc mandate* and conciliation are, in some ways, the equivalent of mediation and debt counselling as they are confidential proceedings available for the debtor to find rescue, restructuring or rehabilitation solutions.

These preventive solutions are not mandatory. They are at the initiative and option of the debtor only, depending on its situation (without suspension of payments or close to suspension of payments). Such procedures need flexibility and should remain at the sole initiative of the debtor to be fully efficient. These procedures work and good results have been recoded when they are opened. The work to be done is not to require them to be mandatory, but to obtain an evolution of the entrepreneur's culture towards a preventive culture (having difficulties might happen and facing them in a preventive framework may save the company from the worst difficulties).

Anticipating difficulties is part of good business management and France has a variety of very effective tools for this purpose. Prevention has been particularly emphasised for several years and many steps have been taken to inform companies so that they do not shrink from the obstacle and seek outside help if they can finance the negotiation or observation period. The efficiency of these preventive procedures is more and more recognised, even if small and medium-sized companies are either not aware of them and do not use them or are still afraid of them because they necessarily involve the intervention of the court.

Preventive and confidential proceedings are effective to cut time and costs to restructure. They help to maintain the necessary trust between MSMEs and their economic partners. They also preserve relationships and reputations if the debtor is acting in good faith and not trying to gain time instead of trying to find constructive solutions.

[14] French Civil Code, art 1343-5.

3. Challenges Faced

3.1 Stigma associated with insolvency

Most of the time, insolvency is still experienced in France as a personal failure. In a way, when financial difficulties come up, the MSME's representatives suffer from a trauma and personal or family consequences.

Too often and also because a lack of information (although a lot of efforts are now made by the French Government, Commercial Courts, associations and professionals), this leads to an inward-looking reflex and behaviours governed by the desire of many businesses to solve problems by themselves.

Within this context, instead of openly asking for help and advice (from IPs, the Commercial Court or from other actors in the insolvency landscape), the MSME promoter / entrepreneurs might hide the MSME's financial difficulties and might try to solve the problems themselves. That may not be desirable as it might prevent the MSME promoter / entrepreneurs from taking advantage of the pre-insolvency tools (*ad hoc mandate* / conciliation). The financial situation may deteriorate, and the MSME promoter / entrepreneurs may be obliged to file for bankruptcy, sometimes without any possibilities to restructure the business of the MSME.

These behaviours are due to the fact that, in France, failure has not been well perceived. This has led to post-bankruptcy stigma such as, in case of a new entrepreneurial project, discrimination in access to new financial resources from banks, job loss for both the entrepreneur concerned and the employees of his or her company and consequences for the personal life of these entrepreneurs.

3.2 Availability of financial information

A great deal of information, such as the certificate of registration, beneficial owners, debt reports, official documents, annual financials, modifications history and insolvency proceedings, is accessible to third parties through the Trade and Companies Register (*Infogreffe*).

Third parties may order documents such as a Kbis extract representing the true updated "identity card" for a company, debt statements and pledges. *Infogreffe* allows a person to track a company and receive alerts when an event concerning it occurs, such as modification to the entry at the register, filing annual accounts, instruments filed at the registry office and updates to debt statements.

3.3 Access to new money

Pre-insolvency proceedings and insolvency proceedings should be distinguished.

In pre-insolvency proceedings, especially in conciliation, creditors that grant any new financing in order to ensure the continuation of the company's activity and its durability will benefit from priority if the company files for bankruptcy in the future.

However, these creditors will benefit from a "new money privilege" only if the conciliation agreement (in which the new financing is provided for) is homologated

by the Commercial Court.[15] It is to be noted that the privilege does not apply to contributions made by the debtor's shareholders and partners in connection with an increase of capital.

In insolvency proceedings, there is also a "post money privilege", the aim of which is to encourage and facilitate cash contributions to companies in safeguard or judicial reorganisation proceedings.[16] Creditors that grant any new financing during an insolvency proceeding in order: (i) to ensure the continuation of the company's activity and its durability, by keeping the company afloat; or (ii) to ensure the establishment of a restructuring plan, will benefit from priority only if the financing has been authorised by the judge in charge of the insolvency proceedings.

3.4 Secured creditors *vis-a-vis* unsecured creditors

Under French law, there are different secured claims defined by the law (e.g. the secured claim of the landlord or the secured claim of the bank) or by the agreement concluded between the parties (e.g. a retention right or mortgage).

All these secured creditors have priority over unsecured creditors. Secured creditors will therefore benefit from a priority during the process of the liquidation of the assets by being better ranked. Some secured creditors (with priority reservation rights under the agreement between the parties) will have the possibility of restitution of goods. Among the secured creditors, some benefit from priority over others.

The analysis to rank secured and unsecured creditors in insolvency proceedings requires a case-to-case analysis.

3.5 Insufficient asset base

Alow asset base might have an impact on the possibilities for a MSME to restructure its business in case of financial tensions. It is not in the hand of creditors to decide whether the asset base is not enough to try to restructure the business. It is in the hands of the IPs and the Commercial Court or the insolvency judge to define, alongside the legal representative of the MSME, whether or not the observation period will be of long enough duration to establish a restructuring plan rather than having to sell assets or consider a liquidation procedure.

3.6 Personal guarantees (PGs)

The PG is mainly granted by a natural person (director / manager of the company) or financial / bank companies. The fate of the PG will depend on which stage the company is in for its insolvency process:

- in conciliation, French law provides that the guarantors may take advantage of the provisions of the conciliation agreement established by the judge or approved by the court. Thus, if the agreement allows the company to benefit

[15] French Commercial Code, art L 611-11.
[16] *Idem*, arts 622-17 and 626-10.

from payment deadlines, its guarantors cannot be called upon if the agreement is respected;

- in safeguard, the opening judgment suspends any action against the guarantors until the judgment adopting the plan or pronouncing the liquidation. The court may then grant deadlines or deferred payment up to a maximum of two years. Individual guarantors may avail themselves of the provisions of the judgment which adopts the plan;

- in judicial reorganisation, the opening judgment suspends any action against the individual guarantors until the judgment adopting the plan or pronouncing the liquidation. The court may then grant deadlines or a deferred payment within a limit of two years; and

- in judicial liquidation, no provision protecting the guarantors is provided for in matters of judicial liquidation. Guarantors can therefore be sued according to the rules of ordinary law.

3.7 Further challenges

No additional challenges are to be identified.

4. Moving Ahead

For this section, we have interviewed President Mr Dominique-Paul Vallée, Consular Judge at the Commercial Court of Paris and General Delegate for the Pre-Insolvency Department of the Commercial Court.

It should be noted that in France, the judges in charge of business difficulties are the judges of the Commercial Court, elected by the traders for a renewable period of six years and who exercise this responsibility without being paid. This system has been in operation since well before the French Revolution of 1789. There are 134 Commercial Courts in France, of which, since 1 March 2016, 18 are specialised courts.

Commercial Courts in France in 2020 handled more than 652,000 cases, among which there were more than 10,500 confidential meetings for prevention with managers, 2,638 *mandate ad hoc* proceedings and conciliations, 686 safeguards, 6,846 judicial restructurings and 29,628 liquidations.

4.1 Best way to safeguard the interests of MSMEs

Judges of the Commercial Court have a strong business background because they are coming from the economic environment. They are entrepreneurs themselves, they have a pragmatic approach and they know about business, which is less the case for civil judges who are professional civil servants. Therefore, MSMEs benefit from an efficient dialogue and operational advice from the Commercial Court.

To initiate this dialogue to enable MSMEs to find solutions to their financial difficulties, the Paris Commercial Court has simplified the approaches for MSMEs to contact the Commercial Court (simplified website) and to obtain an appointment with the judges in a confidential way. The idea is to discuss objectively the situation

and the short term financial prospects (no more than two years) and to advise MSMEs, as best as possible, on the preferable tools to restructure the business, to solve the financial or shareholder tensions and to regain the creditors' / suppliers' trust.

Within this context, the pre-insolvency tools are those used by MSMEs (at an average of 75% of the cases submitted to the Paris Commercial Court) with good results in terms of solutions found with creditors and restructuring of the activity. These pre-insolvency measures are the best way to safeguard the interests of MSMEs.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Unfortunately, even if the lawmaker tried to avoid the stigma of business failure (*faillite* / bankruptcy) with the use of more positive words (safeguard / reorganisation), the opening of a formal insolvency such as a judicial reorganisation proceeding is still experienced as a failure for a MSME's managers. Part of the work of the Commercial Court is to reassure a MSME's managers on the benefit of formal proceedings (safeguard or judicial reorganisation).

On one hand, MSMEs can consider a formal insolvency as a handicap to run their business, as any formal proceedings will be mentioned on their commercial registration and this information will be accessible for their creditors, banks, suppliers and competitors.

On the other hand, MSMEs can take an advantage of the opening of a formal insolvency. Such proceedings will enable MSMEs: (i) to prevent creditors from launching any judicial actions or enforcing any judicial decision; (ii) to benefit from a moratorium on debts; and (iii) to build a restructuring plan with the help and the expertise of an IP to spread out payment of the debts originated before the opening judgment for a period of time up to 10 years.

This is a true protection granted by the Commercial Court to give more possibilities / time to the company to restructure its debts and improve its financial status under the supervision of the IP. The mission of the judge from the Commercial Court, with the help of the IPs, is to reduce stress and to show all the advantages to MSMEs by opening a formal insolvency when necessary.

During the COVID-19 period, among other things, judges could decide:

- the interruption / prohibition of judicial actions brought with a view to having the insolvent company ordered to pay further sums or to terminate contracts;
- the interruption / prohibition of any enforcement proceedings implemented by creditors towards both movable and immovable property; and
- before any formal notice or judicial actions, to postpone or spread out payments due to creditors for a period of up to two years.

At the Paris Commercial Court, these measures have been implemented many times during the COVID-19 crisis. By Ordinance 2021, the Government maintained part of the measures adopted to face the COVID-19 crisis. The debtor is now able

to ask the judge to postpone or spread- out payments due to creditors for a period of up to two years, with a contradictory judicial action. The COVID-19 measure has been modified on this aspect as it was considered too aggressive due to the absence of a hearing and the possibility for creditors to develop their arguments. To remedy to this lack of contradictory, the Paris Commercial Court, before the Ordinance, had developed an unofficial hearing where creditors were able to develop their arguments to promote a conciliation between the insolvent and its creditors.

The Paris Commercial Court has also developed the appointment of an *ad hoc* agent to supervise the implementation of debt payments by the insolvent during the two year period. This gives confidence to creditors in the spreading out of the payment of their claims.

These changes should be continued in the future as they contribute to a better way for MSMEs to find solutions to keep their businesses out of financial difficulties and to prevent their employees from being dismissed.

4.3 Simplified insolvency proceedings

As mentioned in section 1.4 above, there is now a "crisis exit treatment" after COVID-19 for MSMEs.

For now, we understand that few companies have been able to benefit from such proceedings. The refusal decisions were based on the fact that the difficulties were not connected to the COVID-19 crisis (a mandatory precondition) or the restructuring perspectives were not foreseeable (parties must provide the Commercial Court with a restructuring plan alongside a provisional accounting statement).

The near future will give more examples of MSMEs seeking to benefit from the new crisis exit treatment.

GERMANY

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

The German Insolvency Code of 1 January 1999 (*Insolvenzordnung* - InsO) is the main law for insolvency and reorganisation in Germany. There are several ancillary laws regulating insolvency proceedings and their effects in Germany.

Since its initial enactment, there have been many minor or major amendments to the German Insolvency Code. The latest big change in German insolvency law was the StaRUG, which came into force on 1 January 2021. It implemented the European Directive (EU) 2019/1023 on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures (EU Directive).

Additionally, the German legislator passed a law to suspend the obligation to file for insolvency temporarily and to limit directors' liability in the case of insolvency caused by the COVID-19 pandemic (discussed further below).

In general, the German Insolvency Code contains regulations on two types of insolvency proceedings, namely the regular proceedings equivalent to a United States Chapter 11 proceeding called "*eigenverwaltung*", and the plan proceedings. Furthermore, there are regulations on personal bankruptcies and corporate bankruptcies, debtor in possession management, discharge of residual debt, proceedings of a decedent's estate and proceedings with international references.

The existing formal insolvency framework does not specifically address the needs of MSMEs but the regulations work for all kinds of enterprises, regardless of the size.

1.2 Specific insolvency legislation

Germany has more than 2.6 million MSMEs, which equates to 99% of all enterprises.[1]

There is no specific insolvency legislation for MSMEs. However, there are some regulations that only apply to medium and large enterprise insolvencies, such as the mandatory implementation of a preliminary creditors' committee and the insolvency administrator's duty to provide an electronic information system for creditors. Those regulations apply if the debtor satisfied two of the following three criteria in the previous business year:

- a minimum balance sheet total of EUR 6 million;
- a minimum of EUR 12 million in sales revenue in the 12 months prior to the balance sheet date; and
- at least 50 employees on an annual average.

[1] Federal Statistical Office - DSTATIS - Genesis-Online, downloaded 17 January 2022, available at: https://wwwgenesis.destatis.de/genesis/online?operation=previous&levelindex=1&step=1&titel=Ergebnis&levelid=1642435531900&acceptscookies=false#abreadcrumb

However, for efficiency reasons, most insolvency administrators provide an electronic information system to creditors, even if it is not mandatory.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

In the case of a so-called consumer insolvency procedure (*verbraucherinsolvenz-verfahren*), out of court restructuring activities are mandatory before a debtor can enter formal insolvency proceedings. The debtor needs to try to reach an out of court agreement with creditors on a plan to satisfy their claims before court proceedings can be initiated. When filing for insolvency, the debtor has to prove its unsuccessful attempts to find an out of court agreement. Without such proof, the application is inadmissible. In almost every case, the out of court restructuring activities do not succeed. The abolition of these regulations would be reasonable.

Those regulations apply only to natural persons who do not pursue a self-employed economic activity.

There is no formal framework for out of court assistance or workouts regulating corporate insolvencies. However, since the StaRUG came into force, there are several new possibilities and duties. The StaRUG aims to avoid formal insolvency proceedings by implementing a duty of the company management to recognise crises at an early stage. Those new regulations are applicable in cases of imminent illiquidity. The requirements of imminent illiquidity are legally defined in § 18 of the InsO. Imminent insolvency is given if the debtor is not expected to be able to meet the existing payment obligations at the time they fall due. As a rule, a forecast period of 24 months is to be taken as a basis.

In case of identified risks, a restructuring plan must be elaborated. Part of the restructuring plan is to present that there is a reasonable prospect that the company's continuation of its business can be ensured or restored.

The restructuring plan enables a reorganisation of the legal relations between the debtor and its creditors. The creditors' approval of the restructuring plan is necessary. However, the debtor can decide which creditors are affected by the restructuring plan, and only their approval is required. It is also the debtor's decision whether the court is involved in the vote on the restructuring plan. Upon request, the debtor may receive a preliminary judicial review of significant issues or an enforcement and liquidation freeze. The court can be involved at any time, but it is not mandatory to do so.

1.3.2 Informal framework

There is no informal framework for out of court assistance or workouts as such. Of course, there is always the possibility to find comparative settlements or deferral agreements with creditors. However, creditors such as the tax office and social security agencies cannot usually be included in those agreements.

1.4 Accelerated restructuring or liquidation of MSMEs

There is no mechanism for accelerated restructuring or liquidation of MSMEs in

Germany. Nonetheless, there is always the possibility of an insolvency plan according to §§ 217 to 269 of the InsO, which apply to all kinds of companies.

An insolvency plan can reduce the duration of insolvency proceedings to three to six months. Insolvency plan proceedings are a special kind of insolvency proceedings which aim to achieve the best possible satisfaction of the creditors. The debtor can elaborate an insolvency plan which has effects on the legal relations to all creditors after their and the insolvency court's approval to the plan is given. Usually there is a one-off payment to the creditors, which is higher than the expected insolvency quota for them. The insolvency plan is a comparative settlement on the debtor's arrears. A sponsor provides the money for the payment. As soon as the insolvency plan comes into force, the insolvency proceedings are suspended and the debtor regains its ability to act.

Liquidation, on the other hand, is the winding up of a company by the sale of all assets, the payment of all debts and the distribution of the remaining funds to the shareholders. The creditors must be fully satisfied. The regulation of liquidation for different company forms is set out in the corresponding special law.[2]

1.5 Discharge of debts for natural persons

Natural persons can obtain discharge of their residual debt if they fulfil certain requirements, irrespective of whether they were self-employed or not. The relevant part of the Insolvency Code was recently modified to shorten the time after which discharge is granted and to strengthen creditors' rights. The residual debts of individual persons can be discharged now after three years.

When filing for insolvency proceedings, the debtor has to apply for discharge of debt and declare that he or she transfers his or her distrainable salary or income to an appointed trustee for three years (transfer period).[3] If the application is permitted, the court rules that the debtor is granted discharge at the end of the transfer period if he or she complies with his or her obligations and no requirements of refusal are fulfilled. The discharge is granted in more than 80% of individual insolvency proceedings. The discharge does not include debts resulting from tort, tax arrears or fines.

Extended or suspended repayment terms for MSMEs during the pandemic.

There were no measures taken to facilitate the repayment of loans, but the German legislator passed a law with a comparable strategic goal.

Specifically, in the period of 1 April 2020 until 30 June 2020, consumers and small businesses were allowed to withhold their payments for rent and utility services (energy, gas). Since 1 July 2020, any withheld payment was due again, so every positive effects from those measures only lasted for a short time span.

[2] For example, §§ 145ff., 161 HGB for OHG and KG, §§ 66ff GmbHG for the GmbH / limited liability company.
[3] InsO, § 287.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

No special procedural insolvency measures were passed with respect to MSMEs during COVID-19.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

As mentioned above, the German legislator took special measures in March 2020 to suspend the obligation to file for insolvency and to limit directors' liability in the case of insolvency caused by the pandemic.

Normally, a director of a company is obliged to file for insolvency without undue delay after the occurrence of a reason for insolvency.[4] In the case of illiquidity, this step has to be taken within three weeks. In the case of over indebtedness, it must occur within six weeks. Filing too late leads to the director's personal liability for every payment from the company's assets after the occurrence of insolvency. There are also penal consequences of up to three years' imprisonment.

The directors' duty to file for insolvency was suspended from 1 March until 30 September 2020. Furthermore, the duty to file for insolvency due to over indebtedness was suspended until the end of 2020 and under certain circumstances the suspension was prolonged until 30 April 2021.

There were also further temporary amendments in the period from 1 March 2020 to 30 April 2021:

- limitation of directors' liability for payments by the insolvent company; and
- restrictions concerning the avoidance of legal acts by the later insolvency administrator (which leads to lower risks for business partners and shareholders to interact with a company close to insolvency).

Further, in the period up to 30 September 2023, the repayment of a new loan granted during the suspension period, including from shareholders, as well as the provision of collateral to secure such loans during the suspension period, shall not be deemed to be detrimental to creditors. Thus, payments in this context are subject to the avoidance of legal acts by the later insolvency administrator.

Additionally, the German Government enacted short term bridging measures to support companies affected by the pandemic since June 2020. Those measures were amended and improved, and were extended until June 2022. Tax relief applies for the entire year of 2022.German companies can apply for those support payments, which cover their fixed costs and (in part) loss of profits. The measures of the German State worked out quite well and avoided a brutal wave of bankruptcies in Germany. The German Government spent a total of EUR 129.4 billion directly in supporting the German economy.[5]

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[4] *Idem*, § 15a.

[5] According to data provided by the German Federal Ministery for Economic Affairs and Climate Action, as of 05 August 2022, available at: https://www.bmwk.de/Redaktion/DE/Coronavirus/informationen-zu-corona-hilfen-des-bundes.html

Furthermore, there is something called "*kurzarbeitergeld*". The German Employment Agency provides *kurzarbeitergeld* when employees' working capacity is not needed due to economically difficult times. Its purpose is to compensate a loss of income for employees and to secure their jobs. While the Employment Agency is paying *kurzarbeitergeld* to employees, the employer is relieved from those costs and does not need to lay employees off. The Employment Agency pays up to 67% of the regular income to the employees. As soon as the reason for granting *kurzarbeitergeld* ceased, the employer resumes paying the wages.

Since 2019, the number of corporate insolvency proceedings declined significantly. The decline adds up to around 25%.[6] The number of insolvencies is now on the level of 1993 in Germany. There were 18,830 corporate insolvencies in Germany in 2019, 16,040 in 2020 and 14,300 in 2021.[7] This decline results primarily from the financial support provided by the Government.

This decline is a general development, so MSMEs are affected as well as large companies. Only the number of consumer insolvencies experienced a heavy upward trend in 2021, which stopped in 2022.

For the upcoming months, a slight increase of corporate insolvencies is predicted.[8]

2.3 Insolvency procedural deadlines

See the information set out in section 2.2 above.

2.4 Minimum debt requirements to initiate insolvency proceedings

There is no minimum debt requirement to initiate insolvency proceedings in Germany. According to the InsO, only the three legally defined reasons allow initiation of insolvency proceedings: (i) illiquidity; (ii) imminent illiquidity; and (iii) over indebtedness.[9] Imminent illiquidity only grants a right to the debtor to initiate insolvency proceedings by filing for insolvency.

If one of these conditions is present, the minimum value of the expected insolvency estate must be sufficient to cover the procedural costs, which include the court costs as well as the insolvency administrator's compensation. If the expected insolvency estate is sufficient, the insolvency court will resolve on the commencement on insolvency proceedings.

A creditor can request insolvency proceedings for its debtor. According to § 14 of the InsO, a creditor needs a legal interest in the commencement of insolvency proceedings and has to make its claims credible. These provisions are complied with if a creditor presents a certificate from the bailiff that proves an unsuccessful

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[6] According to data provided by Euler Hermes Deutschland, downloaded 05 August 2022, available at: https://www.allianz-trade.de/presse/pressemitteilungen/euler-hermes-studie-anstieg-weltweiter-insolvenzen-in-2022.html. /content/dam/onemarketing/ehndbx/eulerhermes_com/en_gl/erd/publications/pdf/2021_10_06_Insolvency.pdf.

[7] According to data provided by Verband der Creditreform e.V., downloaded on 1 February 2022, available at: https://www.creditreform.de/muenster/aktuelles-wissen/pressemeldungen-fachbeitraege/news-details/show/insolvenzen-in-deutschland-jahr-2021.

[8] See n 6, above.

[9] InsO, §§ 17-19.

attempt to enforce the claim. To enforce a claim, the creditor needs an enforceable title, such as a judgment or an enforcement order by a court. It can take several months or years to receive such a title, due to legal remedies against judgments or enforcement orders.

On the other hand, the tax offices and social security agencies are self-titling. This means they can create enforceable titles by themselves without formal court proceedings. Therefore, they are much faster compared to private creditors and in most cases, those public bodies will initiate insolvency proceedings.

2.5 Suspending specific creditors' rights

The regulations of the COVInsAG suspended creditors' right to initiate the opening of insolvency proceedings concerning their debtor in the period from 28 March 2020 to 28 June 2020. This regulation did not apply if the reason to open insolvency proceedings already existed prior to 1 March 2020.

2.6 Mediation and / or debt counselling

As mentioned above, the StaRUG provides debtors with the possibility to reach agreements with creditors and an enforcement and liquidation freeze (this is not mandatory). Besides those new regulations, there are no mediations or debt counselling in Germany as part of the insolvency process.

Making mediation mandatory would have the following benefits:

- avoidance of involvement of the courts to relieve the justice system;
- lower costs, as the court costs and insolvency administrator's compensation would not be present, therefore leaving more assets as part of the debtor's estate; and
- maintaining the goodwill and business relations of the debtor.

On the other hand, a disadvantage of making mediation mandatory is the possible loss of time and money, as often the first days or weeks of insolvency proceedings are critical. When the mediation is not successful, the insolvency administrator might find a much worse situation to cope with, compared to the situation without this loss of time due to the unsuccessful mediation.

Mediation can help MSMEs cut time and costs pertaining to restructuring and formal insolvency if the debtor is able to find a solution with creditors without formal insolvency proceedings. The probability of successful mediation attempts depends on the point in time when the debtor takes action. In many cases, the debtor waits too long and there are no sufficient assets to grant the creditors. Accordingly, there are lower prospects of success.

3. Challenges Faced

3.1 Stigma associated with insolvency

In Germany, there is still a stigma associated with insolvency. Insolvency

proceedings are public proceedings, and according to the InsO, many circumstances (such as the opening of insolvency proceedings) have to be published on the internet.[10]

This is one of the benefits of the StaRUG regulations, insofar as those proceedings are not published and therefore a public stigma is not expected. Only the involved creditors will be aware of the restructuring activities.

After going through insolvency proceedings, getting a bank loan is not as easy for a business. There are institutions like the Schufa (General Credit Protection Agency) which lists insolvency proceedings and other information about debtors to rate their creditworthiness. With a negative registration in those lists, banks will ask for more securities to give out loans or will refrain from lending money altogether.

3.2 Availability of financial information

The availability of financial information concerning MSMEs is not consistent. The legal form of the enterprise determines whether it is obliged to publish an annual financial statement in the Federal Gazette. This regulation applies to limited liability companies and other capital companies.

Registered merchants are obliged to keep records and fulfil their accounting obligations if their turnover exceeds EUR 600,000 or their profit exceeds EUR 60,000.

To have access to the financial information of MSMEs, the regulations of limited liability companies should be applicable to all kind of companies, regardless of their size or economic strength.

3.3 Access to new money

- *Insolvency Payments (Insolvenzgeld) by the Employment Agency (Bundesagentur für Arbeit)*

  Insolvency payments are not a form of financing by a credit institution but rather a kind of insurance payment. If insolvency occurs before the next monthly salary payment is due, the future monthly salaries of employees can be pre-financed by a credit, which is covered for a maximum period of three months by future insolvency payments of the Employment Agency. This tool is used in preliminary insolvency proceedings and enables personnel costs to be saved for up to three months.

- *New loan*

  The Insolvency Code distinguishes between two basic types of preliminary insolvency administrator. If a preliminary insolvency administrator is appointed at the same time as a general prohibition of disposal is imposed on the debtor,[11] the right to manage and dispose of the debtor's assets vests in the

[10] On the website https://www.insolvenzbekanntmachungen.de/, which is accessible for everyone.
[11] In accordance with InsO, § 21(2).

preliminary insolvency administrator.[12] In this case, the administrator is known as a "strong" preliminary insolvency administrator.

If the preliminary insolvency administrator is merely granted a reservation of approval, the administrator is known as a "weak" preliminary insolvency administrator.

In principle, it is possible that both a "strong" preliminary insolvency administrator and a "weak" preliminary insolvency can take out a new loan during the period of the preliminary insolvency administration period.

In the open proceedings right after the preliminary insolvency administration period, these new loan liabilities are regarded as preferential claims. This means they are repaid with priority before quota payments are made to all unsecured bankruptcy creditors.[13]

In practice, the bank or new lender will only grant a new loan against the provision of valuable unsecured collateral from the debtor. The risk for the bank in the event of a mass inadequacy or an impending mass inadequacy of not getting its new loan repaid in full when the proceeding is opened, despite the priority according to § 209(1) of the InsO, is too high. An additional specific individual authorisation by the court enables the "weak" provisional insolvency administrator to use specific free assets from the debtor to secure a new loan to be taken out. However, because the debtor often does not have the necessary unsecured assets, it is unusual to get such a new loan financing.

In addition, it would also be possible for the preliminary insolvency administrator to grant personal liability for the repayment of a loan. However, this will only happen in exceptional cases.

- *"False" insolvency estate loan with revolving collateral*

  The already engaged credit institute can grant some form of a "new" loan by a so-called agreement loan (*Vereinbarungsdarlehen*). In this new agreement loan, the secured bank provides and allows the preliminary insolvency administrator to use the already secured current assets of the debtor and the income of the already secured sales receivables to finance the business. In the agreement loan, the insolvency administrator has to ensure that new assets and the sales receivables in the future are used as the new collateral for the already existing old credits in circulation to the same extent.

- *Mass costs subsidy*

  In order to enable the opening of insolvency proceedings, it is permitted that third parties can pay a sum of money into the proceedings to cover the procedural costs. In general, this does not happen to finance the continuation of the ongoing of the business.

[12] *Idem*, § 22(1).
[13] *Idem*, § 38.

3.4 Secured creditors *vis-a-vis* unsecured creditors

There is a distinction between secured and unsecured creditors.

Furthermore, the German Insolvency Law distinguishes between two types of secured creditors. Those creditors that can claim on the basis of a real right (*in rem*) or a personal right (*in personam*) are not insolvency creditors, as their assets do not form part of the insolvency estate as such. Those creditors have a right to segregation of the asset.[14]

There are also creditors entitled to separate satisfaction.[15] Those are creditors to whom the debtor transferred ownership of a movable object or assigned a right as security for a claim and creditors that have a right of retention under the Commercial Code. In addition, creditors that hold mortgages on real property belonging to the insolvency estate, or that have a contractual lien, a lien acquired through levy of attachment or a statutory lien, have the right to separate satisfaction.

All other creditors are unsecured creditors and so-called insolvency creditors that participate in the final distribution after the realisation of the insolvency estate has been completed. They will receive a quota depending on their claim.

3.5 Insufficient asset base

Where there is a low asset base, insolvency proceedings are not opened. As mentioned above, a minimum amount of assets is necessary. The estimated insolvency estate needs to cover the court costs and the insolvency administrator's compensation.

It is possible for a creditor or the debtors to give a procedural grant, which means they are willing to pay for those minimum costs. In practice, this possibility is nearly never used.

3.6 Personal guarantees (PGs)

PGs are an important measure concerning the liquidity of MSMEs. Regarding small corporates, there is a close correlation of the corporate's assets and the shareholders' private assets. Apart from very small loans, a bank will only grant financing if the repayment is secured by a PG.

Common PGs in Germany are guarantees "on first request", which means the guarantor is liable in addition to the debtor. The guarantee creditor can hold both directly liable.

Furthermore, mortgages are very frequent if the debtor has real estate. In addition, other assets like cars or valuables can be mortgaged. The cession of the payout claim of a life insurance policy is another common security.

[14] InsO, § 47.
[15] *Idem*, §§ 49-51.

If the debtor has no sufficient personal assets, family or friends will be asked to give a PG for the debtor.

3.7 Further challenges

One of the biggest issues is that the persons in charge wait too long before they take action to approach the companies' problems. When the formal insolvency proceedings are initiated too late, there are no unsecured assets of value. This situation leads to low expectations concerning the business continuation and a bigger loss for all the creditors.

In fact, plugging gaps is a typical behaviour in this situation. Liquidity gained from ongoing business is used to serve old liabilities until the liquidity is not sufficient any longer.

4. Moving Ahead

Interviews were conducted, for the purpose of this section, with Dr Robert Hänel and Dr Annerose Tashiro.

Dr Robert Hänel is lawyer and managing director at Anchor Rechtsanwaltsgesellschaft mbH. He is court-appointed insolvency administrator since 2000. Since then he has successfully handled a large number of private and corporate insolvency proceedings and is expert in international insolvency law. He is member of the Board of Directors of VID e.V. (Association of Insolvency Administrators and Administrators in Germany), Co-Chair of the Insolvency Office-Holders Forum of INSOL Europe and Member of the Small Practice Issues Committee at INSOL International.[16]

Dr Annerose Tashiro is lawyer, Registered Foreign Lawyer (SRA) and expert for cross-border and restructuring at Schultze & Braun Rechtsanwaltsgesellschaft für Insolvenzverwaltung mbH since 2004. She is Vice President for International Affairs of the American Bankruptcy Institute, Vice-Chair of International Secured Transactions & Insolvency Committee of the American Bar Association and Member of INSOL International.[17]

4.1 Best way to safeguard the interests of MSMEs

- *Dr Robert Hänel, Anchor Rechtsanwälte*

  There are three ways to achieve this aim: incentives, pressure and education / information.

  In relation to incentives and education, an idea is to grant tax advantages or other benefits for the MSME if it chooses a managing director with a certified qualification for the job. There should be a kind of (voluntary) "driving license" for managing directors.

[16] More details can be found at https://www.anchor.eu/en/team/dr-robert-haenel/.
[17] More details can be found at https://www.schultze-braun.de/en/people/annerose-tashiro-69/.

The "pressure" can be installed by specified early warning systems, as mentioned in article 3 of the EU Directive, and by sanctions for disregarding red flags.

Furthermore, it might be helpful to codify a shift of duties for managing directors to give priority to creditor interests (over shareholder interests) from a certain stage of a financial crisis. The German legislator has already made first steps to implement that in the new StaRUG. In this context, stricter liabilities for tax consultants who do not warn their customers in cases where it is necessary could be a supplementary measure.

Another measure would be to help managing directors by providing checklists and further information (such as tutorials) for critical situations online. These checklists and information could be provided on the website of a federal ministry.

- *Dr Annerose Tashiro, Schultze & Braun GmbH*

I often see MSMEs with very rudimentary accounting and bookkeeping. Often they are too late to realise how bad the situation is and restructuring then becomes more and more unlikely. I would go beyond education and checklists and even try to offer a software (web-based, free or with little costs, subsidised by the Government) that guides the managing director through a survey Q&A, and sufficient liquidity planning. The lack of planning is crucial and often the killer for early noticing and understanding of upcoming trouble.

On the other hand, the requirement for financial planning documentation under the StaRUG is too much and too expensive for MSMEs.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

- *Dr Robert Hänel, Anchor Rechtsanwälte*

In case of a responsible managing director, the formal insolvency procedures are helpful rather than a threat. Regardless of the size of an enterprise, German insolvency law provides effective tools for restructuring if the debtor files for insolvency proceedings in time.

On the other hand, when the insolvency procedures are initiated too late, it puts a lot of pressure on the person in charge.

Of various measures introduced during COVID-19, the most noteworthy ones which helped MSMEs are "*kurzarbeitergeld*", State support which helped to prevent viable businesses from becoming illiquid, and temporary suspension of the obligation to file for insolvency proceedings (to bridge the time until State support arrived).

These temporary measures should revert to the former position after COVID-19, as the State support with a "scattergun approach" also keeps non-viable businesses artificially alive. This leads to market distortions and inhibits necessary transformation processes.

However, legislators should evaluate what worked and what did notwork and – as preventive measures – equip a "toolbox" for quick and targeted use in future disaster situations.

- *Dr Annerose Tashiro, Schultze & Braun GmbH*

  In some family owned MSMEs that have injected often lots of their private money and placed a mortgage on the family house, there is insufficient protection of those families – especially when it comes to the subordination of shareholder loans, avoidance of payments or security provision. The strict rules in the law are sometimes too black and white in terms of "bad shareholder versus good creditor". To avoid losing everything, family owned MSMEs often delay filing. A more softened approach would help.

  I agree that *kurzarbeitergeld* has been proven an effective tool that existed before and was made applicable more extensively during COVID-19.

  Various governmental backed loans also provided large amounts of cash to help bridge lockdowns in particular. I agree that these interim measures should revert back to the previous position after COVID-19.

4.3 Simplified insolvency proceedings

- *Dr Robert Hänel, Anchor Rechtsanwälte*

  In general, a modular approach for MSMEs is not needed in Germany. This approach may be worth considering where insolvency proceedings are inflexible, too expensive, too long and too inefficient. That is not the case in Germany. In general, the insolvency "infrastructure" – courts and practitioners – works well enough and is sufficiently reliable. In particular, the remuneration system for insolvency administrators does not incentivise slow and inefficient work.

  Furthermore, the court fees and the minimum remuneration for insolvency proceedings are innocuous. Proceedings with no or low value assets do not get overly costly.

  However, bureaucratic obstacles such as the tax administration or (excessively strict) data protection requirements adversely affect the duration – and sometimes the costs – of insolvency proceedings.

  Nevertheless, some simplifications in German insolvency proceedings would be very helpful, such as avoiding asset sales, which only cover their costs or economically useless distribution of micro-amounts to creditors.

- *Dr Annerose Tashiro, Schultze & Braun GmbH*

  In addition to the above, entry qualification for restructuring tools (the StaRUG or the InsO) are very high and documentation and planning prerequisites are costly and often an overkill for MSMEs. Government-backed checklists, specimen planning, sample insolvency / restructuring plans and AI tool kits would help to reduce cost and lower the hurdles.

The fear of someone misusing the insolvency toolbox appears quite extensive, but is not as significant in practice. Easing the entry into restructuring would help many MSMEs.

HUNGARY

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

This summary is intended to provide a high-level overview of the Hungarian insolvency regime, and it does not necessarily cover every detail or aspect of the topics with which it deals. The information in this summary applies only to Hungarian law.

Hungarian insolvency legislation is divided into two main parts:

- Act XLIX of 1991 on bankruptcy and liquidation proceedings (Insolvency Act); and
- Act CV of 2015 on the settlement of debts of natural persons (Personal Bankruptcy Act).

Additionally, as a response to the negative effects of the COVID-19 pandemic on the Hungarian market, in April 2021 a new procedure (reorganisation proceeding) was introduced by the Hungarian Government (under Government Decree 345/2021 (IV.18) on the reorganisation of enterprises) and confirmed and extended by the Hungarian Parliament (under Act XCIX of 2021 on temporary measures regarding the state of danger (Temporary Measures Act)), to support Hungarian businesses.

In addition to the Temporary Measures Act, in June 2021, the Hungarian Parliament adopted Act LXIV of 2021 on restructuring (Restructuring Act), implementing Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt (EU Directive). The Restructuring Act entered into force on 1 July 2022.

- *Insolvency Act*

  The Insolvency Act applies to corporate entities, including MSMEs which are corporate entities. A different regime, the Personal Bankruptcy Act, applies to natural persons (including sole traders). There is no special legislation applicable to the bankruptcy or insolvency of MSMEs in particular.

  Pursuant to the Insolvency Act, the main types of proceedings applicable to insolvent companies are: (i) corporate bankruptcy proceedings; and (ii) liquidation proceedings.

  The purpose of a corporate bankruptcy proceeding is the restructuring and settlement of the debts of a financially distressed company, in order to avoid its winding up to the extent possible. Corporate bankruptcy proceedings may be initiated only by the debtor itself. If the court finds the debtor eligible for a bankruptcy proceeding (which requires that there is no other ongoing liquidation or corporate bankruptcy proceeding against the same debtor), it orders the bankruptcy proceeding, appoints an administrator, declares a payment moratorium in respect of the debtor's existing and future debts (for a

period of 180 days, which may be extended up to 365 days from the commencement date of the corporate bankruptcy proceeding) and publishes its order in the Company Gazette (in Hungarian: *Cégközlöny*).

The creditors have 30 days from the publication to register their claim with the administrator. During the bankruptcy proceedings, the creditors and the debtor aim to reach an arrangement on the treatment of outstanding debt (composition agreement). If the bankruptcy proceeding is unsuccessful (i.e. a composition agreement is not reached), the court automatically orders the liquidation of the debtor.

The aim of a liquidation proceeding is the winding up of a company. Liquidation proceedings may be solvent (in Hungarian: *végelszámolás*) or insolvent (in Hungarian: *felszámolás*).

Insolvent liquidation proceedings may be initiated by any creditor, the debtor itself or a liquidator appointed to a solvent company (to the extent the assets are less than the liabilities of the company). Liquidation proceedings may commence *ex officio* (by the order of the court) if a corporate bankruptcy proceeding was unsuccessful.

If the insolvency proceeding commences upon request (i.e. not *ex officio*), the court first examines the insolvency of the debtor and if the debtor is found insolvent, the court orders the liquidation proceeding, appoints a liquidator and publishes its order in the Company Gazette. The creditors have 40 days from the publication to register their claim with the liquidator. Upon request of the debtor, the court may allow a maximum period of 45 days for the debtor to settle its debt before the liquidator may commence liquidation of the debtor's assets. Thereafter, the liquidator must try to collect the debtor's outstanding claims and sell the debtor's assets at the highest price possible on the relevant market. The proceeds must then be distributed among the creditors in accordance with a specific order set out in the Insolvency Act and after the fees and costs of the liquidator are reimbursed from the proceeds.

- *Personal Bankruptcy Act*

Under the Personal Bankruptcy Act, the aim of a debt settlement proceeding is to ensure that a natural person in financial difficulties is able to settle its debts and restore its solvency with a guaranteed daily living allowance, without significant harm to the interest of creditors. To achieve this, the debtor and the creditor(s) enter into a debt settlement agreement. The process starts as a non-contentious proceeding, where participation is voluntary. The debtor can initiate the process with the main creditor. The minimum required debt in this process is HUF 2,000,000 (approximately EUR 5,600), but various additional requirements apply in connection with the personal circumstances of the debtor. The settlement protection is also subject to an upper limit of HUF 60,000,000 (approximately EUR 168,000), which makes this process inapplicable to most small and medium sized enterprises. Above the HUF 60,000,000 threshold, a natural person cannot apply for bankruptcy protection. If non-contentious proceedings are ineffective, the debtor can apply for judicial settlement proceedings, the purpose of which is the same –

that is, to achieve a debt settlement between the debtor and the creditor(s) with the court's coordination.

1.2 Specific insolvency legislation

There is no special legislation applicable to the bankruptcy or insolvency of MSMEs in Hungary. The Insolvency Act is applicable for all businesses incorporated as legal persons regardless of their size and the Personal Bankruptcy Act applies to natural persons (including sole traders). However, as noted above, the upper limit of HUF 60,000,000 (approximately EUR 168,000) can make the debt settlement proceeding inapplicable to most small and medium sized natural persons, including sole traders.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

Insolvency proceedings for enterprises and natural persons in Hungary start as non-contentious proceedings. The purpose of these proceedings is to reach agreement between the debtor and the creditor in order to settle the debt as soon as possible without a lengthy legal procedure.

Under the Insolvency Act, both liquidation proceedings and corporate bankruptcy proceedings require the involvement of the court. The proceedings may be initiated with the court and in each case, the court must approve the agreement between the debtor and the creditor(s), to the extent an agreement was achieved during the corporate bankruptcy or liquidation proceeding.

Under the Personal Bankruptcy Act, the debt settlement process can consist of two parts. During the first phase, which starts with the notification of the creditor(s) by the natural person debtor, the debtor and the creditor(s) liaise with each other without the involvement of the court. The aim is to agree on the treatment of the debts under a debt settlement agreement. The Family Bankruptcy Services (in Hungarian: *Családi Csődvédelmi Szolgálat*) can support the parties during the first phase, so that the court's approval of the debt settlement agreement is not a must. If the debtor and the creditor(s) enter into a debt settlement agreement, it must be registered with the Debt Settlement Register (in Hungarian: *természetes személyek adósságrendezési nyilvántartása*). If the agreement is not challenged, the process ends. If the first phase of the proceeding is not successful (i.e. the debtor and the creditors cannot reach an agreement within 120 days, or if the agreement is challenged), the court takes over the case and the second phase starts as a contentious proceeding.

As a response to the negative effects of the COVID-19 pandemic on the Hungarian market, in April 2021, a new procedure (reorganisation proceeding) was introduced by the Hungarian Government, and confirmed and extended by the Hungarian Parliament under the Temporary Measures Act, to support Hungarian businesses. The reorganisation proceeding is also a non-contentious proceeding, which may be initiated only by the debtor itself before the court, when the director(s) of the company foresee that the company will not be able to meet its payment obligations on time. In order to prevent a bankruptcy or insolvency proceeding, the new legislation provides a possibility for the debtor to receive

financial and / or material support or a loan with more favourable terms and conditions than under general market conditions. Upon request of the debtor, the court may order moratorium for up to 60 to 170 days while the company must develop reorganisation plans by involving specified creditors and a reorganisation expert. The reorganisation plan must be approved by the Metropolitan Court and its implementation will be monitored by the reorganisation expert.

Further, a new procedure (restructuring proceeding) was introduced Hungary in June 2022 under the Restructuring Act, implementing the EU Directive. Similarly to reorganisation proceedings, restructuring proceedings may be initiated by the debtor before the court. However, the imminent threat of insolvency of the company is not a prerequisite. This allows the debtor to prevent insolvency at an early stage. In order to prevent a bankruptcy or insolvency proceeding, the Restructuring Act includes the possibility for the debtor to receive financial and / or material support or a loan with more favourable terms and conditions than under general market conditions. Upon request of the debtor, the court may order a moratorium for up to four to 12 months while the company must develop restructuring plans by involving specified creditors and a restructuring expert. The restructuring plan must be approved by the court and its implementation will be monitored by the restructuring expert.

1.3.2 Informal framework

- *Recommendation of the Hungarian National Bank*

  The Hungarian National Bank has published a recommendation on the negotiated restructuring process of claims against co-financed corporate borrowers, addressed to institutional lenders. The recommendation sets out the proposals of the Hungarian National Bank concerning the negotiated restructuring process in relation to claims against co-financed corporate borrowers that are cooperative within the meaning of the recommendation. However, there is no specific informal framework for out of court assistance or workouts, nor specific guidance in relation to MSMEs in particular.

  The recommendation gives guidance and a general framework for the process of negotiated restructuring, the success of which can help to avoid generally lengthy and costly judicial enforcement proceedings. Providing a framework, the recommendation primarily aims to draw up broad principles of negotiation. However, compliance with these principles during the restructuring process takes place in various specific ways, taking into account all the circumstances of the particular case, the proposals of the advisors and the information obtained in the course of due diligence.

  Under the framework, one key good practice is that if the borrower notifies a lender about its payment difficulties, that lender shall inform the other institutional lenders and, to the extent necessary, set up a restructuring panel. The primary objective of a restructuring panel is to ensure efficient information sharing among the institutional lenders and between institutional lenders and the co-financed corporate borrower, to coordinate the activity of the institutional lenders and their communication with the borrower, to provide a platform for dispute settlement and, if applicable, to give instructions to and coordinate the joint advisors of the institutional lenders.

The recommendation suggests the application of a *de facto* moratorium as a temporary behaviour, during which the institutional lenders providing co-financing that fall within the scope of the recommendation refrain from initiating legal debt adjustment proceedings against the co-financed corporate borrower or taking any steps to enforce any claim or collateral provided in favour of such lenders. The recommendation expects that the *de facto* moratorium lasts for the shortest possible duration. The purpose of a moratorium is to encourage cooperation between the institutional lenders and the corporate debtors and to allow the institutional lenders to assess the financial situation of the debtor. In addition to setting out the general principles of a *de facto* moratorium, the recommendation provides guidelines for agreements between the institutional lenders and the corporate debtors on individually negotiated moratoria.

Although the priority aim of the Hungarian National Bank was to help to restore the solvency of borrowers in order to reduce non-performing exposures while ensuring the continuity of their businesses, without an effective mechanism to compel cooperation in good faith of the borrowers, the recommendation does not work particularly well in practice.

- *Early warning system*

  Under the Restructuring Act, the Hungarian Government will publish pre-insolvency early warning tools and "best practices" for companies, in particular for MSMEs and their shareholders and directors. The early warning tools will be available on an online platform. The early warning tools aim to support MSMEs in identifying financial risks, avoiding unnecessary financial risks and managing financial difficulties. The ultimate aim of the early warning system is to limit the risks of MSMEs becoming insolvent.

1.4 Accelerated restructuring or liquidation of MSMEs

A simplified insolvency proceeding may apply to accelerate the liquidation process. This proceeding does not specifically apply to MSMEs, but is available where the insolvent estate is not sufficient to cover the foreseeable costs of liquidation, or insufficient reliable information is available in the records of the debtor to allow liquidation proceedings to take place satisfactorily.

1.5 Discharge of debts for natural persons

Under Hungarian law, the personal insolvency regime is regulated under the Personal Bankruptcy Act.

The purpose of the debt settlement procedure is to reach an agreement between the debtor and the creditor(s) on restructuring the debt, which may include payment relief, to the extent the agreement does not favour any particular creditor. During the procedure, enforcement proceedings against the debtor are suspended in order to preserve the debtor's solvency and facilitate an effective debt settlement with the creditors.

The duration of the procedure is limited to five years, which may be extended by the court for an additional two years, provided that the extension has a prospect of

promoting the recovery of the creditors' claims. Upon termination of the procedure, to the extent the debtor complied with the debt settlement agreement (registered with the Debt Settlement Register), the debtor will be discharged from its obligations by the court. Following the discharge, the debtor may not apply for personal bankruptcy protection again within 10 years.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

As a response to the negative effects of the COVID-19 pandemic on the Hungarian market, a payment moratorium was introduced, suspending the payment obligations related to commercial loans, purchase agreements or lease agreements until the end of October 2021. As from November 2021, the payment moratorium remained available until 30 June 2022 only for certain social groups and enterprises in financial difficulties, such as businesses in difficulty, including companies, sole traders and the self-employed in financial difficulty, in each case subject to their request.

Under this special moratorium, interest is not capitalised but remains owing: the accumulated interest shall be paid back in equal annual instalments by the maturity date (extended where necessary).

Another important measure to protect debtors was the prohibition on acceleration of loan agreements by creditors. However, this protection expired on 30 June 2021.

The above measures allowed MSMEs (businesses and sole traders) to efficiently defer their debts during the pandemic. The measures have, however, been criticised on the basis that many debtors unnecessarily availed themselves of the automatic moratoria protections, thus increasing their debt burden.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

As noted above, the Hungarian Government introduced a new temporary pre-insolvency "reorganisation procedure" in Hungary in April 2021, confirmed by the Hungarian Parliament under the Temporary Measures Act. In addition, as noted above, in June 2021, the Hungarian Parliament adopted the EU Directive under the Restructuring Act, which entered into force on 1 July 2022.

The main purpose of both the reorganisation procedure and the restructuring procedure is to give a distressed company the opportunity – with the assistance of a reorganisation or restructuring expert appointed by a State body – to develop and implement a plan to restructure its financial indebtedness. Unsuccessful reorganisation and restructuring procedures do not automatically turn into insolvency proceedings such as corporate bankruptcy proceedings. As a result, they may prove to be a better alternative for distressed companies.

Neither the reorganisation proceedings, nor the restructuring proceedings, are tailored specifically for MSMEs, but both aim to provide a pre-insolvency option for distressed companies to avoid insolvency.

Additionally, from July 2021, certain important changes were incorporated into the Personal Bankruptcy Act, regulating debt settlement proceedings. Debt settlement proceedings aim at normalising natural persons' ability to settle their debts through creating and structuring the regulatory procedural background, thus also creating better potential to cooperate with creditors. The recent amendments allow a more beneficial position for debtors during debt settlement proceedings: by reducing certain administrative costs and extending the scope of natural persons who qualify for entering into debt settlement proceedings (allowing debtors to enter into debt settlement proceedings if their principal debt reaches at least 80% of the value of assets that may be included in the debt settlement).

The Hungarian Government also adopted a decree (which was then confirmed and extended by the Hungarian Parliament under the Temporary Measures Act) regulating the position of debtors during a debt settlement who elect to benefit from the payment moratorium. The main achievement of the regulation is that the prolongation of the term of loans falling under payment moratorium must be considered when the deadline for payment is set during debt settlement proceedings and in respect of out-of-court and court debt settlement arrangements as well.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

No specific measures have been introduced to suspend the requirement to initiate insolvency, liquidation or bankruptcy proceedings during COVID-19.

2.3 Insolvency procedural deadlines

In the first year of the COVID-19 pandemic, insolvency deadlines were extended temporarily between March and 31 December 2020, requiring creditors to wait at least an additional 75 days after the expiry of a payment deadline before initiating an insolvency proceeding against the debtor.

The effect of these measures was limited as the same rules reduced the courts' ability to set a further payment deadline (upon request of the debtor) from 45 days to 15 days.

In addition to the above, some permanent changes were introduced in relation to corporate bankruptcy proceedings:

- a 180 day moratorium comes into effect upon publication of the start of proceedings, instead of the previous 120 day period in case of procedures started from 1 August 2020; and
- in case of corporate bankruptcy proceedings which started after 1 August 2021, the deadline for arranging a meeting to reach a composition agreement is 90 days instead of 60 days.

2.4 Minimum debt requirements to initiate insolvency proceedings

Minimum debt requirements increased from HUF 200,000 (approximately EUR 550) to HUF 400,000 (approximately EUR 1,100) in terms of initiating liquidation proceedings.

2.5 Suspending specific creditors' rights

The payment moratorium discussed in section 1.6 above prevented debts from falling due. However, in respect of debts to which the moratorium did not apply (e.g. new borrowings and non-financial indebtedness), no additional restrictions on initiating insolvency proceedings were introduced.

2.6 Mediation and / or debt counselling

Economic mediators may advise MSMEs in respect of rehabilitation to be able to avoid insolvency proceedings. However, no relevant market practice or specific regulation of insolvency mediation exists in Hungary. Mediation is only regulated on a more general level. Mediation is expressly prohibited once enforcement proceedings have commenced.

Making mediation mandatory in a pre-insolvency scenario would have the benefits of easing the negotiation process, with a view to achieving mutually beneficial outcomes for the parties involved, even if the parties would be reluctant to acknowledge that they have a chance to find common ground right from the start. It would also reduce procedural formalities, delays and costs.

On the other hand, parties with conflicting interests may not be as cooperative if forced to enter into a mediation procedure compared to where parties mutually agree to enter into mediation. From the creditors' perspective, mediation may be viewed as a time-delaying strategy.

Due to the limited amount of cases where mediation is applied in Hungary to help MSMEs in an insolvency scenario, it is difficult to assess whether mediation could effectively cut time and costs pertaining to formal insolvency or restructuring. However, based on the apparent issue of overly prolonged and costly formal proceedings typical in Hungary and the general stigma attached to bankruptcy proceedings, mediation may be a valid alternative if its regulation and specific training processes for qualifying economic mediators to be able to effectively help parties in a pre-insolvency scenario are worked out in the future.

3. Challenges Faced

3.1 Stigma associated with insolvency

Traditionally, no strong social stigma is attached with the MSME promoters / entrepreneurs in case of insolvency. Courts can prohibit them participating in the management or supervisory board of any businesses (for a limited period of time no longer than five years) if the court finds that their financial management strategies or actions (or the lack thereof) led to the insolvency or winding up of the company and the creditors' claims cannot be satisfied. If such a prohibition is ordered, MSME promoters / entrepreneurs shall be removed from their existing offices and cannot be appointed to similar positions in new companies. Additionally, they cannot acquire or retain a controlling interest in a company during the time of the prohibition.

3.2 Availability of financial information

When MSMEs are natural persons, they usually operate as sole traders. Pursuant to the current Hungarian legislation, such MSMEs are required to prepare their yearly tax return statements which contain key information about their income and tax liability. The Hungarian National Tax and Customs Administration publishes this information, which can be accessed on the official web site upon providing the tax number of the MSME.

It should be noted that certain MSMEs' financial information is not required to be published. For example, there is no such obligation regarding the financial information of licensed traditional small-scale producers (in Hungarian: *mezőgazdasági őstermelő*), attorneys, public notaries, veterinarians, individual patent agents and individual bailiffs.

3.3 Access to new money

Traditionally, new financing has not been common in Hungary. However, new financing can be available to MSMEs during the reorganisation procedure recently introduced in Hungarian law and similar rules apply under the Restructuring Act.

Temporary financing includes any new financial support provided by an existing or new lender, which includes at least the financial support that is reasonably and immediately necessary to enable the debtor to continue its operations during the moratorium and during the implementation of the reorganisation or restructuring plan. Any new financing must be included in the reorganisation or restructuring plan.

3.4 Secured creditors *vis-a-vis* unsecured creditors

Secured creditors have preferential rights *vis-à-vis* unsecured creditors in respect of those assets within the liquidation pool over which they have security.

During liquidation proceedings, the liquidator sells the assets and / or enforces the receivables of the insolvent debtor (including those over which secured creditors have securities). Where the asset is subject to security, the proceeds of its liquidation will be paid directly to the relevant secured creditor (following deduction of the costs of the sale / enforcement and other costs and fees arose in connection with the liquidation process). Possessory security (including security deposits over bank accounts and securities) can be directly enforced by the secured creditor (i.e. security deposits can be directly applied to the repayment of the debt by the secured creditor).

The proceeds of the liquidation pool (other than the proceeds of a security asset and / or receivables) shall be applied to, in the following order, the payment of:

- the costs and fees arising in connection with the liquidation, employees' salaries and similar payments, and taxes and similar payments;
- any remaining claim of a secured creditor not covered by the deducted amount of the proceeds of the security assets / receivables (up to the value of the assets / receivables);

- maintenance allowances and similar payments;
- damages and similar payments; and
- other public debts.

The remainder of the proceeds can be applied to the payment of the claims of unsecured creditors.

3.5 Insufficient asset base

In theory, if the creditors and a MSME can cooperate in good faith, the low asset base of the MSME alone would not push the creditors to opt for liquidation rather than keeping the debtor as a going concern. Such cooperation would include that the creditors have sufficient and reliable financial information regarding the MSME.

In practice, however, it is difficult for creditors to assess the creditworthiness and solvency of a MSME, given that MSMEs and their financial information are typically less transparent (with less financial information publicly available for MSMEs). This leads to uncertainty in terms of informal discussions between creditors and the MSME regarding a potential debt restructuring. This uncertainty often pushes creditors to opt to initiate insolvency proceedings.

3.6 Personal guarantees (PGs)

PGs for MSMEs are rather common in Hungary. When applying for a commercial loan, banks usually request PGs from the shareholders / directors of MSMEs.

The enforcement of PGs is dealt on a case-by-case basis and there is no special proceeding in place for MSMEs. However, there are certain limitations in terms of enforcement against the personal assets of such guarantors (including, in particular, residential property). Also, when the guarantors' assets form part of a matrimonial property, enforcement against those assets can apply only to a limited part of the assets which the guarantor owns (the statutory ratio being 50-50% of the matrimonial property). However, banks usually request a declaration of the spouse or (where applicable) the amendment of any contractual arrangement between spouses in relation to matrimonial property, stating that the guarantor's spouse expressly consents to the guarantee undertaking.

4. Moving Ahead

4.1 Best way to safeguard the interests of the MSME's

There is no special legislation applicable to the bankruptcy or insolvency of MSMEs in particular. As a response to the negative effects of the COVID-19 pandemic on the Hungarian market and households, certain legislation entered into force (as referred to above), which aims to safeguard the interests of debtors, such as the increase of the minimum debt requirement in insolvency proceedings and the ability to apply for payment moratoria, but these are not specifically tailored to MSMEs.

According to insolvency practitioners, a key element to safeguard the interests of MSMEs in getting through restructurings and formal insolvency would be if Hungarian legislation would encourage, and simultaneously financially support, MSMEs to involve qualified financial and legal advisors, in order to ensure that their financial management is adequate and efficient. However, in most cases (in particular for MSMEs that are private individuals), there are no specific requirements to employ such experts.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Participating in a formal insolvency proceeding is neither cost nor time efficient. Legal representation is mandatory during a formal insolvency proceeding with significant legal costs in addition to the liquidators' and third-party experts' fees and costs that can also be significant. Formal insolvency proceedings are rather long, often due to the fact that the courts are overwhelmed with ongoing proceedings, and rarely end with satisfying the majority of the creditors' claims, legal costs, fees and expenses.

Most of the regulations adopted as a response to the negative effects of the COVID-19 pandemic were temporary and, at this stage, we cannot estimate the benefits or potential long-term changes in the Hungarian legislation. What we have experienced over the past years is that companies were able to efficiently defer their debt and preserve their liquidity due to the payment moratorium. The most significant measures (e.g. the payment moratorium) were helpful for debtors, but burdensome on the financial sector. Therefore, such disproportionate measures may not be sustainable on a long term basis.

4.3 Simplified insolvency proceedings

As a general note, the need for a comprehensive update and modernisation of the currently applicable insolvency legislation in Hungary is urgent. The formal insolvency mechanisms are not efficient but burdensome. Creditors usually tend to use such proceedings as a weapon against debtors, whereas debtors take any and all actions available to frustrate or delay the proceeding or a potential settlement of the creditors' claims. Therefore, under the current legislation and "approach", usually neither the creditors, nor the debtors, can expect the benefits of a reasonable and well-balanced outcome of an insolvency proceeding.

The reorganisation procedure introduced in Hungary in April 2021 as well as the Restructuring Act implementing EU provisions regarding restructuring proceedings (which entered into force on 1 July 2022) may be helpful for MSMEs but there is no or very limited experience in practice in Hungary at this stage.

INDIA

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

The Insolvency and Bankruptcy Code, 2016 (IBC) is the main law for insolvencies and reorganisations in India. It is a new law and the provisions relating to insolvency and liquidation of only corporate persons came into force on 1 December 2016.

The provisions in the IBC relating to personal bankruptcy are not fully notified. The Government has recently notified certain provisions of the IBC relating to insolvency resolution of only personal guarantors to corporate debtors.

Besides the IBC, the Companies Act, 2013 (Companies Act) deals with schemes of reorganisation by companies (in a non-insolvency or non-liquidation scenario). The Companies Act provides for schemes of arrangement between the company and its creditors or any class of them or the company and its shareholders or any class of them. The scheme between the company and its creditors can be for any compromise or arrangement and can provide for restructuring of debt, reduction or preponement of debt or conversion of debt into other instruments.

India has around 65 million MSMEs and out of these, only three to four million MSMEs are corporate entities. The IBC is applicable at present to corporate entities only and does not apply to sole proprietorships and partnerships (unlimited liability). A scheme of pre-pack was also introduced on 4 April 2021, catering specifically to MSMEs (corporate entities).

1.2 Specific insolvency legislation

There is no specific insolvency legislation for MSMEs. There are general provisions that prevent the present promoters of the company from filing a resolution plan for their own companies. However, for MSMEs, this rule has been diluted and promoters of MSMEs can opt for giving a resolution plan to the creditors subject to conditions. As noted, in April 2021, a pre-pack scheme, especially for corporate MSMEs, was launched.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

In India, reliance may be placed on the guidelines issued by the Reserve Bank of India (RBI).

Restructuring of a debtor company can be given effect in terms of the RBI Circular dated 7 June 2019. Thereafter, another circular dated 6 August 2020[1] was issued by the RBI, aptly named as "Resolution Framework for COVID-19-Related Stress" as the means to restructure and resolve the stress to loans created by the onset of COVID-19. As per this circular, lending institutions were permitted to offer a limited window to individual borrowers and small businesses to implement

[1] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12085&Mode=0.

resolution plans in respect of their credit exposures while classifying the same as standard upon implementation of the resolution plan.

The resolution plans implemented under this window may *inter alia* include rescheduling of payments, conversion of any interest accrued or to be accrued into another credit facility, revisions in working capital sanctions and granting of moratoria based on an assessment of income streams of the borrower. However, compromise settlements are not permitted as a resolution plan for this purpose.

The key features of the circular dated 6 August 2020 were:

- the moratorium period may be for a maximum of two years;
- the extension of the residual tenor of the loan facilities may also be granted to borrowers, with or without payment moratorium;
- the resolution plan may provide for conversion of a portion of the debt into equity or other marketable, non-convertible debt securities issued by the borrower;
- the resolution plan should be finalised and implemented within 90 days from the date of invocation of the resolution process under this window;
- asset classification and provisioning; and
- working capital support for small businesses where resolution plans were implemented previously.

1.3.2 Informal framework

Other than formal workouts as detailed above, debtors can seek the assistance of financial institutions to get concessions on their loans and credit to the extent of the assistance that can be provided as per the internal rules and regulations of the financial institutions.

1.4 Accelerated restructuring or liquidation of MSMEs

The pre-packs relating to MSMEs noted above provide for accelerated restructuring / liquidation. However, being a very new framework, few MSMEs have used this tool. The time limit for accelerated restructuring is 90 days. The minimum threshold limit for the pre-pack is INR 1 million.

The pre-pack process is not available to those corporate debtors who have undergone an insolvency process in the three years preceding the date of the application. Before a corporate debtor can file an application to initiate a pre-pack, it requires consent from at least two thirds in value of the unrelated financial creditors and a special resolution passed by its shareholders. The corporate debtor must furnish the financial creditors with a base resolution plan before seeking approval from the creditors for initiation of the process.

Upon approval of the application for initiation of a pre-pack by the adjudicating authority, the moratorium will come into effect and a resolution professional /

resolution representative shall be appointed. The pre-pack follows debtor in possession with a creditor-in-control model. A committee of creditors (CoC) must pass the base resolution plan (BRP). If the BRP is not passed by the requisite majority of the CoC, an invitation to the applicant must be made to file for alternate resolution plans.

1.5 Discharge of debts for natural persons

Presently, the chapter relating to individual insolvency in the IBC has not yet been notified by the Central Government and hence the earlier Acts – namely the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act 1920 – are still operational. These Acts have not been able to assist the individuals in their restructuring / insolvency as it takes many years for the official liquidator to discharge the debts of natural persons.

In the case of personal guarantors to corporations, the IBC has been notified and after the invocation of the personal guarantee, personal insolvency or bankruptcy can be initiated only for the personal guarantors to the corporate persons and, after following the due process of law, the personal guarantor can be discharged subject to the other provisions of law.

All assets of the debtor form part of the bankruptcy estate except:

- unencumbered tools, books, vehicles and other equipment as are necessary to the debtor or bankrupt for personal use or for the purpose of employment, business or vocation;
- unencumbered furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his / her immediate family;
- any unencumbered personal ornaments of such value as may be prescribed of the debtor or his / her immediate family which cannot be parted with, in accordance with religious usage;
- any unencumbered life insurance policy or pension plan taken in the name of debtor or his / her immediate family; and
- an unencumbered single dwelling unit owned by the debtor of such value as may be prescribed.

The following will not form part of the discharge under bankruptcy of an individual:

- liability to pay a fine imposed by a court or tribunal;
- liability to pay damages for negligence, nuisance, or breach of a statutory, contractual or other legal obligation;
- liability to pay maintenance to any person under any law for the time being in force;
- liability in relation to a student loan; and

- any other debt as may be prescribed.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

Seeking to provide a quicker and value-maximising outcome for stressed MSMEs, the Government introduced a pre-packaged resolution process for such enterprises by amending the insolvency law.

The Government has also taken several measures to soften the pains emanating from COVID-19. It increased the threshold of default for filing of an insolvency application from INR 100,000 to INR 10 million to prevent MSMEs from being pushed into insolvency proceedings.

The RBI also permitted lending institutions to extend the moratorium on term loan instalments by six months and time for resolution under the prudential framework by 180 days.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

In June 2020, an ordinance was promulgated to suspend fresh insolvency proceedings and the same came into force retrospectively from 25 March, the day when the nationwide lockdown to curb the spread of coronavirus infections had come into effect. Later, a Bill to replace the ordinance that had amended the IBC was cleared by Parliament in September last year.

Initially, the suspension of fresh proceedings was for six months starting from 25 March. The same was extended twice for three months each, one until 24 December 2020, and then until 24 March 2021. The Corporate Affairs Ministry had suspended sections 7, 9 and 10 of the IBC (sections dealing with filing of insolvency petitions), to provide relief for companies hit by the pandemic. Sections 7, 9 and 10 deal with initiation of the corporate insolvency resolution process by a financial creditor, operational creditor and corporate debtor respectively. On 22 March, the Ministry had told the Lok Sabha (the Lower House of Parliament) that the benefit of the suspension was applicable to all those defaults of the corporate debtor that occur from 25 March 2020, until the end of period of the suspension.

The Government of India announced that insolvency proceedings under the IBC could not be initiated based on defaults that occurred between 25 March 2020 and 25 March 2021. The Government also announced that even for defaults that had occurred prior to this period, insolvency proceedings under the IBC could not be pursued unless a default of at least INR 10 million had taken place (up from the previous INR 100,000).

These measures were taken to prevent businesses from being forced to default or enter insolvency proceedings due to temporary distress that would be attributable to COVID-19. This became particularly important in the context of insolvency proceedings under the IBC, since these proceedings result in a change of control, and in many cases, the existing management / promoters are barred from presenting resolution plans to resolve the distress of the company. Given the global macro-economic scenario, there was a concern that third-party resolution

applicants would not be forthcoming for businesses, and a large number of businesses would be pushed into liquidation due to a paucity of applicants, even where the business should have been saved. Arguably, recourse to insolvency proceedings under the IBC was also suspended to "flatten the bankruptcy curve" and ensure that the National Company Law Tribunals (NCLTs) that were already combating infrastructural and capacity constraints did not have to deal with large volumes of applications filed for initiation of insolvency proceedings, particularly when they had to limit their functioning to only hear urgent cases in view of COVID-19 related restrictions.

Operationally, too, the Government and courts took various measures to ensure that timelines under the IBC were relaxed. The strict requirement to complete the corporate insolvency resolution processes (CIRP) within 330 days was also relaxed by an order of the National Company Law Appellate Tribunal, while the requirements to take various steps in CIRP and liquidation processes within stipulated timelines were eased by regulatory changes.

The industry had been looking for something to immediately rescue the fund starved MSME sector. The suspension of filing of insolvency proceedings along with the increase in the threshold limit helped MSMEs to stay out of the insolvency zone. However, with zero revenue coming in throughout the lockdown periods, the survival of MSMEs is today very much at stake. The cost of salary and wages in the sector goes up to 30 to 35%, and there are fixed costs such as rentals and electricity. Also, the cost of wages and salaries are higher in this sector, because of the lack of automated operations. However, the regulators and the Government did not do enough to mitigate the above situations.

2.3 Insolvency procedural deadlines

Please refer to the responses in section 2.2 above.

2.4 Minimum debt requirements to initiate insolvency proceedings

As noted above, the minimum threshold to initiate IBC proceedings against all debtors including MSMEs was raised from INR 100,000 to INR 10 million. The Government also exempted all COVID-related debts from the definition of default and stalled the invocation of for the IBC for one year, to allow ailing enterprises to cope with the crisis.

2.5 Suspending specific creditors' rights

The changes made to the insolvency regime have helped debtors. during COVID-19. The changes effectively suspended all creditors from initiating formal insolvency proceedings. However, neither the Central Government nor the RBI provided regulatory measures to alleviate the operational and lending risk confronted by creditors. With the IBC route (i.e. initiating insolvency proceedings under the Code) unavailable, creditors had to fall back on pre-existing restructuring, recovery and security enforcement mechanisms to recover dues in an environment where the probability of default was heightened.

These measures helped MSMEs in mitigating the defaults that may have been due to the black swan event of COVID-19. However, there are always two sides to a

coin: the MSME debtor has had protection against insolvency, while creditors have not been able to collect their debts. The IBC had become a great tool, which had brought in a paradigm shift in the way business was conducted in India. The debtors had the sword of insolvency dangling over their head, and that pushed them to pay their debts in time. The suspension of the IBC and the increase in the threshold limit has affected all creditors in getting their dues back in time.

2.6 Mediation and / or debt counselling

Mediation is still at a nascent stage of development in India. It is starting to gain popularity as a successful dispute resolution mechanism with the Supreme Court furthering its use to solve various kinds of disputes in the country, but there is one area where the use of mediation is still unexplored: in cases pertaining to insolvency law under the framework of the IBC.

Presently in practice, there is no mandatory requirement to initiate mediation or debt counselling or financial education for any type of rescue, restructuring or rehabilitation, prior to formal insolvency. As stated earlier, personal insolvency has not yet been notified by the Central Government in India. However, the rules and regulations of personal insolvency have a mandatory requirement for mediation prior to the filing of formal insolvency of individuals and partnership firms.

There are several advantages of mandatory mediation:

- debtor rehabilitation – the consensual approach of mediation can allow debtors to exercise certain control over their assets while also curing their over-indebtedness. Thus, mediation is an excellent dispute resolution tool for creditors and debtors who aim to ensure repayment of debt as well as the sustainability of the business enterprise;

- development of a holistic resolution plan – mediation allows parties to come up with creative, out-of-the-box solutions that incorporate the common interests of all parties to the mediation. This contributes to the possibility of the development of a holistic resolution plan that is financially beneficial for all creditors;

- time and cost efficiency – mediation is very efficient, helping to not only ease the burden of cases on courts but also to ensure a time-bound resolution process as envisioned under the IBC. Additionally, mediation reduces the procedural complexity of the process and makes it a cost-efficient alternative. This is economically viable for the parties and helps in maximising the value of assets as envisaged under the IBC;

- consideration of common interest – formal insolvency is collective in nature, where the debts of all creditors are sought to be settled. Mediation can help facilitate a process that accounts for the needs and interests of all stakeholders; and

- preserving reputation and relationships – the private and confidential nature of mediation ensures that the reputation of the insolvent corporate debtor is not damaged beyond repair. The goodwill of the corporate debtor is preserved as financial information about the debtor is confined between stakeholders.

In terms of the disadvantages of making mediation mandatory for corporations (not currently a part of formal proceedings under the IBC), financial institutions are not inclined to go for mediation in the initial stages of restructuring and insolvency. Rather, financial institutions prefer to negotiate with debtors directly, without the presence of mediators. Thus, mandatory mediation would be met with resistance by financial institutions.

Further, insolvency proceedings are proceedings in rem and affect multiple stakeholders like employees, creditors and workmen, who should be assisted with equitable treatment under a binding settlement / mediation agreement.

This, however, may make mediation unsuitable for large insolvency cases involving multiple stakeholders.

However, taking everything into account, mediation has preponderant advantages that can help in the successful implementation of the insolvency resolution process envisaged under the IBC.

3. Challenges Faced

3.1 Stigma associated with insolvency

In the last 70 years, we see that there is fear and shame associated with insolvency and bankruptcy. The stigma of insolvency is an issue, and this stigma stops business owners from acknowledging this fact and causes them to fail to take steps to restructure their business in time. Business owners are afraid and ashamed to even talk about insolvency and bankruptcy, lest it becomes public knowledge, and they feel that if it becomes public knowledge their business, families and their personal life would suffer, and they would lose their place in the society.

This mindset needs to change so that the perception of insolvency and bankruptcy does not signify any stigma and / or shame. Businesses not doing well need to shut down or restructure themselves and this should be analogised with a person developing a physical condition which requires the intervention of a doctor to rectify the problem and make the person normal again.

3.2 Availability of financial information

As noted above, most MSMEs in India are not corporate persons and most are sole proprietorship and partnerships, and they do not have enough funds at their disposal to retain professional accountants or lawyers to help them. Most MSME business owners use help from friends and family to file their tax returns or try and do that themselves. Their financial information is not publicly available.

However, after the advent of GST (goods and services tax) legislation that came in place of VAT, some aspects of business' financial information has come within the domain of government agencies. The GST paid can be used to calculate the turnover. The credit rating agencies have helped to determine the credit worthiness of individuals. This has brought some semblance in respect of individuals financial information and credit worthiness in public domain.

3.3 Access to new money

There are two sources of MSME finance in India. One is non-institutional, which includes loans from local money lenders, friends and relatives who charge a high rate of interest. The other is institutional. As per the fourth census of MSMEs recently conducted, only 5.18% (both registered and unregistered) had availed themselves of finance through institutional sources, with 2.05% obtaining funds from non-institutional sources and most (92.77%) having no finance or depending on self-finance.[2]

Since the IBC came into existence in 2016, the legislation provides that the creditors infusing new money or interim finance shall have super priority status in the overall waterfall mechanism. Despite these provisions, the trend is to fund only those companies which have a large asset base so that creditors (mostly banks and financial institutions) feel secured from their perspective. MSMEs are therefore high-risk borrowers due to having an insufficient asset base and low capital. This sector is highly vulnerable to market and economic fluctuation.

3.4 Secured creditors *vis-a-vis* unsecured creditors

In the Indian insolvency regime, the differentiation of creditors is based on financial creditors (these who have given money on interest or where there is a concept of the time value of money) and operational creditors. Financial creditors can be secured or unsecured. Financial creditors form the committee of creditors, and they manage the business of the corporate debtor while the insolvency process is underway. They take all the decisions in respect of keeping the company as a going concern or to push the corporate debtor towards liquidation. Secured financial creditors have rights to dispose of their security interests.

The operational creditors include all the vendors, consultants, suppliers, dues of the government and so forth. They have no say in the management of the corporate debtor subject to some exceptions. They are, however, entitled to a minimum of the liquidation value in respect of their debt.

The secured creditors can choose to alienate their security at the end of the resolution process.

3.5 Insufficient asset base

As noted in section 3.3 above, MSMEs are mostly dependent upon non-institutional finance for their credit requirements. This credit is typically provided at an exorbitant rate of interest. MSMEs typically are more opaque than large firms because they have less publicly available information. Consequently, it becomes difficult for banks to assess the creditworthiness of MSMEs, which can discourage lending and the lenders can substitute the lack of information with a higher requirement for collateral. Due to a heavy dependency on cash transactions, the reported data is also different from actual figures of sales and profitability. As a result, MSMEs qualify for lesser amounts of loans than what is required. This results in a constant shortage of funds for MSMEs.

[2] https://www.ies.gov.in/pdfs/Problems_of_MSME.pdf.

Besides this, due to high transaction cost and lower margins, lack of product innovation by MSMEs and low-risk appetite of financial institutions, MSMEs are unable to get timely and adequate credit. Categorisation as non-productive assets (NPA) is another factor in this segment which creates fear among bankers in providing loans.

All these factors have a direct impact on the financial institutions to opt for liquidation of MSMEs rather than keeping them as a going concern. The liquidation route is more preferred as the proceeds from liquidation can be used to fund companies which have a high level of compliance in accounting, governance and use of institutional finance. Presently, the financial institutions are flush with funds, however their risk appetite has decreased, despite there being immense demand for funding by MSMEs from all sectors.

Current trends in financing within the MSME sector reflect certain skews that need to be corrected. The MSME ecosystem is biased toward lending to medium enterprises over micro and small ones. 5,000 medium enterprises account for an exposure of INR 5.64 trillion, which is one-third of the total supply of INR 16.9 trillion to the MSME sector.[3]

According to an RBI Report, in India, the total addressable demand for external credit is estimated to be INR 37 trillion, while the overall supply of finance from formal sources is estimated to be INR 14.5 trillion. Hence, the overall credit gap in the MSME sector is estimated to be INR 20 to 25 trillion.[4]

3.6 Personal guarantees (PGs)

The concept of a "guarantee" is derived from section 126 of the Indian Contracts Act, 1872. If the debtor fails to repay the debt to the creditor, the burden falls on the guarantor to pay the amount. PGs to corporate MSMEs are very much prevalent in India. The liability of the corporate entities and their shareholders are only to the extent of their contributions. To cover the debt equity gap, all financial creditors take recourse to having PGs of the promoters or directors to safeguard their credit.

It is a settled law in India that the liability of a guarantor and the principal is co-extensive, and the creditor has the option of proceeding against either of them for recovery of its debt or initiating simultaneous proceedings against the corporate debtor and a personal guarantor of a corporate debtor for the same debt.[5]

This may lead to a situation where the creditor, despite having filed and recovered part of its debt before a resolution professional in the resolution process of the corporate debtor, proceeds to file its claims for the complete debt in the insolvency resolution process of the personal guarantor.

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[3] https://www.microsave.net/wp-content/uploads/2021/01/201207_Bridging-the-Credit-gap-for-MSMEs.pdf.

[4] https://www.globalgovernanceinitiative.org/post/council-on-sustainable-development-financing-msme-sector-a-major-need-for-india.

[5] In *re Lalit Mishra and Others v. Sharon Bio Medicine Ltd.* (NCLAT) available at: https://nclat.nic.in/Useradmin/upload/16294684985c1a14f4221dc.pdf.

The Insolvency Law Committee Report, 2020 (published by the Ministry of Corporate Affairs, India) recognises this anomaly and suggests that, upon recovery of any portion of claim by a creditor in one proceeding, there should be a corresponding revision in the claim filed in another proceeding. This is to prevent the creditors from unjustly enriching themselves and realising more amounts than what is due to them. The same has been affirmed by the Supreme Court.[6]

3.7 Further challenges

The Insolvency Law is a very recent piece of legislation in India, which was enacted in 2016-17. The law has been evolving since its inception and many amendments have taken place in this specific legislation. The legislature is contemplating more amendments soon to incorporate a cross border insolvency section and notification of individual insolvency. These suggested enhancements have not yet been finalised.

There is a need for creating more Insolvency Courts (NCLTs) to cater to the potential increase in filings.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

As noted, over 97% of MSMEs in India are sole proprietorships or partnerships with unlimited liability. The Insolvency Law has not yet been notified for sole proprietorships or partnerships with unlimited liability.

There is a need to educate and train MSMEs on the following aspects to be able to properly safeguard their interests:

- imparting basic financial education and understanding of the concepts of cash flows;
- the actual concept of insolvency and bankruptcy as a part of the life cycle of a business and not to be seen as a stigma as it is perceived;
- to understand and recognise early warning signals of financial distress; and
- guidance to negotiate and mediate whenever necessary with their financial providers to reorganise and restructure themselves in the initial stage of financial distress

Additionally, there is a need to:

- create and strengthen out of court workout protocols, specifically to help MSMEs in reorganising their businesses within a specific time;

[6] In *re Lalit Kumar Jain Vs Union of India & Ors Supreme Court of India,* available at: https://main.sci.gov.in/supremecourt/2020/26016/26016_2020_37_1501_28029_Judgement_21-May-2021.pdf.

- have a separate insolvency procedure for MSMEs which is not costly and can be run in a short span of time, with minimum intervention from the courts;

- streamline the MSME pre-pack, so that the process becomes a viable tool to rehabilitate and reorganise MSMEs;

- change the mindsets of banks and other finance providers to step back from contemplating recoveries from a failing business unit and to try and keep the business unit as a going concern through infusion of funds or other restructuring tools. This will help the businesses which are genuinely failing because of cash flow issues or operational issues to get back on their feet;

- promote the rehabilitation, rescue and reorganisation of businesses by accrediting such professionals to use their knowledge and experience for support to MSMEs;

- bring about changes in law and policy on effective resolution of stressed MSMEs to incorporate some of the above factors and use courts only as a last resort or simply to approve the rehabilitation or reorganisation between the MSME and the financial provider; and

- set up a fund for MSMEs for their refinancing needs for rehabilitation and rescue.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

As stated above, the formal insolvency procedures for individuals and partnership firms have not yet been notified. Formal insolvency has only been notified for the legal persons / entities. Post COVID-19, the threshold limit of filing for insolvency has been increased one hundred times to INR 10 million from INR 100,000.

This has not helped MSMEs to file for insolvencies against defaults on their payments since most of the MSMEs do not have such elevated level of overdue payments. The Government had brought in pre-pack legislation in April 2021 for MSMEs specifically, but this legislation has been a non-starter due to a lack of pre-pack filings.

4.3 Simplified insolvency proceedings

As such, India does not have any simplified restructuring, liquidation and discharge mechanism for majority of MSMEs.

The pre-pack for MSMEs, as noted above, is not an effective tool in its present form. Major changes are essential in the law to have an efficient restructuring regime for MSMEs. The major factors for MSMEs' better financial resolution can be summed up as:

- limiting the cost of running a restructuring or an insolvency process specifically for MSMEs;

- time is of the essence in any restructuring or insolvency to have a major impact for maximising the value in the business;

- the processes of rehabilitation and reorganisation for MSMEs need to be user friendly as most promoters of MSMEs may be financially illiterate and / or cannot afford lawyers and accountants to get proper financial advice;

- use of resolution tools such as mediation and pre-insolvency negotiations may have a much greater impact on MSMEs' resolution of their financial stress than court related interventions;

- strengthening the early warning tools to help the promoters of MSMEs to pre-empt the insolvency scenarios; and

- mandatory rehabilitation, reorganisation, rescue and restructuring culture before getting into formal insolvency filings.

If a simplified mechanism can be structured or legislated around the aforesaid factors, it will help MSMEs to get out of their financial and operational stress and contribute to the economy and the growth of GDP of India.

JAPAN

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

1.1.1 Overview

In Japan, there are two types of proceedings: liquidating-type insolvency proceedings (similar to United States Chapter 7), which include bankruptcy and special liquidation, and restructuring-type insolvency proceedings (similar to United States Chapter 11), which include civil rehabilitation proceedings (*minji saisei tetsuduki* or civil rehab) and corporate reorganisation proceedings (*kaisha kosei tetsuduki* or corporate reorganisation).

Special liquidation and corporate reorganisation are available only to corporations. Corporate reorganisation is designed for and used mainly by large corporations. Civil rehabilitation was originally designed as a restructuring-type procedure for MSMEs and private business operators, but today it is more often used by large or mid-sized companies above a certain size. If MSMEs consult with a specialist, they often are recommended simply to file for bankruptcy.

However, civil rehabilitation also provides special procedures for individuals (see section *1.1.2* below). Also, while it is based on practices, rather than the law, bankruptcy affords special treatment to cases of small-scale debt (see section *1.1.3* below).

1.1.2 Civil rehab procedures for individuals

In civil rehab procedures for individuals, a debtor is required to make repayments for three years (in general) based on the approved repayment plan.

There are two types of civil rehab procedures for individuals: (i) rehabilitation for individuals with small-scale debt; and (ii) rehabilitation for salaried workers.

- *Rehabilitation for individuals with small-scale debt*

  This is mainly for individuals who operate small businesses. A person is eligible as an individual with small-scale debt if:

  - they are likely to earn income continuously or regularly in the future; and

  - the total amount of rehabilitation claims which they owe (excluding the amount of home loan claims and certain other amounts) does not exceed 50 million yen.

  The minimum amount to be paid through this procedure (in general) is as follows.

Total amount of debt* (JPY)	**Amount to be paid (JPY)**
Up to 1 million	100% of debt
1 - 5 million	1 million
5 - 15 million	one fifth of total debt
15 - 30 million	3 million

30 million or more	One-tenth of total debt

*Excluding home loan debt and certain other amounts.

- *Rehabilitation for salaried workers*

  This is mainly for individuals who have regular income from their employment.

  In addition to the criteria noted above, such individuals are also required to be "likely to receive a salary or earn similar regular income and the amount of the salary or income is expected to fluctuate only within a small range".

  The minimum amount to be paid through this procedure is the higher amount of either the amount calculated under the criteria noted above, or the total amount of the individual's disposable income for a period of two years.

1.1.3 Special treatment in bankruptcy procedures in the case of small-scale debt

While this is based on practices, rather than the law, some courts afford special treatment to bankruptcy procedures in cases of small-scale debt.

The greatest advantage of this treatment is that the deposit amount can be lower than usual. In general, it is necessary to pay around 0.5 to 7 million JPY as a deposit to the court when filing for bankruptcy. However, if this special treatment is applied, a debtor is generally required to pay only 0.2 million JPY.

The purpose of this treatment is not only to allow a smaller deposit amount to be paid, but also to simplify and facilitate bankruptcy procedures. Therefore, this treatment is typically applied in cases of small-scale debt, cases which do not require measures in relation to bankruptcy estates (for example, a case with few or no bankruptcy estates) and cases which are expected to conclude in a short period of time. However, it is required that such cases be filed by an attorney.

The Tokyo District Court permits this treatment not only for individuals, but also for entities.

1.2 Specific insolvency legislation

Other than the rehabilitation for individuals with small-scale debts mentioned above, there is no specific insolvency legislation for MSMEs in Japan.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

- *For corporations*

  (i) Turnaround Alternative Dispute Resolution

  Other than purely consensual, negotiation-based workouts, there is the Turnaround Alternative Dispute Resolution (TADR) process sponsored by the Japanese Association of Turnaround Professionals, as a formal, rule-

based, out of court workout. The TADR is the most popular process these days (especially for larger-scale debtors).

The TADR is a process through which debtors may adjust or restructure debts owed to participating creditors with the consensus of those creditors (which typically would be limited to financial creditors). Formal, rule-based, out of court restructuring processes are, in most cases, based on a statute allowing specific entities to set rules for a process offered to debtors through which a debt adjustment or restructuring can be achieved on a consensus basis with the participating creditors. They do not, however, involve any court supervision or approval of the resultant workout plan and thus are pure out of court processes.

(ii) Workout supported by the SME Vitalisation Councils (*Chusho-kigyo Kasseika Kyogikai*), previously the SME Revitalisation Support Councils (*Chusho-kigyo Saisei Shien Kyogikai*)

The SME Vitalisation Councils provide measures to support MSMEs. Since the Councils were established in 2003, there have been more than 48,000 cases for consultations, and more than 15,000 cases for which the Councils provided and completed their support (in total).

A MSME which meets all the requirements below can apply for the Councils' support:

- suffering from business management difficulties or there is a risk of suffering from such difficulties due to financial deterioration or decline of productivity caused by excessive debts or excessive capital investment; and

- there is a possibility of business revitalisation, such as the target business being productive or having future prospects.

In addition to the requirements above, if a debtor plans to establish a business restructuring plan which includes debt waiver, the MSME is required to meet all the requirements below:

- suffering from business management difficulties mainly due to excessive debt which is difficult to resolve;

- formal insolvency proceeding may cause problems in resolving debt, as such a proceeding might lead to a decline of the debtor's credibility or otherwise have a negative material effect on its business value; and

- there is economic rationality for creditors, for example in the case where creditors may receive a repayment amount which is greater than the amount which would result from formal insolvency proceedings.

The Councils support qualified MSMEs in the following ways:

- they assist debtors with drafting business restructuring plans;

- they assist debtors with obtaining consent from their main creditors; and

- after a plan is approved, the Councils continuously monitor and provide advice on the implementation of the plan.

The Councils provide this support free of charge. However, the fees of any specialists involved in the establishment of such a business restructuring plan, such as accountants or legal advisors, should be paid by the debtor. Therefore, these measures provided by the Councils may be available only to MSMEs which possess sufficient funds.

(iii) Special conciliation

In addition, as a formal workout scheme for MSMEs, there is a special conciliation (*tokutei chotei*) process (see section 2.6 below).

- *For individual persons*

There is no formal framework specifically for individual persons.

1.3.2 Informal framework

- *For corporations*

There is no informal framework specifically for MSMEs.

- *For individual persons*

There are two sets of guidelines: one for owners or directors who provide a guarantee for a debtor company (Guidelines for Management's Guarantees), and one for individual persons who are unable to pay back their existing loans (including housing loans and business operation loans) due the effects of the Great East Japan earthquake that occurred in 2011 or other major natural disasters in Japan.

Regarding the Guidelines for Management's Guarantees, see section 3.6 below.

1.4 Accelerated restructuring or liquidation of MSMEs

There is no specific mechanism for accelerated restructuring or liquidation of MSMEs in Japan.

1.5 Discharge of debts for natural persons

The debtor shall be discharged from all its liabilities for all bankruptcy claims when a discharge order by the court becomes final and binding (in a civil rehab case, the debtor is discharged from all its liabilities or rehabilitation claims when an order to confirm a rehabilitation plan by the court becomes final and binding), save for distribution through a bankruptcy procedure or repayment based on an approved rehabilitation plan, as well as a few other exceptions and in cases of certain tax claims.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

The loans that MSMEs struggled to repay due to the COVID-19 pandemic in Japan mainly consist of emergency loan programs provided by the Japanese Government (including local governments, such as prefectures and cities) and Government-affiliated financial institutions, in addition to various other financial subsidies provided by the Government.

In addition, although this is not specifically applicable to MSMEs, on 6 March 2020, the Financial Services Agency (FSA) requested that banks and other financial institutions respond promptly and flexibly to debtors' requests for changes to the terms of their existing debts, including deferring repayments of principal and interest. The FSA (together with the Ministry of Economy, Trade and Industry) also repeatedly requested that banks and other financial institutions provide financial support by taking into account the size of businesses.

According to a survey conducted by the FSA, there were 599,829 cases where MSMEs applied to banks for changes to the terms of their existing debts during the period from 10 March 2020 to 31 August 2021, and 99% of these applications (excluding those which are still under examination or which were withdrawn) were approved.

Although this measure does not directly extend or suspend the repayment terms of loans, the SME Vitalisation Councils provide the following measures in support of MSMEs whose sales in the last month (or in the six most recent months) have decreased by 5% or more when compared to the same period in the previous three years:

- the Councils collectively request the deferral of principal repayments to financial creditors on behalf of the debtor;
- the Councils assist the debtor in drafting a special one year restructuring plan, encourage consensus-building among financial creditors to agree to the plan, and help the debtor obtain new loans from governmental and private banks as bridge loans, if necessary; and
- after the plan is approved, the Councils continuously monitor and provide advice to the debtor on the debtor's cash flow (if the debtor so requests).

As explained in section 1.3 above, the SME Vitalisation Councils have also provided other measures in support of MSMEs, but due to the unique circumstances of the COVID-19 pandemic, several of the requirements have been relaxed (for example, the "possibility of business revitalisation" is not required).

As described above, this measure does not allow for the extension or suspension of the repayment of loans by MSMEs. However, the financial support offered by the Government and banks is believed to have contributed to preventing insolvencies, as the number of insolvencies in Japan has decreased during the COVID-19 pandemic. According to a survey by Teikoku Databank, the number of in-court insolvencies in 2020 decreased by 6.5% from 2019, and this trend has continued in the first half of 2021.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

No special insolvency measures or specific insolvency rules have been introduced for the simplification of proceedings for MSMEs during COVID-19 in Japan. As mentioned in section 1.6 above, the measures introduced by the Japanese Government to support MSMEs during COVID-19 were mainly taken by way of emergency loan programs and various other financial subsidies.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

No measures suspending the requirement to initiate insolvency / liquidation / bankruptcy proceedings have been introduced in Japan.

2.3 Insolvency procedural deadlines

No measures extending insolvency procedural deadlines during COVID-19 for MSMEs have been introduced in Japan.

2.4 Minimum debt requirements to initiate insolvency proceedings

Japan has not introduced any minimum debt requirements for creditors to initiate insolvency procedures during COVID-19.

2.5 Suspending specific creditors' rights

No measures suspending specific creditors' rights to initiate insolvency procedures during COVID-19 have been introduced in Japan.

2.6 Mediation and / or debt counselling

2.6.1 Overview of special conciliation

As mentioned in section 1.3 above, special conciliation (*tokutei chotei*), which is governed by the Act on Special Conciliation for Expediting Arrangement of Specified Debts, is available in Japan for the rescue, restructuring or rehabilitation of MSMEs. Special conciliation is a type of mediation proceeding administered by the court or court-appointed conciliation commissioners (*chotei iin*) and is particularly aimed at adjusting monetary debts owed by financially distressed debtors (rescheduling and discharge of debts). One of the characteristics of special conciliation is an "Article 17 Order", which is based on Article 17 of the Civil Conciliation Law. Where an agreement between the parties cannot be reached, if the court finds it appropriate, it can issue a necessary Article 17 Order, which can bind all the parties to the proceedings, including those who were opposing the agreement, unless any party raises an objection to the order within two weeks.

Generally, the advantages of special conciliation are:

- as trade creditors can be excluded from the proceedings, the going concern value of the debtor deteriorates less than in the case of formal insolvency;

- since special conciliation is a proceeding based on the agreement of the parties, the content of the debtor's restructuring plan can be more flexible than in formal insolvency proceedings;

- unlike an informal out of court workout, since the court and / or court-appointed conciliation commissioners engage in the proceedings as a fair and independent third party, it is more likely that the parties will reach an agreement, including debt adjustments; and

- although in principle unanimous consent of the parties involved in the proceedings is required to reach an agreement, if any party unreasonably objects to an agreement, the court can issue an Article 17 Order.

Since the Act on Special Conciliation for Expediting Arrangement of Specified Debts came into force in 2000, special conciliation has often been used by individuals seeking to adjust financial debts. For corporate entities, including MSMEs, in some cases special conciliation was used where certain financial creditors did not agree with the debtor's restructuring plan developed in an out of court workout, but generally it has not been commonly used.

However, it should be noted that recently there have been moves to facilitate the use of special conciliation for corporate entities, especially MSMEs.

2.6.2 JFBA Guidelines

The Japan Federation of Bar Associations (JFBA), after discussions with the Supreme Court, the Ministry of Economy, Trade and Industry, and the Small and Medium Enterprises Agency, issued "Guidelines to utilise special conciliation to assist in business restructuring" (JFBA Guidelines) in December 2013 (amended in June and December 2014 and in February 2020) documenting good practices in leveraging special conciliation for restructuring of MSMEs.

Under the JFBA Guidelines, an attorney-at-law representing the debtor is supposed to take the following steps:

- examine the possibility of restructuring the debtor's business by using special conciliation;

- develop the debtor's restructuring plan including a repayment plan and debt adjustment (rescheduling and discharge of debts) by collaborating with other experts;

- hold pre-negotiations for the restructuring plan with financial creditors and ensure that the creditors informally agree on the plan;

- file a petition for special conciliation with the summary court; and

- reach a formal agreement (ratified by the court under the proceedings) between the debtor and the creditors based on the restructuring plan.

As the debtor and its attorney are supposed to obtain an informal agreement with the creditors on the restructuring plan prior to commencing special conciliation,

the court typically holds only one or two hearings, and therefore it is expected that the time and costs can be reduced compared to formal insolvency.

2.6.3 TDC New Operation

From April 2020, the Tokyo District Court launched a new operation for special conciliation (TDC New Operation) in order to achieve more rapid and cost-effective special conciliation procedures after discussions with insolvency practitioners and financial institutions. The TDC New Operation mainly covers cases where most creditors consent to a restructuring plan presented in a prior formal and rule-based out of court workout, but certain creditors do not.

Under the previous Tokyo District Court operation, the application deposit – mainly used for the fees for conciliation commissioners or investigating attorney (*chousa shokutakusaki bengoshi*), who should be insolvency experts – was a fixed amount (JPY 12 million), which is relatively expensive for MSMEs. On the other hand, under the TDC New Operation, the court decides the amount of the application deposit taking into consideration the amount of the relevant debts, the difficulty of the case, and other relevant factors on a case-by-case basis. The amount of the application deposit should be no more than that for civil rehab and reasonable (inexpensive) by limiting the matters examined by the court-appointed conciliation commissioner or investigating attorney.

In addition, under the TDC New Operation, given the debtor's restructuring plan was already examined by independent third parties in the prior formal and rule-based out of court workout, the court or the court-appointed conciliation commissioner aims to procure that the parties reach an agreement via three court hearings (this number is less than that for previous operations), which, according to the model schedule in the TDC New Operation, may take only approximately seven weeks. Also, the court has announced that it will make more active use of Article 17 Orders to facilitate a resolution between the parties.

As of April 2021, only one case appears to have been filed following the TDC New Operation, but its use is expected to increase in the future.

2.6.4 Advantages and disadvantages

It is not mandatory to initiate special conciliation prior to formal insolvency in Japan.

From a practical point of view, it may not be appropriate to make pre-insolvency special conciliation a mandatory requirement to file for formal insolvency in all cases, since some matters are not suitable for it. For example, in the case where the debtor's cash flow is very tight, immediately using the framework of formal insolvency, which has a broader and stronger effect on creditors, could be more helpful to the debtor's restructuring.

With that said, in general, considering the advantages of special conciliation described above, it is probable that the debtor, including MSMEs, can reach an agreement with financial creditors on its restructuring plan more rapidly and cost-efficiently than formal insolvency.

Also, as noted, both the JFBA Guidelines and the TDC New Operation are designed to make special conciliation less costly and less time-consuming for the efficient restructuring of entities, including MSMEs. By taking advantage of these, we believe that MSMEs can reduce the time and costs related to restructuring.

3. Challenges Faced

3.1 Stigma associated with insolvency

Although the primary purpose of formal insolvency proceedings in Japan is not to impose sanctions against insolvent debtors but to secure "rehabilitation of the business or economic life of debtors", there is some social stigma attached to debtors including MSME promoter / entrepreneurs involved in insolvency proceedings in Japan.

In the past, especially, before the enactment of the Civil Rehabilitation Act in 2000, the insolvency proceedings in Japan were more time-consuming and cumbersome, and sometimes involved anti-social forces. Therefore, insolvency proceedings were regarded as the very last resort for debtors and filing for insolvency proceedings meant a social disgrace.

At present, there are still some social disadvantages to filing for insolvency proceedings: (i) some laws restrict bankrupts' eligibility for certain occupations (e.g. attorney-at-law, certified public accountant, director of a financial instruments business operator) for a certain period; (ii) commencement of insolvency proceedings and the name of the debtor (if the debtor is a company, including the name of its representative) are published in the Official Gazette; and (iii) once the fact that an individual files for insolvency proceedings is registered in his / her credit information organised by credit bureaus (see section 3.2 below), the individual cannot borrow money or use credit cards for approximately five to 10 years.

Having said that, over the past few decades, key players in the field of insolvency / restructuring in Japan (including the courts and the government) have continuously made tremendous efforts to make insolvency proceedings more accessible and easier to use, especially for corporate debtors' business restructuring and individual debtors' fresh start, and to rid themselves of any negativity associated with insolvency proceedings, such as enacting the Civil Rehabilitation Act in 2000, introducing more flexible operation of the proceedings. We believe that, due to such efforts, the common social perception regarding insolvency proceedings has shifted from the "death" in an economic context to just one of the tools to restructure businesses or the economic life of debtors efficiently.

3.2 Availability of financial information

Credit bureaus in Japan organise the credit information of individuals based on certain data (the amount of outstanding debts, repayment history and so forth) received from its member financial institutions (including banks, non-banks and credit card companies) and other sources and provide such credit information to its member financial institutions at their request. Therefore, the financial

information of a MSME, including individual natural persons, can be easily accessed by such financial institutions.

An individual may request credit bureaus to disclose his / her registered credit information. If there are any errors in the disclosed information, the individual may request the member financial institution that provided the original data to correct the errors.

3.3 Access to new money

Under civil rehab and corporate reorganisation, it is possible for a debtor, including MSMEs, to obtain interim or new finance from a potential sponsor or other lenders either: (i) after the filing but before the commencement of the proceedings; or (ii) after the commencement of the proceedings.

In the case of (ii), the interim or new finance is automatically categorised as a "common benefit claim" (similar to administrative expenses under the United States Chapter 11 process), while in the case of (i), the court or supervisor (*kantoku iin*)'s approval is required for the finance to be categorised as a "common benefit claim". If the finance is categorised as "common benefit claim", it is given a priority over general unsecured claims but ranks *pari passu* with other common benefit claims under Japanese insolvency laws.

3.4 Secured creditors *vis-a-vis* unsecured creditors

Under corporate reorganisation, secured creditors' rights to exercise their security interests, as well as other claims, are stayed during the proceedings while under the other proceedings including civil rehab and bankruptcy, secured claims are not stayed in principle.

Notwithstanding the types of insolvency proceedings, at the stage of repayment based on a restructuring plan or distribution, proceeds derived from collateral must be preferentially used for the repayment or distribution to the secured creditors holding the security interest on the collateral.

3.5 Insufficient asset base

A lender who provides finance to a debtor under insolvency proceedings typically requests the debtor to provide its uncollateralised assets as security. Therefore, if a debtor MSME's asset base is low, and there is nothing to provide as security, the possibility for the debtor to obtain interim or new finance during the restructuring-type insolvency proceedings would be reduced. This could force the debtor to enter into bankruptcy.

3.6 Personal guarantees (PGs)

It is prevalent in Japan that, if a MSME is a corporate, its representative and / or other management will provide PGs to secure loans for the MSME.

In relation to the enforcement of PGs, it has been quite common that, if a MSME undergoes formal insolvency (or an out of court workout with debt haircuts), its management who provided PGs have no choice but to file for bankruptcy to deal

with the PG liabilities. This practice could be an obstacle to early restructuring of MSMEs as management usually does not wish to commence their own personal bankruptcy.

To address this problem, a study group jointly established by the Small and Medium Enterprise Agency and the FSA in January 2013 published "Guidelines for Management's Guarantees" after discussions between MSMEs and financial institutions, together with academia and turnaround specialists, about management guarantees for SMEs in December 2013. The Guidelines aim to provide a reasonable framework for the adjustment of management guarantees, which is more favourable than that in bankruptcy, so that management can determine restructuring (or closure) of MSMEs as soon as possible. The Guidelines are not legally binding since they merely consist of rules which were voluntarily and autonomously established, but currently they are commonly used where the management of MSMEs attempts to adjust their guarantee obligations together with the MSME's restructuring and are usually referred to and followed by the relevant parties.

According to the Guidelines, on or after a MSME (principal debtor)'s petition for formal insolvency proceedings or a formal rule-based out of court workout, the management (guarantor) of the MSME can propose to its creditors (normally financial institutions) an adjustment of the guarantee obligations pursuant to the Guidelines, for which a formal rule-based out of court workout can be utilised. In the adjustment of guarantee obligations: (i) the assets owned by the guarantor would be, in principle, realised and used to repay the creditors; and (ii) the remaining obligations would be discharged. Despite (i) above, the guarantor is permitted to continue holding a certain amount of money for living expenses and a "not gorgeous" house for living under the Guidelines (this is broader than the scope of statutory exempt properties in a bankruptcy).

3.7 Further challenges

3.7.1 Guidelines for out of court workouts for MSMEs

As many MSMEs suffering during the COVID-19 pandemic have taken advantage of emergency financing programs provided by the Japanese Government and Government-affiliated financial institutions to maintain their cash-flow, there is concern that a large number of MSMEs will become financially more vulnerable from the accumulation of excessive debts.

To tackle this issue, the Guidelines for Restructuring of Small and Medium Enterprises (*Chusho-kigyo no Jigyosaiseitou ni kansuru Guidelines*) (SME Restructuring Guidelines), prepared by representatives from financial institutions and MSMEs, experts, and academics, were published on 4 March 2022 and became effective on 15 April 2022.

As the SME Restructuring Guidelines are generally based on the previous formal, rule-based, out-of-court workout frameworks mentioned in section *1.3.1* above, the structure of the procedures and the general rules under the frameworks are similar. However, because the SME Restructuring Guidelines have been formulated particularly for MSMEs, the framework thereunder has the following specific characteristics:

- Third-party supporting experts system (utilising private sector experts such as attorneys-at-law)

  Independent organisations such as the SME Vitalisation Councils and the Japanese Association of Turnaround Professionals are not involved. However, the debtor appoints "third party supporting experts" (*daisansha shien senmonka*) from the list of accredited experts, which is publicly available, with the consent of "major creditors" (*shuyou saikensha*) for the examination of whether the debtor's proposed restructuring plan is reasonable from a fair and neutral standpoint.

- Relatively flexible substantive requirements for restructuring plans

  Some substantive requirements for restructuring plans under the SME Restructuring Guidelines are more generous than those in the TADR, and several requirements can be construed flexibly depending on the debtor's actual circumstances based on the SME Restructuring Guidelines.

- Subsidies for expert costs

  In the case where an out-of-court workout based on the SME Restructuring Guidelines is carried out, provided that certain requirements are satisfied, it is possible to apply to the Small and Medium Enterprises Agency (*Chusho-kigyo Cho*) for subsidies to cover two-thirds of the costs of outside experts and third-party supporting experts (up to JPY 7 million).

3.7.2 Attempt to reform collateral law system

Traditionally in Japan, real property has been the most common form of collateral provided for loans in practice. However, to provide more flexible options for financing, recently there has been growing recognition that assets other than real property should be more readily available to be used as collateral. In this regard, although collateral over movables and claims have also been used in practice in Japan, the rules for these types of collateral have been formed mainly by court decisions, and thus they remain unclear in part. Therefore, the Ministry of Justice has been conducting a study to reform the collateral law system, especially to clarify the rules for collateral over movables and claims.

In relation to this, the FSA has established a study group and has discussed with experts the possibility of a system under which a business as a whole could be provided as security for financing. In December 2020, the study group presented the concept of a "Business Growth Security Interest", which is expected to have advantages such as:

- the new security interest focusing on business value, including intangible assets, can promote financing businesses with no or limited tangible assets;

- it can facilitate financing in the restructuring phase (e.g. DIP financing); and

- it can encourage security holders, through the monitoring process of the security, to understand the debtor's business better, which could make it easier to reach an agreement on a restructuring plan in the restructuring phase.

As there are still various points to be considered regarding the reform of the collateral law system and the new security interest, further discussions will be held before they can be put into practice. Considering the purposes of the reform and the new security interest, they could assist MSMEs by increasing their access to financing in the restructuring phase.

4. Moving Ahead

We conducted an interview with Mr Takashi Sonoo and Mr Akimitsu Takai, who are renowned insolvency practitioners in Japan.

Mr Takashi Sonoo is a former Judge and has experience serving as the Chief Judge of the Division in Charge of Bankruptcy and Civil Rehab at the Tokyo District Court (20th Civil Division). He is famous for the invention of a new form of implementation of bankruptcy proceedings, which is easy for individual debtors and MSMEs to use, when he was Chief Judge. He is also well known as an experienced insolvency practitioner based on his career after he retired as a judge and became a lawyer.

Mr. Akimitsu Takai is an attorney-at-law who is famous in the field of restructuring and insolvency workouts. As an executive director of the Small and Medium Business Legal Support Centre at the Japan Federation of Bar Associations (JFBA), he played a leading role in establishing the JFBA Guidelines, which were proposed by the JFBA to support MSMEs executing a quick turnaround or winding up of their business. Through this experience, he has intimate knowledge of the restructuring of MSMEs.

4.1 Best way to safeguard the interests of MSMEs

Mr. Sonoo points out that Japan's current formal insolvency procedures do not improperly undermine MSMEs' interests. Before 2000, bankruptcy proceedings were too expensive and time-consuming for MSMEs to meet the needs for the winding up of their businesses. In addition to that, the status of being bankrupt had a strong negative image and there was strong public sentiment against bankruptcy at that time. Consequently, bankruptcy proceedings were nothing but an object of fear for MSMEs and were considered mainly as a tool for creditors to threaten their debtors.

This situation has dramatically changed with the nationwide spread of the new implementation of bankruptcy proceedings – that is, special treatment in cases of small-scale debt mentioned in section *1.1.3* above – that Mr Sonoo first devised and implemented at the Tokyo District Court beginning around 2000.

Thanks to this new implementation, MSMEs, including individuals, can now obtain relief through bankruptcy proceedings cheaply and quickly. Also, under the civil rehab process enacted in 2000, rehabilitation debtors have been able to pay their debts to minor creditors with the permission of the court. This new mechanism has relieved MSMEs that are acting as a supplier to medium and large companies and that enter civil rehab from some of the fear of defaulting. Due to such changes in the legal system related to Japanese insolvency and its implementation, Mr Sonoo points out that since the 2000s, Japan's formal insolvency system has been able to adequately protect the interests of MSMEs in both its system and its

implementation. However, he also says that there is still some room for improvement towards the elimination of the negative image regarding insolvency and further protection of the interests of MSMEs (see section 4.3 below for more information on this point).

Mr Takai emphasises the importance of protecting the value of MSMEs' businesses. This "value" includes not only financial value (cash flow generated by the MSMEs' businesses), but also the social importance of the business, such as being an indispensable part of a supply chain or creating employment in a specific area. Mr Takai suggests that out of court workouts should be tried first so that MSMEs can maintain stable business relationships with the large companies that are their important clients, and the best way to protect the MSMEs' value should be explored throughout that procedure.

In this respect, there is a widespread practice of out of court workouts for restructuring debts incurred by management (including guarantee obligations for company loans) based on the "Guidelines for Management's Guarantees" in Japan. These Guidelines are a set of rules established voluntarily by a study group consisting of experts and relevant parties, including SME associations and financial institution associations. By using this framework together with proper out of court workouts for MSMEs, it would be possible to restructure the excessive debts of MSMEs and their management at once and in a consistent manner.

Incidentally, Mr Takai does not exclude the fact that avoiding the negative image of pursuing formal insolvency procedures by choosing an undisclosed out of court workout may help protect the interests of MSMEs (or their managers), but he also claims this should not be a top priority. He states that the use of formal insolvency proceedings should be considered a realistic option if it is suitable or necessary to protect the value of MSMEs' businesses.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Mr Sonoo's views on Japanese formal insolvency proceedings are described in section 4.1 above.

Mr Takai agrees with Mr Sonoo's views that the current formal insolvency proceedings are helpful, not harmful, for MSMEs. In particular, he points out that since the enactment of the Civil Rehabilitation Act in 2000, people have become more open-minded about MSMEs restructuring their businesses, and hence the psychological barrier for MSMEs against formal insolvency has been lowered. Also, creditors (mainly financial institutions) have become more sophisticated regarding formal insolvency proceedings and have become more supportive of borrowers (MSMEs) in the process of civil rehab once the proceedings start. Because of those changes in the circumstances surrounding the restructuring of MSMEs, Mr Takai concludes that, currently, formal insolvency proceedings can be referred to as supportive tools for MSMEs.

There has been no significant change in laws (including subordinate legislation) after the beginning of the COVID-19 pandemic with regard to the restructuring of MSMEs in Japan. However, to support MSMEs' businesses under the harsh economic conditions caused by the pandemic, the Japanese Government has provided a significant amount of liquidity to MSMEs directly (e.g. provision of

special subsidies to negatively affected MSMEs) and indirectly (e.g. the implementation of loan programs guaranteed by Government agencies). As a result of those measures, the number of formal insolvency cases has remained relatively low over the past year in Japan.

Mr Takai found the support from the Government to be quite meaningful as a relief for MSMEs given the harsh economic conditions experienced due to COVID-19. However, he also points out that the problem would be how to wind up the support once the pandemic is over. He worries that if the current measures continue even after the end of the pandemic, it might cause MSMEs to miss the timing for a fundamental restructuring of their business and thereby diminish the vitality of the country's whole economy, as the excessively long-lasting support from the Government based on the SME Financing Facilitation Act and its successive laws and practices once undermined the vitality of the economy.

To avoid such a situation, Mr Takai recommends that the current special Government support to MSMEs should be wound back after the pandemic, unless there is an absolutely necessity (e.g. if a state of emergency is declared again). At the same time, he suggests that a system be developed to look after MSMEs which may face difficulties in continuing their business due to the eventual decrease in Government support. Such a system should have specialists who have expertise in management support provide advice on business restructuring. Additionally, urther dissemination of easy and quick out of court workouts under certain rules should be put in place. According to Mr Takai, as a part of such a support system, the JFBA is currently working with the Small and Medium Enterprise Agency regarding the establishment of a public support system for MSMEs' M&A for business succession.

Mr Sonoo forecasts that MSMEs will continue to receive support for a while. However, he also worries that the continuation of the current situation would prevent people involved with the revitalisation of MSMEs from becoming aware of the need for a fundamental restructuring of MSMEs' businesses. As a measure to overcome this situation, Mr Sonoo recommends the implementation of new rehabilitation proceedings that are easy for MSMEs to use and that enable MSMEs to achieve business restructuring without abruptly terminating their businesses. The details of his proposal are stated in section 4.3 below.

4.3 Simplified insolvency proceedings

For further and faster relief of distressed MSMEs, Mr Sonoo emphasises the necessity of new forms of implementation of civil rehab that are simpler than the current standard implementation. Civil rehab is one of the reconstructive insolvency proceedings based on the Civil Rehabilitation Act and is widely used to restructure distressed businesses of various sizes. However, since the established implementation of the proceedings requires the appointment of proven bankruptcy lawyers as supervisors in order to avoid abuse of the procedures, the process as a whole tends to be too complicated and time consuming for MSMEs, which in many cases do not have enough resources.

Also, because of these complicated proceedings, the procedural fee for civil rehab is relatively high for many MSMEs. That issue is said to be a factor preventing MSMEs from utilising civil rehab. Considering those problems, Mr Sonoo points

out that it would be necessary to establish a simple and fast proceeding for small companies to restructure their business by reviewing the implementation of civil rehab, referring to Chapter 11, Subchapter V in the United States Bankruptcy Code (which is a simplified version of the larger and more complex process under Chapter 11). The reason why he advocates for the establishment of the new proceedings through operational changes rather than legal reforms is that changing the implementation is much easier than changing laws, and hence it is preferable to quickly address the pressing issue of the relief of MSMEs in the post COVID-19 era.

According to Mr Sonoo, a branch of a District Court in the Tohoku region established a new implementation of civil rehab based on the principles stated above, but it has not yet been fully utilised. Mr Sonoo says that given the persistent negative image of formal insolvency proceedings in regional areas, it would be desirable to start such an implementation in urban areas like Tokyo where psychological resistance to formal insolvency proceedings is relatively weak, and then gradually spread nationwide in order to promote a new implementation.

On the other hand, Mr Takai points out that there needs to be generally accepted rules for an out of court workout that can provide a clear path to revitalisation or discontinuation of MSMEs' businesses. It is estimated that there are more than 50,000 cases of business closures, including de-facto closures, without formal insolvency or dissolution proceedings among MSMEs per year in Japan, and a significant percentage of these cases are ones without clear procedures in place and under chronic deficit. No legal discharge will be given to MSMEs and their managers in such cases. Therefore, Mr Takai concludes that there would be a high potential need for a useful out of court workout protocol for MSMEs that allows for clear business discontinuation (or business turnaround if the situation permits).

The JFBA Guidelines are exactly the protocol that was designed to meet such needs, and Mr Takai intends to promote the further utilisation of the Guidelines in the future. According to Mr Takai, the JFBA is currently considering the implementation of a mechanism to obtain opinions on the proposed plan for rehabilitation or discontinuation of a business from a person with a certain level of authority in the proceedings under the JFBA Guidelines to further promote the use of the Guidelines. Such opinions may make it easier for financial institutions as creditors to agree to the restructuring of MSMEs using the Guideline.

MALAYSIA

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

In Malaysia, the Companies Act 2016 (CA) and Companies Winding Up Rules 1972 govern the formal insolvency and restructuring framework for corporate entities. The CA sets out the provisions for schemes of arrangement, judicial management, corporate voluntary arrangement and the winding up of companies.

The Insolvency Act 1967 governs the bankruptcy regime for individual persons.

In Malaysia, the term "winding up" or "liquidation" refers to companies, while the term "bankruptcy" refers to individuals.

1.2 Specific insolvency legislation

There is no specific legislation for the insolvency of MSMEs. Rather, MSMEs fall under the general legislative framework outlined above.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

For formal out-of-court assistance for companies, Malaysia has the corporate voluntary arrangement (CVA). The CVA is part of the corporate rescue mechanisms under the CA. The CVA is similar to the company voluntary arrangement framework in the United Kingdom.

However, access to the CVA in Malaysia is not limited to MSMEs. All private companies can utilise the CVA, unless the company is regulated by laws under the purview of the Central Bank of Malaysia (BNM) or a company subject to the Capital Markets and Services Act 2007. One restriction, however, is that a company that has a charge over its property or any of its undertakings cannot apply for the CVA.

The CVA is an out-of-court mechanism that will allow the private company to restructure only its unsecured debts. The process is guided by an insolvency practitioner who takes on a role known as the nominee. A restructuring proposal is tabled before the shareholders and creditors of the company. This restructuring proposal must be approved by more than 50% of the shareholders, and at least 75% in value of the creditors present and voting at the meeting. The proposal cannot affect the rights of secured creditors unless they consent. Once approved, the proposal becomes binding on the creditors.

As this is an out-of-court mechanism, there is no further court approval of the proposal and there are no express provisions in the CA to challenge the proposal.

For individuals, there is a pre-bankruptcy mechanism known as a voluntary arrangement. It is a blended procedure involving out-of-court negotiations and also requires individuals to obtain certain court orders.

An individual debtor, before he / she is adjudged bankrupt, may propose a voluntary arrangement to his or her creditors. In doing so, the debtor must appoint

a qualified nominee to serve as an independent party to oversee and supervise the implementation of the voluntary arrangement process.

Next, the individual must obtain an interim order from the court by way of a court application. The interim order stays all legal proceedings for 90 days. After securing the interim order, the nominee will notify all creditors and convene a meeting to approve the debtor's proposal for a voluntary arrangement. The proposal must be approved by at least 75% in value of the creditors present and voting at the meeting. The proposal cannot affect the rights of secured creditors unless they consent.

If the proposal is passed, the nominee will report the results to the court. The proposed voluntary arrangement, once passed, will bind all creditors.

1.3.2 Informal framework

There is an informal framework for the restructuring and rescue of companies and individuals.

In relation to companies, in 2003, the BNM established a Small Debt Resolution Scheme (SDRS) to assist SMEs facing business financing problems with financial institutions through debt restructuring or the rescheduling of loans.

The SDRS is a platform for financial institutions and SMEs to agree to debt rehabilitation solutions collectively without resorting to legal enforcement options. Starting 1 September 2020, the SDRS[1] was transferred to be managed by the Credit Counselling and Management Agency (AKPK).

The eligibility for SMEs under this scheme is as follows:

- Malaysia-owned companies (at least 51%) in all economic sectors;
- satisfy the SME definition criteria – so that the number of full-time employees does not exceed 200, or annual sales turnover does not exceed RM 50 million;
- difficulties with financing from financial institutions;
- applicable for business related financing only; and
- business is still ongoing.

To facilitate a workout for larger debts, the BNM also established the Corporate Debt Restructuring Committee (CDRC).[2]

The CDRC provides corporate borrowers and their financial institutions with a platform to agree to feasible debt resolutions informally. The CDRC acts as a mediator to facilitate this process. The process is governed by the CDRC Code of Conduct.[3]

[1] https://www.akpk.org.my/sdrs.
[2] https://www.cdrc.my/.
[3] https://www.cdrc.my/pdf/Code_of_Conduct.pdf.

Companies seeking to resolve their debt obligations through the CDRC must fulfil the following broad criteria:

- aggregate indebtedness of RM 10 million or more;
- indebted to at least two financial creditors;
- not in receivership or liquidation, except is receivers have been appointed only over certain specified assets and the directors remain in control of the companies' overall operations; and
- experiencing difficulties in servicing their debt obligations but may not have already defaulted.

Alternatively, the CDRC process can be used by any company listed on the Main Market or ACE Market of the Malaysia Stock Exchange that has already been classified as a PN17 or GN3 company respectively. Companies fall under these classifications essentially when certain financial distress criteria are triggered.

Both these processes require the distressed debtor to apply for admission. The SDRS or the CDRC then decide whether there are merits in allowing the debtor to proceed with the scheme. The merits would normally centre on whether there is a genuine attempt at restructuring and whether there is a business case for a potential rescue.

An admission into the SDRS or the CDRC would then normally allow for an informal standstill arrangement between the debtor and the financial institution creditors. This is to allow for breathing space and for the SDRS or CDRC to mediate between the debtor and the financial institution creditors to try to achieve a successful restructuring.

For individuals, the AKPK provides a debt management programme for individuals who require assistance in managing their personal debts with the participating financial service providers.

Under the programme, the individual will work with financial advisors to develop a personalised debt repayment plan in consultation and agreement with the relevant financial institutions.

1.4 Accelerated restructuring or liquidation of MSMEs

There is no mechanism in Malaysia for the accelerated restructuring or liquidation of MSMEs at present.

1.5 Discharge of debts for natural persons

In Malaysia, the personal insolvency regime provides effective discharge of debts for natural persons.

The first method is the annulment of the bankruptcy under section 105 of the Insolvency Act 1967. An annulment will wipe out the bankruptcy order altogether. Some of the key grounds for annulment are where the debt has been fully settled

or where the bankrupt's proposal for a composition or scheme of arrangement is accepted by the creditors.

The second method is a discharge of the bankruptcy through a court order. The bankrupt may apply under section 33 of the Insolvency Act 1967. The court must consider a report from the Director General of Insolvency on the bankrupt's conduct and affairs. The court has a wide discretion to consider the rights of the creditors and that of the bankrupt to have a second chance in life.

The third method is a discharge of the bankruptcy through a certificate issued by the Director General of Insolvency. The bankrupt may only apply under section 33A of the Insolvency Act 1967 for such a discharge after five years from the date of bankruptcy. The creditors may challenge the discharge, but the court may only postpone the discharge for two years.

The fourth method is a form of automatic discharge under section 33C of the Insolvency Act 1967. The bankrupt is required to pay an amount to be decided by the Director General of Insolvency and to comply with the requirements to be decided by the Director General of Insolvency. The bankrupt shall be discharged from the bankruptcy on the expiration of three years from the submission of his or her statement of affairs. The creditors may also challenge the discharge but the court may only postpone the discharge for two years.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

In relation to MSMEs, Malaysia introduced measures extending or suspending the repayment terms of loans (including interest or penal interest) and periodic debt service obligations during COVID-19. These measures included:

- An automatic six month moratorium from 1 April 2020 to 30 September 2020.[4]

  The BNM allowed for an automatic six month moratorium to be granted for loans and other financing (excluding credit card balances) granted by financial institutions to individuals, SMEs and corporations from 1 April 2020 to 30 September 2020. This was subject to the conditions that the loan (or other financing) was: (i) not in arrears for a period exceeding 90 days as of 1 April 2020; and (b) denominated in Malaysian ringgit.

  Under this six month moratorium, the financial institutions did not impose any compound interest or penalty interest.

  After the expiry of the moratorium, financial institutions shifted to targeted repayment assistance to help borrowers who had reduced income or had lost their jobs as a result of the pandemic. Financial institutions were strongly encouraged to facilitate requests by corporate customers for a moratorium on loan repayments to enable them to preserve jobs and swiftly resume economic activities when conditions stabilised and improved.

[4] https://www.theedgemarkets.com/article/bnm-announces-6month-loan-moratorium-smes-and-individuals-confirms-edge-financial-daily.

- Opt-in six month loan moratorium available to all individuals, microenterprises and affected SMEs starting 7 July 2021.[5]

  Due to the extended lockdown in Malaysia in 2021, the BNM offered an opt-in six month loan moratorium to all individuals, microenterprises and SMEs starting 7 July 2021. Similar to the automatic loan moratorium granted in April 2020, the financial institutions agreed not to impose any compound interest or penalty interest during the moratorium. However, the repayment assistance was not open to borrowers who had been overdue in their payments for more than 90 days or those undergoing bankruptcy or winding-up proceedings.

  In addition to the moratorium, financial institutions also offered a reduction in instalments and other packages, including the ability to reschedule and restructure financing to suit the specific needs of each borrower.[6]

- Abolition of Loan Scheme Interest Rates.[7]

  In April 2020, the Government of Malaysia also announced the abolishment of interest rates for micro-enterprises who have subscribed to loan schemes such as the Micro Credit Scheme administered by Bank Simpanan Nasional (BSN) or the soft loan scheme for micro-enterprises provided by TEKUN Nasional.

All of these measures significantly assisted the MSMEs through the Covid period.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

There were no special insolvency measures introduced for MSMEs.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

Malaysia did not introduce any measures to suspend the requirement to initiate insolvency or liquidation proceedings.

2.3 Insolvency procedural deadlines

The Companies Commission of Malaysia announced a temporary measure to provide relief from winding up for all companies. This measure was effected through the Companies (Exemption) (No 2) Order 2020.[8]

From 23 April 2020 to 31 December 2020, companies were given a six month period to respond to a statutory demand instead of the original 21 days. However, the period to respond to a statutory demand has since reverted to 21 days.

That extended six month period gave MSMEs valuable breathing space from winding up proceedings.

[5] https://www.bnm.gov.my/RA.
[6] https://www.bnm.gov.my/-/six-mth-mora-begins-20210707.
[7] https://www.nst.com.my/news/nation/2020/04/581827/prihatin-micro-credit-loan-interest-abolished.
[8] https://www.ssm.com.my/Pages/Legal_Framework/Document/PUA123_2020.pdf.

Nonetheless, this measure would not have stopped other legal proceedings from being commenced against the companies. For example, creditors with monetary judgments could have carried out garnishee proceedings or creditors could have used alternative ways to wind up a company without the issuance of a statutory demand.

2.4 Minimum debt requirements to initiate insolvency proceedings

As relief measures during the pandemic, the minimum debt requirements for insolvency proceedings against companies and individuals were increased.

For companies, from 23 April 2020 onwards, the minimum debt requirement for the issuance of a winding up statutory demand was increased from RM 10,000 to RM 50,000.[9] Since then, this minimum debt requirement has been maintained at RM 50,000.[10]

For individuals, from 23 October 2020 onwards, the minimum debt requirement for bankruptcy proceedings against individuals was increased from RM 50,000 to RM 100,000. This increase was through the Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) Act 2020 (known as the COVID-19 Act). This increased threshold of RM 100,000 for bankruptcy proceedings against individuals continues to remain through amendments to the Insolvency Act 1967.

We have seen the various relief measures assist companies. There was a reduction in the number of winding-up petitions submitted to the Companies Commission of Malaysia. There were 3,044 winding up petitions filed in 2019, and it was reduced to 1,627 winding up petitions in 2020. From January to April 2021, only 644 winding up petition were recorded.[11]

For bankruptcy, 12,051 debtors were made bankrupt in 2019 and it was reduced to 8,351 in 2020. From January to June 2021, only 3,684 debtors were made bankrupt.[12]

2.5 Suspending specific creditors' rights

There were measures suspending specific creditors' rights to initiate insolvency procedures during COVID-19.

One of the key provisions of the COVID-19 Act was to provide parties with relief for the inability to perform contractual obligations from the period of 18 March 2020 until 31 December 2020. This contractual relief provision was since extended until 22 October 2022.

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[9] https://www.ssm.com.my/Pages/Legal_Framework/Document/Direction%20of%20Minister%20under%20para%20466(1)(a).pdf.

[10] https://www.ssm.com.my/Pages/Legal_Framework/Document/GN%20No.%204159_Penetapan%20Amaun%20Keterhutangan%20Syarikat.pdf .

[11] http://www.mdi.gov.my/index.php/legislation/liquidation/1824-liquidation-statistic-april-2021.

[12] http://www.mdi.gov.my/index.php/legislation/bankruptcy/1828-bankruptcy-statistic-2021.

Under this provision, parties were prevented from exercising their rights under the contract due to any non-performance of contractual obligations. This provision would have indirectly provided companies some insolvency relief as creditors would not have been able to initiate legal proceedings or winding up proceedings based on non-performance of those contractual obligations. However, this relief only applied to certain types of contracts such as construction work-related contracts or event contracts.

2.6 Mediation and / or debt counselling

The mediation and debt counselling available for MSMEs in Malaysia are the SDRS and the CDRC described in section 1.3.2 above.

The COVID-19 Act also saw the establishment of a specialised mediation centre[13] to assist the public in resolving certain disputes due to being unable to perform contractual obligations arising from the pandemic. Such disputes may be resolved by mediation where the disputed sum is not more than RM 300,000.

It is not mandatory to initiate mediation or debt counselling or financial education for any type of rescue, restructuring or rehabilitation prior to formal insolvency in Malaysia.

The merits of some form of mandatory mediation or debt counselling would be the saving of time and costs compared with formal court insolvency proceedings. Rather than the zero-sum game often seen in court proceedings, the consensual approach of mediation can often achieve a far greater win-win situation.

Specialised distressed debt mediation can help MSMEs cut time and costs. An example in Malaysia would be the SDRS or the CDRC framework. With the backing of the BNM, it is a powerful mediation platform where the SDRS or CDRC committee members are able to mediate between distressed debtors and the financial institution creditors. There is also a filtering process to be admitted into this mediation framework, since only deserving debtors with a viable hope of a turnaround will be accepted.

On the other hand, any mandatory mediation may merely result in delaying the inevitable. The insolvent MSME may only incur even further debts with no viable business plan in place, and the creditors in that event would be left worse off.

3. Challenges Faced

3.1 Stigma associated with insolvency

Access to credit / funding may be a real problem due to the record ofinsolvency or bankruptcy captured by credit companies and / or financial institutions and government agencies due to the statutory notices that must be published in local newspapers. These notices can also cause reputational stigma and harm.

[13] https://www.malaysianbar.org.my/article/news/press-statements/press-statements/press-comment-specialised-mediation-centre-to-assist-the-public-under-the-new-covid-19-act.

Credit reporting agencies will track information relating to insolvency proceedings. This may affect ongoing loan facilities and also make it difficult to take on fresh loan facilities.

Upon an individual being made bankrupt, the individual faces the following restrictions and there may then be the associated stigma:

- no overseas travel: the individual will need to surrender their passport and would have to apply to the Director General of Insolvency for permission to travel;
- directorship: the individual will be disqualified from being a director of a company and cannot engage in the management of any business or trade run by the individual's spouse, children or relatives;
- bank accounts: the individual can only open a bank account with the approval of the Director General of Insolvency for crediting their monthly income;
- assets and properties: the Director General of Insolvency will administer all the individual's assets, and trace and monitor their conduct. An account of income and expenditure will need to be submitted once every six months;
- income and salary: the bankruptcy court may order the individual to pay part of their wages or salary to the Director General of Insolvency; and
- credit card: the individual may only use a credit card up to a value of RM 1,000. For a higher value, the individual must notify the bank or finance company as to the status of the bankruptcy and those institutions can then decide whether to continue to extend credit.

3.2 Availability of financial information

There is no availability of direct financial information on natural persons.

However, there is other financial-related information available through the following databases:

- bankruptcy searches: these are publicly available from the Malaysian Department of Insolvency to confirm if an individual has been adjudged bankrupt or not;
- credit reporting agency searches: there are credit reporting agencies that can provide some financial information on natural persons; and
- Central Credit Reference Information System (CCRIS): this is a central credit reporting system from the BNM and accessed by allfinancial institutions. Private credit rating agencies also have access to this CCRIS system. The CCRIS reports will contain financial information on individuals, including information on current loans and any defaults on those loans.

3.3 Access to new money

Interim or new finance is not readily available to MSMEs post filing or post commencement of insolvency.

Under existing laws, interim or new finance post commencement of insolvency is not accorded any form of super priority. Hence, there is little incentive for funders to provide such funding to MSMEs in insolvency.

In proposed amendments to the CA, there is provision for super priority rescue financing to apply for a restructuring through a scheme of arrangement and judicial management. The super priority rescue financing would be seen as part of the successful rehabilitation of a distressed company and to try to stave off liquidation. These proposed amendments are due to be tabled later in 2022.

3.4 Secured creditors *vis-a-vis* unsecured creditors

There are no specific liquidation laws in relation to MSMEs.

On general liquidation principles, secured creditors are free to enforce their rights against the debtor and they can choose to stand outside the liquidation procedure. Where there is inadequate security, secured creditors can file a proof of debt for the balance of their unsecured debts. Finally, the secured creditor is also free to surrender its security and treat its debt as an unsecured debt for the purposes of the liquidation.

3.5 Insufficient asset base

The low asset bases of MSMEs tend to result in the insolvency process being conducted by the Malaysian Department of Insolvency. This Department is essentially funded by the Government.

For the bankruptcy of individuals, upon the court making the bankruptcy order, all the of assets of the bankruptcy individual will vest with the Director General of Insolvency under the Malaysian Department of Insolvency. The Director General of Insolvency will then administer the bankruptcy process. Malaysia does not have a concept of private trustees in the bankruptcy of individuals.

For the winding up of companies, and especially of MSMEs, it is also common to appoint the Director General of Insolvency to be the liquidator of the MSME. The Malaysian Department of Insolvency then bears all the initial fees and expenses of liquidation and will recover those fees out of the realisation of the assets of the wound-up company. It is also possible to appoint a private liquidator.

In some cases, creditors will not go for liquidation of their debtor but merely to secure a court judgment to write off the debt in order to be deducted from its income. In other cases, creditors may still opt to push for liquidation as a matter of principle.

3.6 Personal guarantees (PGs)

In Malaysia, many promoters / founders of MSMEs will have to give PGs if the

MSMEs wish to take out a loan from financial institutions or to get a credit line from suppliers.

In some cases, PGs will be enforced after a creditor has enforced any of its secured rights and the proceeds realised from the secured assets are less than the outstanding debt amount.

In a scenario where there are no charged assets, PGs will be enforced when the MSME fails to repay its debts. Any legal action taken against a MSME will include its PGs and most of the time, the bank will enforce the PGs simultaneously after obtaining the judgment.

Nonetheless, in relation to individuals having given PGs, there is some bankruptcy protection.

First, bankruptcy proceedings cannot be taken out against an individual who is a social guarantor. A social guarantor is defined as a person who provides, not for the purpose of making a profit, the following guarantees:

- a guarantee for a loan, scholarship or grant for educational or research purposes;
- a guarantee for a hire-purchase transaction of a vehicle for person or non-business use; or
- a guarantee for a housing loan transaction solely for personal dwelling.

Second, bankruptcy proceedings cannot be taken out against other guarantors, other than a social guarantor, unless the creditor first obtains permission from the court. In obtaining permission, the court must be satisfied that the creditor has exhausted all modes of execution and enforcement to recover the debts owed by the principal debtor.

3.7 Further challenges

In Malaysia, there is the issue of whether interest should continue to run after a MSME has been wound up.

Prior to the CA, the Federal Court had stated clearly in *Pilecon Realty Sdn Bhd v Public Bank Bhd & Ors and another appeal* [2013] 3 MLJ 1 that interest should stop running as at the date of winding up, which was based on the provision in the Bankruptcy Act 1967. As the CA has removed the reference to the Bankruptcy Act 1967, the impact has yet to be seen to date.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

Mohamed Raslan Abdul Rahman, the current President of the Insolvency Practitioners Association of Malaysia, opined that distressed MSMEs are unable to benefit from the formal restructuring mechanisms and formal insolvency procedures provided under the different Acts. MSMEs are very small companies or

unincorporated businesses, and could therefore benefit from mechanisms which are less costly, easier and faster.

Dato' Dr. Ler Cheng Chye and Lum Tuck Cheong, both seasoned and experienced insolvency practitioners for more than 40 years, said that arrangements are needed to assist MSMEs' cashflow. It is imperative that the repayment of interest and / or liabilities accrued during the moratorium period be taken out of MSMEs' profits. Anything falling short of this may not work for the majority of MSMEs because of the inability to generate cashflow to repay accrued liabilities.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Raslan was of the view that formal insolvency / restructurings have not helped MSMEs enough. On the other hand, Dato' Dr. Ler and Lum shared the view that the formal insolvency regime has helped MSMEs. This is predicated on the objective of formal insolvency to allow businesses to have a second chance to succeed and for failed businesses to be placed into liquidation. Nevertheless, they agreed that businesses could benefit more if entrepreneurs were educated on the rationales behind the formal insolvency regime.

All three agreed that there have been some relief measures during the pandemic which have helped MSMEs.

Raslan pointed to the longer period to respond to winding up statutory demands, the increase to the minimum debt threshold for winding up and some of the temporary repayment measures, especially for certain rental payments. He was of the view that this relief should be continued.

Dato' Dr. Ler and Lum pointed out that the COVID-19 relief measures merely slowed down the process of recovery of debt by creditors. They commented that the problem would be where the interest and liabilities continue to compound and MSMEs would have to find ways to generate more cashflow. They speculated that it will be extremely difficult for many MSMEs to generate income within such a short period of time without fresh injection of funds. They also agreed that the relief should continue but that would not tackle the difficulty of MSMEs' ability to repay their debts.

4.3 Simplified insolvency proceedings

Raslan agreed that a simplified restructuring, liquidation and discharge mechanism is required for quick resolution for MSMEs as compared to the present mechanisms. This will provide them with a process which is less costly, easier and faster. Such a mechanism should be made permanent to allow MSMEs to benefit in the same manner that companies with larger asset bases do.

On the other hand, Dato' Dr. Ler and Lum believe that the existing insolvency mechanisms are adequate. They identify the problem being instead that MSMEs may only seek help at a very late stage. They add that the fastest way to stop entrepreneurs from aggravating cashflow is to make prompt decisions. If the business is not profitable, they should immediately wind up the business and company via a members' voluntary or creditors' voluntary liquidation, without having to go to court. This is already a cost saving mechanism.

MEXICO

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

Mexico's legal system has formal legislation for the insolvency of corporate entities called *Ley de Concursos Mercantiles*. The *Ley de Concursos Mercantiles* was enacted in 2000, after México adopted the UNCITRAL Model Law on Cross-Border Insolvency and abrogated its old *Ley de Quiebras y Suspensión de Pagos*.

The main purpose of the *Ley de Concursos Mercantiles*, as contained in its first article, is to preserve companies and prevent an outcome where the debtor's generalised default of payment obligations jeopardises its viability and the viability of other enterprises with whom the debtor maintains a business relationship.

The *Ley de Concursos Mercantiles* can also be applied to the insolvency of individual persons, provided they can be considered merchants in terms of the Mexican Code of Commerce. Article 3 of the Code of Commerce indicates that individual persons are merchants when they have the legal capacity to exercise acts of commerce and have made commerce their daily occupation.

Consequently, individual persons that are not dedicated to commercial acts cannot be subject to the insolvency proceeding set out in the *Ley de Concursos Mercantiles*. Instead, they must resort to the Civil Code and the Code of Civil Procedure that correspond to the State where they have their domicile.

1.2 Specific insolvency legislation

The *Ley de Concursos Mercantiles* is applicable to all companies, including MSMEs.

Article 5 of the *Ley de Concursos Mercantiles* specifies that a debtor whose due and matured payment obligations do not exceed the amount of 400,000 Investment Units (UDIS) at the time the insolvency request is filed will be considered a "small merchant" or "small debtor".

The insolvency of MSMEs or "small merchants", as the *Ley de Concursos Mercantiles* calls them, was a much discussed matter when approving the law, where some congressmen disagreed that they should be subject of the proceeding. However, in order to avoid a legal void, it was accepted that MSMEs will be declared insolvent when they voluntarily accept to undergo the process.[1] Thus, article 5 of the law indicates that "small merchants" will only be declared bankrupt when they voluntarily and in writing accept the application of the *Ley de Concursos Mercantiles*.

This provision has been criticised, as it leaves it to debtors to decide whether the law should apply, leaving creditors without a defence when requesting the bankruptcy of a MSME to enforce their claims against the debtor. This may lead to the case where only the creditor who first seized the debtor's assets through an

[1] Explanatory Memorandum to the Commercial Insolvency Law, 12 May 2000, available at: https://legislacion.scjn.gob.mx/Buscador/Paginas/wfProcesoLegislativoCompleto.aspx?q=V95NcogKxHpUN4bFbjWt9j8muee4v7g9xqmeAc4IckxeEdPlu8MLP2XcTLligZH5+9Xr8Frx8ByonAabfeZ8hg==.

ordinary proceeding will be able to collect its claim.[2] Furthermore, it has been argued that the mentioned article violate the characteristics of generality and abstraction that all laws should have, by establishing special rules for "small merchants" and allowing them to refuse undergoing an insolvency proceeding.[3]

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

In Mexico, there is no formal framework for out of court assistance or workouts for either corporate or individual persons. Nonetheless, the *Ley de Concursos Mercantiles* does contain the possibility for any merchant, either a company or entrepreneur, to ask the Federal Institute of Insolvency Specialists (IFECOM) to choose a conciliator registered with the IFECOM to act as a "friendly negotiator" between the debtor and its creditors. Furthermore, any creditor that has a due debt in its favour can also ask the IFECOM for the list of registered conciliators in order for one of them to act as negotiator between the creditor and its debtor.

However, the workout assisted by the conciliator assigned by the IFECOM will not be conducted by special rules or a formal framework.

Moreover, several states of Mexico have enacted legislation for alternative dispute resolution, such as the *Ley De Justicia Alternativa Del Tribunal Superior De Justicia Para El Distrito Federal* (Alternative Justice Law of the Superior Court of Justice in Mexico City), which contains a framework to mediate civil, family, commercial and some criminal matters. Consequently, debtors could use these laws to restructure their debts within an arranged, assisted, and peaceful process.

1.3.2 Informal framework

In Mexico, there is no informal framework for out of court assistance or workouts, nor an informal restructuring or rescue specific culture for MSMEs.

1.4 Accelerated restructuring or liquidation of MSMEs

There is currently no mechanism in Mexico for accelerated restructuring or liquidation for MSMEs. However, as a result of the COVID-19 pandemic, on 27 April 2020, the parliamentary group "*Partido Revolsucionario Institucional*" presented to the Senate an "Initiative with a Draft Decree adding the Fifteenth Title 'Emergency Bankruptcy Regime' to the Commercial Insolvency Law".

This initiative proposed an accelerated proceeding for formal restructurings. For example, it intended for courts to automatically admit the commercial insolvency requested voluntarily by the debtor, indicating that it should be sufficient for the debtor to declare under oath that it is in the insolvency premises indicated by the law for the proceeding to be admitted.

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[2] Sanromán Martínez, Luis Fernando, «*Supuestos de Concurso Mercantil*», *Concursos Mercantiles*, Porrúa, First Edition, México, 2016, 26-27; Bucio Estrada, Rodolfo y Casasa Arujo, Aldo, «*Los Presupuestos Procesales*», *Concursos Mercantiles. Procesos y Procedimientos en México*, Porrúa, First Edition, México, 2006, 53.

[3] *Ibid*.

Likewise, the initiative proposed that the judgment that declares the company in commercial insolvency should be issued within a period of three days, ordering injunctive relief to protect the company's viability and assets, without the need for the "*visita*" period.[4]

Thus, the initiative seeks to speed up and make more efficient insolvency proceedings in Mexico for debtors affected by cases of *force majeure*, fortuitous events, or declarations of emergency, such as the COVID-19 pandemic. However, the initiative has not yet been approved by the Senate.

1.5 Discharge of debts for natural persons

The insolvency regime for natural persons who are merchants would be considered effective to discharge their debts under the *Ley de Concursos Mercantiles*. However, in practice the law has been barely used for natural persons. Indeed, according to the statistics published by the IFECOM, until November 2020, out of the 805 insolvency proceedings that have been filed since 2000, only 30 (4%) corresponded to natural persons.[5]

Furthermore, as mentioned, individual persons that are not dedicated to commercial acts must file the insolvency proceedings foreseen in the Civil Code and the Code of Civil Procedure that corresponds to the State where they have their domicile.

According to a study made by Dr Rosa María Rojas Vertíz in the Superior Court of Justice of Mexico City, between 2012 and 2016 there were only 98 civil insolvency proceedings filed, which represents just 0.01% of the total of proceedings filed during that period.[6] Furthermore, according to the study, half of the filed civil insolvency proceedings were not admitted by the Court and none of the ones that were admitted and reviewed ended with a restructuring agreement.[7]

Consequently, the insolvency regime in Mexico for the discharge of debts of natural persons is not effective.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

In March 2020, the Nacional Banking and Values Commission (*Comisión Bancaria y de Valores*) issued the special accounting criteria (*Criterios Contables Especiales*) in order for financial institutions to implement and offer different programs to their clients to mitigate the economic effects caused by COVID-19.

These measures consisted in the partial or total deferment of the payment of interest or capital for four to six months, as well as for 18 months regarding loans

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[4] According to the *Ley de Concursos Mercantiles*, before the debtor is declared as commercially insolvent, a "*visita*" or "visit" must be conducted by a specialist appointed by the IFECOM, whose job is to review the debtor's information, documents and accounting to verify its situation complies with the insolvency premises foreseen by the law.

[5] *Estadísticas en Materia Concursal*, *Cifras del 1 de junio al 30 de noviembre de 2020*, December 2020, available at: https://www.ifecom.cjf.gob.mx/resources/PDF/informesEst/2.pdf.

[6] Rosa María Rojas Vértiz, «*La Insolvencia de personas físicas no comerciantes en México*», First Edition, 102-122.

[7] *Ibid*.

directed to the rural and agricultural sectors, without implementing additional interest, commission, asking for additional collateral or cancelling lending facilities. However, despite the fact that more than 8.5 million Mexican pesos worth of loans were restructured in terms of the mentioned criteria, according to the statistics published by the National Statistics and Geography Institute (INEGI), out of the 4.9 million MSMEs registered in 2019, only 3.85 million survived the economic impact of the COVID-19 pandemic, meaning that more than one million establishments closed by December 2020.[8]

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

There were no procedural insolvency measures introduced with respect to MSMEs to simplify their insolvency proceedings during COVID-19. However, as mentioned above, there was an attempt to introduce a simplified proceeding for MSMEs, which has still not been approved.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

In Mexico, there is no legal requirement to initiate an insolvency or liquidation proceeding under any circumstance. Accordingly, there were no measures introduced to suspend the requirement to initiate an insolvency / liquidation / bankruptcy proceeding.

2.3 Insolvency procedural deadlines

There were no measures introduced in Mexico to extend the insolvency procedural deadlines during COVID-19 for MSMEs. Nonetheless, in the proposed initiative outlined above, it was contemplated that some deadlines should be shorter in order that the proceeding would be quicker and more efficient.

2.4 Minimum debt requirements to initiate insolvency proceedings

The Mexican Government did not introduce any minimum debt requirements for creditors to initiate insolvency procedures during COVID-19.

2.5 Suspending specific creditors' rights

In Mexico, there were no measures suspending specific creditors' rights to initiate insolvency proceedings during COVID-19.

2.6 Mediation and / or debt counselling

Mediation is available in Mexico to rescue, restructure and rehabilitate MSMEs. As noted above, several of Mexico's states have mediation legislation for parties to solve civil, commercial, family and some criminal matters. The agreements entered into pursuant to these kinds of laws are considered *res judicata*. This means that mediation contracts have a similar legal nature as judicial judgments, so that if one

[8] *Comunicado de Prensa número* 617/20, 2 December 2020, available at: https://inegi.org.mx/contenidos/saladeprensa/boletines/2020/OtrTemEcon/ECOVID-IE_DEMOGNEG.pdf.

of the parties fails to fulfil its obligations, its counterparty can immediately enforce the agreement before a court. Consequently, a debtor and its creditors could use mediation to enter a reorganisation agreement, and the creditors could easily enforce the agreement if the debtor does not fulfil it.

Also, as mentioned before, the *Ley de Concursos Mercantiles* contains the possibility for any merchant, either a company or entrepreneur, to ask the IFECOM to choose a registered conciliator to act as a "friendly negotiator" between the debtor and its creditors.

Nonetheless, there is no mandatory mediation or debt counselling or financial education for any type of rescue, restructuring or rehabilitation prior to formal insolvency proceedings in Mexico. Any debtor that believes it has generally breached its payment obligations in the terms foreseen by the *Ley de Concursos Mercantiles* can file for insolvency. Furthermore, any creditor that believes a debtor is insolvent can present an insolvency complaint against the debtor.

When a debtor decides to file for an insolvency proceeding, it is in a critical situation in which it immediately needs the protections granted by the law and courts to defend its assets, liquidity and its business. Thus, pre-insolvency requirements, including mediation or debt counselling, should not be mandatory because that could delay the protection a debtor needs. While mediation and other alternative dispute resolution processes are useful in theory in allowing the parties to enter friendly agreements and in helping the courts to progress matters, insolvency scenarios are generally more complicated, and it is not an easy task to line up so many interests and points of views.

Nevertheless, mediation could help MSMEs to cut time and costs in the restructure of their debts compared to an insolvency proceeding, and could work for MSMEs that have few creditors, as well as no seizures, frozen assets or civil and commercial proceedings already filed against them. If the situation is already complicated and the creditors have opted to enforce the debtor's assets or initiate proceedings against the debtor, the best option would be for the debtor to be immediately able to file for an insolvency proceeding and for the court to grant the injunctive relief that may allow it to keep its business going and to protect its assets.

3. Challenges Faced

3.1 Stigma associated with insolvency

In Mexico, there is great stigma towards insolvency. A clear example of this stigma is that, as noted above, until November 2020, there were only 805 insolvency filings since the "*Ley the Concursos Mercantiles*" was issued in 2000.[9]

There is very little "*cultura concursal*" (insolvency culture), and people in general do not even know what an insolvency proceeding means or the existence of this kind of process. Many entrepreneurs and MSME promoters associate the "*concurso mercantil*" (insolvency proceeding) with bankruptcy and the liquidation

[9] *Estadísticas en Materia Concursal*, *Cifras del 1 de junio al 30 de noviembre de 2020*, December 2020, available at: https://www.ifecom.cjf.gob.mx/resources/PDF/informesEst/2.pdf.

of the company, and do not even consider it as an option to deal with their financial problems or their company.

Furthermore, MSME promoters and entrepreneurs are very afraid of how their or the company's reputation will be damaged by entering an insolvency proceeding, including what their suppliers will think, how their business relationships will be affected or even if financial institutions will loan them money ever again. Accordingly, many MSME promoters, entrepreneurs and even big companies often make use of insolvency as a last resort.

3.2 Availability of financial information

In Mexico, MSMEs' financial information is not easily accessible because financial information is private. Nonetheless, bankruptcy and insolvency proceedings are public and anyone can ask the National Institute of Access to Information (INAI) for data concerning a specific proceeding or a copy of an MSME's financial information. If the INAI considers that the information requested need not remain private, the petitioner can have access to it.

The Ministry of Economy has a branch for MSMEs and a MSME fund, which have developed a scheme to counsel MSMEs financially in order to promote a stronger financial culture in that sector. A network of financial counsellors encourages the relationship between MSMEs and the financial products available for them. These counsellors also give MSMEs advice so that they can obtain the most adequate financing according to their needs and can learn how to deal with debt.

3.3 Access to new money

Post-commencement financing is available for MSMEs. Funding can be requested at the time of filing of the insolvency petition, or at any time during the proceeding, for the debtor to maintain its business and liquidity during the proceeding. This kind of financing can even be available during liquidation, if the receiver believes it necessary to obtain it to manage the company, sell its assets and pay the recognised creditors.

Post-commencement financing is considered a "claim against the insolvency estate", and consequently it has priority status. However, post-commencement lenders will be granted super-priority only in relation to the collateral that the Bankruptcy Courts approve to guarantee the loan. However, if no collateral is approved, post-commencement lenders will not have super priority status, since they will not get paid over secured creditors and other protected classes, such as employees. Employees' salaries for up to two years before the beginning of the proceeding will be the first amounts to be paid in a liquidation scenario. Moreover, secured creditors have the right to be paid with the sale of their collateral, up to its value.

3.4 Secured creditors *vis-a-vis* unsecured creditors

There are no special rules for MSMEs in the Mexican insolvency law, so that the same powers of secured creditors are applied to all companies that are liquidated. Secured creditors can initiate or continue enforcement proceedings to collect their claims outside the insolvency proceeding by executing their collateral, whereas

unsecured creditors must get paid according to the order foreseen by the law and with whatever the receiver is able to obtain from the sale of the debtor's assets and rights.

Secured creditors will not be able to enforce their collateral if the receiver believes it will be easier or more beneficial for the insolvency estate for the company to be sold as a whole unit or for the secured creditor's collateral to be sold as a part of a group of assets. In these cases, the secured creditors will obtain the payment of their claims according to what the receiver obtains from the sale of the collateral, and if it is not enough to pay the whole amount of their claim, the rest will be paid as an unsecured claim.

3.5 Insufficient asset base

Since the same rules apply for big companies, MSMEs and natural persons dedicated to commerce, the low asset base of MSMEs can inhibit the funding of a formal insolvency process or even a liquidation. To access the insolvency proceeding, debtors must guarantee the visitor's fees. The visitor will review the debtor's accounting, documents and information to make sure its insolvency situation complies with the hypothesis contained by the law. Consequently, companies must pay around 130,000 Mexican pesos to guarantee the visitor's fees, which is not as easy to disburse for a troubled MSME.

Furthermore, the time in which an insolvency proceeding is processed can be inconvenient to the low asset base of MSMEs, since the sole payment of their insolvency lawyers' fees can be too expensive. Also, under the assumption the MSME subscribes to a reorganisation agreement with its creditors, it will be obliged to pay a percentage of the total of recognised claims to the conciliator for his or her services. Thus, a MSME must consider the payment of the conciliator's fees when planning the reorganisation of its debt, as such fees are considered claims against the insolvency state.

In case the debtor enters bankruptcy, the conciliator's fees and the receiver's fees will be paid from the sale of the debtor's assets and rights. Consequently, MSMEs must have at least sufficient assets for the specialist fees to be paid, as well as other claims against the insolvency state, since the *Ley de Concursos Mercantiles* indicates that the proceeding can be terminated if there are not enough assets to pay the claims against the insolvency state.

The low asset base of MSMEs does in practice push creditors to request a formal liquidation rather than a restructuring proceeding, given the challenges they face regarding costs and time when going through the process. It may sometimes be easier for their shareholders to start a new business from zero and choose to liquidate the troubled company, instead of trying to maintain it.

3.6 Personal guarantees (PGs)

MSMEs often grant PGs to their creditors to obtain loans. Normally the MSMEs' shareholders guarantee the debts, which means that their assets are endangered when the MSME faces an insolvency situation.

The Commercial Insolvency Law does not contain any protection for guarantees granted by persons other than the debtor, including PGs. Therefore, the debtor must expressly request protection for the PGs granted by its shareholders or other third parties.

Furthermore, the Commercial Insolvency Law specifies that if the debtor subscribes to a reorganisation agreement, the creditors must expressly liberate the co-debtors from the collateral and guarantees granted or they will be able to collect the full amount of their debt by enforcing the collateral and guarantees.

Consequently, creditors can enforce PGs outside the insolvency proceeding to collect their claims since injunctive relief will generally only protect the debtor and its assets.

3.7 Further challenges

One of the main challenges MSMEs and even big companies face in Mexico in restructuring their debts through an insolvency proceeding is the difficulty in having insolvency proceedings admitted. The *Ley de Concursos Mercantiles* contains several requirements that may not be as easy to comply with in an urgent situation. Furthermore, courts are very strict and sometimes they even insist on requirements not contained in the law, so that if a debtor does not comply perfectly with everything, the court will not admit their request.

If the proceeding is not admitted by the court, debtors cannot enjoy the injunctive relief that will prevent creditors from enforcing their collateral or insisting on the payment of their claims, causing the debtor's financial problems to worsen.

MSMEs specifically face the challenge of not having special rules for their insolvency proceedings. The *Ley de Concursos Mercantiles* was created with big companies in mind, and it is not always as efficient to deal with the insolvency of a MSME as it is for large enterprises.

Also, as mentioned above, there were no MSME-specific insolvency measures approved in Mexico due to COVID-19, so that MSMEs could not have the benefit of special rules during these troubles times that could support them to overcome their insolvency.

Moreover, specialised courts in Mexico for insolvency proceedings were just created in March 2022. Before the creation of specialized bankruptcy courts, the competent courts that used to process insolvency proceedings were Federal Courts that also resolve *amparo* claims, civil, commercial, and even labour matters. Consequently, Bankruptcy Courts were full of work and insolvency proceedings are not given the attention they should. The insolvency cases filed before November 2020 are still being processed by Federal Courts, thus they still face such challenges.

Besides, since there is no obligation for any kind of debtor to request an insolvency proceeding at any time, companies often resort to insolvency as the last option and when it is too late to save their business. Indeed, instead of requesting the insolvency proceeding before creditors have enforced their collateral or filed any types of complaints against the debtor, in order for the injunctive relief to be

able to protect the company, debtors use the proceeding to try to reverse seizures, the freezing of assets and condemnatory judgments.

In addition, there is not yet a debtor in possession (DIP) financing market in Mexico since lenders will not obtain a super-priority. This has made these loans unattractive, causing companies to find it challenging to restructure their finances once they are undergoing an insolvency proceeding. Furthermore, Mexican banking laws provide different barriers for distressed or insolvent companies to obtain a loan, including the demand for reserves and for banks and their directors, officers and / or employees to analyse the economic solvency of the borrower.

Finally, the priority granted to tax claims and the rules that govern these kinds of claims are also challenges MSMEs must face when undergoing an insolvency proceeding. First, because tax claims must be paid after claims against the estate (which includes labour claims), secured creditors and special privileged claims, in a liquidation situation unsecured claims will most likely not be paid. Secondly, even when the *Ley de Concursos Mercantiles* and the Tax Code foresees the possibility for the tax authorities to grant debtors a condonation of their debts when they subscribe to a reorganisation agreement with their creditors, tax authorities rarely comply with these provisions. Furthermore, the Tax Code has recently been amended to eliminate this possibility for tax claims to be condoned in insolvency cases. Consequently, even if companies are able to negotiate with their creditors and enter a reorganisation agreement, in many cases the obligation to pay tax claims in full makes liquidation or bankruptcy inevitable.

4. Moving Ahead

The following experts have been interviewed for this section:

- Edgar Bonilla, Director of the IFECOM;
- Luis Manuel Mejan, Former Director of the IFECOM; and
- Fernanda Pérez Correa, Specialist Registered as Conciliator and Liquidator at the IFECOM

4.1 Best way to safeguard the interests of MSMEs

Several countries have enacted *ad hoc* legislation for MSMEs but that is not the case in Mexico.

The Bankruptcy Law allows both small and medium-sized enterprises to access the insolvency procedure. However, small and medium-sized enterprises do not normally choose to access the formal insolvency procedure since it is a technical and specialised process, and an onerous procedure. An example of this is the guarantee that they must pay for the inspector's fee (articles 20 and 24 of the Commercial Bankruptcy Law).

Options for safeguarding the interests of MSMEs in this context are considered below.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

There has not been a micro enterprise that went through insolvency proceeding. On the other hand, some small and a number of medium enterprises have used the system with good results.

Despite the fact that there is no restriction on access to the formal insolvency procedure, it was not designed for small and medium-sized enterprises. Therefore, small and medium-sized enterprises normally decide to access ordinary procedures to resolve their financial problems.

However, insolvency procedures are key tools to protect enterprises with insolvency issues, without prejudice to the fact that to be more effective and efficient, procedural terms must be reduced and insolvency specialised judges must be involved.

There has not been any legislation adopted for MSMEs' insolvency post-COVID 19. In 2020, a project on emergency legislation was presented to the congress, but it has been unsuccessful so far. This piece of legislation could be the basis for an *ad hoc* regime for MSMEs. Other options could include the adoption of the recommendations of UNCITRAL for MSME insolvencies.

Nevertheless, because of the COVID-19 pandemic, some tax incentives were applied at a local and national level, including exemptions, discounts, and extensions, as well as granting credits under preferential conditions.

It is important to continue with these measures and even more incentives should be provided by authorities. Moreover, since the COVID-19 economic impact is not over yet, it is important to promote legal mechanisms that allow enterprises to have access to agile and flexible restructuring procedures.

4.3 Simplified insolvency proceedings

In general, it is important to update the insolvency procedure according to the issues faced by MSMEs nowadays, through a flexible, agile and effective process that maximises the viability of the company. For example, there could be legal reforms to add a shorter and more flexible procedural regime for debtors.

A simplified proceeding is key to a successful restructuring of micro and small enterprises. In our system, a medium sized enterprise can go through the regular regime without any special difficulty. Apart from MSMEs, enterprises affected by the pandemic should also have access to a simplified proceeding. This should form the basis for amending Mexico's insolvency legislation. This one of the beneficial outputs of the pandemic.

Additionally, there is no discharge mechanism under the current laws. This is one of the features that should be added to the insolvency regime.

MYANMAR

Preliminary Note

For almost six decades, the people of Myanmar (formerly known as Burma) lived under a military dictatorship in which all aspects of life, including commercial activity, were controlled by the central government. Most business of any scale was conducted through entities under the control of senior military officers. Such banks as operated in the country were grossly undercapitalised and untrusted by the population. Credit for small businesses (let alone MSMEs) was virtually unknown. Change began around 2011, after the release from house arrest of Aung San Suu Kyi, together with the introduction of a number of liberalising measures and constitutional reform. While the new constitution included many provisions aimed at protecting the position of the military and their commercial interests, general elections to a parliament were permitted and, at the 2015 general election, the National League for Democracy (NLD) claimed 43 of the 45 seats available to non-military members. These developments resulted in reforms aimed at modernising and "opening up" Myanmar's economy. However, on 1 February 2021, a military coup led by General Min Aung Hlaing over-threw the constitution and (once again) imprisoned Aung San Suu Kyi, members of the NLD and many others.

Since the coup, reliable information about what is happening in the country has been difficult to come by. However, we understand that NLD appointments to the judiciary have been dismissed (and, in some cases, imprisoned). With them has gone what commercial law experience existed in the judiciary. Further, it appears that much of the country's economy has reverted to the state control that existed before 2011.

In the circumstances, this chapter is not as comprehensive a response to the issues on which INSOL has sought contribution as we would like it to be but seeks to be as accurate as circumstances allow.

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

Myanmar's Insolvency Law 2020 (Law) was passed by the Parliament and assented to by the President of the Union in March 2020 with the intention of creating a unified corporate and personal insolvency and debt rehabilitation framework which would support the economic development of the country and encourage foreign investment. In addition to winding up and personal insolvency provisions, Part V of the new Law provides a process for the rehabilitation and rescue of financially distressed companies or, if that is not possible, to at least ensure a better return for creditors than under a liquidation. In addition, Part VI of the Law includes specific provisions addressed to the insolvency of incorporated *and* unincorporated MSMEs. Provisions for schemes of arrangement are preserved in the Myanmar Companies Law 2017.

Acknowledging the vital role played by insolvency practitioners in any effective insolvency regime, the Law also provides for the development of an appropriately skilled and regulated insolvency profession.[1]

[1] Law, Part III..

1.2 Specific insolvency legislation

Part VI of the Law establishes a regime dedicated specifically to MSMEs, acknowledging that MSMEs constitute all but a very small part of the Myanmar economy. Part VI largely mirrors the corporate rescue provisions in Part V, but with significant alterations to simplify processes, reduce costs and address creditor passivity.

Part VI provides MSMEs with more, and more appropriate, options upon insolvency and seeks to minimise the formal processes involved in MSME insolvency. In providing a more streamlined process for MSMEs, the regime enables them to save both time and costs.

Prior to the enactment of the Law, financially distressed MSMEs had no option other than potentially expensive winding up or bankruptcy procedures. However, the Law provides directors or proprietors of debtor MSMEs with the option to seek the assistance of an appropriately qualified and experienced insolvency practitioner, who may be appointed as a "rehabilitation advisor", without requiring the directors or proprietors to relinquish control of their business.[2]

While creditors are currently unable to appoint rehabilitation advisors, Part VI provides additional creditor powers. For example, a secured creditor with security over all or the majority of the MSME's assets may replace the rehabilitation advisor within five business days of receiving notice of the advisor's appointment.[3] Creditors can also elect to remove or replace the rehabilitation advisor.[4]

Sadly, we are unable to report on the effectiveness of the Law in helping MSMEs as the coup has adversely impacted its implementation. While we understand that efforts are being made by the insolvency practitioners of Myanmar to comply with the requirements of the Law for the training and regulation of practitioners, there are issues with the readiness of the regulator to take up its role under the Law and the ability of the judiciary to supervise appointments.

1.3 Framework for out of court assistance or workouts

There is no formal structure for out of court settlements under the Law. However, the Myanmar Companies Law 2017 provides for schemes of arrangement and, as in most common law jurisdictions, the corporate and MSME rehabilitation provisions of the Law may be accessed without court order.

1.3.1 Corporate

Although seldom used, provisions of the Myanmar Companies Law 2017[5] allow for schemes of arrangement to effect a reorganisation of a business or to be used as a tool for rehabilitating a financially distressed enterprise through a rescheduling of its debts and obligations. This procedure can be expensive to implement, requiring professional assistance from lawyers and potentially involving extended negotiations with a number of interested parties. It is generally intended for

2 *Idem*, s 97.
3 *Idem*, s 99.
4 *Idem*, s 120.
5 Myanmar Companies Law 2017, ss 287-289.

solvent reorganisation, requiring court approval (albeit not by an insolvency process).[6] The procedure is, therefore, more suited for the restructuring or rehabilitation of large companies or corporate groups, but is of little use to the types of businesses that make up around 99% of the Myanmar economy.

Of greater relevance are the rescue and rehabilitation processes available under the Law, which may be commenced with or without court assistance. While decision-making and the overall process can proceed without court orders, the Law has mechanisms in place to allow for court intervention when deemed necessary.

The rescue and rehabilitation process begins with the "rescue stage".[7] If a company is insolvent or is likely to be insolvent, the company or a secured creditor of the company may appoint a rehabilitation manager, without the need to obtain approval from the court.[8] Provision for the court appointment of a rehabilitation manager is also included.[9] On appointment, the rehabilitation manager assumes control of the company with all the powers of directors.[10] He or she will have personal liability for the debts of the company incurred during the rehabilitation process, subject to a first priority right of indemnity from the assets of company.[11]

During the rescue stage, efforts are to be made to prepare a rehabilitation plan with the assistance of the rehabilitation manager and any interested parties.[12] The purpose of this plan is to rescue the company as a going concern.[13] Once prepared, a rehabilitation plan is submitted to creditors and comes into effect if a majority of creditors in number and a majority in value vote to approve it.[14] There is no requirement to obtain court approval for the adoption of the rehabilitation plan, although the rehabilitation plan may be terminated by the court where its objective is not being achieved or there is an abuse of process.[15]

If creditors vote in favour of the plan, the company enters the "plan stage" of the rehabilitation process. The rehabilitation manager becomes the plan supervisor and the plan is implemented.[16] If the rehabilitation plan fails to secure a majority vote, the company is placed in liquidation.[17]

1.3.2 Personal

Insolvency processes available to an individual under the Law include voluntary arrangements which utilise a combination of both out of court processes and in court processes but may be entered into without the intervention of the court. Out of court mediation is also available to assist in certain circumstances. These processes are summarised below.

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6 *Idem*, s 287.
7 Law, s 40.
8 *Idem*, s 43.
9 *Idem*, s 43(c).
10 *Idem*, s 54(a)(iv).
11 *Idem*, s 62.
12 *Idem*, s 72.
13 *Idem*, s 41(a).
14 *Idem*, s 73(c).
15 *Idem*, s 87.
16 *Idem*, s 73(a).
17 *Idem*, s 88.

- *Voluntary arrangements*

  Voluntary arrangements may be entered into with creditors prior to the commencement of formal bankruptcy proceedings and without the intervention of the court. The debtor is required to submit a proposal to a nominated insolvency practitioner who will review and report on the proposal.[18] This proposal is circulated to creditors, who may vote to implement the proposal.[19] Unless 50% of creditors by number and value vote against the proposal,[20] it will bind creditors.[21] There is no need to obtain court approval of a voluntary arrangement. However, an application can be made to a court by a creditor, debtor or nominee who seeks to challenge a decision approving a voluntary arrangement.[22]

- *Mediation*

  Where a debtor has formed the view that he or she is not, or is not likely to be, able to pay his or her debts, he or she may appoint a mediator to mediate any dispute regarding any outstanding debt(s) with the creditor or facilitate the negotiation of a voluntary arrangement with creditors.[23] Court approval is not necessary for the appointment of a mediator.[24] However, if the debtor would like to avoid a bankruptcy order being made against him or her during mediation, they will need to apply to the court for a moratorium order which cannot last for more than 28 days.[25]

  It is to be noted, however, that mediation has not yet been widely adopted in Myanmar as a means of dispute resolution and it is presently unclear how quickly it will be taken up as an effective means of minimising the costs of insolvency.

1.3.3 MSMEs

There are no formal structures for out of court workouts for MSMEs, other than the voluntary arrangement procedure described above for the proprietor(s) of unincorporated MSMEs. However, as with corporate rehabilitation, MSMEs can access the rescue and rehabilitation provisions of Part VI without commencing court proceedings.

For more information regarding the insolvency processes available to MSMEs, see section 0 below.

[18] *Idem*, s 234..
[19] *Idem*, s 237(a).
[20] *Idem*, s 237(c).
[21] *Idem*, s 239(b).
[22] *Idem*, s 240.
[23] *Idem*, s 262.
[24] Ibid.
[25] *Idem*, s 263.

1.4 Accelerated restructuring or liquidation of MSMEs

1.4.1 MSME rehabilitation

The Law includes a simplified, streamlined and less expensive rehabilitation process for MSMEs.[26]

Unlike corporate rehabilitation under Part V of the Law, the MSME provisions in Part VI are based on a "debtor in possession" model – that is, one where the directors of an incorporated MSME or the proprietors of an unincorporated MSME remain in control of the business and its assets after an insolvency process is commenced by the appointment of a rehabilitation advisor.[27] The rehabilitation advisor is appointed by the MSME to assist and advise it on the preparation of a rehabilitation plan.[28] The purpose of the rehabilitation plan is to rescue the MSME as a going concern or, if this is not possible, ensure a better return for creditors than would be available under a liquidation or bankruptcy scenario.[29]

In contrast to corporate rehabilitation, MSME rehabilitation advisors do not take control of the business and are not personally liable for the debts and liabilities incurred by the MSME during the rehabilitation process.[30] Any debts incurred in the course of the MSME rehabilitation process, including any liability for rent, remain liabilities of the MSME and must be paid by it in the ordinary course of business.[31] If the rehabilitation advisor becomes aware that these debts and liabilities are not being paid in the ordinary course, he or she must act to transition the MSME to winding up or bankruptcy.[32]

Court supervision is an important aspect of the MSME regime, but the scope for expensive litigation is limited. The formalities surrounding creditor participation have also been minimised in recognition of what the World Bank has described as "creditor passivity"[33] – a phenomenon of particular concern to MSMEs where creditor debts and, consequently, returns are unlikely to be large.

As is the case with corporate rescue and rehabilitation in Part V, Part VI divides the MSME rehabilitation proceeding into a rescue stage and a plan stage.[34] The rescue stage commences upon the appointment of a rehabilitation advisor and concludes upon the commencement of the plan stage or the winding up or bankruptcy of the company or proprietors of the MSME.[35]

Access to the regime provided by Part VI of the Law is limited to MSMEs, which have been defined by reference to business debt, whether or not the business entity is incorporated, and excludes those enterprises that become insolvent due to personal or consumer debt.[36] "Business debt" is defined to mean a debt

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[26] *Idem*, Part VI.
[27] *Idem*, ss 104 and 105(c).
[28] *Idem*, ss 102(a) and 121.
[29] *Idem*, s 94.
[30] *Idem*, s 112(a).
[31] *Idem*, s 112(b).
[32] *Idem*, s 112(d).
[33] World Bank, *Report on the Treatment of MSME Insolvency*, 2017, 12-14 and Box 3.4.
[34] Law, s 93(a).
[35] *Idem*, s 93(b).
[36] *Idem*, s 2(u).

incurred for the purpose of carrying on an enterprise or business, whether by way of finance to fund its operations or capital requirements, for the supply of goods and services to the business, or otherwise.[37] Creditors do not have the right or entitlement to commence a MSME rehabilitation process or appoint a rehabilitation advisor.[38] This is intended to operate as an incentive for a MSME to proactively seek assistance from a professional insolvency practitioner rather than awaiting a more formal and costly appointment by a creditor.

Prior to appointment, the rehabilitation advisor must confirm in writing that he or she has received a list of creditors of the MSME setting out the name, address and approximate value of the debts owed to each, and that, having received this and any other records provided by the MSME and conducting any other enquiries, he or she is satisfied with his or her appointment and that the objectives of Part VI can be fulfilled.[39]

A secured creditor must be given notice of the appointment and may, within five business days of receiving the notice, replace the rehabilitation advisor with an insolvency practitioner of its own choice.[40]

The principal functions of the rehabilitation advisor are to *advise and assist* the directors or proprietors of the MSME in exploring options for a rehabilitation plan and in continuing the MSME's business during the rescue stage.[41] In this regard, the rehabilitation advisor's role (to investigate and report on any rehabilitation plan that may be developed and circulated to creditors)[42] is substantially similar to that of a rehabilitation manager under Part V of the Law.

During the rescue stage, all the powers of the directors or proprietors of the MSME to conduct business or dispose of property outside of the ordinary course and to pay creditors that are not connected with associates of the MSME for debts arising prior to the commencement of the Part VI Process may only be exercised with the written consent of the rehabilitation advisor or the leave of the court.[43]

Moratorium provisions (including those pertaining to dealing with security) prevent the bringing of debt recovery proceedings against a MSME once a process under Part VI of the Law has commenced.[44]

As soon as is reasonably practicable after the commencement of a process under Part VI of the Law, the MSME must make out and submit to the rehabilitation advisor a statement of its affairs in a prescribed form.[45] A rehabilitation advisor may rely on information supplied in the statement of affairs unless he or she has reason to doubt its accuracy.[46]

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37 *Idem*, s 2(i).
38 *Idem*, s 97.
39 *Idem*, s 98(c).
40 *Idem*, s 99.
41 *Idem*, ss 102(a)(i) and (ii).
42 *Idem*, s 102(b).
43 *Idem*, s 105(d).
44 *Idem*, ss 106 and 107.
45 *Idem*, s 114.
46 *Idem*, s 115(a).

With the intention of limiting the costs of a proof of debt process, Part VI provides that, within five business days of receipt of the statement of affairs, the rehabilitation advisor must send a notice to each creditor identified in the statement, seeking verification that the MSME is indebted to that creditor as described in the statement,[47] and notifying the debtor or creditor that unless he or she disputes the stated indebtedness within five business days, its correctness will be assumed, in the absence of proof to the contrary.[48] Any dispute that arises in respect of a debt or claim that cannot be resolved within the time provided to put in place a rehabilitation plan will result in the unsuccessful conclusion of the MSME rehabilitation process.[49] A mediator may be appointed by the rehabilitation advisor to mediate any dispute between the MSME and its creditors or debtors in respect of any debt or claim by or against the MSME or a Part VI rehabilitation plan that may be proposed.[50]

Similarly, Part VI attempts to limit the need to call creditors' meetings and avoid expensive voting procedures by providing that a copy of any proposed rehabilitation plan must be sent to every creditor at their respective last known address and must include notification that the recipient must vote for acceptance or rejection of the proposed plan within 21 days of the date of the notice and that such acceptance or rejection should be notified in writing to the rehabilitation advisor.[51] Creditors must also be notified that unless written rejections to the proposed rehabilitation plan are received from creditors whose claims represent more than 50% in value of total claims and more than 50% of the total number of creditors, within 21 days of the date of the notice, the plan will come into effect on the day that is 28 days after the date of the notice.[52] The notice and the rehabilitation plan to be sent to creditors must be accompanied by a report of the rehabilitation advisor.[53]

The rehabilitation advisor will only summon a creditors' meeting if, within 21 days of sending the proposed rehabilitation plan and notice, such a meeting is requested by creditors whose claims amount to at least 30% of the total value of business debts of the MSME, or if the rehabilitation advisor is otherwise notified of creditor rejections to the plan that would result in the plan being rejected, but considers there to be a reasonable prospect of obtaining approval for the plan, or the plan with some modification to it.[54]

It will be necessary for a rehabilitation plan to be likely to produce a return to creditors that is at least equal to the likely return if the plan does not come into effect and it must include the same claim priorities as would apply if the plan does not come into effect.[55]

If a rehabilitation plan under Part VI is not approved within 10 weeks of the commencement of a Part VI Process, the Part VI Process will end.[56] Where a

[47] *Idem*, s 115(b).
[48] *Idem*, s 115(c).
[49] *Idem*, s 124(a).
[50] *Idem*, s 118.
[51] *Idem*, s 122(a)(i).
[52] *Idem*, s 122(a)(ii).
[53] *Idem*, s 122(b).
[54] *Idem*, s 123(a).
[55] *Idem*, ss 121(c) and 121(d).
[56] *Idem*, s 124(a).

rehabilitation plan is rejected by creditors or otherwise terminated, the MSME is to transition to a creditors voluntary winding up or bankruptcy.[57]

1.4.2 MSME liquidation

When an incorporated MSME transitions to a winding up, Part VII of the Law (concerning company winding up) will apply save for modifications which include:[58]

- filing and lodgement fees will be 50% of those prescribed for non-MSME companies;[59]
- any debt or claim proved in the winding up of an incorporated MSME that is either of, or for the benefit of, a person connected with an associate of the MSME must be subordinated to those of all other creditors of the MSME, whether secured or unsecured, preferential or otherwise;[60]
- a liquidator appointed to wind up an incorporated MSME is not liable to comply with his or her obligations to investigate the affairs of the company,[61] nor to prosecute or pursue any claim or action that may be available to him or her or the company under the Law,[62] save that, on the application of a creditor or member of an incorporated MSME, the court may order or direct the liquidator to incur a particular expense on condition that the creditor or member indemnifies the liquidator in respect of the recovery of the amount extended and gives such security to secure the amount of the indemnity as the court thinks fit;[63] and
- if, upon appointment, the liquidator of an incorporated MSME finds that the company has no property which might permit a distribution to its creditors, he or she must send a notice to that effect to the Directorate of Investment and Company Administration (DICA),[64] which will result in the automatic dissolution of the company three months later unless the court otherwise orders in the meantime.[65] The liquidator must circulate to all creditors, notice of his or her intention to file such a notice with DICA at least five days before doing so.[66]

1.5 Discharge of debts for natural persons

After a term of three years, a person bankrupted under Part VIII of the Law will be automatically discharged unless his or her trustee obtains an order extending the administration of the bankrupt's estate.[67]

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57 *Idem*, s 139(a).
58 *Idem*, s 140.
59 *Idem*, s 141.
60 *Idem*, s 142.
61 *Idem*, s 143(a).
62 *Idem*, s 143(b).
63 *Idem*, s 143(c).
64 *Idem*, s 144(a).
65 *Idem*, s 144(e).
66 *Idem*, s 144(c).
67 *Idem*, s 266.

2. Special Measures

While there has been no legislative change to assist MSMEs during COVID-19, prior to the coup, the Myanmar Government and large commercial banks had introduced measures to lessen the financial burden of businesses, including MSMEs and sole traders, in the early months of the pandemic.

On 9 April 2020, the Government introduced specific COVID-19 loans with fixed one-year terms and an annual interest rate of 1%, compared to the 10% rate charged by commercial banks. To be eligible for the loan, businesses had to be registered, but not necessarily incorporated, must have paid applicable taxes the previous fiscal year, and must not have been sued by a bank for defaulting on a loan.[68]

Further, on 6 April 2020, the Financial Regulatory Department, under the Ministry of Planning, Finance and Industry, issued a directive ordering microfinance institutions to suspend lending and collection of loans until 15 May 2020. In particular, the directive banned loan collection "by force". The Ministry also offered working capital loans focused on MSMEs as well as financial support to smallholder farmers. The World Bank has noted, however, that the Ministry and the Myanmar Agriculture Development Bank indicated future loans would only be available to clients who had paid back previous loans and, as of the end of May 2021, less than 20% of clients had been able to do so.[69]

In the absence of any formal requirement on banks to provide relief to debtors from Myanmar's primary banking regulator, the Central Bank of Myanmar, some banks in 2020 implemented a principal loan repayments deferral program. This included instating a moratorium on repayments of up to six months and offering the option to restructure loans and financing.[70] Myanmar's biggest bank, KBZ Bank, for example, rolled out a COVID-19 Credit Assistance Program tailored to MSMEs. This gave the debtor an opportunity to apply to extend overdraft facilities and term loans for up to six months, or to defer or capitalise principal and interests for up to six months.[71] Some of these programs have been extended after the military coup.

We understand that, under the military junta, businesses may still access these loans, and have also been afforded two six-month extensions. The Working Committee for Remedial Works on Economic Impacts of COVID-19 extended the term of the loans first on 17 March 2021, as the fixed one-year term was nearing expiry, and allowed businesses to defer repayment of both principal and interest for six months.[72] It extended the term a second time on 11 September 2021, despite in August ordering debtors to repay the loans in full or risk prosecution.[73]

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[68] Chan Mya Htwe, "Myanmar Govt Gives out Third Batch of COVID-19 Loans", *Myanmar Times*, 20 November 2020: https://www.mmtimes.com/news/myanmar-govt-gives-out-third-batch-covid-19-loans.html.

[69] World Bank, *Myanmar Economic Monitor July 2021: Progress Threatened; Resilience Tested*, 2021: https://www.worldbank.org/en/country/myanmar/publication/myanmar-economic-monitor-july-2021-progress-threatened-resilience-tested.

[70] Yoma Bank, Loan Deferral Program: https://www.yomabank.com/loan-deferral-program.

[71] KBZ Bank, COVID-19 Credit Assistance Program for SMEs: https://www.kbzbank.com/en/covid-19-credit-assistance-program-for-smes/.

[72] See DICA: https://www.dica.gov.mm/sites/default/files/news-files/noti_1-2021.pdf.

[73] See DICA: https://www.dica.gov.mm/sites/default/files/news-files/20210911_noti_2_2021_for_next_6_month_covid_loan.pdf.

However, the implementation of the Law, which was passed by Myanmar's Parliament not long before the initial global COVID-19 outbreak followed by the military coup, appears to have stalled at the stage of registering insolvency practitioners. Despite reporting in 2020 on the expected influx of new insolvency cases, it currently does not appear that any creditor or debtor has been able to use the provisions of the Law in a court proceeding or an out of court debt rehabilitation process. The filing system for forms prescribed in the Insolvency Rules is also still not in place. Moreover, the Insolvency Practitioners' Regulatory Council, established under Part III of the Law as the peak regulatory body, met only twice in 2020,[74] and has not convened a meeting since the military coup on 1 February 2021.

As the World Bank reported in 2020, the rate of company insolvencies has increased due to COVID-19. By October 2020, 35% of companies expected to face insolvency by the end of the year and 53% indicated that the most needed form of Government support was access to loans and credit guarantees.[75] This was supported by findings in September 2020 that 26% of companies had outstanding loans and 14% were unable to pay suppliers.[76]

Precise figures for 2021 and 2022 are not available, but the continued introduction of measures by financial institutions to assist companies suggests that the situation has not improved – rather, the negative effects of COVID-19 and the coup are ongoing. The Central Bank of Myanmar has made further cuts to interest rates, reducing the rate incrementally over the period from March to May 2021.[77] As of July 2021, the Myanmar Government announced it would guarantee half the loans private banks made to companies that did not receive assistance from the Government's COVID-19 Fund.[78] Further, the Government continued its April 2020 efforts by providing the Myanmar Economic Bank with MMK 400 billion for a COVID-19 Fund through which businesses, in particular MSMEs, would be granted soft loans at 1% interest for a year; and provided MMK 600 billion in loans to farmers.[79]

Despite introducing the measures outlined above, the banks have nevertheless suffered a lack of confidence since the 1 February 2021 coup. Lack of, or significantly smaller, repayments in conjunction with mass non-performing loans have placed strain on banks which were only beginning to establish themselves following the end of the first military dictatorship in 2011, and prompted informal service providers to step in to cater to the public's fiscal demands.[80] As predicted in INSOL's 2020 Global Guide, it appears that the combined stresses of the pandemic and the economic and political uncertainties surrounding the coup have

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74 Office of the Auditor General of the Union, "Holding the Insolvency Practitioners' Regulatory Council Meeting 1/2020": https://www.oagmac.gov.mm/news-activities/1827; Asian Business Law Institute, "[Interview] Three Months after the Insolvency Law 2020 Came into Effect in Myanmar", COVID-19 News Aggregator: https://abli.asia/NEWS-EVENTS/Whats-New/ID/141.

75 World Bank, *Myanmar Economic Monitor December 2020: Coping with COVID-19*, 2020: https://www.worldbank.org/en/country/myanmar/publication/myanmar-economic-monitor-december-2020-coping-with-covid-19

76 *Ibid.*

77 IMF, *Key Policy Responses as of July 1, 2021: Monetary and Macro-Financial*, 2021: https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#M.

78 IMF, *Key Policy Responses as of July 1, 2021: Fiscal*, 2021: https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#M.

79 *Ibid.*

80 See n 75 above.

had significant impact on Myanmar's economy. However, the details and extent of this impact remain largely unknown.

2.1 Procedural insolvency measures with respect to MSMEs

Other than the measure referred to above, we are not aware of any specific procedural insolvency measures having been introduced in Myanmar with respect to MSMEs during the pandemic.

2.2 Suspending the requirements to initiate insolvency / liquidation proceedings

We are not aware of the suspension of any of the requirements for the initiation of insolvency or liquidation proceedings since the commencement of the pandemic.

2.3 Insolvency procedural deadlines

We are not aware of any extension or alteration to any insolvency procedural deadlines having been introduced since the commencement of the pandemic.

2.4 Minimum debt requirements to initiate insolvency proceeding

We are not aware of any alteration to minimum debt requirements for the initiation of insolvency proceedings having been introduced in Myanmar during the pandemic.

2.5 Suspending specific creditors' rights

Other than the measure referred to above, we are not aware of the suspension of any of specific creditors' rights since the commencement of the pandemic.

2.6 Mediation and / or debt counselling

Mediation and debt counselling afford MSMEs the opportunity to resolve issues with creditors and attempt restructuring or rehabilitation in a swift and cost-effective way. However, even before the coup, mediation was not a widely utilised means of dispute resolution in Myanmar and the stalling of the implementation of the Law since the coup is likely to prevent it from becoming so, at least in the context of insolvency, including MSME insolvency.

As noted above, the Law makes express provision for the utilisation of mediation at various points in the insolvency process, including, in the case of MSMEs, the appointment of a mediator to mediate any dispute regarding outstanding debts with creditors, to facilitate the negotiation of a voluntary arrangement with creditors,[81] or in relation to the terms of any rehabilitation plan that may be proposed.[82]

[81] Law, s 262.
[82] *Idem*, s 118.

3. Challenges Faced

3.1 Stigma associated with insolvency

Myanmar is a highly religious society that does not have a culture of risk-taking. The literal translation of the Myanmar word for "insolvent" is "a beggar with nothing".

Prejudice against insolvent individuals is engrained in Myanmar's legal system, and even its constitution. Attempts to remove provisions for the imprisonment of debtors were resisted in the course of the insolvency law reform process and remain in place.[83] Under Myanmar's (suspended) constitution, persons who have been declared insolvent have no right to vote in the election of representatives to the Parliament,[84] and are not entitled to be elected to the Parliament.[85]

Efforts to alter these attitudes are likely to be stalled along with the implementation of the Law.

3.2 Availability of financial information

3.2.1 Myanmar Companies Online

DICA runs "Myanmar Companies Online", a directory of companies registered in Myanmar.[86] Members of the public are able to conduct company searches and view the filing history of the relevant companies. The filing history includes copies of the relevant companies' annual returns and registration of mortgages and charges.

Putting in place an accessible electronic registry has been challenging for DICA, which had an entirely paper-based registry until just a few years ago. The extent to which DICA's diligent efforts to progress this task may have been impacted by the coup is unclear. The availability of financial information online remains limited.

3.2.2 Annual financial reports

Every company is required to maintain written financial records to enable the preparation of financial statements.[87] A copy of these financial statements is required to be filed with DICA,[88] and each member of the company is entitled to access to copies of these financial statements.[89] The extent to which these requirements have been enforced to date are unclear. It will also be noted that these provisions will not apply to unincorporated MSMEs.

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[83] See ss 51(c), 55 and 56, together with Order XXI, rule 30 of the First Schedule, Code of Civil Procedure 1909.
[84] Myanmar's Constitution, s 392(d).
[85] *Idem*, s 121(d).
[86] See https://www.myco.dica.gov.mm/ for access to Myanmar Companies Online.
[87] Myanmar Companies Law 2017, s 258.
[88] *Idem*, s 266.
[89] *Idem*, s 268.

3.2.3 Credit reporting

On 30 December 2020, Myanmar Credit Bureau Limited (MMCB) launched a credit reporting system using information gathered about borrowers from financial institutions in Myanmar.[90] The type of information that may be accessed includes names, contact information, accounts, repayment history and collateral used to secure loans. However, as MMCB's membership base consists entirely of national and local banks, foreign bank branches and non-bank financial institutions, credit reporting data about MSMEs may be limited as MSMEs do not have established credit facilities with commercial banks.

As MMCB's website is not accessible outside of Myanmar,[91] the full extent of the information available and its accessibility of this information to the general public is unclear.

3.3 Access to new money

The Law makes no express provision for arrangements that may be entered into for interim new finance for a MSME after commencement of a Part VI rehabilitation process.

3.4 Secured creditors *vis-à-vis* unsecured creditors

As part of the rehabilitation process for MSMEs, secured creditors have the following rights and powers:

- in relation to corporations generally, a secured creditor, who holds security over all or a majority of the company's property and where the terms of that security permit the appointment of a receiver, has the power to appoint a rehabilitation manager to the company;[92]

- while there is no scope for a secured creditor to appoint a rehabilitation advisor to a MSME, if a rehabilitation advisor is appointed by the MSME and the secured creditor has security over all or a majority of the MSME's property, the secured creditor may, within five business days of receiving notice, replace the appointed rehabilitation advisor with an insolvency practitioner of his, her or its choice;[93]

- secured creditors are only bound by a rehabilitation plan if they vote in favour of it;[94]

- a rehabilitation plan must not deal with secured property in a manner that may prejudice the interests of the secured creditor without its consent.[95]

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90 Kang Wan Chern, "First Modern Credit Bureau Launched in Myanmar", *Myanmar Times*, 31 December 2020: https://www.mmtimes.com/news/first-modern-credit-bureau-launched-myanmar.html.
91 See: https://creditbureau.com.mm/other-contact-us/ for IP access restriction message.
92 Law, s 43(b).
93 *Idem*, s 99.
94 *Idem*, ss 77(b), 77(c), 128(b) and 128(c).
95 *Idem*, s 111.

In contrast, unsecured creditors:

- have no power to appoint a rehabilitation manager over a company or MSME other than by application to the court; and
- rank in priority behind secured creditors, employees, rehabilitation debts, the insolvency practitioner's remuneration, legal costs and the insolvency practitioner's expenses.[96]

3.5 Insufficient asset base

The limited implementation of the Law to date has not provided the basis for an assessment of the bearing of a MSME's low asset base on funding the formal process of insolvency or liquidation under the Law.

3.6 Personal guarantees (PGs)

While we are not aware of any data on the prevalence of PGs granted by the directors of incorporated MSMEs in Myanmar, the application of Part VI of the Law to both incorporated and unincorporated MSMEs acknowledges that the prevalence of such guarantees limits the relevance of incorporation when assessing the consequences of insolvency for an MSME.

3.7 Further challenges

On 14 February 2020, Myanmar's Parliament (Pyidaungsu Hluttaw) passed the Law, which came into effect on 25 March 2020 and substantially changed the insolvency regime in a country that had, to that time, relied on a nineteenth century insolvency regime left over from British imperial rule. The Law introduced a corporate rehabilitation and rescue process, with specific provision for the insolvency of MSMEs.

Since 1 February 2021, when the military staged a coup and assumed power in Myanmar, there has been significant economic deterioration in the country, compounded by the rapid spread of COVID-19.[97] From an insolvency perspective, there are reports of liquidity shortages, cash flow issues and banking sector disruptions which are limiting business' ability to pay employees and suppliers.[98] For example, 31% of firms in the jurisdiction delayed payments to suppliers in June 2021.[99] More generally, public confidence in the Government and private banks is low, and the value of Myanmar's currency has significantly decreased. Foreign companies have made attempts to leave Myanmar by selling their operations but have been prevented from doing so by military officials.[100]

The Law has the potential to become a significant part of the legal landscape in Myanmar as its economy continues to deteriorate and the rate of business failure

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96 *Idem*, s 196(b).
97 *World Bank, Myanmar Economic Monitor July 2021*, 2021, 2.
98 Richard C. Paddock, "They Wait Hours to Withdraw Cash, But Most ATMs are Empty", *New York Times*, 7 August 2021: https://www.nytimes.com/2021/08/07/world/asia/myanmar-cash-coup.html.
99 See n 97 above, 25.
100 Poppy McPherson, "Telenor Executives 'Requested' Not to Leave Myanmar – Junta Minister", *Reuters*, 29 October 2021: https://www.reuters.com/article/myanmar-politics-telenor-idUSL4N2RF2E5.

increases. However, the implementation of the Law has stalled. It seems that neither creditors nor debtors have been able to make use of the new procedures available under the Law. Further, the filing system required under the Insolvency Rules made under the new Law has not been implemented.

4. Moving Ahead

The capacity of Myanmar to implement and move ahead with insolvency reform while it remains under the rule of the military appears to be limited. This statement may be applied to any form of commercial law reform or business and financial liberalisation that is not considered to be in the interests of the ruling generals. It is apparent at this time that implementation of the Law is not considered to be in the interests of the generals.

We understand that legal and practical structures to support the Law have not been put in place, with the result that, while the old law no longer applies, the new Law is not capable of practical administration. By way of example, the registration of insolvency practitioners required by Part III of the Law and essential to its operation, has not, as far as we are-aware, been effected.

4.1 Best way to safeguard the interests of MSME's

Unfortunately, it is very difficult to obtain any reliable information from Myanmar regarding the position of MSMEs within the country. However, having regard to the above, it appears that Myanmar's MSMEs have obtained no practical benefit from the enactment of the Law and remain in the largely unprotected position that they were in prior to the Law's enactment. The best way to safeguard the position of MSMEs in Myanmar would, in our view, be the implementation of Part VI of the Law, with all administrative and professional structures contemplated by the Law put in place.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

The lack of information available from Myanmar makes it impossible for us to answer this question. However, the matters described above suggest no change to the lamentable position of MSMEs in Myanmar.

4.3 Simplified insolvency proceedings

The need for Myanmar to have an effective insolvency law with simplified provisions for the specific purpose of assisting MSMEs remains as acute as ever. The failure of those presently in power to take appropriate steps to implement the Law is a source of great frustration for those in Myanmar who worked so hard to put it in place. However, the failure to address an area of much needed reform in Myanmar is a greater tragedy for those who seek to build the country's economy from within, as well as those seeking the opportunity to invest in this resource-rich country from abroad.

The future for the Law, like that of the people and economy of Myanmar, is bleak.

NEW ZEALAND

1. Insolvency Framework – General Overview

The COVID-19 pandemic brought about an economic consequence that has affected most businesspeople in New Zealand. Buoyancy has occurred for some businesses that have been able to exploit new opportunities but many in sectors affected by lockdown have not been able to transition and their businesses have become unsustainable as a result.

Formal states of insolvency are markedly down on pre-pandemic levels. The reason for this apparent contradiction is the direct support that has flowed from the Central Government to business owners to support their continued existence.[1]

In this maturing COVID-19 era, there is likely to be high demand for workouts, turnarounds, and business rehabilitation. The insolvency industry is young in this curve, but a ground swell exists as an alternative to the liquidation mindset that has largely been the technique that has prevailed for the insolvency industry.

Perhaps an increased demand from business owners, together with emerging cultural change among insolvency practitioners, can work together to save businesses.

Information from the Ministry of Business, Innovation and Employment shows that, for the year ending 2019, there were 546,732 businesses active in New Zealand. One metric for measuring their size is employee count. An employee count range will place the business into one of five categories. The acronym MSME (micro, small and medium) covers three of the five groupings. The table[2] below illustrates the different categories and the range of employees for each category.

Volume of Active Business as at 2020 Grouped by Number of Employees			
Category	**Employee Range**	**Quantity**	**Percentage**
Micro	Owner only	388,323	71%
Small	1 to 5	100,662	18%
Small to Med.	6 to 19	41,316	8%
Med. to Large	20 to 49	10,536	2%
Large	50 and greater	5,895	1%

By far the dominant category is the sole trader (micro), representing 71% of the total. Activity may be conducted on their own or through a company incorporated for the purpose. Notably, the MSME categories make up 97% of all business entities active in New Zealand and, collectively, they employ 51% of New Zealand's work force. MSMEs are, as a result, significant in New Zealand's economy.

Importantly, the business owners in the MSME categories are typically the least knowledgeable in business practices and frequently are not as sophisticated as their larger counterparts.

The MSME categories deserve special attention for the reason above, but just as important is the social justification that many MSMEs are sole traders, and much of the innovation that distinguishes economies comes from these contributors.

[1] On the back of criteria - a significant one being the preservation of employee welfare.
[2] Sourced from material supplied by the Ministry of Business, Innovation and Employment.

Moreover, MSMEs participate in a way that the warp and weft of their activities creates the very fabric of the economy that society relies on.

1.1 Formal insolvency legislation

New Zealand legislation provides for personal and corporate solvency to be dealt with separately. The Insolvency Act 2006 provides for the adjudication and discharge of an insolvent natural person, while the Companies Act 1993 provides for the commencement, administration and termination of a company. Both Acts contain provisions on how the terminal event of bankruptcy, or liquidation, can be avoided if possible.

The requirements of the two Acts are mutually exclusive. The Insolvency Act in section 6 records that corporations and other entities[3] are not able to use the terms of that Act. The Companies Act implicitly has mirroring limitations by providing that the Act is exclusively about companies.[4] That exclusivity is extended to other Acts that import the Companies Act liquidation provisions.[5] While the respective Acts distinguish the insolvency of an individual from the insolvency of a company, they do not differentiate between small and large.[6]

1.1.1 Insolvency legislation for individuals

For individuals, part 5 of the Insolvency Act provides for three out of court workout programs. They are compositions, proposals and provisions involving debt repayment orders and no asset procedure. Each are considered below.

- *Compositions*

  Compositions relate to a person that is already a bankrupt but his or her creditors are inclined to accept a compromised settlement in exchange for the annulment of the bankruptcy. The framework is comprised of a resolution, called the preliminary resolution, that carries a proposal intended to be considered by creditors of the bankrupt. The preliminary resolution is put before the general body of creditors at a meeting convened for that purpose.

  The creditors may accept or reject the resolution or may accept it on the proviso that it carries modifications contributed to by the creditors. The preliminary resolution is adopted if the threshold of a special resolution[7] is affirmed. If adopted, the preliminary resolution becomes the confirming resolution.

Of note are the creditors that are excluded from the calculation to determine if the put resolution has met the voting threshold. All creditors that participate in the proposal, and where the proposal intends to settle their claim at 100 cents in the

[3] For example, incorporated societies and body corporates.
[4] Section 2 of the Companies Act provides that a company comes into existence by the provisions of the Act. Section 15 of the Companies Act states that, upon incorporation, the company becomes a separate legal entity.
[5] The Incorporated Societies Act 1908 and the Limited Partnership Act 2008.
[6] The Insolvency Act does differentiate between, and treat differently, consumer and commercial debt when presented as the cause of the insolvency.
[7] Section 92(1)(b) of the Insolvency Act provides that a special resolution must be affirmed by both three quarters in number and value for it to be adopted.

dollar, are excluded for calculating whether the voting threshold has been met. The policy justification for this restriction is to ensure that the outcome of the voting is not distorted by settling large volumes of small creditors that are relatively insignificant when considered against the bankrupt's total admitted debt.

On achieving success for the confirming resolution, either the bankrupt or the Assignee[8] must apply to the court for approval of the confirming resolution. On approval, the bankrupt and Assignee must execute a deed of composition which must also go before the court for approval. If approved, the bankruptcy is annulled.

- *Proposal*

  A proposal can be made[9] to the creditors of an insolvent person for the payment or satisfaction of their debts for the purpose of avoiding bankruptcy. The Act provides scope for the proposal to include settlement by way of instalment payments, by a compromise of the full amount, by deferment of the amount or any other arrangement for the satisfaction of the debts that is acceptable to the insolvent and his or her creditors.

  The structure of the settlement offering requires the insolvent to prepare a proposal in the prescribed form. This will include a statement of affairs, the proposal itself, the nomination of a trustee and the details of a meeting of the creditors to be convened for the purpose of considering the proposal. The trustee is likely to be an insolvency practitioner or lawyer engaged for the purpose of preparing the proposal and undertaking all the required activities in respect of it.

  On completion of the proposal, the insolvent is required to file a copy of it in the court nearest to where the insolvent lives. Once filed, the proposal cannot be withdrawn without the court's consent. The policy for this restriction is that having made the decision to achieve settlement with his or her creditors, a decision of either approval or adjudication must result. On filing in the court, the nominated trustee becomes the provisional trustee. The time and date of the filing in court is when the claims of creditors are determined.

  After filing the proposal with the court, the provisional trustee must call a meeting of the insolvent's creditors for the purpose of submitting the proposal for consideration. In this meeting, the creditors may examine the insolvent, accept the proposal together with any modifications made, and confirm or replace the provisional trustee. The proposal is accepted by creditors if a majority in number, and three quarters in value, of those entitled to vote and who do vote affirm the resolution. If the proposal is not accepted by the creditors, the chairperson, or the provisional trustee, must return the proposal to the court carrying the endorsement "not accepted by creditors".

The proposal must provide that all preferential creditors will be treated in the prescribed way that would be required if the insolvent's estate was being

[8] Assignee means the Official Assignee for New Zealand. The Assignee is trustee for bankruptcy in all New Zealand personal bankruptcies.
[9] Insolvency Act, sub-part 2 of part 5.

administered in bankruptcy.[10] If the proposal does not provide for settlement of preferential creditors, the court is not entitled to approve it. A preferential creditor is entitled to waive their position of priority, but that is an unlikely circumstance.[11]

Upon the proposal being accepted by creditors, the provisional trustee must, as soon as practicable,[12] apply to the court for approval of the proposal. When the matter is called, objectors are entitled to be heard. The court must refuse to approve the proposal if, on its determination, the proposal is not compliant or if it is not calculated to benefit the general body of creditors. If the court does approve the proposal, it is binding on all creditors that have provable debts and are affected by the terms of the proposal. Importantly, there is no catch-all constructive notice to creditors. It is assumed, as a result, that only the creditors that are informed of the proposal are bound by its terms when approved by the court.

Upon approval of the proposal by the court, the provisional trustee becomes the trustee. Approval requires that the insolvent must do everything necessary to put the proposal into effect. This will include measures such as realising property, providing security interests or dedicating funds. It is the trustee that will undertake this activity, as, by means of the approval by the court, a duty has been imposed upon the trustee to take control of the property that is the subject of the proposal.

The trustee is obligated to file six monthly reports with the registrar of the court. At any time after the proposal has been approved, and on the application of the trustee or a creditor, the court may vary or cancel the proposal. The grounds for varying or cancelling the proposal include:

- the statement of affairs did not substantially set out the true position;
- the insolvent failed to comply with the proposal;
- an injustice may be visited upon a creditor; and
- any other reason that the court considers appropriate in the circumstances.

In the event of cancellation, the property of the insolvent that has been vested in the trustee and is not sold or disposed of, is transferred back to the insolvent, or if the court adjudicates the insolvent to become a bankrupt, then the property is vested in the Assignee.

- *Debt repayment orders and no asset procedure*

  The remaining options as alternatives to bankruptcy are known as debt repayment orders[13] and the no asset procedure.[14] Both procedures are more tailored to deal with persons that have become insolvent because of consumer

[10] *Idem*, s 274.
[11] An occasion where this may occur is a friendly employee who is prepared to be subordinated for the benefit of securing consent to the proposal.
[12] Insolvency Act, s 333(1).
[13] *Idem*, sub-part 3 of part 5.
[14] *Idem*, subpart 4 of part 5.

debt. In each case, the procedure is not available to debtors whose total indebtedness exceeds NZD $50,000.00.[15]

It is conceivable that a debtor could be engaged in commercial activity and could avail themselves of either of these options. However, these options are not workouts that are negotiated with creditors, but rather the debtor submitting to a scheme that sees a periodic dividend ordered to be paid under a debt repayment order program or by cancellation ordered by the Assignee under the no asset procedure.[16]

1.1.2 Insolvency legislation for companies

For companies, there are three statutory based workout models that can be used to rectify insolvency:

- compromises with creditors;[17]
- approval of arrangements, amalgamations, and compromises by the court;[18] and
- voluntary administration.[19]

All three are designed to address the needs of a company requiring a restructuring of its affairs.

The most adaptable of the three options is the law relating to compromises with creditors. This observation is made on the ground that its provisions are so general in nature that a high degree of flexibility is available to the proponent.

Approval of arrangements, amalgamations and compromises is the process used when a company needs to reorganise its shareholding interests. Such a requirement may include the shareholding interest of an overseas company. This provision will not be addressed given that it is less relevant than the other processes in the context of MSME restructuring.

Voluntary administration is a model used for business rehabilitation. It is a template model framed by precise timing requirements, alteration of authority and compliance expectations that are rigid as to their requirements, but flexible as to their application.

- *Compromises with creditors (part 14 scheme of arrangement)*

  The compromises with creditors model is often called a part 14 scheme of arrangement. A compromise is defined[20] to mean a compromise between a

[15] This threshold is adjusted from time to time to take account of increases in the New Zealand Consumer Price Index.
[16] The exceptions to complete forgiveness are court fines, student loans, debts incurred after being accepted into the scheme, debts incurred fraudulently, child support or maintenance and secured debt (if the collateral remains in the hands of the debtor).
[17] Companies Act, part 14.
[18] *Idem*, part 15.
[19] *Idem*, part 15A.
[20] *Idem*, section 227.

company and its creditors, including a cancelling of all or part of a debt, varying the rights of creditors or altering the company's constitution that affects the ability of the company to pay a debt.

The board of directors, a receiver, a liquidator or, with the leave of the court, any creditor or shareholder of the company, may propose a compromise. The most likely party to propose is the board of directors. However, if a creditor or shareholder is minded in doing so, the court, on providing consent, may order the company to supply such details of other creditors as may be required to enable the creditor or shareholder to propose the compromise.

The proponent must then prepare a submission for creditors to consider. This will include compiling a list of creditors and the amounts owed. That schedule must define each creditor within a class and record the number of votes the creditor is entitled to cast. One dollar of claim is a proxy for one vote.

It is not a requirement that all known creditors are included in a compromise. It is possible to compromise with a subset of creditors. However, if the objective is to include all creditors, then it is important to ensure they are all informed as only creditors that are notified can be bound by the proposal if it is adopted.[21] Arguably, if the objective is to include all creditors, and a particular creditor was not made aware of the proposal, they would not be bound by it.

The proposal must also provide essential information that will enable the creditors to make an informed decision. This will include the proponents' details, describing the terms of the compromise, projecting foreseeable consequences, and explaining that if the resolution that adopts the proposal is affirmed, then it is binding on all creditors.[22]

The proponent must convene a meeting for the purpose of considering the proposal. All creditors, the company,[23] any receiver or liquidator and the Registrar of Companies must be notified of the meeting. In that meeting, once convened, a resolution is put that seeks to have the proposal affirmed. To be affirmed, the proposal must be supported by a majority in number that represent 75% in value of those entitled to vote and who do vote.

On adoption of the resolution, it is binding on the company and on all creditors that have been notified. The proponent is obliged to give written notice of the outcome of the meeting to all creditors, the company, any receiver or liquidator and the Registrar of Companies.

If ever required, a variation of the compromise can be achieved by means of any procedural method explained within the compromise documents[24] or by approval adopting the same process that achieved adoption of the original proposal. A variation of the compromise must be notified to the Registrar of Companies.

[21] *Idem*, s 230(2).
[22] *Idem*, s 229(2)(b).
[23] If it is a creditor prompted proposal.
[24] Already agreed to be creditors by means of adopting the proposal.

The court is not engaged in the process, but on the application of the proponent or the company, directions may be requested of the court as regards the compromise. In particular, the court may give directions as to any procedural requirement imposed by part 14 or waive, or vary, any requirement. In addition, the court may order that a proceeding initiated by any creditor is stayed or, if a creditor has commenced enforcement action, an order may be made to refrain from that action.[25]

The most common role of the court is to hear applications by dissatisfied creditors[26] and for the court to decide whether the compromise should be set aside or whether it should not bind particularised creditors. The enforceable rights of secured creditors are unaffected as regards the compromise.

The compromise may have life after death. If the compromise is approved and in force prior to liquidation, the court may order that the compromise can continue in effect and be binding upon the liquidator after it goes into liquidation. All costs of the compromise are to be borne by the company as a direct cost or as a cost of receivership or liquidation if either of those states have been initiated. If costs are incurred by any other person, such as a proposing creditor, and if the company goes into liquidation, then that person becomes a preferential creditor for the purpose of dividend distribution.

- *Voluntary administration*

Voluntary Administration, or VA as it is often referred to, is the model introduced into New Zealand law in 2006. The law became effective on 1 November 2007. Before then, there was no statutory regime that facilitated the workout of a company in financial distress. Reconstruction activity was conducted in the shadow of the law.

The law is, in substance, a reproduction of Australian law.[27] It has been adopted in New Zealand law in recognition of CER[28] and the quest to harmonise business laws between Australia and New Zealand given their proximity and the degree of commerce conducted between them. There is significant advantage in having compatible law when business failure occurs in an enterprise that has representation in both countries.

The VA model is an admirable representation of legislation, offering the potential for business recovery within the model and at the same time providing limitations designed to contain recovery activity. On the one hand, the model conceives of freedom to develop a recovery plan in an entrepreneurial manner but on the other, it requires compliance expectations to be met so that entrepreneurial hope does not override creditor interests.[29]

[25] Such orders are only effective for the period commencing not earlier than when notice was given and not after 10 working days from when notice of the result of voting was provided.
[26] Companies Act, s 232(3).
[27] Refer to Part 5.3A of the Corporations Act 2001 (Cth).
[28] New Zealand-Australia Closer Economic Relations (CER).
[29] One example is the time limits imposed to ensure that current creditor interests are not worsened any more than necessary by the passage of time.

The model also caters for the multiple dynamics that are present in most insolvent circumstances. It achieves this by ensuring secured creditors are free to act, preferential creditors' rights are preserved and a moratorium acts as an overlay to contain rights while a recovery plan is developed. Although the scheme is not strictly a debtor in possession model,[30] the directors are an essential and integral part of the rehabilitation process.

The administration is marked out by three distinct time periods: the initiating period, the investigating period, and the decision period. All three are to be conducted within 25 working days from the date of appointment of the administrator. The Companies Act marks out the 25 working days by a 20 day convening period[31] and a five day notice period for the "watershed meeting" (discussed below).

The initiating period ends on day eight. This is the day when the creditors convene to affirm the appointed administrator, or to appoint a replacement administrator. The next 14 days are dedicated to investigating the affairs of the company which will result in the production of the administrator's report. The last five days are intended to provide time for creditors to digest the administrator's report and then to participate in a meeting convened for the purpose of considering the future of the company. That meeting is called the watershed meeting and is appropriately named, given that the outcome of the meeting will be a watershed moment in the life of the company.

An administrator's appointment can be made by the company through its board of directors. A secured creditor having a charge over the whole or substantially the whole of the property of the company may also appoint, as well as a liquidator or interim liquidator. The Court also has power to appoint on the application of a creditor, a liquidator, or the Registrar of Companies.[32]

In most instances, the board of directors will make the appointment given the knowledge they have of the affairs of the company. The appointment is, in a sense, an act conceding that the company requires external assistance. The appointment must be made for a proper purpose and be compliant with the statutorily defined objects of the voluntary administration regime. These are defined as being to provide that the business, property, or affairs of the company are administered in a way that maximises the opportunity for the company, or its business, to continue in existence, or if that is not possible, that administration will result in a better outcome for creditors than immediate liquidation.

On appointment, the administrator must provide notice in writing to all secured creditors holding a general security agreement, and the Registrar of Companies, by the end of the next working day. The appointment is required to be publicly notified and all known creditors given notice in writing within

[30] On the basis that an appointed administrator has control of all the property of the company and the directors are only entitled to speak or act in the name of the company with the consent of the administrator.
[31] There is an ability to extend the convening period by application to the court. It is common to do so and provided the request is reasonable in the circumstances, consent is likely to be given.
[32] The FMA may also petition the Court to appoint an administrator if the company is a financial markets participant.

three working days.

After being appointed, the administrator must investigate the affairs of the company to determine how its insolvent circumstances can be rectified. This is a demanding time for the practitioner. In addition to the operational requirements which must continue to be met, the administrator has the challenge of investigating the company's affairs to determine what has gone wrong and to prepare a recovery plan that will be acceptable and supported by creditors.

This must all be done by day 20 of the administration and must result in a report that will allow the creditors to make an informed decision as to the future of the company. The report provided must address four essential pillars – the company's business, its property, relevant affairs, and its financial circumstances. The clear intention of the Act is for the administrator, under those four heads, to undertake a thorough investigation of the activity of the company so that a recommendation can be provided as to how the situation can be corrected.

The investigating period ends at the end of the convening period, day 20, unless extended by the court. No later than the last day of the convening period, the administrator must convene the watershed meeting, giving five days' notice of that event. Together with the notice, the administrator must provide a copy of the administrators report. The report must provide an opinion about the options available to creditors and provide reasons for that opinion.

The convened watershed meeting brings the decision period to an end. In this meeting, the creditors are required to determine the future of the company by electing one of three options available – appoint a liquidator, agree to execute a deed of company arrangement, or return the company back to the directors. The creditors can defer the decision by agreeing to adjourn the meeting for up to 30 working days. If the meeting ends irresolute, then the administration will come to an end and control will revert to the directors.

An example of when the affairs of the company would revert to the director by way of a resolution is when the board has arranged funding that would satisfy the expectations of all creditors. This is the most likely scenario in which this option would be chosen.

In a manner consistent with the objects of administration (to see whether the business can continue in existence), the outcome that is desired to be achieved is the execution of a deed of company arrangement. This is a deed executed between the company and an appointed deed administrator[33] that binds the company, its creditors, and the deed administrator. The objective of the deed will be to achieve the outcomes submitted by the administrator in the administrator's report and approved by the creditors in the watershed meeting.

The legal mechanism for binding the creditors, who are not direct parties to the deed, is on the ground that the future of the company was in their hands to

[33] That will normally be the administrator.

determine at the watershed meeting. If an election was made to execute a deed in the company's name, creditors are deemed to have consented to its terms.[34]

The third option available to the creditors in the watershed meeting is to appoint a liquidator. The frequency of liquidation following administration is high but that does not necessarily mean that the VA process has failed. The purpose of the VA model is to see whether the company or the business can continue in existence. The administrator may well have concluded upon that question and resolved that it cannot – this is not a failure of VA but rather a failure of management of the company to attend to matters early enough. In this situation, the appropriate option to be considered is liquidation.

Other circumstances may also have prevailed in the administration. The business may well have been sold to a third party and the company is now left with no trading assets. In those circumstances, it is appropriate that the company go into liquidation and creditor claims are dealt with by the liquidator.

1.2 Specific insolvency legislation

On 16 May 2020, a new schedule 13 was introduced into the Companies Act. This new law allows for companies that were facing liquidity problems because of the pandemic, to hibernate debt if it resulted in the ability of the company to continue in existence.

The ability for companies to enter the business debt hibernation scheme came to an end on 31 October 2021. As at the date of this report, the scheme has not been re-introduced and is not likely to be, given that the focus of the Central Government is now to leave the pandemic behind us and deal with the recessionary pressures that exist in the economy.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

This is outlined in section 1.1 above.

1.3.2 Informal framework

There is no informal framework that can be particularised. The human actors involved must perceive a solution to be found and strive to achieve that outcome using the resources available. A good starting point would be to engage a local accountant, lawyer, or registered insolvency practitioner. In this way, the facts of the matter can be considered, and proposals made for addressing the issues.

1.4 Accelerated restructuring or liquidation of MSMEs

There is no law in New Zealand that specifically provides for accelerated restructuring or liquidation.

[34] On the basis that it was exclusively their right to consent to it.

1.5 Discharge of debts for natural persons

If a natural person becomes adjudicated a bankrupt, their included debts will be discharged when the bankruptcy comes to an end. Unless objected to, the bankruptcy will automatically end three years after the filing of the required statement of affairs.[35] The bankrupt will not be released from excluded debts at the time of discharge. Excluded debt will include court fines and reparation, debt that was incurred after the applying for bankruptcy and any student loan.

Secured creditors will be entitled to enforce their rights over property. If the property is to be preserved in the hands of a bankrupt, for say a matrimonial home, then the obligation to the secured creditor will need to be met. Additionally, debts incurred fraudulently will not be discharged, nor will obligations for child support or maintenance.

MSMEs are not distinguished or treated in a special way as regards personal debt.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

There are no legislative measures that distinguish MSMEs from other commercial entities that are larger in size.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

There is no obligation to initiate insolvency or liquidation proceedings in New Zealand law. There are, however, sanctions that the law may impose upon a person that did not respond to their insolvent circumstances in a timely way, or with the appropriate level of responsibility in relation to their creditors.

In response to the pandemic, safe harbour provisions were inserted[36] into the Companies Act to protect honest directors for actions taken to preserve their company's welfare. Prior to the introduction of this provision, directors may not have been protected in those circumstances.

The safe harbour provisions expired on 30 September 2021 but may well be reinstated if the pandemic reasserts itself during 2022. As at the date of this report, these measures have not been reinstated and are not likely to be, given recent case law and the expressed view of many commentators regarding directors' responsibilities and the need for them to protect creditors' interests in the event of insolvency.

2.3 Insolvency procedural deadlines

There has not been any legislation that alters procedural deadlines for the commencement of creditor motivated initiation of insolvency proceedings.

[35] Insolvency Act, s 290(1).
[36] Companies Act, schedule 12.

2.4 Minimum debt requirements to initiate insolvency proceedings

For personal insolvency, the traditional way of confirming the debtor's obligation is by way of summary judgment proceedings. If successful, and the judgment is for an amount greater than NZD $1,000 and continues to remain unsatisfied, the creditor may ask the court to issue a bankruptcy notice and serve it upon the debtor.[37] Non-compliance with the bankruptcy notice is an act of bankruptcy, which will provide the right for the judgment creditor to petition the High Court for adjudication of the judgment debtor.

For creditors entitled to claim in the affairs of a debtor company, the initiating process for insolvency proceedings is typically the serving of a statutory demand.[38] No court judgment is required to issue the demand. The demand must be for an amount greater than NZD $1,000. The debtor has 15 working days to meet the claim or provide security for the claim to the satisfaction of the demanding creditor. If the claim is in dispute, or a counterclaim exists, the debtor may apply to have the demand set aside but must do so within 10 working days,[39] or the opportunity will be lost.

If no legitimate reason exists to rebut the claim and the amount remains due when the demand matures,[40] the non-payment can be used as evidence of the insolvency of the company.[41] Such evidence can form the basis of a petition to the High Court for the obtaining of an order for liquidation.

2.5 Suspending specific creditors' rights

There is no legislation in New Zealand that suspends creditors' rights in response to the COVID-19 pandemic.

2.6 Mediation and debt counselling

There is ample supply of professional providers for mediation and debt-counselling. In addition, there is free advice from many government departments.

There is no expectation that mediation and debt-counselling should be mandatory but there is an advantage in dealing with issues which manifest as quickly as possible. One way of preventing the event of a formal state of insolvency, and minimising the harm that may result, is to engage with a qualified person and address the issues that are causing the economic distress as soon as possible. In the course of such an engagement, solutions may emerge that were not before understood. On the other hand, the absence of engagement, or lack of follow through on any positive conclusions reached, may cause a worsening of the condition for the want of decisive action and incremental exposure to creditors may result.

[37] Insolvency Act, section 13.
[38] Companies Act, section 289.
[39] *Idem*, section 290.
[40] 15 working days from date of service.
[41] Note that the valid period for use of the non-compliance with the demand is only 30 working days from when the demand matures.

3. Challenges Faced

3.1 Stigma associated with insolvency

New Zealand is accepting of the fact of insolvency. Despite that, the creditor immediately impacted is likely to express displeasure towards the debtor that has caused their loss. For the most part though, an insolvent circumstance that has arisen due to commercial misadventure or an exogenous event (like the pandemic) will not cause harsh views or criticism.

Although New Zealand legislation is neither debtor nor creditor friendly, there is a groundswell of interest in pursuing recovery from directors where their conduct shows indifference for the welfare of creditors' interests[42] or where fraudulent activity has taken place.

3.2 Availability of financial information

Privacy laws are strict in New Zealand. There are no general obligations to disclose solvency or otherwise of trading activity. If, however, a natural person becomes a bankrupt, they will be required to furnish to the Assignee a full and comprehensive statement of position.

There will be occasions where the MSME debtor may elect to disclose financial information for contractual reasons – for example, when applying for credit or demonstrating economic substance while seeking to be engaged for contract works.

There is an obligation to disclose the finances of the trading activity to Inland Revenue in a manner that is sufficient to determine the tax obligations of the taxpayer.

3.3 Access to new money

For the insolvent business owner, access to new money will be problematic. Even though a strong business case may be presented, current or new suppliers of credit will be jaundiced by the fact of the insolvent circumstances.

If an insolvency practitioner becomes involved in a formal state of insolvency, then supplier credit is likely to be available through the practitioner. The provider will be entitled to look to the practitioner for settlement of the funding or goods and services provided. The practitioner will have recourse back to the property of the company to meet his or her exposure to the new creditor.

By these means, working capital is introduced into the business activity so that viability within controlled circumstances can be ascertained. If the outlook is demonstrably positive, then investment capital may become available.

3.4 Secured creditors *vis-à-vis* unsecured creditors

Secured creditors will have an absolute right to proceed against property of the

[42] At a time when the director owes a duty to creditors.

debtor in accordance with the enforceable terms of the agreement executed between the parties.

Where a creditor has a security interest that is general in nature, such as an all present and after acquired property security interest, there is a limited carve out of the secured creditor's rights over inventory and accounts receivable in favour of unsecured preferential creditors.[43] This right will be triggered by the event of liquidation and administered by the liquidator.

Any distribution arising from a scheme of arrangement, composition or compromise made between a debtor and related creditors will need to align to the preferential provisions described in schedule 7 of the Companies Act. If not provided for, an aggrieved party may seek to have the arrangements set aside in full or in part.

3.5 Insufficient asset base

Generally speaking, the insolvency industry is comprised of licensed insolvency practitioners that will, initially, contribute some free time to a party suffering from financial difficulties. Beyond that, the insolvency practitioner will need to be paid and will look to make arrangements for meeting costs and fees outside the resources of the failing business if it is apparent that there is no ability to be paid from the business.

This is a reasonable position to take given that the time to seek advice is usually much earlier than when advice is sought. The insolvency practitioner can reasonably take the view they are not obliged to continue providing resources without charge when the debtor had an opportunity to engage someone at a more appropriate time.

Regardless of the early-stage discussions, the ease of them or the need to meet costs and fees external to the enterprise, there is a significant barrier to MSMEs to enter restructuring activity because of the costs involved. The restructuring costs may well be out of all proportion to the asset base of the business, resulting in the costs dwarfing any benefit. The only response to this dilemma is to address the difficulties as soon as possible so that the issues to remedy are not as complicated and lower cost results.

3.6 Personal guarantees (PGs)

In the circumstances of MSME trading activity being conducted through a company, it is common to have a provider of credit facilities bind all directors by way of a contract of guarantee. This will also often include a pledge to be made over tangible property to support the supply made.

Many contracts of guarantee will deem the guarantor to be a co-debtor of the supply made. As a result, an event of default is not required by the company for action to be initiated by the creditor against the guarantor. Regardless of this provision, it is normal for the creditor to wait for a period to see if redemption can

[43] For a full list of unsecured preferential creditors, refer to schedule 7 of the Companies Act. The unsecured preferential creditors that are protected by this provision include employees and Inland Revenue.

be made by the primary debtor, before enforcing rights against the guarantor.

The normal procedure for enforcement against the guarantor would be to negotiate with the party to see if settlement can be achieved. If that fails, then recourse may be had to any pledged tangible asset. The creditor will be entitled to issue summary judgment proceedings against a defaulting guarantor and, if successful, the judgment may be used to support a bankruptcy notice, with non-compliance entitling the creditor to petition for adjudication into bankruptcy.[44] The guarantor will always, prior to any adjudication, be entitled to propose an arrangement or composition, as earlier addressed in section *1.1.1* above.

3.7 Further challenges

There are no significant abnormal challenges confronting MSMEs in the New Zealand business setting.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

The best way to safeguard MSMEs in their business activities is to conduct business in a way that cautiously exploits the business opportunities available to them while at the same time constantly recording the activity being undertaken.

More often than not, there is inadequate record keeping of the commercial activity. Basic accounting principles need to be understood and adhered to. Government agencies take the view that the skill required to deliver the value provided by MSMEs is only a portion of the required activity for the proper functioning of a business. Knowledge necessary to meet compliance expectations is not only essential to meet the requirements of reporting but is also vital to know so that the affairs of the business should be managed properly and profitably.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Formal or informal insolvency proceedings can greatly assist MSMEs that are struggling but it is up to the principal to seek that assistance. There are challenging issues that the MSME must face in times of financial distress that, if ignored, will just grow into an unmanageable condition, and eventually business failure.

Asking for assistance is confronting for the business owner but it really is no different to any other health depreciating condition – if it remains unattended then the consequences will be serious, if not fatal.

4.3 Simplified insolvency proceedings

Insolvency proceedings are frightening for the business owner. Creditors that were friendly when business was good, may well have an entirely different perspective of the debtor when it is not going so well. This is likely to be a new situation for the business owner, and the perception of complexity is made worse with new

[44] On the basis that the Judgment Debtor has committed and act of bankruptcy by not settling Bankruptcy Notice.

language and concepts used that were not known before. Simplification is more likely to occur by the debtor achieving, as rapidly as possible, an understanding of the processes involved so that they are less likely to become a victim of them.

New Zealand has achieved a good balance between ensuring the rights of the disappointed creditor are protected while at the same time giving every opportunity for the debtor to rectify the insolvent circumstances. The law available to achieve this is already relatively simple – the complexity exists in the business circumstances that are being addressed and the level of knowledge available within the parties responsible to rectify the circumstances.

NIGERIA

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

In Nigeria, the Companies and Allied Matters Act 2020 (CAMA) is the regulatory framework on formal insolvency for corporate entities and vehicles. CAMA is new law that came into force on 1 January 2021. On the other hand, the Bankruptcy Act 1979 (BA) deals with individual persons and persons trading under a business name. The BA provides that a receiving order shall not be made against any corporation or against any association or company incorporated under the CAMA. However, depending on the circumstances of the individual trading under a business name, one would have the option of either initiating a bankruptcy proceeding against the individual (particularly where a personal guarantee has been provided) or proceeding under the administrative process in Part E of the CAMA (discussed below).

Nigeria classifies businesses into micro, small and medium (MSMEs and SMEs). Any business enterprise employing less than 10 workers and having an asset base of less than N 5 million is regarded as a micro enterprise. The employment base for small scale enterprises is set between 10 and 49 employees with an asset base of over N 5 million and less than N 50 million. Medium scale enterprises are those that employ between 50 and 199 workers, with an asset base of over N 50 million and less than N 500 million. MSMEs constitute around 80% of Nigerian businesses. They have contributed about 48% of the national GDP in the last five years and account for around 84% of employment. Remarkably, many MSMEs and SMEs are in the informal sector with registered business names, rather than being companies limited by shares. This explains some of the innovations under the CAMA, such as the creation of single shareholding limited companies and limited partnerships (LPs).

Part E of the CAMA provides for the registration of a business name carried on by an individual, firm or corporation and the removal of the name from the register by the Registrar of the Corporate Affairs Commission in certain cases. Importantly, the Registrar may, upon reasonable cause and in the absence of an answer to a notice on whether the individual, firm or corporation has ceased to do business, remove the business name from the register within two months from the date notice for an answer is provided.

Part C of the CAMA provides for the incorporation of limited liability partnership (LLPs) as a separate legal entity from the partners. The liabilities of a LLP must be met out of the property of the LLP and a partner is not personally liable, directly or indirectly, for an obligation of the LLP (contractual or otherwise) solely by reason of being a partner of the LLP, except in the case of fraud. A LLP may be wound up either voluntarily or by the court on various grounds, including if the LLP is unable to pay its debts. There are similar provisions for LPs.

Part B (Chapter 25) of the CAMA also provides for the winding up of unregistered companies if the company is dissolved, has ceased to carry on business (or is carrying on business only for the purpose of winding up its affairs), is unable to pay its debts, or if the court is otherwise of the opinion that it is just and equitable that the company should be wound up. An unregistered company extends to an exempted foreign company, partnership or association (each of which must

ordinarily be registered under the CAMA in order to be allowed to do business in Nigeria).

1.2 Specific insolvency legislation

There is no specific insolvency legislation for MSMEs in Nigeria. However, professional bodies such as the Business Recovery and Insolvency Professionals of Nigeria (BRIPAN, which has contributed substantially towards the reform of the Nigerian insolvency framework) and more recently the Nigerian Bar Association Section on Business Law (NBA-SBL), are engaging with the Corporate Affairs Commission and the Presidential Enabling Business Environment Council (PEBEC) to encourage a MSME-specific insolvency process. These efforts have also been pursued with policy makers such as the World Bank and INSOL International.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

Prior to the adoption of the CAMA, practitioners and commercially-oriented judges had been using the instrumentality of court-ordered alternative dispute resolution (ADR) to promote out of court assistance or workouts (OCWs). A limitation of that process is that it is time bound to a period of 30 days.

CAMA formally introduced new options for rescuing or restructuring financially distressed companies, such as company voluntary arrangement (CVA) and administration. Embedded in these procedures (without prejudice to certain rules such as preferential payments, subject to court sanction or exceptional intervention power) is a tacit acknowledgment of OCWs, including pre-pack administration procedures between the company and its creditors.

There is no formal framework for personal or individual insolvency *per se*, particularly as efforts are still ongoing to repeal the antiquated BA. However, in certain cases relating to non-performing loans sold to the Asset Management Corporation of Nigeria (AMCON), the earlier mentioned statutory powers of the court to direct the parties to ADR, and the AMCON Practice Direction, are tools available to encourage an OCW.

1.3.2 Informal framework

As noted, the introduction of new procedures under the CAMA acknowledges the relevance of OCWs and now potentially is paving the way for debtors to use their initiative to make proposals for a workout – including through the use of a pre-pack. These developments are encouraging greater flexibility and creativity and a more habitual use of tools such as negotiation and mediation in multi stakeholders workouts and a de-escalation of a litigious "race to collect" approach.

1.4 Accelerated restructuring or liquidation of MSMEs

There is no specific mechanism for accelerated restructuring or liquidation of MSMEs in Nigeria. As identified above, the new procedures introduced under the CAMA apply to all companies generally and are not MSME-specific.

1.5 Discharge of debts for natural persons

Although the BA[1] provides for an unconditional order of discharge of the bankrupt upon application (except if the Official Receiver reports to the court any fact, matter or circumstance which would justify the court in refusing an unconditional order of discharge), the reality is that various other provisions of the BA militate against an effective discharge of debts by natural persons. First, an order of discharge does not release the debtor from certain creditors' claims (State or court related debts, sanctions, penalties, bail bond, liability arising from a fraud or fraudulent breach of trust to which the debtor was a party, including where the creditors involved assented to a scheme of arrangement with the debtor). The BA also provides for a plethora of conditions to be met before a court can grant an effective discharge.[2]

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

The Central Bank of Nigeria (CBN) in its circular dated 23 March 2020 stipulated the guidelines for the implementation of a N 50 billion targeted credit facility to support households and MSMEs with verifiable evidence of being adversely affected by the COVID-19 pandemic as well as enterprises with bankable plans. The guidelines also provided at the time for a three month moratorium period being granted for all government funded loans. Some other aspects of these key policy measures included:

- a one year moratorium on all principal repayments;
- an interest rate reduction on intervention facilities from 9% to 5%; and
- the loan limit for SMEs under the scheme was a maximum of N 25 million (and N 3 million for households), with both at an interest rate of 5% per annum (all inclusive) up to 28 February 2021, and thereafter 9% per annum (all inclusive).

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMES

No special insolvency measures or specific insolvency rules have been introduced for the simplification of proceedings for MSMEs during COVID-19 in Nigeria, whether under the corporate or personal insolvency framework.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

No special measures were introduced during the pandemic suspending the requirement to initiate insolvency or liquidation proceedings, other than the general requirements and suspension features available under the new procedures introduced by CAMA 2020 during the pandemic.

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[1] BA, s 103.
[2] *Idem*, ss 28(4), 28(10) and 29.

2.3 Insolvency procedural deadlines

No specific measures were introduced during COVID-19 extending insolvency procedural deadlines. However, some regulators extended timelines for various return actions, which MSMEs were able to benefit from.

For example, the Lagos State Internal Revenue Service (LIRS) extended the deadline for filing annual tax returns for employees and self-employed persons by two months from 31 March 2020. These measures assisted in mitigating the financial impact of the pandemic on MSMEs.

2.4 Minimum debt requirements to initiate insolvency proceedings

During COVID-19, the relevant minimum debt requirement initially remained as provided under the relevant CAMA and Bankruptcy Laws.

However, in August 2020, the threshold was generally increased and became effective by 1 January 2021. Under CAMA, a company may be wound up by the court if the company is unable to pay its debts in a sum exceeding N 200,000, while the BA (which is yet to be reformed) remains at N 2000.

2.5 Suspending specific creditors' rights

No measures were introduced during COVID-19 suspending specific creditors' rights to initiate insolvency proceedings. The relevant general moratorium provisions introduced with the new CAMA law remained in place.

2.6 Mediation and / or debt counselling

Mediation and debt counselling for the rescue, restructuring or rehabilitation of MSMEs was generally absent prior to the CAMA.

However, since the CAMA entered into force in January 2021, in practice many entities have been exploring debt counselling and have sought for experts retained to engage in informal discussions with critical stakeholder creditors to achieve informal arrangements.

Some of the existing ADR provisions in court procedural rules also enjoin out of court dispute resolution. The ADR approach may also be taken advantage of at the onset of cases in court. Generally, the State High Court Civil Procedure Rules provide for a mandatory pre-action protocol confirming the parties have explored amicable settlement of the issues by way of mediation prior to the commencement of the suit. MSMEs are expected to comply with that requirement, and to explore mediation with a view to rescue or restructure the business and avoid litigation. In addition, Multi Door Courthouses attached to the courts are available to further mediate and counsel parties to foster amicable settlement. However, there is no such mandatory requirement at the Federal High Court to initiate any mediation or debt counselling prior to commencement of any formal insolvency proceeding – and it is in the Federal High Court that insolvency procedures are usually commenced.

Nevertheless, the Court still has powers to give directions for ADR inclusive of mediation for a given period before the parties are returned for a formal dispute resolution.

Making mediation and debt counselling mandatory in a pre-insolvency scenario would be meritorious. This would promote business rescue / continuity, time and cost efficiency and ultimately greater value for creditors rather than a liquidation or receivership scenario. This approach should only be avoided where there is clear evidence of fraud and elements of criminality, particularly from the directors or alter egos of the MSME.

The impact of the new provisions in the CAMA, such as CVA and administration, is already changing the landscape of insolvency practice in Nigeria as debtor companies and entrepreneurs – with the support of restructuring practitioners – have found a window of engagement with creditors pre-formal insolvency. We are beginning to witness a paradigm change and a less toxic environment for business rescue and insolvency practice.

Mediation can help MSMEs cut time and costs pertaining to restructuring and formal insolvency. This is critical for MSMEs to thrive as doing business in Nigeria is at times challenging given the paucity of infrastructure, and substandard energy supply.

That said, the absence of any protective moratorium / coercive effect on stakeholder creditors (i.e. buy in by all is required) is a limitation on the use of mediation.

3. Challenges Faced

3.1 Stigma associated with insolvency

There is a strong stigma in Nigeria attached to an individual who is adjudged bankrupt, and bankruptcy extends to disqualification from certain political office. This in part explains a cultural resistance to the cumbersome and rescue unfriendly BA in Nigeria. Having regard to the fact that the identity and personality of the promoter / alter ego of a MSME is closely linked and connected to the business itself, and that personal security usually features for facilities taken by MSMEs, the reputation of the promoter is likely to take hit where it is found out that the business is insolvent.

The publicity associated with formal insolvency procedures (which before 2021 were purely liquidation-oriented), and special insolvency regimes such as receiverships under the AMCON Act, expose promoters, directors, key shareholders and alter egos to public odium and condemnation for alleged mismanagement or fraud. There is also the impact of a debtor's credit standing since the advent of the Credit Reporting Act in 2017 – which may inhibit the ability of the entrepreneur to access new finance from financial institutions. Where a MSME fails and is wound up, the promoter will find it difficult to promote another MSME in the same industry or region, as both investors, financial institutions and customers will not confer the new MSME with much business credibility.

3.2 Availability of financial information

Without prejudice to the implementation of CAMA, a large percentage of MSMEs in Nigeria operate in the informal sector and do not keep or have proper and accurate financial information. The business is also often run outside the formal banking system, thereby making it difficult, if not impossible, to obtain and verify the accurate financial information and standing of MSMEs.

Where the MSME is a trade by a natural person, it is even more difficult to have access to the financial information of the MSME, and there is usually no separation of the individual and the business account. Notwithstanding, personal income tax laws require natural persons to conduct a self-assessment and file a return of income. So, it is possible that the financial information be within the custody of tax authorities, although tax compliance by self-employed persons is extremely low in Nigeria.

Government efforts are ongoing to improve financial literacy among MSMEs, including migration from the informal to the formal sector through public enlightenment and offer of tax incentives. A migrated MSME business is mandated to file returns with tax authorities and the Corporate Affairs Commission (CAC). It is hoped that access to financial information and data on MSMEs in Nigeria will improve and assist in legislative reform.

3.3 Access to new money

Generally, interim or new finance or post-commencement finance (PCF) is not readily available in Nigeria. However, this seems to be a nascent market, particularly with some of the government initiatives through the CBN noted earlier (which appear to have come to stay). There are a few other targeted intervention funds initiatives from the government in certain sectors through development banks. The introduction of the CVA and administration also lend credence to this, particularly as the provisions on administration specifically acknowledge the possibility of PCF. Also, the concept of distressed financing is not alien to the Nigerian corporate industry.

Notwithstanding, PCF for business rescue promotion purposes would not have priority over existing secured claims, except in the context of an arrangement and with the consent of existing secured and preferential creditors.

3.4 Secured creditors *vis-a-vis* unsecured creditors

While there is no special regime for MSME insolvency in Nigeria, the general insolvency regime can be applied to MSMEs.

Generally, secured (proprietary, appropriating or possessory interest) creditors in formal insolvency proceedings enjoy primacy over and above unsecured creditors. For example, secured creditors can do the following:

- take possession of secured assets;
- appoint a receiver / manager over the assets of the MSME where empowered by the agreement or seek the order of the court;

- exercise the right of sale over the secured asset; or
- sue for foreclosure (in the case of a mortgage).

However, the holders of a floating charge are not secured creditors within the strict meaning of that term under the Nigerian legislation. While the claims of secured creditors – particularly in a liquidation – shall rank in priority over all other claims (including insolvency costs and expenses and preferential payments), floating charge holders come after preferential creditors.

Also, the rights of secured creditors to enforce their rights / security cannot be modified via a CVA or administration process except with the concurrence of the secured creditor, or in certain cases the Administration Court.

3.5 Insufficient asset base

As noted, there is no MSME-specific formal insolvency regime in Nigeria. The low asset base of MSMEs would, accordingly, impact on the ability to fund the formal process of insolvency by way of a CVA or administration (which in Nigeria operates in the same manner, with the same costs and time requirements, for all companies) for MSMEs. However, this may also present more opportunities for funding informal processes of insolvency, provided there is clear economic prospect found in the business.

3.6 Personal guarantees (PGs)

As earlier stated, PGs are prevalent in Nigeria, particularly for MSMEs, as they serve as an additional layer of security for high cash and low asset-based businesses.

Therefore, upon the default of a MSME, a counterparty to the loan transaction can have resort against the personal guarantor.

There is no general or coordinated procedure or structure provided in any law or regulation that governs the enforcement of a PG in Nigeria. Rather, PGs are enforced in line with the terms, provisions and conditions stated in the agreement of the parties. The general civil procedures (whether fast tracked or not or brought under summary or undefended procedures as the case may be) for enforcement of contracts are applicable to PG enforcement.

3.7 Further challenges

Financial illiteracy of owners of MSMEs, as well as a sound commercial understanding of business rescue and insolvency, are challenges which are being worked on in Nigeria through legislative reform. Government incentives to keep proper books and financial transparency while running MSME businesses, as well as capacity building (particularly for the judiciary), are works in progress.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

Our recent engagements with regulators, judges and insolvency practitioners at

the BRIPAN Annual Conference held on 23 and 24 September 2021 revealed that deference to and appointment of turnaround advisers and restructuring practitioners – both for internal advice and engagement with creditors – and the use of formal or informal CVA frameworks to achieve a consensual and business rescue approach in the best interest of the business, would be the best way to safeguard the interests of MSMEs. This is because the informal workout culture is not very strong and the minimal role of the court in the context of a CVA (along with the critical role of the insolvency practitioner) has created a favourable impression among MSMEs that a director / company initiated CVA is not really a formal procedure but more of a process done in the shadow of the court.

This was also the opinion of judges, who deferred to turnaround practitioners' expertise, reports and dealings outside the court.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Formal insolvency procedures in Nigeria prior to the CAMA have been unfriendly and unhelpful to MSMEs for the purpose of business continuity, and the pandemic exacerbated these issues. However, the introduction of the CVA (being executed in the shadow of the law by turnaround practitioners without displacing the debtor's management) and administration has had the inverse effect and is leading to a paradigm shift, and greater communications and engagements between the debtor (and their insolvency practitioner) and creditors in an orderly manner.

Practitioners have over the years observed that financial literacy is key among MSMEs, and experts who may be appointed by the debtor owner of the business are key to bridge that gap and create the requisite atmosphere of confidence and credibility between the debtor and creditors for the purpose of business rescue.

However, overall the formal framework remains generic and is not well customised for MSMEs with simplified procedures.

There has virtually been no post-COVID legislation or subordinate legislation specifically or even generally targeted at improving the lot of MSMEs. The promulgation of Insolvency Regulations in April 2022 - to complement the substantive laws on business rescue - are generic in nature as well.

4.3 Simplified insolvency proceedings

There is no simplified insolvency or restructuring procedure for MSMEs distinct from the present mechanism in the Nigerian jurisdiction. Indeed, the newly introduced procedures of CVA and administration do not boast of any subordinate procedural rules to implement them, unlike the liquidation rules. Accordingly, the process is not a simplified process but one currently guided by the discretion or interpretation of the courts to cover the field.

The majority of the insolvency mechanisms available in Nigeria require a certain minimum or maximum level of court involvement and / or approvals which may cause delay and congestion of the court's docket. Ancillary to this is the cost of engaging legal practitioners and insolvency practitioners to push the process.

Considering the above, it is expedient to establish a simplified insolvency framework that is flexible and broad enough to address the insolvency challenges faced by MSMEs. A simplified insolvency framework which provides alternatives to a full formal court proceeding, such as mediation and arbitration, would reduce the number of steps, requirements and documentation, and address the peculiarities of MSMEs during insolvency in Nigeria. This would go a long way in increasing the number, lifespan and viability of MSMEs in Nigeria.

PORTUGAL

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

MSMEs are defined as enterprises that: (i) do not have more than 250 employees; and (ii) have turnover that does not exceed EUR 43 million. In Portugal, 99.9% of the existing businesses are MSMEs.

Insolvency for both corporations and individual persons in Portugal is regulated by the Insolvency and Corporate Recovery Code (Insolvency Code).

Although in force since September 2004, the Insolvency Code has been subject to several changes throughout the years, among which the inclusion of the multi-creditor workout "Processo Especial de Revitalização" (PER) stands out.

In April 2022, the Insolvency Code was subject to a material change as a result of the transposition of the Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt.

Portuguese courts have jurisdiction to open insolvency proceedings and special restructuring proceedings (i.e. PERs) against debtors having their centre of main interests in Portugal.

Save for certain financial institutions, insurance companies, public undertakings and certain state-owned companies, all debtors with their centre of main interests in Portugal may be subject to the proceedings set out in the Insolvency Code.

The Insolvency Code is divided in two main sections:

- ***Special Restructuring Proceeding (PER)***

  For companies and other businesses (but not consumers) still not insolvent but in a difficult economic condition (that is, with serious difficulties to pay and discharge matured debts due to a liquidity shortfall or lack of access to third party financing), the Insolvency Code lays down a multi-creditor workout tool, the PER. This is fully or partially supervised by a court, whereby such companies or businesses may get a stay for the restructuring of their assets and / or liabilities with the objective of rendering their businesses financially and economically viable.

  The PER, which always presupposes the approval by the court of the agreement reached between the debtor and the majority of its creditors, may unfold in two distinct alternative ways:

  - negotiation of an agreement for the recovery of the company after the PER has been commenced in court, in which case the debtor submits a statement to the court expressing its willingness, together with a creditor or creditors representing at least 10% of non-subordinated claims (which in justified cases may be reduced by the judge), to enter into negotiations leading to recovery. Once started, negotiations must be concluded within

two months, extendable only once by one month, subject to a prior written agreement between the appointed provisional judicial administrator and the debtor.

If approved by the majority of the creditors, the agreement will be submitted to the court for ratification, which will confirm by verifying the required majority of approval; and

- approval of an out-of-court recovery agreement, in which case the debtor files an application with the court seeking approval of the agreement with creditors representing the majority required for approval. In this case, as the negotiation has already been concluded extrajudicially, there is no negotiation stage during the pendency of the process.

This is a significantly faster means of having the recovery plan approved as it does not involve the negotiation stage (which will have been previously established). Furthermore, it restricts the number of creditors that participate in the out-of-court negotiation, as it will be sufficient to involve the majority of the creditors (with limitations in what concerns subordinated credits), which promotes a more efficient and quick negotiation.

Both alternatives have aspects in common, namely:

- they are voluntary, with no obligation deriving from the law for a debtor to file a PER;

- they presuppose the issue of a written and signed statement attesting that the debtor meets the necessary conditions, issued no more than 30 days prior to the beginning of the process by a certified accountant or statutory auditor, whenever the auditing of accounts is legally required, certifying that it is not in a situation of current insolvency; and

- when initiated, the court appoints a provisional judicial administrator, whose functions are different from those of the insolvency administrator (appointed within the insolvency proceedings), to the extent that the debtor retains its administration capacity. However, there are some limitations on the exercise of these administration duties and the debtor cannot perform acts of special importance without the prior consent of the provisional judicial administrator.

A PER has a standstill effect and therefore, while it is pending:

- creditors are prevented from filing debt collection proceedings; and

- ongoing collection proceedings, statute of limitation and prescription periods and insolvency proceedings in which the insolvency of the enterprise has not been declared are suspended.

Depending on the terms and conditions of the restructuring agreement approved during a PER, certain tax benefits from corporate tax, stamp tax, property transfer tax and municipality tax set out in the Insolvency Code may also apply to the agreement. For instance, the positive equity variation

resulting from a debt haircut shall not be treated as taxable income at the level of the debtor for CIT purposes and shall be recognised as a deductible tax loss at the level of the creditors.

- ***Insolvency***

  The Insolvency Code foresees only one type of insolvency proceeding, which encompasses a standard preliminary stage aimed at verifying whether or not a debtor is insolvent and, if so, a subsequent stage aimed at the liquidation of the debtor's assets and the pro rata satisfaction of the creditors' claims via the liquidation proceeds or following approval of an insolvency plan.

  Creditors may nevertheless: (i) propose that the liquidation of the insolvency assets, their distribution among the creditors and the liabilities of the debtor thereafter is governed by an insolvency plan; or (ii) approve a restructuring plan containing the terms and conditions of the recovery and continuity of a company or business in lieu of its liquidation.

  The approval of an insolvency plan or a restructuring plan is not an option for individuals that are not owners of a business or are owners of small businesses (liabilities not exceeding EUR 30,000, no more than 20 creditors and no employee claims). These individuals may, however, propose a payment plan (special payment plan process), which immediately suspends the insolvency proceeding, to be approved by all of the creditors.

  Individual persons also have other particular rules that apply to them only, with relevance to the possibility of discharging their debts in order to allow them to have a fresh start.

  Under the terms of the Insolvency Code, debtors are deemed to be insolvent if they are unable to generally pay and discharge their matured debts (cash-flow test).

  Corporate persons are also considered insolvent when their liabilities manifestly exceed their assets, in accordance with the applicable accounting rules (balance sheet test). However, the insolvency shall not be deemed to occur, provided that the assets of the corporate person are higher than its liabilities, in accordance with the following rules:

  - the identified liabilities and assets will be considered, even if not registered in the accounts, at their fair value.

  - if the debtor owns a business, the value of the assets and liabilities shall be assessed considering a scenario of survival or liquidation (depending on what is the most likely), but always excluding the goodwill account; and

  - the liabilities shall not include debts only payable through distributable funds or the remaining assets debts further to the satisfaction of the remaining common, secured and privileged credits creditors.

1.2 Specific insolvency legislation

The Insolvency Code does not include a specific regime for MSMEs, but rather provides for a general regime with particular rules that only apply to individual persons.

However, during the pandemic period, certain interim measures were introduced to benefit MSMEs (discussed in further detail below).

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

- *Regime on the Extrajudicial Restructuring of Businesses (RERE)*

  With exception to individual persons who do not own a business, other individual persons and corporate persons in a difficult economic condition or in the imminence of insolvency may resort to the out of court workout designated by the Regime on the Extrajudicial Restructuring of Businesses (in Portuguese, *Regime Extrajudicial de Recuperação de Empresas*, commonly and hereinafter abbreviated to RERE).

  The purpose of the RERE is to regulate the terms and effects of the negotiations and the agreements entered into between a debtor and one or more creditors. The object of such agreements is the modification of the structure and conditions of the assets and liabilities of a debtor, or any other part of its capital structure.

  Parties may apply the RERE only to the effects of an executed restructuring agreement or also to the effects of the negotiations leading to the execution of that restructuring agreement. For RERE eligibility, the participating creditors must at least hold 15% of the total unsubordinated liabilities of the debtor.

  If the parties wish to subject the negotiation stage to the RERE, they may prepare and deposit with the commercial registry a negotiation protocol. Upon deposit of the negotiation protocol:

  - unless previously authorised by the creditors, any relevant management decisions (such as the sale of a substantial part of its assets) are subject to the prior consent of the creditors or, if any, the creditors' committee;

  - creditors cannot reject any commitments assumed in the negotiation protocol during the agreed negotiation period, unless there is a serious breach of the debtor's obligations thereunder;

  - any insolvency proceedings filed by a participating creditor or party to the negotiation protocol are immediately suspended, if insolvency has not yet been declared;

  - unless otherwise provided in the negotiation protocol, any proceedings aimed at forcing performance of payment obligations initiated by participating or acceding creditors shall be closed (in case of enforcement proceedings) or suspended (in case of any other proceedings); and

- essential service providers (i.e. water, electricity, natural gas and electronic communications, among others) cannot terminate or suspend the delivery of such services;

- if the parties successfully close the negotiation stage and execute a restructuring agreement or if they simply subject it to the RERE, such agreement must also be deposited at the registry office, upon which:

  (i) the restructuring agreement is fully effective between the debtor and (only) each creditor party thereto as of the date of the deposit (no retrospective effect being permitted) and shall be characterised as an enforceable instrument, while a restructuring agreement subject to a RERE shall not be effective against creditors that are not party thereto; and

  (ii) any declaratory, enforcement or injunction proceedings in respect of claims comprised in such restructuring agreement shall be immediately closed, the same occurring in relation to insolvency proceedings filed against the debtor by a creditor party to such agreement, if no insolvency has been declared yet.

  There is a principle of confidentiality applicable to the negotiations and to the resulting restructuring agreement, which is viewed as a great advantage of the RERE as compared with the PER. Moreover, there is no need to involve a court, which also brings benefits in terms of timing.

▪ *Regime on the Conversion of Debts into Capital (RCCC)*

The RCCC is applicable to the conversion of debts into capital occurring in commercial companies with head offices in Portugal whose turnover is equal to or higher than EUR 1 million.

However, the RCCC cannot apply to the indebtedness of insurance companies, credit institutions, financial companies, investment companies, public listed companies or claims held by public entities (except public sector companies).

For the application of the RCCC, the following conditions must be satisfied:

- the net assets of the company must be lower than its equity; and

- there must be a delay over 90 days in the payment of unsubordinated claims over the company whose value exceeds 10% of the total amount of unsubordinated claims, or, in the case of payments to reimburse partially capital or interest, provided that these relate to non-subordinated claims of more than 25% of total non-subordinated claims.

The proposal for the conversion of debt into capital must be signed by creditors whose claims represent at least two thirds of the company's total liabilities and the majority of the unsubordinated claims.

Once the proposal is received, a general meeting of the company must be convened within 60 days to approve or reject the resolutions required to

implement the proposal. Within that period, the relevant company may negotiate and agree with the creditors any modifications to the original proposal, which must be communicated to the shareholders within the time limits provided for by law.

The shareholders of the company always hold a pre-emption right in respect of any share capital increase, which shall be paid in cash, such cash then being applied in the discharge of the debts of the company. If not all the shareholders exercise their pre-emption right, it may be exercised by the remaining shareholders on a pro rata basis.

In the event that (i) the creditors' proposal is rejected; (ii) the meeting is not held; or (iii) for any reason, the resolutions taken therein are not implemented within 90 days of their approval, creditors may then apply for a judicial ruling in lieu of the required resolutions. Once the application is received, the court shall appoint an interim judicial administrator and shall notify the other creditors of the existence of the proposal and shall publish the list of claims.

After the determination of the final list of claims, the court will review the proposal and approve it if all the conditions provided by law are met. The ruling issued by the court constitutes a sufficient instrument for the share capital reduction, the share capital increase, the modification of the company's bylaws, the conversion of the company and the exclusion of shareholders and required registrations.

No later than 30 days of the final ruling, shareholders may still acquire or cause the acquisition by third parties of any shares resulting from the changes approved by the court, at their nominal value, provided that they also acquire or pay the total outstanding amount of the remaining claims of the proposing creditors against the company.

If the company is declared insolvent:

- any debt conversion proposal or any resolutions taken by the company shall be of no effect; and

- if an application has already been filed for a ruling in lieu of the required resolutions, the proceedings are closed.

If any share capital modifications have already been registered and the insolvency has not yet been declared in pending insolvency proceedings, the modifications must be immediately communicated to the court and pending court proceedings shall be closed.

1.3.2 Informal framework

Portugal formally adopted in 2011 a set of principles closely inspired by INSOL's Statement of Principles for a Global Approach to Multi-Creditor Workouts for application to all court or out of court workouts and / or restructuring proceedings (Restructuring Principles). Creditors and debtors are required to comply with the Restructuring Principles in connection with formal workout proceedings, such the

PER and the RERE but, aside from those proceedings, adhesion to the Restructuring Principles is voluntary.

However, the Restructuring Principles have been approved for general application and therefore are capable of applying to both MSMEs and non-MSMEs. Generally, the Restructuring Principles and the formal restructuring proceedings are not specifically designed for MSMEs.

That said, the Portuguese banking system is usually accessible to companies undergoing out of court restructuring, usually by way of an extension of the maturity of existing loans and other forms of financing and a payment plan. However, for tax reasons, a restructuring involving a write-down of the debt is normally conducted in formal restructuring proceedings, because otherwise a haircut may not be recognised as a loss for tax purposes at the creditor level and may be taxable as a capital gain at the debtor level.

We have also seen in certain instances the conversion of existing debt in hybrid (convertible debt) or equity instruments. However, these types of restructuring options are only available to large debtors and not to MSMEs.

1.4 Accelerated restructuring or liquidation of MSMEs

The PER, described above as a judicial multi-creditor workout tool, is an urgent proceeding, which means that it should be prioritised in relation to other non-urgent proceedings and completed in a short timeframe.

In the scenario where the restructuring agreement is negotiated after the proceeding is filed, those negotiations should not take longer than three months, which means that the proceeding is usually concluded five months after being filed in court. If the agreement is already approved when the PER is filed in court, the duration is normally no longer than three months.

PER is quite an efficient tool which has indeed helped MSMEs in Portugal, in particular those that actually have access to investors and new money and where the recovery relies on a solid restructuring plan (usually encompassing structured financial and corporate restructurings).

As for insolvency, although it is also an urgent proceeding, the complexity that it can assume is not always compatible with the possibility of avoiding liquidation. Usually the debtor and / or the creditors take a while before managing to file an insolvency plan aimed at recovery, which still may be subject to amendments and finally to its approval by the majority of creditors and by the court.

In any case, whenever the insolvent assets are presumably insufficient to pay for the judicial costs (i.e. are under EUR 5,000) and the presumable debts of the insolvency estate (e.g. remuneration of the insolvency administrator), the insolvency proceeding is closed. In this case, corporate persons will be liquidated in accordance with the regular administrative proceeding aimed at the liquidation of companies.

1.5 Discharge of debts for natural persons

One of the specific provisions that only applies to natural persons under the insolvency regime is the possibility of having an effective discharge of debts. For that purpose, the natural person must request thr discharge, which will only occur three years after the insolvency proceeding is closed (fresh start).

The discharge of debts is not granted by the court if:

- the application is not filed on time by the insolvent;
- the insolvent, with intent or gross negligence, within the three years prior to the commencement of the insolvency proceedings, provided wrongful or incomplete information about his / her financial circumstances aimed at obtaining credit or subsidies from public institutions or in order to avoid payments to such institutions;
- the insolvent already benefited from the discharge of debts within the 10 years prior to the date of the commencement of the insolvency proceedings;
- the insolvent has failed to comply with the duty to file for insolvency or, not being under an obligation to do so, has failed to do so within six months following the onset of the insolvency, with prejudice, in either case, to the creditors, and knowing, or being unable to ignore without serious fault, that there is no serious prospect of improvement of the economic situation;
- there is already evidence in the proceedings, or is provided until the time of the decision by the creditors or the insolvency administrator, which indicates with all probability the existence of guilt on the part of the insolvent in creating or worsening the insolvency situation;
- the insolvent has been convicted by a final decision of any of the insolvency related crimes provided and punished under the Portuguese Criminal Code in the 10 years prior to the date of filing the application for declaration of insolvency or after that date; or
- the debtor, with intent or gross negligence, has violated the duties of information, presentation and collaboration arising from the Insolvency Code during the insolvency proceeding.

During the three year period before the discharge of debt, the insolvent must deposit in favour of an Insolvency Administrator the available income – with exception to the amount necessary:

- to secure a minimum dignified support for the debtor and his / her family, which shall not be over three times the minimum wage;
- to perform his / her professional activity; and
- to pay other specific expenditure determined by the court – so that it can be distributed to the creditors during that period.

This discharge of debts is commonly requested by the insolvent individual and, as a general rule, granted by the courts.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

During COVID-19, the Portuguese Government approved a statutory moratorium in the payment of principal and interest under existing credit agreements, a measure applicable to individuals and companies and businesses. It is generally accepted that the moratorium has contributed to the survival of companies that would otherwise be unable to overcome the pandemic. However, an assessment is still to be made on whether a proper screening of viable businesses has been made prior to the application of the statutory moratorium.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

The Portuguese legislator implemented specific restructuring and insolvency measures aimed at supporting insolvent or struggling corporate and individuals in general, some of which lifted on 31 December 2021.

Besides the suspension of the duty to initiate insolvency (discussed below), the following measures were implemented with the intention of mitigating the impact of the pandemic:

- ***Special Business Recovery Process (PEVE) – the new restructuring multi-creditor workout tool***

  The Special Business Recovery Process (in Portuguese, Processo Extraordinário de Recuperação de Empresas, or PEVE), is a new multi-creditor workout tool that was implemented due to the pandemic.

  The PEVE is a judicial process available to businesses that are proven to be in a difficult economic situation or in a situation of imminent or current insolvency due to the pandemic, but which are susceptible to recovery.

  Micro and small businesses may resort to the PEVE even if on 31 December 2019 their assets did not exceed their liabilities provided that:

  - there are no pending insolvency proceedings, PERs or a special payment plan process at the date of submission of the court application for a PEVE;

  - the business received rescue aid under the temporary State aid measures to support the economy during COVID-19 and it has not been reimbursed in accordance with the law; or

  - it is covered by a restructuring plan under the State aid measures.

  The purpose of the PEVE is to allow the debtor, even if already in a current insolvency situation, to enter into a restructuring plan approved by the majority of its non-subordinated creditors, aimed at recovery. This agreement approved

by the required majority and subsequently ratified by the court is binding on all creditors, even those that voted against the restructuring plan.

While the process is underway, the debtor is prevented from performing acts of particular importance without the prior authorisation of a provisional judicial administrator.

This process has a standstill effect. Therefore, during a PEVE:

- creditors are prevented from filing debt collection proceedings; and

- pending collection proceedings, statute of limitation and prescription periods and insolvency proceedings in which the insolvency of the enterprise has not been declared are suspended.

The PEVE has been available since 28 November 2020 and will remain in force until 30 July 2023.

- ***Failure to comply with the approved insolvency plan due to an event occurring after 7 April 2020***

The law foresees that any creditor that has not been paid in accordance with the approved insolvency plan or recovery plan approved under a PER may demand from the debtor the payment of the amounts that are due, plus default interest granting the debtor a period of 15 days to do so. If the debtor fails to make the payment within the given 15 days, the moratorium or write-down provided in the insolvency plan / recovery plan becomes ineffective.

However, pursuant to Law No. 75/2020 of 27 November 2020, the 15 day period was suspended until 31 December 2021, provided that non-compliance resulted from an event, whether or not related to the pandemic, occurring after 7 April 2020.

This suspension therefore prevented corporate or individual persons that were unable to comply with the insolvency plan / restructuring plan from seeing the credits that have been waived being revived and / or having to pay, immediately, the full amount of the credits due which possibly would be incompatible with a recovery.

- ***Mandatory partial payments in relation to insolvency proceedings***

Pursuant to Law No. 75/2020 of 27 November 2020, in all the insolvency proceedings that were pending on 28 November 2020, it became mandatory to distribute to creditors a part of the amount deposited in favour of the insolvency estate, provided the amount was over EUR 10,000.

This measure was particularly important considering that many creditors are also MSMEs, usually ranked as common creditors. Before this measure, unsecured creditors had to wait for the liquidation of the entire insolvency assets before receiving any amount, which may take several years to occur. Thus, this partial distribution of the proceeds of the sale of the insolvency

assets allowed an earlier reimbursement of unsecured creditors, namely MSMEs.

The importance of this measure led to its introduction in the Insolvency Code with effect since 11 April 2022 and therefore partial payments in insolvency proceedings are now mandatory.

- ***Extension of time for negotiations under a PER***

  Law No. 75/2020 of 27 November 2020 also established the possibility of obtaining an extraordinary one-month extension of the deadline to conclude the negotiations for the approval of the recovery plan.

  This measure aimed precisely at countering the difficulties, in the context of the pandemic, of communication between the various interlocutors in the negotiation process and understanding the real effects of a possible reduction of the debtor's activity, essential to define the necessary steps for restructuring.

  This extension also applied to the special payment process accessible to individuals, as described above.

  This temporary measure was revoked on 31 December 2021.

- ***Incentive of financing by shareholders and other persons especially related to the corporate person in relation to PER proceedings***

  Law No. 75/2020 of 27 November 2020 determined that shareholders and any other persons especially related to the corporate person that, between 28 November 2020 and 31 December 2021, financed the company's activity would, in case of insolvency, be ranked as a preferred creditor in relation to the debtor's movable assets.

  This is a deviation from the general rule, which was at that time in force, that provided shareholders and other persons especially related to the corporate person would be ranked as subordinated, thus serving as an important incentive for these persons to directly invest in the company without the need to resort to external funding, which is not always easy to obtain for corporate persons in financial difficulties.

  This temporary measure was introduced with permanent effect in the Insolvency Code as of 11 April 2022 and currently shareholders and any other persons especially related to the corporate person that financed the company's activity during the PER benefit from the preferred ranking in relation to the debtor's movable assets (ranking before employees).

- ***RERE proceedings***

  As regards the RERE, the Portuguese legislator provided that corporate persons that were actually in an insolvency situation – and not only those in a difficult economic situation or in a situation of imminent insolvency – but which were still susceptible to recovery, could also resort to this restructuring workout tool.

However, only corporate persons that were in an insolvency situation due to COVID-19 could benefit from this measure. Thus, it was necessary to demonstrate, in accordance with the applicable accounting standards, that the corporate person, on 31 December 2019, had assets in excess of liabilities.

This temporary measure was revoked on 31 December 2021.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

Under the insolvency law, a person is obliged to apply for their own insolvency within 30 days of the date of knowledge of the insolvency situation in accordance with the tests referred to in section 1.1 above.

Indeed, the breach of the duty to file for insolvency may even lead to the insolvency being declared by the court as being culpable, which may entail serious consequences for the corporate person's directors, and may also constitute the commission of a crime of negligent insolvency.

However, Law 4-A/2020 of 6 April 2020 provided for the suspension of the debtor's duty to file for insolvency of the debtor with retroactive effects as of 9 March 2020, regardless of whether the situation of insolvency was motivated by the pandemic.

In any case, the suspension of the duty to file for insolvency does not prevent any corporate or individual person from doing so, nor does it prevent any creditor or whoever is legally liable for the debts from requesting it.

The aforementioned law does not provide a deadline for this exceptional measure to be lifted, which means that the duty to file for insolvency still remains suspended. However, when the suspension is lifted, the duty to file for insolvency will again require a filing within 30 days of acquiring knowledge of the insolvency situation, which may be insufficient to initiate and implement the necessary restructuring measures with a view to recovery. Therefore, it is important that those affected by the pandemic adopt recovery measures in a timely manner in order to avoid insolvency.

This suspension of the duty to file for insolvency should therefore be interpreted as an opportunity to act in order to implement the necessary measures for recovery, avoiding subjecting the corporate or individual person in distress to insolvency proceedings and the upheavals, limitations and risks that this entails.

2.3 Insolvency procedural deadlines

Although not introduced for MSMEs in particular, besides the suspension of the debtor's duty to initiate insolvency (a measure that remains to be lifted), the legislator extended for an additional period of 15 days the deadline to file the insolvency plan proposal in order to grant additional time to adjust it to the pandemic context. This latest measure was targeted at assisting the insolvency plan proposed within the insolvency proceeding in view of the recovery, and not for the insolvency plan aimed at the liquidation of the insolvent.

The 15 day extension measure aimed at adjusting an insolvency plan to the pandemic context. However, it had a very limited beneficial effect, not only because it was only introduced by the end of 2020, but also since it remained hard to accurately predict the actual effects of the pandemic and how they would be an obstacle to the recovery of an insolvent person.

2.4 Minimum debt requirements to initiate insolvency proceedings

The requirements to initiate an insolvency proceeding remained unchanged and in fact, although the duty of the debtor to initiate insolvency was and still is suspended, any creditor could during COVID-19 initiate insolvency procedures against a certain debtor provided the insolvency requirements (failure of the cash-flow and / or balance sheet test) were met.

The courts are sensitive to the COVID-19 temporary effects argument if an insolvent person is able to present evidence of the casual link between the pandemic and the insolvency. The courts are also sensitive of the recovery should the restriction measures imposed due to the pandemic be lifted.

2.5 Suspending specific creditors' rights

Although the debtor's duty to file for insolvency was suspended, any creditor was and is still allowed to initiate insolvency procedures during COVID-19 against any of her / his / its debtor based on the failure of the latter to pass the cash-flow and / or the balance sheet tests.

In fact, creditors' rights were only affected until 31 December 2021 in the terms mentioned in section 2.1 above.

2.6 Mediation and / or debt counselling

Mediation and debt counselling are available in Portugal for corporate persons that under the Insolvency Code are in a difficult economic situation or are insolvent, in order to give the necessary advice in negotiations with creditors with a view to reaching a restructuring agreement aimed at recovery.

Although mediation is not referred to in the Insolvency Code, the RERE regime (the out of court workout tool described above) specifically foresees the possibility of the debtor appointing a mediator to provide the necessary support and advice during the negotiation stage.

Mediation, debt counselling and financial education is not mandatory for any type of rescue, restructuring or rehabilitation.

An experienced, reputable and independent mediator may theoretically have an essential role in the designing a workout solution that aligns the interests of a debtor and its creditors, mainly in instances where the debtor is a MSME or has no experience in financial matters. We have nevertheless seen that role in pre-insolvency scenarios being performed by corporate advisors engaged by debtors or increasingly by servicing providers engaged by lenders. A cost sensitive debtor may also hesitate if it has to bear the mediation costs.

In out of court proceedings, we see potential in the appointment of a mediator in the reduction of cots and the length of a restructuring proceedings insofar as the mediator has the expertise, the drive and the knowledge required to strike the best solutions. However, as referred to above, the appointment of a mediator is not mandatory in form.

3. Challenges Faced

3.1 Stigma associated with insolvency

Form a cultural perspective, the insolvency of an entrepreneur or promotor is generally viewed as a sign of personal inability to pursue a business or professional activity. The insolvency is registered in the personal public records of a person (public civil registry) for at least five years and it may determine a prohibition to carry a professional or commercial activity or the ineligibility for certain functions in the administration or supervision of legal entities. The insolvency of an individual may also be relevant in the assessment of the suitability as prospective directors and senior officers of regulated entities (mainly in the financial sector) carried out by supervisory authorities.

3.2 Availability of financial information

Although it is possible to have access to information on whether a natural person is party to a recovery, insolvency or enforcement proceeding, other types of information – namely in relation to the existing assets – may be difficult to obtain.

If the creditor has an enforceable instrument (a document which foresees and confirms the existence of a credit) against the debtor (e.g. a judgment, a certified document by a competent authority or a negotiable instrument), it is possible to initiate a Pre-Enforcement Out-of-Court proceeding (in Portuguese Procedimento Extrajudicial Pré-executivo, or PEPEX). Within PEPEX, and subject to the payment of EUR 51, an enforcement agent is appointed to research on the available public data of a certain debtor to verify if there are any assets (properties, vehicles, shares, bank accounts and any income / salary).

The goal of this procedure is not to attach any assets but only to verify if it is worth starting an enforcement proceeding. This can also be helpful for insolvency as it is a way of anticipating the outcome of such proceeding: recovery or liquidation. Either way, since PEPEX may be used only by creditors that have an enforcement title and the debtor is notified whenever such proceeding is initiated, the instrument is not used very often. The instrument may not always be an advantage for creditors if they do not want the debtor to have advance knowledge of potential actions which may in turn lead to the dissipation of any assets.

It is therefore common that creditors resort to specialised asset tracing companies that usually have the means to obtain more information, namely by researching public information.

Due to data protection measures, it is difficult to put in place other measures allowing creditors to have access to financial information of a natural person. The creditors, in particular financial institutions, should therefore – as is common –

obtain as much information as possible on the financial information, including about the existing assets, when financing a natural person.

3.3 Access to new money

There is no new money with a preferred status post filing or post commencing of an insolvency proceeding. The protection to new money is only afforded in a PER or a PEVE by way of a general statutory preference to other unsecured liabilities of a debtor, such that new money will not rank senior to exiting secured creditors. Security interests provided as security to the obligations in respect of new money are also protected from "hardening period" rules.

3.4 Secured creditors *vis-a-vis* unsecured creditors

Secured creditors, which rank above common creditors but may rank below specific preferred creditors include, for example, creditors holding mortgages, pledges, rights of retention over assets and general or specific statutory liens over movable property or real estate.

Secured creditors may propose to the insolvency administrator the acquisition of the secured asset for the amount of its projected sale price or fixed sale price. Plus, secured creditors are mandatorily consulted by the insolvency administrator regarding the secured asset's sale method that should be chosen and are also informed about the projected sale price of the asset to a certain entity or about what its fixed sale price should be.

In addition, after the secured asset is sold, secured creditors are immediately paid (after deduction of the estimated insolvency estate expenses and in accordance with their ranking), whereas other creditors usually have to wait before the entire insolvency estate is liquidated in order to receive any amount.

3.5 Insufficient asset base

A formal insolvency proceeding makes third party new financing less likely. A low asset base makes also financing more difficult. In any case, whether a low asset based companies are liquidated or restructured may depend on other factors other than its assets, mainly if the business of a MSME requires certain types of assets or the feasibility of a prospective business plan proposed by, or to, the investors.

3.6 Personal guarantees (PGs)

PGs are quite prevalent in MSMEs where there is a corporate structure and are usually required by financial institutions when entering in financing agreements. Promissory notes signed by a MSME and guaranteed by shareholders (usually the Ultimate Beneficial Owners (UBOs) or mortgages granted by a third party (also usually shareholders / UBOs) are still the most common PGs.

PGs are – unless otherwise agreed with creditors – not affected by any haircut or moratorium foreseen under the insolvency plan aimed at the recovery of a debtor.

As PGs are usually enforcement titles, under Portuguese law, creditors may file enforcement proceedings against the guarantor, in each case upon occurrence of a failure to pay or any other event of default. Save for certain exceptions, and unless otherwise agreed with one or more creditors, all the assets of a guarantor may be enforced to discharge the debtor's liabilities. Enforcement proceeds deriving from the enforcement of the guarantor's assets are rateably distributable among creditors, unless there are any lawful causes of preference among the creditors (assets separation, subordination or secured claims).

There is no required protocol or structure, and enforcement is generally carried out depending on the specific circumstances of the MSME involved.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

Insolvency should clearly be avoided if the intention to the create the condition for the restructuring of MSMEs. Although some improvements have been made, there is still some room to improve efficiency and ensure that experienced and reputable insolvency professionals are designated to handle matters more efficiently.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Insolvency proceedings are still regarded as a process that negatively impacts the reputation of MSMEs (and other companies, for that matter) and their directors. Hence, for viable MSMEs in financial stress, it is more beneficial to seek a restructuring out of an insolvency proceeding.

The suspension of the duty to file for insolvency and statutory moratorium have certainly benefitted MSMEs as, according to the latest available statistics, insolvency proceedings have not increased substantially as it would be expected due to the financial distress caused by COVID-19.

This allowed many corporate and individual persons to recover a certain economic stability while avoiding going through an insolvency proceeding.

Some of the temporary measures introduced by COVID-19 legislation were included in the Insolvency Code, thus revealing their importance. In particular, the incentive for shareholders and other related persons to finance the company in distress during a PER and the obligation to proceed to a partial reimbursement of creditors (including, therefore, unsecured creditors) within the insolvency proceeding even when the liquidation of the insolvency assets is not concluded are important measures that will continue.

However, the suspension of the duty to file for insolvency is a measure that should be lifted as the effects from COVID-19 have become clearer and debtors are already capable of measuring the odds of recovering.

4.3 Simplified insolvency proceedings

Although the restructuring workout tools foreseen under Portuguese law are already quite straightforward and allow a simple restructuring, there is still some

work to be done in relation to the duration of the insolvency proceeding.

As mentioned in section 1.4 above, the Portuguese Insolvency Code already foresees a simplified liquidation mechanism whenever the insolvency estate is presumably insufficient to pay for the judicial costs associated to the proceeding.

However, whenever this is not the case, an insolvency proceeding still takes a while before being concluded which may be detrimental to many creditors.

With the transposition of the EU Directive, which is quite recent, it is expected that the PER and also insolvency proceedings will move faster and allow a swifter liquidation and discharge of the insolvent persons.

ROMANIA

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

In Romania, there are specific insolvency regulations for both professional debtors (traders) and individuals (consumers). The Insolvency Act No 85/2014 on pre-insolvency and insolvency proceedings regulates pre-insolvency, reorganisation and bankruptcy proceedings in relation to professionals (traders). Quite recently, a new law came into force, Law No 216/2022,[1] which transposes the EU Directive 2019/1023 on preventive restructuring frameworks, the discharge of debts and disqualifications and measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debts (EU Directive on Restructuring and Insolvency), which amended and supplemented the Insolvency Act No 85/2014.

The Consumer Insolvency Act No 151/2015 regulates procedures for the recovery of the financial situation of consumers, in good faith, covering to the greatest extent possible a consumer's liabilities and discharging his or her debts.

Until the transposition of the EU Directive on Restructuring and Insolvency, the legal framework of pre-insolvency for professionals did not include special provisions for MSMEs. In practice, such entities ended up in bankruptcy in most cases, typically due to: (i) lack of a negotiating culture to make timely use of insolvency prevention means; (ii) somewhat burdening mechanisms proposed by the pre-insolvency proceedings (the ad-hoc mandate and the preventive concordat); (iii) late recourse even to the formal procedure of a judicial reorganisation, the only one that could restore the business; and (iv) lack of resources needed to achieve a successful reorganisation.

Law No 216/2022 proposes new solutions in terms of the mechanisms likely to offer support during the restructuring of those debtors whose net turnover or, as appropriate, gross income does not exceed the Lei equivalent of EUR 500,000 the year before the reference date. The new Law is generally intended to offer an efficient instrument to support and safeguard MSMEs facing financial difficulties.

This Law repealed the pre-insolvency proceeding titled "ad-hoc mandate", which was considered basically impracticable, and it introduced, instead, the "restructuring agreement" proceedings, which may be considered a "pre-pack" proceeding, in which the court of law's interference is minimal and is confined to confirming the agreement.

In addition, the new Law proposes a much improved version of the preventive concordat proceeding, which includes some of the advantages proposed by the former regulation on insolvency (such as the limited stay of enforcement, the continuation of ongoing contracts, the possibility to have "cram-down" in terms of the concordat plan, the protection and stimulation of new and interim financing and the protection of employees).

Before the transposition of the EU Directive on Restructuring and Insolvency, for companies or sole traders, the most similar proceedings to schemes of

[1] Official Gazette of Romania, Part I, No 709 of 14 July 2022.

arrangement were *procedura concordatului preventiv*, which were pre-insolvency judicial proceedings seeking the repayment of creditors' claims against a solvent debtor's estate. To this end, the debtor sought a judicial order to have the proceedings opened and to have an *administrator concordatar* appointed by the syndic judge. The *administrator concordatar* drew a repayment plan (*oferta de concordat preventiv*) and convened the creditors' meeting to have the repayment plan voted on. If at least 75% of the claims were favorable to the repayment plan, the *administrator concordatar* submited the *concordat preventiv* to the syndic judge for homologation. The *concordat preventiv* could haircut the claims. If homologated, the creditors and the debtor were bound by the *concordat preventiv*.

The most similar proceeding to an individual voluntary arrangement was the *mandatul ad-hoc*, regulated by the Romanian Insolvency Act No 85/2014. The *mandat ad-hoc* proceedings were confidential, and were initiated by the debtor, who lodged a petition with the president of the tribunal, requesting the appointment of his / her / its proposed insolvency practitioner as a *mandatar ad-hoc*. Once appointed, the *mandatar ad-hoc* negotiated an amicable agreement with all or some of the creditors, to be concluded no later than 30 days after his / her / its appointment. The agreement could include debt restructuring, debt reduction, termination of ongoing contracts and employees' dismissals. The *mandatar ad-hoc* negotiated its fee with the debtor and the fee was sanctioned by the court.

In relation to formal restructuring proceedings, Law No 85/2014 provides for a judicial reorganisation procedure, considered to be a procedure in which an attempt is made to remedy an already existing state of insolvency, through a reorganisation plan approved by creditors and confirmed by the syndic judge.

In the end, the provisions of Law No 216/2022 provide that the pre-insolvency and insolvency proceedings initiated before the date when it became effective shall continue.

With regard to the insolvency of natural persons, Law No 151/2015 provides: (i) an administrative procedure based on a debt repayment plan; (ii) a judicial insolvency procedure by liquidation of assets; and (iii) a simplified insolvency procedure for the natural person debtor who has no assets or income or the total amount of its obligations is not higher than the equivalent of 10 minimum wages per economy (currently, at the time of writing this study, the minimum wage per economy is in the amount of 2,300 Ron, the equivalent of EUR 464 Euro at the rate of 1 EUR = 4.95 Ron).

In relation to the administrative procedure based on a debt repayment plan, natural person debtors have to submit extensive documentation, which is examined by an insolvency commission, an administrative body set up at territorial level. This insolvency commission appoints an administrator of the procedure from among the insolvency practitioners, bailiffs, lawyers and notaries registered on a list drawn up for this purpose, the appointment of the practitioner being random. The administrator of the procedure acts under the control of the insolvency commission. The proposed debt repayment plan must contain, according to the law, at least the amounts the debtor considers will be able to be paid to creditors. The share of debt coverage must be, cumulatively: (i) higher than the coverage

rate that could be obtained by creditors in insolvency proceedings through the liquidation of assets; and (ii) greater than the value of the debtor's traceable assets, represented as a percentage of the total value of the debtor's traceable assets and income. If the decisions of the insolvency commission are challenged, they are to be resolved by the competent court. In practice, the implementation of this law has not been successful. According to statistics, it was concluded that at the end of five years after the entry into force of the law, only 62 people had resorted to these procedures.

However, it has been recently reported that the number of personal insolvency files opened until May 2022 was equal to the number of similar files opened during all of 2021.

Order No 450/2022 on some actions intended to inform consumers about the insolvency of natural persons came into force on 17 July 2022 and shall become binding and effective as of 17 September 2022. This Order is intended to raise awareness among consumers about the solutions and actions they are offered in terms of the insolvency of natural persons and for such purposes the providers of financial banking and non-banking services as well as pawn shops are under the obligation to provide the authorities with basic information about them.

In addition, the new Law No 216/2022 provides for a treatment likely to allow natural persons undergoing insolvency as well, who accrued both personal and professional debts, to revert to the insolvency mechanisms laid down in Law No 85/2014, so as to obtain a discharge of debts.

Romania has around 500,000 MSMEs, about 99% of all firms in the economy, which contribute about 60% of gross domestic product and employ 60% of the workforce.[2] The profile of the Romanian entrepreneur is represented by people with economic and social technical expertise, with an average entrepreneurial experience of about 10 years, and operating as a single partner while involving family members in running the business. About seven out of 10 entrepreneurs are owners of businesses.[3]

1.2 Specific insolvency legislation

There is no specific insolvency legislation for MSMEs.

General provisions in Law No 346/2004 define and regulate the measures for stimulating and developing MSMEs (in particular, by simplifying the administrative procedures and preventing the unreasonable increase in the costs of compliance thereof with the regulations in force), in accordance with the Recommendation of the European Commission of 6 May 2003, establishing the same conditions regarding staff and turnover.

[2] Emergency Ordinance No110/2017 on the Support Programme for small and medium-sized enterprises and small enterprises with medium market capitalisation - IMM INVEST ROMÂNIA, amended and supplemented by Emergency Ordinance No 67 of 29 June 2021

[3] White Charter for SMEs in Romania 2020, Edition No 18, CNIPMMR, 26.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

Before the date when Law No 216/2022 came into force, in Romania there was no formal framework for out of court assistance or workouts (OCWs) regulating an agreement between participating creditors seeking to establish the terms governing collective out of court restructurings with a set of debtors, corporate and individual persons, except some new regulations which have been introduced regarding out of court restructurings in relation to public authorities and budgetary debts as a response to COVID-19, for budgetary tax payment treatment and other tax measures intended to support the business environment.

The new Law No 216/2022 currently provides for: (i) the restructuring agreement proceeding (*procedura acordului de restructurare*), as a formal framework negotiated with creditors of the debtor facing difficulties, in which the court's involvement is minimal; and (ii) the preventive concordat proceeding (*procedura concordatului preventiv*), in a much improved format, in which the court's role is confined to several situations and the entire proceeding is highly non-contentious.

The main advantages of the new pre-insolvency proceedings available to a debtor facing difficulties but not undergoing insolvency consist of the simpler and more efficient mechanisms offered. The restructuring agreement proceeding relies on a restructuring draft project prepared by the insolvency practitioner and then negotiated with the creditors, who are required to cast their vote on it. The syndic judge shall only have a role when it comes to the confirmation of the restructuring agreement.

The preventive concordat proceeding debuts with a petition for the opening of the proceeding, the benefit of which is that enforcements are stayed. Then, a concordat plan is prepared, negotiated and voted upon by the affected creditors and approved by the syndic judge.

Throughout the entire duration of the restructuring proceedings, the debtor is permitted to run and manage its own business.

Before the effective date of Law No 216/2022, the previous Law No 85/2014 did not provide for a restructuring that falls exactly within the typology of out of court proceedings. At most, it can be considered that the pre-insolvency proceeding *mandatul ad-hoc*, as it was regulated by Law No 85/2014, allowed for an amicable, confidential restructuring procedure. The intervention of the court was ensured only by confirming the agreement of the parties if that level had been reached. As noted above, in this procedure, an insolvency practitioner named *mandatar ad-hoc* was appointed. This practitioner carried out the mandate to reach an agreement between the debtor and one or more creditors to overcome the debtor's financial difficulties. To achieve the objective of the mandate, the ad hoc trustee could propose remissions, rescheduling or partial debt reductions, continuation or termination of ongoing contracts, staff reductions, and any other measures deemed necessary. However, in practice, the ad-hoc mandate was rarely used, mainly due to: (i) the low interest / reluctance of creditors to negotiate in such a procedure, as they prefer the insolvency court procedure where they consider that they have a means of controlling the debtor; (ii) the debtors' lack of confidence in

the success of such a procedure; and (iii) the difficulty of negotiating when there is no possibility to suspend, within the ad-hoc mandate proceeding, possible forced executions.

1.3.3 Informal framework

As previously mentioned, no OCWs or assimilated frameworks were available until 14 July 2022, when the new Law No 216/2022 came into force.

Currently, as the implementation of the EU Directive on Restructuring and Insolvency has been completed, we anticipate an increased interest from entrepreneurs and their advisers in the new restructuring proceedings

1.4 Accelerated restructuring or liquidation of MSMEs

The new Law No 216/2022 provides for efficient restructuring mechanisms and is basically intended for MSMEs, a long awaited law by the business environment.

As regards liquidation, there is no special proceeding in place for MSMEs in the current Romanian legislation.

1.5 Discharge of debts

In relation to companies or sole traders facing difficulties, upon the confirmation of a restructuring agreement / plan by the syndic judge, the debtor is restructured accordingly, and any reduction of the claims is enforceable. If the debtor fulfils all his / her / its obligations laid down in the reorganisation plan / agreement, the preventive restructuring proceedings come to an end and the debtor is finally discharged of those portions of the claims that were reduced (the haircut).

The same applies for the successful reorganisation proceedings.

The new Law No 216/2022 comes up with a new concept, the "discharge of debts", meaning the legal discharge of the differences between the debts existing at the time the proceeding is opened and the debts reduced via a restructuring agreement, concordat plan or reorganisation plan, as appropriate, pursuant to the closing of the proceedings after successful implementation of the agreement / plan proposed according to the law. In the case of bankruptcy, the discharge of debts operates based on a final court decision on the closing of the proceedings.

Should the debtor not fulfil his / her / its obligations laid down in the reorganisation plan, the reorganisation plan is deemed to have failed and liquidation proceedings are opened against the debtor. The haircut is then reversed, and the creditors' claims are reinstated to their respective values before the haircut.

In the event that a pre-insolvency proceeding resulted in a discharge of debts, the debtor is not allowed to revert to another pre-insolvency proceeding for 12 months from the closing thereof.

If, during the proceeding, it has been determined based on a final decision that fraudulent payments or transfers were made, the debtor who is a professional

natural person shall be discharged of debts only insofar as they were paid during the proceeding.

A debtor who is a professional natural person, discharged of his / her unpaid debts, is allowed to access any support facilities offered to entrepreneurs. The discharge for natural persons (consumers) is not automatic.

In the case of the debt repayment plan proceedings and of the simplified insolvency proceedings, no later than 60 days from the moment the proceedings are closed, the debtor may lodge with the court a petition seeking the discharge from debts not paid during the proceedings.

In the case of the liquidation of assets proceedings, after the liquidation is completed, the debtor must continue to make payments to creditors according to the judicial decision / administrative decision ending the proceedings. He / she may be discharged from the unpaid remainder if he / she has paid either:

- at least 50% of the claims in the following year; or
- at least 40% of the claims in the following three years.

In case the debtor, in good faith, has been unable to pay at least 40% of the claims, the court may discharge him / her from the unpaid remainder, but no sooner than five years after the proceedings have ended.

Before being discharged, the debtor is subject to a sum of obligations and disqualifications.

2. Special Measures

By Government Emergency Ordinance No 37/2020[4] on the granting of facilities for loans granted by credit institutions and non-banking financial institutions to certain categories of debtors, a series of measures were regulated to support debtors experiencing financial difficulties due to COVID-19. To benefit from a stay of repayment of principal instalments, interest and fees, the due date until which debtors were supposed to provide creditors with a request in this respect was 15 March 2021.[5]

These measures were continued by Government Emergency Ordinance No 227/2020,[6] with the possibility of suspending the payment of the obligations resulting from the accessed credits, for a maximum period of nine months, including both the legislative moratorium implemented previously[7] and the non-legislative moratoriums. These legislative frameworks also apply to MSMEs,

[4] Published in the Official Gazette of Romania, Part I, No 261 of 30 March 2020.
[5] On 9 March 2022, Government Decision No 171 of 3 February 2022 on the extension of the state of alert in Romania and on the actions applicable during the state of alert to prevent and control the effects of COVID-19 pandemic ceased to be valid.
[6] Published in the Official Gazette of Romania, Part I, No 1331 of 31 December 2020.
[7] The measures were initially regulated by Government Emergency Ordinance No 37/2020 published in the Official Gazette of Romania, Part I, No 261 of 30 March 2020 on the granting of certain facilities for loans granted by credit institutions and non-bank financial institutions to certain categories of borrowers. The implementing rules of GEO No 37/2020 were approved by GD No 270/2020, published in the Official Gazette, Part I, No 285 of 6 April 2020.

considering that "[i]n the exceptional circumstances created by the SARS-CoV-2 outbreak, small and medium-sized enterprises face a severe liquidity shortage."[8] It was also considered that "the evolution of the SARS-CoV-2 virus pandemic, which has generated a series of restrictions on the development of certain economic activities, [has impacted] on the maintenance of the workforce at enterprise level"[9] and that, "according to the European Banking Authority's Guidelines on legislative and non-legislative moratoriums on loan disbursements in the context of the COVID-19 crisis EBA / GL / 2020/15, prudential flexibility is provided for exposures covered by moratoria initiated until 31 March 2021 for [a] generalised moratorium, for a maximum of nine months in total, including previous deferrals."[10]

The main business opportunities for MSMEs during 2020 were an increasing demand in the domestic market, the use of new technologies, the uptake of new products, penetration of new markets and support from EU and Romanian funds.[11] At a business level, it is considered that the measures taken have not been able to effectively protect MSMEs, as they remain vulnerable to the evolutions and dynamics of the pandemic.

In the context of market analysis conducted by the specialised press,[12] it was revealed that the National Council of Small and Medium Private Enterprises in Romania (CNIPMMR), in surveys carried out among MSMEs (with 8,374 entrepreneurs interviewed), concluded that 98.6% of entrepreneurs considered themselves to be affected by the pandemic and only 1.4% answered "No". Among the main effects mentioned were a decrease in sales (65.6%), suspension of business (56.4%), difficulties in collection (54%) and restriction of activity (51.4%). The same analysis also shows that the Romanian Business Club launched a survey among MSMEs which indicated that 74% of respondents are considering reducing the number of employees and only 30% have developed a business strategy in place to help them overcome the crisis.

In 2021, the European Commission[13] approved a EUR 358 million Romanian scheme to support small and medium-sized businesses affected by the pandemic and the restrictive measures the Romanian Government has had to implement to limit the spread of the virus. The aid could not exceed EUR 1.8 million per beneficiary and could be granted until 31 December 2021.

Further, in June 2022, the state aid schemes for MSMEs and administrative and territorial units – IMM PROD and GARANT CONSTRUCT – coordinated by the Ministry of Finance, were approved by the European Commission.[14] These programs shall be implemented via the National Fund for Guaranteeing of Credits

[8] In this regard, see paragraph (3) of the Explanatory Memorandum of GEO 37/2020.
[9] See paragraph (2) of the Explanatory Memorandum of GEO 227/2020.
[10] See paragraph (5) of the Explanatory Memorandum of GEO 227/2020.
[11] See n 2 above, 49.
[12] https://economie.hotnews.ro/stiri-finante_banci-24049654-impactul-pandemiei-asupra-imm-urilor-romanesti-masuri-luat-alte-state-care-putea-inspira-autoritatile-romane-planuri-afaceri-simplificate-proceduri-rapide-pentru-acordarea-garantiilor-stimularea-inova.htm.
[13] Authorisation Decision of the European Commission published in the Official Journal of the European Union No 275 of 09.07.2021 (2021/C275/01) (Aid number SA, 63354 (2021/N)) http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_63354.
[14] See the communication of the Ministry of Finance, available at: https://mfinante.gov.ro/despre-minister/-/asset_publisher/uwgr/content/comisia-european-c4-83-a-dat-und-c4-83-verde-imm-prod-c8-99i-garant-construct

dedicated to MSMEs (FNGCIMM), and the Romanian Fund for Counter-guarantees (FRC) and the total amount of guarantees offered is 4 billion Lei. The program is mainly intended to support projects in the area of energy efficiency enhancement, investments in the green energy and compliance with the environmental objectives implemented by MSMEs operating in construction and administrative and territorial units, via governmental guarantees of a maximum of 90% of the financing amount.

For 2022, the total amount of guarantees is 2.5 billion Lei and shall be equally distributed between the two components.

2.1 Procedural insolvency measures with respect to MSMEs

No special insolvency measures have been introduced for MSMEs. However, some of the protective effects provided at legislative level in the field of insolvency are also applicable to MSMEs.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

By means of Law No 55/2020[15] on some measures to prevent and combat the effects of the COVID-19 pandemic, the debtor's obligation to request the opening of insolvency proceedings was suspended during the state of alert (currently in Romania, the state of alert ended on 9 March 2022). It was also stipulated that any creditor(s) requesting the opening of the insolvency proceedings for their debtor must prove that a reasonable attempt to reach an agreement on payment had been made beforehand.

As stated in a study carried out by a specialised agency[16] and quoted in the economic press,[17] almost 5,560 new insolvency proceedings were opened in 2020, 13% below the level recorded in the previous year. It can be seen that the measures taken to protect debtors from opening insolvency proceedings, either by suspending the obligation to report it or by raising the standards that creditors must meet to request the insolvency proceedings against the debtor, have resulted in: (i) either postponing the moment at which those MSMEs whose activities were substantially and irreversibly affected by COVID-19 will file for insolvency; or (ii) allowing those companies that have been in financial trouble before COVID-19 to access insolvency anyway.

2.3 Insolvency procedural deadlines

Law No. 55/2020 established, at a general level and not only specifically for MSMEs, the possibility of extending specific procedural deadlines for conducting pre-insolvency or judicial reorganisation proceedings. Essentially, there are six categories of intervention regarding time limits:

- for the preventive concordat proceedings in progress at the date of entry into force of the law, the period in which the negotiations on the draft preventive concordat could take place was extended by 60 days. Also, in the case of the

[15] Published in the Official Journal, Part I No 396 of 15 May 2020.
[16] Study conducted by Coface Romania.
[17] https://adevarul.ro/economie/stiri-economice/domeniile-cele-mai-mari-pierderi-insolvente-provocate-pandemie-1_602ce5eb5163ec4271154205/index.html.

debtor in the execution of the arrangement with creditors on the date of entry into force of the law, the period for the payment of the claims was extended by two months;

- extension of the observation period by three months, such a period being established by law as one year, being necessary for the debtor to file a reorganisation plan, failing which the debtor will enter bankruptcy proceedings;

- for a reorganisation plan existing at the time of the entry into force of the law, for those debtors in relation to whom, as a result of the COVID-19 pandemic, the prospects of recovery changed, the persons entitled to submit a reorganisation plan could, within three months, submit a modified reorganisation plan. In the case of the debtor in judicial reorganisation on the date of entry into force of the law, the period of execution of the judicial reorganisation plan was extended by two months;

- a debtor under judicial reorganisation, who had ceased its activity entirely because of measures adopted by the public authorities to prevent the spread of COVID-19, had the possibility of applying to the syndic judge, within 30 days of the entry into force of the law, to suspend the execution of the plan for a period not exceeding two months;

- in case of a debtor in judicial reorganisation at the date of entry into force of the law, which had ceased all or part of its activity as a result of measures adopted by public authorities to prevent the spread of COVID-19, the period of execution of the reorganisation plan could be extended, but without exceeding a total duration of its development of five years, with the corresponding modification of the plan; and

- for a debtor who had ceased all or part of its activity totally or partially because of the measures adopted by public authorities to prevent the spread of the COVID-19 pandemic, during the state of emergency and / or alert, the initial duration of execution of the reorganisation plan was increased to four years (this was previously three years), with the possibility of extension, without exceeding a total duration of five years.

Law No 55/2020, which came into effect on 18 May 2020, was intended to have only temporary effect, applicable for a determined period (in some cases for only two or three months), and there has not been a subsequent extension of its operation. With some small exceptions, Law No 55/2020 was dedicated solely to those debtors whose activity was suspended – in full or in part – due to Government-ordered lockdowns and restrictions. It was not, therefore, applicable to all debtors undergoing insolvency proceedings. Debtors benefited from these extensions of terms, with many registered cases in which these extensions have been successfully accessed, thus creating the necessary time to adapt to economic dynamics and developments.

2.4 Minimum debt requirements to initiate insolvency proceedings

Law No 113 of 8 July 2020 for approval of Government Emergency Ordinance No 88/2018 amends and supplements certain regulations on insolvency and other

laws. It represents a distinct legislative change which also impacts on the Law on pre-insolvency and insolvency proceedings No 85/2014. These changes are permanent – not merely temporary. One permanent change is that the minimum amount or threshold of the debt that can be used by a creditor to apply for opening of an insolvency proceeding is raised from 40,000 Lei to 50,000 Lei.

2.5 Suspending specific creditors' rights

Pursuant to Law No 55/2020, for the situation of a debtor who has suspended all or part of its activity as a result of measures adopted during the state of emergency by public authorities, creditors could, during the state of emergency, only apply for the opening of insolvency proceedings after reasonable attempt, evidenced by documents communicated between the parties by any means, including by electronic means, to conclude a payment agreement.

There is no denying the positive effects of these additional conditions imposed on creditors wishing to access insolvency proceedings for their debtor. In particular, there was a decrease in the use of insolvency proceedings by creditors with the sole aim of "forcing" the debtor to pay.

That said, the number of insolvency files opened in 2021 was 10% higher than the previous year, yet lower than the number of insolvency files opened before the impact of the pandemic.[18]

The interest of debtors in what the restructuring proceedings have to offer is expected to be significantly higher pursuant to the coming into force of the law transposing the EU Directive on Restructuring and Insolvency.

2.6 Mediation and / or debt counselling

No special negotiation procedures, mediation or debt counselling are regulated for the purpose of restructuring in Romania, except for the ad-hoc mandate discussed above. Also, the preventive concordat, as a pre-insolvency proceeding, includes a negotiation component between the composition administrator and creditors. However, such pre-insolvency proceedings are addressed, in general, to all traders (professionals) and not just MSMEs.

We believe that the establishment of a prior and mandatory obligation to negotiate, if the business environment and especially the banks and institutional creditors do not perceive the efficiency of restructurings, may create harmful adverse effects. Firstly, the introduction of a mandatory pre-insolvency mediation procedure can only be effective if it is closely linked to a change in attitudes toward restructuring tools. Otherwise, the establishment of an obligation can only led to formalism, necessary to be respected as such, but without any substance in terms of economic, legal, social or human effects. Secondly, the change of mentality / the emergence of a negotiating culture must be achieved gradually, by understanding the benefits. Under these conditions, the imposition of such an obligation, in this context, may result in the perception of creditors that the passage of time degrades the level of debt recovery. On the contrary, we believe that regulating effective

[18] According to the survey conducted by Coface, 24.02.2022, available at: https://www.coface.ro/Stiri-Publicatii/Stiri/STUDIU-COFACE-INSOLVENTELE-IN-ROMANIA-AU-CRESCUT-CU-10-IN-2021-FATA-DE-ANUL-PREDECENT.

restructuring frameworks in the perception of these creditors may lead to a natural increase in their interest in negotiating, becoming the first interested in doing so.

The new restructuring proceedings proposed by Law No 216/2022 are expected to offer a boost of debtors' confidence in taking advantage of their benefits. In particular, the new preventive concordat proceeding promotes some of the efficient instruments which only the previous insolvency proceeding offered, such as the stay (for a limited period) on enforcement, the possibility to implement a "cram-down" in respect of the restructuring agreement / plan, the protection of essential ongoing contracts, the protection of employees and the stimulation of financing. All that is required is for the debtors facing difficulties to timely revert to such restructuring solutions so that they reach the intended objective. In this respect, early warning instruments and proceedings are provided by the new Law as far as the occurrence of the financial difficulty is concerned.

In addition, it is essential that a mediation procedure between MSMEs and creditors be assessed as beneficial by the latter, through concrete positive effects. This is precisely the role intended by the new Law for insolvency practitioners, who shall act as restructuring administrators or, as appropriate, concordat administrators, and assist the MSMEs in the business recovery process.

3. Challenges Faced

3.1 Stigma associated with insolvency

Insolvency proceedings in Romania already have more than 20 years of use in practice.

One of the complaints of creditors, faced with the insolvency of their debtor, is that the debtor has the legal and economic levers to "orchestrate" its insolvency proceedings. On the other hand, the debtor may go through several stages in an insolvency proceeding, from trying to save its business, struggling to convince creditors, to indifference and acceptance of a failure towards the end of the proceeding.

Before the coming into force of Law No 216/2022, the pre-insolvency mechanisms were considered rather unsatisfactory.

In general, in Romania the "stigma" of the debtor's insolvency operates on two levels: either the creditors suspect that the debtor has, in the immediate past to the insolvency, carried out acts or operations to extract assets from the insolvency proceedings, or otherwise consider that the debtor's involvement in another business, as long as the debtor is still in an insolvency proceeding, is *per se* a fraud against their interests. Acceptance of a debtor's "failure" can be difficult for creditors because such acceptance makes it impossible to recover the debt. On the other hand, there are certain developments in the behaviour of creditors in insolvency, in the sense of supporting a reorganisation process, when they are convinced of its effectiveness.

The new restructuring frameworks, resulting from the complete implementation of the EU Directive on Restructuring and Insolvency in Romania, shall be confronted

with the challenges of the business environment, but their success depends entirely on an increased confidence of participants in each other.

3.2 Availability of financial information

The category of MSMEs includes authorised natural persons, entrepreneurs who are sole proprietors and family businesses carrying out economic activities. In their case, financial statements are not available as is the case for legal entities, whose financial statements in extract can be identified by the unique registration code on the website of the Ministry of Finance / Trade Register.

3.3 Access to new money

The regulation of financing in pre-insolvency or insolvency procedures applies generally and there is not a specific process for MSMEs.

The system of Law No 85/2014 regulates a financing priority both for the restructuring agreement and preventive concordat procedure (pre-insolvency proceedings) and for the observation proceeding (part of the judicial insolvency proceeding) and also for a reorganisation proceeding.

In respect of interim financing as well as of new financing, the pre-insolvency proceedings provide for a privileged position of the funds provider, in an attempt at encouraging such mechanisms, which are necessary for an efficient restructuring.

In formal insolvency proceedings, there are two categories of possible financiers. The rules for granting this financing during the observation period are as follows:

- financing shall be made only with the consent of the creditors' meeting and shall be secured mainly by assets or rights which are not subject of preferential claims, being free of encumbrances;

- in the absence of unencumbered assets, the financing will be secured by collateral already in place, with the consent of the pre-existing secured creditors; and

- in the absence of unencumbered assets or in the absence of the agreement of pre-existing secured creditors, the financing will be borne: (i) by secured creditors, pro rata, to the totally encumbered assets; and (ii) in case of insufficiency of encumbered assets, for the unsecured party, priority will be given to the other available resources.

Through these legal provisions, this financing benefits from a statutory preference. In relation to the priority of financing granted under a confirmed reorganisation plan, this is secured, as appropriate, depending on the way in which it was negotiated and constituted, in practice as a secured claim arising during the proceedings, which means secured by the creation of a conventional mortgage, immediately after the procedural costs.

3.4 Secured creditors *vis-a-vis* unsecured creditors

There are no special provisions for distributions to creditors for MSMEs.

3.5 Insufficient asset base

There are no regulations on funding the formal process of insolvency or liquidation in the current legislation, as far as MSMEs are concerned. Law No 85/2014 provides for the possibility to use the liquidation fund to cover the expenses related to the insolvency proceedings. This fund is regulated by Government Ordinance No 86/2006 on the organisation of the activity of insolvency practitioners and is intended to cover expenses in proceedings where there are no assets in the debtor's patrimony.

As for the rescue procedures, it is expected that the new legislation which entered into force to support efficient instruments to cover the costs has enabled MSMEs to avoid the formal process of insolvency and liquidation proceedings.

3.6 Personal guarantees (PGs)

PGs are not separately regulated in relation to MSMEs. In general, PGs are required in bank financing structures for such entities, to increase the level of recovery in case of default. The enforcement of PGs is subject to the general enforcement legal regime, as follows: (i) if they are subsumed in a credit structure from banks or credit institutions, they enjoy the legal regime of enforceable titles; and (ii) if they are related to non-bank guarantee structures, they may be enforced after a final court decision has been obtained.

3.7 Further challenges

In Romania, before Law No 216/2022 came into force, it had been considered that little progress had been achieved on giving MSMEs a "second chance". The legal framework was deemed too burdensome to allow for progress.

In this respect, the new Law, which transposes the EU Directive on Restructuring and Insolvency, is expected to be implemented so as to encourage the use of pre-insolvency procedures and prevent as much as possible the insolvency proceedings (in which the business recovery is either much more difficult or impossible), while also increasing recourse to alternative dispute resolution and mediation, streamlining procedures, enhancing the efficiency of the pre- insolvency mechanisms, increasing the availability of bank financing and access to credit, improving specialised expertise including the use of technology, training and specialisation of practitioners and courts.

All these changes are expected to generate positive effects, including the better protection of MSMEs.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

First and foremost, efforts should be made to change the mentalities in respect of MSMEs. On the one hand, creditors should be incentivised and motivated to give debt restructuring a chance by understanding its potential benefits. On the other hand, the entrepreneurial business environment should be educated so that

MSMEs feel safe to revert to safeguard proceedings before they reach the point of no return, where the only option is then liquidation.

The major issue here is a chain reaction: if the MSME debtor waits too long before it reverts to safeguard proceedings, the effects on other businesses throughout the economic chain will already be present.

In the end, there is the matter of costs as well: access to necessary consulting expertise should be provided to MSMEs, against reasonable costs, so that they benefit from early restructuring proceedings and, therefore, find a safe way through rescue.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

As indicated above, there have been some recent changes in legislation. The changes already implemented were not specifically targeted to MSMEs, but the changes did have a positive impact in supporting them.

On the other hand, both businesses and restructuring professionals expect positive reactions from the freshly passed Law No 216/2022, dedicated in particular to protecting MSMEs, precisely to prevent the use of insolvency proceedings.

As a general rule, formal insolvency proceedings result in the liquidation of MSMEs, which are not currently equipped with sufficient means to successfully restructure their businesses. This is all the more an argument in favour of prevention instead of insolvency, which is not a solution for MSMEs.

The practical course of implementation of the new prevention and business restructuring mechanisms is yet to be examined, taking into account that they were intended to rescue a distressed debtor and not an insolvent debtor, which might, indeed, be the true purpose of reversing the initial cause of distress.

During the COVID-19 era, MSMEs benefited from some tax and financial support measures, some of which were quite efficient.

The actions and measures intended to support MSMEs should be carried forward post COVID-19. However, it is necessary to make them more efficient, via profound changes in terms of the rules governing pre-insolvency proceedings and the stimulation of restructuring.

In the new context, it is even more necessary to educate entrepreneurs and improve the business thinking model so that, in the end, all stakeholders benefit from treatment that is equally adequate, preventive and predominantly intended to identify and remedy the causes of distress.

4.3 Simplified insolvency proceedings

The new Law No 216/2022 proposes a new, simplified restructuring mechanism in maximising the prospect of saving viable businesses carried out by MSMEs.

In addition, where no other solution exists, a rapid liquidation of those MSMEs which no longer qualify for restructuring is still necessary. Time and funds would thus be saved, and a chance would be given to new opportunities, by accepting and efficiently taming the failure which would be pinned down and overcome.

Given the undisputed importance of MSMEs in the Romanian economy, the elaboration and implementation of a set of rules that are adequate and tailored to the particulars in which they operate is a must.

SINGAPORE

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

The Insolvency, Restructuring and Dissolution Act 2018 (IRDA) consolidates and sets out the specific legislative framework relating to both corporate and individual persons in Singapore with effect from 30 July 2020. Prior to the IRDA, the written laws relating to individual persons and corporate insolvency were provided in the Bankruptcy Act, Cap.20 and the Companies Act, Cap.50 respectively.

While the provisions in the IRDA do provide the necessary formal insolvency framework for MSMEs, the costs may become a deterrent. As part of the COVID-19 response, the Singapore Government introduced an Amendment Bill for a Simplified Insolvency Programme for MSMEs and is considering whether these provisions ought to be made permanent. Further information on the Simplified Insolvency Programme is outlined in section 1.2 below.

1.2 Specific insolvency legislation

There are no specific insolvency laws under the IRDA which address MSMEs. However, an Amendment Bill passed in October 2020 as a response to COVID-19. It introduced a two-part Simplified Insolvency Programme (SIP), made up of the Simplified Debt Restructuring Programme (SDRP) and Simplified Winding Up Programme (SWUP), to provide simpler, faster and lower cost proceedings for MSME companies to restructure or wind up their affairs.

To qualify for the SIP, the following criteria must be met:

- liabilities of S $2 million or less, number of employees 30 or less and number of creditors 50 or less;
- annual sales turnover does not exceed S $10 million; and
- a cap of S $50,000 on realisable unencumbered assets for SWUP only.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

- *Corporates*

  There is no formal framework for out of court assistance or workouts for corporate entities in Singapore.

- *Individual persons*

  If a bankruptcy application is filed against an individual person, the court may refer the case to the Official Assignee to consider whether a debt repayment scheme can be initiated, rather than undertaking a formal bankruptcy process. The debt repayment scheme is a pre-bankruptcy scheme which can be utilised by individual persons if their unsecured debts are less than S $150,000,

allowing the individual to enter a debt repayment plan for a period not exceeding five years, subject to satisfaction of a list of qualifying criteria.

The qualifying criteria includes:

- the debt or the aggregate of the debts in respect of which the bankruptcy application is made does nort exceed the prescribed amount of S $150,000;

- the individual person is not an undischarged bankrupt, and has not been a bankrupt at any time within the period of five years immediately preceding the date on which the bankruptcy application is made;

- a voluntary arrangement is not in effect, and was not in effect at any time within the period of five years immediately preceding the date on which the bankruptcy application is made;

- the individual person is not subject to any debt repayment scheme, and has not been subject to any such debt repayment scheme at any time within the period of five years immediately preceding the date on which the bankruptcy application is made; and

- the individual person is not a sole proprietor, a partner of a firm within the meaning of the Partnership Act, or a partner in a limited liability partnership.

Once the plan proposed by the individual is approved by the Official Assignee, the debt repayment plan is binding on the debtor and every creditor who has proved a debt against the individual person and whose debt is included in the plan. Thereafter, the bankruptcy application against the individual person is deemed to be withdrawn upon commencement of the plan.

1.3.2 Informal framework

Informal restructuring remains an option for companies that are facing financial distress. The informal process may be undertaken bilaterally with specific creditors and / or undertaken on a holistic level and may involve financial and / or operational restructuring. This will largely depend on the individual circumstances of the companies involved. Often, restructuring advisors or legal representatives are engaged to assist with this informal restructuring process.

The overall aim is to seek a balanced compromise between the debtor and creditor without liquidation and for the debtor to remain as a going concern.

However, Singaporean companies, like many Asian counterparts, are generally less receptive to an informal restructuring. The Asian culture of “losing face” often deters companies, and in particular family-owned businesses, from undertaking informal restructuring processes, which means that there is a higher chance companies leave it too late to be able to undertake a meaningful restructuring and will end up in a formal restructuring or insolvency process.

1.4 Accelerated restructuring or liquidation of MSMEs

1.4.1 General legislation

Sections 209 and 210 of the IRDA provide businesses with the option to apply for early dissolution (administered by the Official Receiver or liquidator). However, there must be reasonable cause to believe that the company's assets are insufficient to cover the expenses of the winding up and the affairs of the company do not require any further investigation. This is particularly useful for smaller companies seeking a fast-track procedure to wind up their operations while avoiding unnecessary expenses and costs.

1.4.2 COVID-19 specific legislation

Separately, companies may also apply for the SWUP between 29 January 2021 and 28 July 2022. Through this route, companies can seamlessly wind up by way of a simplified creditors' voluntary winding up proceeding without the need to hold a creditors' meeting, and with the Official Receiver automatically appointed as the liquidator.

The SDRP also provides a faster procedure for companies seeking restructuring by way of a scheme of arrangement. Instead of two court applications required in a typical scheme of arrangement, this programme allows for the applicant company to dispense with a court hearing to convene a meeting of creditors, thereby commencing what is known as a "pre-packaged" scheme of arrangement. The moratorium period against the company will also last until the end of the SDRP, instead of the standard 30 days.

Essentially, the scheme managers would set out the details of the scheme and seek in-principle approval from creditors prior to the court application.

1.5 Discharge of debts for natural persons

Bankrupts may be discharged from bankruptcy in three ways, namely:

- annulment of the Bankruptcy Order by full settlement or offer of composition or a scheme of arrangement;
- discharge by the High Court; or
- discharge by Certificate of the Official Assignee.

The process and effects of each of these methods varies, and are summarised in the table below:

Type	Process	Effect
1. Annulment of the Bankruptcy Order by full settlement or offer of composition or	Bankrupt can make a debt repayment proposal to his or her creditors at a meeting. If accepted by 50% in number of	Bankrupt will be placed in the same position as if no Bankruptcy Order has been made

scheme of arrangement	creditors who hold at least 75% value of debt, bankrupt will be issued a Certificate of Discharge and will be removed from the bankruptcy register five years after issuance and upon full repayment of debts. If accepted by all creditors, bankrupt will be issued a Certificate of Annulment and will be removed from the bankruptcy register immediately, notwithstanding the bankrupt ensures repayment of his or her debt according to the proposal thereafter.	against him.
2. Discharge by the High Court	Upon full repayment of debt, the bankrupt may apply to the court for an order of discharge.	Debtor will be known as a "discharged bankrupt" and while he / she is released from all debts provable in the bankruptcy, it does not release the bankrupt from all other debts.
3. Discharge by Certificate of the Official Assignee	The Official Assignee will issue the bankrupt with a Certificate of Discharge upon meeting the following two requirements: - bankrupt has fully paid off target contribution; and - a certain validity period must have passed. Generally, a bankruptcy may be for a period of three years, up to seven years dependent on the compliance of a first time bankrupt or five to nine years if a repeat bankrupt.	

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

The Singapore Government passed the COVID-19 (Temporary Measures) Act 2020 to mitigate the impact of COVID-19 on the economy and businesses. In particular, MSMEs were able to seek relief from banks and / or finance companies on repayment of their secured loans up to 19 November 2020. However, MSMEs would have to meet the following criteria to qualify for relief:

- the loans had to be secured against commercial or industrial immovable property located in Singapore or plant, machinery or fixed assets in Singapore used for business purposes.
- the MSME must have entered into the loan before 25 March 2020; and
- the MSME must have been unable to repay the secured loans from 1 February 2020 or later due to COVID-19.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

As noted above, the IRDA was amended to establish the SIP on 29 January 2021, targeted at helping distressed MSME businesses that were facing financial difficulties due to COVID-19. The SIP consists of the SDRP and the SWUP. Companies may apply for either one of the programmes between 29 January 2021 and 28 July 2024.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

There were no specific measures that allowed for the debtor to suspend the requirement to file for insolvency during COVID-19. However, it is apparent that, given the low number of insolvency cases in Singapore, debtors were largely able to utilise the temporary relief measures to remain in existence notwithstanding that there are general director duties under the IRDA regarding wrongful trading.

2.3 Insolvency procedural deadlines

Under the COVID-19 (Temporary Measures) Act, MSME and individual debtors were given six months to respond to statutory demands served to them, up from the standard 21 day statutory period.

However, these temporary measures ended on 19 October 2020.

The impact of these measures is described in section 2.4 below.

2.4 Minimum debt requirements to initiate insolvency proceeding

The COVID-19 (Temporary Measures) Act was passed to provide temporary relief to debtors from enforcement action by creditors. The monetary threshold to commence winding up proceedings against a company increased from S $15,000 to S $100,000. Similarly, the threshold to commence bankruptcy proceedings against an individual person increased from S $15,000 to S $60,000.

However, these temporary measures ended on 19 October 2020.

These measures, and those relating to the extension of procedural deadlines (see section 2.3 above), had differing effects on MSME debtors.

For MSMEs that were viable prior to COVID-19, the temporary relief measures allowed them to be in a state of hibernation. The temporary measures provided the necessary moratorium on debts, so that once the restrictions were lifted and with the re-opening of economies, there were new opportunities to pick up from where they left off and to quickly rebuild and take on new projects and contracts.

However, for MSMEs already facing financial difficulties before the pandemic, COVID-19 led to losses and debts accruing and possibly accelerating. The temporary measures were only a short-term solution to meet short-term obligations. Therefore, a number of companies remained in existence as "zombie" companies, without any viable business.

What has transpired is that COVID-19 has delayed the inevitable restructuring and insolvency required for many companies already facing financial challenges. This delay has potentially caused further deterioration of the businesses which in turn affects the overall ability of creditors to recover their outstanding debts.

Notwithstanding that the threshold limit has been reverted, the number of liquidation cases has decreased over 2020 and 2021. It appears that creditors are holding back on enforcement due to the ongoing pandemic but are also not willing to put more money in to essentially wind-up companies without a chance of recoveries.

2.5 Suspending specific creditors' rights

Suspension of creditors' rights related to the increased monetary thresholds and statutory response periods, as outlined in sections 2.3 and 2.4 above.

2.6 Mediation and / or debt counselling

While mediation and debt counselling are not prescribed processes under the SDRP, there does not appear to be any bar against parties opting for these processes. However, as the SDRP is a relatively new regime, it is not clear whether, in practice, parties under the SDRP have made use of mediation and debt counselling.

Notwithstanding the above, in recent years, there has been a strong push for the use of mediation in restructuring proceedings generally, both judicially and extra-judicially.

In *Re IM Skaugen SE*, the Honourable Justice Kannan Ramesh observed that an experienced and skilled insolvency practitioner can "play the invaluable role of building consensus between the debtor and the creditors in the development of the restructuring plan, and build trust in the process".

Likewise, in the Report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring published in 2016, the utility of mediation in restructuring proceedings was emphasised (at paragraph 3.54). Among other things, it was observed that mediation would lead to significant time and cost savings for the parties involved.

In terms of merits, even in a pre-insolvency scenario, it is in all stakeholders' interests to reach a feasible and acceptable economic solution to the financial issues of the debtor company. In this regard, mediation and debt counselling provides a constructive and measured approach in trying to achieve the end-goal of an acceptable economic solution for all parties involved.

On the other hand, mandatory mediation and / or debt counselling impinges on party autonomy. Making mediation and debt counselling mandatory constrains a party's right of access to the court. Secondly, the utility of making mediation and debt counselling mandatory may be limited given that ordinarily in mediation, a party may walk away at any point in time with relatively limited repercussions. Ordinarily, in Singapore, while the court has the discretion to award adverse costs orders for an unreasonable refusal to engage in alternative dispute resolution, this

is ineffective and unsuitable for restructuring proceedings as many reasons can be put forward by the debtor or creditor in refusing to mediate.

Mediation has its benefits in terms of resulting in significant time and cost savings for the parties involved through an out of court process. Potentially, it may be a useful process to be deployed alongside the SDRP which has already been implemented for MSMEs.

However, it must be considered carefully whether mediation should be made mandatory for MSMEs. Together with the potential demerits of making mediation mandatory (as discussed above), certain factors such as the complexity of the case and the difference in bargaining power may affect whether mediation is the more appropriate route as opposed to a court-led approach for MSMEs.

3. Challenges Faced

3.1 Stigma associated with insolvency

In Singapore, there is a stigma of being a director of a company in liquidation especially since directorship records are readily available to the general public (obtained via the Accounting and Corporate Regulatory Authority).

3.2 Availability of financial information

MSMEs in Singapore are likely to be micro family-owned businesses in sole proprietorships, partnerships or private limited companies.

In Singapore, sole proprietorships, partnerships, limited liability partnerships or limited partnership businesses are not required to file annual financial statements with the Accounting and Corporate Regulatory Authority.

Companies are required to file their financial statements annually. However, there are lesser filing requirements for companies that are deemed as "small and non-publicly accountable companies". Singapore MSMEs are likely to fall in this category and are therefore required to file simplified financial statements consisting of a statement of financial position, statement of comprehensive income, statement of changes in equity and statement of cashflows. There is no requirement for such smaller companies to disclose notes or further elaboration to their financial statements.

3.3 Access to new money

There are three main restructuring or insolvency processes that can be undertaken: a scheme of arrangement, judicial management and liquidation.

The IRDA sets out the relevant provisions and the Singapore courts have generally allowed for various levels of post commencement financing in the above situations.

- **Scheme of arrangement**

  Similar to the super priority financing provisions as found in the United States, the Singapore courts can make orders pursuant to section 67 of the IRDA to

afford super priority to debt arising from any rescue financing obtained, so that it:

- is treated as part of the costs and expenses of the winding up;
- has priority over all the preferential claims and all other unsecured debts;
- is secured by a security interest on property not otherwise subject to any security interest or that is subordinate to an existing security interest; and
- is secured by a security interest on property subject to an existing security interest, of the same priority as or higher priority than that existing security interest.

However, it must be demonstrated to the court that reasonable efforts were made to obtain rescue financing without the super priority status, that there is adequate protection for the existing security interest holders and that the financing is necessary for the survival of the company and / or to achieve a more advantageous realisation of the assets than in a winding up.

- **Judicial management**

Similar to the scheme of arrangement above, a company that enters into judicial management may also rely on the provisions in section 101 of the IRDA and on application to the court to seek super priority financing.

Generally, in a judicial management process, funding would be sought to continue the operations of the business as a going concern and the provisions generally mirror that of the scheme of arrangement as mentioned above.

- **Liquidation**

As a liquidation process generally means the winding up of the affairs of a company, it is unlikely that there will be a need to obtain super priority financing to keep a company as a going concern.

However, an appointed liquidator may seek third-party funding to pursue claims and recover greater assets (e.g. via court actions such as those relating to transactions at an undervalue, unfair preferences, fraudulent trading or wrongful trading).

Such funding, if accorded by the court, will be deemed as "super priority", and treated as if it were a cost or expense of the company's winding up.

It is noteworthy to mention that super-priority rescue financing is usually sought by larger companies in distress, and / or undergoing judicial management. It is unlikely that MSMEs would seek such funding.

3.4 Secured creditors *vis-à-vis* unsecured creditors

There are no specific procedures specifically targeted at MSMEs in relation to the rights of secured creditors over unsecured creditors. Section 203 of the IRDA

outlines the priority of debts in a formal liquidation procedure.

Generally speaking, secured creditors that have a fixed charge on a company's assets will be able to exercise their rights over the sale of that specific asset / property and will be entitled to the full amount of the sale proceeds. In relation to secured creditors that have a floating charge, the assets under a floating charge are subordinated to priority claims and must be paid accordingly out of any remaining property comprised in or subject to that charge, but will be paid in priority to all unsecured creditors.

3.5 Insufficient asset base

The introduction of the SIP has made it more cost effective for MSMEs to consider a restructuring or liquidation process. In the alternative, MSMEs will need to ensure that sufficient funding is available to a proposed liquidator in a creditors' voluntary liquidation process to be commenced.

From a creditors' perspective, to commence a court liquidation process to wind up a company, there will be costs incurred, including the legal fees, deposits with the Official Receiver and any funding required by the proposed liquidator. Therefore, it appears that many creditors are not willing to put more money in to essentially wind-up companies without a chance of recoveries. A creditor may be willing to provide space to a company if there is potential that it can remain as a going concern, but this will ensure a high level of cooperation and transparency between the MSME and the creditors, including the provision of necessary financial information to determine the financial status of the MSME in distress.

3.6 Personal guarantees (PGs)

It is common for PGs to be provided by directors of MSME companies. If there is an event of default or insolvency event, it is also common for the PG to be called and to the extent it cannot be settled, enforcement may lead to the issuance of a statutory demand and personal bankruptcy proceedings. However, this is on a case by case basis and an assessment of the assets available for recovery by the guarantor will need to be undertaken to determine whether there is merit in calling on the PG and taking enforcement steps.

3.7 Further challenges

There are no relevant additional matters to highlight.

4. Moving Ahead

The below commentary has been provided by Keith Han, Partner and Co-Head, Restructuring & Insolvency Practice at Oon & Bazul LLP.

4.1 Best way to safeguard the interests of MSMEs

The best way to safeguard the interests of MSMEs would be to have a simple, yet effective legislative regime that caters specifically to MSMEs undergoing restructuring or formal insolvency. This is especially so where existing insolvency / restructuring regimes may be too costly and complicated for MSMEs.

A legislative framework for MSMEs should be simple in the sense that it is capable of being understood by the lay businessman. As noted above, MSMEs are often family-owned, small partnerships which may not have the financial capabilities to seek comprehensive legal advice.

The framework should also be effective, in the sense that it confers significant practical benefits to MSMEs who seek to rely on it. An example would be a simple moratorium on proceedings should MSMEs choose to put forward a restructuring plan.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

As noted, Singapore introduced the SIP on 29 January 2021. The SIP provides a simpler, faster, and lower-cost restructuring and insolvency proceedings for eligible MSMEs and complements existing insolvency processes under the IRDA.

Pre-SIP, Singapore's insolvency regime did not differentiate between large and small corporations. This was not ideal, as Singapore's insolvency regime then generally provided for processes for corporate entities with substantial assets. This may not have been well-suited for MSMEs which were not as well-resourced. Complex, costly procedures under the IRDA often meant that MSMEs seeking to restructure or undergo formal insolvency would likely have to seek legal advice on how they may go about doing so – which would lead to increased costs. In the circumstances, it is quite likely that this created more stress for MSMEs.

While it was initially envisaged that the SIP would apply for a period of six months (29 January 2021 to 28 July 2021), this was further extended to 28 July 2022 as Singapore transitions into an endemic COVID-19 situation. There are two distinct programmes under the SIP: the SDRP and the SWUP, as defined above.

The SDRP adopts a debtor in possession model. It largely involves an out of court restructuring, during which an automatic moratorium comes into force if the restructuring plan is approved. A restructuring advisor is assigned to assist the company with implementing the restructuring plan.

The SWUP is modelled on the existing creditors' voluntary winding up process (it is also an out of court process). Among other things, the Official Receiver will be the liquidator of the applicant company, with the power to appoint a qualified person to act as a special manager.

The overall benefit to MSMEs is a more accessible insolvency regime calibrated to the profile of MSMEs. The SIP regime is simpler, more accessible (the SIP adopts an online form-filling process) and more cost-friendly than the previous one-size-fits-all insolvency regime pre COVID-19.

These changes should continue. The legislative changes are welcome developments for MSMEs in Singapore as the SDRP and SWUP are real and accessible options for MSMEs seeking to undergo restructuring or insolvency processes. As it stands, several COVID-19 relief measures have begun tapering off in Singapore. As such, there may be a need for the SIP to continue for several months to come. In fact, this may a reason why the application period for the SIP

was extended for a further 12 months from 28 July 2021 to 28 July 2022 and a final extension was granted until 28 July 2024.

4.3 Simplified insolvency proceedings

As discussed earlier, the present SIP mechanism in Singapore provides for a simplified restructuring, liquidation and discharge mechanism for MSMEs. For the reasons stated above, it is a welcome change and should continue.

SOUTH AFRICA

1. Insolvency Framework – General Overview

The South African economy is made up of the formal and informal sectors and MSMEs straddle both, comprising approximately 50% of the market at 2.8 million MSMEs.[1] Of these, approximately 70% are in the informal sector.

1.1 Formal insolvency legislation

Formal insolvency legislation exists for both corporate and individual persons. However, the Insolvency Act 24 of 1936 is in desperate need of updating.

From a debtor's perspective, dependent on the juristic status and size of outstanding debt, there are a few formal remedies available:

- administration – a debtor can apply to have their estate administered in terms of section 74 of the Magistrate's Court Act 32 of 1944. However, this only applies to debts less than R 50,000;
- debt review – under the National Credit Act 34 of 2005 (NCA), a "consumer" may apply to a debt counsellor to be declared over-indebted. A consumer is defined to mean all natural persons as well as some juristic persons. Only enterprises with an asset value or annual turnaround of less than R 1 million are classified as consumers for the purpose of the NCA;
- sequestration or liquidation – an insolvent individual is sequestrated and a corporate entity is liquidated under the Insolvency Act 24 of 1936 (Insolvency Act);
- business rescue utilising Chapter 6 of the Companies Act 71 of 2008 (Companies Act). Business rescue is available to both companies and close corporations but is not accessible to individuals, partnerships or trusts; and
- a section 155 compromise (contained in section 155 of the Companies Act) is available to both companies and close corporations but is not accessible to individuals, partnerships or trusts.

From a MSME perspective, the challenge is that business rescue (and a section 155 compromise) is not available to sole proprietorships, partnerships or trusts, leaving only sequestration as a remedy for financial distress for these types of enterprises. Business rescue is also considered a costly procedure and therefore restricts the number of companies that will apply for relief under this Chapter of the Companies Act. Debt review, in terms of the NCA, applies to credit agreements that fall within its ambit and so may not necessarily address the total indebtedness of the enterprise, leaving it vulnerable.

1.2 Specific insolvency legislation

No specific insolvency legislation exists that addresses the needs and requirements of MSMEs in the South African market. The need for specific MSME procedures was

[1] THE UNSEEN SECTOR A Report on the MSME Opportunity in South Africa Findings and Recommendations (edse.org.za).

again highlighted in the July 2021 rioting in the provinces of KwaZulu Natal and Gauteng. Many MSMEs were affected and were left with little choice regarding a "second-chance" process, with liquidation or sequestration being the only real solutions available to them.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

While no formal out of court process exists for MSMEs, a voluntary application for business rescue under Chapter 6 of the Companies Act, which is not contested, can take place outside of the court process.

However, if liquidation proceedings have already been initiated against the company (or close corporation), the directors would have to apply to court to commence the business rescue process.

1.3.2 Informal framework

Other than the formal workout procedures described above, MSMEs can seek assistance from their financial institutions to extend repayment terms, provide relaxation of covenants or waive covenant breaches. However, typically these requests need to be accompanied by reliable financial information, including a cash flow forecast, which is oftentimes rudimentary with MSMEs.

The Prudential Authority did temporarily amend Directive 7 of 2015 on Restructured Exposures for the duration of the COVID-19 pandemic. This had the effect that loans that were restructured as a result of COVID-19 would not attract higher capital charges. This amendment specifically covered loans to households, MSMEs and corporates.[2]

1.4 Accelerated restructuring or liquidation of MSMEs

Unfortunately, no mechanism for accelerated restructuring or liquidation for MSMEs exists in the South African market, despite the power of this sector in the economy.

1.5 Discharge of debts for natural persons

For natural persons, there is an automatic discharge from certain pre-insolvency debts. Automatic rehabilitation takes place in terms of section 127A of the Insolvency Act when the insolvent has not been rehabilitated by the court within a period of 10 years from the date of (provisional) sequestration.

An insolvent may also make an application to the relevant High Court for the discharge of their pre-insolvency debts. An insolvent can generally make an application for rehabilitation four years after sequestration. However, this time period can change dependent on the specific set of circumstances, for example:

- if the insolvent was convicted of a fraudulent act in relation to his / her

[2] Covid-19: Freeze dividends and exec bonuses, Sarb tells bankers - Moneyweb.

insolvency, then the application for rehabilitation can only be made after five years have elapsed from the date of conviction;

- where the first account in the estate has been confirmed by the Master, the insolvent may apply for rehabilitation after a period of 12 months from the confirmation; and

- an insolvent may make an application for rehabilitation if no claims were proved against the estate within six months from the sequestration.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

No formal measures were introduced that extended or suspended the repayment terms of loans or periodic debt service obligations during COVID-19. However, the majority of banks in South Africa granted various forms of relief, which would have been assessed on a case-by-case basis or with the assistance of scorecards (typically for the MSME sector).

National Treasury, through the COVID-19 Loan Guarantee Scheme,[3] initially provided R 100 billion to the banking industry through the South African Reserve Bank to assist eligible businesses (including sole proprietorships) during the COVID-19 pandemic. The banks were not permitted to profit from these loans and any surpluses generated accrued to National Treasury.

The Department of Small Business Development made over R 500 million available to assist small, medium and micro enterprises that were in distress through a SMME Support Intervention Plan. MSMEs that were already funded by the Small Enterprise Funding Agency (SEFA) and were negatively affected by COVID-19 qualified for the SEFA-Debt-Restructuring Facility where a payment holiday of up to six months was available.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

No special measures have been introduced to simplify proceedings for MSMEs during COVID-19.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

No measures have been introduced that have suspended the requirement to initiate insolvency / liquidation proceedings during COVID-19.

2.3 Insolvency procedural deadlines

Procedural deadlines were not extended during COVID-19.

2.4 Minimum debt requirements to initiate insolvency proceedings

Only a creditor that has a liquidated claim of at least R 100 may bring an

[3] COVID-19 loan guarantee scheme FAQs 26 July.pdf (treasury.gov.za).

application to the court for the sequestration or liquidation of an insolvent.[4] This threshold has remained in place throughout the COVID-19 State of Disaster in South Africa.[5]

2.5 Suspending specific creditors' rights

No specific measures were taken to suspend the rights of creditors to initiate insolvency procedures during the COVID-19 pandemic.

2.6 Mediation and / or debt counselling

Debt counselling or debt review, as contained in the National Credit Act, is available to "consumers". This may have some relief for certain MSMEs to the extent they meet the definition of "consumer".

If the debt counsellor concludes that the consumer is indeed over-indebted, a proposal is issued to the Magistrates Court recommending that an order is made in relation to one or more of the consumer's obligations.

An application for sequestration of a debtor under debt review is possible as the court will exercise its discretion when considering whether to place the estate under sequestration.

Mediation is available but can be considered a costly resolution process, as there is no regulation over cost. Debt mediation is a debt relief programme known as Voluntary Debt Mediation Solution (VDMS), which was implemented in 2012. This programme is unregulated and not recommended for consumers, who are rather encouraged to follow the debt counselling process, described above. In fact the National Credit Regulator (NCR) has issued a circular dated November 2014 in which the NCR actively discourages the use of voluntary debt mediation as it allegedly undermines the NCA.[6]

To the extent that voluntary debt mediation is a consideration, there are a few advantages and disadvantages.

In terms of the advantages:

- agreement can be reached without the need to incur legal fees / court costs to make the agreement an order of court; and
- the process can be less costly than more formal processes as the fees are agreed between the client and third-party mediator.

In terms of the disadvantages:

- there is no legal protection, unlike a debt counselling agreement which is an order of court. This may leave assets at risk of repossession;

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[4] *Lamprecht v Klipeiland (Pty) Limited* [2014] JOL 32350 (SCA).
[5] A State of Disaster was declared in South Africa by President Cyril Ramaphosa on 15 March 2020, as contained in No. 43096 of the Government Gazette. The State of Disaster was still in force as at January 2022.
[6] Circular (Voluntary Debt Mediation).pdf (ncr.org.za)

- there is no single payment plan, unlike debt counselling. Rather, each individual creditor requires separate mediation to reach agreement on potential revised repayment terms and conditions; and

- the cost of the process is unregulated and determined at the mediator's own discretion and agreement with the client.

The consideration of whether mediation should form part of a mandatory pre-insolvency process is an interesting one – especially given the stance of the NCR in relation to VDMS.

In relation to small and medium enterprises which are registered as companies or close corporations, and do not meet the definition of a "consumer", there may be significant benefits in having to undergo mediation ahead of more costly processes like business rescue or terminal insolvency processes like liquidation. However, the resources necessary to service this segment of the market in terms of mediation may in fact drive up the cost of credit and ultimately be detrimental to this sector of the economy.

3. Challenges Faced

3.1 Stigma associated with insolvency

An unrehabilitated insolvent has many restrictions placed upon him / her and even upon rehabilitation, the stigma of having been sequestrated lingers. Any credit that is applied for, or potential employment, requests confirmation whether the individual has "ever" been placed under debt review or has been sequestrated. This hinders the ability to really achieve a "fresh start", as access to finance and employment can be problematic.

There is still a high degree of shame associated with a failing business, and given that in many MSME situations, the shareholders / owners are inextricably linked to the business, the failure of the business oftentimes leads to the insolvency of the individual.

3.2 Availability of financial information

Access to the financial information of any MSME is very difficult. Only listed entities in South Africa have publicly available information. There is no access to unlisted financial information, and in many cases what is produced when requested is unaudited.

The filing of annual returns is required for all incorporated entities with the Companies and Intellectual Properties Commission (CIPC). The information contained in an annual return is very high-level and mostly relates to the level of turnover and confirmation of the statutory information relating to the entity.

The majority of MSMEs are, however, unincorporated and mostly are sole proprietorships and partnerships. In these enterprises, the ability to keep accurate records and draft financial statements is limited and outsourcing is considered expensive.

To the extent that the MSME has turnover exceeding R 1 million in a financial year, there is a requirement to register for VAT with the South African Revenue Service (SARS). This does allow for some tracking of revenue and compliance.

3.3 Access to new money

In a 2020 study conducted by the IFC, 85% of MSME finance was obtained from two sources – friends and family (45%) and banks (40%).[7]

In an insolvency situation, only business rescue in the Companies Act makes specific provision for post-commencement finance (PCF) and confers a super-priority status. PCF is generally granted by the existing financial institution and is assessed on a case-by-case basis. Given the restriction that business rescue only applies to companies and close corporations, as well as the costs associated with business rescue, it is rare for a MSME to file for business rescue and then also successfully raise PCF.

3.4 Secured creditors *vis-à-vis* unsecured creditors

There is no distinction between the powers of secured or unsecured creditors as they relate to MSMEs. The distinction of their powers applies irrespective of whether the insolvent is a MSME or not.

If a secured creditor states in the affidavit in support of their claim that they rely solely on the proceeds of the security for the satisfaction of the claim, the creditor is not entitled to a concurrent (unsecured) claim.

3.5 Insufficient asset base

In many instances, liquidation or sequestration is the only option available to MSMEs if they are not a company or close corporation or do not have the necessary funding available to support a business rescue. Therefore, a low asset base is unlikely to impact on the funding for a formal process because the formal process is unlikely to be used as a mechanism for rehabilitation.

To the extent that there are insufficient assets to cover the costs of the liquidation or sequestration, then there is the concept of "contribution" in the Insolvency Act. Essentially, concurrent creditors that have proved their claims will need to contribute towards the cost of the process, payable out of the "free residue".

3.6 Personal guarantees (PGs)

PGs or suretyships are standard practice for facilities granted to MSMEs by financial institutions. This is due to the inextricable link between the shareholder / owner and the business.

PGs and suretyships survive insolvency and therefore the failure of the business is often the precursor to the failure of the individual and contributes to the stigma of failure.

[7] THE UNSEEN SECTOR A Report on the MSME Opportunity in South Africa Findings and Recommendations (edse.org.za).

3.7 Further challenges

The Insolvency Act requires updating. New flexible, efficient procedures to appropriately deal with MSME insolvency should be included that allow for a "second-chance", as opposed to the more terminal procedures like liquidation and the long automatic discharge associated with personal insolvency.

Given the prevalence of the informal sector in South Africa, obtaining accurate data on this sector of the economy remains a challenge. Significant "red tape" and mistrust in the system are barriers to MSMEs transitioning from the informal sector to the formal sector.

4. Moving Ahead

The South African economy is made up of the formal and informal sectors and MSMEs straddle both, comprising approximately 50% of the market at 2.8 million MSMEs.[8] Of these, approximately 70% are in the informal sector.

4.1 Best way to safeguard the interests of MSMEs

MSMEs in South Africa are a vital part of the economy – creating much-needed employment opportunities. It is said that one employed person in South Africa supports approximately seven to 10 unemployed people, so the loss of one job has a knock-on effect to those other persons.

South Africa currently has the highest unemployment rate in the world.[9] Therefore, the ability to safeguard jobs is of critical importance to MSMEs. In the informal economy, it is more likely that these enterprises are sole proprietorships and therefore no formal restructuring process is available to them, apart from sequestration, which applies outdated statutory preferences to employees as the Insolvency Act is in dire need of reform.

Given it is most likely that MSMEs are dealing with sequestrations, an efficient and robust administration and regulation process of sequestration is an important safeguard to ensure that claims from employees and creditors are dealt with expediently.

There is a need to bring our Masters' Offices into the present as currently no electronic filing is available – rather all claim forms need to be submitted as originals which can significantly delay proceedings if forms are misplaced or lost.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Education and understanding of the processes available to MSMEs needs to improve. Currently, there is little understanding of potential formal restructuring processes available to those enterprises registered as companies – i.e. business rescue and a section 155 compromise.

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[8] THE UNSEEN SECTOR A Report on the MSME Opportunity in South Africa Findings and Recommendations (edse.org.za).

[9] South Africa, Namibia, Nigeria have the highest unemployment rates in the world - report | Business Insider Africa

With the cost of these processes considered a significant deterrent to undergoing formal restructuring, it can be argued that they have created additional stress as the only realistic (and potentially more affordable process) is a liquidation, which is terminal.

For sole proprietorships and partnerships, sequestration still remains the only available option and this creates significant stress due to the impact on the insolvent's ability to access credit in the future and reputational issues associated with having previously been sequestrated.

The availability of advisors to MSMEs is also a challenge as the quality of advice that business owners receive when it comes to periods of financial distress and insolvency can be cause for concern.

4.3 Simplified insolvency proceedings

The MSME market in South Africa would benefit from a simplified restructuring and discharge mechanism. Simplification implies efficiency and affordability – two of the critical aspects that are current challenges to accessing restructuring and liquidation / sequestration processes. Timely resolution of stakeholder claims is especially important, particularly for employees.

A useful first step would be insolvency reform of the outdated Insolvency Act.

Allowing a process similar to business rescue, that provides a moratorium or breathing space for financially distressed MSMEs (those that are sole proprietorships and partnerships), would provide an alternative to sequestration and give credence to the concept of a "second chance" economy – one that protects jobs and includes mechanisms to ensure that terminal insolvency processes are the last option that are explored and not the first.

THE NETHERLANDS

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

Dutch insolvency law is primarily found in the Dutch Bankruptcy Act (*Faillissementswet,* or DBA) and case law. The DBA provides four formal insolvency proceedings: suspension of payments, bankruptcy, debt restructuring under the Debt Restructuring Natural Persons Act (WSNP), and the "Dutch Scheme" (as defined below). Both corporates and individual persons can be declared bankrupt, while the WSNP is only available to individual persons, and suspension of payments and the Dutch Scheme are only available to legal entities or to individual persons who have a business.

1.2 Specific insolvency legislation

There is no specific insolvency legislation for MSMEs.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

Since 1 January 2021, Dutch law has provided a framework that allows debtors (including MSMEs) to restructure their debts outside formal insolvency proceedings under the Dutch Scheme by offering a restructuring plan which can be confirmed by the court. The restructuring plan can be offered to all or part of the creditors and / or shareholders. Creditors and shareholders with dissimilar rights are placed in different classes. Creditors and shareholders are considered to have dissimilar rights if: (i) they have different rights in case of bankruptcy proceedings; and / or (ii) are offered different rights under the restructuring plan. Under the Dutch Scheme, MSMEs, in their capacity as *creditors,* have a specific position. MSMEs with an unsecured claim for supplied goods, or a claim based on tort, must be placed in a separate class if they receive a distribution of less than 20% of their respective claims.

Creditors and / or shareholders whose rights are affected by the restructuring plan are entitled to vote. The voting will be done per class and can take place either at a meeting or electronically. A two-thirds majority in value is required for a particular class to consent to the restructuring plan. At least one class of creditors must vote in favour of the plan in order for the debtor or the restructuring expert to be able to request the court for a confirmation of the restructuring plan.

Upon confirmation by the court, the restructuring plan becomes binding on the debtor and all creditors and shareholders who were entitled to vote. The court has to test the restructuring plan at its own motion against the general grounds for refusal and must reject the plan if any of those grounds applies, for example if procedural requirements have not been met, the performance of the plan is not sufficiently guaranteed, or the plan is a result of fraud.

The court may also reject the restructuring plan at the request of opposing creditors or shareholders if they would be significantly worse off under the plan compared to a liquidation scenario (termed the best interests of creditors test).

If one or more classes reject the restructuring plan, the court can still confirm the plan if at least one "in the money class" has accepted the plan (a cross-class cram-down). However, in such a scenario, the court must reject the plan at the request of opposing creditors or shareholders, when, for example:

- the statutory or contractual order of priority[1] is disregarded in relation to the opposing class, unless a reasonable ground for justification exists and the deviation is not detrimental to the relevant creditors (the absolute priority rule); or

- the relevant creditors are not offered a cash amount equivalent to the amount that would have been received in the event of a liquidation.

When it comes to confirmation of the restructuring plan, the position of MSMEs is also carefully tested by the court. In addition to the foregoing, the court must also refuse the confirmation of the restructuring plan at the request of opposing creditors or shareholders when (in short) MSMEs with an unsecured claim for supplied goods, or a claim based on tort, have been offered a payment of less than 20% of their claim and there is no compelling reason to do so.

1.3.2 Informal framework

In the Netherlands, there is an informal framework for out of court restructuring: so-called debt counselling (*schuldhulpverlening*) in which local authorities play a central role. This entails that a debt counsellor will help the debtor to reach a consensual agreement with its creditors.

1.4 Accelerated restructuring or liquidation of MSMEs

Dutch law provides for accelerated liquidation proceedings, which allow a quick and easy liquidation (the so-called *turboliquidatie*). This helps MSMEs as it is both time and cost-efficient. However, if the company's debts exceed its assets, the liquidator (typically the managing directors) must file for bankruptcy unless all creditors consent to liquidation outside bankruptcy. This proceeding does have a stigma of fraud, particularly because of its easy and quick nature.

1.5 Discharge of debts for natural persons

Under Dutch law, individual persons in financial difficulties can apply for the WSNP. The District Court will typically grant the application if the person shows that: (i) he / she is unable to reach a consensual agreement with his / her creditors; (ii) during the five years before the application he / she acted in good faith when incurring debts; and (iii) the person has not been subject to the WSNP in the preceding 10 years. If the District Court grants the application, it will also appoint

[1] Under Dutch law, the starting principle is that all creditors have an equal right to be paid from the net proceeds of their debtor's assets in proportion to their claims. There are exceptions: creditors' claims can (i) have priority; or (ii) be subordinated. Subordination to certain or all other creditors must be included in an agreement entered into with the debtor. Priority (*voorrang*) over certain or all assets results from a right of pledge, a right of mortgage, privilege (*voorrecht*) and other grounds provided for by Dutch law. Contractual order of priority does not override statutory law, but it may result in a creditor being contractually obliged towards another creditor to exercise its rights in a certain way, even if such creditor has statutory priority.

an administrator who will manage the person's finances, which means that the person will be given a limited amount to pay living expenses, and all other income will be used to settle the person's debts. In principle, the WSNP applies for three years. Shortly summarised, if the WSNP is terminated because the time period for which it was granted has lapsed, and during the applicability of the WSNP the person has met all obligations correctly, he / she will be granted a clean sheet, so that all unpaid claims will no longer be enforceable by operation of law.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

In the Netherlands, there were no general measures introduced regarding the extension or suspension of the repayment terms of loans or periodic debt service obligations during COVID-19. However, banks and the Dutch tax authorities have generally been accommodating when borrowers and tax subjects respectively have requested an extension or suspension. Additionally, the Dutch Government has taken several measures in order to enable companies (including MSMEs) to meet their obligations.

2. Special Measures

2.1 Procedural measures with respect to MSMEs

During COVID-19, insolvency proceedings were procedurally simplified by allowing court hearings by telephone or videoconference.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

In the Netherlands, the requirements to initiate insolvency proceedings have not been amended and neither was a minimum debt requirement introduced during COVID-19.

However, the Dutch legislator introduced temporary legislation pursuant to which the District Courts could grant a stay of the bankruptcy application if the debtor could successfully argue that its financial difficulties were caused by governmental measures in connection with COVID-19. In addition to the stay of the bankruptcy application, the District Courts could rule that no enforcement could be taken or that any attachments levied be lifted (or both), each during a specific period of time set by the District Court.

This temporary legislation has proven to be effective for certain debtors, but the main reason for the fact that there are not many bankruptcies in the Netherlands at the moment is that the Government has provided financial support and the tax authorities and important creditors such as banks have been accommodating, for example by granting extensions.

2.3 Insolvency procedural deadlines

The Netherlands has not introduced measures extending insolvency procedural deadlines during COVID-19 for MSMEs.

2.4 Minimum debt requirements to initiate insolvency proceeding

In the Netherlands, there was no minimum debt requirement introduced during COVID-19.

2.5 Suspending specific creditors' rights

As set out above, the Dutch legislator introduced temporary legislation pursuant to which the District Courts could rule that no enforcement could be taken or that attachments levied be lifted (or both), each during a specific period of time set by the District Court.

2.6 Mediation and / or debt counselling

Mediation and debt counselling are available, but not strictly mandatory in the Netherlands (see section 1.3.2 above). However, when applying for the WSNP, the person has to show the District Court that he or she has not been able to reach a consensual agreement with his or her creditors.

The merit of making mediation or debt counselling mandatory in a pre-insolvency scenario is that chances of debtors being able to reach an amicable solution pre-insolvency might increase. On the other hand, under certain circumstances, creditors may need protection, which can be provided for by insolvency proceedings – and such protection may be unavailable if the parties are first required to go through mediation or debt counselling. Additionally, commencing mediation or debt counselling may trigger creditors to start enforcement given the potential prospect of insolvency. In our opinion, no formal obligation for mediation or debt counselling is required as in the Netherlands, MSMEs already engage frequently and informally with their creditors to see if reaching an amicable solution would be possible.

3. Challenges Faced

3.1 Stigma associated with insolvency

Historically, a stigma has been associated with insolvency in the Netherlands. Even today, many parties consider insolvency as a failure. Under international influence, and due to the adoption of the business rescue culture by the legislator, which led to the introduction of the Dutch Scheme, the negative image of bankruptcy and insolvency is beginning to shift.

3.2 Availability of financial information

Financial information of natural persons is only available in the Netherlands on a limited basis. Obviously, certain information has to be provided to the tax authorities, but such information is not made publicly available. When MSMEs meet certain thresholds, they have to file limited financial statements with the trade register that are publicly available. We do not believe further information should be made publicly available given the privacy of the persons involved. Moreover, when a person becomes subject to formal insolvency proceedings, the appointed insolvency practitioner generally has access to the required financial information.

3.3 Access to new money

In theory, new money can be provided post filing or post commencement of insolvency. However, due to the increased risk of annulment on the basis of fraudulent preference, it is highly unlikely that parties will be willing to provide new money post filing for insolvency.

Under the Dutch Scheme, however, this is slightly different, as in such a case new money can be provided with the protection of the District Court. Shortly summarised, if the District Court believes that: (i) the new money is indeed required for the going concern of the company during the preparation of the restructuring plan; and (ii) provision of the new money is expected to be in the interests of the company's creditors (and none of the individual creditors' interests will be significantly harmed), the District Court can rule that the legal acts by which the new money is provided cannot be annulled on the basis of fraudulent preference.

3.4 Secured creditors *vis-à-vis* unsecured creditors

Creditors whose claims are secured by a right of mortgage (*hypotheek*) or a right of pledge (*pandrecht*) are secured creditors. Subject to any applicable freeze order, secured creditors are entitled to foreclose their collateral during insolvency proceedings. The bankruptcy trustee is in principle not entitled to the proceeds of the sale of the secured assets, nor is he / she entitled to withhold these assets. The secured creditors cannot be charged with the costs of the bankruptcy. The secured creditor and the bankruptcy trustee may also agree that the bankruptcy trustee will sell the collateral in return for a percentage of the proceeds (*boedelbijdrage*).

3.5 Insufficient asset base

As a result of the low asset base of MSMEs, there are often insufficient funds available to pay for the costs of insolvency (including the fees of the bankruptcy trustee). The bankruptcy trustee, however, does have to perform a certain amount of work by law. For example, the bankruptcy trustee has to liquidate the bankrupt entity's assets, review the company's books and records to check whether there have been any irregularities that have caused or at least contributed to the bankruptcy, complicate the liquidation of the bankrupt estate or have increased the shortfall in the bankruptcy. If there are no assets in the bankrupt estate (for example, if the bankrupt entity has no assets at all, and there is no ground for personal liability of a director, or if the director is personally liable but does not provide recourse), the bankruptcy trustee's fees will not be paid. In the Netherlands, there are no general sources of funding for the formal process of insolvency or liquidation, but there are certain specific arrangements pursuant to which the bankruptcy trustee can request the Government to provide an advance payment to finance, for example, directors' liability or claw-back proceedings.

We do not believe the low asset base necessarily pushes creditors to opt for liquidation or bankruptcy, as in such a scenario the limited value of the assets will generally be allocated to the costs of the liquidation (due to its higher ranking) and not be available for the creditors.

3.6 Personal guarantees (PGs)

PGs have no specific status in the Netherlands and are enforced on an individual basis.

4. Moving Ahead

4.1 Best ways to safeguard interest of MSMEs

According to our experts, Toni van Hees and Sophie Beerepoot, the best way to safeguard the interests of MSMEs is by including a variety of effective, quick and low-cost restructuring mechanisms in local law. Dutch law does to a certain extent provide for such mechanisms, in particular through the Dutch Scheme and the WSNP. However, our experts believe that the Dutch Scheme might still be too complicated, meaning costly advice is required, and therefore MSMEs could be hesitant to make use of this restructuring mechanism. In the opinion of our experts, this could be addressed by setting up a cost efficient restructuring desk (or by including experts on the Dutch Scheme on the existing debt counselling organisations).

Additionally, in our experts' opinion, limiting the power of secured creditors could help MSMEs as most or all of a business's assets are generally pledged for the benefit of secured creditors such as banks. As a result, the majority if not all value of the MSMEs is allocated to secured creditors and those creditors in practice have full control over the restructuring process. However, our experts noted the downside of introducing (further) limitations is likely that such creditors will be less willing to provide credit in the first place, which is also likely to negatively impact MSMEs.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Our experts noted that suspension of payments is often converted into bankruptcy, and due to the reputational risks and the negative stigma of a bankruptcy, insolvency has created more stress for MSMEs.

In our experts' opinion, the WSNP and the introduction of the Dutch Scheme will positively impact restructuring opportunities for MSMEs as those proceedings are more solution oriented. While not necessarily insolvency related, the Dutch legislator has published a draft bill amending the procedure for expedited dissolutions (*turboliquidatie*), which was introduced as a result of COVID-19 and is also likely to be helpful to MSMEs to wind down their businesses in a controlled manner while avoiding the current stigma of fraud. The current procedure for an expedited liquidation barely provides for safeguards to creditors and therefore it is often considered a mechanism that is open for abuse. The draft Bill aims to improve legal protection of creditors and prevent abuse, as it provides for a number of measures to increase transparency. For example, under the draft Bill directors that dissolve a legal entity by way of an expedited liquidation must disclose a number of documents (such as a balance sheet, distribution statement, annual accounts) in the Commercial Register of the Dutch Chamber of Commerce and they must notify the creditors immediately after such publication. In our experts' view, any changes that help MSMEs to restructure or wind-down in a controlled, cost-efficient and effective manner are to be encouraged.

Any COVID-19 measures only addressed the consequences of the pandemic, and mostly reverted to the pre-COVID scenario.

4.3 Simplified insolvency proceedings

Our experts are of the view that almost two years of Dutch Scheme proceedings has shown that it is an effective restructuring mechanism for big and small businesses alike. One expert believes it should be further assessed whether the Dutch Scheme can be simplified for MSMEs. The other expert noted that whilst there may be room for improvement with regard to costs of advice, we should also keep in mind the interests of creditors and make sure that any proceedings forcing creditors to accept less than full satisfaction of their claims contain sufficient safeguards to protect their interests (such as information requirements and judicial / independent supervision). Therefore, this expert believes that insolvency proceedings should not be over-simplified.

TURKS AND CAICOS ISLANDS

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

The Insolvency Ordinance 2017 (IO) is the main insolvency legislation in the Turks and Caicos Islands (TCI). The IO governs both corporate and individual insolvency (bankruptcy) in TCI and came into force on 1 January 2019.

The IO provides for, among other things, company arrangements between the company and its creditors or any class of them (Part III), placing a company in administration (Part IV), placing a company in receivership (Part V), liquidation of a company (Part VII), personal insolvency agreements (Part XI) and the bankruptcy of individuals (Part XII).

Unfortunately, the IO does not make specific provision for MSMEs and as such the terms of the IO are only relevant to MSMEs that have been incorporated or insofar as the individual owner of an unincorporated MSME seeks to file for personal bankruptcy under Part XII.

1.2 Specific insolvency legislation

There is no specific insolvency legislation for MSMEs in TCI.

1.4 Framework for out of court assistance or workouts

1.3.1 Formal framework

In TCI, the only formal framework for an out of court workout for a company is that which is contained in Part III of the IO – that is, the section relating to company arrangements. Such arrangements permit the directors of the company to entertain a compromise between the company and its creditors, or one or more classes of creditors, proposed and approved in accordance with the provisions of Part III. The implementation of a company arrangement is overseen by a supervisor acting as a trustee or otherwise.[1]

Individuals may enter into personal insolvency agreements under Part XI of the IO, which is essentially a compromise between a debtor and creditors, or one or more classes of creditors, proposed and approved in accordance with that Part. Again, the implementation of a personal insolvency agreement is overseen by a supervisor.[2]

1.3.2 Informal framework

Other than the formal workouts detailed above, MSME debtors can seek the assistance of financial institutions to get concessions in their loans and credit under the internal rules and regulations of the financial institutions.

Additionally, the Micro, Small and Medium Enterprises Development Ordinance CAP 20.16 sets out various government concessions (reduction of customs import

[1] IO, s 23.
[2] *Idem*, s 294.

duties or a cash grant) that MSMEs may be entitled to by virtue of their status under the Ordinance as applicable entities.

The interpretation section of the IO defines "small business" as a MSME that:

- is not a wholly or majority-owned business or subsidiary of a larger company; and
- is majority owned by Turks and Caicos Islanders.

A "small enterprise" refers to a business that is registered under the Business Licensing Ordinance, with at least two of the following attributes:

- has not less than six employees, but not more than 19 employees;
- has not more than USD $1,000,000 in net assets; and
- has not more than USD $1,000,000 in annual turnover.

1.4 Accelerated restructuring or liquidation of MSMEs

There is no legislation in TCI that provides for the accelerated restructuring or liquidation of MSMEs.

1.5 Discharge of debts for natural persons

Parts XI and XII of the IO provide for personal insolvency agreements and the bankruptcy of individuals. Eligible individuals are automatically discharged at the end of a three-year period under section 414 of the IO.

A bankrupt may also apply to the court for their discharge at any time after six months from the date of the bankruptcy order under section 416 of the IO.

Under section 418, the effect of a discharge is that it releases all debts claimable in the bankruptcy, but has no effect:

- on the functions, so far as they remain to be carried out, of the trustee; or
- on the operation, for the purposes of the carrying out of those functions, of the provisions of the Ordinance.

The discharge of a bankrupt does not affect the right:

- of any creditor of the bankrupt to claim in the bankruptcy for any debt from which the bankrupt is released; or
- of any secured creditor of the bankrupt to enforce his security interest for the payment of a debt from which the bankrupt is released.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

No special procedural measures have been enacted relative to MSMEs.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

There was no suspension of the requirement to initiate insolvency proceedings in respect of MSMEs specifically, or any other entities as a result of the COVID-19 pandemic.

The impact during the State of Emergency imposed upon the Islands in March 2020 and the accompanying closure of the country's airport was particularly difficult for MSMEs. Although the daily curfews imposed ended three months later, the continued closure of the airport until the third week in July 2020 caused a sudden shock to the tourist economy which did not really begin to abate until the typical "high" season for tourists in TCI began in November 2020. During that period, all Islanders were assisted (both those with small enterprises and otherwise) by the Government with a small stimulus cheque of about USD $1200. There was another disbursement of a similar amount in the middle of 2021 to Islanders.

2.3 Insolvency procedural deadlines

There was no change in respect of procedural deadlines relevant to MSMEs or other entities.

2.4 Minimum debt requirements to initiate insolvency proceedings

The minimum threshold, or "prescribed minimum" to initiate an insolvency proceeding / issue a statutory demand against all debtors, including MSMEs, was not affected by the pandemic.

2.5 Suspending specific creditors' rights

No changes have been made in relation to the suspension of creditors' rights arising from the pandemic.

2.6 Mediation and / or debt counselling

Although not specifically implemented in light of the pandemic or MSMEs, court-connected mediation has been introduced by the Chief Justice to deal with a range of disputes. However, these provisions are not applicable to insolvency proceedings, which means that any debtor counselling / mediation will have to take place on an ad hoc basis.

In an insolvency context, meditation has its advantages. It is often more expedient and timely than formal insolvency proceedings as there is less bureaucracy and rigidity to the statutory processes of the insolvency proceeding. Mediation also provides a confidential environment for participants to explore options and can modify their positions without fear of compromising their legal rights.

However, a party cannot be forced to enter into mediation and in the event that they do so and the result of the mediation happens to be non-binding, the exercise may have become a waste of time and money.

Further, since a mediation may require the parties to retain a mediator in addition to their counsel, the process can be more costly than insolvency proceedings. In the event, however, that the parties are willing to forego the attendance of their counsel, mediation may be much more cost effective.

3. Challenges Faced

3.1 Stigma associated with insolvency

In TCI, as in many places, there is a stigma concerning insolvent debtors and directors of insolvent corporate entities as there is a common perception that such persons are to blame for the financial difficulty. Of note, an undischarged bankrupt is disqualified from acting as a director of a company under the Companies Ordinance. It is also more difficult for individuals, in particular, who have previously been declared bankrupt to obtain loans following the procedure. In respect of corporate debtors, undergoing insolvency proceedings will mean banks are much more hesitant to provide capital otherwise than on significantly onerous terms, or with guarantees as to repayment over and above other creditors.

3.2 Availability of financial information

Most MSMEs in TCI are not corporate entities but are rather sole proprietorships and partnerships. They usually do not have the funds to retain professional accountants to prepare financial statements as such. In respect of MSME companies, annual returns which are mandated to be filed by the Companies Registry do not require the filing of financial information. Financial information in relation to MSMEs is therefore largely private.

3.3 Access to new money

There are no specific provisions in the IO giving priority to providers of new money in the context of restructuring proceedings (whether pertaining to MSMEs or otherwise). The availability of new money will depend on the willingness of the insolvency office holder, the debtor, new lenders and existing lenders to agree on suitable terms.

3.4 Secured creditors *vis-a-vis* unsecured creditors

Under section 211 of the IO, a secured creditor (of a MSME company or otherwise) may either value the assets subject to the security interest and claim in the liquidation as an unsecured creditor for the balance of their debt or surrender their security interest to the liquidator for the general benefit of creditors and claim in the liquidation as an unsecured creditor for the whole amount. They are not obliged to do either, but may at any time apply to the liquidator to amend the value that they placed on the security interest in their claim.

Subject to the above, under section 206 of the IO, the assets of a company in liquidation (a MSME or otherwise) are first applied in paying the costs and

expenses properly incurred in the liquidation, after which admitted preferential claims are paid, then other admitted claims and lastly any interest payable under section 215 (interest after the commencement of the liquidation).

3.5 Insufficient asset base

As with MSMEs in other jurisdictions, the relatively high costs associated with insolvency procedures such as administrations and company arrangements often prevent TCI MSMEs from taking advantage of the benefits of those processes. Instead, MSMEs are more likely to be either liquidated, or eventually struck off the Registry for delinquency in the filing of annual returns.

3.6 Personal guarantees (PGs)

It is the norm in TCI that a creditor will seek a PG from the individual shareholder(s) of a parent MSME. Because the creditor may enforce its debt against either or both the principal and the surety under TCI law, a situation may arise where the creditor, despite having filed and recovered part of its debt before a liquidation of the MSME or bankruptcy of the individual is commenced, may proceed to file a claim for the complete debt in liquidation. This anomalous situation remains and insolvency practitioners (IPs) must take precautions to ensure that double compensation is not obtained by a creditor and that the debtor obtains the best possible price in the selling of its assets. The IP's duty will be to obtain the best price bearing in mind the IP's liability to the guarantor for negligent mishandling of a sale of the company's property.[3]

3.7 Further challenges

Many MSMEs in TCI are not limited liability companies and operate as sole traders. They therefore operate outside the IO, unless they file for personal bankruptcy. In times of financial distress, the private individuals operating MSMEs are therefore not completely insulated from debt collection efforts against their personal property, including their homes, which form part of the estate under section 348(1)(a) of the IO. This often hinders their ability to "bounce back", so to speak, from financial and economic shocks.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

MSMEs in TCI would receive significant support from an insolvency process specifically aimed at addressing the often protracted and costly insolvency procedures contained in the IO. This is particularly so as most MSMEs cannot afford the legal assistance required to complete such procedures when in financial difficulty or when insolvent.

Legislation specifically targeting MSMEs in financial distress would go some way to addressing the above issue, especially if provision is also made in such legislation for court workouts and out of court workouts.

[3] *Standard Charted Bank Ltd v Walker* [1982] 3 All ER 93.

The following measures can be adopted to better safeguard the interests of MSMEs in getting through restructuring and formal insolvency:

- financing for MSMEs without the requirement of security or PGs (small business loans);
- coaching and mentoring programs for small business owners in respect of micro-economics, accounting and legal issues in particular;
- provision of educational material and texts aimed at assisting small business owners; and
- programs aimed at building information technology and digital skills in small business owners to improve competitiveness by leveraging technology.

4.3 Has formal insolvency helped MSMEs or created more stress for MSMEs?

The present procedures, insofar as they do not specifically cater to MSMEs, are more of a non-factor to debtors as they often do not have the funds to take advantage of them and may not be fully aware of their importance. Often, when MSMEs do take advantage of current insolvency procedures, they do so too late, which is to their detriment.

4.4 Simplified insolvency proceedings

Simplified insolvency proceedings would assist MSMEs and should relate to personal and corporate MSME insolvencies. The bulk of MSMEs tend to be sole traders and therefore when their businesses face financial difficulties, creditor action is usually directed at the individuals themselves.

Such an insolvency procedure should also not require the debtor to undertake the bulk of the financial burden of funding the insolvency proceedings as MSMEs, particularly the smaller ones, often will not be able to take advantage of the process if that is the case.

The procedure should be designed to allow debtors and creditors to meet and interact to resolve a situation of financial distress in an effort to allow debtors to re-enter the market. From a creditor perspective, the funds in contention will not be that significant and with some governmental assistance and a payment plan, debtors will likely be able to get back on their feet or re-enter the market in another form. The procedure should be much more simplified than presently exists as MSMEs tend to be simpler organisations in structure.

Awareness is also an important issue. Many MSMEs are unaware of the possible benefits which exist in engaging in the current insolvency procedures. They therefore do not take advantage of them. If insolvency proceedings specifically relevant to MSMEs are being considered, then a campaign to raise public awareness should be undertaken by the government in light of that.

UGANDA

1. Insolvency Framework – General Overview

In Uganda, the definition of MSMEs includes all types of enterprises irrespective of their legal form (such as family enterprises, sole proprietorships or cooperatives) or whether they are formal or informal enterprises. The Uganda Bureau of Statistics has adopted a categorisation of enterprises based on the fulfilment of the minimum requirements of any two of the criteria of number of employees, capital investment and annual sales turnover.

In quantitative terms, micro enterprises are those businesses employing not more than five people and with total assets not exceeding UGX 10 million. On the other hand, small enterprises employ between five and 49 people and have total assets between UGX 10 million and UGX 100 million. The medium enterprise employs between 50 and 100 people, with total assets more than UGX 100 million but not exceeding UGX 360 million.[1]

MSMEs dominate Uganda's economic landscape. They are the engine of Uganda's economic growth and are key drivers in fostering innovation, job creation and wealth creation and the socioeconomic transformation of the country as outlined in the Uganda Vision 2040.[2]

1.1 Formal insolvency legislation

Ugandan law provides for certain formal business rescue mechanisms and liquidation proceedings under the Insolvency Act 2011. The Act applies to both corporate and individual insolvency situations. However, 70% of the MSMEs are informal / unregistered[3] businesses and therefore do not have any corporate status attached to them. Accordingly, the procedures available are those that apply to individuals.

For individual debtors who intend to make an arrangement with creditors, section 119 of the Insolvency Act sets out the procedure to follow to obtain an interim order. Once an order is granted, it shall:

- act as a moratorium against bankruptcy proceedings, if any;
- stay any order of execution if there is any application made; and
- stay an application of receivership in relation to properties.

Making the order is appropriate for the purpose of facilitating the consideration and implementation of the debtor's proposed arrangement. The order ceases to have effect at the end of 14 working days after the making of the order.

Upon the court making an interim order, the debtor must submit to the proposed supervisor a document setting out the terms of the arrangement which the debtor is proposing and a statement of his or her affairs containing particulars of the

[1] UBOS 2010/11 statistics.
[2] Uganda Micro, Small and Medium Enterprise (MSME) Policy 2015.
[3] International Financial Corporation (November 2021), Market Bite Uganda, Challenges and Opportunities for MSME finance in the time of Covid-19

debtors, creditors, debts and assets. Section 123(1) of the Insolvency Act enables the proposed supervisor to give the court a report stating whether in his / her opinion a creditors' meeting should consider the proposed arrangement.

Section 123(3) of the Insolvency Act gives the court powers to, on application by the proposed supervisor, extend the period for which the interim order has effect to provide more time to prepare the report. After considering the report, the court may order the proposed supervisor to call a creditors' meeting to consider the proposed arrangement and for that purpose, may extend the period for which the order has effect.

The formal insolvency procedures applicable to formal businesses constituting 30% of the MSME market are mainly administration, receiverships and liquidation.

1.2 Specific insolvency legislation

Currently, there is no specific insolvency framework governing MSMEs only. The law that governs insolvency in Uganda is the same that applies to MSMEs – being the Insolvency Act and the Regulations made thereunder.

As indicated above, it is important to note that the majority of MSMEs in Uganda do not have a corporate status, meaning that the individuals running the enterprise are solely liable.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

The formal framework available is out of court but court supervised. This involves the debtor and creditors having an arrangement where the debtor proposes a plan to make payment to the creditors (as indicated above). The creditors appoint the provisional administrator who shall help to ensure that the proposal is implemented.

1.3.2 Informal framework

Informal modes of out of court assistance or workouts include:

- mergers and acquisitions. This involves two enterprises joining resources and working together. This helps to reduce management costs;
- renegotiating contracts with creditors to remedy default and breach of contract;
- obtaining new funds such as bank loans; and
- debt restructuring. This may involve renegotiating with banks so that an agreement on a new payment plan is arrived at and could also include debt write off.

However, the Government's Uganda Vision 2040 project aims to improve access for credit for MSMEs to assist with informal workouts. Objective 5 of Uganda Vision

2040 states that the Government intends to:

- increase access to credit and financial services;
- promote and strengthen linkages between MSMEs and financial institutions for extending flexible credit facilities such as hire purchase, asset / inventory financing, leasing and credit schemes;
- establish a special MSME fund to cater for innovations, start-ups and growth; and
- promote financial literacy training to entrepreneurs and encourage responsible borrowing and lending.

1.4 Accelerated restructuring or liquidation of MSMEs

According to the Insolvency Act, there is no accelerated process available for MSMEs.

1.5 Discharge of debts for natural persons

Discharge happens by order of the court upon the application of a bankrupt. There is no prescribed time for filing an application for discharge. A copy of the application must be served on the Official Receiver, the trustee and every creditor with an unsatisfied claim against the estate. The Official Receiver is mandated to respond to the application by providing a report on the conduct of the bankruptcy. The court considers this report together with that of the trustee of the bankrupt (if provided). The court has a discretion to hear the Official Receiver, trustee or a creditor on the application before determining the application. Where the court makes an order discharging the bankrupt, the court must issue to the bankrupt a certificate of discharge in the prescribed form.

A discharge order releases a bankrupt from all bankruptcy debts but not from any bankruptcy debt which he or she incurred by means of any fraud or fraudulent breach of trust to which he or she was a party or any liability in respect of a fine imposed for an offence or any other bankruptcy debts as the court may in its absolute discretion prescribe at the making of an order of discharge.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

Uganda does not have any procedural insolvency measures specific to MSMEs, and even during COVID-19, none were introduced.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

Uganda does not have any specific measures suspending insolvency proceedings. What was introduced were the Central Bank temporary "Credit Relief Measures (CRM) to mitigate the economic impact of COVID-19" suspending creditor enforcements and allowing for regulated repayment holidays, extension of loan tenor and restructuring until September 2021.

2.3 Insolvency procedural deadlines

Uganda did not introduce measures extending insolvency procedural deadlines for a limited period during COVID-19 for MSMEs.

2.4 Minimum debt requirements to initiate insolvency proceedings

Uganda did not make any changes in the minimum debt requirements to initiate insolvency proceedings.

2.5 Suspending specific creditors' rights

Uganda did not introduce any direct measures aimed at suspending creditors' rights. However, as noted above, in 2020, the Central Bank, under the temporary CRM to mitigate the economic impact of COVID-19, issued certain guidelines for relief of borrowers from commercial banks, credit institutions and micro finance deposit taking institutions. The guidelines were principally directed to enable these institutions to allow repayment holidays and restructure debts that would ordinarily not restructure. The measures lapsed in September 2021.

2.6 Mediation and / or debt counselling

Uganda has no specific framework for mediation and debt counselling for the rescue, restructuring and rehabilitation of MSMEs. However, mediation is legally established as one of Uganda's dispute resolution mechanisms which is generally available in all cases, including insolvency. On the other hand, debt counselling is not embedded in the legal framework. Rather, it is carried by some supervised financial institutions as a business strategy to enable borrowers to repay their loans. It is not mandatory to initiate mediation or debt counselling or financial education for any type of rescue, restructuring or rehabilitation, prior to formal insolvency.

The general benefits of making these processes mandatory include cost management, flexibility, time savings and privacy, and the prospect of an easier resolution of an insolvency situation or particular aspects thereof. Making these mechanisms mandatory would also reduce court backlog, allow more room for negotiation and foster reconciliation of the parties.

On the other hand, not all disputes can be mediated and mandatory mediation would in those cases amount to time wastage in a delicate situation, hence causing further losses. Further, mediation and debt counselling require full cooperation of the parties involved, so making them mandatory for unwilling parties could lead to the depletion of capital and further losses.

3. Challenges Faced

3.1 Stigma associated with insolvency

The stigma associated with insolvency proceedings involves negativity associated with social beliefs that insolvents are irresponsible, fraudulent and almost criminals. Creditors commonly believe that their insolvent debtors syphoned money out of their businesses in order to cheat them. Suppliers of goods and

services of insolvents, even when duly paid, commonly cease dealings for fear of incurring losses (insolvents are high risk) or association with insolvents.

3.2 Availability of financial information

Generally, the financial information of MSMEs is not easily available in Uganda. The majority of MSMEs are informal and therefore do not keep records. According to the National Small Business Survey of Uganda of 2015, only 28% of MSMEs do full financials and 19% of micro enterprises keep full financials.

It would be useful to each and motivate MSMEs to create and keep financial information. The Government is taking steps in this direction through the Registration Bureau that is encouraging formalisation via business registration. Creating access to affordable financing is one of the ways in which MSMEs can be motivated to keep and share their financial information.

3.3 Access to new money

There is no framework for interim or new finance.

3.4 Secured creditors *vis-à-vis* unsecured creditors

In proceedings of bankruptcy, the secured creditors are given priority while making payments. Therefore, the likelihood of them declining the arrangement proposal is minimal since they can easily recover their money. This leads to conflict where the unsecured creditors stand less chance of getting anything.

3.5 Insufficient asset base

One of the most recognised assets in Uganda is land, and it is also the leading form of collateral for debt financing. Most MSMEs in Uganda have no land and as such they are unable to access financing from financial institutions. It follows that they always suffer capital shortages and struggle to come back from business shocks which eventually leads to liquidation. Nonetheless, Nigeria recently passed the Security Interest in Movable Property Act 2019, which provides for use of movable property as security. This will increase access to credit for MSMEs, to enable them to grow their businesses and asset bases and to also enable formalisation of their transactions.

3.6 Personal guarantees (PGs)

PGs are quite prevalent in the borrowings of MSMEs in Uganda. The practice is for directors to issue PGs for the loans being granted to the companies. These PGs are enforced by way of civil suit for recovery of the guaranteed sums or via other agreed enforcement mechanisms.

3.7 Further challenges

Apart from the challenges highlighted above, the current insolvency regime is still very novel to many, including professionals. There is generally limited understanding of the whole insolvency practice, which leads to misunderstanding and frustration of activities of the few professionals in the market. There are also

aspects of insolvency legislation that need to be reviewed for various reasons such as inconsistency among provisions.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

Most MSMEs are owned by illiterates. There is a need to train them in the basics of bookkeeping, business development, accounting and financial literacy. Secondly, the Government should put in place incentives for local MSMEs, such as access to cheap financing and tax holidays. This will help to provide financial security and stability and prevent financial distress.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Formal insolvency has in some instances helped but in others it has created more stress on MSMEs.

As noted above, the temporary CRM to mitigate the economic impact of COVID-19, and the Guidelines issued to commercial banks, credit institutions and microfinance deposit-taking institutions, helped alleviate some of the financial distress faced by MSMEs. It would be beneficial for MSMEs for these measures to continue.

4.3 Simplified insolvency proceedings

The current law needs amendments. It has many conflicting provisions in the Act and Regulations. A simplified insolvency process for MSMEs is needed.

UNITED ARAB EMIRATES

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

In the United Arab Emirates (UAE), Federal Law No 9 of 2016 (Corporate Bankruptcy Law) deals with the bankruptcy / restructuring of traders. Under the Commercial Transactions Law No 18 of 1993 (Commercial Code), every person performing, in his own name and for his own account, commercial acts as a profession shall be deemed a merchant. This includes individual traders and commercial companies of all types (including sole establishments and single person limited liability companies).

In addition to the Corporate Bankruptcy Law, there is the Federal Decree-Law No. 19 of 2019 on Insolvency to regulate the cases of insolvency of natural persons (Personal Insolvency Law).

The key difference between the Corporate Bankruptcy Law and the Personal Insolvency Law is that the Personal Insolvency Law only applies to natural persons and the estate of the deceased. It does not apply to merchants, traders, commercial companies and similar persons which fall under the scope of the Corporate Bankruptcy Law.

The Corporate Bankruptcy Law provides for two restructuring methods prior to bankruptcy and liquidation: preventive composition and restructuring in bankruptcy proceedings. However, both processes are court supervised.

- ***Preventive composition (PC)***

  The PC is an arrangement between the debtor and creditors and is available to a debtor that is in financial difficulties but not yet insolvent or has been insolvent for a period of less than 30 consecutive business days. The procedure aims to facilitate the rescue of a business. The debtor should not meet any insolvency test in the Corporate Bankruptcy Law but needs to show that it has encountered financial hardship that requires assistance to reach a settlement with creditors.

  The debtor gets bankruptcy protection and the benefit of a moratorium. The Corporate Bankruptcy Law provides that all legal proceedings against the debtor are suspended following the adjudication of bankruptcy or the commencement of a PC. Therefore, no claim in a UAE court could be commenced, nor could there be any enforcement of a local or foreign judgment or award.

  Secured creditors may apply to the court to grant them an exception to the suspension of proceedings so that they can enforce their rights.

- ***Bankruptcy***

  Bankruptcy is a court-supervised process for which a debtor or creditor can apply. A debtor must apply if it has ceased repayment of its debts on the maturity dates for over 30 consecutive business days due to either its "shaken financial position" or assets being insufficient to cover at any time its due

liabilities. A bankruptcy filing could lead to a court-supervised restructuring process or liquidation.

Creditors can specify if an application to the court is for restructuring purposes or for bankruptcy and liquidation, however it is for the court to determine (based on the feedback received from the appointed trustee) which process will apply, and it may mandatorily put the debtor into liquidation if it determines that the business cannot be salvaged by a restructuring.

If the court accepts the restructuring option, with consent of the debtor, the process would largely follow PC (under the Corporate Bankruptcy Law) by the appointment of a trustee who oversees the preparation of the restructuring plan in consultation with the debtor and creditors (through a creditors' committee). The scheme of restructuring can be for five years (with three years' renewal). As the restructuring (within bankruptcy) usually favours unsecured creditors, secured creditors are excluded from voting on the restructuring scheme unless they submit their debts (or waive their security rights) or if the restructuring plan impacts the secured rights.

Under the Personal Insolvency Law, a debtor facing financial difficulties may apply to the court for assistance and guidance in the settlement of his or her financial commitments through court-appointed experts to reach a settlement plan. Acceptance of the debtor application places a moratorium on creditors' actions except in relation to assets that are subject to a pledge / mortgage.

While not dealt with in detail within this Chapter, it should be noted that each of the financial free zones in the UAE (the Abu Dhabi Global Market (ADGM) and the Dubai International Financial Centre (DIFC)) have their independent insolvency laws to which companies in those respective jurisdictions are subject to.

The DIFC Insolvency Law, Law No 1 of 2019, is relatively new. The DIFC Insolvency Law addresses distressed and bankruptcy-related situations in the DIFC.

The DIFC Insolvency Law provides for an in court-supervised rehabilitation process. Directors of a DIFC company proposes a scheme of arrangement of the company's affairs to its creditors. The scope of the rehabilitation regime in the DIFC is similar to the process under Chapter 11 of the United States Bankruptcy Code.

The insolvency regime in the ADGM is subject to the provisions of the ADGM Insolvency Regulations 2015. The ADGM Insolvency Regulations are quite similar to the DIFC Insolvency Law and they deal with distressed and bankruptcy situations in the ADGM.

Additionally, the ADGM Companies Regulation of 2020 provides for a scheme of arrangement. There is no specific scope for a scheme of arrangement, and it could be an arrangement or settlement that the ADGM company reaches with its creditors. This is a court-sanctioned process. The ADGM Insolvency Regulations also offer an administration process, which is a court sanctioned

process. In an administration process, an administrator is appointed to take over and control the management of the distressed company.

1.2 Specific insolvency legislation

There is no specific insolvency legislation for MSMEs. They are likely to fall under the Corporate Bankruptcy Law in the UAE if they are conducting business as traders or merchants (even if they are individuals).

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

The only option available outside the court supervised restructuring / bankruptcy process is recourse to the Financial Restructuring Committee (FRC). The FRC has been introduced by the Corporate Bankruptcy Law to supervise financial restructuring of merchants in all designated industries. Creditors can consider a consensual restructuring process with the cooperation of the borrowing group under the auspices of the FRC. The purpose of the FRC is to supervise the financial reorganisation of UAE-licensed entities to facilitate consensual arrangements between debtors and creditors on an amicable basis, albeit with no power to bind creditors.

Technically the FRC has no power to issue orders, including a moratorium, nor does it have the power to bind non-consenting creditors (i.e. there is no cram down). It is possible that if a consensual restructuring is not possible under the supervision of the FRC, the matter could be referred to the courts. In a recent referral from the FRC to the courts, the courts recognised the outcome of the FRC reports on the case.

There is no similar out of court restructuring route under the Personal Insolvency Law.

1.3.2 Informal framework

Informal frameworks usually include restructuring / settlement plans with financial institutions.

1.4 Accelerated restructuring or liquidation of MSMEs

There is no mechanism for accelerated restructuring or liquidation of MSMEs in the UAE. There are certain restructuring and liquidation processes under the Corporate Bankruptcy Law and the Personal Insolvency Law, but nothing specific to MSMEs.

1.5 Discharge of debts for natural persons

Under the Personal Insolvency Law, a debtor shall have restored all of his or her rights anytime if: (i) he or she reaches a settlement with creditors and commits to its execution; or (ii) the debtor establishes that all his or her creditors have discharged him or her from the debts.

A creditor whose debt was finally accepted by the court in insolvency proceedings, and whose debt was not fully paid, can have a claim against the debtor's assets for the shortfall even after the court's decision to terminate / close the insolvency proceedings against the debtor. Therefore, a debtor is actually discharged when all the creditors whose debts were accepted by the court agree to discharge the debtor from its liabilities.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

The UAE Central Bank (CBUAE) offered a Targeted Economic Support Scheme (TESS) to support banking customers from COVID-19 repercussions through a range of relief measures to the banking sector related to funding, liquidity, lending and capital. The CBUAE extended zero cost facility to banks and finance companies participating in the TESS in order for such banks and finance companies to provide new loans and facilities to customers negatively affected by the pandemic.

The schemes mostly targeted individuals and MSMEs.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

No specific rules were introduced during the pandemic for the simplification of insolvency proceedings in the UAE.

However, Law 21 of 2020 amended the Corporate Bankruptcy Law in relation to "applications filed by a creditor during an emergency financial crisis".

An "emergency financial crisis" was declared by Cabinet Resolution 5 of 2021 (Resolution), which is defined under the Corporate Bankruptcy Law as "a general condition affecting trade or investment in the country, such as an epidemic, natural or environmental crisis, war, etc.... determined by a decision of the Council of Ministers". The Resolution announced the "period between 1 April 2020 until 31 July 2021 as an "emergency financial crisis" as a result of the pandemic.

During an emergency financial crisis:

- debtors may, but are not obligated to, file for bankruptcy;
- creditors may not file to place a debtor in bankruptcy; and
- a light touch process is set out for debtors to agree a settlement with creditors, which restricts a settlement to a period of 12 months.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

During the declared emergency financial crisis referred to in section 2.1 above, debtors were entitled to, but were not required to, file for bankruptcy.

2.3 Insolvency procedural deadlines

Other than declaring the emergency financial crisis discussed in section 2.1, no other measures were declared by the UAE Government.

2.4 Minimum debt requirements to initiate insolvency proceedings

Generally, under the Corporate Bankruptcy Law, a creditor is entitled to file for bankruptcy of a person indebted to it where the creditor holds an ordinary debt (i.e. unsecured and not preferential) of at least AED 100,000 and the creditor has given written notice of the debt to the debtor within 30 consecutive business days of the notice to pay. The threshold for creditors' debt is AED 200,000 under the Personal Insolvency Law and the creditor must give a written notice to the individual debtor within 50 business days from the notice to pay.

The threshold limits have not changed during the pandemic, nothing that for corporates, creditors were prevented for initiating bankruptcy during the emergency financial crisis.

2.5 Suspending specific creditors' rights

See the measures that applied during the emergency financial crisis, referred to in section 2.1 above.

2.6 Mediation and / or debt counselling

There are private companies working in this field in the UAE as well as financial institutions.

For viable businesses, mediation would be a good addition to the UAE landscape and could potentially settle disputes that would otherwise result in insolvency. In saying that, insolvency is not necessarily that common in the UAE, with many creditors preferring other recovery actions, so the practical impact on the industry is unclear.

3. Challenges Faced

3.1 Stigma associated with insolvency

At the outset, there have been very few creditor-linked bankruptcies and few initiated by bank lenders due to the public nature of the proceedings and allowing other creditors (not linked to the syndicate) to participate in the bankruptcy proceedings.

From the debtor's perspective, historically the stigma of bankruptcy was one of the contributing factors which meant that there were no examples of insolvency under the old bankruptcy regime. That has changed in recent times, with many more debtor-driven bankruptcies, especially in the MSMEs space. In saying that, there were also large companies that filed for bankruptcy in recent times which further removes the historical stigma.

3.2 Availability of financial information

Financial information is not easily accessible. However, in recent years, the creation of the Credit Bureau has facilitated the availability of such information for financial institutions.

In addition, with the introduction of VAT and, from 2023, corporate income tax, it is likely that the availability of financial information will improve as small businesses move to a system where financial statements are more common.

3.3 Access to new money

Under the Corporate Bankruptcy Law, a debtor may request from the court to obtain new financing (secured or unsecured). New financing approved by the court will have priority over ordinary debts existing at the time of commencing the bankruptcy proceedings. The new financing can be secured by security over the debtor's assets. If the assets are already subject to security, the new financing can rank second to the existing first ranking security. The main challenge is the speed at which such new money can be approved by the court.

3.4 Secured creditors *vis-a-vis* unsecured creditors

Under the Corporate Bankruptcy Law, secured creditors may enforce their security with the permission of the court. Therefore, if sufficiently secured, they do have the ability to sit outside the insolvency.

However, on the other side, as part of any restructuring, secured creditors may not vote on the plan unless they waive their security or if the plan affects their rights.

3.5 Insufficient asset base

3.6 Personal guarantees (PGs)

It is common in the UAE to obtain PGs from shareholders / individual owners of MSMEs. The enforcement of PGs requires the filing of a substantive civil case in the court. Once a final unappealable order is obtained against the personal guarantor, an execution file will be opened and enforcement commences against the assets of the personal guarantor.

3.7 Further challenges

No additional challenges are applicable.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

Historically in the UAE, the main challenges to MSMEs were:

- the uncertainty of bankruptcy proceedings;
- potential liability for any shortfall; and

- criminal liability for bounced cheques.

This is changing in the UAE. With more precedent in the courts comes more certainty, and from 2022 the criminal liability attaching to bounced cheques largely falls away. There is still some work to ensure the process is as smooth as possible and that owners can have certainty around residual liability should a business fail, through no fault of their own.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

In the UAE, it has been largely debtor-driven cases before the courts. Therefore, we believe an improved bankruptcy regime has helped MSMEs.

During COVID-19, emergency legislation did give comfort as MSMEs did not have to file for bankruptcy and could not be placed into bankruptcy. The measures were appropriate during COVID-19, but cannot be a long-term solution.

4.3 Simplified insolvency proceedings

A simplified restructuring, liquidation and discharge mechanism is potentially useful in the UAE. The regime in the UAE has improved materially, and in recent years many MSMEs have relied on it. In saying that, potentially more could be done under the system to differentiate between debtors based on the size and complexity of their business and the process appropriate in each case.

UNITED KINGDOM

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

The Insolvency framework within England and Wales is covered by the Insolvency Act 1986 (IA) and the Insolvency (England and Wales) Rules 2016 (IR).

While there is no particular framework within the IA or IR which covers corporate MSMEs. In its 2016 review of the corporate insolvency framework, the United Kingdom Government stated that having an efficient and effective insolvency regime is one of the ways through which entrepreneurship, investment and employment can be achieved. The review and the impact of pandemic resulted in the creation of a number of new permanent measures:

- a new restructuring plan to help viable companies struggling with debt obligations. Courts can sanction a restructuring plan (that binds creditors) if it is "fair and equitable". Creditors vote on the plan, but the court can impose it on dissenting creditors (known as cross-class cram down);

- a free-standing moratorium to give United Kingdom companies "breathing space" in which to pursue a rescue or restructuring plan. During this moratorium, no creditor action can be taken against the company without the court's permission. The moratorium is overseen by a monitor (an insolvency practitioner) but responsibility for the day-to-day running of the company remains with the directors (a debtor-in-possession procedure); and

- a prohibition on termination (or *ipso facto*) clauses that are engaged when a company enters an insolvency procedure, a moratorium or begins a restructuring plan. The IA prevents suppliers from stopping their supply while a company is going through a rescue process. The IA includes safeguards to ensure that continued supplies are paid for, and suppliers can be relieved of the requirement to supply if it causes hardship to their business.

The measures marked a major change in United Kingdom insolvency towards a business rescue culture more in line with that of the Unites States.

The Government has embarked upon a review of the personal insolvency framework. The consultation ran from 5 July 2022 to 23 October 2022. At present, with respect to personal insolvency, the provisions of the IA cover:

- bankruptcy;

- individual voluntary arrangements (IVAs); and

- debt relief orders (DROs).

It should be noted that DROs in particular are relevant to MSME individuals.

1.2 Specific insolvency legislation

In corporate insolvency, previously, companies which met the definition of a MSME were able to apply for a moratorium prior to proposing a creditors' voluntary

arrangement (CVA). However, this was replaced by the Corporate Insolvency and Governance Act 2020 (CIGA 2020) on 26 June 2020, with the introduction of the aforementioned new moratorium process which is available to all companies (regardless of size).

With regards to personal insolvency, DROs were introduced as an alternative to bankruptcy and IVAs. The advantages of a DRO are that it is cheaper, comprising of a one-off fee of £90. An IVA, in comparison, can cost thousands to cover fees / dividends to creditors, and a bankruptcy will cost £680 assuming the individual has no assets. The eligibility criteria for DROs changed in June 2020 and is as follows:

- debt level of £30,000 or less;
- disposable income of £75 or less; and
- net assets of £2,000 or less

Given that the criteria has only recently changed, it is too early to assess the future impact.

1.2.1 IVA

Individuals propose an IVA with the assistance of an insolvency practitioner and normally the process does not require the assistance of court. The purpose of an IVA is to provide an opportunity for individuals to compromise their debts with the benefit of protecting assets such as properties (although IVAs are not exclusive to homeowners).

The advantage of having an IVA in place is that there is a moratorium for the duration of the IVA in respect of the creditors listed in the IVA.

1.2.2 Debt respite scheme

This scheme provides individuals with a moratorium against creditor action for up to 60 days while the individual assesses their options. A longer moratorium period is available if the individual is receiving mental health crisis treatment. Once the scheme is in place, the individual still has an obligation to pay their debts, but creditors are unable to add interest or charges to the debts and creditors are not able to take enforcement action or contact the individual.

This scheme can only be started by a debt advice provider who is authorised by the Financial Conduct Authority to offer debt counselling, or a local authority (where they provide debt advice to residents).

The benefit of the scheme is that it provides the individual with time and space to engage with debt advice and find a long-term debt solution.

1.2.3 Informal framework

Individuals have the option to contact their creditors directly and negotiate either payment holidays, freeze interest, or agree a compromise. Other options include:

- instructing a third party to formulate and agree a debt management plan (informal payment plan) with creditors;
- obtaining a debt consolidation loan and repaying existing debts; or
- seeking new finance (e.g. a second loan against property).

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

- ***Moratorium***

  The CIGA 2020 introduced a new standalone moratorium procedure for companies.

  The moratorium is a director-led process which leaves the directors *in situ* to trade the company, with an insolvency practitioner acting in the role of "monitor" overseeing the company's affairs. The aim is to afford companies some breathing space from creditor action to formulate a turnaround plan without adding significant costs. The moratorium is focused on the recovery of the company rather than the realisation of its assets.

- ***Out of court administration order***

  The Enterprise Act 2002 simplified the administration order process by allowing the company or its directors to make an out of court application.This accelerates the administration process as well as reducing costs, which were previously seen as a high barrier for MSMEs. Prior to the out of court application, a majority of MSMEs preferred to enter into a liquidation as it was perceived to be cheaper.

  In order to make an out of court application, the company has to meet the criteria specified in Schedule B1 to the IA.[1]

- ***Company Voluntary Arrangement (CVA)***

  A CVA is a legally binding agreement between the company and its creditors, where the company compromises its debts by either offering monthly payments (usually 36 to 60 months) and / or through lump sum payments (either through a cash injection from investors or sale of assets). The company can continue to trade in the CVA and, following successful completion, the balance of any unsecured debts are written off. The CVA proposal is made by the directors of the company with the aid of an insolvency practitioner.

- ***Members' Voluntary Liquidation (MVL)***

  A MVL is initiated by company shareholders and used to close solvent companies. In restructuring, MVLs are used to simplify corporate structures where there are a number of limited companies in the same group. A group

[1] https://www.legislation.gov.uk/ukpga/1986/45/schedule/B1/paragraph/25.

may elect to close companies because they are no longer trading, or they have transferred or sold the assets to another entity. An essential feature of MVLs is that all the companies debts are paid in full and a distribution is usually made to the shareholders of the company who can utilize Business Asset Disposal Relief to reduce their tax bill by undertaking an MVL procedure.

- ***Scheme of arrangement***

  Pursuant to the Companies Act 2006, a scheme of arrangement is available to companies that wish to restructure their debts without going through an insolvency process. The scheme of arrangement is a binding creditor agreement and needs the approval of creditors (75% approval by creditor value and by at least 50% by number of creditors in each class) and the court.

- ***Restructuring plan***

  A restructuring plan is a tool which was introduced by the CIGA 2020 and is similar to a scheme of arrangement. However, the key difference is that in a restructuring plan, shareholders or creditor classes which do not meet the 75% approval criteria can be "crammed down" and thereby the plan can be approved by the court if:

  - the court is satisfied that no member of the dissenting class(es) would be any worse off under the restructuring plan than they would be in the relevant alternative; and

  - it can be shown that a minimum of one class who votes in favour of the restructuring plan would benefit from the relevant alternative.

  The term "relevant alternative" has no specific definition, and instead is the court's interpretation on what will happen to the company in the event a restructuring plan is not approved. For example, the alternative could be liquidation.

1.3.2 Informal framework

Informal frameworks for companies will normally require the assistance of an accountant and / or corporate finance specialists.

Options available through advisors include:

- group reorganisation;

- restructuring debt by way of negotiations with existing lenders (to either extend terms or provide grace period);

- raising finance from new lenders at favourable terms or to consolidate; and

- companies also have the option to seek debt for equity through either existing and / or new shareholder investment.

Companies may also seek new or additional finance by way of:

- property finance;
- asset based financing; and
- debtor factoring.

Finally, companies could also consider a non-insolvency sale of the business.

1.3.3 Mediation and / or debt counselling

Companies can instruct debt specialists or solicitors to negotiate with creditors, which can be very useful if the company only has a handful of creditors. Alternatively, if the company granted security to a creditor, it may instruct a specialist to carry out a security review and subsequently propose solutions such as those listed in the informal framework in section 1.3 above.

There are no statutory laws requiring companies to initiate mediation, debt counselling or financial education prior to formal insolvency. Instead, emphasis is placed on the directors' fiduciary duty to act in the interests of stakeholders and for the professional advisors to provide informed options available to the company.

For individuals, they can either use the private sector or public sector for debt counselling. Companies which provide debt counselling to individuals must be regulated by either the Financial Conduct Authority or by a relevant professional body for example solicitors, accountants or insolvency practitioners. The sole exemption from this is the local authority.

In respect of debt mediation, there is emphasis on duty of care from creditors. In particular, creditors are expected to engage with individuals early on so as to not worsen the position of the individuals. This may include talking to the creditor's in-house debt management team which could involve assessing individual budgets to re-evaluate debt affordability or signposting individuals to debt charities such as Stepchange.

In terms of making mediation or debt counselling mandatory in a pre-insolvency setting, the advantages would be:

- requiring immediate creditor engagement, which creditors will appreciate and hopefully will result in greater creditor acceptance;
- potentially lower professional costs for the company and individuals when compared to dealing with insolvency professionals;
- directors and individuals may feel more in control of the process when compared to insolvency where the matter is often taken out of their hands;
- if the process is agreed to by all parties, it is not something which is published in the public domain and there would therefore be less stigma; and

- in relation to individuals, they can apply for Breathing Space (see section *1.3.1* above), which will give them space and time to formulate a debt plan.

The disadvantages would be:

- there is no obligation from creditors to take part in the process. Therefore, it can only be effective if all creditors agree to the process. Directors and individuals may feel like they are wasting time and money in trying to go through a process which may ultimately still result in an insolvency process;

- there is a risk that directors and individuals engage with unregulated professional advisors, resulting in incorrect advice being given; and

- companies may face creditor actions especially if it will likely take a significant amount of time to formulate and implement a plan (e.g. financial affairs being complex), since there is no moratorium against creditor pressure.

1.4 Accelerated restructuring or liquidation of MSMEs

Insolvent companies may apply for a pre-pack administration for an accelerated sale of the business or restructuring purpose. However, a pre-pack must achieve its intended purpose.

Due to ongoing concerns relating to the perceived lack of transparency in relation to pre-packs and in particular where it involves a sale to a connected party (which tend to be more common with MSME companies), additional measures were introduced.[2]

The Administration (Restrictions on Disposal etc to Connected Persons) Regulations 2021 (Regulations) came into force on 30 April 2021. The legislation revised the following Statements of Insolvency Practice (SIP)

- SIP 16: Pre Packaged Sales in Administrations; and

- SIP 13: Disposal of Assets to Connected Parties in an Insolvency Process

The Regulations imposed conditions on substantial disposals of a company's assets in administrations to connected persons – namely that an administrator must not proceed with a disposal of company property to a connected person within the first eight weeks of appointment without:

- creditors' Consent; or

- an independent opinion of the disposal (a qualifying report)

The Regulations were not limited to sale made under a pre-pack arrangement but extend to all sales made to a connected person in an administration.

Pre-packs have been a useful tool for MSMEs as a means for restructuring and the ability for purchasers to buy assets prior to the insolvency event (thereby

[2] https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration

maintaining value). However, in reaction to the negativity from stakeholders who are not involved in the sale process, the position surrounding pre-pack administrations is constantly changing from a regulatory point of view.

The introduction of the deemed consent procedure for placing companies into a creditors' voluntary liquidation has been a useful tool when dealing with MSME insolvencies as these can now be implemented within a short space of time.

1.5 Discharge of debts for natural persons

In bankruptcy, an individual's provable debts are written off once the individual is discharged from bankruptcy. The bankrupt normally receives automatic discharge after 12 months. However, discharge can be suspended in certain circumstances, for example where the bankrupt fails to co-operate with the trustee

If an individual applies for a DRO, their debts are automatically written off after 12 months. In certain circumstances, the DRO can be suspended, resulting in the individual debts not being written off.

In an IVA, the debts are written off once the IVA successfully concludes. IVAs tend to last for five years but can be shorter or longer depending on the individual's circumstances. If an IVA fails, for example due to non-performance by the individual, the debts listed in the IVA are not written-off and creditors are no longer bound by the IVA and can pursue the individual for payment of their debt and / or petition for the individual's bankruptcy.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

The United Kingdom Government did not introduce specific insolvency measures for the simplification of proceedings for MSMEs during COVID-19.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

As part of the CIGA 2020, the Government introduced restrictions on statutory demands and winding up petitions where it could be demonstrated that a company was unable to pay its debts (including rent) due to COVID-19. Where the petitioning creditor had reasonable grounds for believing COVID-19 had not impacted the company, or alternatively the company debts would have arisen in any event if COVID-19 did not happen, then the creditor could go ahead a seek a winding up order. This suspension ended on 30 September 2021.

These measures resulted in a reduction of company insolvencies for July 2021 by 24% compared to July 2019.[3]

The temporary ban on statutory demands extended to individuals. This resulted in a reduction of 34% in bankruptcies, 22% in DROs and 7% in IVAs when comparing registration figures for July 2021 against July 2019.

[3] https://www.gov.uk/government/statistics/monthly-insolvency-statistics-july-2021

2.3 Insolvency procedural deadlines

While there was no general extension of insolvency procedural deadlines for a limited period during COVID-19, the CIGA 2020 introduced a new moratorium for companies who propose a CVA. The initial moratorium is for 20 days, allowing the company protection from insolvency while it formulates a restructuring plan. The moratorium can be extended to 40 days without consent and up to a year with consent of creditors or a court application.

The moratorium may be seen as a useful option for companies, though the uptake has been limited.

2.4 Minimum debt requirements to initiate insolvency proceedings

From 1 October 2021 up until 22 March 2022, the Government introduced the following measures which creditors were required to satisfy if they wished to issue a winding up petition:

- the debt must be a liquidated amount, has fallen due for payment, and is not for rent and any other payments due under a tenancy agreement;
- the debt owed is at least £10,000; and
- prior to presenting the winding up petition, creditors must seek proposals for payment from the Company, giving them 21 days for a response before they can proceeding with winding up action.

Previously, the requirements for issuing a winding up petition were:

- a minimum debt level to issue a winding up petition was £750;
- an unsatisfied judgement debt; or
- the court was satisfied the company was unable to pay its debts when they fell due.

The introduction of the new measures meant that smaller companies and tenants, which were both significantly impacted by the pandemic, are protected.

2.5 Suspending specific creditors' rights

The CIGA 2020 introduced measures in relation to landlords who wished to take debt recovery action against commercial tenants. Specifically, forfeiture of the tenancy due to non-payment of rent was suspended until 25 March 2022.

Also, action pursuant to Commercial Rent Arrears Recovery (CRAR), which allowed landlords to instruct enforcement agents to take control of a tenant's goods and sell them to recover the value of any rent arrears (minimum rental seven days arrears), was suspended unless rent was due for 554 days on or after 24 June 2021.

3. Challenges Faced

3.1 Stigma associated with insolvency

There are still certain stigmas associated with insolvency, mainly due to the information being in the public domain. Members of the public can very easily find out which company or individual has entered into an insolvency process.

For business owners, the stigma can also be attributed to their personal reputation, which may have taken years to develop, immediately being tarnished due to insolvency.

Also, due to the exchange of information, directors in their individual capacity are concerned that any kind of insolvency event needs to be personally disclosed with their own banks, insurers and any other financial institutions. As a result, directors may have reservations about instigating an insolvency process, as they feel that there is no distinction concerning the impact on the company and the impact on themselves.

Conduct of the directors are also reported to the insolvency service who would consider whether this director poses a risk to the general public and whether there is a need to disqualify the individual from being a director in the future.

3.2 Availability of financial information

In terms of measures in place for corporate insolvencies, the liquidator does not have an automatic entitlement to see the director's personal financial information. This normally has to be disclosed by the director voluntarily or the officeholder has to carry out separate investigations, which can be limited. This can frustrate the officeholder in the event there are recoveries to be made against the director as a result of antecedent transactions, as the officeholder may not be able to determine if it is cost effective to carry out the relevant process.

An individual's financial information listed in the public domain is limited to show:

- if they are a director, shareholder and / or person of significant control of a limited company;
- how much they are paid in terms of salary and dividends, depending on the level of disclosure in the financial accounts;
- if a person has been or is bankrupt; and
- if a person is currently in an IVA.

Creditors are able to get further information if the individual consents to a credit check. The credit report will show live fixed term secured loans, unsecured loans, overdrafts and utilities along with the payment schedules for these accounts. In addition, the report will also list closed accounts for the last six years.

In certain insolvency types such as bankruptcy, the officeholder (trustee) has wide powers in order to collect financial information on the individual. These powers include:

- requesting books and records from third parties such as professional advisors;
- requesting bank statements directly from the bank;
- obtaining tax records from HM Revenue & Customs (HMRC); and
- performing a land registry search to ascertain if the individual owns any property in the United Kingdom.

The trustee has a wide range of powers, but the trustee must demonstrate these powers are being used for the benefit of the bankruptcy estate and not as a fishing exercise.

3.3 Access to new money

Due to historically low interest rates, along with the increased competition within the challenger bank and asset-based lenders sectors, access to new finance is readily available for MSME successor firms. Many of the mainstream banks will look into any past failures and see whether the directors pose any risk of future loses for the bank should they lend money to them. If the risk is deemed high, the lender may seek personal guarantees from the director(s) or the lender may seek security against company assets.

3.4 Secured creditors *vis-à-vis* unsecured creditors

Subject to the powers conferred to the secured creditor pursuant to the specific charge document, the secured creditor usually has the following powers available to it in order to commence insolvency proceedings (which are not available to unsecured creditors):

- the power to commence administration proceedings under its floating charge;
- the power to appoint an administrator receiver under its fixed charge if the charge was created pre 15 September 2003; and
- the power to appoint a Law of Property Act receiver under its fixed charge if the charge was created post 15 September 2003.

If the company elects to go down the liquidation route, it must first seek consent from the secured creditor, at which point the secured creditor may decide to appoint its own administrator or allow the company to continue with their chosen insolvency action.

In certain procedures, if the officeholder can only make a return to secured creditors, then he / she will seek approval of certain actions from only secured creditors (and any preferential creditors), which means unsecured creditors are excluded.

In CVAs, secured creditors are usually excluded. Thereby, only unsecured debts are compromised in the arrangement.

In the event a dividend is payable in an insolvency process, the secured creditors rank in priority over unsecured creditors. Fixed charge creditors are paid out first from the realisation of the asset they have security over.

In the event the secured creditor has a floating charge, the costs of realisation along with preferential creditors and a deduction of the prescribed part are paid in priority.

This usually means that unsecured creditors normally receive either a low value dividend or receive no dividend at all.

3.5 Insufficient asset base

Where companies have minimal to nil assets, it is becoming increasingly common for directors to personally fund the CVL process themselves. This is so the directors do not fall foul of their fiduciary duties of dealing with the companies affairs in a timely manner by liquidating the company, as opposed to waiting for a creditor to issue a winding up petition, which may take months.

At the same time, there are still a high number of zombie MSMEs in the United Kingdom due to cheap credit and passive creditor action (due to the high costs involved in petitioning for a wind up), resulting in it being easier for companies to continue to trade all the way until there is no choice but to liquidate. This has been detrimental to the United Kingdom economy, as zombie companies have contributed to the productivity gap compared to other competitive countries. Further, electing to continue to trade until the company becomes insolvent means there are limited options available to the company. The issue of zombie companies is now more prevalent due to the generous financial packages introduced by the Government to mitigate the risks of COVID-19.

3.6 Personal guarantees (PGs)

PGs have always been a useful tool for creditors in particular lenders to mitigate against risk, be it due to the company not having any trade history or the lender itself may not be in the normal parameters of the lender's risk profile. Recently, PGs have become more prevalent for two reasons, outlined below.

3.6.1 Tax debts

From 1 December 2020, HMRC was granted secondary preferential creditor status for certain tax debts. Previously, all HMRC debts were unsecured claims in the insolvency process. This has impacted lenders, as their floating charge has been diluted, given that they will only receive a dividend after preferential creditors are paid in full.

3.6.2 Coronavirus Business Interruption Loan Scheme (CBILS)

Where a company took a CBILS loan, the Government permitted lenders to take personal guarantees on any lending over £250,000 provided that:

- recoveries under the PG are capped at a maximum of 20% of the outstanding balance of the CBILS facility after the proceeds of business assets have been applied; and

- a principal private residence (PPR) could not be taken as security to support a PG or as security for a CBILS-backed facility.

In terms of enforcement, this normal debt recovery process unless it can be demonstrated that the PG is not equitable or contains unfair terms. Challenging the PG normally will require the assistance of a solicitor.

3.7 Further challenges

With COVID-19 support having ended, the short-term challenges mainly relate to the lack of resources in the insolvency sector labour market. The industry is currently dealing with current record levels of MSME insolvencies, with the trend expected to remain upward.

Traditionally, there has always been a low number of qualified insolvency practitioners in the United Kingdom (there are now approximately 1,600). This is mainly due to the high barrier of entry into profession, including the need to pass the professional papers which have an exam success rate of approximately 35% to 40% and can only be sat once per year, along with the requirement of completing 600 hours of higher experience in insolvency administration before a regulatory body will issue a practicing license and inclusion.

4. Moving Ahead

For this section, we have interviewed Rehan Ahmed, Managing Director at Quantuma Advisory Limited. Rehan is a qualified insolvency practitioner and serves on the Insolvency Service steering committee for diversity.

4.1 Safeguard the interests of the SMEs

While the United Kingdom Government has introduced new rescue tools such as moratoriums (breathing space) and restructuring plans, the costs involved in these measures are substantially high compared to traditional restructuring options. It is considered that the cost of a straightforward SME rescue plan are in the region of £100,000 to £150,000, which is not viable for companies that are already insolvent. Due to these high costs, it is evident that MSMEs are discouraged from exploring certain options which can be seen in the low numbers of companies that have used moratoriums and restructuring plans since their inception.

Given that moratoriums and restructuring plans are new processes, it is hoped that once they have bedded in over time, efficiencies will be identified, resulting in lower costs and thereby becoming more viable for SMEs to consider.

4.2 Impact of the insolvency framework on SMEs

The reclassification of certain HMRC debts to secondary preference status has hindered the viability of CVAs for MSMEs. As a result, company proposals will need to ensure HMRC debts such as VAT are paid in full ahead of unsecured creditors,

such as trade creditors. This has discouraged a lot of MSMEs from considering CVAs due to the likelihood that trade creditors will unlikely support proposals where there are substantial HMRC debts.

The temporary suspension of the wrongful trading section of the IA has brought relief from certain personal liability risks to directors of companies who considered formal insolvency options during COVID-19. This supported directors when making the decision on whether to place their company into liquidation / administration due to the less likelihood of being pursued for wrongdoing. This relief was withdrawn on 1 July 2021.

Companies were also provided with COVID-19 funding options specifically created to assist with working capital. These funding options included Bounce Back Loans (BBLs), Coronavirus Business Interruption Loan Scheme (CBILS) and local authority grants. Many MSMEs took advantage of these loans as the lending criteria was considered to be less restrictive in comparison to traditional funding options. For example, there were no requirements for a personal guarantee (PG) for companies that took out BBLs. For CBILs, lenders could only request a PG for loans above £250,000 and even if a PG was required, the lender could not include the director(s) principle private residence as security. The deadlines for applications for COVID-19 funding solutions ended on 31 March 2021.

4.3 Simplified insolvency proceedings for SMEs

The introduction of deemed consent procedure has been useful for SMEs when entering into liquidation. This is because there is no requirement to hold a virtual or physical creditors meeting unless there is 10% of creditors in amount, value, or in number who object to the deemed procedure and instead wish to hold a physical meeting. This has reduced a lot of initial administration work. Future streamlining will need to be considered carefully given the balance between the need to support MSMEs through insolvency and acting in the interests of MSME stakeholders.

Rather than a terminal procedure being the most common insolvency procedure, a simplified version of the restructuring plan which allows businesses to be turned around and survive should be the ideal solution. Reducing the minimum threshold to approval on each class to a simple majority of more than 50% would help in reducing the high entry barrier to this procedures.

* The opinions expressed in this article are those of the authors and do not represent the views or opinions of Quantuma Advisory Limited.

UNITED STATES OF AMERICA

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

The Bankruptcy Code (Code) is the primary source of bankruptcy law in the United States.[1] It provides for bankruptcy filings by businesses, individuals and municipalities. Business and individual debtors can choose to file under one of the four chapters of the Code set out below and may select from three broad categories of bankruptcy; liquidation, reorganisation and adjustment of debts:

- Chapter 7 – liquidation proceedings for individuals and businesses;
- Chapter 11 – reorganisation proceedings for individuals and businesses;
- Chapter 12 – adjustment of debts of family farmers and fishermen; and
- Chapter 13 – adjustment of debts for individual debtors.

Chapter 7 is the most common form of bankruptcy in the United States.[2] In a Chapter 7 liquidation, a trustee is appointed to sell the assets of the bankruptcy estate and distribute the proceeds to creditors. Chapter 7 allows individual debtors to have a "fresh start" by providing a discharge of most types of debt. However, in most cases, a means test is applied to determine if individual debtors are eligible for this relief. If the debtor's income exceeds certain statutory thresholds, the Bankruptcy Court will dismiss the Chapter 7 case or convert it to a debt adjustment proceeding under Chapter 13. In contrast, business debtors in Chapter 7 are not entitled to a discharge of debts and will be dissolved at the end of the proceeding.[3]

In a Chapter 11 case, there is a strong presumption in favor of a debtor in possession retaining control of the company (which allows existing management to continue to operate the company during the bankruptcy case).[4] This allows financially distressed debtors to restructure via a plan of reorganisation, provided the plan has sufficient support from impaired creditors and / or meets the requirements of the Bankruptcy Code.

Once a Chapter 11 petition is filed, an automatic stay, among other things, prohibits creditor collection efforts, giving the debtor breathing space to formulate a plan of reorganisation. The debtor has an initial 120-day exclusivity period to file a plan of reorganisation before other interested parties may propose a plan. A consensual plan may be confirmed if each impaired class votes in favor it. A class is deemed to consent to the plan if at least two thirds in value and a majority in number vote in favor of it. If a class is unimpaired, it is deemed to have voted in favour of the plan.

If an impaired class does not consent to the plan, the plan may be "crammed down" on that class if the plan meets certain requirements. Among these, the court must consider whether the plan is in the best interests of creditors, does not discriminate unfairly, and is fair and equitable.

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1 K M Lewis, *Bankruptcy Basics: A Primer* (2018) Congressional Research Service, 8.
2 A Best, "Lying Lawyers and Recumbent Regulators" (2015) 49 *Indiana Law Review* 1, 13.
3 See above, n 1.
4 Unless a trustee is appointed under 11 U.S. Code § 1104.

Economically, reorganisation is justified when the value of the assets sold individually is less than the going concern value of the business.[5] Many small businesses in financial distress have little hope at rehabilitation, and Chapter 11 reorganisation can be a prohibitively expensive process for those that do. Hence, Chapter 7 liquidation has been more often used by small businesses than Chapter 11.

Outside of Chapter 7 and Chapter 11, a company can face the appointment of a federal or state court receiver or foreclosure. If a debtor and creditor are so inclined, and state law is favorable, an assignment for the benefit of creditors (an ABC) may be possible.

ABCs provide a state law statutory or common law alternative to a bankruptcy where a company's assets are assigned to a third-party assignee selected by the company and charged with liquidating the assets to satisfy creditors' claims. It is often a cost-effective alternative to Chapter 11 and was highly utilised following the dot com crash in 2001.

1.2 Specific insolvency legislation

The United States Small Business Administration Office of Advocacy defines small businesses as firms with fewer than 500 employees. There are 32.5 million such businesses in the United States, making up 99.9% of United States businesses and employing over 61 million[6] people. Between March 2019 and March 2020, small businesses accounted for 909,808 openings and 843,229 closings.[7]

The Small Business Reorganisation Act of 2019 (SBRA) became effective on 19 February 2020. The SBRA was passed by the Unites States Congress with the goals of providing distressed small business owners the opportunity to reorganise their businesses more quickly and at a lower cost and allowing creditors to get paid sooner.[8] Under the SBRA, as originally enacted, small business debtors are defined *inter alia* as debtors with less than USD $2,725,625 in non-contingent liquidated debts. These debtors may elect to have their cases administered under the new Subchapter V of Chapter 11 of the Bankruptcy Code.

In response to the COVID-19 pandemic, the Coronavirus Aid, Relief and Economic Security (CARES) Act increased the Subchapter V debt limit from USD $2,725,625 to USD $7,500,000 until 27 March 2021. The increased limit was later extended through 21 June 2024.

The SBRA creates Sub-Chapter V and streamlines the Chapter 11 process for small business debtors by establishing a plan filing deadline 90 days after the filing of a petition and requiring a status conference within 60 days[9] of the filing of the petition. Although a trustee is appointed, the Subchapter V trustee takes on a different role than a Chapter 7 or Chapter 11 trustee. In a Subchapter V case, the trustee acts more as a consultant or advisor, and only the debtor can propose a

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5 E I Altman, E Hotchkiss and W Wang, *Corporate Financial Distress, Restructuring and Bankruptcy* (4th ed, Wiley & Sons, 2019).
6 Source: United States Census Bureau, 2018 Census.
7 Source: U.S. Bureau of Labor Statistics.
8 C J White, "Small Business Reorganisation Act: Implementation and Trends", ABI Journal, January 2021.
9 *Ibid.*

plan of reorganisation. Notably, unlike a standard Chapter 11 case, a disclosure statement is not required and an unsecured creditors' committee is not appointed. Both greatly reduce the complexity and the cost of the case.

For plan confirmation, the SBRA requires only that the plan not discriminate unfairly, be fair and equitable, and provides that all the debtor's projected disposable income will be applied to payments under the plan or the value of property to be distributed under the plan is not less than the projected disposable income of the debtor.[10] Importantly, a Subchapter V plan can be confirmed without a class of creditors voting in favor of the plan.

There were 1,537 Subchapter V cases in the first year following enactment of the SBRA. The volume of cases increased every month from April 2020 (68) to September 2020 (160).[11]

Recent data indicates that debtors were able to confirm a plan in approximately 62% of Subchapter V cases. The average number of days between the petition and the date of confirmation was 184 days. The median liability of debtors was approximately USD $1.6 million.[12]

1.3 Framework for out of court assistance or workouts

There is no formal or informal framework for out of court restructuring in the United States. Jim Feltman of Kroll says that "each work out situation is different and must be tailored to address the relevant needs of constituencies, which can and often do shift during negotiations."[13] James Sprayregen of Kirkland & Ellis shares this view, noting that "the facts of every case are different, and there is no single 'optimal' template for a consensual, out-of-court restructuring."

1.4 Accelerated restructuring or liquidation of MSMEs

As noted above, small business debtors that elect to have their Chapter 11 cases proceed under Subchapter V are subject to a tighter timeline. Director of the Executive Office for United States Trustees, Clifford J. White, describes it as follows:

> "Within 24-48 hours after a small debtor files and elects to proceed under Subchapter V, the U.S. Trustee appoints a Subchapter V trustee and schedules the §341 meeting of creditors for a date as early as possible in accordance with applicable rules. The U.S. Trustee also conducts the initial debtor interview within 10 days of the filing. In addition, the court holds a status conference within 60 days of filing, and the debtor must file a plan within 90 days".

[10] Bailey and Rice, "The Small Business Reorganisation Act", Tampa Bay Business & Wealth, February 2020.
[11] McCullagh, Moses and Hurley, "Subchapter V's First Year in Review", Journal of Corporate Recovery, Turnaround Management Association.
[12] M M Harner, E Lamasa and K Goodwin-Maigetter, Subchapter V Cases by the Numbers, ABI Journal, October 2021.
[13] Interview with J Feltman, J Sprayregen and J Zappone, Out of Court Restructuring Alternatives, Financier Worldwide, June 2016.

In contrast, in a traditional Chapter 11 case the debtor retains the exclusive right to file a plan for 120 days.

1.5 Discharge of debts for natural persons

Chapter 7 "allows an individual to obtain a 'fresh start' in the form of a discharge of most types of debt by surrendering for distribution his or her nonexempt property."[14] This discharge is subject to a means test, whereby the debtor's current monthly income, reduced by certain allowable expenses, is measured against statutory thresholds established by the Code. Should the debtor's income exceed the statutory thresholds, the Bankruptcy Court must dismiss the Chapter 7 case or convert it to a debt adjustment proceeding under Chapter 13.

A discharge of debts for natural persons is also available under Chapter 13. A Chapter 13 plan must propose to pay a portion of the debtor's debts over the next three to five years. Once the debtor completes all payments under the Chapter 13 plan, the court will grant the debtor a discharge of all debts existing as of the date of the filing of the Chapter 13 petition. Thus, the discharge may not be obtained as quickly in Chapter 13 as in Chapter 7.

Under Subchapter V, a plan may be confirmed consensually or non-consensually. Except as otherwise provided in the plan or confirmation order, the confirmation of a consensual plan discharges the debtor under §1141(d). Thus, the discharge is effective at the time of confirmation. When a plan is confirmed non-consensually, under §1192 the debtor will not receive a discharge until after the debtor has made all plan payments due under the plan.[15]

Not all debts are discharged. The debts discharged vary under each Chapter of the Bankruptcy Code. Section 523(a) of the Code specifically excepts various categories of debts from the discharge granted to individual debtors. Therefore, a debtor must still repay those debts after bankruptcy. There are 19 categories of debt excepted from discharge under Chapters 7, 11, and 12. A more limited list of exceptions applies to cases under Chapter 13.[16]

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

The SBRA was enacted prior to COVID-19. However, as noted above, in response to COVD-19, the CARES Act amended the SBRA to increase the eligibility threshold from USD $2,725,625 to USD $7,500,000 of aggregate noncontingent liquidated secured and unsecured debts for small businesses filing under Subchapter V for a period of one year. The limit was subsequently extended until 21 June 2024.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

The Code does not contain any requirement to initiate insolvency, liquidation or bankruptcy proceedings.

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[14] See above, n 1.
[15] Handbook for Small Business Chapter 11 Subchapter V Trustees
[16] https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/discharge-bankruptcy-bankruptcy-basics

2.3 Insolvency procedural deadlines

Insolvency procedural deadlines were left unchanged during COVID-19.

Some Bankruptcy Courts granted authorisation to temporarily suspend certain Chapter 11 cases to get past the government-imposed lockdowns during COVID-19.

The COVID–19 Bankruptcy Relief Extension Act of 2021 allowed Chapter 13 plans to be modified if the debtor experienced material financial hardship due to COVID-19. In these circumstances, payments may be extended up to seven years after the time that the first payment under the plan fell due.

2.4 Minimum debt requirements to initiate insolvency proceedings

The minimum dollar level of unsecured debt needed to file an involuntary petition against a debtor remained unchanged during COVID-19.

2.5 Suspending specific creditors' rights

The Unites States did not introduce any measures suspending specific creditors' rights to initiate insolvency procedures during COVID-19.

Many state and local governments temporarily halted actions such as evictions, foreclosures, and water and utility shutoffs.

2.6 Mediation and / or debt counselling

Although mediation is not mandatory in Chapter 11 or Chapter 7, most bankruptcy courts encourage parties to engage in a facilitative mediation process as an alternative means of resolving disputes. Mediation has been used to reach consensual agreement on Chapter 11 plans of reorganisation and to resolve adverse proceedings in bankruptcy. By truncating the process and alleviating the cost burden, mediation can make bankruptcy more effective and accessible. Nevertheless, not all matters are suitable for mediation and a mandatory process would burden these cases with unnecessary costs and delays.

Pre-bankruptcy credit counseling and pre-discharge debtor education is mandatory for all individuals who declare bankruptcy. Section 111 of the Bankruptcy Code requires the Bankruptcy Court to maintain a publicly available list of nonprofit budget and credit counselling agencies, and instructional courses concerning personal financial management approved by the United States trustee.

Pre-bankruptcy counselling can help debtors understand the advantages and disadvantages of bankruptcy, as well as to determine if alternatives such as debt management may be a better way to resolve financial distress.

3. Challenges Faced

3.1 Stigma associated with insolvency

In the United States, large corporate failures have largely desensitised the

American public to the stigma once associated with bankruptcy. However, a recent survey of small business owners conducted by researchers from Brigham Young, Harvard, University of Chicago and University of Toronto suggests that the negative stigma prevails when it comes to small business bankruptcy.[17] Their findings were as follows:

- 65% of small business owners agree that it is embarrassing for a business owner to file for bankruptcy;
- 60% of small business owners agree that friends and family may look down on a business owner who files for bankruptcy;
- 58% of small business owners agree that employees will be less willing to work for a business that filed for bankruptcy; and
- 54% of small business owners agree that clients will be less willing to buy from a business owner who filed for bankruptcy.

The researchers also found that education helps business owners reduce stigma around bankruptcy and see it as a potential tool.

3.2 Availability of financial information

The financial information of private companies in the United States is not usually publicly available. While public companies are required to make filings to regulatory bodies such as the SEC, there are no such requirements for private companies, which comprise most small businesses in the United States.

The United States Small Business Administration Office of Advocacy disseminates small business economic data and statistics to highlight their economic contributions and importance to policymakers.[18]

3.3 Access to new money

New financing is available for eligible debtors in Chapter 11. Section 364 of the Code authorises a debtor to obtain credit in a Chapter 11 case. A debtor may obtain unsecured credit, with the creditor receiving a priority administrative expense claim. If the debtor is unable to obtain unsecured credit, a Bankruptcy Court may authorise either an extension of credit with a priority over ordinary administrative expenses of the debtor, or for the debtor to obtain secured credit. In addition, if a debtor establishes that it cannot obtain credit on any other more favorable basis, Bankruptcy Courts also can authorise a debtor to borrow funds on a secured basis through a "priming" DIP loan. This allows the debtor to borrow money on a secured basis and grant the lender a "priming lien" with priority over pre-petition secured creditors as well as a super-priority claim above all other claims.[19]

[17] https://www.score.org/resource/infographic-small-business-bankruptcy-failure-or-reset.
[18] https://advocacy.sba.gov/data-on-small-business/.
[19] H B Winsberg, and B D Goodman, "A Primer on DIP Financing in the COVID-19 Landscape", Troutman Pepper Insights, April 2020.

Although DIP finance is more accessible to larger businesses, lenders are now also targeting smaller businesses. In March 2021, the Legalist DIP Fund I announced that it had raised USD $ 50 million dedicated to providing DIP financing in the USD $1 million to USD $10 million range to small businesses in bankruptcy.[20]

3.4 Secured creditors *vis-a-vis* unsecured creditors

The powers of both secured and unsecured creditors are reduced in Subchapter V, as compared to a traditional Chapter 11 case, in several ways:

- the absolute priority rule is eliminated, meaning that a Subchapter V debtor may retain its property even if it does not pay its creditors in full;
- a Subchapter V plan may be confirmed without an impaired class voting in favor of it;
- the requirement to form an unsecured creditors' committee is eliminated;
- the payment of administrative claims may be stretched out over three to five years; and
- the plan may modify the rights of the holder of a claim secured by a security interest in the principal residence of the borrower.[21]

Nonetheless, Subchapter V creditors retain some leverage because a consensual plan provides the debtor with a discharge at confirmation and the right to keep post-petition property outside of the bankruptcy estate – thereby incentivising the debtor to come to terms for a consensual plan rather than a non-consensual plan with creditors.

A non-consensual plan may be confirmed if it does not discriminate unfairly, and the plan is fair and equitable, with respect to each class of claims or interests that is impaired and has not accepted the plan.[22]

The "fair and equitable" standard for confirming a non-consensual plan over the objection of a secured creditor class is unchanged in Subchapter V and protects secured creditors' rights with respect to the collateral on which their claim is secured. In contrast to a traditional Chapter 11 case, Subchapter V provides that if a mortgage is not a purchase money mortgage and was used to finance a business enterprise, then the debtor may be able to modify that mortgage.

For unsecured creditors, a plan is fair and equitable if, as of the effective date of the plan, it provides that: (i) all the debtor's projected disposable income for the three to five-year period (as fixed by the court) will be applied to make payments under the plan; or (ii) the value of the property to be distributed under the plan during the three to five year period is not less than the projected disposable income of the debtor.[23]

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[20] https://www.legalist.com/press-releases/legalist-raises-50-million-to-invest-in-small-business-bankruptcies.
[21] This right is subject to certain limitations as set forth in § 1190 (3) of the Bankruptcy Code.
[22] 11 U.S.C. § 1191(b)
[23] 11 U.S.C. § 1191(c)(2).

3.5 Insufficient asset base

Recent data suggests that the average value of a Subchapter V debtor's assets is approximately USD $1.6 million. The median value is even lower at USD $614,000.[24]

The average fees awarded to Subchapter V trustees are low at approximately USD $8,000.[25] However, professional fees can run significantly higher and remain a prohibiting factor for potential Subchapter V debtors. Nonetheless, it appears that Subchapter V has improved the prospects for reorganisation for small debtors with low asset bases.

3.6 Personal guarantees (PGs)

PGs are a feature of small business lending in the United States.

In 2021, the United States Small Business Administration (SBA) approved USD $32.85 billion of 7(a) loans.

7(a) loans are the most common type of SBA loans and can be used by small businesses to fund real estate, working capital, debt refinancing and the purchase of fixture and fittings. The loans have a competitive interest rate because the SBA guarantees up to 85% of the loan, which is provided by a private lender. All SBA loans must be personally guaranteed by at least one individual. Furthermore, all individuals who own 20% or more of the business applicant must provide an unlimited full personal guarantee.[26]

When a business files for bankruptcy, the guarantor is personally liable for a guarantee of the business debt. In the past, this has caused many small business owners to declare bankruptcy personally. A split of authority exists on whether small business owners may seek Subchapter V bankruptcy relief where the business giving rise to the debts is no longer operating. Hence, an owner's ability to restructure personal guarantees of business debt may be impaired if the business operations have ceased. In the case of *In re Wright*, 2020WL 2193240 (Bankr. D S.C. 2020), the court ruled that an individual who guaranteed debts of two limited liability companies that were no longer operating could proceed in a Subchapter V case. Other courts have concluded that a debtor must currently be engaged in business to be eligible for Subchapter V relief.[27]

4. Moving Ahead

For this section, Jack Rose, Managing Director in Kroll's Restructuring practice, has been interviewed. Jack is a member of the Bankruptcy Council of the Commercial Law League of America, serves on a number of national Committees for the League and serves on the Committee on Bankruptcy and Corporate Reorganisation. Jack is also Chairperson of the Pro-Bono Sub Committee for the Bar Association of the City of New York.

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[24] See above, n 12.
[25] *Ibid.*
[26] *P Winn, Approved: How to Get Your Business Loan Funded Faster, Cheaper and with Less Stress* (2015, Morgan James Publishing) 69.
[27] I L Herman and E J Zucker, "Lenders and Small Businesses: A New Dynamic under Subchapter V of Chapter 11", Commercial Law Newsletter, September 2021.

4.1 Best way to safeguard the interests of MSMEs

Subchapter V relies on the integrity of counsel and the interests of owners of small businesses to safeguard the small businesses in bankruptcy. Owners retain control and continue to operate the business during the bankruptcy and will act to protect their business and its goodwill. Counsel in turn has a fiduciary duty to their client, the business itself and is bound by the code of professional conduct. Finally, the Subchapter V trustee acting as an advisor completes the trifecta of actors safeguarding the Subchapter V system from abuse, the debtor as it navigates the Subchapter V process and the court as it attempts to understand the intricacies of the case. There is no doubt that the table is tilted in the debtor's favour, but this is intentional. Congress drafted the SBRA to favour small business debtors and foster their survival, just as the original Bankruptcy Code in 1978 favoured Chapter 11 debtors.

A key but likely unforeseen risk for a small business in Subchapter V is the cost of the process itself. Although trustee fees are modest, professional fees can easily run over USD $100,000, and possibly several hundred thousand dollars, which is often too expensive for the SBRA debtor to shoulder. The process needs to be streamlined. Automation that could reduce professional fees and enhance judicial efficiency could answer this need. This would allow the Bankruptcy Courts to better serve the vital function Congress has tasked them with under SBRA by providing small businesses with a fast, cost-efficient bankruptcy process that to date is only a dream.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Because Subchapter V is young, the jury is still out. For very small businesses, the process is still too expensive but larger businesses are starting to find their way through. Ideally, I would like to see SBRA reorganisations completed at a cost below USD $100,000 and for micro companies below USD $50,000.

Regarding the expansion of the cap to USD $7.5 million, you will find that most restructuring professionals believe it should continue and at a minimum be made permanent. Many believe it should be increased. In my view, it should be increased to at least USD $10 million and probably USD $20 million.

Outside of the Bankruptcy Code small businesses benefited from support provided in the CARES Act, and other measures including moratoriums on eviction and foreclosure. These were extraordinary measures, and it would not be feasible for them to continue. They also benefited from the Paycheck Protection Program and Economic Injury Disaster Loans. However, as these programs end, small businesses will need to survive without the additional funds they provided.

4.3 Simplified insolvency proceedings

The SBRA is a simplified restructuring mechanism. Could it be further streamlined? Yes, but it is a great first step. We need to allow the process to evolve and be developed. Working with the courts and allowing the system to work itself through, it will get more streamlined than it is now, but we have taken the first step. The Bankruptcy Code evolved from 1978. It took a long time to get to where it is now.

Relatively speaking, the SBRA is still an infant and has some growing to do before it reaches maturity.

VENEZUELA

1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

Venezuelan corporations (*compañías anónimas*) are subject to an insolvency regime regulated under the Code of Commerce (last amended in 1955, although it can be dated further back a century to 1862 and has remained largely unaltered since 1904). Insolvency proceedings pursuant to the Code of Commerce consist of: (i) moratorium (*beneficio de atraso*); and (ii) bankruptcy (*quiebra*). Special reorganisation rules – under specific, industry-oriented legislation – apply to financial institutions, insurance companies and stock brokerage houses.

The moratorium (*atraso*) is a strictly voluntary judicial relief conceived to facilitate an orderly reorganisation or liquidation of a business that is undergoing liquidity problems, but that is essentially solvent.[1] For its part, a bankruptcy or *quiebra* proceeding may be either voluntary (filed by the debtor) or involuntary (brought forward by a creditor). The bankruptcy proceeding provides for voidable preferences and automatically stays all collection actions against the debtor.

Non-merchants,[2] as opposed to corporations and merchants alike, are subject to the insolvency rules of the Civil Code and the Code of Civil Procedure, allowing the following: (i) surrendering of property (*cesión de bienes*); and (ii) involuntary bankruptcy (*concurso necesario*). Most individuals would typically fall under this civil insolvency regime. In practice, it has been extremely rarely used.

1.2 Specific insolvency legislation

There is no insolvency regime tailored specifically to MSMEs under the Code of Commerce, or Venezuelan law in general. Instead, as MSMEs tend to qualify as merchants, they are in practice covered by the standard insolvency proceedings set forth in the Code of Commerce (i.e. moratorium and bankruptcy).

However, the Code of Commerce does provide a simplified bankruptcy proceeding for small claims (cases in which the aggregate outstanding claims are below Bs. 0.0000000001, equivalent to a tiny fraction of a US cent), addressing the liquidation of small businesses (*quiebra de menor cuantía*).[3] In practice, though, this proceeding has been rendered non-existent, by virtue of the wiping out of real value of the local currency (*i.e.*, the Bolivar) and the absence of legislative reforms updating the threshold amount.[4]

Special restructuring programs and regimes covering MSMEs may be enacted by executive order or decree,[5] in situations of economic and financial emergency.

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1 Code of Commerce, art 898.

2 In the sense relevant under Civil or Roman Law jurisdictions, where a distinction is drawn between Civil and Commercial Law. See L Register. *The Dual System of Civil and Commercial Law* (1913) 61 *University of Pennsylvania Law Review* 240, 242.

3 Code of Commerce, arts 1,069-1,081.

4 An adjustment of the threshold amount would require either: (i) legislative action, in the form an amendment to the Code of Commerce; or (ii) it may be possible to be carried out by the judiciary in case law (as has been the case, for instance, with the rules of procedure for small claims, which were amended directly by the Supreme Court in 2009).

5 See article 9 of the Law for the Promotion of Small and Medium Enterprises and Social Units, published in Official Gazette No. 40,550, 27 November 2014.

However, to date, no such specific regime has been set in place.

1.4 Framework for out of court assistance or workouts

No general framework exists for out of court workouts (OCWs) in Venezuela. OCWs are usually conducted through bespoke agreements tailored to the specifics of the situation, on a deal-by-deal basis.

Debtors qualifying under certain special situations, such as banks or financial institutions, are subject to specific restructuring guidelines set by their regulating agency, the *Fondo de Protección Social de los Depósitos Bancarios* (FOGADE, the Venezuelan equivalent to the Federal Deposit Insurance Corporation).

On the other hand, under certain scenarios, particular OCW guidelines may apply. For instance, under Venezuela's privatisation program of the 1990s, distressed transactions involving debt recapitalisation and debt-equity swaps required the scheme of arrangement to address the following:[6]

- detailed and itemised budgeting plans;
- detailed allocation of the funds obtained through the debt-equity swaps;
- sources of external financing for the investment;
- operational and marketing policies;
- business plans and strategies aiming at the turnaround of the business;
- debt conversion schedule; and
- payments and disbursements schedule.

Due to, among other things, the typical length of bankruptcy proceedings (which tend to stretch for several years), the underdevelopment of insolvency practice and the liquidation-oriented spirit of the outdated legal regime, the common practice in Venezuela is to address insolvency situations, first and foremost, through out of court restructurings (*reestructuración de pasivos*).[7]

1.4 Accelerated restructuring or liquidation of MSMEs

There are no mechanisms for the accelerated restructuring or liquidation of MSMEs in Venezuela.

1.5 Discharge of debts for natural persons

Discharge of an individual debtor occurs only upon settlement of either all the

[6] See article 4(f) of the Statutory Provisions Applicable to Operations of Conversion of External Public Indebtedness to Investments to Avoid Bankruptcy of Businesses, published in Official Gazette No. 34,828, October 28, 1991.

[7] For instance, a couple of decades ago, Sidor (Venezuela's largest steel producer) restructured more than USD $1.8 billion of outstanding financial debt, through an OCW; the largest financial restructuring by a Venezuelan private corporation to date.

outstanding debts, or, at least, the reduced amounts deriving from a duly approved restructuring plan.[8] Otherwise, the creditors retain legal remedies for the unliquidated balance of their claims, following an estate liquidation proceeding.[9]

The same general rule applies to civil individual restructurings carried out under either the surrendering of property or involuntary bankruptcy proceedings, pursuant to the Civil Code and the Code of Civil Procedure, in which debts are only discharged up to the *pro rata* share settled to each creditor, following the liquidation of assets.[10]

Guarantors' obligations are not dischargeable upon settlement of the obligations set forth in a restructuring plan, unless otherwise provided expressly in the terms of the restructuring plan.[11]

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

No special procedural measures have been adopted in Venezuela in relation to moratorium or bankruptcy proceedings during COVID-19.

However, the country has enacted policies limiting the repossession of property during the emergency situation. Indeed, enforcement, execution and attachment on collateral granted under secured credit facilities, for loans disbursed up until 13 March 2020, were suspended during the "State of Alert" decreed by the Central Government,[12] pursuant to article 7, Resolution No. 002.21, passed by the Superintendent of Banking Institutions – SUDEBAN (the Temporary Measures).[13]

The Temporary Measures provided a cushion for financial debt owed to banks and chartered financial institutions by borrowers in general, affected by the "suspension of their commercial activities and which have not recorded sufficient revenues for the sale of goods or providing of services" (i.e. weathering business disruption from COVID-19), by allowing such qualifying debtors to submit an out-of-court restructuring plan to their lenders, including a refinancing schedule, for their approval within a narrow 15-day window.[14] The Temporary Measures lapsed on 30 June 2021.[15]

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

There has been no measure introduced to suspend the requirement to initiate insolvency / liquidation proceedings.

[8] Code of Commerce, art 1,063.
[9] *Idem*, art 1,056.
[10] Civil Code, art 1,943(1).
[11] Code of Commerce, art 1,023.
[12] Published in Official Gazette Extraordinary No. 6,519, March 13, 2020.
[13] Published in Official Gazette No. 42,092, March 22, 2021.
[14] Temporary Measures, art 3.
[15] Temporary Measures, art11.

2.3 Insolvency procedural deadlines

There has been no measure introduced in relation to insolvency procedural deadlines.

2.4 Minimum debt requirements to initiate insolvency proceeding

No minimum thresholds for filing for bankruptcy have been passed under any of the relief programs adopted during the pandemic.

2.5 Suspending specific creditors' rights

In addition to special measures precluding creditors from attaching collateral (see section 2.1 above), pursuant to article 1 of the Presidential Decree No. 4,168 (the Economic Relief Decree),[16] repayment of principal and interest on credit facilities granted by financial institutions may be refinanced and rolled over for up to 180 days, to be determined on a case-by-case basis by the financial institution (upon prior request for relief and restructuring raised by the debtor). Accrual of default interest is suspended during the refinancing or suspension period.[17]

To the extent that the credit facility is granted by a financial institution, periodic debt service thereunder would be covered under the relief program enacted in the Economic Relief Decree. No specific emergency measures have been passed in connection with debt service specifically for MSMEs.

The measures passed under the Economic Relief Decree were linked to the persistence of the "State of Alert" decreed by the Central Government, which was repeatedly extended until its definitive lapsing on 30 March 2021.[18]

2.6 Mediation and / or debt counselling

There are no mandatory cooling-off periods or requirements to initiate mediation prior to filing for bankruptcy, and no specific rule has been passed to that effect regarding the insolvency of MSMEs.

Although mediation as an alternative dispute resolution mechanism (including even court-mandated mediation) has been relatively on the rise in Venezuela during the past couple of decades, it has yet to be incorporated as a common practice in the context of insolvency proceedings. Court-mandated mediation may be a well-tailored tool to manage multi-party, complex cases, such as insolvency proceedings, in which creditor coordination may otherwise prove difficult.

Venezuela is a signatory to the United Nations Convention on International Settlement Agreements Resulting from Mediation (also known as the Singapore Convention on Mediation),[19] which enhances the potential of mediation within the toolkit of the restructuring practitioner, in the context of cross-border insolvencies.

[16] Published in Official Gazette Extraordinary No. 6,521, March 23, 2020.
[17] Economic Relief Decree, art 1(5).
[18] Final provision No. 8, State of Alert Decree (as of its last iteration, published in Official Gazette Extraordinary No. 6,618, 28 February 2021).
[19] Ratification and entry into force is still pending, as of November 2021.

3. Challenges Faced

3.1 Stigma associated with insolvency

Given the liquidation-oriented nature of insolvency legislation in Venezuela, the formal initiation of bankruptcy proceedings entails a prominent reputational stigma for the debtor, which is generally held by the financial and business community as being entering its final steps into death row, in what ultimately tends to be a long and troublesome path towards liquidation. Business turnaround is not regarded as a likely, or even possible, outcome from formal bankruptcy (notwithstanding it being a theoretical possibility under the rules of the Code of Commerce).

Additionally, from an operational and practical perspective, filing for either moratorium or bankruptcy inevitability triggers a cascade of defaults, debt accelerations and / or early contractual terminations, further limiting the prospects for a successful reorganisation.

3.2 Availability of financial information

The Law for the Promotion of Small and Medium Enterprises and Social Units, passed in 2014, provides multiple mechanisms for dissemination and availability of relevant information on MSMEs, including the creation of an institutional watchdog (the *Observatorio de la Pequeña y Mediana Industria y Unidades de Propiedad Social*, which is conceived as a special division of the National Institute for the Development of the Small and Medium Industry or INAPYMI),[20] as well as an integrated information system.[21]

In practice, however, there are few, if any, sources for reliable official data and financial information on MSMEs and their business performance in Venezuela. Little information is made available through online resources.

For MSMEs organised and incorporated as corporations, the standard registry and publication requirements, set forth in the Code of Commerce, apply. This includes the yearly filing of audited financial statements before a Commercial Registry office. However, such information, although publicly available, is not compiled, processed nor segregated in any form, allowing easy-to-access, industry-wide, analysis.

3.3 Access to new money

Financing has dried up in Venezuela, for the better part of the past decade. A myriad of reasons are behind this, including the distortions induced by an exchange control put in place in early 2003, which ran for over a decade and a half. Thus, access to credit tends to be a major hurdle towards business growth. Although banks are required to commit a certain percentage of their portfolio to MSMEs' financing, the total aggregate outstanding amount of such portfolios – for the whole financial system – reaches barely the equivalent of around US $10 million.

[20] Law for the Promotion of Small and Medium Enterprises and Social Units, art 25.
[21] *Idem*, art 26.

The INAPYMI is allowed to oversee special financing programs for MSMEs. This financing is tied up to mandatory blanket terms and conditions, including the acceleration upon occurrence of an event of default,[22] and the ineligibility for additional financing by public sector financial institutions and State-owned banks, for repeat defaulters.[23] However, so far, the track record shows that these programs have been of rather reduced scope.

3.4 Secured creditors *vis-à-vis* unsecured creditors

The absolute priority rule means that, in practice, secured creditors will get paid first, following the liquidation of assets.[24] This is a key aspect shaping the dynamic of any restructuring. For instance, in the context of a formal bankruptcy proceeding, holdout secured creditors who do not endorse a restructuring plan retain their security interest or privileged claim.[25]

In the case of MSMEs, when the financing was extended under special programs enacted by INAPYMI, the regulatory agency retains a special power to carry out the forfeiture and foreclosure of the debtor's property,[26] even in instances where its credits may rank as unsecured and subordinated.

3.5 Insufficient asset base

MSMEs face tremendous limitations when it comes to sources of financing, given the drying up of credit, as noted in section 3.3 above. A rapidly shrinking economy has also pushed MSMEs into direct competition with mature incumbents within their industries, further driving down their competitiveness and the prospects for market share growth. Lenders, then, are usually in a position where they rather deploy their limited assets in investments with long standing clients.

The absence of sources of financing coupled with the reducing of markets, means that it is particularly cumbersome for start-ups and MSMEs alike to be able to expand their asset base and bulk up their balance sheets.

As a result, business failures of MSMEs are almost inevitably resolved through out of court liquidations, undertaken directly with their creditors (usually their top suppliers, property lessors and staff), and often involving the outright surrendering of property.

3.6 Personal guarantees (PGs)

It is extremely common for MSMEs' shareholders to be required to post PGs to cover obligations assumed by the business, including not only financial debt, but also commercial payables and property rent. Financing is almost inexorably conditioned upon business owners stepping in as guarantors, assuming liability for loan repayment (and thus expanding their risk exposure beyond the corporate entity's equity).

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[22] *Idem*, art 38.
[23] *Idem*, art 39.
[24] Code of Commerce, art 1,049.
[25] *Idem*, art 1,022.
[26] Law for the Promotion of Small and Medium Enterprises and Social Units, art 38.

In the context of insolvency proceedings, guarantors' obligations are not dischargeable upon the debtor and its creditors entering into a restructuring plan, unless otherwise provided (as already mentioned in section 1.5 above). This means that specific releases covering such guarantors would need to be included in the court-approved scheme.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSME

MSMEs do not operate in a vacuum, so their growth prospects are intertwined with the faith of the economy and financial sector in general. Similarly, the efficiency of the insolvency framework is largely dependent upon the health of the financial system. Thus, tailoring specific business turnaround and reorganisation rules to MSMEs will probably come only after prior structural reforms have been conducted by Venezuelan policy makers and legislature.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

One obvious consequence of the dilution to which the country's insolvency system has undergone for the past decades is the shift in creditors' mindset when it comes to risk exposure. The structural dynamic of debtors and creditors needing to coordinate their efforts, in the shadow of bankruptcy and liquidation law (a given in most developed economies), has been somehow erased from the Venezuelan economic and legal landscape. Limiting creditors' response to simply write off credits and claims has increasingly become more common, in the face of defaults.

For MSMEs, this means that insolvency is essentially a non-issue, not being factored in at all when it comes to business operations. That, coupled with the scarce access to financing sources (described in section 3.3 above), means that, in practice, bankruptcy risks are not a stress factor weighing down on MSMEs' performance.

As a flipside to the above, should at any point Venezuela's economy face continuous and structural growth, making credit more easily available once again, then the need to address the outdated and underdeveloped status of the country's insolvency system will likely become an issue of immediate interest.

4.3 Simplified insolvency proceedings

Any effort aiming towards simplification of restructuring proceedings for MSMEs should probably be preceded by a deep-reaching, structural reform of Venezuela's insolvency system as a whole.

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