INSOL INTERNATIONAL

TREATMENT OF SECURED CLAIMS IN INSOLVENCY AND PRE-INSOLVENCY PROCEEDINGS II

INSOL INTERNATIONAL

International Association of Restructuring,
Insolvency & Bankruptcy Professionals

INSOL International, 6-7 Queen Street, London, EC4N 1SP
Tel: +44(0) 20 7248 3333 | Fax: +44(0) 20 7248 3384
www.insol.org

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PRESIDENT'S INTRODUCTION

Banks and other lending institutions will extend credit provided they can obtain effective security in the event of default. This results in the lender being assured that it has the right to recover its debt in a quick and efficient manner.

When a borrower defaults under a loan agreement, the lender is usually unaware of the extent of the debtor's financial difficulties. There is always a risk that the debtor may be unable to repay other creditors in addition to the lender and be forced into insolvent liquidation proceedings.

Unsecured creditors usually receive very little or nothing through the rateable distribution process employed in such proceedings. However, in most jurisdictions secured creditors stand outside the insolvency proceedings and the credit instruments would give the lender the ability to enforce its rights without utilizing the courts. A secured creditor also has the right to pursue recovery as an unsecured creditor for any balance of the debt which the security does not satisfy.

In June 2007 INSOL published the first edition of this book. The subject matter continues to be of interest and relevance to practitioners and, as a result, the INSOL Technical Research Committee decided that a second edition of this book should be published. INSOL International is delighted to present this new and updated 20 chapter book which includes seven new country chapters (namely, Brazil, BVI, Cayman Islands, Hong Kong, Mexico, Nigeria and Singapore) and 13 updated and revised chapters of previously included countries. The chapters cover a wide range of key issues that practitioners would find useful, including the types of security rights that are available, the enforcement of such rights, circumstances when the granting of secured rights may be challenged and declared void, and the impact of reorganisation of a company on secured creditors, to name but a few.

The project was led by Evan C Hollander of Orrick, Herrington & Sutcliffe LLP, New York. Evan was also involved in the publication of the 1st edition of this book and we are very grateful for his guidance, interest, and ongoing commitment to publish this book to a very high standard. Evan had a great team working on this project and we are indebted to all of them for committing their time to the editing and review process. We would also like to thank the contributors for taking the time to write / update these chapters, despite their busy schedules.

Julie M Hertzberg

Julie Hertzberg
President
INSOL International

FOREWORD

Consistent with INSOL's mission statement to "facilitate the exchange of information and ideas", the Technical Research Committee first produced in 2007 a comparative study of the treatment of secured claims in pre-insolvency and insolvency proceedings. The template utilized in the prior edition of this guide, developed with the assistance of my predecessor Andrew DeNatale Of Counsel and Head of the Special Situations Lending Group at Stroock & Stroock & Lavan, provided a handy, accessible and well-organized reference tool outlining the issues impacting the enforcement of secured claims in the twelve jurisdictions covered in that edition. Thus, that template has been incorporated with slight modification into this new edition covering the laws in 20 jurisdictions.

The treatment of secured claims is a matter that insolvency practitioners address in virtually every case in every jurisdiction. This new volume clearly illustrates the advantages and limitations of secured status in in pre-insolvency and insolvency proceedings in each of the 20 jurisdictions covered. As more corporations have extended their presence across borders, it has become critical for practitioners and investors to understand the nuances of the treatment of secured claims in multiple locations. It is the Committee's hope that this study will enable practitioners to navigate the complexities that arise in multinational restructurings, and to provide investors with a handy guide for sound practical information regarding the risks and rewards of secured investments in different countries.

The project would not have been possible without the help and support of others. The initial acknowledgement must go to the Technical Research Committee for developing the concept and format of the project, and to my predecessor who oversaw the production of the prior edition of this volume. I also extend my thanks to the contributors, each of whom submitted excellent material for the jurisdictions covered by the project. Finally, I would like to extend my sincere gratitude to my colleagues, Scott Morrison, Vincent Yiu and Nicholas Sabatino for assisting in the editing of the chapters in this volume and Emmanuel Fua, Peter Amend and Monica Perrigino, who assisted in drafting the materials on the United States.

Evan C Hollander

Evan Hollander
Orrick, Herrington & Sutcliffe LLP
USA

CONTRIBUTORS

Australia	**Samantha Kinsey,** INSOL Fellow **Georgia Boyce** King & Wood Mallesons
Brazil	**Gilberto Deon Corrêa Jr.** **Luis Felipe Spinelli** **Gabriel Lucca Garibotti** Souto Correa Advogados
BVI	**Richard Evans** Conyers Dill & Pearman
Canada	**Brian Empey** **Andrew Harmes** Goodmans LLP
Cayman Islands	**Caroline Moran** **Justin Naidu** Maples Group
France	**Richard Jadot** **Valérie Claver** Ravet Associes
Germany	**Dr. Detlef Hass** **Christine Borries** **Dr. Martin Strauch** Hogan Lovells
Hong Kong	**Naomi Moore** **Jeremy Haywood** Akin Gump Strauss Hauer & Feld
India	**Sanjay Bhatt** Kesar Dass B & Associates
Italy	**Giorgio Cherubini** **Giancarlo Cherubini** EXP LEGAL – Italian & International Law and Tax Firm – Rome and Milan
Mexico	**Rodrigo Valverde** **Santiago Corcuera Cabezut** **Irene Cuellar** Curtis, Mallet-Prevost, Colt & Mosle, S.C.
Nigeria	**Ejemen Ofoman** **Wolemi Esan** Olaniwun Ajayi LP
Russia	**Pavel Boulatov** **Julia Zagonek** **Irina Maisak** **Julia Lymar** White & Case LLC
Singapore	**Debby Lim,** INSOL Fellow BlackOak LLC
South Africa	**Prof. Reghard Brits** University of Pretoria
Spain	**Juan José Berdullas Pomares** **Eduardo Fernández Goñi** Garrigues
The Netherlands	**Barbara van Gangelen** **Clark Warren** Houthoff
UAE	**Marcus Booth** **Claire Matheson Kirton** **Alexander Malahias** **William Watson** White & Case LLP
UK	**Richard Calnan** **Rebecca Oliver** Norton Rose Fulbright LLP
USA	**Evan Hollander** **Emmanuel Fua** **Peter Amend** **Monica Perrigino** Orrick, Herrington & Sutcliffe LLP

CONTENTS

AUSTRALIA

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

1.1 Rights in respect of personal property

1.1.1 Introduction of the Personal Property Securities Act 2009 (Cth)

The law governing securities over personal property in Australia underwent a major overhaul with the introduction of the Personal Property Securities Act 2009 (Cth) (PPSA), which came into effect on 30 January 2012. The PPSA consolidated the law relating to tangible and intangible personal property securities and introduced the Personal Property Securities Register (PPS Register). With limited exceptions, all security interests in personal property are now governed by the PPSA and need to be registered on the PPS Register.

The PPSA takes a functional approach to security interests, covering all interests in personal property which "in substance" secure payment or performance of an obligation.

All the most common pre-PPSA security interests in personal property fall within the definition of security interests in the PPSA, including:

- fixed and floating charges;
- retention of title and consignments (such as inventory financing arrangements);
- goods mortgages;
- hire purchase agreements;
- pledges;
- liens;
- leases of goods; and
- flawed asset arrangements.

In addition to "in substance" security interests, the PPSA also provides for certain "deemed" security interests, being:

- transfers of accounts, common in accounts receivable financing and factoring arrangements;
- commercial consignments; and
- PPS Leases – generally, these are chattel leases for two years or more.

In commercial lending and supply arrangements, security interests in personal property are often created under either:

- a general, or "all assets", security agreement, which grants to the secured party a security interest over all present and after-acquired property of the grantor; and

- a specific security agreement granting to the secured party a security interest in specific personal property of the grantor, such as a retention of title clause.

These security interests are granted through private contractual arrangements, although in most cases they will also require "perfection" through public registration on the PPS Register.

1.1.2 General security agreements and AllPAAP security interests

General security agreements, or all assets security agreements, grant the secured party a security interest in all present and after-acquired property of the grantor, known as an "AllPAAP" security interest. General security agreements replaced the pre-PPSA concept of fixed and floating charges.

The property of the grantor is classified as either "circulating assets" or "non-circulating assets". Circulating assets are those assets, such as the grantor's inventory, book debts, and cash at bank, which the grantor is free to deal with in the ordinary course of business. A "circulating security interest" attaches to the circulating assets of the grantor.

Non-circulating assets are those items of property which the grantor may not deal with in the ordinary course of business, such as plant and equipment, and which cannot be disposed of without a release from the secured party. A "non-circulating security interest" attaches to the non-circulating assets of the grantor.

In practice, an AllPAAP security interest confers two main benefits on the secured party:

- in the event of default, the security agreement will often provide that the secured party can appoint a receiver to take possession of the property, sell it and remit the proceeds to the secured party (see section 3.4 below); and

- in the event of the company being wound up, the secured property is not available for payment of the company's unsecured creditors, unless the value of the secured property exceeds the amount of the secured creditor's claim (see section 4.1 below).

1.1.3 Retention of title clauses

Retention of title is a method by which a person who agrees to sell goods retains title to the goods until some specified event occurs. Usually, this event is payment of the price of the goods, but title to goods can be retained until payment of:

- the price of those goods, and other goods previously supplied; or

- all money owed by the buyer to the seller.

Enforcement means that the seller demands return of the goods and, ultimately, retakes possession of them from the buyer. Since the seller is, and the buyer is not, the owner of the goods, this demand cannot be resisted either by the buyer, or anyone claiming through the buyer, except a customer of the buyer who previously bought the goods in the ordinary course of the buyer's business. Thus, the seller's claim to the goods is superior to that of a company receiver and manager appointed by a secured creditor of the buyer and is still available to the seller notwithstanding the buyer's insolvency. If a voluntary administrator is appointed for the buyer, this may delay enforcement of a retention of title clause.

A retention of title clause – sometimes also called a "Romalpa clause" – is an "in substance" security interest for the purposes of the PPSA and requires registration by the seller on the PPS Register. The security interest created by a retention of title is a "Purchase Money Security Interest" (PMSI) and will take super-priority over most other security interests including an AllPAAP security interest.

1.1.4 Leases and bailments

Leases are now treated as security interests in most cases. Hire purchase agreements, and leases where the rent covers the cost of the goods and a finance charge (often called finance leases), have an economic effect similar to a loan and mortgage and so are likely to fall within the "in substance" concept of a security interest.

However, any lease that falls within the definition of a PPS Lease is now deemed to be a security interest, even if in substance the arrangement is not a financing arrangement – such as what used to be called an operating lease. In particular, any lease or bailment for a term of over two years may be a PPS Lease.

Accordingly, leases and bailments may be security interests for the purposes of the PPSA and may require registration by the lessor on the PPS Register. The security interest created by a PPS Lease is a PMSI and will take super-priority over most other security interests, including an AllPAAP security interest.

1.2 *Rights in respect of real property*

In Australia, there are three main systems of landholding – Torrens title, general law (common law) title and Crown land. Most land in Australia is held under the Torrens system, which is a system of "title by registration" where registration confers indefeasible title and is conclusive evidence of ownership. Each state and territory operate its own public register.

Common forms of security over land include mortgages and caveats.

1.2.1 Registered mortgages

The most common form of security over land is a real property mortgage. The rights of mortgagees of land will depend on the terms of the mortgage, the relevant legislation and the type of land involved. Mortgages can be registered on the relevant state's land register (legal mortgage) or unregistered (equitable mortgage). However, mortgages must be registered in order to get the benefit of indefeasible title. A mortgage registered over Torrens land operates as a charge on the relevant land for the amount of the debt secured.

The PPSA and the PPS Register do not apply to interests in land. If a general security agreement grants the secured party an interest in property, including in land, the registration on the PPS Register will not be effective to register the security interest with respect to the land. For this reason, usually the secured party will also obtain a mortgage which is registered on the relevant land register.

1.2.2 Caveats

A secured party with an interest in land can also lodge a caveat on the title, which operates as a statutory injunction preventing the owner from taking certain actions with respect to the land and putting the public on notice of the existence of the interest. Caveatable interests include an equitable mortgage and the right of a purchaser under an agreement for sale.

2. How are security rights enforced? Is a court process or out-of-court procedure required, or are both methods available? What are the practical difficulties experienced when security is enforced?

2.1 Enforcement of security interests

Subject to some exceptions, security rights are generally enforced out of court. The major exception is the enforcement of a security interest while a company is in voluntary administration (see section 6.1 below).

The rights of secured creditors and the remedies available to them are dependent upon the nature, extent and terms of the security held, as well as the Corporations Act 2001 (Cth) (Corporations Act) and the common law.

A secured creditor can elect to:

- appoint a receiver, if the secured creditor holds a security interest over property of the company and the terms of the security agreement grant the secured creditor this right (no court process required);
- appoint a voluntary administrator, if the secured creditor holds a security interest over the whole or substantially the whole of the company's property (no court process required);
- take possession of the secured assets as a mortgagee in possession (court process may be required in some cases);
- apply to have the company wound up by the court (court process is required); or
- commence enforcement or recovery proceedings in court.

2.1.1 Practical difficulties in enforcement

Some practical difficulties may potentially affect the enforcement of security by way of the appointment of a receiver:

- as a consequence of the receivers' status as an agent and officer of the company, receivers can be personally liable:
  - for certain taxes (including capital gains tax) which may crystallise upon the sale of secured assets; and
  - pursuant to various legislation (including environmental and occupational health and safety legislation) in respect of issues which arise in the course of the receivership;

- the appointment of a voluntary administrator to the company will impose a temporary moratorium on the enforcement of security interests (see section 6.1 below); and

- the appointment of a liquidator to the company. Although receivership and liquidation can exist side by side, there can be disputes relating to either the relative priority for payment of the liquidator's and the receiver's remuneration and expenses, or the validity of the security under which the receiver was appointed.

2.1.2 Ipso facto reform

On 1 July 2018, a stay on the enforcement of *ipso facto* clauses in certain circumstances was introduced in Australia. The reform prevents a party to a contract from enforcing contractual rights that arise merely because the other party is under certain forms of external administration, i.e. those rights are stayed. The purpose of the reform is to preserve a company's contracts while it attempts to restructure.

The *ipso facto* stay applies while a party to a contract is under:

- administration;

- receivership; or

- subject to a creditors' scheme of arrangement to avoid an insolvent liquidation.

During the stay, contractual rights, including the right to terminate the contract or call on a guarantee, cannot be enforced against a company if they arise solely because that company is under administration, receivership or scheme, or because of the company's financial position during one of those processes.

The *ipso facto* stay is subject to many exceptions, including, importantly, step-in rights, rights of set-off, and the right of a secured party with a security interest over the whole, or substantially the whole, of a company's assets under an all assets security to enforce that security.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***

- ***What are the criteria used for opening the proceeding?***

- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***

- ***Does the debtor's management remain in control of the business during the proceeding?***

- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***

- ***What is the level of creditor consent that is required to effectuate a restructuring?***

- ***Is shareholder consent required in order to effectuate a restructuring?***

The main corporate pre-insolvency procedures currently available in Australia are:

- voluntary administration;
- deed of company arrangement (DOCA);
- scheme of arrangement;
- receivership; and
- provisional liquidation.

3.1 Voluntary administration

Voluntary administration provides a short moratorium for a company that is insolvent or nearly insolvent. The object of a voluntary administration is to administer the affairs of the company in a way that:

- maximises the chances of the company, or its business, continuing in existence; or
- if the company or its business cannot continue in existence, results in a better return to its creditors and shareholders than would result from an immediate winding-up.

Voluntary administration is initiated when the board of directors of the company, a liquidator, or a creditor with a security interest over the whole or substantially the whole of the assets of the company, appoints an administrator to the company. The most common of these methods is appointment of an administrator by the board of directors of the company itself. For the board of directors to appoint an administrator, they must pass two resolutions:

- that the company is, or is likely to become, insolvent; and
- that an administrator should be appointed.

The administrator is an independent person who assumes control of the company and has a duty to act in the interests of all creditors of the company. Voluntary administration is, therefore, neither a "debtor in possession" nor a "creditor in possession" regime.

Voluntary administration has particular attractions for small and medium-sized companies in financial difficulties. It is designed to be implemented quickly and to be uncomplicated, inexpensive and flexible. It provides for a short period of external administration of the company, during which options for its continued survival can be explored. Unlike a Chapter 11 bankruptcy process in the United States, a voluntary administration will usually take place without any involvement of the court.

The administrator takes control of the company's business, property and affairs. This imposes an immediate moratorium on the enforcement of claims against the company. Legal proceedings, winding-up proceedings and execution against company property are stayed during the administration, except with the leave of the court.

The administrator investigates the business and financial circumstances of the company and issues a report to the company's creditors giving their opinion as to whether it would be in the interests of the creditors for:

- the company to execute a DOCA (discussed below);
- the administration to end and control of the company to be handed back to the board of directors; or
- the company to be wound up.

The administrator must hold a first meeting of the company's creditors within eight business days of appointment, and a second meeting of creditors within 25 business days of appointment (or longer if extended by the court or at the meeting itself). At the second meeting, the creditors vote on which of the three options to adopt.

3.2 Deed of company arrangement

A DOCA is a document which records the terms of a restructuring of a company and which completes the process instituted in the voluntary administration provisions of the Corporations Act.

A DOCA is a compromise or arrangement approved by the creditors of a company. Approval requires the majority vote of the creditors in number and by value; if only one of those majorities is obtained, the administrator has a casting vote. A DOCA is a flexible restructuring tool and can take many different forms (including a debt for equity swap). Commonly, a DOCA will contain some or all of the following elements:

- payment of a sum of money by the directors or third parties, with that sum to be distributed to creditors;
- a period of time within which the company is to obtain an investor, sell certain assets or otherwise obtain capital or some other asset for the benefit of the creditors; or
- release or subordination of debt by a related party or sympathetic creditors.

Once the DOCA has been executed it binds the company, its officers and members, the administrator, all unsecured creditors and those secured creditors who voted in favour of it.

If the proposal contained in the DOCA is not put into effect, the creditors can terminate the DOCA and resolve that the company be wound up.

Alternatively, the DOCA may be terminated by court order, creditors' resolution or by occurrence of circumstances specified in the DOCA (e.g. some act of default or the completion of the restructuring process set out in the DOCA).

3.3 Scheme of arrangement

A scheme of arrangement is usually initiated by the debtor company and allows the company, with the approval of its creditors or members, to effect a reconstruction of its capital, assets or liabilities through a court-appointed procedure under the Corporations Act. Schemes of arrangement have enormous flexibility and can be used to effect a wide range of corporate restructures, including, for example, an amalgamation of companies or a debt for equity swap. There is no formal insolvency appointment under a scheme of arrangement and the company's management remains in control during the proceeding.

Importantly, a scheme need not involve all creditors or members of the company, as the scheme can be expressed to bind only particular classes of creditors or members. A successful scheme requires the approval of 75% in value and 50% in number of each class of creditors (for a creditors' scheme) or members (for a members' scheme) present and voting at a scheme meeting, plus the approval of the court.

Schemes of arrangement are less common than DOCAs because the scheme procedure is complex and requires two court approvals. However, there are a number of advantages to schemes of arrangement. Because a scheme can take place without a formal insolvency appointment, it may be preferred where a formal appointment would put key contracts at risk, or where a restructure of secured debt will allow the company to otherwise remain solvent. Schemes can bind secured creditors and include the release of creditor rights against third parties such as guarantors.

3.4 Receivership

A receiver is normally appointed out of court by a secured creditor under the powers contained in a security agreement, such as a general security agreement, charge or mortgage. The terms of the security agreement govern the nature and scope of the receivership, including setting out the events of default which allow the secured creditor to make the appointment. The receivership is also regulated by the Corporations Act and the general law. Receivers can be appointed by a court, although this is far less common.

Receiverships can, and often do, run concurrently with voluntary administrations and liquidations.

The powers of a receiver are derived from the security agreement and the Corporations Act. They usually include power to:

- enter into possession and take control of the property charged;
- lease or sell the property charged;
- initiate legal proceedings;
- carry on the business of the company; and
- make contracts and execute documents on behalf of the company.

A receiver must operate within a framework of duties. These duties, which flow from the general law and the Corporations Act, include:

- to comply strictly with the terms of the appointment;
- to exercise their powers *bona fide*;
- to act honestly in the exercise of his or her powers and the discharge of the duties of his or her office;
- to exercise the degree of care and diligence that a reasonable person in a like position would exercise; and

- most importantly, in exercising a power of sale, to take all reasonable care to sell the property of the debtor company for not less than its market value or, if it has no market value, the best price reasonably obtainable in the circumstances.

While most security agreements allow the secured creditor to charge back to the debtor company all costs associated with the enforcement of the security, including the costs of the receiver, such a provision is only as good as the value of the secured assets. Where there is a shortfall, the secured creditor will bear the burden of these costs. Where there is a surplus, the surplus is returned to the company, or the administrator or liquidator if there is a concurrent appointment.

3.5 Provisional liquidation

The aim of provisional liquidation is to ensure that the assets of a company are preserved prior to the making of a winding-up order. It differs from other winding-up procedures in that it is not concerned with maximising the assets available for distribution among creditors but is simply an interim procedure aimed at preserving the *status quo* until liquidation commences. Provisional liquidation is usually sought by a creditor who has applied to have the company wound up and who:

- is concerned that the assets of the company will disappear before the winding-up order is made; and / or
- believes that it is necessary to shift control of the company away from the directors in the interim.

Generally, a provisional liquidator has the power to carry on the business of the company and has most of the powers of a liquidator. However, as the purpose of the provisional liquidation is to preserve rather than distribute the company's assets, the provisional liquidator does not have the power to do "all such things as are necessary for winding up the affairs of the company and distributing its property" and is expected to exercise his / her powers in a way that preserves the assets of the company.

This does not mean, however, that the assets of the company can never be sold. For example, assets could be sold if the point of selling the particular assets can be said to preserve the assets of the company overall.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***

- ***Is shareholder consent required in order to effectuate a restructuring?***

4.1 Liquidation

Liquidation (also called winding-up) is a procedure used to bring a company's existence to an end where it has insufficient assets to satisfy all of its liabilities.

There are two main forms of insolvent liquidation:

- winding-up by a court-appointed liquidator; and
- winding-up by a liquidator appointed by a meeting of the company's creditors.

Most court applications to wind up a company in insolvency are based upon a failure to comply with a statutory demand for payment of a debt over AUD2,000. That failure gives rise to a *prima facie* presumption that the company is insolvent. If the company does not disprove the presumption, it will be wound up by the court. An application to a court to wind up a company in insolvency is most commonly made by a creditor relying on an unsatisfied statutory demand. However, an application can also be brought by the company itself, a creditor (including a secured, contingent or prospective creditor), a shareholder, a director, a liquidator, a provisional liquidator or the Australia Securities and Investments Commission (ASIC).

A winding-up order by a court, or the entry into a creditors' voluntary winding-up, has several immediate consequences:

- no action or other civil proceeding can continue or be commenced against the company except by leave of the court;
- in the case of a court-ordered winding-up, any disposition of property made by the company or any transfer of shares or alteration in the status of the members of the company made after the commencement of the winding-up is, unless the court otherwise orders, void. In the case of a creditors' voluntary winding-up, any attachment, sequestration, distress or execution put in force against the property of the company after the passing of resolution to wind up the company is void; and
- in the case of a court-ordered winding-up, the company cannot, without the leave of the court, resolve that it be wound up voluntarily, although it can apply for the appointment of a provisional liquidator or a stay of the winding-up order in order to propose a DOCA (see section 3.2 above).

4.1.1 The effect of liquidation on the company

Liquidation primarily affects the status of a company. Upon the appointment of a liquidator, the power of management is transferred from the directors and members to the liquidator and creditors in a general meeting. Once a resolution has been passed or an order made for the winding-up of a company, the company and its creditors can expect the following to occur:

- the company ceases trading, and the employees are terminated, either immediately or after a short trade-on period if required to realise the assets;
- the liquidator collects company property not claimable by secured creditors;

- the liquidator seeks to recover property improperly transferred when the company was insolvent;
- the liquidator investigates the affairs of the company and reports to creditors and regulators;
- proceedings against the company in liquidation are stayed;
- the liquidator undertakes a "proof of debt" process by which claims against the company may be asserted and quantified; and
- the liquidator follows the statutory order of priorities for distribution of the company's property.

4.1.2 The effect of the liquidation on secured creditors

The principal function of the liquidator is to collect and realise the company's assets. This requires the liquidator to determine what security interests exist in the assets of the company, to apply the assets to meet those security interests and to distribute any surplus initially among unsecured creditors and then shareholders.

Both non-circulating and circulating security interests survive liquidation. In the case of non-circulating assets, such as plant and equipment, the liquidator will either allow the secured creditor to collect the assets or realise the assets and remit the sale proceeds to the secured creditor.

In the case of circulating assets, such as cash at bank and accounts receivable, the liquidator will realise those assets and create a circulating asset pool. Where the unsecured assets of the company (also called the "free assets") are insufficient to meet unpaid entitlements owed to employees, the liquidator is required to use the circulating asset pool to satisfy those employee entitlements first before remitting the balance of the circulating assets to the secured creditor.

4.1.3 The effect of the liquidation on unsecured creditors

The primary effect of a liquidation on the unsecured creditors of a company is that they are no longer able to pursue ordinary courses of action to recover their debts. Creditors need to consider how their claim would rank as against other claimants if a company were wound up in insolvency. In a liquidation, the free assets available for distribution among unsecured creditors of a company include:

- the company's own property not subject to a circulating or non-circulating security interest;
- if the company has share capital, any unpaid calls on shares;
- compensation recoverable by the liquidator from directors or a holding company for insolvent trading;
- voidable transactions that can be clawed back by the liquidator including unfair preferences or uncommercial transactions; and
- any surplus after the assets subject to circulating and non-circulating security interests have been realised and secured creditors paid in full.

Ordinary unsecured creditors rank *pari passu*, or on equal footing, with each other. This means that, if the free assets of the company are insufficient to meet the claims of unsecured creditors in full, which will be the case in the vast majority of liquidations, then any assets available for distribution will be divided *pro rata*.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

5.1 While the company is solvent

While the company is solvent, a security interest given in favour of a director or officer of the company is voided if the director or officer attempts to enforce it within six months of its creation without the leave of the court.

5.2 While the company is insolvent

Once the company is in liquidation, the liquidator can attack a security interest on a number of grounds (in addition to a failure to properly register the security interest according to the requirements discussed above):

- circulating security interests created in the six months before the "relation-back" day (i.e. the day on which the formal process of placing the company in external administration began), or between that day and the commencement of winding-up, will be void as against the liquidator to the extent that they secure liabilities that arose before the creation of the security interest, unless the company was solvent when the security interest was created; and
- security interests are voidable by a court if they constitute a "voidable transaction".

Voidable transactions are transactions which took place before the company entered winding-up and which, in general terms, confer a benefit on the creditor, which is unfair having regard to the position of other creditors or the company itself. There are a range of voidable transactions and a range of time frames before the relation-back day (six months to 10 years) within which they can occur.

6. Is enforcement of security rights treated differently in each type of proceeding?

6.1 Voluntary administration

Upon appointment of a voluntary administrator, a secured creditor with a security interest in the whole or substantially the whole of the company's property has a 13-day "decision period" in which to decide whether to take enforcement action. If it chooses to enforce its security interest, it must enforce the interest in relation to all the property of the company subject to the security interest, for example, by appointing a receiver. If the secured creditor does not choose to enforce its security interest during the decision period, then it will not later be able, without the written consent of the administrator or the leave of the court, to enforce its security during the period of the administration.

This moratorium against enforcement during the period of administration applies with even greater force to secured creditors with security over less than the whole or substantially the whole of the company's property, unless the secured creditor took steps to enforce its security interest prior to the appointment of the administrator. Even then, the administrator may be able to apply to the court and obtain an order restricting the powers of the secured creditor.

6.2 Deed of company arrangement

The rights and remedies of secured creditors are not affected by a DOCA, except to the extent that the secured creditor votes in favour of the DOCA or as ordered by the court. The same preservation of rights applies to owners and lessors of property against the company.

6.3 Receivership

A receiver is appointed to that property of the company which is subject to the security interest of the appointing creditor. The rights and remedies of other creditors are not stayed by the appointment of a receiver, except to the extent that another secured creditor cannot enforce against the property subject to the receivership unless that second secured creditor has a higher-ranking security interest in relation to the property. For example, if the holder of an AllPAAP security interest appoints a receiver, a supplier of inventory who holds a retention of title PMSI security interest will still be able to claim the inventory because the PMSI has super-priority.

Unsecured creditors can initiate recovery proceedings or take action to place the company in liquidation during a receivership.

6.4 Liquidation

As noted above at section 4.1.2, security interests survive liquidation. Creditors with a non-circulating security interest have proprietary claims over particular non-circulating assets, such as plant and equipment, and those assets or their proceeds will be returned to the secured creditor in priority to unsecured creditors. To the extent there is a shortfall between the value of the asset and the amount owed to the secured creditor, the secured creditor will rank equally for that shortfall with unsecured creditors.

Creditors with a circulating security interest have a proprietary interest in the circulating asset pool. Where the unsecured assets of the company are insufficient to meet employee entitlements such as unpaid wages, superannuation, annual leave, long-service leave, payment in lieu of notice and redundancy pay, these employee entitlements have priority over the circulating asset pool, and any balance remaining after satisfying these entitlements is remitted to the holders of circulating security interests.

The unsecured, or free, assets of the company are distributed according to a statutory priority, which ranks the liquidators' costs, charges and expenses of the liquidation first, followed by employee entitlements, and then claims of unsecured creditors.

6.5 Scheme of arrangement

The impact of a scheme of arrangement on the security interests of creditors will depend on the terms of the particular scheme. Secured creditors may have their security interests limited or extinguished by a scheme. As discussed above at section 3.3, a scheme can bind secured creditors even if they do not vote for the scheme, provided the scheme receives the approval of 75% in value and 50% in number of each class of creditors and the approval of the court.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

7.1 Voluntary administration

Because voluntary administration is a pre-insolvency process, there is no distribution and hence no priorities.

7.2 Deed of company arrangement

A DOCA can adopt any scheme of priorities that the creditors want. Where the object of the DOCA is to maintain the company or its business as a going concern, it will usually provide some priority for employees and trade creditors, ahead of debts owed to the directors and their associates. This is subject to two caveats:

- the courts can intervene to set aside a DOCA on the grounds of oppression or prejudice to a creditor or group of creditors; and
- the DOCA must provide employee entitlements the same priority they would enjoy in a liquidation unless the employees have passed a resolution waiving this requirement.

7.3 Receivership

As noted above, the proceeds of realisation of a circulating security interest are subject to a special priority claim for employee entitlements, if those entitlements cannot be met from the unsecured assets. This priority for employee entitlements applies in receivership as well as in liquidation.

Otherwise, the receiver’s duty is to realise the assets subject to the security interest for the benefit of the secured creditor.

7.4 Liquidation

Where the company is being wound up, the Corporations Act lists the order of priority in which the proceeds of realisation of the company’s unsecured assets are to be applied. In general terms, that order is:

- the costs and expenses of the insolvency administration;
- employees’ entitlements (*pari passu* up to a fixed amount);
- unsecured creditors (*pari passu*); and
- shareholders (*pari passu*, having regard to the amount of money paid up on their shares).

Unless the secured creditor surrenders its security, secured assets remain outside the control of the liquidator and so the proceeds of secured assets are first applied to the debt held by the secured creditor. This is subject to the priority claim over circulating asset proceeds for employee entitlements if those entitlements cannot be met from the unsecured assets.

7.5 Scheme of arrangement

Whether there is any distribution to certain classes of creditors, and the priority of those distributions, will depend on the terms of the particular scheme.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

Apart from the normal credit controls, creditors can mitigate their losses by acting quickly to place the company into administration, receivership or liquidation once it is clear that the company is suffering terminal financial problems. This reduces the opportunity for further dissipation of the company's assets, either in the normal course of a failing business or through asset alienation by the company's officers.

Once the company is in liquidation, creditors may be asked by the liquidator to provide funding for litigation to recover assets for the company. Such litigation may, if successful, produce a greater pool of funds for distribution for creditors; where a creditor has financially supported such litigation, the court is empowered to (and usually does) grant that creditor a greater share of the proceeds of the action than it would otherwise be entitled to under the *pari passu* rule.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

Administration, deeds of company arrangement, receivership and liquidation do not generally affect creditor rights against third parties such as guarantors. For this reason, creditors usually protect their rights against guarantors by taking security over assets of the guarantor. The exception to this general rule is that, during the administration of a company, a guarantee given by a director of the company or a spouse or relative of the director cannot be enforced without the leave of the court.

By contrast, a scheme of arrangement can affect creditor rights against third parties such as guarantors, depending on the terms of the scheme.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

10.1 Personal property

Security interests in personal property are required to be perfected in one of three ways:

- registration on the PPS Register (this is by far the most common method of perfecting a security interest in personal property);
- possession; or
- control.

Possession and control are only available for certain types of assets.

A security interest which has not been perfected by registration, within either 20 days of creation or six months prior to the appointment of an administrator or liquidator, will vest in the company which granted the security interest. This effectively means the creditor loses their security interest and ranks as an unsecured creditor with respect to that debt unless a court grants an extension of time for registration of the security interest.

10.2 Real property

Mortgages over real property should ideally be registered on title with the relevant state land register. If a mortgage is not registered on title, the mortgage will not prevent the land being sold, and any purchaser of the land will take the land free of the mortgage. The mortgagee will lose the benefit of their security and may be left with only an unsecured personal right against the mortgagor for the debt. In the event that the mortgagor goes into liquidation, the mortgagee will likely rank as an ordinary unsecured creditor with respect to that debt.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged? If so, how?

This is dealt with under section 6 above.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

As explained above under section 3, the administrator is allowed to use the secured creditor's collateral during the voluntary administration unless the moratorium is lifted by the court. Similarly, a liquidator may use any collateral until a secured party seeks to exercise rights in respect of that collateral. There are no special rules for the use of cash collateral. An administrator is generally entitled to use cash collateral.

Generally, an administrator or liquidator cannot sell a secured creditor's collateral without the consent of the secured party. However, there are some exceptions. For example, an administrator can sell collateral if the sale takes place in the ordinary course of the company's business or with leave of the court. A liquidator can also sell collateral without the secured party's consent with leave of the court.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

Receivers and administrators can use the company's property as security for fresh borrowings (subject to any pre-existing security rights). The power (or otherwise) of an administrator of a DOCA to grant security would depend upon the terms of the DOCA (as decided by the company's creditors). Likewise, a scheme of arrangement may create new security interests depending on the terms of the scheme.

Administrators have a statutory lien over the assets of the company to secure costs incurred during the administration, the administrators' remuneration and any money borrowed by the administrators. This lien has priority over debts of the company secured by a circulating security interest in property of the company. As a consequence, any funds borrowed by administrators are automatically secured by the assets of the company.

An administrator, liquidator or receiver will also be entitled to a lien over an asset of the company for their costs and expenses incurred exclusively in the care, preservation and realisation of that asset. This lien, usually referred to as a "universal distributing" lien, arises by operation of equity and does not require the consent of the secured creditor.

14. What distribution will a secured creditor receive if a company is reorganised?

Unless the secured creditor surrenders its security interest (or the security interest is extinguished in a scheme of arrangement), its ability to recover its debt is limited to:

- the proceeds of realisation of the security; and
- if those proceeds are less than the debt, the difference – ranked *pari passu* as an unsecured debt.

If the secured creditor surrenders its security, it is treated as an ordinary unsecured creditor and ranks *pari passu* with other unsecured creditors.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

Yes (except as otherwise provided for in a DOCA which is approved by the secured creditor or a scheme of arrangement which compromises the secured creditor's rights). The security attaches to the assets and the security is inalienable from the asset without the consent of the creditor.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

If a secured claim is over-secured, the proceeds of realisation of the asset are applied first in payment of the debt and then paid over to the company (or the liquidator, if the company is in winding-up, for distribution amongst other creditors).

If a secured claim is under-secured, the secured creditor may prove for the balance in the liquidation as an ordinary unsecured creditor.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court jurisdiction to do so?

17.1 Recognition of foreign insolvency proceedings

Australian courts can recognise foreign restructuring processes under the Cross-Border Insolvency Act 2008 (Cth) (CBIA), which incorporates and gives effect to the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency (Model Law).

For a foreign restructuring process to be recognised in Australia, an application needs to be made to the court containing evidence of the commencement or existence of foreign insolvency proceedings. The application must be made by a person or body appointed as a foreign representative (i.e. external administrator) of the insolvent debtor in the foreign insolvency proceedings.

The application must substantiate that the foreign proceeding is:

- a collective judicial or administrative mechanism in a foreign state (including an interim proceeding);

- pursuant to a law relating to insolvency;
- one in which the assets and affairs of the debtor are subject to control or supervision by a foreign court;
- for the purposes of reorganisation or liquidation.

The application for recognition must be accompanied by:

- a certified copy of the decision commencing the foreign proceeding and appointing the foreign representative, or a certificate from the foreign court affirming the existence of the foreign proceeding and of the appointment of the foreign representative;
- a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative; and
- a statement identifying relevant proceedings in respect of the debtor under Australian law, including voluntary administration, receivership, liquidation or personal bankruptcy, that are known to the foreign representative.

If these criteria are satisfied, the court will recognise the foreign proceeding. The court retains an ultimate discretion not to recognise a foreign proceeding if to do so would be "manifestly contrary" to public policy in Australia.

17.2 Effect of recognition of foreign insolvency proceedings

Following recognition, contractual arrangements governed by Australian law may be affected by the operation of stays on actions against the insolvent debtor. For example, if the recognised foreign proceedings have been commenced in the foreign jurisdiction where the debtor has its centre of main interests, any actions or proceedings against the debtor in Australia are automatically stayed, and the debtor's right to dispose of its assets is suspended. This has the effect of preventing a counterparty from bringing any action to enforce its contractual rights against the debtor. However, the counterparty may seek, with the court's leave, an exemption from the stay, in order to pursue its contractual rights. The court retains an ultimate discretion in this regard.

If requested by the foreign representative, the court may also grant other relief, including entrusting the administration or realisation of the debtor's assets in Australia to the foreign representative or another person designated by the court.

17.3 Rule in *Gibbs* case

The English Court of Appeal has recently reaffirmed the 'rule in *Gibbs* case', which holds that English law will not recognise the compromise of a debt governed by English law in a foreign insolvency proceeding, unless the creditor participated in the foreign insolvency proceeding or the proceeding was subject to an equivalent English proceeding.

It is unclear whether an analogous rule applies in Australia. Nonetheless, Australian courts have accepted that they have the power to approve a scheme of arrangement even where it compromises debts governed by foreign laws.

BRAZIL

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

The distinct types of security rights available under Brazilian law may be categorised in three groups: (i) personal securities (suretyships), (ii) *in rem* securities and (iii) fiduciary liens.

1.1 Personal securities (suretyships)

Personal securities (suretyships) are not backed by any assets: they are a promise made (by an individual or a legal entity) to accept responsibility for some other party's debt. Therefore, by being granted a personal security as collateral, a creditor makes a third party also responsible for the payment of the secured obligation. There are two kinds of personal securities: (a) *fiança* and (b) *aval*.

A *fiança* is granted by a guarantee agreement, a letter of guarantee or the direct inclusion of specific clauses in a finance or other sort of agreement. On the other hand, an *aval* is granted directly in an instrument of credit itself (*título de crédito*), such as a promissory note, check or bills of exchange. A signature of a person as guarantor in the instrument of credit is enough to create a guarantee of the credit obligation.

A *fiança* differs from an *aval* in that a guarantor under a *fiança* ordinarily becomes liable only in case the principal obligor has defaulted and does not have sufficient assets to pay upon demand by the creditor. There is no need for the creditor to exhaust remedies against the primary obligor before making demand on the guarantor. When presenting his defense, the guarantor may demand that the assets of the primary obligor be seized first in order to satisfy the debt. However, when doing so, it is the guarantor's obligation to promptly present a list of the primary debtor's assets that may be seized in order to pay the debt. Under an *aval*, on the other hand, the guarantor is jointly liable with the debtor for the payment of the debt and the guarantor may not be excused from paying the debt by indicating assets of the original obligor.

Another difference between a *fiança* and an *aval* is that in a *fiança* the guarantor's obligations are dependent upon the enforceability of the underlying obligation of the primary obligor. In an *aval*, however, the obligation of the guarantor is independent of the obligation of the primary obligor. For example, if the creditor assigns the claim to a third party in good faith and the underlying transaction between the primary obligor and the creditor is later void, the guarantor will nonetheless remain liable to the assignee.

1.2 *In rem* securities

A second group of security rights, *in rem* securities, are obligations backed by assets of the debtor. A given obligation of the debtor may be secured by movable or real property. There are three types of *in rem* securities under Brazilian law: (i) pledges, (ii) mortgages and (iii) antichresis.

1.2.1 Pledges

Pledges consist of the allocation of movable assets as security for a given obligation. Ordinarily, a pledge depends on the actual transfer of the collateral to the possession of the creditor. Receivables and shares also fit into the concept of movable assets, and pledges over these types of assets are also common. When a pledge is placed over receivables, sometimes the transfer of the original document that represents the credit (such as a promissory note or a bill of exchange) occurs, but it is not mandatory. A pledge over shares does not depend on the transference of any share certificate to the creditor.

In order for a pledge to be valid and enforceable against third parties, it needs to be registered with the Registry of Titles and Documents of the place where the parties are domiciled.[1] Certain assets, however, require special registration provisions for the pledge to be valid and enforceable. For example, the pledge of a vehicle needs to be registered with the State Department of Vehicle Registration of the state where the vehicle is registered, and a pledge of machinery and equipment must be registered with the Real Property Registry of the place of the real property in which the machinery and equipment are situated.[2] A rural pledge (which offers livestock, growing or unharvested crops, processed or stored produce, cut firewood and vegetable charcoal as collateral) must be registered with the Real Property Registry of the place where these assets are located.[3] Finally, a pledge over shares must be registered in the company's Book of Nominative Shares; in case the company has book entry shares, the pledge needs to be registered with the financial institution that is responsible for the book entries. There is no specific rule regarding additional registration of the pledge of quotas of a limited liability company, but it is advisable to register the pledge agreement with the Board of Trade and to make reference to the existence of the pledge in the articles of association of the company.

Loans provided to debtors by financial institutions are often secured by pledge agreements over receivables of the debtor. In order to facilitate enforcement, lenders generally require debtors to direct payment of receivables to designated accounts. This structure allows banks to immediately seize the deposited proceeds in case of default.

1.2.2 Mortgages

Mortgages are the *in rem* security interests that serve the general purpose of allocating immovable property as collateral for the payment of a debt. However, the full scope of assets that may be used as collateral under a mortgage is slightly broader than just real property:

- real property and its accessories,[4]
- certain ownership rights on real property,
- railroads,[5]
- vessels and

[1] Federal Law 6.015/1973, Articles 127, II and IV, and 130.
[2] Federal Law 10.406/2002 (the Civil Code), Articles 1.462 and 1.448 and Federal Law 6.015/1973, Articles 129, item 7 and 167, item 4.
[3] Federal Law 10.406/2002, Articles 1.438 and Federal Law 6.015/1973, Article 167, item 15.
[4] "Accessories" are assets incorporated to the land, which cannot exist without it. For instance, additional constructions or trees. Note, however, that a standing forest, if located in the property and duly annotated in the records of the real property, might be sold separately and, in this case, is considered as a movable asset.
[5] A mortgage over "railroads" encompasses the rails, the soil, the marginal terrain, the equipment and the stations.

- aircrafts, their engines, parts and accessories.[6]

In order to be valid and enforceable against third parties, any mortgage over real property whose value exceeds thirty minimum wages[7] must be formalised by a public deed[8] and must also be annotated in the records of the real property with the Real Estate Registry (each real property has its own public record). A public deed is not necessary when the mortgage is created in connection with finance agreements entered into with financial institutions within the National Housing System.[9] Mortgages securing certain obligations also do not require public deeds in order to be valid.[10] Finally, a mortgage on an aircraft and its parts must be registered with the National Registry of Aircrafts[11] and a mortgage on vessels must be registered with the Maritime Court.[12]

1.2.3 Antichresis

A third type of *in rem* security is the antichresis. This security is hardly ever used. It consists of an agreement by which the debtor assigns the income arising from real property to a creditor. In other words, it is a security that could be used, as an example, to direct the rent deriving from a lease of a real property towards the payment of a given obligation.

1.3 Fiduciary liens

Finally, a third group of security rights is granted by means of fiduciary guarantees. Fiduciary liens could also be categorised as *in rem* securities, since assets of the debtor also back this kind of security. However, fiduciary liens grant the creditor a strong, distinct guarantee right: when granted a fiduciary lien, the creditor actually holds title to the asset that serves as collateral. Only when the debt is fully paid will the debtor become the owner of the collateral. That distinction plays a major role in the business scenario, allowing for the creditor to obtain a quicker repossession of the collateral, sometimes even without the need of going to a judicial court in order to do so. Since fiduciary liens grant creditors with a quicker response to the default of a debtor, this type of security is increasingly used in Brazil, mostly by financial institutions.

Both movable and immovable property may be used as collateral under a fiduciary agreement. Perfection of a fiduciary lien does not depend on a public deed, but the agreement must be properly registered with the Real Property Registry, with the National Registry of Aircrafts or with the Maritime Court if the assets are, respectively, real property, an aircraft or a vessel. A fiduciary title on a vehicle must be registered with the State Department of Vehicle Registration. Fiduciary title on other movable assets (not vehicles) must be registered with the Registry of Titles and Documents of the place where the debtor is domiciled.

Lease-purchase agreements work similarly to fiduciary liens in Brazil. The creditor holds the title of the asset that is being leased with a purchase option – should the debtor default on the scheduled payments, the creditor may retain title to the asset.

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[6] Federal Law No. 7.565/1986, Article 138, main section and 1st para.

[7] The minimum wage refers to a worker's salary over the period of one month. At the time this article has been written, in February 2020, the minimum wage is BRL 1,039,00. The amount of 40 minimum wages (R$ 41,560.00) adds up to, in February 2020, an amount close to USD 10,000.00.

[8] In Brazil, agreements transferring the ownership or creating in rem liens on real property must be prepared by and signed before a public notary. Certain exceptions to this rule apply for transactions within the financial market. See Civil Code, Article 108.

[9] Federal Law 4.380/1964, Article 61, para 5.

[10] Federal Decree-law 167/1967, Federal Decree-law 413/1969, Federal Law 8.929/1994, Federal Law 10.931/2004.

[11] Federal Law 7.565/1986, Article 141.

[12] Federal Law 7.652/1988, Article 12.

1.4 Common forms of security over movables

Movable property is subject to pledges and fiduciary liens. Receivables and shares also fall into this category. In addition, movable assets can be sold with retention of title, in which case the purchaser, who acquires the assets on credit, will only receive the property title after full payment. In order to be enforceable against third parties, the retention clause needs to be registered with the Registry of Titles and Documents of the place where debtor is domiciled.

1.5 Common forms of security over immovables

Real property is subject to mortgages and fiduciary liens. The proceeds of the use of the real property (such as rent) are also subject to antichresis agreements. Movable assets can be sold with retention of title, in which case the purchaser will receive title after payment is done. To be enforceable against third parties the retention clause needs to be registered with the Registry of Titles and Documents of the place where the debtor is domiciled.

All types of securities – personal, *in rem* and fiduciary guarantees – depend on a contract in order to be valid and enforceable. Nonetheless, it is worth mentioning that all types of securities are regulated by statutory provisions. The Civil Code[13] (CC) is the main statute regulating securities.

2. How are security rights enforced? Is a court process or out of court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

2.1 The enforcement of security rights depends on the type of security

The enforcement of security rights depends on the type of security that has been granted.

Debts secured by personal property (suretyships) – *aval* and *fiança* – require the creditor to use a judicial process in order to satisfy its claim. Personal guarantees are usually connected to judicial[14] or extrajudicial[15] executive titles, which allow for the creditor to initiate an execution lawsuit against the guarantor. Execution lawsuits are quicker than ordinary lawsuits since there is no *cognizance* phase, *i.e.*, the scope of the procedure is limited.

In rem security interests grant the creditor the right to foreclose on the asset backing the debt as collateral. A distinction must be drawn between, on the one hand, pledges and mortgages, and on the other hand, antichresis. In both pledges and mortgages, creditors will file a lawsuit before a judicial court in order to proceed to the auctioning and sale of the collateral. If the proceeds from the sale do not suffice for the payment of the debt, the debtor will remain liable for the deficiency. In case of an antichresis, the creditor is not allowed to sell the property, but it might retain it. Under Brazilian Law, creditors may not become the proprietors of the collateral– an auction is necessary when executing the guarantee.

Contracts secured by pledges, mortgages and antichresis are regarded as extrajudicial executive titles, allowing for a quicker judicial process (skipping the *cognizance* phase).

Fiduciary securities are enforceable out of court, granting creditors an easier path for collection. However, even then, the Judiciary may be required to take a part in the enforcement of the security interest: movable assets usually remain in the possession of the debtor, which may require the creditor to file a

[13] Law No. 10.406/2002.
[14] Brazilian Civil Procedure Code (CPC), Article 515.
[15] CPC, Article 784.

"search and seizure" lawsuit prior to the sale of the collateral. Once in possession of the collateral, the creditor can proceed to a judicial or an out-of-court sale of the asset.

In addition to that, in certain transactions, such as a lease-purchase agreement, if the debtor defaults on the scheduled payments, the creditor is entitled to seize the asset that was being leased.

The main practical difficulty experienced by creditors when enforcing their security interests is the fact that the Brazilian judiciary system tends to be a rather inefficient institution. On average, an execution proceeding lasts seven years and eleven months at the federal level and six years and nine months at the state level.[16] The World Bank Doing Business ranks Brazil in 109th among 190 countries in terms of enforcing contracts.[17] The long time it takes for a lawsuit to have a final solution might very well be the main hardship encountered by creditors in Brazil when enforcing their security rights.

Another difficulty some creditors might face is specifically related to personal guaranties. Since a guarantee of an *aval* or *fiança* is not secured by any particular asset of the guarantor, the creditor might have a difficulty enforcing a guaranty against an individual guarantor as assets such as homesteads and wages are among types of property that are exempt from creditor collection efforts under Brazilian law.[18]

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

The statute regulating restructuring and liquidation proceedings under Brazilian law is Federal Law No. 11.101/2005 (BRBL). The BRBL provides three distinct types of procedures: (i) extrajudicial recovery, (ii) judicial recovery and (iii) bankruptcy (liquidation).

Each type of procedure is designed to deal with companies in varying states of financial distress.

3.1 Judicial and extrajudicial recoveries (pre-insolvency proceedings)

Extrajudicial recoveries are structured to deal with incipient, less drastic, financial adversities, whereas judicial recoveries are the proper procedure for dealing with severe financial crisis of businesses that,

[16] See: <http://www.cnj.jus.br/files/conteudo/arquivo/2018/09/8d9faee7812d35a58cee3d92d2df2f25.pdf>.
[17] See: <http://portugues.doingbusiness.org/pt/data/exploreeconomies/brazil>.
[18] BCPC, Article 833.

nonetheless, are still viable and capable of being successfully restructured. Businesses that are no longer capable of being restructured will face bankruptcy, thus being liquidated.

The BRBL does not distinguish between pre-insolvency and insolvency proceedings. There is no doubt that the judicial recovery (and to some extent even the extrajudicial recovery) derives many of its aspects from the American Chapter 11 proceeding, which is in itself a hybrid between pre-insolvency and insolvency proceedings.[19] In light of these similarities, both judicial and extrajudicial recovery proceedings will be hereby categorised as "pre-insolvency" proceedings, though such distinction is not exactly static, nor does it play any particular role under Brazilian law.

Both a judicial and an extrajudicial recovery essentially consist of the debtor presenting a recovery plan to its creditors. The procedures function as a collective forum in which debtor and creditors seek to find a way for the debtor to adjust its debt and keep the business in operation (preserving the business' going concern). The recovery plans usually provide for debt reduction, grace periods, maturity extensions, payment plans, etc., though a wide range of restructuring means are made available for the debtor. In case of a judicial recovery, failure to obtain the approval of the plan by the creditors will result in the liquidation of the business.

The judicial recovery is a court-supervised proceeding designed to aid businesses facing severe economic-financial crisis. The extrajudicial recovery, on the other hand, is not entirely supervised by a judicial court – as a general matter, the court only takes part in it to confirm the recovery plan.

The goal of a judicial or extrajudicial recovery is to make it possible for the debtor to overcome its economic and / or financial crisis. By doing so, the debtor is able to maintain the production of goods and the offering of services, to retain jobs and to preserve the interests of the creditors.

The recovery procedure cannot be used to liquidate the business; the sale of the entire business of an insolvent debtor should occur under a bankruptcy proceeding. Since restructuring allows for the business to keep operating and thus preserves jobs, there is a strong social role played by recovery procedures in Brazil (it is not rare for a judicial court to interpret the BRBL in a debtor-friendly fashion).

It is also worth mentioning that prior to filing for a judicial or an extrajudicial recovery, a debtor may try to informally rearrange its debt with strategic creditors. It is becoming relatively common for debtors to engage in informal creditor workouts, including sometimes the use of standstill contracts (which are not statutorily regulated in Brazil).

3.1.1 Initiating the proceedings

Only the debtor may initiate the judicial or extrajudicial recovery proceedings. No creditor may force the debtor to restructure under the legal framework of the BRBL.

Not all debtors qualify for entering a judicial or an extrajudicial recovery. According to Article 1 of the BRBL, only *business* legal entities and individual entrepreneurs qualify as suitable debtors to initiate an extrajudicial or a judicial recovery proceeding. Non-business entities and individuals who do not carry out business activities may not file for any of the proceedings listed in the BRBL. Examples of non-business

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[19] "In truth, chapter 11 is a hybrid of a pre-insolvency restructuring proceeding and a formal rehabilitation procedure. Indeed, as financial markets have changed over time, and as practice has evolved in response, chapter 11 has come to function as a multi-purpose 'one-stop' shop". Mevorach, Irit; Walters, Adrian. The Characterization of Pre-Insolvency Proceedings in Private International Law (July 1, 2019). European Business Organization Law Review (Forthcoming). Available at SSRN: <https://ssrn.com/abstract=3448821>.

entities include law firms, accounting firms, physician clinics, etc. Another important remark is the fact that associations arranged under the form of "co-operatives" are always regarded as non-business entities.

The Brazilian legal system does not offer an efficient proceeding for non-business associations and individuals to restructure their debt. Even the liquidation of these entities, in a process called a "civil insolvency", is hardly ever used due to its overall inefficiency.

Furthermore, some types of businesses are not eligible for the recovery procedures of the BRBL. For example, in light of the systemic risk that is inherent to intensely regulated economic fields, such as financing, supplementary pensions and health care insurance, companies in those industries are subject to separate regulations.

Debtors engaged in business activities must also comply with additional conditions in order to apply for a BRBL proceeding. For example, a businessperson or a business entity that wants to file for extrajudicial or judicial recovery must prove that the business activities have been carried out for at least two years. Further, in order to qualify for a BRBL proceeding a debtor must (i) not be currently bankrupt nor have any outstanding liabilities under a bankruptcy proceeding, (ii) not have filed for judicial recovery in the past five years and (iii) not have been convicted of any offences related to insolvency proceedings.

Finally, entities that are wholly or partially held directly by the state (government-controlled entities) are also excluded from initiating a judicial or extrajudicial recovery proceeding. In other words, the BRBL does not apply to *empresas públicas* (wholly held by the state) and *sociedades de economia mista* (majorly held by the state); currently there is no statute regulating bankruptcy proceedings for such entities.

3.1.2 Criteria to satisfy in order to initiate the proceedings

A judicial recovery proceeding, is commenced by the submission of mandatory documentation along with the request for judicial recovery.

Article 51 of the BRBL provides the list of mandatory documents that a debtor must present when filing for judicial recovery. Among the many documents, there are financial statements, a list identifying all creditors, etc.

Recently some courts have required that an expert report detailing the financial status of the debtor be summitted as a prerequisite to opening the case. This requirement also helps to assure that all required documents have been submitted and that the debtor is eligible for a judicial recovery under the BRBL.

An extrajudicial recovery is commenced by the presentation of the recovery plan to the court: the plan's terms, its justification and the signatures of the consenting creditors must be filed together with the plan.[20] Although these documents suffice for a voluntary extrajudicial recovery case, should the debtor seek to confirm an extrajudicial plan over on a non-consensual basis, an additional set of documents is required:

- a statement on the debtor's current assets and liabilities;
- accounting statements for the last financial year and accounting statements specially drawn up to support the petition, as per Article 51 of the BRBL;
- documents evidencing the powers of the subscribers to novate or compromise;

[20] BRBL, Article 162.

- a full nominal list of creditors, stating their addresses, the type, rating and updated amount of each claim, specifying its origin; and

- documents evidencing the accounting records of pending transactions.[21]

3.1.3 Key parties to the proceedings

A few key actors play important roles both on judicial and extrajudicial recoveries.

One of the most important actors in recovery proceedings is the judicial court. Judicial courts in charge of recovery and liquidation proceedings under the BRBL are led by members of the Judiciary. The Brazilian Judiciary is comprised of state and federal courts, each having a trial court and two appellate levels (the third level is common to both). Bankruptcy proceedings are administered by the state courts.

In some parts of the country bankruptcy cases are administered by general state court justices who hear all types of civil proceeding. However, in more cosmopolitan areas specialised courts have been established that deal exclusively with bankruptcy and business law matters.

Although the BRBL was enacted in 2005, the legislation has only recently become popular after the Brazilian financial crisis of 2016. As a result, questions about the proper interpretation of the law are only now reaching courts. As a general matter, courts tend to interpret the BRBL in a manner favourable to the debtor (even though the legislation itself is quite neutral).

Another key actor in Brazilian insolvency proceedings is the judicial administrator, who is appointed in both judicial recovery and liquidation proceedings. The judicial administrator is appointed by the court and appointment is solely at the discretion of the judge in charge of the proceeding. The judicial administrator must be a reputable professional, preferably a lawyer, an economist, a business manager, an accountant or a specialised legal entity.

The judicial administrator oversees the judicial recovery procedure, the notification of creditors of the commencement of the procedure, the analysis of the proof of claims presented by creditors, presiding over the general meeting of creditors, keeping the court informed about the implementation of the recovery plan and the debtor's financial situation, among many other activities. The judicial administrator must also analyse requests presented by different stakeholders during the insolvency proceedings and take before the court in respect to such requests. The main duties of the judicial administrator are listed in Article 22 of the BRBL.

In insolvency proceedings, the judicial administrator will become responsible for the sale of the debtor's assets and the payment of the debts of the estate. In some cases, the administrator may seek authorisation to continue to manage the business in order to maximize the value of the assets by selling the company as a going concern. In judicial recovery cases, management of the debtor generally remains in the hands of the debtor's pre-existing management, and the debtor is the only party that may submit a recovery plan.

The judicial administrator is an extension of the bankruptcy judge, who helps the court with the analysis of the claims presented by creditors and keeps the court and other stakeholders informed about the financial performance of the debtor.

Creditors also play an active role in Brazilian insolvency proceedings. In addition to filing their own proofs of claim, creditors may object to any other claim asserted in an insolvency case, and may also object to the

[21] BRBL, Article 163.

debtor's recovery plan. Creditors may also initiate bankruptcy proceedings, seeking the involuntary liquidation of a company that has defaulted on a given debt.

A committee of creditors may be formed in either recovery or liquidation proceedings, however, as a practical matter committees are rarely formed in Brazilian insolvency proceedings. One of the reasons for this has to do with the fact that the fees of the committee professionals are paid by the committee members themselves, who are rarely willing to spend funds in the restructuring of the debtor. On top of that, there are concerns regarding the risk of liability for members of the committee.

In those rare cases where a committee is formed, it will be charged with several significant duties, such as supervising the activities of the debtor, examining the accounts of the judicial administrator, monitoring the course of the proceedings and informing the court regarding any violation of rights or injury to interests of the creditors. In a judicial recovery, the committee of creditors will also supervise the debtor's activities, submit monthly reports to the court and supervise the fulfilment of the debtor's obligations under the recovery plan.

Finally, the public prosecutor's office also plays an important role in the BRBL proceedings. The public prosecutor's office is granted access to the case records and information on the debtor and its business. In this regard, the prosecutor may file appeals against a decision that confirms a recovery plan, may question any debt included in the list of creditors, may oppose the terms and conditions for the sale of assets, may file revocation suits to make certain transactions of the debtor void or ineffective, among many other possible measures. Occasionally, the prosecutor's office may even file criminal charges – the BRBL also contains a section on bankruptcy related crimes.

In an extrajudicial recovery there is no judicial administrator, creditor's committee nor general meeting of creditors.

3.1.4 Managing the business during the insolvency proceedings

The debtor continues to manage the business during the course of a BRBL proceeding, under the supervision of the court; the creditor's committee, if formed; the judicial administrator; the creditors and the public prosecutor. During the course of a judicial recovery proceeding, management cannot dispose of or encumber any long-term assets without authorisation from the court.

In rare cases where the debtor's management fails to comply with its obligations as a debtor in a BRBL proceeding, the debtor's management can be displaces by the court. In such cases the judge will call a general meeting of creditors to determine who is to assume the management of the debtor. Until the meeting is called, the judicial administrator will take interim control of the business.

In an extrajudicial recovery, the debtor or its administrators must operate the business in the ordinary course; there is no provision for the removal of the debtor's management.

3.1.5 Dealing with secured and unsecured debts

Subject to certain exceptions, both secured and unsecured debt may be adjusted in judicial and extrajudicial recovery proceedings without the consent of affected creditors. There are, however, more restrictions on the involuntary adjustment of secured claims than there are with respect to unsecured claims.

Creditors secured by fiduciary liens may not have their claims adjusted by a recovery plan. The BRBL, Article 49, 3rd paragraph, lists these special types of secured claims and contracts that are not subject to being restructured, which include contracts providing for fiduciary liens, contracts containing irreversibility or irrevocability clauses, lease-purchase agreements, among other exceptions where title to the property is held in the name of the creditor. Advances on foreign-exchange contracts are also not subject to judicial recovery.[22] Such creditors are, of course, free to consensually agree to the terms of a recovery plan if they so choose.

Nonetheless, fiduciary creditors are not immune from the consequences of judicial recovery: during the stay period, no capital good considered "essential" for the business activities of the debtor may be repossessed by the creditor. The stay period is 180 days, but it is usually extended by the court until the recovery plan is confirmed. Once the plan is confirmed and distributions begin, creditors should be able to repossess the goods in which they have a security interest, but even then courts have the power to prohibit the secured creditor from repossessing the collateral in equitable grounds that such action would have drastic consequences for the debtor. Unfortunately, even fully secured creditors face uncertainties under BRBL proceedings.

Creditors who hold security interests *in rem* are subject to adjustments to their secured claims. In either a judicial or on an extrajudicial recovery process, *in rem* secured creditors vote in a separate class. A class of holders of *in rem* secured claims is deemed to have approved a plan if a majority in number of creditors holding a majority of the claims voting in such class vote in favour of the plan. The BRBL provides that the sale of an asset encumbered by an *in rem* security interest is only possible with the consent of the secured creditor.

As for personal guarantees, BRBL states that the creditor preserves its rights against the guarantor. The same rule applies to extrajudicial recoveries. That is to say, the commencement of a recovery procedure does not prohibit a creditor from enforcing personal guarantees against third-party guarantors.

Despite the fact that the BRBL clearly provides that *in rem* security interests may not be extinguished without the beneficiary's consent, and that the restructuring of the obligations of a primary obligor does not affect the liability of a third-party personal guarantor, some courts have allowed these claims to be extinguished without creditor consent.

One possible reason why courts have permitted the extinguishment of these rights is the fact that BRBL does not only provide for rules, but also principles. Among the many principles that regulate the application of BRBL, the most recurrent one is the *preservation of the business activity* principle, which prioritizes the preservation of the debtor's activities to allow for the maintenance of jobs, tax collection, services, etc.

The BRBL is silent on a debtors ability to adjust contracts under a recovery proceeding. As a result, debtors are unable to adjust long term contracts in a recovery procedure and must seek to adjust such obligations in independent lawsuits seeking such relief.

Nonetheless, a few provisions of the BRBL provide the debtor with some leverage to deal with contract counterparties in a recovery proceeding. For example, during the stay period,[23] a creditor may be prohibited from seeking to terminate its contract with the debtor even where the applicable contract provides for the automatic termination of the contract upon the commencement of a recovery proceeding.

[22] BRBL, Article 49, para 4.

[23] The stay entering into effect is actually dependent on the court allowing the commencement of the procedure (which is conditioned on the debtor properly presenting the mandatory documentation and fulfilling the prerequisites set forth under BRBL, such as carrying on a business activity).

Finally, it should be noted that any amount of claim that exceeds the value of the collateral under a fiduciary or an *in rem* security interest is treated as an unsecured claim.

3.1.6 Creditors' consent

In the case of a judicial recovery, the level of creditor consent to effectuate a restructuring is set by Article 45 of the BRBL.

After filing for a judicial recovery, the debtor has sixty (60) days to file its recovery plan before the court. Should no creditor object to the plan, a judge will assume there is a tacit approval of its terms and proceed to a confirmation judgment. Should a single creditor object to it, the calling of a general meeting of creditors is mandatory, so that the plan is put to a vote.

Under a judicial recovery, creditors are categorised under four classes according to the type of claim they hold against the debtor:

- labour claims,
- *in rem* secured claims,
- unsecured claims and
- claims held by micro and small enterprises.

Depending on the class, plan approval depends on either a majority solely based on the number of favourable creditors or on a double majority that encompasses both the number of creditors and the amount of claims voted in the class, as follows:

Class	**Criteria for Approval**
Labour Claims	Majority by head count of attending creditors
In rem Secured Claims	Majority by head count and by value of the claims held by the attending creditors
Unsecured Claims	Majority by head count and by value of the claims held by the attending creditors
Claims held by micro and small enterprises	Majority by head count of attending creditors

If a general meeting of creditors is called and the plan is rejected, a cram down might still be an option. Article 58 of the BRBL contains provisions on the cram down of the judicial recovery plan. Cram down grants courts discretion to confirm recovery plans that, despite not being approved by the general meeting of creditors, still obtained (i) favourable votes by creditors representing over half the total amount of credits held by the creditors present at the meeting, (ii) the approval of two classes and (iii) over 1/3 of favourable votes in the classes that rejected it. Additionally, the judicial recovery plan may only be confirmed if it does not entail discriminatory treatment among the creditors of the class that rejected it. Once a plan has been approved, it will be enforced against all dissenting creditors.

Concerning the extrajudicial recovery, an extrajudicial recovery might be voluntary (when all the creditors voluntarily agree to it) or involuntary (when the plan must be imposed against a portion of dissenting creditors).

A voluntary extrajudicial recovery requires the consent of every creditor that is affected by the plan – the restructuring is not forced upon any creditor. An involuntary extrajudicial recovery, on the other hand, allows the debtor to enforce the recovery plan against dissenting creditors as long as a 60% of the total amount of claims in every class of creditors consents. The division of creditors into classes under an involuntary extrajudicial recovery is not the same as in a judicial recovery. Article 163 of the BRBL does not refer to classes of creditors but to species of creditors, to differentiate from the four classes of creditors in which the creditors are included in a judicial reorganization. As a consequence, it is possible for the debtor to organise the creditors in different groups, as far as there is a reasonable business explanation for doing so. Note, however, that tax and labour claims are not subject to an extrajudicial recovery.

3.1.7 Shareholder consent

The equity holders must always approve the filing of a recovery proceeding. The two most commonly used types of business entities under Brazilian law are limited liability companies (*sociedades limitadas*) and corporations (*sociedades anônimas*).

The authorisation for a limited liability company to file for a recovery proceeding must be formalised by a partner's meeting,[24] whereas the authorisation for a corporation to do so depends on a shareholders' meeting.[25]

Limited liability companies require 75% of favourable votes by the quota holders[26] in order to allow for the filing of a restructuring proceeding, whilst corporations require a simple majority of the voting capital present at the shareholders' meeting.[27]

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

As mentioned in item 3 (pre-insolvency proceedings), the BRBL does not divide its proceedings into pre-insolvency and insolvency proceedings. The restructuring proceedings under the BRBL function as hybrids between pre-insolvency and insolvency proceedings (which is especially true with regards to

[24] Civil Code, Article 1.071.
[25] Federal Law No. 6.404/1976, Business Corporation Act), IX, Article 122.
[26] Civil Code, I, Article 1.076.
[27] Business Corporation Act, X, Article 136.

judicial recoveries), so both were discussed in the item above. Accordingly, for insolvency proceedings, we refer to the third and final proceeding the BRBL provides for: bankruptcy (liquidation).

4.1 Bankruptcy proceedings

The BRBL is designed for individuals and associations who perform business activities. Individuals (consumers) and civil associations that do not perform business activities may liquidate their debt by means of a "civil insolvency" proceeding (regulated by the 1973 Civil Procedure Code), despite the fact that said proceedings are very rare due to its overall incapability of offering non-business debtors with a quick and effective manner to liquidate their liabilities.

Solvent individuals or legal entities may liquidate their business out of court. Insolvent individuals or legal entities, on the other hand, must go to court to liquidate under the terms of BRBL.

The purpose of a bankruptcy procedure is to liquidate the assets of the debtor and use the proceeds to pay the creditors. One of the goals of the BRBL is to preserve the productive use of the company's goods, assets and productive resources. In order to do this, the BRBL states that the debtor's assets should be sold altogether, as a business unit, whenever possible. The BRBL states that liquidation procedures must be carried out in the fastest and most cost-effective way.

4.1.1 Who can initiate the proceedings

There are two ways to initiate a liquidation proceeding: voluntary, when the request for bankruptcy is filed by the debtor, or involuntary, when the request is filed by a creditor.

4.1.2 Criteria to satisfy in order to initiate the proceedings

Voluntary bankruptcy cases (auto-liquidations) are regulated by Article 105 *et seq* of the BRBL. There is no minimum amount of debt for filing. There is also no statutory obligation to file for liquidation under any circumstances. The only conditions for opening the proceeding is the debtor properly presenting all of the mandatory documents that must be presented along with the request for bankruptcy. Said documentation is vast and encompasses financial statements, accounting books, a list of creditors, a list of assets, among many other general documents related to the business. Additionally, if the debtor is a business legal entity, the authorisation of its partners or shareholders is necessary.

Creditor-initiated bankruptcy proceedings, on the other hand, depend on the creditor meeting at least one of the criteria set out in Article 94 of the BRBL. Three situations allow the commencement of an involuntary bankruptcy procedure in Brazil:

- the debtor, without a relevant reason under the law, does not pay on the due date a debt with a certain value (*dívida líquida*) and it is expressed in one or more extra-judicially or judicially enforceable titles duly protested, the sum of which exceeds the equivalent of 40 minimum wages on the date of the petition for bankruptcy;
- the debtor faces an execution proceeding related to any *dívida líquida*, does not timely pay the debt, deposits the amount due and / or appoints sufficient assets for attachment within the proper time frame of the execution proceeding;
- the debtor has performed one of a series of acts set out in Article 94, III, BRBL, which allow for a formal assumption that the debtor is insolvent, such as liquidating assets precipitately, simulating transactions, offering additional collateral without keeping sufficient assets free and clear to settle its liabilities, etc.

All three gateways are similar in that they do not require actual proof of the insolvency of the debtor.

If the creditor is a business legal entity or an individual entrepreneur, the regularity of the business must be proved by means of a certificate from the Board of Trade. If the creditor is not domiciled in Brazil, a bond must be posted in order to secure a potential future payment of court costs, legal fees including fees of counsel.

Bankruptcy may also be requested by the surviving spouse, any heir of the debtor or the estate's administrator, as well as the shareholder of the debtor under the law or the articles of incorporation of the company.

4.1.3 Key parties to the proceedings

The main actors in a bankruptcy proceeding are essentially the same as the actors in restructuring proceedings.

One of the most important actors in liquidation proceedings is the judicial court. The same judge may be responsible for a bankruptcy proceeding and any other given type of lawsuit. However, the closer a business is to an important business center, the more likely it is for the judiciary of that specific location to have provided for the creation of specific courts that are designed to deal solely with bankruptcy and business law matters.

Another key actor is the Judicial Administrator. The judicial administrator is appointed by the court to carry out liquidation procedures. Nomination of the judicial administrator depends solely on the discretion of the judge in charge of the bankruptcy proceeding. The judicial administrator must be a reputable professional, preferably a lawyer, an economist, a business manager, an accountant or a specialised legal entity.

The judicial administrator's tasks include carrying out the liquidation procedures, the analysis of proofs of claims presented by creditors in order to review the list of creditors, and keeping the court up to date with regards to the sale of the debtor's assets, among other activities.

In bankruptcy, the judicial administrator takes over the management of the estate and becomes responsible for the sale of the debtor's assets and payment of creditors. Under certain circumstances, the judicial administrator may seek court authorisation to continue the business activities in order to preserve the value of the assets during the winding up of the debtor. In addition to that, the judicial administrator also oversees the procedure as a whole, granting validity to the acts performed under the bankruptcy procedure.

The judicial administrator is an extension of the bankruptcy judge, who helps the court with the analysis of the claims presented by creditors and keeps the court and other stakeholders up to date on the performance of the debtor.

The debtor itself is also one of the most important actors of the BRBL proceedings with many duties, particularly to collabourate with the court and the estate.

Creditors also play an active role in bankruptcy procedures. Other than presenting their proof of claim in judicial recoveries and bankruptcies, creditors may object to any claim listed in the public notices of each procedure, thus acting as supervisors. In addition, creditors are often the parties who initiate bankruptcy proceedings, seeking the involuntary liquidation of a company that has defaulted on a given debt.

Either in restructuring or liquidation proceedings, a committee of creditors may be formed. Despite the statutory provision, the cases where a committee is formed are very rare. One of the reasons for this might be the fact that the fees of the members of the committee are paid by the creditors themselves, who might not be willing to spend funds in the restructuring of the debtor. On top of that, there are concerns regarding the risk of liability for members of the committee.

In a bankruptcy proceeding, the general meeting of creditors does not play a significant role. Such a meeting is usually restricted to decisions about alternative methods of asset sale.

Finally, the public prosecutor's office also plays an important role in the BRBL proceedings. The public prosecutor's office is granted access to the case records and information on the debtor and its business. In addition, the prosecutor may file appeals against certain decisions, may question any debt included in the list of creditors, may oppose the terms and conditions for the sale of assets, may file revocation suits to make certain transactions of the bankrupt debtor void or ineffective, among other measures.

Occasionally, the prosecutor's office may even file criminal charges – BRBL also contains a section on crimes related to bankruptcy proceedings.

4.1.4 Managing the business during the insolvency proceedings

Unlike restructuring proceedings (judicial and extrajudicial recoveries), the debtor does not remain in control of the business during liquidation. As soon as the bankruptcy is declared by the court, management steps out and the court-nominated judicial administrator takes control over the business. The debtor is disqualified from engaging in any business activities from the declaration of its bankruptcy until the decision that extinguishes its liabilities. The debtor also loses the right to manage and dispose of its property.

The judicial administrator's role is to liquidate the assets of the debtor in a timely and cost-effective manner. In some exceptional cases, operating the business for a short period might be the best outcome for the estate. Regardless of whether the debtor has its activities completely shut down or not, it is the judicial administrator who will be in charge of managing the estate.

4.1.5 Dealing with secured and unsecured debts

Bankruptcy is aligned towards the liquidation of the estate and payment of the proceeds to the creditors. Since it does not involve any restructuring, contracts and debts are not adjusted by means of a liquidation proceeding.

Still, the declaration of bankruptcy does affect the debtor's contracts. As a rule, the judicial administrator has the discretion to choose between terminating a contract or keeping it in effect, as long as it benefits the estate (in case the contract preserves the debtor's assets or reduces the total liabilities of the debtor).

There are no statutory rules for the treatment of essential contracts (such as those relating to the provision of water, electricity and communication services, for example).

Secured and unsecured debts will not be adjusted under bankruptcy proceedings. Under liquidation, creditors shall be paid accordingly to a *pro rata* distribution of the proceeds of the sale of the debtor's assets.

Secured creditors benefit from the fact their credit is collateralized. That is, creditors who possess *in rem* secured credits and fiduciary liens are in a better position when compared to unsecured creditors.

In rem securities such as pledges and mortgages grant the creditor the right to the proceeds of the sale of the collateral, which is to be carried out by the judicial administrator. Creditors with fiduciary liens, on the other hand, may file restitution suits, which allow them to repossess the collateral immediately.

4.1.6 Creditors' consent

Restructuring of debt is not provided for under a liquidation proceeding. Once the bankruptcy of the debtor is declared, its winding up, the sale of its assets and the distribution of proceeds to creditors does not depend upon creditor consent.

4.1.7 Shareholder consent

Bankruptcies are commonly initiated by creditors, which means the equity holders' consent does not come into play.

In the case of a voluntary bankruptcy proceeding, the consent required for its initiation is the same level of consent it would take for the equity holders to extinguish the business association as a whole.

The two main types of business associations under the Brazilian legal system are limited liability companies (*sociedades limitadas*) and corporations (*sociedades anônimas*).

Liquidation of a limited liability company requires a 75% favourable vote by the quota holders. The dissolution of a corporation requires only a simple majority of the voting capital.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

The granting of a security right or interest to a specific creditor may be voided under certain circumstances.

Once a judicial recovery case initiates, despite the fact that the debtor remains in charge of its management, under Article 66 of the BRBL, the debtor cannot dispose of or encumber any items or rights of his permanent (long-term) assets unless the court authorises the act (or said disposal or encumbrance is provided for by the recovery plan). Thus, if the debtor grants a creditor a security interest in one of its assets during the judicial recovery procedure without court approval, the security interest will be declared invalid.

Extrajudicial recoveries, on the other hand, do not impose limitations on the disposal or encumbrance of the debtor's assets.

With respect to avoidance actions in bankruptcy proceedings, the BRBL provides for the "ineffectiveness and revocation of acts performed prior to the bankruptcy procedure". The provisions allow the estate to claw-back some of its property, voiding certain acts made before the declaration of bankruptcy, thus protecting the group of creditors against unlawful favouring of an individual creditor. The statute distinguishes between two different scenarios: (i) an exhaustive list of acts which shall not produce any effects, regardless of the intention of the contracting parties [28]; and (ii) a general provision stating that, in case of intent to defraud creditors, any act may be revoked.[29]

[28] BRBL, Article 129.
[29] BRBL, Article 130.

The acts enumerated in Article 129 include, among other provisions, the payment of debts not yet due, the payment of enforceable claims in a way not provided for under its respective contract, or the constitution of *in rem* guarantees, among other situations, if, in any of the cases, implemented within a certain term before the bankruptcy order. As previously stated, the BRBL assumes these acts are illicit with no need for further investigation of the intent of the contracting parties. Article 130, on the other hand, voids any act under upon proof that there was both an intent to defraud creditors and the act caused harm to the bankruptcy estate. Acts provided for under Articles 129 and 130 may still be valid against third parties, but they will not produce effects against the bankrupt estate.

6. Is enforcement of security rights treated differently in each type of proceeding?

Yes, the treatment of security rights varies according to each type of proceeding.

Personal securities, *in rem* securities and fiduciary securities are treated differently in a judicial recovery procedure.

According to the BRBL, the filing for a judicial recovery does not affect the personal securities a creditor holds against third parties; the creditor may execute the security immediately.

A third party who pays for a given debt due to a personal security is entitled to repayment by the debtor. The debtor will remain liable before the guarantor.

In rem claims under a judicial recovery do not allow for foreclosure against the collateral. However, creditors with *in rem* securities vote for or against the recovery plan under a specific class of creditors, so the debtor has to offer an appealing plan in order to have the plan approved in said class of creditors. As stated, per statute, both personal and *in rem* security interests may only be extinguished with creditor's consent. Some courts, however, make exceptions to these rules in order to favour the maintenance of the business activity of the debtor.

Fiduciary securities may be executed while the debtor is in a judicial recovery proceeding. Fiduciary claims are often referred to as "*créditos extraconcursais*", meaning claims not subject to the effects of recovery proceedings, although this is not entirely true. Collateral cannot be repossessed during the stay period if it is considered an "essential" capital good for the business activity of the debtor (Article 49, BRBL). Even after plan confirmation, however, creditors could face difficulties repossessing their collateral because courts have a tendency to favour decisions that allow the debtor to keep the business running, which preserves jobs. This debtor-friendly interpretation of the BRBL unfortunately gives rise to uncertainties for secured creditors.

As for an extrajudicial recovery, creditors also maintain their ability to execute personal securities against third party guarantors. Likewise, *in rem* creditors also vote the extrajudicial recovery plan under a separate class. Personal and *in rem* security interests may only be extinguished with the creditor's consent.

Extrajudicial recovery procedures do not provide for a stay period. Accordingly, the repossession of fiduciary collateral tends to be easier for the creditor in an extrajudicial recovery than in a judicial recovery.

In a bankruptcy case, creditors can also go forward with the execution of personal securities against third parties. In the bankruptcy proceeding, such credits are classified as unsecured credits. Assets of the debtor encumbered with *in rem* liens grant the creditor the right to its proceeds upon the sale of the asset. If the business is sold as a whole unit, the creditor will be entitled to a portion of the proceeds equivalent to the value of the asset. Creditors who hold a fiduciary lien over a certain asset of the debtor can take immediate repossession of the asset by means of a petition for restitution.[30] In any event, the credit is classified as a claim secured by *in rem* or fiduciary security interests to the limit of the value of the encumbered asset – and it will be listed as an unsecured claim for the amount of the credit that exceeds the value of the collateral.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

The law does not provide any guidance on priorities concerning payments in an extrajudicial recovery. All of the credits that are subject to the effects of an extrajudicial recovery proceeding will be paid in accordance to the recovery plan presented by the debtor. As noted above, some claims cannot be adjusted in an extrajudicial recovery, including labour and tax claims (the latter is also immune from judicial recoveries).

In a judicial recovery, distributions must be sufficiently appealing so that each class of creditors approves the plan, but no class is particularly more important than the other is. One exception to the uniform treatment of creditors under judicial recoveries is the fact that the labour claims class is granted additional protection from the recovery plan's adjustment of claims: (i) labour claims must be paid in full within one year of the plan's confirmation and (ii) labour claims fallen due up to three months prior to the judicial recovery filing must be paid within thirty days (limited to 5 minimum wages per worker) as of the confirmation of the plan.

Under either extrajudicial or judicial recovery cases, claims secured by fiduciary liens cannot be adjusted by recovery plans.

On the other hand, the order of distribution in a bankruptcy proceeding is as follows:

- Indispensable expenses relating to the administration of the bankruptcy, including the necessary payments for the provisional continuation of the business activities, must be paid by the judicial administrator as cashflow allows;
- Labour claims for salary due in the three months preceding the bankruptcy decree, up to an amount equalling five minimum wages per employee, must be paid as soon as there are available funds;
- Cash restitution claims;
- Super priority claims (Article 84, BRBL);[31]
- Labour claims up to 150 minimum-wages (less the amounts already paid according to letter b) above) and claims resulting from on-the-job accidents;

[30] BRBL, Article 85.
[31] Super Priority, as for Article 84 of the BRBL, includes:
I – fees payable to the judicial administrator and his assistants, and labor-related credits or occupational accident credits referring to services rendered after the decree of bankruptcy;
II – sums provided to the bankrupt estate by the creditors;
III – expenses with schedules, management, asset realization and distribution of the proceeds, as well as court costs of the bankruptcy proceedings;
IV – court costs with respect to actions and executions in which the bankrupt estate is defeated;
V – obligations resulting from acts performed during the judicial recovery, or after the decree of bankruptcy, and taxes relating to tax triggering events occurring after the decree of bankruptcy.

- Secured claims;
- Credits listed as Public Collectible Debts;
- Special privileged credits;
- General privileged credits;
- Unsecured claims;
- Credits related to contractual penalties and fines for breach of criminal or administrative law, including tax-related fines;
- Subordinate credits, as follows: those so provided for by law or contract, as well as the credits of partners and officers without an employment bond;
- Interest on claims due after the decree of bankruptcy (except for interest due on debentures and for interest due on claims guaranteed by *in rem guarantees*, in the latter case up to the value of the collateral, which are paid together with the other claims subject to the bankruptcy proceeding (para e) above).

The balance, if any, after all creditors have been paid, must be distributed to the bankrupt debtor.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

How a secured creditor protects its interest depends on the type of security interest and type of proceeding.

Creditors who own fiduciary liens over assets of the debtor will seek repossession of the collateral. As explained above, extrajudicial recovery proceedings usually do not provide for a stay period, so repossession may occur immediately as long as the debtor has defaulted on its obligation. Under a judicial recovery, fiduciary creditors cannot seek repossession of the collateral during the stay period if it is considered as an essential capital good for the business activity of the debtor. Once the plan is confirmed, repossession of the collateral should be possible, but even then, some courts may impose barriers to creditors in light of the importance of keeping the business running in order to preserve jobs In a liquidation, creditors secured by fiduciary liens can file restitution suits to repossess the collateral immediately.

The protection of *in rem* securities under judicial and extrajudicial recoveries is largely provided for by the BRBL's provisions categorizing *in rem* creditors in a separate class of creditors. According to the BRBL, the substitution or suppression of an *in rem* guarantee can only be accomplished with creditor consent. Under a bankruptcy case (liquidation), the assets that serve as collateral will be sold along with the business as a whole whenever possible. If there are no potential acquirers of the business as a going concern, assets of the debtor are sold separately. Monitoring the proceeding is important for the creditor to be able to bar sales that do not properly value the debtor's assets, which could result in a loss for the creditor.

As per the BRBL, personal guarantees are not affected by recovery or liquidation proceedings. The creditor should be able to enforce the security against third party guarantors, even during the stay period of judicial recoveries.

In practical terms, however, restructuring proceedings may present obstacles of their own for secured creditors. Despite the BRBL's provisions protecting creditors secured by personal and *in rem* guarantees from having their security rights adjusted, certain judicial cases have allowed for the debtor's restructuring to suppress said rights as long as the recovery plan provides for it.

In September 2016, the Special Appeal (*Recurso Especial*) no. 1.532.943/MT was decided by the Superior Court of Justice. The Court decided that a recovery plan that suppresses or substitutes *in rem* securities and personal securities provided by the debtor itself is binding to all creditors as long as the plan is approved by the majority of creditors. In April 2019, the Superior Court of Justice decided the Special Appeal no. 1.700.487/MT, deciding once again that a recovery plan may suppress personal and *in rem* securities without the consent of every single creditor. Case 1.700.487/MT even went further and allowed for the suppression of personal securities granted by third parties, not merely those granted by the debtor itself (as long as the recovery plan provides for it). The current standing of the Superior Court of Justice on the suppression of guarantees might be confirmed or might be reversed by the judgment of Special Appeal no. 1.797.924/MT, which deals with the same issues and should make up for a more definite position on the matter.

Unfortunately, the BRBL does not provide for "adequate protection" suits. That is to say, should the asset that serves as collateral – either as an *in rem* security interest or a fiduciary security interest – depreciate over time, there is no statutory provision allowing the creditor to seek the substitution or the granting of additional security interest in order to preserve the value of the collateral.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

Rights of a creditor against non-debtor guarantors are either granted by personal security arrangements (*aval* and *fiança*) or *in rem* guarantees granted by third parties.

As previously stated, as far as the statutory provisions provide for, restructuring and liquidation proceedings of the principal debtor do not alter nor affect the security rights of a creditor against third parties. However, in light of the Special Appeals no. 1.700.487/MT, judged by the Superior Court of Justice, the current setting of the matter is that the Judiciary will allow for a recovery plan of the principal debtor to suppress security rights held by creditors against third party guarantors (who are not even subject to the restructuring proceeding).

Since the aforementioned suppression must be provided for by the terms of the recovery plan, it cannot occur under a liquidation case.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

The perfection of security rights is essential for the creditor to be categorised as a secured creditor under restructuring and liquidation proceedings.

Perfection is usually obtained by registering the contract with the proper Public Registry. This applies to both *in rem* and fiduciary security rights, which are asset-backed rights. In this sense, the collateral itself will define the proper type of Public Registry before which the contract must be registered – there are real estate registries, general titles and documents registries, vehicle registries, etc.

Personal security rights, on the other hand, do not depend upon its registration with a Public Registry in order to be perfected.

If the contract that provides for the security right is not properly registered, the security right is deemed ineffective and the creditor shall be considered as an unsecured creditor.

One exception to the aforementioned is the case of fiduciary guarantee rights over receivables of the debtor (*cessão fiduciária*). The Superior Court of Justice has decided that the lack of registration of said guarantee contracts does not interfere with the impossibility of the collateralized debt being adjusted under a recovery proceeding.[32]

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor?

Under judicial recovery cases, a stay period will be in place as soon as the court declares the commencement of the proceeding. The stay period lasts for 180 days, although several court decisions have extended this term, and prevents any execution acts – including the foreclosure of collateral – against the debtor whilst it negotiates its recovery plan with creditors.

Asset-backed guarantees fall into either the *in rem* or the fiduciary securities category.

In rem security interests cannot be foreclosed during judicial recovery cases – the security grants the creditor the right to be a part of a class of creditors that votes the plan separately. Unless the recovery plan itself provides for the foreclosure on the *in rem* security interest, it will not be foreclosed by the creditor. That is true because property of the debtor may not be foreclosed during the stay period, which usually lasts until the recovery plan is confirmed; once the plan is confirmed, debts will be paid according to its terms. If the plan is fully implemented (distribution is complete), the debt is extinguished. Once the debt is extinguished, so is the *in rem* security interest.

Fiduciary securities, on the other hand, may be foreclosed during judicial recoveries, allowing the creditor to take possession of the collateral except capital goods that are essential for the debtor's business may not occur during the stay. Whether certain assets fall into the "essential capital goods" category is a heated discussion between creditors and debtors – any judgment on the matter is very fact intensive. Certain assets are essential for a specific type of business, whereas the same kind of asset may be simply accessory in a different business field. Nonetheless, statutory provisions alone allow for the fiduciary creditor to repossess its collateral once the stay period is over.

A recurrent discussion related to this issue deals with the fiduciary assignment of receivables. Since receivables amount to a future stream of cash flow, its characterisation as a "capital good" is not so evident. On the other hand, there may hardly be anything more essential for the debtor's operation to keep running other than cash. Overall, fiduciary assignments are usually enforced, but some courts might try to construct an in-between compromise between debtor and creditor, allowing for a certain percentage of the receivables to be used by the debtor. Some courts may even grant the debtor full access to the receivables.

As for extrajudicial recoveries, the BRBL does not provide for stay periods. Since it may not be possible for the debtor to reorganise while simultaneously dealing with execution lawsuits, it is increasingly common for debtors to file for an extrajudicial recovery and require a stay period, a measure that many

[32] Special Appeal no. 1.412.529/SP.

courts find to be in accordance with the principles of the BRBL. If a stay is granted, *in rem* creditors will not be able to foreclose on any property. As for fiduciary creditors, the repossession of a given asset should be possible at any time (even if it is an essential capital good).

In a liquidation, foreclosure of fiduciary securities may be promptly enforced by restitution lawsuits. The assets that serve as collateral under *in rem* security agreements will be sold along with the debtor's business as a whole (whenever possible) or individually – the proceeds after the sale are directed towards the creditor.

In general terms, the stay period will prevent any sort of creditor from collecting from the debtor. There are no statutory exceptions to the stay period so that a given creditor could be paid before the remaining creditors. The Judiciary has also not created an exception.

Nevertheless, according to Article 6 of the BRBL, the stay period cannot exceed one hundred and eighty days from the acceptance of the judicial recovery by the court. That demonstrates the Legislator's intent to see quick solutions to businesses' crises. However, the 180-day period is often insufficient for the debtor to obtain the approval of the recovery plan, particularly in large cases. As long as the debtor has not contributed to the delay of the proceeding, the 180-day stay period tends to be extended by the court. However, if a creditor shows that the debtor is responsible for the delay of the proceeding, the stay period can be challenged as a whole.

Should a court decide to not extend the stay, creditors will be able to carry on execution lawsuits against the debtor (which is likely to lead to its bankruptcy).

The Superior Court of Justice has already decided that creditors cannot automatically resume foreclosure measures as soon as the 180-day term is over.[33] No asset of the debtor may be seized without the consent of the Bankruptcy Court. This scenario sometimes makes it very difficult for the holder of a fiduciary title to enforce his rights, especially as Courts tend to decide in a debtor-friendly manner.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

Under statutory provisions, collateral in which a secured party has an interest cannot be used by the debtor or sold without the consent of the creditor. Nevertheless, the BRBL does not only contain rules, but also principles, which can lead the judiciary to interpret the statute in a non-literal manner. One of the main principles of the BRBL is the "preservation of the business activity", a recurrent principle that permeates the judiciary with judgments that end up favouring the debtor in order to preserve its social value (jobs, services, taxes, etc.). In this sense, the adjustment of *in rem* secured credits has recently acquired new contours.

As stated, asset-backed collateral falls into either the *in rem* or the fiduciary security interests group. Fiduciary security interests are considered "stronger" than *in rem* guarantee agreements.

A creditor who holds a fiduciary security interest over an asset of the debtor is protected against the debtor consuming or selling it. Under the default of the principal contract, a fiduciary agreement allows

[33] STJ, AgRg on CC 127.629, Second Joint Panel, Reporting Justice João Otávio de Noronha, decided on April 23th, 2014.

the creditor to repossess the asset in order to sell it and use its proceeds to pay the debt. More importantly, credits secured by fiduciary security agreements are not subject to the effects of a recovery plan. In this sense, assets encumbered with fiduciary liens cannot be sold, substituted or consumed by the debtor without the consent of the creditor (and said consent is very unlikely to be offered since the recovery plan cannot adjust credits backed by fiduciary guarantee agreements). The collateral can, however, be used (but not consumed) by the debtor during the recovery proceeding. For example, assets that are considered "essential capital goods" for the business activity, such as machinery, cannot be repossessed during the stay period (sometimes not even once the stay period is over).

The scenario is different for *in rem* guarantees. As per the BRBL, Article 50, the sale, suppression or substitution of an asset that works as collateral in an *in rem* guarantee agreement requires creditor consent. Nonetheless, a more recent trend shows that certain debtors have included provisions in their recovery plans providing for the extinction of *in rem* security rights over their assets. Recently, the Judiciary has taken a stance that benefits debtors by allowing the recovery plan to suppress *in rem* guarantees.

As already mentioned, judicial precedents have significantly impacted the protection offered by certain security rights. In the years of 2016 and 2019, the Superior Court of Justice judged decided two different cases stating that a recovery plan may indeed suppress personal and *in rem* securities as long as it is approved by the creditors; upon approval, the suppression will reach even dissenting creditors. The current standing of the Superior Court of Justice on the suppression of guarantees might be confirmed or might be reversed by the judgment of Special Appeal no. 1.797.924/MT, which deals with the same issues and should make up for a more definite position on the matter.

The previously mentioned judgments have given rise to a lot of criticism. Even though debtors will face an easier path towards their restructuring, the suppression of guarantees is not provided for by the BRBL, and the impact of said judgments on new credit is still uncertain. Additionally, there are no criteria defining the terms in which the suppression of guarantees should be admitted.

The sale of an asset "free and clear" of any outstanding liabilities (tax debts, labour debts, etc.) is possible if the recovery plan provides for the restructuring to occur by means of a sale of an "isolated productive unit" (*unidade produtiva isolada* or simply UPI), as provided for by Article 60of the BRBL. In light of the recent judgments of the Superior Court of Justice, it seems possible for a recovery plan to provide for the sale of an asset that previously served as collateral under an *in rem* agreement, even without the creditor's consent. As per the Judiciary's point of view, consent is actually obtained by the approval of the plan under the *in rem* secured creditors' class, which approves the plan on a double majority: number of creditors and amount of credit. Thus, a creditor may oppose the sale of an asset but still not be able to stop it, as long as a majority is formed. The sale of "isolated productive units" is very attractive both for the debtor and the potential acquirers, since outside of a recovery plan the sale of a group of assets would mean it would also carry on its liabilities and liens.

Under an extrajudicial recovery case, assets cannot be sold under the form of an "isolated productive unit". The fact that extrajudicial recoveries do not provide for "free and clear" sales is precisely one of the reasons why extrajudicial recoveries are not so appealing for debtors seeking to restructure their debts.

Under liquidation cases, the assets of the debtor that serve as collateral under fiduciary guarantee agreements will be repossessed by the creditor by means of restitution suits. Assets encumbered by *in rem* guarantee agreements will be sold along with the business as a whole (preferably) and its proceeds will be directed to the creditor. In bankruptcy proceedings, assets are sold free and clear of any liabilities and liens.

The BRBL does not contain specific rules regarding the use of cash collateral.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

Under the BRBL, once a recovery proceeding has started, the sale or encumbrance of any permanent asset of the debtor depends on judicial approval.[34] An additional lien on a secured creditor's collateral would thus require court authorisation. Credits granted during the judicial recovery will be considered as *créditos extraconcursais* (super priority claims) if the proceeding is converted into a bankruptcy. Under judicial recovery cases, unsecured claims held by suppliers who do not interrupt the supply after the debtor files for judicial recovery will be considered as general privileged claims if the bankruptcy is declared, up to the value of the goods or services provided during the judicial recovery period.

The BRBL does not contain any provision regulating priming liens. It is possible for a debtor to offer a lien on an already encumbered asset as long as the debtor still has sufficient equity on the asset. It is common, as an example, for real property to be the object of more than just one mortgage agreement (since the real property usually has a value that exceeds the debt of a single obligation). In this sense, it is possible for courts to authorize the granting of additional mortgages on already encumbered real property, but the granting of a "super priority" security, violating the rights of the original secured creditors, would require that such provision be provided for by the recovery plan. As a matter of fact, as per the BRBL itself, the violation of an *in rem* secured creditor's rights is not possible at all. However, since the Superior Court of Justice has allowed for recovery plans to even suppress *in rem* guarantee agreements altogether, it is safe to assume that the granting of a priming lien would also be possible as long as it is part of the recovery plan.

Assets that are encumbered with fiduciary securities are actually property of the creditor (the debtor only becomes the asset's proprietor once the debt is fully paid). In this sense, it would not be possible for the debtor to grant additional liens on said assets.

In the case of bankruptcy, there is no purpose in granting additional liens on assets of the debtor, since the assets will be sold and the proceeds will be used to pay creditors.

The lack of provision regulating priming liens is also subject to criticism by scholars and practitioners. Unfortunately, under Brazilian recovery cases, debtors who seeks to restructure their activities face difficulties obtaining new financing.

14. What distribution will a secured creditor receive if a company is reorganised?

The distribution a secured creditor will receive in the case of a recovery depends largely on what type of security the creditor holds.

Fiduciary security agreements prevent the debtor from adjusting the secured credit. Either in a judicial or in an extrajudicial recovery, creditors who are secured by fiduciary security agreements are considered as creditors who are not subject to the effects of recovery plans. Fiduciary creditors are entitled to repossess their collateral (although not immediately in the case of judicial recoveries, in which stay periods will be in effect), so there will not be any distribution directed to them under the terms of the plan.

[34] BRBL, Article 66.

In the case of creditors secured by personal and *in rem* securities, distributions will vary widely according to the terms of the recovery plan.

As per the BRBL, the recovery (judicial or extrajudicial) of the principal debtor does not stop creditors from going after third party guarantors who have granted personal securities. In that sense, the creditor would be paid by a third party who, after said payment, would then have a credit right against the debtor. Since the original creditor will be paid by a third party, it would no longer be a creditor subject to the effects of the recovery. The guarantor who pays for the secured debt will be paid by the debtor according to the terms of the recovery plan for unsecured creditors.

In rem creditors, on the other hand, are paid according to the terms of the (judicial or extrajudicial) recovery plan. Since *in rem* creditors vote the plan in a separate class, the terms by which these creditors will get paid must be attractive enough for them to approve the plan.

As previously stated, however, the Judiciary has allowed debtors to insert provisions on judicial recovery plans so as to suppress *in rem* and personal guarantees completely. The Judiciary has not gone the same length when it comes to extrajudicial recoveries (there are no decisions on the matter). Truthfully, secured creditors face many uncertainties when a debtor restructures, for it seems recovery plans may implement adjustments that are not even provided for by the BRBL itself.

It is common for debtors subject to recovery procedures to include large haircuts and grace periods on recovery plans. It is also very common for the debtor to restructure by selling "isolated productive units", an arrangement of assets that is sold "free and clear". The exact payment a secured creditor gets will depend largely on the debtor's proposal for restructuring under its recovery plan.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the recovery of the company?

The rights a secured creditor will hold after a recovery proceeding depend on the type of security interest the creditor held before the proceeding. As previously stated, creditors secured by assets of the debtor fall into either the *in rem* secured or the fiduciary secured creditors category.

Creditors secured by fiduciary security agreements cannot have their credits adjusted by recovery plans. Therefore, the rights of creditors who own fiduciary guarantees over assets of the debtor will remain intact subsequent to the recovery.

Concerning *in rem* secured creditors – as well as personal secured creditors – on the other hand, the rights of the creditor over the property of the debtor will not remain intact after the recovery proceeding. Since the secured credit will be adjusted by the plan, the payment of the secured claim under the plan's terms leads to the full extinction of the debt as a whole. Given that there is no more debt once the recovery is completely implemented (distributions are over), there is also no more guarantee agreement with regards to said debt (*in rem* guarantee agreements are "accessory" agreements, thus lacking purpose without a "principal" contract). The same applies to creditors secured by personal guarantees, but the creditor maintains the right to enforce the obligation against the guarantors.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

The consequence of a creditor being under-secured is the classification of the exceeding debt as an unsecured claim.

Being over-secured has no practical consequences under recovery proceedings. Under a bankruptcy case, the exceeding proceeds of the property that served as collateral shall revert to the bankrupt estate in order to be distributed among the remaining creditors.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

Brazil currently has no statutory provisions regulating cross-border restructuring proceedings.

Nonetheless, the enforcement of a foreign judicial decision will necessarily follow certain steps. In essence, whenever the enforcement of a final or even a preliminary decision from a foreign court is sought in Brazil, the Superior Court of Justice has to approve its enforcement so that it can produce any sort of effects in Brazil. The Superior Court of Justice will not always allow a foreign decision to produce effects in Brazil. Common grounds for denying recognition to foreign decisions include matters that are offensive to Brazil's sovereignty, matters that are offensive to the dignity of any individual and matters that are against the general concept of "public order".

A potential reform of the BRBL is currently under discussion at the Legislative level – the new statute could contain a chapter contemplating UNCITRAL's Model Law on Cross-Border insolvency.

BRITISH VIRGIN ISLANDS

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

As an international financial centre, and one that is widely recognised as an asset-holding jurisdiction, in practice the question of security in the British Virgin Islands (BVI) is focused on security over shares in BVI incorporated companies. That said, BVI law recognises a wide range of security arrangements over virtually every asset class.

1.1 Movable property

As noted, the most common form of security right taken in BVI is a charge over the shares in a BVI registered company. It is also common to encounter charges over the assets in a BVI incorporated company (which frequently will comprise shares in a foreign subsidiary).

There are various mechanics to ensure the formal validity and enforceability of a BVI share charge, none of which can be considered especially onerous. Registration of a share charge (both by recording it in the company's register of charges and also by publicly filing a copy of the share register with the Registry of Corporate Affairs) is a highly prudent step to ensure priority, although a failure to register does not affect validity.

Pledges of BVI shares, in the strict sense, are not possible under BVI law, given that share certificates (which otherwise would be the subject of the pledge) are not documents of title under BVI law. They cannot therefore effectively be pledged, but rather must be charged.

Moving away from shares, as a maritime jurisdiction with a full-service shipping registry, charges and mortgages over vessels are also encountered in the BVI.

BVI contract law recognises the concept of retention of title clauses, although from a practical level, they are extremely rare, given that it is not common to encounter commercial sales agreements that are governed by BVI law.

Under BVI common law, a lien may come into existence, as a means by which to enforce a payment obligation referable to services rendered. An example may be a lien over an item sent for repair, or a solicitor's lien over documents held.

Finally, fixed and floating charges are both recognised under BVI law and are expressly dealt with in BVI insolvency legislation.

1.2 Immovable or real property

BVI law recognises the concept of charges and mortgages over real property, and these are common in relation to purely domestic / internal financings.

A system of registration exists in BVI, whereby charges and mortgages are registered. Enforcement of real estate charges or mortgages by sale requires a court order.

The above forms of security are created by way of contract. We also note that it is possible for a judgment creditor to apply to the court for the imposition of a charging order over shares in a BVI company. The effect of such an order, if made, is to create a valid and enforceable security right over the specified shares. Given the prevalence of BVI companies, charging orders (and subsequent orders for sale of shares subject to them) are a common form of enforcement in the BVI.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

For the most part, out-of-court enforcement of most forms of security is both possible and the default. For example, taking the most common example of a charge over shares in a BVI incorporated company, providing all formal and registration requirements have been fulfilled and a full suite of enforcement documents has been provided at the time of creation of the security, upon the right to enforce properly accruing, enforcement can be as straightforward as submission of the requisite enforcement documents to the company's registered agent with a request to give effect to enforcement. In many cases, this is all that is required to effect at least some degree of enforcement. A well-drafted security package will provide a range of powers to the chargee, including powers of sale, ability to appoint a receiver and powers of attorney.

If the security rights permit the appointment of a receiver, this also generally can be effected without the need for court intervention.

Given that frequently the role of a BVI company within a larger corporate structure is to hold assets (frequently shares in another company, whether BVI or not), an important feature of enforcement is often taking control of assets lower than the BVI company level. This may entail a change of board members in subsidiary entities. Accordingly, enforcement often requires a clearly designed sequence of steps, commencing with those in the BVI, followed by other co-ordinated steps elsewhere.

If the grantor of the charge or the company whose shares are charged either actively opposes enforcement, or simply fails to co-operate, it may be necessary to commence enforcement proceedings in the BVI. These generally take the form of an application for a declaration as to the validity of the right to enforce (that is, as to both the validity of the security right and the act of default or other trigger for enforcement) and orders for rectifying the corporate records of the subject company to reflect the fact and means of enforcement. In a suitable case, where a real risk of dissipation of assets on the part of the subject company can be demonstrated, interim protective measures may be sought.

Given the status of the BVI as an asset-holding jurisdiction, many have described the jurisdiction as being "creditor friendly". This is largely an accurate description, to the extent that it reflects the fact that enforcement of security is generally designed to be straightforward and expeditious, absent any genuine grounds for resisting enforcement.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***

- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Consistent with both the status of the BVI as an asset-holding jurisdiction and also its creditor-friendly approach, commentators have noted that the BVI insolvency regime is focused more upon recovery of assets and the protection of security rights than it is with rescue of distressed enterprises. There are cogent grounds to justify this commentary. For instance, and by way of example, the BVI does not have any express provisions for a moratorium, such as that which exists under the English administration regime or Chapter 11 of the United States (US) Bankruptcy Code. More precisely, the BVI Insolvency Act 2003 does, in fact, contain provisions closely modelled on the administration regime contained in the former UK insolvency legislation (namely a court-appointed administration). However, those provisions have never been applied in the 16 years in which our statute has been in force. There appears no appetite for doing so. This strongly underscores the contention that BVI really is creditor friendly.

That apart, BVI legislation does contain certain provisions designed to assist with pre-insolvency restructuring, and these can certainly be successful if the circumstances are suited to their use.

Essentially, three potential mechanisms exist:

- the company creditors' arrangement;
- the scheme of arrangement; and
- the plan of arrangement. The source of these statutory provisions is spread between the Insolvency Act and the BVI Business Companies Act 2004.

Turning first to the creditors' arrangement, this takes the form of a statutory compromise between a debtor company and its creditors, under the supervision of a supervisor acting as a trustee or otherwise. The process is one that is subject to court supervision (but not, in the first instance, court approval). The mechanism is a powerful one which may include (a) cancelling all or any part of, or varying, the liability of the debtor company or (b) varying the rights of the debtor company's creditors or the terms of a debt.

The process is initiated by the board of directors of a company (unless the company is in liquidation) which may propose an arrangement and nominate an interim supervisor to oversee the proposed arrangement. The basis for commencing an arrangement is that the board believes on reasonable grounds that the company is insolvent or is likely to become insolvent. In addition, the board must have passed a resolution:

- stating its belief that the company is insolvent or is likely to become insolvent;

- approving a written proposal containing the information prescribed; and
- nominating an eligible insolvency practitioner to be appointed as interim supervisor.

An important feature of the creditors' arrangement is that, unless the written agreement of a secured or preferential creditor concerned has been obtained, it cannot (a) affect the secured creditor's right to enforce its security interest or vary the liability secured by the security interest; or (b) result in a preferential creditor receiving less than it would receive in a liquidation or bankruptcy of the debtor had it commenced at the time of approval of the arrangement. This highlights perfectly, the creditor-friendly approach in BVI.

Once the formal requirements for the appointment of an interim supervisor have been completed, their roles are:

- to prepare a report on the proposal for the creditors;
- to carry out any duties assigned by the statutory regime;
- to undertake such functions and duties as they may agree to undertake with the board; and
- to monitor the affairs of the company, including the conduct of its business, during the proposal period.

The interim supervisor is then tasked with calling a meeting of the company's creditors. At that meeting, the creditors may resolve to:

- approve the proposal, with or without amendment and appoint the interim supervisor, or another eligible insolvency practitioner, to be the supervisor of the arrangement;
- adjourn the meeting to a date no later than three months after the commencement of the proposal period; or
- to reject the proposal.

The requisite majority to pass a resolution at the creditors' meeting is 75% by value.

Approval of the proposal by a creditors' meeting has the effect of making the arrangement binding on the company, on each member, and on each creditor of the company as if the creditor were a party to the arrangement. Upon approval, the interim supervisor becomes the supervisor and the assets that are comprised in the plan are put under the control of the supervisor. The directors, however, remain in office. There are mechanisms whereby the assistance of the court may be sought.

The lack of any form of statutory moratorium in aid of a creditors' arrangement has inevitably limited their attraction and adoption in any pre-insolvency scenario. However, judicial inventiveness in the BVI has, to a degree, plugged that gap with the adoption of the so-called "soft-touch" provisional liquidation. In *In the matter of Constellation Overseas Limited et al* BVIHC (Com) 2018/0206 (5 February 2019) the BVI Commercial Court described the effect of such an arrangement:

> The essence of a "soft touch" provisional liquidation is that a company remains under the day to day control of the directors but is protected against actions by individual creditors. The purpose is to give the Group the opportunity to restructure its debts,

or otherwise achieve a better outcome for creditors than would be achieved by liquidation. It may be appropriate where there is no alleged wrongdoing of the directors.

The decision was an innovative and welcome one, the full scope of which has yet to be explored, but it certainly has potential, in appropriate cases, to make creditors' arrangements (and the other forms of pre-insolvency restructuring identified in this chapter) more available in the BVI.

The second mechanism available pre-insolvency is the scheme of arrangement. It is provided for in the corporate law statute in BVI, namely the Business Companies Act. It is modelled on the English law equivalent.

Schemes of arrangement are arguably more flexible yet more regulated than plans. For example, schemes of arrangement are designed to bind the company, on the one hand, and one or more classes of people, on the other. The classes may be members, creditors, or both. The essence of a BVI scheme of arrangement is that a proposal is formulated by the company. It is then presented to the court for consideration. Those who may make an application to the court are:

- the company;
- a creditor of the company;
- a member of the company;
- if the company is in administration within the meaning of the Insolvency Act, the administrator;
- if the company is in voluntary liquidation within the meaning of section 202, the voluntary liquidator; or
- if an Insolvency Act liquidator has been appointed, that liquidator.

The court may, if satisfied, summon a meeting (or meetings) of the class intended to be affected by the scheme.

At the meeting or meetings, if a majority of at least 75% in value of the creditors, or class of creditors, or members, or class of members, as the case may be, present and voting agree to any compromise or arrangement, the compromise or arrangement, if sanctioned by the court, is binding on all the creditors, or class of creditors, or the members, or class of members, as the case may be, and also on the company or, in the case of a company in voluntary liquidation or in liquidation under the Insolvency Act, on the liquidator and on every person liable to contribute to the assets of the company in the event of its liquidation.

Thus, a BVI scheme of arrangement can achieve much and, in particular, by the use of different classes of meetings can attempt to achieve a complex restructuring within one unified procedure. However, they may be considered more cumbersome by reason of their multi-stage approach. The above observations in relation to the lack of an effective moratorium (save for soft-touch provisional liquidation) also apply in relation to schemes.

Finally, we note the availability of plans of arrangement. While schemes find their origins firmly in English law, BVI plans trace their parentage to the USA. Although available and of potential value in restructuring contexts, plans are arguably more directed at corporate and not necessarily insolvent restructurings.

This is clear from the sorts of arrangements that can be the subject of a plan:

- an amendment to the memorandum or articles;
- a reorganisation or reconstruction of a company;
- a merger or consolidation of one or more companies that are companies registered under the BVI Business Companies Act with one or more other companies, if the surviving company or the consolidated company is a company incorporated under the BVI Act;
- a separation of two or more businesses carried on by a company;
- any sale, transfer, exchange or other disposition of any part of the assets or business of a company to any person in exchange for shares, debt obligations or other securities of that other person, or money or other assets, or a combination of them;
- any sale, transfer, exchange or other disposition of shares, debt obligations or other securities in a company held by the holders thereof for shares, debt obligations or other securities in the company or money or other property, or a combination of them;
- a dissolution of a company; and
- any combination of any of the examples specified above.

Plans differ from schemes in that approval by meetings of each class are not a pre-requisite (the court may require such meetings), although court approval is required. A further significant distinction between schemes and plans of arrangement is that the latter inherently permit (if the court so directs) members of a company to assert and pursue their dissent rights. There is an entire mechanism for the pursuit of dissent rights which permit a dissatisfied member in specified circumstances (including adoption of a plan of arrangement) to obtain “fair value” in return for their shares.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor’s management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Since the coming into force of the Insolvency Act in 2004, the BVI has benefitted from a modern insolvent liquidation process.

There are two mechanisms by which liquidation may be commenced under the Insolvency Act. First, the members of a company may (providing certain disqualifying circumstances do not prevail) pass a resolution to place the company into liquidation. The far more common form of insolvent liquidation is that commenced by application to the court.

Those who may apply are:

- the company;
- a creditor;
- a member;
- the supervisor of a creditors' arrangement in respect of the company;
- the Financial Services Commission; and
- the Attorney General.

Leaving aside applications to appoint a liquidator on the grounds of it being just and equitable, or public policy, the ground for appointment is insolvency. This is established if any of the following tests are satisfied:

- the company fails to comply with the requirements of a statutory demand that has not been set aside under the terms of the Insolvency Act;
- execution or other process issued on a judgment, decree or order of a BVI court in favour of a creditor of the company is returned wholly or partly unsatisfied; or
- it is proved to the satisfaction of the court that:
  - the value of the company's liabilities exceeds its assets, or
  - the company is unable to pay its debts as they fall due.

Given that liquidation is a group remedy, the process is a public one, at least until the appointment of the liquidator. Accordingly, the application must be advertised, sufficient to be drawn to the attention of potential creditors, and the hearing of the application is public, in "open court".

It is for the applicant creditor to nominate a proposed professional as liquidator. They must be a BVI licensed insolvency practitioner, although the court is open to making joint appointments with suitably qualified overseas insolvency practitioners in appropriate cases (which can be very useful).

The effects of a liquidation order are stark:

- the liquidator has custody and control of the assets of the company;

- the directors and other officers of the company remain in office, but they cease to have any powers, functions, or duties other than those required or permitted under the Insolvency Act or authorised by the liquidator;

- unless the court otherwise orders, no person may:

    - commence or proceed with any action or proceeding against the company or in relation to its assets; or

    - exercise or enforce, or continue to exercise or enforce any right or remedy over or against assets of the company;

- unless the court otherwise orders, no share in the company may be transferred;

- no alteration may be made in the status of or to the rights or liabilities of a member, whether by an amendment of the memorandum, or articles, or otherwise;

- no member may exercise any power under the memorandum, or articles, or otherwise, except for the purposes of this Act; and

- no amendment may be made to the memorandum or articles of the company.

Wholly consistent with the creditor-friendly approach of BVI, liquidation does not affect the right of a secured creditor to take possession of and realise or otherwise deal with assets of the company over which that creditor has a security interest.

The fact of a BVI liquidation order alone does not affect any ongoing contracts to which the company is a party (although there may be contractual provisions within the particular contract that do have that effect).

BVI law incorporates a mechanism of disclaimer of onerous property, and this extends to unprofitable contracts to which the company is a party. A prescribed procedure must be followed, which permits the contractual counterparty to seek relief. To the extent that that party suffers loss, they may claim in the liquidation for that loss.

Otherwise, there is no mechanism for the general readjustment of any debt – each unsecured creditor is entitled to share in the available unsecured assets to the full extent of their admitted claim, *pari passu*.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

BVI insolvency law recognises the concept of vulnerable transactions, that is, transactions entered into by a company in the twilight period before it enters liquidation which are capable of being challenged by a liquidator.

Unfair preferences, undervalue transactions, voidable floating charges and extortionate credit transactions are all vulnerable, in certain circumstances.

Unfair preferences are transactions that were entered into at a time when the company was insolvent or caused the company to become insolvent, or within a period of six months before the onset of insolvency (two years for a connected person). This period, whichever applies, is referred to as the vulnerability period. If the effect of the transaction was to put the creditor in a position which, in the event of the company going insolvent, will be better than the position the creditor would have been in if the transaction had not been entered into, then there will be an unfair prejudice. There is no subjective test or mental element involved in determining such a preference. It is a matter of objective determination as to whether there was betterment of the position or not.

Undervalue transactions occur when a gift is made or no consideration passes to the company, or where the company receives consideration which, in money or money's worth terms, is significantly less than the value of the consideration provided by the company. In either case the transaction needs to be one made at a time when the company was insolvent or made such as to cause the company to become insolvent and was entered into during the vulnerability period.

Floating charges created within the vulnerability period and which cause the company to become insolvent are voidable. Note, however, these are not voidable to the extent that they secure money paid to a company after creation of the charge; and to the amount of any liability discharged or reduced at the same time as, or after, creation of the charge; and the value of assets sold or supplied or services provided at the same time or after creation of the charge.

Extortionate credit transactions are those entered within the vulnerability period requiring grossly exorbitant payments, or those which otherwise grossly contravene ordinary principles of fair trading.

Upon a successful application by a liquidator, the court enjoys a wide range of powers for restoring the position of the parties to that which existed before the vulnerable transaction took place.

6. Is enforcement of security rights treated differently in each type of proceeding?

As outlined earlier, BVI, being a creditor-friendly jurisdiction, seeks to place as few barriers as possible in the way of a creditor with a valid security right enforcing that right.

Whether enforcement is taking place before or after a liquidation process has commenced, those rights remain fully enforceable.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

Bearing in mind that security rights are treated differently (that is, a secured creditor may simply look to enforce the security independently), the priority of other payments in a BVI liquidation are:

- in priority to all other claims, the costs and expenses properly incurred in the liquidation in accordance with the prescribed priority;
- after payment of the costs and expenses of the liquidation, in paying the preferential claims admitted by the liquidator in accordance with the provisions for the payment of preferential claims prescribed;
- after payment of the preferential claims, in paying all other claims admitted by the liquidator; and
- after paying all admitted claims, in paying any interest payable under the Insolvency Act.

In the event that there is a surplus, then the members share *pro rata*.

Preferential claims in BVI, as a matter of practice, are very rare. They are limited to wages and taxes (and similar claims) up to prescribed statutory maximum sums.

It is useful here to address priorities for payment in the case of administrative receivership, namely the situation where a secured creditor who holds a floating charge has chosen to appoint a receiver as the means of enforcement. Strictly, receivership is not necessarily an insolvency event; however, as a consequence of the appointment of a receiver, that is frequently the inevitable result.

The priority of payments in administrative receivership, assuming that the company is not in liquidation, is as follows. Preferential creditors are paid out of the assets coming into the hands of the receiver in priority to any claims for principal or interest in respect of: (a) the debenture or other instrument under which the receiver is appointed; and (b) any other debenture or other instrument of the company secured by a floating charge. Payments so made are recouped, as far as possible, out of the assets of the company available for payment of unsecured creditors.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

The most effective means by which secured creditors can best protect their interests in the BVI are several. First, they should ensure that the security package that they obtain is the most effective and comprehensive one available. For example, in the case of taking a charge over shares in a BVI company, ensuring the fullest suite of security documents is obtained in order to make enforcement as streamlined as possible. It is also essential to ensure that all forms of available registration are undertaken to gain maximum protection, including as to priority. Finally, routine checks should be made with professional advisors to ensure that all current requirements as to potential enforcement are satisfied.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

Under BVI law, depending upon the precise terms of the guarantee in question, liquidation of the primary obligor will not discharge the liability of the guarantor, although credit will need to be given for any recoveries made by the creditor by claiming in the liquidation.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

Questions of registration under BVI law merely go to the question of priority, not validity.

If the security purportedly granted has not been perfected for some reason, then the secured creditor will need to take such steps as may be available to it to perfect the security itself, for example, by enforcing any relevant contractual covenants, or reliance on a contractual power of attorney. If, at the time of liquidation of the debtor company, the security is not perfected, and it is incapable of being perfected, then it is likely that the creditor will be rendered unsecured.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor?

A secured creditor remains free to enforce its security at a time of its choosing, wholly unaffected by the existence (or not) of insolvency proceedings.

To the extent that a secured creditor wishes to pursue an unsecured claim against the debtor, like any unsecured creditor, it may not do so after the appointment of a liquidator – all claims must be pursued by way of a claim in the liquidation.

Save for security rights, no form of enforcement can be brought or continued after the appointment of a liquidator.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

This is not possible under BVI law.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

Once a company enters liquidation in the BVI, there can be no lawful dealing with its assets (other than by a secured creditor in respect of assets that are validly secured) or affairs other than by the liquidator.

As for a pre-insolvency situation, any actions by a third party with knowledge of the security rights would likely be defeated by the secured creditor.

It is essential for secured creditors to undertake all available registration processes in the BVI in order to ensure that their security takes priority over any subsequent grant of security.

However, if the first charge holder fails to register its security, and, without knowledge of that arrangement, a subsequent creditor obtains security, in good faith, for value, and registers that security, then it will take priority over the first security.

14. What distribution will a secured creditor receive if a company is reorganised?

A secured creditor looks to its security which will be unaffected (other than with its consent) in any reorganisation. To the extent that a secured creditor is under-secured, it will receive a *pari passu* distribution alongside other unsecured creditors.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

Yes, absent the secured creditor's consent.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

In the case of over-security, upon enforcement of the security (if that were the course adopted by the secured creditor) the secured creditor would be bound to pay any surplus over to the company or, if in liquidation, its creditors.

If a secured creditor chooses not to enforce its security, but retain it, novel issues arise as to whether the liquidator could compel sale in order to receive the surplus for the benefit of unsecured creditors. A likely practical outcome would be to raise finance in order to repay the indebtedness and release the security. This is an area where a liquidator might be expected to make use of the power to apply to the BVI court for directions.

In the case of under-security, the position is more straightforward. The secured creditor must value its security and may claim in the liquidation in respect of the unsecured balance.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

The extent to which the BVI Court will give effect to foreign restructuring is a relatively complex one and highly fact specific. For a BVI law-governed contract to be varied, consent of the contracting parties is required, either in relation to the specific variation or by reason of an agreed contractual provision that permits one party to effect subsequent specified variations. On this analysis, the effect of the foreign restructuring therefore becomes a question of authority. Did the contracting party under lawful control (by reason of the foreign restructuring) agree to a contractual variation? If that party was properly amenable to the foreign restructuring process such that it did agree to a variation, then there would be no basis for a BVI court to dissent. If, however, there is a dispute as to the submission of the contracting party to the foreign restructuring, or its effect, then the BVI court could be expected, upon appropriate invitation, to entertain an investigation into the efficacy of the variation.

CANADA

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

1.1 Personal property

Generally, in the division of legislative authority between the federal and provincial governments in Canada, property rights are matters of provincial law.

In Canada's 12 common law provinces and territories, the consensual granting of security interests in personal property is generally governed by the particular jurisdiction's Personal Property Security Act (PPSA). Québec is a civil law jurisdiction where security interests in movable property are governed by the Civil Code of Québec. Security interests in Quebec are beyond the scope of this chapter.

The PPSA was modelled after Article 9 of the Uniform Commercial Code (United States) and governs the taking, perfection, priority and enforcement of personal property security in the particular jurisdiction.

1.1.1 (General) security agreement

Under PPSA regimes, the granting of a security interest is a matter of substance over form - any binding agreement, oral or written, that has the effect of granting a security interest in personal property is a "security agreement" for the purposes of the PPSA. An agreement granting a security interest in all or substantially all of the present and after-acquired personal property of a borrower is referred to as a "general security agreement".

A PPSA "security interest" is any interest in personal property of a debtor granted to secure payment or performance of the debtor's obligations to the creditor. For a security interest to be enforceable under the PPSA, it must have "attached". Attachment occurs when: (i) there is a security agreement containing a description sufficient to identify the collateral; (ii) value has been given to the debtor; and (iii) the debtor has obtained rights in the collateral. The concept of attachment replaces, for the most part, the common law concepts of "fixed" and "floating" charges. For a security interest to have the greatest bundle of rights possible under the PPSA, it must also be "perfected", which means: (i) the security interest has "attached"; and (ii) the secured party has either effected a registration under the personal property security registration system (PPSR) or taken possession of the collateral for the purpose of perfection. As to priorities among perfected security interests, the first security interest registered under the PPSR generally prevails, although there are exceptions, including, special priority rules regarding "purchase money security interests" in certain types of collateral.

1.1.2 Debenture

Before the PPSA came into force, debentures were a special form of security granted by corporations and governed by special statute. Now, to the extent that a debenture grants a security interest in personal property, it is simply a security agreement governed by the PPSA.

1.1.3 Pledge

A security agreement may contain a pledge of property, such as a pledge of shares in a private corporation. The PPSA governs the perfection and priority of that security interest. Lenders commonly enter into a pledge agreement in conjunction with a general security agreement where the debtor's investment property is a particularly valuable part of the collateral package.

1.1.4 Purchase money security interest

The PPSA ignores "title" as it relates to personal property, replacing it with the concept of "rights in the collateral" as a requirement for attachment. Conditional sales contracts, title retention contracts and personal property leases of one year or more are security agreements under the PPSA. However, the security interests granted therein may qualify as "purchase money security interests" which are given special priority if properly perfected.

1.1.5 Security interests in "investment property", including "securities"

All PPSA jurisdictions in Canada have implemented a Securities Transfers Act providing a system of rules governing transfers of interests in securities consistent with Article 8 of the Uniform Commercial Code (United States) and integrated with the PPSA regarding security interests in investment property.

1.1.6 Special federal legislation governing certain security interests

Certain security interests are excluded from the PPSA by virtue of being governed by specific federal statutes. One example is security under the Bank Act (Canada), which is only available to federally regulated banks to secure interests in a debtor's inventory and receivables. The Canada Shipping Act provides another example. Generally, there are no statutory priority rules to resolve conflicts with PPSA-governed security interests and priorities are determined by the courts under common law principles. In addition, the registration of security rights in aircraft and aircraft equipment is governed by federal legislation incorporating the Convention on International Interests in Mobile Equipment 2001 (Cape Town Convention).

1.2 Real property

Real property security interests are excluded from the PPSA and are generally governed by provincial mortgage, title and lending statutes, which regulate both the way in which such security is registered and the way in which it is enforced. Real property security is commonly granted through a mortgage or a debenture registered against title and may also be in the form of assignments of rents or leases.

1.2.1 Mortgage

The mortgage is the most common instrument in which a borrower grants a security interest in real property to a secured lender. Each of the Canadian common law provinces and territories have land titles statutes that set out the essential elements to create a valid and enforceable charge over real property.

The mortgage must:

- properly identify the parties;
- secure an underlying debt;

- contain charging language creating a security interest for the secured lender's benefit; and
- contain a proper legal description of the real property.

Priorities are generally in accordance with the order of registration on title.

1.2.2 Debenture

Secured lenders can also use a debenture that creates a (i) promise to pay, (ii) a charge over the real property, and (iii) a floating charge over all present and future real and personal property of the borrower (i.e. the same security interest as the combination of a mortgage, general assignment of rents and general security agreement). A debenture must contain the same essential elements as a mortgage in order to create a charge over the debtor's real property. A secured lender under a revolving credit facility may prefer to use a debenture instead of a mortgage because the charge under a debenture can continue even when the balance outstanding is nil, so that the charge remains in place to secure subsequent draws. This is due to Canadian corporate legislation generally providing that a debenture is a "debt obligation" that is not redeemed by reason only of repayment. On the other hand, in Ontario for example, the Land Registration Reform Act provides that a mortgage is no longer enforceable once the underlying obligations are repaid.

1.2.3 Assignment of rents or leases

The assignment of rents or leases may be important to a secured lender where an income generating property is included as part of the collateral security package. Secured lenders wishing to ensure they can realise on the rental stream without going into possession and risk incurring any liability in such respect can take a general assignment of rents. This generally involves the assignment by the borrower of all of its right, title and interest in the rents and the leases to the secured lender, provided the lender agrees to re-assign the rents and leases once the loan has been fully repaid and all the security has been discharged. Note that this must involve the assignment of a real property interest to be distinct from a mere assignment of a right to payment under a lease that may be subject to PPSA rules. To enforce in the event of the borrower's default, the secured lender only needs to serve the tenants with notice that it has taken an assignment of the rents and instruct the tenants to pay all future rents direct to the secured lender.

1.3 Statutory liens and deemed trusts

Liens on personal and real property may also arise under federal and provincial statutes. Construction liens provide certain payment protection for sub-contractors. In Ontario, the Repair and Storage Liens Act replaces the previous statutory and common law "mechanic's lien" and "warehouseman's lien". Several statutes also contain special provisions designed to enhance the Crown's (or in some instances pensioners' or employees') collection of certain amounts from a debtor (e.g. Crown claims for tax and employee source deductions). The most common methods to provide these statutory protections are through a statutory lien over the debtor's assets or a statutory deemed trust. For the most part, statutory liens and deemed trusts are excluded from the PPSA unless the statute provides otherwise. Determining the priority of a particular kind of statutory lien or deemed trust requires an analysis of the relevant or competing statutes, the type of insolvency proceedings (if any) affecting the debtor and the facts of the case. For instance, certain statutory liens and deemed trusts may lose their priority status in a bankruptcy.

2. How are security rights enforced? Is a court process or out-of-court procedure required, or are both methods available? What are the practical difficulties experienced when security is enforced?

2.1 Enforcing security

A secured creditor intending to enforce its security over all or substantially all of the assets of an insolvent debtor is required to first send the debtor a notice of intention to enforce security in accordance with the Bankruptcy and Insolvency Act (Canada) (BIA). Unless the debtor consents to earlier enforcement after delivery of the notice, no enforcement steps can be taken until the expiration of the 10-day notice period, which may run in parallel with other contractual, common law or statutory notice requirements.

2.1.1 Personal property

In PPSA jurisdictions, a secured creditor is entitled to exercise self-help remedies and take possession of the collateral. Where appropriate, possession may be effected by rendering the collateral unusable. A secured creditor who has taken possession generally has the right, upon complying with certain notice provisions, to either sell the collateral (by private or public sale so long as it is commercially reasonable) to recover the outstanding debt or to foreclose and take the collateral in full satisfaction of the outstanding debt. However, should the debtor or others with an interest in the collateral object to a foreclosure, the secured creditor will be required to sell the collateral. Exercising the foreclosure remedy extinguishes the outstanding debt and prevents a secured creditor from suing for the deficiency while the sale process remedy preserves this right.

In its security documents, a secured creditor may have the right to appoint a private receiver or a receiver and manager to take possession of and realise upon all or some of the debtor's property on the secured party's behalf. A receiver and manager have the authority to operate and manage the debtor's business and affairs.

A secured creditor can apply to the court for the appointment of a receiver or a receiver and manager. Even where the secured creditor has commenced private remedies, the debtor and other interested parties may apply for a court-supervised sale and / or court appointment of a receiver. This is one reason why, despite the procedural efficiencies of private enforcement, secured creditors will often choose a court process for the appointment of a receiver where there is any expectation of potential disputes or complications arising. Unlike a privately appointed receiver, a court-appointed receiver is an officer of the court with a broader duty to act for the benefit of all interested parties, as compared to a privately appointed receiver that acts on behalf of the appointing secured creditor.

2.1.2 Real property

The primary enforcement remedies available to a secured creditor with respect to real property include:

- power of sale (contractual or statutory);
- foreclosure (court-supervised remedy);
- judicial sale (court-supervised remedy); and
- receivership (discussed above).

The various provincial mortgage statutes generally provide for the relevant notice periods that must be observed, and a debtor's rights regarding the curing of defaults and redeeming of the mortgaged property. Other enforcement remedies with respect to real property include:

- voluntary release of the debtor's equity of redemption in the mortgaged property by way of a quit claim deed or a transfer;
- distress (i.e. seizure and sale);
- injunctive relief;
- action for possession of the mortgaged property;
- attornment of rents; and
- action on the covenant.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

A debtor corporation can seek to restructure its debt through a court-supervised financial restructuring pursuant to a plan of arrangement under section 192 of the Canada Business Corporations Act (CBCA). Provincial corporate legislation also includes the ability to implement a financial restructuring through a plan of arrangement. However, the CBCA is the statute most often used for financial restructurings, and it is the corporate statute under which the majority of case law in this area has developed.

Section 192 of the CBCA allows federally incorporated companies to apply to court for an order approving an arrangement effecting a "fundamental change" where effecting such a change is not practicable under any other provision of the CBCA. The definition of "arrangement" under the CBCA includes "an exchange of securities of a corporation for property, money or other securities of the corporation or property, money or securities of another body corporate", thus allowing the section to be used for restructuring the rights of security holders (which includes debt obligations, such as loan and bond debt), but not the rights of general or ordinary unsecured creditors.

The process under a CBCA restructuring is typically to negotiate a restructuring plan (being the plan of arrangement) between the debtor company and its most significant debtholders, usually through the negotiation and execution of a support agreement. Once the plan of arrangement and support agreement are agreed, the debtor will bring an *ex parte* motion to the court seeking an interim court order calling a meeting of the affected security holders to consider and vote on the proposed plan of arrangement. The debtor company also typically requests a court-ordered stay of proceedings to prevent affected stakeholders from enforcing rights while it advances the plan of arrangement. The company then holds the applicable creditor meeting or meetings within 21 to 60 days after the issuance of the interim order calling the meeting(s). While there is no statutory requirement for stakeholder approval, courts typically require approval of at least $66^2/_3$ of each class of affected stakeholders voting on the plan. Shareholder approval is not required, and it is a matter of judicial discretion as to the appropriate level and type of stakeholder approval. Subsequent to stakeholder approval, the debtor must seek a final court order approving the plan of arrangement in order to make it legally binding on all affected stakeholders (including those stakeholders who are part of an affected class that did not vote in favour of the plan).

The three threshold statutory tests to proceed with a CBCA restructuring are: (i) the proposed transaction must be an arrangement as defined under the CBCA (as described above); (ii) the applicant must not be insolvent; and (iii) it must not be practical to effect the desired change under another provision of the CBCA. As discussed in section 4 below, it is still possible to use the CBCA to effect a plan of arrangement in respect of an insolvent corporation.

Provided that the statutory requirements have been met, before approving the plan of arrangement and issuing the final order, the court must also be satisfied that: (i) the plan has been put forward in good faith; and (ii) the plan is fair and reasonable.

The debtor company remains in control of its business and assets at all times during CBCA proceedings. There is no requirement for a court officer to monitor or take control of the debtor company's affairs, although the director under the CBCA, a federal government official, has standing to appear at any hearing with respect to a CBCA plan of arrangement.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Although property and contractual rights are matters of provincial jurisdiction, bankruptcy and insolvency is a matter of federal jurisdiction in Canada. There are six main categories of insolvency proceedings, namely:

- bankruptcy / liquidation proceedings;
- receivership;
- proposal proceedings under the BIA;
- proceedings under the Companies' Creditors Arrangement Act (Canada) (CCAA);
- the aforementioned CBCA plan of arrangement proceedings, and
- proceedings under the Winding-up and Restructuring Act (Canada) (WURA).

4.1 Bankruptcy / liquidation proceedings

The BIA provides a complete code for the liquidation (bankruptcy) of insolvent debtors in Canada. An insolvent person (which term includes, among others, an individual, corporation, partnership and unincorporated association) may initiate bankruptcy proceedings under the BIA by filing an assignment for the benefit of its creditors in the prescribed form and a sworn statement of affairs with the Official Receiver (the federal government appointee responsible for administering the BIA). Once the Official Receiver accepts the assignment for filing, the official receiver must appoint a licensed insolvency trustee (LIT) to act as trustee in bankruptcy. This process can be extremely quick as it is an administrative rather than a judicial procedure. Alternatively, one or more creditors may file an application with the bankruptcy court for a bankruptcy order against a debtor. The creditor must establish that there is a debt of at least CAD1,000 owing to it and that the debtor has committed an act of bankruptcy under the BIA (e.g. ceasing to meet its liabilities as they generally become due) within the six months preceding the filing of the application. Except where the debtor consents, obtaining a bankruptcy order takes significantly longer than an assignment in bankruptcy since court proceedings must be commenced and notice periods observed. Upon the issuance of a bankruptcy order or the filing of an assignment in bankruptcy, the assets of the bankrupt immediately vest in the trustee in bankruptcy (who is an officer of the court and has a duty to act in the interests of all creditors). At this point, the debtor no longer has any ability to deal with its assets and the trustee would generally proceed to liquidate the assets of the estate and distribute the proceeds in accordance with the BIA priority scheme (which is discussed under section 6 below). Under ordinary administration, at the first meeting of creditors a board of approximately five inspectors is appointed. The BIA empowers the trustee to take certain actions with the approval of the inspectors rather than the court.

4.2 Receivership

A receiver may be privately appointed or appointed by a court order. A private receiver is normally appointed by a secured creditor where its security documents provide for such an appointment upon a default by the debtor. A private receiver is, for certain purposes, the agent of the secured creditor appointing it, and for other purposes (e.g. carrying on the business), the agent of the debtor. The Judicature Acts of the Canadian common law provinces allow the court to appoint a receiver or receiver and manager wherever the court determines it to be "just and convenient" to do so. The courts have traditionally appointed a receiver where a secured creditor with a contractual right to appoint a receiver requests the appointment as part of an interlocutory proceeding within an action commenced by a secured creditor. A court-appointed receiver obtains its power and authority to act from the court appointing it and, unlike a private receiver, a court-appointed receiver is an officer of the court with a duty to act in the interests of all creditors. A court-appointed receivership may be appropriate where: (i) there are highly contentious or complex proceedings; or (ii) the debtor is refusing to co-operate with its secured creditor or grant access to the assets charged by the secured creditor's security.

4.3 BIA proposal

Commercial reorganisations under the BIA are conducted by way of a proposal and may only be initiated by a debtor or a person acting on the debtor's behalf and not by a creditor. The BIA requires the appointment of a proposal trustee to assist the debtor and perform various statutory duties under the BIA in connection with the proposal. Unlike in bankruptcy, however, the assets of the debtor do not vest in the proposal trustee and the debtor retains its ability to deal with its assets subject to the supervision of the proposal trustee. The debtor can start the proceedings by filing a notice of intention to file a proposal with the Official Receiver. After filing a notice of intention, the debtor has 30 days to file a proposal with the Official Receiver. This 30-day period may be extended, on application to the court, for up to a maximum of five additional months, provided that such extensions are solely for the purpose of enabling the debtor to file its proposal and are only granted for periods of up to 45 days at a time. After the proposal has been filed, the proposal trustee is required to hold a meeting of creditors to approve the proposal and, thereafter, the proposal must be approved by the court. A proposal may be made to creditors generally or to classes of creditors (both secured and unsecured) who the debtor wishes to compromise in some way. A proposal must be approved by a double majority of creditors – being 50% plus one of the total number of creditors voting in the class, as well as $66^2/_3$% of the total value of claims of voting creditors – in each class of creditors voting on the proposal. A proposal made to a class of secured creditors that is not approved by such secured creditor class cannot affect the rights of those secured creditors but may still become effective against unsecured creditors provided that it is passed by the class or classes of unsecured creditors voting on the proposal. Shareholders are only given a right to vote on a BIA proposal if it is expressly ordered by the court.

On notice to the affected counterparty and to the trustee, the insolvent debtor may disclaim or terminate any agreement to which they were a party prior to the commencement of the proposal proceedings. Certain types of contracts, including financing agreements, cannot be dealt with under these provisions. If the trustee does not approve of the proposed disclaimer or the counterparty challenges the disclaimer, the court can decide whether to approve the disclaimer. In so doing, a court shall consider, among other things: (i) whether the trustee has approved the disclaimer; (ii) whether the disclaimer would enhance the prospects of a viable proposal being made; and (iii) whether the disclaimer would likely cause significant financial hardship on the other parties to the agreement. The party to the disclaimed contract has a provable claim for the loss arising from such disclaimer or termination.

4.4 CCAA proceedings

The CCAA applies to a debtor company or group of affiliated companies that has assets in Canada (or carries on business in Canada) and has total claims against such debtor company or group of affiliated companies exceeding CAD5 million. The debtor company must be insolvent or have committed an act of bankruptcy (as that term is defined in the BIA) in order to seek protection under the CCAA. The courts have interpreted the term "insolvency" broadly under the CCAA, in furtherance of the remedial purpose of the CCAA, and have accepted that a debtor company will be "insolvent" for purposes of the CCAA if there is a reasonably foreseeable liquidity crisis or a hypothetical deficiency of assets to liabilities (including contingent and unliquidated liabilities).

CCAA proceedings begin with an application by the debtor company or, in rare cases, a creditor, and the issuance of a court order declaring that the debtor is a company to which the CCAA applies. The debtor applicant may give little or no notice of the initial hearing (so as to prevent a race to enforce defaults prior to the initial CCAA order being made) which is to be brought in the superior trial court in the province of the debtor's head office or chief place of business. The CCAA authorises the court to order stays of proceedings that allow debtor companies to remain in possession of their assets and continue to manage their business during a CCAA proceeding. A CCAA stay order cannot be made without the appointment of a "monitor" (which must be a LIT) to supervise and report on the debtor company's activities, liaise with creditors and assist in the debtor company's restructuring efforts. Due to recent amendments, the initial stay of proceedings can be no longer than 10 days, thereby requiring a further hearing on notice within those 10 days to consider an extension of the stay of proceedings and possibly further relief being sought by the debtor.

Once the initial order is amended following the second (or third court hearing), in addition to the aforementioned declaration, stay of proceedings and appointment of the monitor, an initial order generally includes, among other things: (i) approval of interim or "debtor in-possession" (DIP) financing; (ii) an order that the debtor company file a plan of arrangement within a certain time frame; and (iii) if applicable, an order requesting the assistance of courts in other jurisdictions to enforce the terms of the initial CCAA order. There is no limit to the length of stay orders after the initial 10-day period, though extensions are typically given in three-month segments. Separate orders will be sought for (i) procedures for calling for claims; (ii) procedures to call and hold meetings of classes of creditors to vote on the plan; and (iii) court sanction (approval) of a plan that has been approved by the creditors. Like a BIA proposal, a CCAA plan must be approved by a double majority in each class of creditor, being 50% plus one of the total number of creditors voting in the class, as well as $66^2/_3$% of the total value of claims voting in each class. Each class of creditor to which the plan is proposed must approve the plan by the requisite double majority. Shareholders are rarely given a right to vote on a CCAA plan and only if it is expressly ordered by the court.

The CCAA contains similar provisions to the BIA that affect a debtor company's pre-insolvency contractual obligations. In particular, the debtor company may, on notice to the affected counterparty and to the monitor, disclaim (unilaterally terminate) certain agreements to which they were a party prior to the commencement of the CCAA proceedings. Types of agreements that a debtor cannot disclaim include financing agreements, eligible financial contracts, collective bargaining agreements and leases of real property where the debtor is the lessor. Where the monitor does not approve of the disclaimer or the counterparty applies to challenge the disclaimer, the court considers the equivalent factors referenced in section 4.3 above. The party to a contract disclaimed has a provable unsecured claim against the debtor to the extent of its loss or damages arising from the disclaimer.

4.5 CBCA proceedings

In certain circumstances, an insolvent corporation may reorganise through a plan of arrangement under the CBCA as discussed in section 3, above. The requirement under the CBCA that the applicant not be insolvent has been found to be satisfied where at least one of the corporate applicants is solvent. This enables the parties to first incorporate a new company to be an applicant which will merge with the debtor (which may be insolvent) as part of the plan of arrangement. The solvency requirement has also been found to be satisfied where two insolvent corporations merge or enter into a transaction or transactions, which results in the emergence of a single solvent restructured entity. Please see section 3 above for further discussion of CBCA proceedings.

4.6 WURA proceedings

Insolvencies of federally regulated banks, trust companies and insurance companies are governed by WURA. Proceedings under WURA will include stays of proceedings and may have other impacts on secured creditors of the insolvent financial institution. A discussion of WURA is beyond the scope of this chapter.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

Under rare circumstances, the granting of a security right or interest to a creditor could be challenged as a fraudulent conveyance or a preference under various provincial statutes. The grounds for challenging a transaction under these provincial statutes vary, although they generally require the moving party to prove that the debtor entered into the transaction with the intent to defeat or defraud creditors.

In certain circumstances, affected parties may also apply to court in respect of certain acts of a debtor company or its directors under the oppression provisions contained in federal and provincial corporate statutes. A court may grant such an application if satisfied that the debtor company or its directors have committed any act or conducted any business in a manner that is oppressive or unfairly prejudicial to or unfairly disregards the interest of any security holder, creditor, director or officer. The court may make any order it deems appropriate, including an order restraining the conduct complained of or an order liquidating or dissolving the debtor company.

The BIA contains provisions whereby a trustee (and, upon court approval, creditors if the trustee fails to act) may challenge certain pre-filing transactions as preferences or transfers at undervalue. For example, under section 95 of the BIA, the granting of a security interest by an insolvent person in favour of a previously unsecured creditor, with the intent to give that creditor a preference over other creditors, may be found void as against the trustee in bankruptcy if it was made less than three months before bankruptcy. Intent is difficult to establish but when the effect of the transfer is preferential, there is a rebuttable presumption that the preference was intended. When the transfer is in favour of a non-arm's length creditor, such as related parties, proof of intent is not required: a non-arm's length transfer is void as against the trustee when made less than 12 months before bankruptcy. In addition, section 96 of the BIA permits a trustee to challenge pre-bankruptcy dispositions of property or transfers made for conspicuously less than fair market value. The court may declare that an arm's length transfer at undervalue is void as against the trustee or order that a party to the transfer pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor if: (i) the debtor was insolvent at the time of the transfer, (ii) the transfer occurred within one year before the initial bankruptcy event, and (iii) the debtor had intent to defraud or delay a creditor. The same order may be made in respect of a non-arm's length transfer at undervalue made within one year prior to the bankruptcy without proof of insolvency or intent to defraud. If the non-arm's length transfer occurred between one and five years prior to the bankruptcy, the court must find that the debtor intended to defraud or delay creditors or was insolvent at the time of the transfer.

The CCAA adopts the preference and transfer at undervalue provisions in the BIA by reference, meaning such provisions are equally applicable in CCAA proceedings except that the court-appointed monitor would act instead of the trustee.

6. Is enforcement of security rights treated differently in each type of proceeding?

In formal restructuring proceedings under the CCAA and proposals under the BIA, secured creditors may be prohibited from enforcing their rights by the stay of proceedings against the debtor company. Where the debtor is bankrupt under the BIA, the stay of proceedings and other elements of the process generally do not apply to affect the rights of secured creditors. Orders appointing receivers will generally include a stay of proceedings to allow the receiver to realise against the collateral, but, to the extent that there are competing security interests, the court-appointed receiver will hold the proceeds until the appropriate distribution is determined. Courts have also exercised their jurisdiction under the CBCA to make "any interim or final order it thinks fit" to grant a stay of proceedings, although such a stay is typically less broad than those granted under the CCAA or BIA.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

Regardless of the proceeding, valid creditor claims have priority under Canadian law over any claims in respect of an equity interest, which includes claims for dividends, return of capital and redemption obligations. In CBCA plan of arrangement restructurings, although there is no priority scheme, the relative priorities of creditors under insolvency legislation provide a useful framework for affected stakeholders in determining whether to vote in favour of the plan of arrangement, and for a court in determining whether the plan of arrangement is fair and reasonable.

The BIA sets out a priority scheme for the payment of all claims against a bankrupt, which takes precedence over any priority scheme set out in provincial legislation. However, that scheme is expressly subject to the rights of secured creditors, who are generally entitled to enforce against their collateral for payment of their respective claims. The trustee's rights are limited to the property of the bankrupt, which means that trust claims, or other competing claims of property interests can result in assets being removed from the estate. If you consider those as priority claims, then, in general, claims in a bankruptcy are ranked in priority of payment as follows:

- claims of owners of property in the possession of the bankrupt (e.g. property held in trust for another person);
- "super-priority" claims in favour of the Crown under the BIA (e.g. statutory federal and provincial deemed trusts for employees' withholdings on account of income taxes, employment insurance and employee contributions to the Canada Pension Plan);
- claims of secured creditors (who must look to the assets charged by their security for payment of their respective claims);
- claims of certain preferred creditors (which are described and ranked in the BIA); and
- all other unsecured claims (that are not postponed claims).

There are also certain claims that are postponed by the BIA so as to rank behind general unsecured claims, the lowest of which being "equity claims", which are defined to include (but are not limited to) a claim for:

- a dividend or similar payment;
- return of capital;

- redemption or retraction obligation; or
- monetary loss resulting from the ownership, purchase, or sale of securities; and / or
- claims for contribution and indemnity in respect of claims of this nature.

The BIA stipulates that a creditor is not entitled to a dividend in respect of an equity claim until all valid non-equity claims have been satisfied in full. Preferred claims are paid in full, in order of their ranking, before any payments to lower-ranking preferred creditors or general unsecured creditors. Secured creditors who are under-secured may file a claim as an unsecured creditor for the balance of their claim, as may preferred creditors whose rights to payment are limited in the priority scheme outlined above. Unsecured claims are paid rateably. After payment of 100 cents on the dollar of claims to the unsecured creditors, and to creditors with postponed claims, the balance of the estate will be applied to pay interest from the date of the bankruptcy at 5% per annum on all claims proven in the bankruptcy according to their priority. Any surplus remaining would then be available for the bankrupt or shareholders of the debtor company as a return of capital.

The BIA priority scheme outlined above generally applies in a receivership, a proposal or CCAA plan (subject to certain variations), although some creditors may agree to different treatment in certain circumstances.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

The most important step secured creditors can take to protect their interests is to always ensure that their security interests are perfected and / or properly registered.

8.1 Pre-insolvency

A secured creditor that is concerned about the debtor's financial condition can protect its interests by enforcing any contractual rights to disclosure, which may include the appointment of a firm or person to monitor the business on behalf of the creditor. If there has been a default under the security documents, a secured creditor can protect its interests in collateral outside of insolvency proceedings by taking the advice of counsel and by acting swiftly to provide adequate notice before taking enforcement action. For example, where a secured creditor intends to enforce security on all or substantially all of the property of the debtor, it must issue to the debtor a notice of intention to enforce security in accordance with the BIA and refrain from taking enforcement steps for 10 days (unless otherwise consented to by the debtor). If that mandatory period has passed before the debtor makes a formal insolvency filing, the secured creditor may be exempt from certain stays of proceedings and other effects of a proposal or bankruptcy process. After providing notice, the secured creditor will then be in a position to consider alternatives, which may include forbearance and negotiations with the debtor (and perhaps other creditors) or continuing with its various enforcement options.

8.2 Insolvency

Once the debtor is in a formal insolvency proceeding, the secured creditor should instruct counsel to represent it and guide the secured creditor through and around the proceedings. In a bankruptcy, the secured creditor will be able to utilise enforcement remedies available in a pre-insolvency scenario because the trustee in bankruptcy takes the assets subject to the rights of secured creditors. However, if the bankruptcy occurs before the 10-day notice period for enforcement has expired, the secured creditor may apply to court for the appointment of an interim receiver to take possession and control of the collateral until possession is taken by a receiver or the trustee.

Where there is a court receivership, CBCA, CCAA or BIA proposal, it is essential to have experienced counsel involved for the court proceedings, claims and voting process, and the inevitable negotiations.

Generally, a secured creditor will need to file a proof of claim in order to receive a distribution and vote in respect of a debtor's proposal or CCAA plan. The BIA sets out the framework for the entire claims process, including the rules for the calling for claims and verifying them. The CCAA, unlike the BIA, does not contain a statutory claims process. The practice that has evolved under the CCAA generally involves the monitor working with the debtor company to prepare and recommend a complete process (including proof of claim forms, notices and a dispute mechanism) for approval by the court. The court order establishing the claims process will also set a claims bar date so that potential claimants will know that, if they fail to file a proof of claim by that date, they may forever be barred from pursuing the claim against the debtor company.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

The commencement of insolvency proceedings against a debtor typically does not result in a stay of proceedings against a guarantor. section 11.04 of the CCAA explicitly provides that the stay of proceedings does not affect any action, suit, or proceeding against a person, other than the debtor company, who is obligated under a letter of credit or guarantee in relation to the debtor. Accordingly, a creditor may improve its prospects of collection by enforcing its remedies against a guarantor as soon as possible after the debtor commences insolvency proceedings. However, in certain cases, the courts have determined that the jurisdiction exists under the CCAA to impose a stay of proceedings in respect of non-applicant related parties, including guarantors, where it is important to the reorganisation and restructuring process.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

In PPSA jurisdictions, an unperfected security interest in collateral is generally subordinate to:

- a perfected security interest in the same collateral;
- the interests of statutory and common law lien holders;
- the interest of a person given priority under any other statute; and
- the interest of a person who has assumed control of the same collateral through a legal process (e.g. execution or garnishment).

PPSA statutes also provide that an unperfected security interest will not be effective against a trustee in bankruptcy. Accordingly, a secured creditor should monitor its PPSA file on a regular basis and make any supplementary filings to maintain the perfection of its security interest under the PPSA (e.g. renewal registrations and recording a change of name of the debtor within 30 days after the secured creditor learns of such name change).

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged? If so, how?

11.1 Pre-insolvency

Prior to the commencement of an insolvency proceeding, a secured party is generally free to foreclose or otherwise enforce its security against a debtor in accordance with the terms of its security agreement and subject to statutory and common law notice requirements.

11.2 Insolvency

11.2.1 Bankruptcy / liquidation proceedings

Upon the bankruptcy of a debtor, whether voluntarily or involuntary, the BIA imposes a stay of any action, execution, or other proceeding by unsecured creditors in respect of the debtor unless the creditor first obtains leave of the court. The stay of proceedings does not generally apply to secured creditors, who are free to exercise their rights of self-help or to otherwise realise on their security outside of the BIA. The one exception to this general rule is that, upon the application of the trustee in bankruptcy, the court may stay the rights of a secured creditor for up to six months. The secured creditor, in that instance, will have the opportunity at the hearing to argue against the stay. This provision is normally only used where lien rights have been asserted by unpaid suppliers of inventory, or the trustee otherwise needs time to ascertain the validity and extent of the secured creditor's interest. For the most part, however, secured creditors may proceed to realise upon their collateral in a bankruptcy and, for this reason, receiverships are often run in parallel to a bankruptcy under the BIA.

11.2.2 BIA proposal

The stay of proceedings arises automatically under the BIA upon the filing of a proposal or a notice of intention and operates to bind all secured and unsecured creditors. The stay of proceedings operates throughout the period from the date of filing the proposal or notice of intention to the date of court approval and, in respect of those debts compromised by the proposal, beyond. There are, however, certain exceptions to the application of the stay of proceedings with respect to secured creditors. In particular, secured creditors who actually took possession of their secured collateral before the debtor filed the proposal or notice of intention are excluded, as are those who actually gave a notice of intention to enforce their security more than 10 days prior to the debtor filing the proposal or notice of intention. The stay of proceedings also does not apply to secured creditors who are not included within the debtor's proposal or who are in a class of secured creditors who have rejected the proposal. In addition, a secured creditor has a statutory right to apply to the court to lift the stay of proceedings where they can show that their security position is deteriorating or detrimentally affected by the stay imposed under the proposal.

11.2.3 CCAA proceedings

The CCAA permits the court to order a stay of proceedings that will be imposed against, among others, all creditors (secured and unsecured), landlords and persons who are not creditors of the debtor company, to prevent them from exercising contractual rights that would make it difficult, if not impossible, for the debtor company to proceed with its reorganisation. Given that the debtor company usually brings the initial application in a CCAA proceeding, the court and the debtor generally have some flexibility to "tailor" the stay of proceedings to the particular circumstances of the case.

Recent amendments reduced the length of a stay of proceedings under the initial CCAA order from a maximum of 30 days to 10 days. Thereafter, the stay of proceedings can be repeatedly extended at the discretion of the court for such further periods as the court deems appropriate (typically intervals of 60–90 days). The length of time over which CCAA proceedings continue is dependent on the complexity of the proceedings, and there is generally no practical expectation that a restructuring will be completed in the initial stay period. In that regard, the initial stay period is intended to ensure that parties affected by the CCAA proceedings have notice and an opportunity to address the court early in the proceedings. Initial CCAA orders also usually contain a "come-back clause" that enables any interested party to return to court within a specified time period to seek to amend or vary the initial CCAA order or to seek any other relief. This clause is particularly important where the initial CCAA application was made without notice to interested or affected parties. Courts in CCAA proceedings have the authority to lift or set aside the stay of proceedings upon motion by a creditor. Courts will balance the interests of all parties when determining whether to grant a request by a party to lift or set aside a CCAA stay of proceedings.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

12.1 Use and sale of assets

12.1.1 Bankruptcy / liquidation proceedings

In a bankruptcy, the bankrupt's assets vest in the trustee in bankruptcy, but subject to the rights of secured creditors. This has been interpreted as meaning collateral does not vest in the trustee. Certainly, the trustee will not maintain possession or control of collateral that is clearly subject to perfected security interests against the actions of the secured creditors, who may realise on their security outside of the BIA or through a BIA-authorised receivership. The trustee normally does not operate the business but may require possession of premises for a period of time while realising on estate property, in which case the trustee will pay occupancy rent, if applicable.

12.1.2 BIA proposal and CCAA proceedings

In both a BIA proposal and a CCAA proceeding (and subject to any contrary court order), the debtor generally retains control and possession of its assets and continues to operate its business during the case.

The court presiding over a BIA proposal or a CCAA proceeding may order that property of the debtor be sold to a purchaser free and clear of any security, charge or other restriction, even if the consent of a secured party has not been obtained. However, if a court orders such a "free and clear" sale, the court will also order that other assets of the debtor or the proceeds of the sale or disposition shall be subject to a security, charge or other restriction in favour of the creditor whose security, charge or other restriction is to be affected by the order.

12.1.3 Receivership

In a receivership (private or court-appointed), a receiver controls all or some of the debtor's assets and may be authorised to operate or "manage" the business in order to maximise realisations. Accordingly, assets in which a secured party has an interest may be used or sold during a receivership, and any sales proceeds that are realised from such asset sales by a receiver are distributed to secured creditors in accordance with priority. In a court receivership, as in a BIA proposal or CCAA, the sale will usually be effected with the benefit of a vesting order, so that the assets are conveyed "free and clear" and the proceeds stand in the place and stead of the transferred assets while priorities and claims are determined.

12.2 Cash collateral

No specific treatment for cash collateral is set out in the BIA or CCAA. Unless the debtor agrees or the courts order otherwise, the debtor can use its cash and other assets in the operation of its business while under creditor protection. Indeed, courts have the power to order charges over the debtor's property (including cash collateral) that have priority over existing pre-filing secured creditors. Specifically, as discussed below, debtor in-possession financing can be approved, including the granting of a super-priority charge.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

13.1 Pre-insolvency

Outside formal insolvency or court proceedings, the debtor cannot avoid the consequences of violating its covenants by granting forbidden liens. The secured creditor should remain diligent, however, against increases in debtor obligations that may be subject to statutory and other involuntary liens and deemed trusts. The CBCA does not specifically provide for the granting of charges on a secured creditor's collateral other than through an approved plan of arrangement. For this reason, if interim or DIP financing is expected to be needed during the CBCA proceedings, the parties should address this contractually in advance – typically through the support agreement.

13.2 Insolvency

In insolvency proceedings, both the BIA and the CCAA provide courts with the authority to order super-priority charges against the property of a debtor in order to secure certain obligations of such debtor. These court-ordered charges may be imposed despite a debtor's pre-filing covenants and may rank in priority or junior to the claims of any existing secured creditor, provided that notice of the motion is given to all secured creditors that are likely to be affected by the charge.

The CCAA provides for the following priority charges: (1) a charge in favour of the lender providing DIP financing; (2) a director and officer charge; and (3) an administration charge (which includes the fees and costs of the debtor's restructuring counsel and of the monitor and its counsel). Additional charges in CCAA proceedings can include a critical supplier charge and / or a key employee retention plan charge, among others.

In determining whether to grant DIP financing, courts are required to consider:

- the expected duration of the proceedings;
- how the debtor company's business and financial affairs are to be managed during the proceedings;

- whether the debtor company's management has the confidence of its major creditors;
- whether the financing would enhance the prospects of a viable compromise or arrangement being made in respect of the debtor company;
- the nature and value of the debtor company's property;
- whether any creditor would be materially prejudiced as a result of the security or charge; and
- the report of the monitor or the trustee, as applicable, on the debtor company's cash flow forecast.

The above list of factors is not exhaustive, and it may be appropriate for the court to consider additional factors. Where approval of DIP financing is sought at the initial application, the terms of the DIP financing must be limited to what is reasonably necessary for the continued operations of the debtor company in the ordinary course of business during the initial 10-day stay period.

14. What distribution will a secured creditor receive if a company is reorganised?

The specific manner in which secured creditors of a reorganised debtor company are treated can take many forms and will depend on a variety of factors. In particular, the treatment of secured creditors in a reorganisation ranges from, among other possibilities, secured creditors being returned their collateral, being left unaffected with their security and collateral remaining in place, receiving payment in full of the value of their secured claim in cash, or, where affected by a plan or proposal that has been approved by the requisite majorities and sanctioned by the court (as described above in section 4), conversion of their secured claim for a new form of debt consideration, conversion of their secured claim into equity consideration, and / or compromise and partial payment in an amount that is less than the full value of their claim.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

Where a debtor successfully reorganises under a BIA proposal or a CCAA plan of arrangement or compromise, the rights of the debtor and of secured creditors in the debtor's property continue, except as affected by the proposal or plan. Therefore, a debtor may reorganise without affecting a class of secured creditors and, in that case, the security interest of pre-filing secured creditors would remain intact *vis-à-vis* the debtor's property following implementation of the proposal or plan.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

16.1 Over-secured claim

If the realisable value of the collateral exceeds the amount of the obligations owed to the secured party, the secured creditor will not be permitted to recover more than to the full amount of the obligations owing to it. Where the secured creditor has realised upon the collateral, any surplus must be paid to the next creditor in the order of priorities or to the debtor or trustee in bankruptcy. In formal proceedings, when contemplating the impact of the stay or other relief sought by the debtor, the court can consider the fact that the creditor is over-secured.

16.2 Under-secured claim

16.2.1 Pre-insolvency

The PPSA provides secured parties with the right to claim any deficiency arising from realization of the collateral against the debtor (unless the security agreement or other legislation provides otherwise). The deficiency claim in these circumstances is made by way of bringing an action against the debtor to obtain a judgment for the outstanding amount.

Secured creditors may not wish to use foreclosure as their remedy where the assets pledged are likely worth significantly less than the debt owed, as any deficiency claim the secured creditor might have will be extinguished.

16.2.2 Bankruptcy / liquidation proceedings

In a liquidation scenario, the secured creditor may proceed to realise on its security and, pursuant to the BIA, it may also submit a claim as an ordinary unsecured creditor for the balance of its claim after deducting the value of the collateral.

If the secured creditor surrenders its security to the trustee for the general benefit of creditors, the secured creditor may submit a claim in the proceedings for the entire amount owed.

16.2.3 Receivership

In a receivership, similar to a secured creditor's pre-insolvency enforcement, if there remains any claim after the realisation on the debtor's collateral, the secured creditor may sue the debtor (or claim in the receiver's claims process if there is a stay of proceedings) for such deficiency.

16.2.4 BIA proposal and CCAA proceedings

In a BIA proposal that is made to a secured creditor class, secured creditors of that class that have filed a proof of security are entitled to vote the entire amount of their claim, provided, however, that the proposal can ascribe an assessed value to their secured claim, in which case, the secured creditor can vote for the lesser of the amount of their claim as they have valued it, or for the proposed assessed value. If the secured creditor is dissatisfied with the proposed assessed value, it can apply to the court for re-assessment.

In CCAA proceedings, depending on the claims procedure, under-secured creditors may be able to claim and vote in two classes: such secured creditors will be able to vote their secured claim in their respective secured class (and be entitled to share rateably in any distribution from the secured creditor pool) and also be entitled to vote any deficiency claim they may have as an unsecured claim (and be entitled to share rateably according to such unsecured claim in any distribution to unsecured creditors). Where the secured creditor is concerned that the debtor's actions are further eroding the value of its collateral, it may apply to court for relief, which will only be granted if the balance of interests of all parties in the context of the benefits of the proposed restructuring rests in favour of the secured creditor's concerns.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for court to do so?

Canadian courts apply comity as a matter of common law where doing so would not be contrary to Canadian public policy. In addition, both the BIA and the CCAA were amended in 2009 to largely adopt the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvencies. The CCAA and BIA both provide that, if an order recognising a foreign proceeding is made, the court may, if satisfied that it is necessary for the protection of the debtor's property or the interests of a creditor or creditors, make any order that it considers appropriate. In certain circumstances, Canadian courts have recognised foreign orders approving and implementing foreign restructurings that bind Canadian creditors, where doing so is consistent with the principles of comity and the fair and efficient administration of the cross-border proceedings. The effect of the foreign plan does not have to be identical to Canadian law. However, in some circumstances Canadian courts have refused to recognise a foreign plan that seeks to compromise Canadian creditors without allowing them to participate in a vote if the court determines that a vote would have been required in a Canadian proceeding. In one parallel CCAA Chapter 11 case, the Canadian court rejected a CCAA plan where unsecured creditors were to have their treatment determined by the Chapter 11 plan but also be bound to the CCAA plan because the unsecured creditors were not given the opportunity to vote on the CCAA plan.

CAYMAN ISLANDS

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***

- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***

- ***Is the security interest granted by law, contract or both?***

1.1 Types of security interests

Cayman Islands law recognises five forms of security interest: a legal mortgage; an equitable mortgage; charges (both fixed and floating); a pledge; and a lien.

1.1.1 Legal mortgage

A legal mortgage is the most comprehensive form of security, often taken with respect to real property and shares. A legal mortgage is the transfer by conveyance or assignment of the whole of the legal ownership of an asset by way of security to the secured creditor. This transfer is, however, subject to an equity of redemption, which is an express or implied obligation to re-transfer ownership of the asset to the debtor if it discharges its debt or obligations to the secured creditor.

1.1.2 Equitable mortgage

An equitable mortgage is the transfer of a beneficial interest in the relevant asset to the secured creditor while the legal interest remains with the debtor. However, it is unregistered and not a charge on the secured property.

For this reason, an equitable mortgage is weaker than a legal mortgage and a pledge because a *bona fide* third-party purchaser without notice can acquire legal title in the asset free from an equitable mortgage.

1.1.3 Charge

Under a charge, specific property (either real or personal) of the debtor is expressly or constructively appropriated to or made answerable for payment of a debt. The secured creditor has a right to resort to the asset in order to realise it towards payment of its debts. However, a charge does not transfer legal or equitable interests in the asset subject to the charge, nor does it confer on the secured creditor a right to possession.

Charges can either be granted with respect to a fixed asset or a floating pool of assets. Generally speaking, a secured creditor will take a fixed charge over specific assets and then a floating charge over all assets which are not already covered by that fixed charge.

1.1.4 Pledge

A pledge (also known as a bailment) is a legal form of security which is created by delivery of possession of an asset to the secured creditor. Such delivery can be actual or constructive.

1.1.5 Lien

A lien is similar to a pledge, the distinction being that with a pledge the owner delivers possession to the creditor as security, whereas in the case of a lien the creditor retains possession of assets which have previously been delivered to it for some other purpose.

1.2 Security over personal or movable property

1.2.1 Intangible property

The most common type of intangible property over which security is granted in the Cayman Islands is in the form of shares. With respect to shares, the most commonly taken security interests are legal mortgages and equitable mortgages.

A legal mortgage is granted through contract (a mortgage agreement between the secured creditor and the debtor) with respect to those shares.

An equitable mortgage can be created through contract or law. As to the latter, an equitable mortgage with respect to shares can be created by: (i) an agreement to create a legal mortgage; (ii) a transfer of shares that is not registered by entering the secured creditor in the company's register of members as holder of the shares; or (iii) the deposit of the relevant share certificate with the secured creditor.

1.2.2 Tangible property

A security interest over tangible movable property will most commonly be created by way of either a fixed or floating charge. These charges are created through contract.

More uncommonly, however, security over movable property will be created through pledges or liens, which are created by either contract or operation of law.

1.3 Security over real property

Security over real property (being freehold and leasehold land) is usually granted by way of a legal or equitable mortgage.

A legal mortgage over real property is granted by way of a contract (a mortgage agreement between the secured creditor and the debtor).

An equitable mortgage can be created through contract or operation of law. As to the former, this will generally be created through an agreement to create a legal mortgage. As to the latter, this can result from: a transfer of land which is not perfected by registering the secured creditor;[1] or the deposit of the title deeds with the secured creditor.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

2.1 Mortgages over real property

2.1.1 Legal mortgage

[1] Pursuant to section 64 of the Registered Land Law (2018 Revision) (Land Law).

A legal mortgage is perfected by a transfer of the land into the name of the secured creditor.[2]

A secured creditor's right of enforcement with respect to the secured property will be outlined in the relevant agreement between the secured creditor and the debtor. Generally speaking, these provisions will provide that, if the debtor defaults on its payment obligations, a secured creditor holding a legal mortgage will be permitted to take the following actions with respect to the secured real property:

- take possession and exercise its power of sale with respect to the real property; or
- appoint a receiver to realise the real property.

In the context of a liquidation of the underlying debtor, the secured creditor may also permit the liquidator to sell the property on its behalf.[3]

2.1.2 *Equitable mortgage*

Generally speaking, a secured creditor that enjoys the benefit of an equitable mortgage does not have a right to take possession of the underlying collateral.

However, if the agreement giving rise to the equitable mortgage contains power of attorney provisions in favour of the secured creditor, then the secured creditor will be able to execute a transfer of land document (and any ancillary documents) to transfer the property into its name on default by the debtor for the purpose of exercising its power of sale.

In circumstances where power of attorney provisions are not in place, a secured creditor will need to make an application to the court seeking specific performance. On a successful application, the secured creditor will either have its equitable mortgage converted to a legal mortgage or be granted the right to enter into possession of the secured property for the purpose of realising it in discharge of the outstanding debt. On conversion of an equitable mortgage into a legal mortgage, the (former) equitable mortgagee will then have the rights and options of enforcement conferred on a legal mortgage holder (as outlined above).

2.2 Mortgages over shares

2.2.1 *Legal mortgage*

A legal mortgage over shares is perfected by a transfer of title to the shares into the name of the secured creditor (or its nominee). The transfer is effective when the company's register of members is updated.

A company's articles of association will often give its directors discretion to accept or decline the registration of share transfers. The secured creditor should therefore require the mortgagor to obtain either (i) the removal of such discretion by way of an amendment of the articles of association, or (ii) evidence of approval of the transfer (i.e. a signed board resolution) before entering into the transaction being secured.

In order to sell the shares, an express power of sale must be granted to the secured creditor in the

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[2] Which occurs when the Register of Lands is updated in accordance with the Land Law.

[3] The liquidator's costs in the care, preservation and realisation of the property will be recoverable in priority to the payment to the secured creditor.

relevant mortgage agreement. The secured creditor is under an obligation to the borrower to act in good faith and to obtain the best price reasonably obtainable for the shares at the time it decides to exercise its power of sale and cannot merely aim to recover the amount of the debt due. Any surplus proceeds must be remitted to the borrower. In the absence of such a power or a breach of the duty of good faith, the mortgagor may apply to the court to prevent or reverse the sale.

Alternatively, on a default, the secured creditor may apply to the court for a foreclosure order, which will result in the secured creditor (or its nominee) becoming the absolute owner of the shares (i.e. no longer subject to any rights of the mortgagor). A foreclosure order will usually only be granted after the court has first ordered a sale of the shares which has proved unsuccessful.

2.2.2 Equitable mortgage

An equitable mortgage is not capable of true perfection, but certain steps are available to a secured creditor to improve the quality of the security. This includes (without limitation) the secured creditor obtaining a power of attorney from the debtor, enabling it to execute a share transfer form in circumstances of default.

If the secured creditor has been granted a power of attorney, on a default it will be able to deliver the executed share transfer to the company and, subject to any discretion of the directors to refuse to register the transfer, the creditor will be registered as the legal owner of the shares. At this point it will be in the position of a legal mortgagee and may take the enforcement steps set out above with respect to a legal mortgage.

If the secured creditor does not have a power of attorney or an executed share transfer form, the secured creditor under an equitable mortgage may apply to the court for an order for sale or foreclosure (i.e. vesting of absolute title to the shares in the secured party).

2.3 Charge

A secured creditor holding a charge (either fixed or floating) over asset(s) of the debtor does not have a right of foreclosure in respect of those assets. However, the secured creditor can seek the appointment of a receiver or to sell the property, either pursuant to the express terms in the charge document or by application to court.

2.4 Pledge

With respect to a pledge, a secured creditor has a right of sale in relation to the secured property in the event of default of the debtor's payment obligations.

2.5 Lien

A secured creditor holding a lien over the debtor's property does not have a right of sale in respect of that secured property but, rather, a possessory right to the collateral until such time as the underlying debt is discharged.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***

- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives, etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

3.1 Type of pre-insolvency proceeding

Debt restructurings can be carried out in the Cayman Islands via a scheme of arrangement. A scheme of arrangement is a court-sanctioned arrangement between a company and its members or creditors (or classes thereof).[4]

A scheme can be used to restructure a company by varying or cramming down the rights of its creditors.

A creditor scheme of arrangement, which is designed to return the company to solvency, is often carried out within a restructuring provisional liquidation (which is outlined further in section 4 below). The appointment of restructuring provisional liquidators gives the company the benefit of a moratorium on proceedings by unsecured creditors during the term of the appointment. This gives the company breathing space in order to restructure.

The restructuring provisional liquidation procedure can also be used in support of foreign restructuring proceedings, such as Chapter 11 in the United States. In those cases, the restructuring of the debt may take place in the foreign proceedings.

3.2 Who can initiate the proceeding?

The scheme process is typically commenced by the company (through its directors). Although creditors or members can also initiate the proceeding, they cannot promote a scheme without the consent of the company.

The application for restructuring provisional liquidators is also made by the company. However, in order to initiate this process, as set out below, it is necessary to first file a winding-up petition. The directors of a company cannot file a winding-up petition without a resolution of the shareholders or authority to do so in the articles of association. Where such approval or authorisation is not possible, a friendly creditor will often file the winding-up petition in order to permit the company to apply for restructuring by provisional liquidators. This process is currently the subject of legislative reform.

3.3 Criteria and process

3.3.1 Provisional liquidation

[4] Section 86 of the Companies Law (2020 Revision) (Companies Law).

A company can make an application to the court to appoint provisional liquidators where: (1) the company is or is likely to become unable to pay its debts;[5] and (2) the company intends to restructure.[6] The process is commenced by the filing of a winding-up petition coupled with an application for the appointment of provisional liquidators. The court will normally require that creditors be put on notice of the application and will hear the application as urgently as the circumstances require.

If the court appoints provisional liquidators, it will adjourn the final hearing of the winding-up petition. If the restructuring is successful, then the winding-up petition will be withdrawn. If not, the court will likely appoint official liquidators to wind up the company.

On appointment of provisional liquidators, no proceedings may be commenced or continued against the company without leave of the court.[7] This gives the company time to implement a scheme of arrangement, consensual restructuring or plan of restructuring in another jurisdiction, without being at risk of litigation from creditors. Notably, however, this stay does not prevent a secured creditor from enforcing its rights with respect to the secured property.

3.3.2 *Creditor scheme of arrangement*

The scheme process is commenced by the company filing a petition for approval of the scheme, together with an application to convene the meetings of creditors (court meeting).

At the first hearing, the court is asked to convene the court meeting, confirm the composition of the classes, and give directions as to the timeline and information to be sent to creditors.

Creditors must be given all information reasonably necessary to allow them to make an informed decision in relation to the merits of the proposed scheme.

The scheme process involves a meeting of each of the relevant classes of stakeholders whose rights are to be subject to the scheme. Those meetings are convened by the court. The scheme must be approved by over 50% by number and over 75% by value of those attending and voting at each meeting.

Creditors whose interests are sufficiently similar so that they can consult together with a view to their common interest are convened to the same class meeting.

If the necessary majorities are obtained at the court meeting, then the scheme can proceed to the sanction hearing. At the sanction hearing, the court will ensure that the prescribed procedure has been followed; however, once the requisite majorities are achieved at the meetings, the court will usually consider that the members are the best judge of their own commercial interests and, provided there has been due process, will sanction the scheme.

3.4 Main actors

The main actors in a scheme of arrangement conducted within the parameters of a provisional liquidation are:

- the court;

[5] This is a cash-flow test of insolvency covering debts that are currently due and payable together with debts that will become payable in the reasonably near future.
[6] Section 104(3) of the Companies Law.
[7] Section 97(1) of the Companies Law; this moratorium does not affect secured creditor rights.

- the company (through its directors);
- the provisional liquidator(s); and
- the relevant stakeholders (creditors and possibly shareholders to the extent they have an economic interest).

3.5 Debtor's management

Where provisional liquidators have been appointed, the powers granted to them will be set out in the order appointing them.

In this regard, the court can tailor the form of the order to suit the circumstances of the case. The court order will often set out a division of powers between the provisional liquidators and the company's directors. Ordinarily the debtor's management will remain in control of the business (with the provisional liquidators taking a supervisory role).

Where the company elects to pursue a scheme of arrangement without appointing provisional liquidators, the directors of the company remain in control of the business.

3.6 Stakeholder (shareholder or creditor) consent

As noted above, the scheme process involves a meeting(s) of each of the relevant classes of stakeholders whose rights are to be subject to the scheme. Those meetings are convened by the court. The scheme must be approved by over 50% by number and over 75% by value of those attending and voting at each meeting.

If the necessary majorities are obtained and the court approves the scheme, then its terms become binding on all the members of the relevant classes, regardless of whether they voted to support the scheme or not.

Shareholder consent is not required for a restructuring unless they are to be subject to the scheme of arrangement or unless it is necessary to amend the company's constitutional documents in order to effect the restructuring.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives, etc.?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***

- ***Is shareholder consent required in order to effectuate a restructuring?***

The insolvency proceedings available under Cayman Islands law are:

- official liquidation;
- liquidation under the supervision of the court; and
- provisional liquidation (outlined above in section 3).

4.1 Official liquidation

Official liquidation is a court process commenced by filing a petition seeking to wind up the company and appoint liquidators.

4.1.1 Who can initiate the proceeding?

A winding-up petition may be made by the company itself, a creditor (including a contingent or prospective creditor) or a shareholder of the company.[8] Also, the Cayman Islands Monetary Authority (the financial services regulator) can apply for winding-up orders against companies not duly licensed or registered, or for certain other regulatory reasons.[9]

A company can only file a winding-up petition provided that the directors of the company have obtained a shareholder resolution authorising them to do so,[10] or they are duly authorised to do so in the company's articles of association.

4.1.2 Criteria

A creditor will normally seek a winding-up order on the basis that the company is unable to pay its debts; which analysis is done on a cash-flow basis.[11] Where a creditor has made a statutory demand for payment that remains unsatisfied after 21 days, the company is deemed unable to pay its debts.[12]

A shareholder will normally seek a winding-up order on the basis that it is just and equitable for the company to be wound up. Dissatisfied shareholders often use the winding-up regime to obtain relief. In general, a shareholder cannot bring a winding-up petition on the grounds of insolvency because it will not have an economic interest in the company, that economic interest being held by the creditors of the purportedly insolvent company.

4.1.3 Debtors' management

On appointment of the official liquidators, the powers of the directors cease. However, the directors are required to assist the liquidator and can be ordered to provide information and deliver up assets or records to the liquidator.[13]

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8 Section 94(1) of the Companies Law.
9 Section 94(4) of the Companies Law.
10 *Re Emmadart* [1979] 1 All ER 599.
11 Cayman Islands law contains no "balance sheet test" for these purposes, but the company's general financial position may be relevant to the question of whether it is just and equitable to wind up a company.
12 Section 93(a) of the Companies Law.
13 Section 103 of the Companies Law.

4.1.4 Creditors' consent to adjust contracts

No adjustment is made to contracts or secured debts unless a scheme of arrangement is implemented (see section 3 above).

4.1.5 Main actors

The main actors in an official liquidation are:

- the party that presents the winding-up petition (often referred to as the petitioner);
- the court;
- the official liquidators; and
- the liquidation committee.

The function of the latter three are outlined further below.

4.1.6 The court

The court plays an active supervisory role in an official liquidation. The majority of substantive tasks, including the sale of assets, engaging in litigation, compromising claims and the payment of the remuneration and expenses of the liquidators require express court approval.[14]

4.1.7 Official liquidators

Official liquidators are responsible for realising and distributing the assets of the company to the unsecured creditors. Liquidators and stakeholders can also apply to the court for directions if difficult issues arise (such as the validity of a purported security interest in respect of the company's property).

4.1.8 Liquidation committee

When the company is placed into official liquidation, a liquidation committee must be established[15] as a representative body of the company's stakeholders to consult with the official liquidators on matters material to the liquidation of the company. In an official liquidation, the liquidation committee consists of not less than three and no more than five members (six in circumstances of doubtful solvency), and the eligibility requirements for the nature of the interest of committee members is contingent on the solvency determination made by the official liquidators.[16]

4.1.9 Stakeholder consent

A restructuring in an official liquidation (which is unusual) would be implemented by way of a scheme of arrangement (see section 3 above).

Typically, once assets are realised, creditors receive a distribution of these assets on a *pari passu* basis. No consent is required for this distribution.

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[14] Section 110(2)(a) of the Companies Law.
[15] Order 9, rule (1)(1) of the Companies Winding Up Rules (2018 Revision) (CWR).
[16] Order 9, rule (1)(3), (4) and (6).

4.2 Court-supervised liquidation

4.2.1 Who can initiate the proceeding?

Companies incorporated in the Cayman Islands may only be wound up outside a court process if they are solvent.[17] Accordingly, where the shareholders of an insolvent company pass a resolution to wind up the company voluntarily, the voluntary liquidators must apply to bring the liquidation under the supervision of the court.

4.2.2 Criteria

If the voluntary liquidators are unable to obtain declarations of solvency within 28 days from each of the company's directors that the company will be able to pay its debts in full within 12 months, the liquidators must apply to the court for a supervision order.[18]

Voluntary liquidators may also apply for court supervision even if a declaration of solvency has been filed, if they believe that the company is or is likely to become insolvent or that bringing the liquidation under the supervision of the court would facilitate a more effective, economic or expeditious liquidation of the company.[19]

Once a supervision order is made, the liquidators are considered to be official liquidators and are officers of the court. The liquidation then proceeds in the same manner as an official liquidation, and the considerations that apply to an official liquidation apply equally to a court-supervised liquidation (see commentary in section 4.1 above on official liquidation).

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

A grant of a security interest can be challenged by a liquidator (or other parties with a sufficient interest) on the following bases:

- avoidance of dispositions of property from the date of the winding-up order;
- voidable preferences; and
- fraudulent dispositions at an undervalue.

These are outlined further below. However, as a general proposition, if security is granted by a debtor in exchange for a further advance of funds in an arm's-length transaction with a third-party, the validity of the grant of security will be difficult to challenge.

5.1 Avoidance of dispositions from the date of the winding-up order

Where a winding-up order has been made, any grant of security with respect to a company's property made after the commencement of the winding-up order is void[20] unless the court orders otherwise.[21]

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[17] Section 116 of the Companies Law.
[18] Section 124 of the Companies Law.
[19] Section 131 of the Companies Law.
[20] Section 99 of the Companies Law.
[21] This provision is identical to section 127 of the Insolvency Act 1986 (UK) and decisions of the courts of England and Wales will be persuasive authority in the Cayman Islands.

The commencement of the winding-up will be deemed to be the date on which the winding-up petition was filed, rather than the date on which the order is made. This means there can be a period of time, after a petition is filed but prior to a liquidator being appointed, during which any grant of security will be void.

The court has the power to validate post-petition grants of security. It can do so prospectively or retrospectively. A company that is the subject of a winding-up petition can therefore seek orders on an urgent basis to validate the grant of security in exchange for new funds being advanced, in an arm's-length transaction.

The court will only make a validation order in a retrospective validation application if the post-petition grant of security enhanced value for the creditors as a whole.[22] As a corollary, where the company is potentially insolvent, a grant of security with no corresponding benefit to the company will almost never be sanctioned.

The court will usually validate the grant of security interests to creditors where the company is clearly solvent, provided that the court is satisfied that an "intelligent and honest" director acting reasonably would come to that decision.[23]

If there is no winding-up petition pending at the time of the transaction, the transaction is not at risk of being void on this basis, but it may be caught by other claw-back actions should the company subsequently be placed into liquidation.

5.2 Voidable preferences

The granting of security in favour of a purportedly secured creditor will be invalid (as opposed to voidable at the election of the liquidator) if the court can be satisfied of the following:[24]

- it is made at a time when the company is unable to pay its debts;[25]
- it is made by with a view to giving such creditor a preference over the other creditors; and
- it is made within the six months immediately preceding the commencement of a winding-up. The commencement of the winding-up will be deemed to be the date on which the petition seeking the winding-up order was filed, rather than the date on which the court's order was ultimately made.

A grant of security will be made "with a view" to giving a preference if it can be established that the transferor's dominant intention was to prefer the creditor, i.e. to put the creditor in a better position than it would otherwise have been.[26] A dominant intention may be inferred by the court in accordance with the general principles of inference from the available evidence.[27] If the company's primary purpose in granting the security was to achieve something else, then it will not be a voidable preference, even if preferring the creditor was an obvious collateral effect of that transaction. For example, if the security was granted to an existing creditor in good faith under legitimate commercial pressure to prevent the company from being sued or wound up, or in order to benefit the company by

[22] See the decision of the Court of Appeal of England and Wales in Express Electrical Engineers Ltd v Beavis [2016] EWCA Civ 765.
[23] *In the matter of Fortuna Development Corporation* [2004–05] CILR 533.
[24] Section 145 of the Companies Law.
[25] On a cash-flow basis, within the meaning of section 93 of the Companies Law.
[26] This has most recently been accepted by the Judicial Committee of the Privy Council in *Skandinaviska Enskilda Banken AB v Conway & Shakespeare (as joint official liquidators of Weavering Macro Fixed Income Fund Ltd) (Cayman Islands)* [2019] UKPC 36.
[27] See *ibid*.

keeping on good terms with an essential supplier or service provider, the security is unlikely to be a voidable preference.

Security provided to a related party of the company shall be deemed to have been made with a view to giving such creditor a preference.[28] A creditor shall be treated as a "related party" for this purpose if it has the ability to control the company or exercise significant influence over the company in making financial and operating decisions.[29]

5.3 Transactions at an undervalue

The granting of security, made (i) with an intent to defraud and (ii) at an undervalue, shall be voidable at the instance of a creditor prejudiced as a result of the purported grant of security (regardless of whether the company is in liquidation) or the official liquidator of the company.[30] The burden of establishing an intent to defraud rests with the creditor or liquidator seeking to have the grant of security set aside.

In this regard:

- "intention to defraud" means an intention of a transferor to wilfully defeat an obligation; and
- "undervalue" is defined to mean the provision of no consideration or a consideration which in money or money's worth is significantly less than the value of the property, the subject of the grant of security.

The existence of a transaction at an undervalue with respect to a grant of security is not enough on its own to invalidate the transaction. The intention to defraud is a prerequisite of a claim under this provision.

There are saving provisions to protect a purported secured creditor that was granted the security in good faith and is unaware of the position the transferor was in before the transaction.[31] Those provisions are intended to put the innocent creditor back to the position that it was before the transaction giving rise to the grant of security.

Any proceeding to avoid a transaction at an undervalue must be commenced within six years from the date of the relevant grant of security.

6. Is enforcement of security rights treated differently in each type of proceeding?

In a liquidation of a Cayman Islands company, secured creditors rank in priority to all other creditors and can realise their security outside of the liquidation process.

With respect to a scheme of arrangement, the rights of secured creditors can be compromised provided they are convened to correctly constituted class meetings, the requisite majorities are obtained, and the court sanctions the scheme.

[28] Sections 145(2) of the Companies Law, which is not rebuttable.
[29] Section 145(3) of the Companies Law.
[30] Section 146 of the Companies Law (in relation to companies only) and section 4 of the Fraudulent Dispositions Law (1996 Revision) which is not limited to companies.
[31] See section 146(5) of the Companies Law and section 5 of the Fraudulent Dispositions Law.

This assumes that the secured creditors are not able to enforce their security on an individual basis and instead need a majority consent of that group of secured creditors, e.g. in the context of security for a syndicated loan or a global note held through a trustee.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

A secured creditor's rights in a liquidation are superior to the rights of all other parties.[32]

The laws of the Cayman Islands provide for a very limited class of preferential unsecured creditors.[33] Preferred creditors rank ahead of unsecured creditors and ahead of secured creditors where the secured creditor's security is in the form of a floating charge, but behind the liquidator's remuneration and expenses.

Unsecured creditors rank *pari passu* in respect of their claims in the liquidation, subject to the priorities of payment out of the assets of a company in liquidation.[34] The quantum of any distribution made to unsecured creditors will be determined by the value of any realisations achieved by the liquidator.

Any amounts due to shareholders *qua* shareholder rank below unsecured creditors. For example, redemption creditors, i.e. shareholders that have redeemed their shares in accordance with a company's governing documents prior to the date of liquidation but have not been paid the redemption proceeds, rank behind ordinary unsecured creditors of the company but before the return of capital to the company's shareholders.[35]

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

As outlined above in section 6, secured creditors can enforce their rights outside of a liquidation process.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

In the context of an official (or court-supervised) liquidation, the rights of a creditor against a non-debtor guarantor cannot be impacted through the proceeding with respect to the primary obligor, unless the underlying debt to the creditor is satisfied.

If the non-debtor guarantor discharges the debt, it will give rise to a right of subrogation for the guarantor to "step into the shoes" of the creditor in the liquidation prior to the discharge of the debt.

However, with respect to a scheme of arrangement, a court can sanction a scheme of arrangement which includes a provision for the release of a guarantee provided by a non-debtor guarantor.[36]

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

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[32] Subject to the rights (if any) of the liquidators to the costs associated with the care, preservation, and realisation of those assets (assuming this is permitted by the secured creditor).

[33] Companies Law, Schedule 2 – e.g. certain amounts due to employees and by way of taxes due to the Cayman Islands government.

[34] Order 20, CWR.

[35] Section 49(g) of the Companies Law.

[36] *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch).

There is no statutory regime in the Cayman Islands that requires perfection of security interests. Provided that the security interest granted in the contract is valid and not voidable for any other reason,[37] it will be enforceable.

Except for Cayman Islands registered ships and aircraft,[38] intellectual property and land,[39] there is no public security registration regime in the Cayman Islands and no public registers for searching. However, where a security interest is created by a Cayman Islands company, the company must enter any security interest created by the company in the register of mortgages and charges of the company, regardless of where the asset is located.[40] However, the failure of the company to update the register of mortgages and charges does not, in and of itself, invalidate any security interest.

While no statutory priority is afforded to the security holder by registering its security interest on the company's register of mortgages and charges, it does put third parties that are provided with a copy of the register of mortgages and charges on actual notice of the existence of the security. As priority of competing security interests over the same assets would be determined on the basis of common law principles, and there are no express statutory limits within which the security must be registered in the company's register of mortgages and charges, it is prudent for creditors taking floating charges to require that brief particulars of any other security granted by the company in respect of the secured assets are included in the register of mortgages and charges.

11. During a pre-insolvency or insolvency proceeding, is the secured creditor permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor?

In the Cayman Islands, secured creditors are always permitted to take enforcement actions against the

collateral once there is an event of default. There is no stay on enforcement by secured creditors similar to the impact of Chapter 11 proceedings in the United States.[41]

However, there is a stay on all other proceedings commenced against the debtor in liquidation (provisional, official or court-supervised) subject to obtaining leave of the court.[42]

12. Can collateral in which a secured creditor has an interest be used by the debtor or sold during a case without the consent of the secured creditor? If collateral may be sold without the secured creditor's consent, may it be sold "free and clear" of the liens of the secured creditor?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

In the Cayman Islands, the secured creditor's interests in the secured property are "king", subject to any issues of subordination to other secured creditors' interest over the same collateral. This means that the property in which the secured creditor has an interest cannot be sold without the secured creditor's consent.

As a matter of practice, in the context of liquidations, a secured creditor may, but is not obliged to, permit the liquidator to sell the secured property on its behalf. The costs associated with the care,

[37] Sections 99, 145 to 147 of the Companies Law.
[38] The Civil Aviation Authority Law (2005 Revision); section 4 of the Mortgaging of Aircraft Regulations 2015.
[39] Section 64 of the Registered Land Law (2018 Revision).
[40] Section 54 of the Companies Law.
[41] This is expressly permitted pursuant to section 143 of the Companies Law.
[42] Section 97(1) of the Companies Law.

preservation, and realisation of the secured asset incurred by the liquidator will be recoverable from the proceeds of sale in priority to the payment to the secured creditor. The proceeds of such a sale, however, are returned to the secured creditor, and only the surplus (if any) can be used for the benefit of the liquidation estate.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

Subject to obtaining the approval of the court, official liquidators and provisional liquidators can raise new finance and grant security over the company's assets.[43] However, that security cannot be granted in violation of the contractual arrangements between the company and the secured creditor.

14. What distribution will a secured creditor receive if a company is reorganised?

A secured creditor will receive the full value of the secured property (to the extent of the secured debt) if it elects to stand outside of the liquidation and enforce its security.

With respect to a scheme of arrangement, and to the extent that the secured creditors can be schemed, the secured creditor must receive a better distribution than it would in a liquidation or the court will not sanction the terms of that scheme of arrangement.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

See answer to section 6 above.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

If the secured claim is "over-secured", any realisations in excess of the secured debt must revert to the party that provided the security (and, in an insolvency context, to the liquidation estate for the benefit of other unsecured creditors). However, if there is more than one secured creditor in respect of that secured asset, the excess realisations will revert to the next party secured (determined by priority of their security), prior to reverting to the party that provided the security / the liquidation estate.

If the secured claim is "under-secured", after realisation of the underlying assets, the previously secured creditor has an unsecured claim against the security provider for the balance (in the context of a liquidation, it can file a proof of debt in the liquidation for that shortfall).

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

The Cayman Islands courts will not recognise a foreign restructuring of a debt governed by the laws of the Cayman Islands. As a matter of Cayman Islands law, a debt arising pursuant to a contract governed by the laws of the Cayman Islands must be compromised pursuant to that governing law.[44]

[43] Section 110(2)(a) of the Companies Law.
[44] *Wight v Eckhardt Marine GmbH* [2003] UKPC 37.

FRANCE

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***

- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***

- ***Is the security interest granted by law, contract or both?***

France is a civil law country.

Rules governing pre-insolvency and insolvency proceedings are intricate and require the assistance of specialised consultants (lawyers, auditors, financial or technical advisers etc.), who have an actual expertise in such kinds of proceedings and are familiar with the actors involved therein (members of the club), in particular to (i) select the appropriate proceeding, (ii) negotiate efficiently, and (iii) meet relevant deadlines for engaging specific actions and / or enforce security rights.

Several specific principles must be considered and verified before granting a loan or a credit to a French entity, including French banking monopoly rules. Only French credit institutions or European Union (EU) credit institutions (*établissements de crédit*) duly licensed by the authorities supervising banking activities are entitled to carry out banking activities (e.g. granting credit facilities to French entities) on a regular / customary basis.

As a general rule, a French company can only issue a security right or grant a guarantee (whether upstream / cross-stream security rights / guarantees) if such guarantee or security right complies with its corporate purpose and interest (*objet et intérêt social*). Several criteria are defined by case law, which must be verified on a case-by-case basis. The absence of corporate interest may result in a misuse of corporate assets or a misuse of the credit of the company, which are criminal offences. French law considers (and protects) the interest of a company separately from the interest of third parties, including other group companies. A guarantee / security right with no corporate benefit could be rendered null and void.

A guarantee or security right (when it secures the debt of a third party, including group companies) granted by a *société anonyme* (SA) or by a *société par actions simplifiée* (SAS) must be approved by its board of directors or relevant corporate body prior to its execution and delivery.

Financial assistance rules prohibit the granting of an up-stream guarantee / security right by a French company to secure the obligations of its direct or indirect parent company in respect of the acquisition debt owed by the direct or indirect parent company.

A guarantee or a security right can be granted in favour of the creditor / lender itself or in favour of a person acting as security agent (*agent des sûretés*) (article 2488-6 and subsequent articles of the Civil Code).

The "parallel debt obligation" concept is also recognised under French law when properly drafted. Legal advice should be sought on a case-by-case basis on its effect, in particular in the context of insolvency proceedings.

The rights under guarantees and security rights can be transferred by the beneficiaries as accessories of the secured debt. Specific provisions have to be inserted with a view to reserve and maintain the effectiveness of the security rights in case of transfer of debts.

Many different forms of loan and finance documents are used in the French market, including internationally recognised forms adapted to French law specificities (e.g. Loan Market Association standard forms).

Security rights are governed by three types of sources: contractual, statutory and judicial.

1.1 Lien (*privilège*)

The security granted by law for personal or movable property is a lien (*privilège*).

A lien allows the secured party to have the debtor's asset sold upon default and the security to be paid out of the proceeds of the sale with preference to the other creditors. Article 2324 of the Civil Code grants the lien according to the quality of the debt; it focuses on public interest (tax, French social security) and the necessity to protect a specific creditor (e.g. the employee). There is no obligation to publish liens.

Article 2330 of the Civil Code distinguishes between general liens (*privilèges généraux*) and specific liens (*privilèges spéciaux*).

General liens cover all assets of a debtor. The secured party has priority regarding the sale of assets but is not protected in the event of a sale by the debtor. Some general liens can be found in the Civil Code (e.g. legal costs, funeral costs, and employee's salary, especially in the event of insolvency proceedings), whereas other general liens can be found in legal texts, such as tax privilege, French social security, and debts that result from insolvency proceedings.

Specific liens are numerous and can apply to one or more assets of a debtor. The main liens are listed in article 2332 of the Civil Code. They provide the right of first refusal (*droit de préférence*), but, contrary to general liens, some of them provide the right to pursue the asset (*droit de suite*) in the hands of a third party in the event of a sale by the debtor. They specifically concern the lessor who has a lien on the goods located in the rented premises. The lessor has a right of first refusal and under certain circumstances, a right to pursue the asset and a right to retain it (*droit de retention*). Another example relates to the seller of the goods in the event of non-payment by the debtor.

In general, a seizure and sale are necessary prior to enforcing the lien.

Priority between liens is organised by articles 2331 and 2332 of the Civil Code. If there is competition between general and specific liens, the latter shall have priority. However, there are exceptions to the rule, especially for tax and employee liens.

1.2 Pledge over tangible assets (*gage de meubles corporels*)

The pledge over tangible assets is defined in Article 2333 of the Civil Code. This pledge consists of providing a creditor with the right to be paid prior to the other creditors over tangible / movable assets, present or future. A pledge agreement must be entered into between the parties, indicating the secured debt and the quantity and nature of the pledged assets. The secured claims can be present or future; in the latter case, they must be determinable.

It is possible to grant a pledge without loss of possession (*gage sans dépossession*). If an asset is pledged several times, the rank of each pledge is determined by its date of registration. It is also possible to pledge present and / or future assets. Two formalities must be accomplished to make the pledge without loss of possession enforceable against third parties: the execution of a pledge agreement and the registration of the pledge agreement in a specific register. Other pledges can be granted over motor vehicles, equipment or stocks.

1.3 Pledge over intangible assets (*nantissement de meubles incorporels*)

Pledge over intangible assets is defined in article 2355 of the Civil Code. This pledge consists of the allocation of an intangible asset or a set of intangible assets, present or future, as security for an obligation. A pledge of accounts receivable would be included in this definition.

The granting of a pledge over intangible assets may be contractual or judicial.

The pledge becomes enforceable against a third party from the date the document is executed and enforceable against the debtor from the date of notification, or from the date of the agreement if the debtor was an original party to it. It is also possible to create a pledge over a future receivable (specifically identified). It should be noted that in practice banks usually prefer the so-called *Loi Dailly* assignment of receivables by way of security (see section 4.1 below).

1.4 Assignment / pledge over receivables (*cession / nantissement de créances*)

Trade receivables can be pledged by (1) way of a common pledge in accordance with relevant provisions of the Civil Code or (2) under the so-called “Dailly” law in accordance with the relevant provisions of the Monetary and Financial Code.

Trade receivables can also be assigned by way of security (assignment of title by way of security) under the “Dailly” law.

A Dailly assignment or pledge of receivables is subject to the following conditions: (1) the beneficiary of the assignment or pledge must be a credit institution (licensed *établissement de crédit* within the meaning of EU regulations); (2) the assignment / pledge can only secure facilities granted to the assignor / pledgor; and (3) the assignment / pledge is only available in respect of receivables owed by corporate bodies or individuals, arising as a result of their professional activity.

1.5 Pledge over business assets (*nantissement de fonds de commerce*)

Business assets can be pledged in accordance with article L142-1 of the Commercial Code. The pledge generally covers the logo, the commercial name, the leasehold right (if any), the goodwill and the clientele. Intellectual property rights (such as patents or trademarks), the furniture used for commercial purposes, tools and equipment can also be included, subject to certain conditions, provided that they are listed in the pledge agreement.

A pledge over business assets does not cover inventory or stocks. The pledgor does not part with possession of the business and can continue to operate it notwithstanding the pledge created thereon. This security is commonly used by banks.

1.6 Pledge over financial securities account (*nantissement de compte de titres financiers*)

The legal regime of a pledge over shares varies according to the corporate status of the company whose shares are pledged.

SAs and SASs do not issue share certificates. The shares are evidenced by means of entries on an account (*compte de titres financiers*) in the books of the company or of a professional intermediary (credit institution). The account (as opposed to the shares themselves) in which the shares are registered can be pledged in favour of a creditor by way of a pledge over a financial securities account, which materialises the pledge over the shares.

Such a pledge is made effective by a statement of pledge (*déclaration de gage*) dated and signed by the pledgor. The pledge must be registered in the books of the company whose shares are pledged and a certificate (*attestation de gage*) is delivered by the company to the pledgee certifying the creation of the pledge.

Pledges over shares issued by other French corporate entities (such as SARL (*société à responsabilité limitée*), SNC (*société en nom collectif*), civil companies (*sociétés civiles*) or partnership with unlimited liability (*groupement d'intérêt économique*)) are generally created in the same way as pledges of ordinary receivables, i.e. by an instrument in writing duly registered with the tax authorities.

1.7 Pledge over monies or bank account (*gage-espèces / nantissement de compte bancaire*)

A security right can be created either over monies (*gage-espèces*) or over the credit balance of an account opened by the debtor with a bank.

A *gage-espèces* is created by the actual delivery of the monies to the pledgee itself or to an agreed depositary by the pledgor.

A pledge over the balance standing from time to time to the credit of an account is a pledge over the claim held by the pledgor against the depositary bank.

The pledge must be established in writing.

1.8 Pledge over tools and equipment (*nantissement de matériel et outillage*)

A pledge over tools and equipment can be granted in favour of the seller of equipment or the lender of the monies made available to purchase the equipment.

The pledge must be established by way of a private instrument describing the tools and equipment pledged. It must be created within two months of the date of delivery of the equipment and registered with the competent commercial court within 15 days of the date of execution of the agreement. It remains effective for five years from the date of registration.

1.9 Delegation of debts (*délégation de créances*)

A grantor can delegate debtors (e.g. insurers which provide certain insurance policies, debtors under the warranty agreement in relation to a share purchase agreement) to a beneficiary (*délégataire*) for the payment of all sums that may be due or become due to the grantor by each of the delegated debtors under the agreement referred to in the delegation agreement (e.g. insurance policy or warranty agreement).

1.10 Mortgage over aircraft / ship (*hypothèque sur aéronef / navire*)

A mortgage can be created over an aircraft or a ship by way of a private or notarised instrument.

Aircraft mortgages are registered on the registry held by the General Directory of Civil Aviation (*Direction Générale de l'Aviation Civile*) and ship mortgages are registered on the registry held by the customs collector where the ship is registered.

1.11 Mortgage over immovable property (*hypothèque sur immeubles*) and lien (*privilège immobilier*)

The main security rights *in rem* are governed by the principle of public registration (*publicité foncière*) in order to be enforceable against third parties.

The main security right used is the mortgage, which consists of a right over an immovable property to secure the discharge of an obligation. The secured party has a right of first refusal (*droit de préférence*) and a right to pursue the asset subject to the mortgage (*droit de suite*). The loss of possession is not required.

A mortgage is statutory, judicial or contractual. A contractual mortgage is entered into by deed with a specific mention of existing and free immovable property by the debtor or a third party (guarantee), for present or future debts. A statutory mortgage is given by law to certain categories of creditors or debtors, such as spouses, guardians and to specific immovable liens, such as a seller of an immovable property, or an architect.

A mortgage can be "rechargeable", allowing the debtor to secure further credit facilities under the same mortgage.

The judicial mortgage is granted to a creditor when a court decision has been pronounced against the debtor based on a judicial request by the creditor.

The second group of security rights related to real estate property comprise of general liens. They cover all the real estate property of the debtor, are granted to cover legal costs and employees have priority with regards to the other security rights *in rem*.

The final security right in this group is the *antichresis*, which is a type of mortgage with loss of possession. It requires a written contract to be registered by a notary and published accordingly. The loss of possession is necessary because it provides the creditor with the use of the asset, the right to retain it until full payment has been made and a right of first refusal.

1.12 Retention of title (*réserve de propriété*)

The retention of title concept is defined as a clause which suspends the transfer of title to an asset until complete payment of the obligation which constitutes its counterparty (Article 2329 of the Civil Code). It falls under the category of a security right in the Civil Code.

1.13 *Fiducie*

The *Fiducie* is defined in Article 2011 and subsequent articles of the Civil Code as a transaction by which one or several grantors transfer their assets, rights or security rights, or a group of assets, rights or security rights, present or future, to one or several fiduciarie(s) (*fiduciaire(s) /* "trustee(s)") who, holding them separately from their own assets, act for a specific purpose for the benefit of one or several beneficiaries. The *fiducie* can be used for managing assets (*fiducie gestion*) or for securing the liabilities of a debtor (*fiducie sûreté*). Assets or rights can be transferred in full property / ownership to a fiduciary, securing the obligations of a debtor towards its creditors. The assets or rights are returned to the grantor once its obligations are satisfied.

It is considered as providing a very high level of security to the beneficiary(ies) (queen of security rights) and is increasingly used in the market (for shares of companies or real estate assets in particular), including in the context of pre-insolvency and insolvency proceedings.

2. How are security rights enforced? Is a court process or out-of-court procedure required or both? What are the practical difficulties experienced when security is enforced?

The enforcement of security rights depends on whether the security right relates to personal or immovable property. The principles described below are necessarily general, and the nature of the relevant procedure and the way to engage it must be checked on a case-by-case basis.

There are no specific practical difficulties other than procedural delays inherent to the procedure itself and those potentially generated by the debtor and its advisors. The enforcement of security rights being a court process, one should always anticipate a fairly long-time scale. However, a provisional seizure or attachment can be obtained by the creditor if the circumstances justify it and if the creditor provides satisfactory evidence of its claim.

Other practical difficulties experienced are delays generated by the debtor or third-party creditors challenging the nature, grounds or validity of the claim or of the action of the creditor.

Options of enforcement are:

- a court awarding the secured asset(s) to the secured creditor by means of a court order following a valuation by a court-appointed expert;
- transfer of title to the pledged assets or rights to the secured creditor by the effect of specific provisions of the security documents (*pacte commissoire*);
- repossession of asset(s); or
- sale of the asset(s) by public auction.

There is no concept equivalent to receivership (i.e. it is not possible for the creditors to appoint a receiver or official whose mission would be to operate or sell the secured assets in order to pay the secured debts).

The commencement of insolvency proceedings freezes the enforcement of security rights or guarantees in most cases.

In a limited number of cases, the enforcement of security rights may be impacted by specific procedures (e.g. in the defence, press / publishing and health sectors).

3. Are pre-insolvency proceedings available? If so, describe the type of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***

- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affecting creditor consent?***
- ***What is the level of creditor consent required in order to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

3.1 General

The aim of pre-insolvency proceedings is to enable the company to solve its financial difficulties, except when there is no possibility of finding a solution acceptable to its creditors, in which case an insolvency proceeding must be initiated. The French system is generally considered as being "debtor protective", and the opening of a proceeding requires a high level of control and the involvement of the creditors to the maximum extent possible.

The key test under French law is to determine whether the debtor is in a state of "suspension / cessation of payments" (*cessation de paiements*). The concept is generally defined as when the debtor "cannot meet its liabilities with its available assets", which leaves room for interpretation and appreciation by the management and the courts.

Each proceeding thus theoretically corresponds to the level of financial difficulties faced by the company. In the event that the company suspends or ceases its payments for more than 45 days, the management must file an application for judicial recovery or judicial liquidation (see section 4 below). Since these two proceedings imply an important loss of control over the activities of the company, the management should be induced to seek solutions using pre-insolvency proceedings.

3.2 Pre-insolvency proceedings

Over the last 30 years, the legislature has accentuated the introduction of principles and proceedings enabling if not forcing creditors and debtors to anticipate financial difficulties at an earlier stage. As a matter of fact, it is well known that the chances of recovery are higher if the business can be rescued or restructured when difficulties can be dealt with at an early stage rather than within the framework of insolvency proceedings.

The main actors are the commercial court, the official appointed by the court for assisting the debtor, the creditors and the debtor itself.

Mandat ad hoc (special purpose agency): the commercial court appoints an official (*mandataire ad hoc*) whose mission is to assist the debtor to negotiate with its creditors with a view to avoiding the company becoming insolvent. The management is still in control of the business of the company.

Conciliation (conciliation): when the level of difficulties is higher and the threat of being insolvent is imminent (or the company has suspended its payments for less than 45 days), the court appoints a conciliator whose mission is also to facilitate an agreement between the company and its debtors.

The management remains in control of the business, but the conciliator can propose solutions and / or plans of recovery, or even the opening of insolvency proceedings (see section 4 below). The parties work on a conciliation plan which can be homologated by the court.

Contracts and secured and unsecured debts cannot be adjusted without the affected creditors' consent. Contractual terms are preserved, and creditors keep their rights to be involved in restructurings in accordance with their respective positions (e.g. the strength of their security right over assets of the company). Enforcement of rights of the secured and unsecured creditors are not frozen or affected, but in practice the threat of the opening of an insolvency proceeding and its potential consequences weigh on the position of the creditors. Shareholder consent is required in accordance with the corporate rules of the company (by-laws) and / or relevant agreements.

4. Are insolvency proceedings available? If so, describe the type of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affecting creditor consent?***
- ***What is the level of creditor consent required in order to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

4.1 General

The aim is still to enable the company which meets financial difficulties to recover, unless the situation is such that the liquidation is unavoidable. Depending on the nature of the proceeding, employees are retained or not. Contracts continue to be performed in accordance with their terms unless terminated in accordance with specific regulations applicable to each proceeding.

Notwithstanding any provision to the contrary, contracts which are ongoing on the date of the opening of the proceeding cannot be terminated or accelerated as a result of the opening of insolvency proceedings.

The main actors are the commercial court, the official appointed by the court for assisting the debtor or liquidating it (*administrateur judiciaire* or *liquidateur judiciaire*), the *juge commissaire* (the judge who supervises the proceeding), the representative of the creditors, the controllers (appointed by lenders, majors suppliers, tax administration etc.), the public prosecutor and the debtor itself.

4.2 Insolvency proceedings

If the debtor suspends or ceases its payments, the debtor itself, the creditors, the competent court or the public prosecutor may initiate insolvency proceedings. The proceedings are aimed at the reorganisation of the debtor via a continuation plan (*plan de continuation)* or transfer plan (*plan de cession)*, or at the liquidation of the company. The solution is decided by the court on the basis of the proposals of the administrator appointed by it, after an observation period. The liquidation may be declared without an observation period if the debtor has ceased its activities or where recovery is deemed impossible. Enforcement of the rights of the creditors are frozen and secured and unsecured debts can be adjusted with different degrees of involvement with and consent of the creditors.

Sauvegarde, *Sauvegarde Accélérée* and *Sauvegarde Financière Accélérée* (safeguard, accelerated safeguard and financial accelerated safeguard): the company has not suspended or ceased its payments but faces difficulties that it cannot surmount. The management still runs the business, but the court appoints officials (professional administrators) whose mission is determined by the court. The administrator can be vested with powers of control over the management, but committees of creditors can be implemented under certain conditions.

Redressement Judiciaire (judicial recovery): the company has suspended / ceased its payments. An administrator, who elaborates a plan for recovery, is appointed by the court to assist and control the management.

Liquidation Judiciaire (judicial liquidation): the level of difficulties is such that the recovery of the company is impossible. The liquidation of the company is declared, and a liquidator is appointed for such purpose.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

The general principle is governed by Article L632-1 of the Commercial Code which lists certain acts which can be nullified if they have “intervened” during the so-called “suspect period” (date between the suspension / cessation of payments and the judgment opening the proceeding), e.g. payments before maturity, security rights, deposits, unbalanced contracts, etc.

Security rights granted as security for debts undertaken or incurred during the suspect period can thus be nullified. In practice, it is crucial when considering the granting of a security right to make a thorough analysis of the financial standing of the grantor in order to ensure that it is not in a suspect period situation.

6. Is enforcement of security rights treated differently in each type of proceedings?

The treatment of the security rights or interests is indeed different at each step of the proceedings.

During pre-insolvency proceedings, the security rights are preserved and are treated normally. Their scope and effect have a strong impact on the discussions between the parties.

During the observation period in the context of safeguard proceedings and recovery proceedings, assets that are the subject of a lender’s privilege and mortgage may be sold by the administrator with the consent of the judge. If those assets are subject to security rights which do not confer an actual right of retention, an amount equal to the lesser of the sale price and the secured debt will be deposited in an account. At the end of the observation period, the secured creditors will be paid from this account in accordance with their respective rank. The secured creditors may also be required to accept alternative security.

If the court orders the continuation of the business under a recovery plan, the secured creditors will remain unable to enforce their security, and they will be forced to accept a rescheduling of their secured debts. Such a recovery plan may last up to 10 years.

If the court orders the sale of the business at the end of the observation period, and provided that the subject matter of the security does not form part of the business assets sold, a secured creditor benefitting from a pledge would be able to enforce its security by applying to the court for an order transferring the subject matter of the security to the creditor. This procedure is known as *attribution judiciaire*. It requires a valuation of the subject matter of the security to be made by a court-approved expert. The *attribution judiciaire* will extinguish the debt in an amount equal to the valuation.

The principal advantage of the *attribution judiciaire* procedure is that it enables the secured creditor to obtain title to the subject matter of the security free of the claims of any prior ranking creditors such as the French state (in respect of taxes).

If the subject matter of the security does form part of the business assets sold, the secured creditor will not be able to request the *attribution judiciaire*. The court will, instead, allocate a part of the sale price to the subject matter of the security. The secured creditor will be able to accept this amount in satisfaction of its claim on the relevant asset, although certain preferred creditors (see the preceding paragraph) will have a prior claim to such amount. In other words, the secured creditor in this situation will be in the same situation as the holder of a security interest that does not confer a right of retention.

However, certain security interests may be enforced without having recourse to the courts. This includes, in particular, pledges over assets whose value is not subject to debate (such as pledges over financial instruments listed on a regulated market) or securities involving a transfer of ownership of the underlying assets (such as securities over cash constituted in the form of cash collateral (*gage-espèces)* whereby the ownership of the cash is transferred to the beneficiary).

In the event that the court orders a liquidation, a secured creditor benefitting from a pledge will be free to seek the *attribution judiciaire* of the subject matter of the security interest.

The secured creditor benefitting from a pledge may also enforce its security without having recourse to the courts if the contract provides that a default event has the effect of making the creditor the owner of the asset (*clause compromissoire*). It requires a valuation of the subject matter of the security to be made by a court-approved expert. The attribution will extinguish the debt in an amount equal to the valuation.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

The following debts, in the order of priority in which they are listed, are treated as preferred debts

and are paid in priority to those owed to unsecured creditors of the company (article L641-13 of the Commercial Code):

- certain salaries and other sums payable to employees;
- certain court costs;
- claims relating to loans or claims when the lender or creditor has accepted a differed payment;
- certain sums advanced in accordance with specific provisions of the Code of Employment; and
- other claims and debts in accordance with their rank.

It should be noted that priorities in the distribution and ranking of claims are governed by intricate rules described in multiple texts and case law. Legal advice should be sought on a case-by-case basis.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

As a general rule, it is crucial to carefully follow the developments in the situation of the debtor, in particular when pre-insolvency or insolvency proceedings start to be contemplated, in order to, for example, determine whether the termination of an agreement could be declared prior to the opening of the proceeding, or before the debtor is deemed to be in the suspect period. Once a proceeding is opened it must be followed on a day-to-day basis when necessary, with the assistance of a legal counsel in particular in order to comply with all delays for declaring claims or filing claims for repossession of assets, or generally to take all appropriate actions.

From the date of the insolvency judgment, the debtor is prevented from making payments regarding the sums that are due and payable prior to the insolvency judgment. In the same way, secured creditors are not allowed to enforce their securities during the observation period.

Any claims against the debtor regarding the payment of any sum, or involving the termination of any contract, and actions relating to the enforcement of previously obtained judgments are stayed. Actions relating to claims arising prior to the insolvency judgment that do not involve the payment of a sum of money or the termination of a contract for payment default may be commenced or continued with the supervision of the judicial administrator and the creditor's representative.

Creditors (other than employees) to whom the debtor became indebted prior to the insolvency judgment and creditors whose claim arose after the commencement of the proceeding but is not linked to the activity of the debtor or was not incurred for the purpose of the proceeding are required to send in a statement of their claims to the creditor representative within two months following the publication of the judgment opening the proceeding in the French Official Gazette (BODACC). Payment of the creditors having duly stated their claims will occur at the end of the insolvency proceeding (subject to the amount of available monies). Debts that arose before the date of the insolvency judgment rank junior to debts arising after the insolvency judgment and after certain preferred creditors (for example, employees).

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

From the opening of a safeguard, recovery or liquidation proceeding, there is a suspension of payments in favour of the debtor. Article L622-28 al 2 and L631-44 of the Commercial Code allow third-party guarantors (*cautions*), first demand guarantors (*garants autonomes*) and joint obligation debtors (*coobligés*), when they are individual entities, to benefit from this suspension during the observation period. These guarantors cannot be sued by the creditor until a plan is adopted. At the end of this period, the court may grant payment postponements (*différé de paiement*) to the guarantor, with a two-year limit.

However, during this stay of actions against the guarantor, article L622-28 al 3 of the Commercial Code allows creditors to take conservatory measures to protect their future claim against the guarantors.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured right?

Creditors must declare their claim(s) within specific time periods to the representative of the creditors. In their statement of claim(s), secured creditors must specify the quality of their security and what steps the creditor has taken to perfect its security rights. The failure to comply with this rule can result in the loss of the preferential rank.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor?

During a pre-insolvency proceeding, secured creditors are theoretically entitled to enforce their rights unless the suspension of the actions of the creditors is pronounced. However, an acceleration of a loan may generate a suspension of payments by the debtor and, as a consequence, the opening of an insolvency proceeding, thus weakening the positions of all parties.

As from the opening of an insolvency proceeding, secured creditors of the debtor are not entitled to enforce their security interests during the observation period, and no further security may be granted over the debtor's assets without the prior consent of the judge. The granting of a mortgage or a charge as security for a prior debt during the *période suspecte* will automatically be invalidated by the court without the possibility of challenging the decision.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

A secured asset cannot be sold by the debtor without the consent of the secured party. The treatment of the secured assets depends on the nature of the security right itself and of the proceeding.

There are no specific rules regarding the debtor's use of cash collateral, which is generally considered a strong security right.

13. During the course of a pre-insolvency proceeding and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

Additional liens on a secured creditor's collateral can be granted to a third party (e.g. a second-ranking mortgage), but the rights of the existing secured creditors cannot be violated. However, the impact of pre-insolvency and insolvency proceedings can be significant in terms of delays and amounts recovered.

14. What distribution will a secured creditor receive if a company is reorganised?

Rules of distribution are intricate and depend on the nature of the proceeding and the ranking of the claims.

For example, article L643-2 of the French *Code de commerce* provides that creditors holding a mortgage or lender privilege are entitled, once they have fulfilled the legal obligation to declare their claims to the creditor's representative, and even where such claims have not yet been acknowledged by the *juge-commissaire*, to enforce their rights if the liquidator or the *commissaire à l'exécution du plan* has not initiated the sale of the charged assets within the three-month period following the date of the judgment which instituted or declared the liquidation or the sale of the business.

If the liquidator does sell the property during such three-month period, the sale price will be distributed to the creditors. In such event, the creditor holding a first-ranking mortgage shall only be paid after payment of the employees' privileged receivables, the legal fees and claims of creditors defined under article L641-13 of the French *Code de commerce*.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

The nature of the rights remains intact, but the standing of the entity which has granted the security may change. If the court orders the sale of the secured asset(s) as part of the business in the context of a business sale plan and in the event that the security had been granted in order to secure a loan which was granted to finance the acquisition of such asset(s), the ultimate purchaser of the asset(s) is bound by the terms of the outstanding loan agreements extended for the purpose of such acquisition and therefore by the security rights previously granted, which remain intact. Different scenarios of sale of secured assets can be agreed depending on the nature of the pre-insolvency or insolvency proceeding, enabling a third-party to acquire the asset(s) free of any secured interest.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

The concepts of "over-secured claim" or "under-secured claim" are not legally qualified concepts. They are just factual.

The general principles are:

- the proceeds resulting from the enforcement of the security interest in excess of the sums due by the debtor must be repaid to the latter;
- if the proceeds resulting from the enforcement of the security interest are not sufficient to repay the sums due by the debtor, the remaining unpaid sums are treated as unsecured debts.

A guarantee issued by an individual in favour of a professional creditor should not be "disproportionate", which concept has to be addressed on a case-by-case basis.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

A foreign restructuring of contractual arrangements governed by French law will be given full force and effect by a French court if it satisfies French law requirements.

Only French pre-insolvency and insolvency proceedings can apply to a French company when it faces financial difficulties, unless it is deemed to perform activities in another jurisdiction enabling creditors to initiate pre-insolvency or insolvency proceedings in such other jurisdiction (e.g. the EU concept of centre of main interest).

The enforcement of foreign courts' decisions will become effective based on applicable treaties or conventions.

GERMANY

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

1.1 Movable or personal property

Security interests in respect of movable or personal property are principally granted through a security transfer of title (*Sicherungsübereignung*), a pledge (*Pfandrecht*), a security assignment (*Sicherungsabtretung*), or a retention of title (*Eigentumsvorbehalt*). In contrast to common law jurisdictions, there is no concept of a floating charge under German law, which means that each category of assets of a German company has to be separately identified and be made the subject matter of appropriate security arrangements. However, it is common that groups of assets, such as all goods contained in a warehouse or all the receivables of the company, are subject to an overall security transfer. Security rights are mostly regulated by the German Civil Code (*Bürgerliches Gesetzbuch*), which applies to every private legal instrument, including commercial transactions, as long as there are no other applicable specific rules.

A security transfer of title is usually used in relation to movable assets like an inventory. Such security interest requires a full transfer of title. It is created by agreement between the parties and the grantor retains possession of the relevant asset. The agreement is not required to be in a particular form, and registration of the security transfer of title is not required or possible.

A pledge is an accessory (*akzessorisch*) collateral, which means that there is a direct legal link between the collateral and the secured claim, i.e. if the secured claim ceases to exist, the collateral will cease to exist, and the collateral cannot be transferred without the secured claim. It is created by agreement between the parties. A pledge is created by pledging a chattel or claim as security for a debt. It is a right *in rem* to satisfy a claim. It requires that the debtor delivers up possession of the chattel. Registration of a pledge is not required or possible. Claims or rights may either be pledged or transferred for security purposes by way of an assignment. In the case of a pledge, the third-party debtor in principle must be notified of the pledge in order for the pledge to be effective.

An assignment (e.g. of receivables, intellectual property rights, or insurances) is, again, effected by agreement between the parties. There are no particular requirements as to the form of such an agreement, and registration is not required or possible. The debtor does not need to be notified of the assignment.

Under a retention of title agreement, the seller of personal property may retain title until the purchase price has been paid (condition precedent).

1.2 Real or immovable property

Security over real or immovable property is available either in the form of a land charge (*Grundschuld*) or a mortgage (*Hypothek*). A land charge is a non-accessory security right, i.e. a land charge is independent from the existence of the secured claims. The link between the land charge and the secured claim is created under a separate security agreement. In credit practice, the claim-secured land charge (*Sicherungsgrundschuld*) as a special type of land charge is a common form of security. The owner of the property may raise objections stemming from the security agreement against the claim from a land charge, e.g. that certain payments are not yet due under the security agreement. It is thus not possible for a third party to acquire the land charge free of the aforementioned objections under the security agreement – i.e. even if a third party were to acquire the land charge not knowing the content of the security agreement, the owner of the property is still entitled to raise the objections under the security agreement against the new third-party owner of the land charge. In contrast to a land charge, a mortgage is an accessory right, depending on an underlying personal debt. Both are created by a private agreement between the parties, a notarised declaration of the chargor (*Eintragungsbewilligung*), and registration with the land register. Notarisation and registration of the land charge will result in fees, which will be calculated by reference to the amount secured by the security interest.

In practice, due to their more flexible non-accessory nature, land charges are considered the preferable real estate security interest and are used in almost all cases.

1.3 Granting security

In general, a security interest is created by contract, but there are a few exceptions. The most important statutory liens are the contractor's lien (*Unternehmerpfandrecht*) and the landlord's lien (*Vermieterpfandrecht*).

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

Since the assets of the debtor are effectively confiscated with the commencement of insolvency proceedings, and the power to manage and administer the assets of the debtor passes to the administrator, the following is related to enforcement outside of insolvency proceedings.

In order to enforce security rights under German law, the creditor must normally obtain a court judgment. For this to happen, court proceedings would have to be initiated, and the debtor would be ordered by the court to make the payments in question. The court judgment could then be used to enforce the security. In order to avoid lengthy proceedings, the mortgage or land charge documentation usually includes a submission of the debtor to immediate enforcement (*Unterwerfung unter die sofortige Zwangsvollstreckung*) against the property in relation to outstanding claims. Such submission to immediate enforcement requires a notarial deed which, for the purpose of enforcement of the mortgage or land charge, replaces a court judgment so that on the basis of the notarial deed enforcement can be initiated without having to obtain a court judgment.

Before a judgment can be executed with state assistance (bailiffs), three essential prerequisites must be fulfilled. First, the creditor must actually hold a court-certified copy of the complete (written) final judgment (*Titel*). Second, the judgment must contain an execution clause (*Klausel*). Third, the judgment with the execution clause must be served upon the debtor (*Zustellung*).

For enforcement against immovable property, the creditor can choose between three alternative steps: a mortgage to be entered in the land register (*Grundbuch*) on application of the creditor by way of execution (*Zwangshypothek*); a sale by court order (*Zwangsversteigerung*); or sequestration with an administrator appointed by the court in order to receive the rents and profits thereof (*Zwangsverwaltung*).

The proceeds from a judicial sale will firstly be used to cover the costs of the proceedings. The proceeds will then be distributed to all mortgagees / chargees according to their ranking, i.e. outstanding claims of the first-ranking mortgagee / chargee will be discharged first.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Following the example of United States (US) Chapter 11 proceedings and the French *procédure de sauvegarde*, the "protective shield proceedings" (*Schutzschirmverfahren*) were introduced to German insolvency law in 2012. Through those proceedings, companies can restructure their business under insolvency court protection by combining an early filing for insolvency with a motion for the ordering of self-administration. The objective is to give the debtor the chance to develop a so-called insolvency plan (see section 14 below) to be implemented in subsequent insolvency proceedings and to protect it from enforcement measures.

Besides the formal (pre-)insolvency proceedings, there are several out-of-court restructuring workouts available such as moratoriums, voluntary liquidations and business restructurings.

3.1 Who can initiate the proceeding?

An application for protective shield proceedings can only be filed by the debtor.

3.2 What are the criteria used for opening the proceeding?

The application must be based on either an impending inability to pay debts or an over-indebtedness of the debtor (for details regarding the criteria for the opening of insolvency proceedings, see section 4.2) and a reasonable expectation of a successful restructuring, which has to be confirmed by a certificate from an insolvency law expert.

3.3 The main actors in the pre-insolvency proceedings

The Insolvency court appoints a preliminary creditors' trustee (*vorläufiger Sachwalter*), which can be chosen by the company itself, and sets a deadline of at most three months for the debtor to submit a draft insolvency plan. Furthermore, the court is allowed to appoint a preliminary creditors' committee (*vorläufiger Gläubigerausschuss*). In larger proceedings a preliminary creditors' committee is regularly appointed.

3.4 Does the debtor remain "in possession" of the business?

In these proceedings, the management of the company remains in control but needs the consent of the preliminary creditors' trustee for certain extraordinary transactions. The same applies to the preliminary creditors' committee for even more extraordinary and relevant transactions. Upon the debtor's further application, the court must order a stay on individual enforcement measures and grant the debtor the right to incur preferential debt for the period until the deadline expires.

3.5 May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?

In insolvency shield proceedings, similar to regular insolvency plan proceedings (see below, section 14), each creditor has the right to approve or to oppose the adoption of the insolvency plan. However, its opposition can be irrelevant if, for example, the plan is approved by the majority of the creditors, namely, the established creditors' groups. For details see the answer to section 11.

3.6 What is the level of creditor consent that is required to effectuate a restructuring?

Creditors' consent is not needed for the initiation of these preliminary proceedings. The creditors can exercise their rights in the preliminary creditors' committee.

3.7 Is shareholder consent required in order to effectuate a restructuring?

Shareholder consent is not necessary to initiate these proceedings. Shareholders also exercise their rights via the preliminary creditors' committee.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

4.1 Who can initiate the insolvency proceeding

The commencement of insolvency proceedings requires a petition to the competent insolvency court by either the debtor or one of its creditors. If a company is insolvent, the management of the company must apply for the commencement of insolvency proceedings without culpable delay and no later than three weeks after the occurrence of a ground for insolvency. The three-week period may only be used for restructuring or negotiations with an investor if it is reasonable and likely that such measures will be successful. The obligation to file for insolvency arises irrespective of the executives' knowledge of insolvency. As a result, the executives are under an ongoing obligation to monitor the standing of the company to exclude the risk of personal civil and criminal liability.

4.2 Criteria used for opening the proceeding

Under the German Insolvency Act (*Insolvenzordnung* or InsO) insolvency proceedings require a reason for being opened. Such reasons can be:

- the debtor's liabilities are greater than its assets (over-indebtedness or *Überschuldung*), or
- the debtor is unable to meet its debts as they fall due (inability to pay debts or *Zahlungsunfähigkeit*).

An event of "impending inability to pay debts" (*Drohende Zahlungsunfähigkeit*) does not give rise to the obligation to file for insolvency proceedings but entitles the debtor (but not the creditors) to do so.

The insolvency court will refuse a request to open insolvency proceedings if the debtor's assets are insufficient to cover the costs of the proceedings. Otherwise, it will open the insolvency proceedings.

4.3 The main actors in insolvency proceedings

Apart from the debtor, the main parties involved in the insolvency proceedings are the insolvency court (*Insolvenzgericht*), the administrator (*Insolvenzverwalter*) and the creditors' representation, i.e. the creditors' meeting (*Gläubigerversammlung*) and the creditors' committee (*Gläubigerausschuss*).

4.3.1 Insolvency court

The main functions of the insolvency court are to create the procedural framework for the realisation of the debtor's assets and to appoint and supervise the administrator. The realisation of the debtor's assets is part of the administrator's job. The insolvency court has exclusive power to terminate insolvency proceedings. It is also able to order or approve special proceedings, e.g. an insolvency plan, self-administration (debtor-in-possession) and the discharge of residual debt.

4.3.2 Administrator

The administrator is a professional person (i.e. always a natural person), usually a lawyer, who derives his or her powers through the appointment by the court. In legal terms, the administrator is not a representative of the creditors or of the debtor – he or she is independent. Upon the opening of the insolvency proceedings the debtor's right to manage and transfer the assets involved in the insolvency proceedings is transferred to the administrator. The administrator can choose to liquidate the company, continue the business and restructure the debt through an insolvency plan, or sell the business as a going concern. The administrator is personally liable for damages occurring because of a disregard of his or her legal duty of care. The administrator owes a duty of care to the debtor and the creditors, as well as to third parties who claim ownership of goods possessed by the estate due to retention of title.

4.3.3 *Creditors' representation*

The creditors' meeting, in its capacity as a supervisory and controlling body, is an institution peculiar to insolvency proceedings. The creditors' meeting is convened by the insolvency court. All secured and unsecured creditors, the administrator and the members of the creditors' committee are entitled to attend the creditors' meeting. If there is no creditors' committee the creditors' meeting votes upon resolutions concerning particular matters of importance and decides whether to cease or continue the debtor's business.

Unlike the creditors' meeting, the creditors' committee is optional. In larger insolvencies, however, a creditors' committee is regularly appointed. Its function, both in liquidation and administration proceedings, is to assist and supervise the administrator's "management". In liquidation proceedings, the creditors' committee is vested with substantial decision-making powers. The prior approval of the committee is required for particularly important transactions to be undertaken by the administrator.

4.4 Does the debtor remain "in possession" of the business?

The position of the debtor is not as strong as it is under US law. Prior to the court's order for the commencement of insolvency proceedings, there are no automatic restrictions on the debtor's power of disposal. However, after filing for insolvency, the insolvency court has the power to make all provisional arrangements that it considers necessary to protect the estate against changes which would be detrimental to the creditors. In particular, the court may impose restrictions on the debtor's power to manage and administer assets. The court regularly appoints a preliminary insolvency administrator (*vorläufiger Insolvenzverwalter*). With the opening of insolvency proceedings, the assets of the debtor are effectively confiscated. Although the debtor retains title to property, the power to manage and administer the assets of the debtor passes to the administrator.

Only in cases of self-administration (*Eigenverwaltung*) will the debtor continue to run and manage the business. However, this takes place under the supervision of a creditors' trustee (*Sachwalter*). The German Insolvency Act of 1999 introduced self-administration into corporate insolvency. The purpose of self-administration does not deviate substantially from the purpose of regular German insolvency proceedings. The management in self-administration may liquidate the company, turnaround and continue the business, or sell the business as a going concern. The self-administration procedure is a useful option where maintaining the specialist skills of the current or established management is likely to benefit the creditors. Self-administration is also useful in international insolvency proceedings of group companies.

4.5 May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?

In regular insolvency proceedings, the administrator can decide whether to continue or discontinue an ongoing contract, often referred to as executory contract (*Wahlrecht*). For example, the administrator can choose not to fulfil an ongoing supply contract after the commencement of the insolvency proceedings. As a consequence, the respective supplier does not have to fulfil its contract any further. Any damages for non-performance or outstanding payments can only be claimed as an unsecured insolvency creditor.

Other than that, the insolvency dividend is determined without creditor consent. In insolvency plan proceedings, each creditor has the right to approve or to oppose the adoption of the insolvency plan. However, its opposition can be irrelevant if the plan is approved by the majority of the creditors, namely, the established creditors' groups. For details see the section 11.

4.6 What is the level of creditor consent that is required to effectuate a restructuring?

In regular insolvency proceedings, it is generally the administrator who makes the decisions. In insolvency plan proceedings, a majority of creditors in each class, and a majority of the value of the claims in each class, must approve the insolvency plan, which is a requirement for a successful restructuring. Even if the necessary majorities have not been achieved, a voting group shall be deemed to have consented if the requirements of so-called prohibition of obstruction (*Obstruktionsverbot*) are fulfilled. According to the prohibition of obstruction, the rejection of the plan by a voting group is irrelevant if:

- the creditors forming such a group are presumed to suffer no loss under the insolvency plan compared to their situation without such a plan;
- these creditors participate adequately in terms of the economic value the parties will receive under the plan; and
- the majority of the voting groups have given their consent to the plan with the necessary majorities in each of them (in terms of the number of creditors and the amounts of their claims).

4.7 Is shareholder consent required in order to effectuate a restructuring?

In regular insolvency proceedings, the shareholders have a very subordinated role. They have no say in any decision of the administrator unless any shareholder subordinated claims are relevant for a quota. In this case, they are treated as creditors, which is obviously rare as it requires full prior satisfaction of all creditor claims. In insolvency plan proceedings, shareholder consent is required in order to effectuate a restructuring in so far as the insolvency plan has to provide a voting group for them. They take part in the voting and can eventually be overruled like any other creditors' group (see section 11 for details).

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

Certain transactions can be challenged by an administrator during insolvency proceedings in order to increase the assets in the estate. Transactions particularly at risk are gifts and certain transactions undertaken during or shortly before the financial difficulties of the debtor. A basic requirement of all challenges under the German Insolvency Act is that the transaction has a disadvantageous effect on the creditors as a body in that it impairs their chances of recovery. Typically, this is the case where the transaction has diminished the assets or increased the liabilities of the future estate. In detail, however, the particular grounds of challenge are rather subtle and are explained only in general terms here.

In particular, the following transactions may be challenged by the administrator:

- transactions undertaken by the debtor during the previous 10 years prior to filing for insolvency, or after such filing, with the intention of disadvantaging creditors where the other party to the transactions was aware of the debtor's intention at the time of the transaction;
- transactions undertaken by the debtor for no consideration within four years prior to the application for insolvency proceedings;

- transactions that, in consideration of a shareholders' claim for repayment of his loan replacing equity, or in consideration of an equivalent claim granted security or satisfaction, if: such transaction was made during the previous ten years in case of security or during the previous year in case of satisfactions, in each case prior to filing for insolvency proceedings or subsequent to such filing;

- transactions made in the three-month period prior to the filing for insolvency and the period between filing for and opening of insolvency proceedings can be set aside even more easily. The law distinguishes between satisfaction of claims or security which the creditor is entitled to (fair consideration) and satisfaction of claims or security which the creditor is not entitled to (unfair consideration).

However, a transaction in principle cannot be set aside if the debtor receives immediate adequate consideration.

If a creditor receives security, collateral, or payment in breach of these rules, the creditor must waive all rights under a security, repay all monies, or retransfer all assets received if the transaction is challenged by the administrator. If the security includes rights in movable goods or rights, the creditor would also be liable for all further damage to the relevant asset.

6. Is enforcement of security rights treated differently in each type of proceeding?

Generally speaking, the German Insolvency Act imposes an automatic stay on the enforcement of rights as soon as the insolvency proceeding commences but does not place any restrictions on enforcement at the pre-insolvency stage.

However, there are several exceptions to the principle of automatic stay (see section 11 for details).

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

Before the opening of insolvency proceedings there are no priorities in distributions among creditors except for those that have been contractually agreed upon, e.g. in an intercreditor agreement. After the opening of insolvency proceedings there is a strict ranking. The German Insolvency Act recognises four types of creditors:

- secured creditors;

- estate creditors (*Massegläubiger* – the creditors of the estate whose claims arise after the commencement of insolvency proceedings, mainly through dealings with the administrator);

- insolvency creditors (the creditors of the debtor who, at the commencement of the insolvency proceedings, have a claim against the debtor); and

- subordinated creditors.

Thereafter, shareholders receive any residual quota against their share capital.

Secured creditors who have security rights in assets that belong to the bankruptcy estate and that are in the possession of the insolvency administrator are not entitled to realise the assets. Instead, the administrator will realise the collateral and pay the proceeds to the secured creditors after discharge of the administrator’s fees.

The estate creditors’ claims must also be satisfied before the proceeds of the liquidation can be distributed among the insolvency creditors. Claims against the debtor which arise after the commencement of the insolvency proceedings upon agreement with or action by the administrator are not treated as insolvency claims. This would apply to a new loan which is provided to the administrator. The estate creditors play a separate role because they have not extended credit to the debtor voluntarily and, thus, have not assumed the risk of the debtor’s insolvency. Moreover, they have enhanced the estate by delivering goods or rendering services, so it would not be justified to treat them on an equal level with the insolvency creditors.

In principal, all other insolvency creditors are treated equally and their claims rank *pari passu*. This means that all claims listed in the list of creditors’ claims are satisfied proportionally, except claims of subordinated insolvency creditors. The latter rank junior to the other claims of insolvency creditors. Some examples of claims of subordinated creditors include: interest accruing from the claims of insolvency creditors since the opening of the insolvency proceedings, shareholders’ claims for repayment of loans replacing equity etc.

Shareholders are paid only after all creditors have been paid in full.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

Generally, in order for a claim of a creditor to be considered, the creditor has to apply for registration of its claim in a list of creditors’ claims (*Insolvenztabelle*) within a certain time limit. This list is set up by the insolvency administrator. However, in general, creditors do not suffer any severe disadvantages if they register late. In the event the insolvency administrator has sold assets that originally secured the creditor’s rights, for example, the creditor may claim the proceeds out of the sale. Nevertheless, it is strongly advisable to indicate the securities, especially any form of retention of title, at an early stage since it puts the creditor in a position to exert influence on the liquidation of the securing assets. Moreover, secured creditors may improve the chances of securing their claims and collateral by entering into so-called "pool-agreements" with other creditors. The administrator communicates with one of the members of the pool rather than each of them. This can reduce the complexity of the proceedings, facilitate the enforcement of the creditors’ rights, and improve their leverage in negotiations with the administrator.

As outlined above, once proceedings have been commenced, the assets of the debtor are effectively confiscated by the administrator, so the creditor is stayed from taking action against its collateral. Possible enforcement actions of creditors are discussed in more detail in section 11 below.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

First, one has to differentiate between an on-demand guarantee (*Garantie*) and a surety (*Bürgschaft*). An on-demand guarantee under German law is a personal security that is non-accessory. An on-demand guarantee is a contractual relationship which is not explicitly governed by statutory law but is developed and shaped by legal practice, in particular by court judgments. A surety under German law is a personal security which is accessory. A surety is a contractual relationship which is governed by particular rules of the German Civil Code. English terms used to describe these concepts vary.

A German law *Garantie* is often translated as "guarantee" and sometimes as "indemnity", and a German law *Bürgschaft* is sometimes called "surety" and sometimes "guarantee".

The commencement of insolvency proceedings does not result in a stay of either a surety or an on-demand guarantee. Therefore, the creditor could take action against the obligor / guarantor to satisfy his or her claims.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

If the acquisition (including registration where required) of a security right of a creditor has not been completed prior to the opening of the insolvency proceedings, the creditor remains unsecured. It is a general principle of German law that, after the opening of insolvency proceedings, rights in objects – be it a land charge, a pledge or even the title itself – forming part of the estate can usually no longer be acquired with legal effect. In case of security assignments of future claims, for example, claims of the estate generated after the opening of proceedings do not secure the creditor's interest.

With respect to real estate, the Insolvency Act provides for the exception of acquisition in good faith under certain circumstances. However, even after the acquisition in good faith there remains the risk that the acquisition will be challenged by the insolvency administrator.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged? If so, how?

With respect to secured creditors, whether the creditor is entitled to take enforcement actions depends on the type of security. Creditors who are secured by retention of title, for example, are still entitled to enforce their right even if the insolvency administrator has chosen not to continue the underlying purchase agreement. Creditors secured by land charges may also enforce their rights irrespective of the pending insolvency proceeding. However, in practice, these creditors might face resistance in trying to enforce their security since their measures might overlap with enforcement actions of the insolvency administrator. Creditors secured by fiduciary transfer of assets / receivables or pledges are generally not entitled to take enforcement action themselves. Instead, the insolvency administrator enforces their rights on their behalf. Generally, the administrator sells the secured assets – charging a liquidation fee of approximately 9% of the proceeds for that action – and pays out the remaining proceeds to the creditors.

At the pre-insolvency stage, claims may generally still be enforced. However, between the filing for insolvency and the opening of the insolvency proceedings (such period usually lasts up to three months in Germany), the insolvency court (respectively the competent court for enforcements with respect to the estate's real property) is entitled to prohibit or suspend enforcement measures by creditors except with respect to immovable assets. This is also the case in protective shield proceedings (*Schutzschirmverfahren* – for details of which see section 3 above).

In general, creditors cannot challenge a stay of enforcement at the pre-insolvency stage or after the commencement of proceedings.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

After the opening of insolvency proceedings, the right to manage and transfer the debtor's assets passes to the insolvency administrator. Thus, the administrator is generally entitled to use and dispose of the debtor's movable and immovable assets. However, with respect to assets that effectively do not belong to the estate – due to a right of segregation of the creditor holding title in the property – the administrator is obliged to release these assets. Movable assets subject to security rights which are in the possession of the insolvency administrator may be used by the administrator for the period until their realisation. However, the secured creditor is entitled to compensation for the loss in value of the asset in which such a creditor has security rights.

Under German law there is no specific treatment for "cash collateral".

In practice, the continuation of the debtor's business often depends on the willingness of creditors to inject fresh capital. In the event an insolvency administrator incurs such loans, the creditor's claim will be satisfied ahead of other insolvency creditors. Nevertheless, usually creditors insist on security rights for these loans. The administrator may grant such right if there are still sufficient "free" assets in the estate to secure the loans. In any case, the administrator may secure the loans by the goods and receivables generated during the continuation of the business.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

In general, the administrator has to respect the secured creditors' rights in its collateral. Insofar as the secured creditor is or has become over-collateralised (subsequent over-collateralisation – see section 16 for further details), the administrator can ask to release parts of the collateral from the lien and grant additional subordinated liens to a third party. By asking for the release, the administrator would, however, not violate any contractual arrangements with the secured creditor.

If the contractual arrangement regarding a lien also extends to future or further assets or collateral created or acquired after the commencement of insolvency proceedings, the administrator can choose not to perform the future part of the contractual arrangement and grant additional liens to a third party regarding these assets or collateral. The creditor can then claim damages for non-performance only as an insolvency creditor, i.e. the creditor would only receive the insolvency dividend.

14. What distribution will a secured creditor receive if a company is reorganised?

Part of the insolvency reforms in Germany included the introduction of a procedure that bears a strong resemblance to the reorganisation procedure of the Chapter 11 US Bankruptcy Code.

The core element of this procedure is the insolvency plan, which is part of the German Insolvency Act and which provides for reorganisation.

If a company is reorganised by an insolvency plan, a secured creditor will generally receive a distribution according to the provisions of the insolvency plan. If the insolvency plan does not contain any provisions regarding the secured creditors, the plan does not affect their rights.

The plan may be proposed by the debtor or by the administrator. In addition, the creditors' meeting is entitled to request that the administrator propose such a plan. The insolvency plan may provide for changes in the legal relationships of the debtor and creditors. There are three types of creditor to be dealt with in this situation: secured creditors, unsecured creditors and subordinated creditors. A group of creditors must be formed for each of these categories of creditors. Subgroups may be formed where certain creditors have homogeneous economic interests. Employees should, and creditors with small claims may, form separate groups. To conclude the plan, the insolvency court determines a date for discussion of and a decision about the plan. A majority of creditors in each class and a majority of the value of the claims in each class must approve the insolvency plan. Even if the necessary majorities have not been achieved, a voting group shall be deemed to have consented if the requirements of so-called prohibition of obstruction (*Obstruktionsverbot*) are fulfilled. According to the prohibition of obstruction, the rejection of the plan by a voting group is irrelevant if:

- the creditors forming such a group are presumed to suffer no loss under the insolvency plan compared to their situation without such a plan;
- these creditors participate adequately in terms of the economic value the parties will receive under the plan; and
- the majority of the voting groups have given their consent to the plan with the necessary majorities in each of them (in terms of the number of creditors and the amounts of their claims).

The prohibition of obstruction resembles the "cram-down rule" in Chapter 11 of the US Bankruptcy Code.

Finally, the plan has to be approved by the insolvency court.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

The confirmation of the plan by the competent court will effect the arrangements provided for in the plan. The general legal concept with respect to insolvency plans provides for discharge of the claims of unsecured creditors to the extent that they do not receive the quota according to the plan. In contrast, the rights of secured creditors remain unaffected if not provided for otherwise in the insolvency plan.

However, as the parties are free to arrange the plan according to their own interest, the plan may deviate from this general rule. The plan may make determinations with respect to the distribution of the debtor's assets between the secured and unsecured creditors. It may also provide for a waiving of the secured rights. As soon as the order confirming the insolvency plan becomes legally binding, it becomes binding upon all the parties involved. If the plan is to create, modify, transfer or waive rights in objects or if shares in a company with limited liability are to be transferred, the declarations of intent on the part of the parties involved which are included in the plan are at the same time deemed to have been given in the form required by law. The same applies to the undertakings included in the plan on which the creation, modification, transfer or waiving of rights in objects or transfer of shares are based. In contrast, the plan does not affect the rights of the creditors of the insolvency proceedings against the debtor's co-obligors and guarantors. Moreover, the rights of such creditors to objects not forming part of the assets involved in the insolvency proceedings or deriving from a priority notice covering such objects remain unaffected by the plan.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

There are two types of over-collateralisation, the initially over-secured (*anfänglich übersichert*) and the subsequently over-secured creditor (*nachträglich übersichert*).

According to the case law of the German Federal Supreme Court (the BGH), a security interest, and the agreements granting such interest, can be void if an initial over-collateralisation is so excessive that it must be considered as being against *bonos mores* (*gegen die guten Sitten*). Although no specific case law exists, a decision by the BGH indicates that the loan-to-security ratio would be well beyond the threshold applied to subsequently excessive collateralisation if the realisable value of the security is more than 150% of the amount of the secured obligations. In addition, in order for the over-collateralisation to be regarded as initially excessive, it must be based on a creditor's reprobate attitude (*verwerfliche Gesinnung*), which is assumed if a creditor, out of self-interest, displays an ethically unbearable recklessness against a borrower.

If the realisable value of the security at any date after being granted permanently exceeds the amount of the secured obligations by more than 10%, the subsequently excessively secured creditor is, according to the case law of the BGH, regularly obliged to release security back to the debtor insofar as the estimated market value of security, which depends on the risks of realisation of the security and on the market situation, exceeds the secured amount by more than such 10%.

A fully secured creditor is entitled to receive payment of the full principal, including pre- and post-interest and expenses in the event the security purpose agreement includes such costs. If this is not the case, claims regarding post-interest and expenses are subordinated.

If secured claims are under-secured, the creditor bears the risk of not recovering all of his or her claims in the event of enforcement. In any case, the secured creditors retain an unsecured claim as an insolvency creditor for the shortfall.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

As a general rule, a distinction must be made between whether or not insolvency proceedings have been opened in a member state of the European Union.

If insolvency proceedings are opened in a member state of the European Union, the European Insolvency Law Regulation takes precedence. The opening of insolvency proceedings by a court of a member state that has jurisdiction under the European Insolvency Law Regulation is recognised in all other member states as soon as the decision is effective in the state in which the proceedings are opened, cf. Article 19(1) of the European Insolvency Law Regulation. Besides this rule, the European Insolvency Law Regulation (Article 34ff) provides for the possibility of opening secondary proceedings in a member state with (significant) assets of the debtor. The European regulator has, however, tried to limit the amount of so-called "synthetic" secondary proceedings. The administrator can now give confirmation to creditors in a different member state that they will be treated according to their local law in secondary proceedings.

The autonomous law of sections 343ff of the German Insolvency Code comes into effect if the insolvency proceedings are opened in a third state or if the decision to open insolvency proceedings concerns an insolvent person who is not covered by the personal scope of the European Insolvency Law Regulation.

The opening of foreign insolvency proceedings is generally recognised pursuant to section 343(1) of the German Insolvency Code. This does not apply if the courts of the state do not have jurisdiction under German law or if recognition leads to a result that is obviously incompatible with the fundamental principles of German law, in particular if it is incompatible with fundamental rights (*ordre public*). Security interests taken after the request to open insolvency proceedings, as well as decisions taken to implement or terminate the recognised insolvency proceedings, are also accepted.

* The temporary adjustments to German insolvency law due to the Covid-19 crisis are not covered in these answers as they are only of a temporary nature.

HONG KONG

1. Briefly summarise the types of security rights available and indicate, in each case:

- *What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?*
- *What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?*
- *Is the security interest granted by law, contract or both?*

Security interests over movable and immovable property in Hong Kong are typically granted by contract, including by way of deed, debenture or another form of security document. There are also certain types of security interests that arise by operation of common law or statute.

1.1 Common forms of security – movable property

The most common forms of security over movable or personal property are mortgages and charges:

1.1.1 Mortgage

For legal or equitable mortgages see sections 1.3.1 and 1.3.2 below respectively.

1.1.2 Fixed charge

A fixed charge is a security interest created over a particular asset where legal title to that asset remains with the chargor but the chargee has the right to enforce the charge following an event of default and satisfy the secured debt with the proceeds of the charged asset. The chargor may only deal with and dispose of the charged asset with the chargee's consent. If the chargee allows the chargor to deal with the asset in the ordinary course of business, the court may treat the charge as floating rather than fixed (see section 1.1.3 below).

1.1.3 Floating charge

Floating charges are created over a class of assets (present and future) and, unlike under a fixed charge, the chargor is permitted to continue to deal with the assets in the ordinary course of business until the charge crystallises upon the occurrence of an event of default or other crystallisation event. On crystallisation, a floating charge is converted into a fixed charge that attaches to the charged assets.

1.2 Other forms of security

Other available forms of security over movable property in Hong Kong include pledges and liens.

1.2.1 Pledges

Although less common than charges and mortgages, it is possible to take security over certain types of movable property by way of a pledge where possession of the asset is transferred to the pledgee who holds the asset until the secured debt is discharged, although legal title to the asset remains with the pledgor. The pledgor has the right to sell the asset upon default.

1.2.2 *Liens*

Common law liens are another form of possessory security interest where the lien holder has the right to retain possession of the property until the relevant obligations are discharged. Liens can also arise under contract or statute.

1.2.3 *Retention of title*

Although they are not necessarily security interests, retention of title arrangements can also be used in commercial transactions to give a seller of goods protection in respect of the purchase price for goods sold on credit.

While possession of the goods is transferred to the buyer, a condition of the sale is that the buyer will not acquire title to the goods until the purchase price has been paid in full. If title has not transferred to the buyer, then those assets should not fall within the buyer's estate upon its insolvency. Retention of title is typically expressed to terminate once the relevant goods have been paid for in full or when the goods have lost their identity (i.e. if they are co-mingled with other goods). A simple retention of title arrangement would not generally require registration as a security interest, provided that it is clear that title to the goods that are subject to the retention of title arrangements has not passed to the purchaser.

However, depending upon the contractual terms, retention of title arrangements can, in certain circumstances, give rise to a charge over the goods which would require registration in accordance with the Companies Ordinance (Cap 622) (CO) (see section 10 below). Examples of such circumstances include where the retention of title arrangement purports to extend to property already owned by the purchaser or to the proceeds of re-sale of the goods to a third party.

1.3 Common forms of security – immovable property

Common forms of security interests over immovable or real property include legal and equitable mortgages, although such security interests can also be taken by way of fixed charge:

1.3.1 *Legal mortgage / legal charge*

A legal mortgage transfers title in the asset to the mortgagee, subject to the mortgagor's equity of redemption, being the right to redeem the mortgaged property upon repayment of the secured debt obligation. The mortgagee has a right of foreclosure (i.e. to take ownership of the mortgaged assets free of the mortgagor's equity of redemption) on default. A legal mortgage over land must be created by way of a deed expressed to be a legal charge.

1.3.2 *Equitable mortgage*

An equitable mortgage can be created by deed, or simply by depositing title deeds or other similar documents with the mortgagee. Unlike a legal mortgage, an equitable mortgage does not transfer legal title to the mortgagee and the mortgagee has no power to sell the land on the mortgagor's default. An equitable mortgage could arise if the parties intended to execute a legal mortgage but failed to comply with the requisite formalities.

1.3.3 *Fixed charge*

See section 1.1.2 above.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

Hong Kong security documents will ordinarily include a contractual right to appoint a receiver without the need for court involvement and will set out the powers of the chargee and / or the appointed receiver in respect of the charged assets. The holder of a legal mortgage or a legal charge or equitable mortgage executed as a deed will, unless contractually varied, have a statutory power of sale under the Conveyancing and Property Ordinance (Cap 219), which can be exercised without an order of the court. A court order is required for a mortgagee to exercise its right of foreclosure.

Practical difficulties can arise in the enforcement of security interests where the co-operation of the chargor is required for the chargee or the receiver to take possession and control of the secured assets. In such circumstances, assistance from the court may be required. Where practical, it is common for measures to be taken at the time the security interest is created to minimise the need for co-operation from the chargor in an enforcement scenario. For example, when taking security over certificated shares in Hong Kong it is customary for security documents to provide that the chargor must, at the time of creation of the charge, deliver to the chargee the original share certificates and, among other things, pre-executed instruments of transfer in respect of the shares and amend the company's articles of association to remove any powers of the directors to refuse to register a transfer of the shares upon enforcement. Without such documentation, co-operation of the chargor or its board of directors would likely be required to effect a transfer of ownership of the shares.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including?

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

3.1 Common pre-insolvency proceedings

As Hong Kong does not have a statutory corporate rescue regime, the most common pre-insolvency proceedings for the purpose of restructuring the debts of a company in Hong Kong are:

- informal workouts; and
- schemes of arrangement.

It is also possible to wind a company up pre-insolvency through a members' voluntary liquidation.

3.1.1 Workout

A workout is an informal out-of-court contractual arrangement between the company and its creditors for the purposes of rescheduling the company's debts. It can be initiated at any time by either the company or its creditors. The debtor's management typically remains in control during and after the workout process subject to any oversight or controls required by the creditor group, such as board observers or nominees, or cash management arrangements to which the company agrees.

Contractual and security rights may only be varied with the consent of the relevant threshold of creditors or secured creditors under the company's existing contractual documentation. Depending upon the terms of the proposed restructuring, shareholder consent may also be required to implement the workout.

3.1.2 Scheme of arrangement

A scheme of arrangement is a court-supervised statutory procedure available under the CO to enable a company and its creditors or any class of creditors to effect a compromise or arrangement in respect of the creditors' claims against the company. The scheme process is typically initiated by the company itself (or its provisional liquidators or liquidators if appointed). The scheme of arrangement procedure can be utilised by a Hong Kong incorporated company and, subject to certain criteria being met, a foreign company. The company does not need to be insolvent to be eligible to propose a scheme.

Unless a liquidator or provisional liquidator has been appointed, the debtor's existing management remains in control of the business of the company during the scheme process. The company will ordinarily appoint legal and financial advisors to formulate and negotiate the terms of the scheme, prepare the scheme documentation and make the relevant applications to the court.

To be binding on scheme creditors (or any class of scheme creditor), a majority of scheme creditors in the relevant class whose claims in aggregate represent at least 75% by value of all scheme creditors in that class who are present and voting at the scheme meeting must vote in favour of the scheme, and it must be subsequently sanctioned by the court. A copy of the court order must be registered with the Companies Registry. The scheme of arrangement can be used to compromise the claims of both secured and unsecured creditors provided the requisite majority in each class have voted in favour of the scheme. Secured and unsecured creditors would ordinarily form separate classes for the purposes of a scheme. Depending upon the terms of the scheme, shareholder consent may also be required to implement the scheme.

The initiation of a scheme of arrangement does not trigger a moratorium on creditor actions and so, in the absence of the appointment of a provisional liquidator or liquidator which would trigger a stay, co-operation from creditors will usually be required in order to avoid enforcement action during the period before the scheme becomes effective.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including?

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***

- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

As noted above, Hong Kong does not currently have a formal rescue regime. Formal insolvency proceedings in Hong Kong are limited to voluntary or compulsory liquidation and provisional liquidation. Should a liquidator or provisional liquidator wish to propose a restructuring to the company's creditors, he or she would have power to propose a scheme of arrangement (see section 3.1.2 above).

4.1 Creditors' voluntary liquidation

A creditors' voluntary liquidation can be initiated by shareholders by way of a special resolution (i.e., at least 75%) to wind up the company. A meeting of creditors must be held not later than 14 days after the date of such resolution. Notice of the creditors' meeting must be sent by post to the creditors and advertised at least seven days before the day of the meeting. A statement of affairs of the company must be tabled at the meeting of creditors, and any nomination of a liquidator by the meeting of creditors will prevail over any contrary nomination of a liquidator by the shareholders.

Alternatively, in limited circumstances, the directors (or the majority of the directors, if there are more than two) can initiate a creditors' voluntary liquidation if they have formed the opinion that the company cannot continue its business due to its liabilities and that it is not reasonably practicable to commence it in any other way. To initiate the procedure the directors must take the following key steps:

- pass a resolution which (among other things) confirms that the directors consider it necessary that the company be wound up and that the winding-up should be commenced under such procedure because it is not reasonably practicable to commence it in any other way;
- call a meeting between the company and its creditors;
- appoint a provisional liquidator with effect from the commencement of the winding-up; and
- deliver a winding-up statement to the Registrar of Companies.

Upon the appointment of the liquidator in a creditors' voluntary liquidation, the directors' powers cease, except to the extent that the creditors' committee (the committee of inspection), if any, or otherwise the creditors, agree that they can continue. There is no moratorium on proceedings against the company. However, the court has discretion to stay legal proceedings on the application of a creditor, contributory or the liquidator.

4.2 Compulsory liquidation

A compulsory liquidation is commenced by the presentation of a winding-up petition to the court. The petition can be presented by various parties, including creditors and the company itself. The party presenting the petition must satisfy certain notice, filing and advertising requirements. In the case of a petition presented by a creditor, a statutory demand is often served first, providing a 21-day window for the company to pay the debt owed to the creditor.

There are a number of grounds upon which the court can wind up a company. The most common grounds are that:

- the company has by special resolution (i.e. at least 75%) resolved that it must be wound up;
- the company is unable to pay its debts – failure to pay a statutory demand within 21 days is an act of presumed insolvency, as is failure to satisfy a judgment debt in whole or in part; and
- the court considers that it is just and equitable that the company be wound up.

The court will not make a winding-up order if the company establishes that there is a genuine dispute on substantial grounds regarding the debt that is the subject of the petition.

The company's existing board and management will remain in control until a winding-up order is made, upon which the powers of the existing directors will cease and the liquidator will take control of the company's affairs under the supervision of the court. During the liquidation, a creditors' committee (the committee of inspection) may be appointed to supervise the liquidator in relation to certain matters. In particular, the court or the committee of inspection must approve compromises with creditors and the commencement of litigation.

At any time after the presentation of the winding-up petition and before the winding-up order is made, the company or any creditor or contributory may apply to the court for a stay of proceedings. The granting of a winding-up order will trigger an automatic stay on all actions and proceedings against the company without leave of the court.

4.3 Provisional liquidation

During the period between the filing of the winding-up petition and the making of the winding-up order, a provisional liquidator can be appointed in appropriate circumstances in order to maintain the *status quo* and preserve the assets of the company pending the making of the winding-up order. The company, a creditor or contributory can apply to the court for the appointment of a provisional liquidator if:

- there is a good *prima facie* case that a winding-up order would be made; and
- it is appropriate in all the circumstances for a provisional liquidator to be appointed, such as in the case of risk of jeopardy to or dissipation of the company's assets.

When a provisional liquidator is appointed, no actions or proceedings can be commenced or continued against the company without leave of the court, and the provisional liquidator will assume control of the company's affairs from the company's directors. The court order appointing the provisional liquidator will determine his or her powers.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

If a company enters into insolvent liquidation, a liquidator has power to examine transactions entered into prior to the liquidation, including the grant of security interests, and may seek to have certain transactions set aside should the requisite criteria be met (see sections 5.1 to 5.4 below for further details). Similarly, a person prejudiced by a transaction entered into with intent to defraud creditors may seek to attack that transaction, although it is unlikely to be set aside if the grantee entered into the transaction in good faith without notice of the intent to defraud. Security interests can also be attacked on the grounds of a failure to register the security interest, where applicable, with the Companies Registry or other relevant asset class register (see section 10 below).

5.1 Unfair preference

A grant of security, and other transactions, made during the six months prior to the commencement of the winding-up (or two years prior if the secured creditor is connected to the company) may be set aside if it is an unfair preference. An unfair preference is any action taken by the company, influenced by a desire to prefer, that puts one creditor in a better position in the event of insolvency than it would otherwise have been in had the action not occurred. Transactions involving persons connected with the company are presumed to be an unfair preference unless proven otherwise.

5.2 Transaction at an undervalue

A security interest granted by the company within the five-year period before the company's winding-up is commenced may be set aside if it was entered into at an undervalue at a time when the company was unable to pay its debts or if the company became unable to pay its debts as a result of entering into the transaction. The company enters into a transaction with a person at an undervalue if (for that transaction) the company receives no consideration or consideration which is significantly less than the consideration provided by the company. The transaction will not be set aside if the court is satisfied that the company entered into the transaction in good faith and for the purpose of carrying on its business, and there were reasonable grounds for believing that the transaction would benefit the company. The courts in Hong Kong have not yet determined whether the grant of a security interest could constitute a transaction at an undervalue.

5.3 Floating charges

Floating charges created by a company may be set aside (save to the extent of any new money provided to the company in return for the charge) if granted by the company within:

- two years before the company's winding-up commenced (if granted in favour of a person who is connected with the company); and
- within 12 months before the company's winding-up commenced (if granted in favour of a non-connected person), and the company is unable to pay its debts at the time it is entered into or becomes unable to pay its debts as a result.

5.4 Extortionate credit transactions

An extortionate extension of credit to the company within three years before the commencement of the winding-up may be set aside upon the application of a liquidator. A credit transaction is extortionate if, having regard to the risk accepted by the person providing the credit, the terms of it are such as to require grossly exorbitant payments to be made (whether unconditionally or in certain contingencies) in respect of the provision of credit, or if it otherwise grossly contravenes ordinary principles of fair dealing.

6. Is enforcement of security rights treated differently in each type of proceeding?

There is no automatic stay in a creditors' voluntary liquidation, although as noted in section 4.1 above, relevant parties can seek a stay from the court. The automatic stay on actions and proceedings against the company which is triggered upon the appointment of a provisional liquidator or the granting of a winding-up order does not prevent secured creditors from enforcing their security interests out of court, such as appointing a receiver. Should secured creditors need to commence court proceedings, such as to enforce their security interest (e.g. foreclosure over mortgaged property), they may apply to court for leave to do so and, ordinarily, the court would be expected to grant such leave to a secured creditor.

A scheme of arrangement that binds secured creditors can provide for a stay on secured creditor action, but such stay will only apply once the scheme becomes effective. As noted at section 3.1.2 above, the scheme will only become effective once it is approved by the requisite thresholds of scheme creditors and sanctioned by the court, and a copy of the court order is registered with the Companies Registry. A company may seek to enter into a contractual standstill arrangement with its creditors to prevent an enforcement prior to the scheme being launched by the company.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

Upon liquidation, creditors usually rank as follows:

- *Secured creditors:* secured creditors are generally entitled to pay themselves from realisation of their secured assets, although they are then entitled to claim as an unsecured creditor for any balance that remains unpaid after realisation of the security. Expenses of a receiver incurred in realising the secured assets can be deducted from the proceeds of the assets. Where there is more than one security interest over the same asset, generally a legal mortgage will rank ahead of an equitable mortgage, and fixed charges will rank in order of date of creation.

- *Liquidators' remuneration and costs and expenses:* these are the costs, charges and expenses properly incurred in the liquidation. The liquidators are entitled to their remuneration first, followed by the costs and expenses of the winding-up.

- *Preferential creditors:* employee claims rank first in this category and can include claims for wages and salaries, severance payments, long-service payments, amounts due in respect of employee compensation and claims for holiday pay, subject to any applicable statutory caps. Government and statutory debts (such as rates and taxes) and, where applicable, claims by bank deposit holders or claims under contracts of insurance can also be included as preferential creditors' claims.

- *Floating charge holders:* where a floating charge has crystallised or a receiver is appointed under the instrument by which the charge was created, floating charge holders can be paid from the proceeds of sale of the assets, but only if the claims of all preferential creditors have been satisfied. A charge holder will be entitled to claim as an unsecured creditor for any balance that remains unpaid after realisation of the security. Any floating charges created over the same assets will rank in order of date of creation.

- *Ordinary unsecured creditors:* all remaining unsecured creditors will share the remaining surplus. If there are insufficient assets to meet the claims of ordinary unsecured creditors, they will receive a share *pro rata* to their respective claims.

- *Shareholders:* any remaining balance is distributed to shareholders in accordance with the articles of association of the company.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

As noted above, there is no automatic stay of proceedings until a winding-up order or provisional liquidation order has been made in respect of the company. The automatic stay generally does not prevent secured creditors from taking steps to enforce their security, by appointing a receiver or taking any other out-of-court action. Therefore, to the extent appropriate, these steps can be taken by the secured creditors to protect their interests in collateral during a pre-insolvency or insolvency proceeding.

Secured creditors that choose to agree to a contractual standstill or forbearance to facilitate discussions in respect of a workout or scheme of arrangement may seek to negotiate termination rights or carve-outs that would enable them to take steps to enforce their security interests and / or preserve the secured assets where necessary or appropriate.

Floating charges will typically include a crystallisation clause which will provide that, upon the occurrence of certain events such as the occurrence of a default or the presentation of a winding-up petition, the charge will automatically crystallise and be converted into a fixed charge. When the charge crystallises, it attaches to those charged assets that are at the time owned by the company which will restrict the ability of the company to deal with those assets without the secured creditor's consent.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

A scheme of arrangement between the company and its creditors can include a release of creditor claims against third-party guarantors, provided that such a release is necessary to give commercial effect to the arrangement between the company and the scheme creditors and can fairly be described as ancillary to the arrangement between the company and the scheme creditors. Generally speaking, the liquidation of a company would not prevent a creditor pursuing claims against a third-party guarantor that is not in liquidation.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

10.1 Immovable property

Registerable security interests over land and buildings must be registered with the Land Registry. Priority will be given effect from the date of: (1) execution of the security document if registered within one month of the date of execution; or (2) registration of the security document if registered more than one month after the date of execution. If a registerable security interest is not registered, it will be ineffective against a *bona fide* purchaser or mortgagee for valuable consideration. Failure to register the security interest will not affect the validity of the charge itself as between the parties to the security.

In general, a company incorporated in Hong Kong or registered in Hong Kong as a non-Hong Kong company must register mortgages over any land it owns or other registerable charges with the Companies Registry within one month after the date of creation of the mortgage or charge. A longer period applies if the document was executed overseas and secures assets which are located overseas.

The registration requirements do not apply to foreign companies that are not registered in Hong Kong as a non-Hong Kong company. If a registrable mortgage or charge is not registered by the requisite deadline, it will be void against any liquidator and creditors of the company. Failure to register the registerable charge or mortgage will not affect the obligation to repay the money secured by the charge.

10.2 Movable property

The required formalities to create and perfect a security interest over movable or personal property and the consequences of failing to take such steps will depend upon, *inter alia*, the form of security interest and the nature of the secured asset. In general, the CO requires that registerable mortgages and charges must be registered with the Companies Registry within one month of creation if the chargor is a Hong Kong incorporated company or a company registered in Hong Kong as a non-Hong Kong company. As noted above, a longer period applies if the document was executed overseas and secures assets that are located overseas. Failure to register a registerable mortgage or charge by the requisite deadline will result in the charge being void against a liquidator and other creditors of the chargor.

Certain classes of assets have separate registries and registration with the relevant registry of security interests over those assets will be required or desirable. For example, mortgages over ships must be in the prescribed form and registered with the Hong Kong Shipping Registry. Notice of security interests in aircrafts is ordinarily provided to the Civil Aviation Department in Hong Kong, although it is not strictly required to perfect the security interest. Public registers also exist in respect of certain types of intellectual property, and security interests over such assets should be registered on those registers by the requisite deadline or priority of the security interest may be impacted.

If the chargor is an individual and the security interest is over personal chattels, the security interest may amount to a bill of sale which needs to be in a prescribed form and attested and registered in the High Court Registry in accordance with the Bills of Sale Ordinance (Cap 20), or the security interest will be void to the extent of those personal chattels.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor?

As mentioned above at section 4.2, the making of a winding-up or provisional liquidation order triggers a stay of actions and proceedings against the company without the leave of the court. The automatic stay does not prevent secured creditors from taking any action to enforce their security out of court, such as appointing a receiver. To the extent the secured creditor needs to take enforcement steps that require an order of the court (e.g. foreclosure by a mortgagee), they may seek leave of the court to pursue such proceedings and the courts will generally grant such leave to a secured creditor.

A scheme of arrangement will ordinarily include a release of claims and / or stay on enforcement action which would bind secured creditors if they are scheme creditors and the scheme becomes effective. There is no stay in place prior to the scheme becoming effective. The extent to which secured creditors can take action prior to the scheme becoming effective will depend upon the terms of the security documentation and the terms of any standstill arrangements they may have entered into.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

"Free and clear" disposal of collateral by the debtor without the consent of the secured party is only possible in the case of floating charges since they do not attach to one particular asset but are created over a class of assets (present and future). In that case, the chargor can continue to deal with the assets in the ordinary course of business, including using and selling such assets, until the charge crystallises into a fixed charge. The extent to which a debtor can use "cash collateral" will depend upon whether the security interest over that cash collateral is classified as a fixed or floating charge and whether the charge has crystallised.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

The Hong Kong insolvency regime does not provide for the creation of super-priority security interests without secured creditor consent. As noted above, a scheme of arrangement could be used to alter the contractual rights of secured creditors, provided the requisite scheme creditor approval is obtained and the scheme is sanctioned by the court (see section 3.1.2 above).

14. What distribution will a secured creditor receive if a company is reorganised?

This will be determined by the terms of the informal workout that is agreed by the secured creditors or the scheme of arrangement which has become binding on secured creditors (as applicable).

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

The rights of a secured creditor over the assets of a debtor will remain intact following any reorganisation of the company unless the terms of the reorganisation provided for the release of that security or alteration of the secured creditor's rights. This can only be achieved with the requisite secured creditor consent in an informal workout or scheme of arrangement.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

If the creditor is over-secured, they are obliged to return to the debtor any surplus proceeds following the realisation of the secured property (see section 7 above). In a compulsory liquidation, if a secured creditor files a proof of debt which does not state that it is a secured creditor, the secured creditor shall surrender its security to the Official Receiver or, where a liquidator has been appointed, to the liquidator, for the general benefit of the creditors (unless the court is satisfied that the omission has arisen from inadvertence).

If the creditor is under-secured, it is entitled to claim as an unsecured creditor for any balance that remains unpaid after realisation of the security.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

Hong Kong does not currently have a statutory regime by which foreign restructurings can be recognised and given effect to nor has it adopted the United Nations Commission on International

Trade Law Model Law on Cross-Border Insolvency (Model Law). The rule in *Antony Gibbs and Sons v La Société Industrielle et Commerciale des Métaux*, (25 Q.B.D. 399) which provides that debt obligations governed by English law cannot be discharged otherwise than under English law (save where the relevant creditor submits to the foreign jurisdiction, typically by participating in the foreign restructuring process) is good law in Hong Kong. As a result of these factors, depending upon the factual circumstances, a foreign restructuring which purports to vary a creditor's contractual rights which are governed by Hong Kong law may not be given effect to in Hong Kong. Where Hong Kong law-governed debt needs to be restructured, it is therefore common to do so by way of a Hong Kong scheme of arrangement in parallel with the relevant foreign proceeding.

The Hong Kong government is currently considering proposals to adopt the Model Law and is exploring the possibility of establishing a bilateral arrangement with Mainland China to provide for reciprocal legal assistance in respect of cross-border insolvency and debt-restructuring matters, but there are no definitive plans to enact such legislation and arrangements at this time.

INDIA

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

In India, lending is generally secured by obtaining one or more of the following forms of security.

1.1 Mortgage

The most common type of security in commercial financing is "mortgage by deposit of title-deeds", commonly known as an "equitable mortgage",[1] where the borrower creates a charge over its immovable property by deposit of title deeds with the lender with intent to create a security interest thereon. In some cases, an "English mortgage"[2] (i.e. a mortgage by way of transfer of immovable property with right of retransfer on repayment) and a "simple mortgage"[3] (i.e. a mortgage without delivery of possession by executing a deed and registration thereof) are also possible. Mortgages other than equitable mortgages are not very prevalent as the stamp duty payable thereon is significant. At times, the immovable property of a guarantor, group company, or a third party is also accepted as collateral security. The mortgage of immovable property and charges are governed by sections 58 to 104 of the Transfer of Property Act 1882 (TPA). Creation of a "negative lien" over property is also used; however, this is not very popular due to the difficulty of enforcement.

1.2 Hypothecation

A hypothecation over movable assets including accounts receivable or book debts is another common form of security taken by lenders.[4] This creates a floating charge on the movable assets while the assets remain in the possession of the borrower. Upon default, the charge gets crystallised. The hypothecation of movable assets is governed by the provisions of the Indian Contract Act 1872 (ICA) and the TPA.

1.3 Personal guarantee

In addition to the mortgage and hypothecation, personal guarantee of the promoters and / or directors or corporate guarantee of holding or group companies is the most prevalent form of security

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1 Section 58(f) TPA: "Mortgage by deposit of title-deeds.–Where a person in any of the following towns, namely, the towns of Calcutta, Madras [and Bombay], and in any other town which the [State Government concerned] may, by notification in the Official Gazette, specify in this behalf, delivers to a creditor or his agent documents of title to immoveable property, with intent to create a security thereon, the transaction is called a mortgage by deposit of title-deeds."

2 Section 58(e) TPA: "English mortgage.–Where the mortgagor binds himself to repay the mortgage-money on a certain date, and transfers the mortgaged property absolutely to the mortgagee, but subject to a proviso that he will re-transfer it to the mortgagor upon payment of the mortgage-money as agreed, the transaction is called an English mortgage."

3 Section 58(b) TPA: "Simple mortgage.–Where, without delivering possession of the mortgaged property, the mortgagor binds himself personally to pay the mortgage-money, and agrees, expressly or impliedly, that, in the event of his failing to pay according to his contract, the mortgagee shall have a right to cause the mortgaged property to be sold and the proceeds of sale to be applied, so far as may be necessary, in payment of the mortgage-money, the transaction is called a simple mortgage and the mortgagee a simple mortgagee."

4 Section 2(n) SARFAESI Act: "'Hypothecation' means a charge in or upon any movable property, existing or future, created by a borrower in favour of a secured creditor without delivery of possession of the movable property to such creditor, as a security for financial assistance and includes floating charge and crystallisation of such charge into fixed charge on movable property."

in commercial financing chapter VIII (sections 124 to 147) of the ICA governs contracts of guarantee.

1.4 Other securities

A pledge of movable assets, specific machinery, shares owned by promoters or holding company, whether listed on stock exchange or not, is another common form of security.[5] Chapter IX (sections 172 to 181) of the ICA governs the contract of pledges. Another prevalent form of security is the creation of an escrow account for routing business proceeds by providing unconditional instructions to the bank to pay the amount demanded by the creditor.

The rights created by a debtor by way of mortgage / hypothecation / pledge are perfected by way of registration. The document evidencing creation of mortgage over immovable property or hypothecation / pledge over movable property must be registered under the Indian Registration Act, 1908 with the office of the concerned Registrar of Assurances situated in every district of India within four months of its execution. However in case of delay in presentation for reasons unavoidable such as execution thereof outside India, the Registrar may accept the same within four months from the date of arrival in India.

Further, in the case of a corporate entity, the particulars of the charge together with the document evidencing creation of the charge must be recorded with the respective Registrar of Companies of the State under section 77 of the Companies Act 2013 within 30 days from the date of its execution. Under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI Act), a Central Registry of Securitisation Asset Reconstruction and Security Interest has also been set up for registration of security interests in India.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

In India, enforcement of security rights can take place through a court process as well as without court involvement. In so far as enforcement through the court process is concerned, the security right by way of mortgage over immovable property can be enforced by a lender by filing a mortgage suit under section 67 of the TPA before the Civil Court, viz. either the District Court or the High Court depending upon the pecuniary and territorial jurisdiction. The functioning of the Civil Courts is guided by the provisions of the Code of Civil Procedure 1908 (CPC). In the case of other security rights such as hypothecation, pledge, guarantee etc., enforcement can be accomplished by filing suit for declaration and recovery. However, if the lender is a bank or financial institution functioning in India, and if the debt due to it is more than INR 20 lakhs (INR2 million), then it is prohibited from approaching the Civil Court and has to necessarily resort to the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act 1993 (DRT Act). The DRT Act was enacted to provide for the establishment of at least one Debts Recovery Tribunal (hereinafter, DRT) in each state in India for expeditious adjudication and recovery of debts due to banks and financial institutions. There is also at least one appellate tribunal, called a Debt Recovery Appellate Tribunal (DRAT) in each state in India. In terms of the DRT Act, banks and financial institutions initiate proceedings by filing an application for recovery against the borrower, guarantor, mortgagor or third-party security provider before the DRT. Strictly speaking, the proceedings before DRTs are in the nature of recovery of debt rather than enforcement of security rights. But, in the event of non-payment of debt, as determined by issuance of a recovery certificate[6] by the DRT post-adjudication, the Recovery Officer, appointed under the DRT Act for execution of the recovery certificate, amongst others, will take measures

[5] Section 172 Indian Contract Act 1872 – "'Pledge', 'pawnor' and 'pawnee' defined.–The bailment of goods as security for payment of a debt or performance of a promise is called 'pledge'. The bailor is in this case called the 'pawnor'. The bailee is called the 'pawnee'."

[6] Section 19(22) DRT Act: "The Presiding Officer shall issue a certificate of recovery along with the final order, under sub-section (20), for payment of debt with interest under his signature to the Recovery Officer for recovery of the amount of debt specified in the certificate."

for enforcement of security rights by way of sale of the secured assets through public auction or private treaty.

A lender can enforce its security interest outside of a court process by resorting to the provisions of the SARFAESI Act. The pre-conditions for invoking the SARFAESI Act are that the lender has to be a bank, financial institution, or an asset reconstruction company, and the account for which it is being invoked should be classified as a non-performing asset in the books of the lender as per the guidelines issued by the Reserve Bank of India (RBI), the banking regulator in India. However, there are some security rights which cannot be enforced under the SARFAESI Act such as a lien on goods, a pledge of movable property, or a guarantee. The DRTs constituted under the DRT Act have also been given the jurisdiction to decide on any challenge made to any action taken by a secured creditor under the SARFAESI Act. The SARFAESI Act also provides for help from the state administrative machinery in the event that the secured lender experiences or apprehends any resistance in taking possession of the secured asset.

The security interest by way of pledge can also be enforced directly outside of a court process under the provisions of the ICA.

Although the DRT Act and SARFAESI Act were enacted with the hope of enabling lenders to expeditiously recover their debts and enforce their security interests, delays in concluding the judicial process before the DRTs, appeals before the DRATs, and challenges thereafter to the High Court and Supreme Court have defeated the object of these Acts. Both the DRT Act and SARFAESI Act provided for a time period of six months to conclude the judicial process. However, in practice it takes on average more than three to four years, if not more, to conclude the judicial proceedings. The recovery proceedings, including the auction process, also witness similar judicial delays. The proceedings before the civil courts, including execution, in any case take five to six years, if not more.

3. Are pre-insolvency proceedings available? If so, describe the type of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceedings?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

After the repeal of the Sick Industrial Companies (Special Provisions) Act 1985 and enactment of the Insolvency and Bankruptcy Code 2016 (IBC) in India, almost all available out-of-court pre-insolvency mechanisms in India were withdrawn. However, recently, the RBI, the regulator and central bank in India, has introduced a prudential framework for the resolution of stressed assets. The directions and framework have been introduced with the object of early recognition, reporting, and time-bound resolution of stressed assets by scheduled commercial banks, financial institutions, small finance banks and systemically important non-banking finance companies in India. The framework requires lenders to classify the borrower's account into different categories where the aggregate exposure is INR50 million and above, based on incipient stress on account of default in payment to any lender. In case of default in payment to any lender, the framework requires the lenders to jointly carry out a *prima facie* review of the account within 30 days of such default. During such review, the lenders are required to decide on the resolution strategy, such as framing and implementation of the resolution plan or initiation of proceedings for insolvency resolution under the IBC or proceedings for recovery. Where the lenders decide to frame a resolution plan, all the lenders are required to enter into an inter-creditor agreement to provide ground rules for finalisation and implementation of the resolution plan for borrowers with a credit facility from more than one lender. The framework envisages that the inter-creditor agreement should provide that any decision agreed by lenders representing 75 per cent by value of total outstanding credit facilities (fund-based, as well non-fund based[7]) and 60 per cent of lenders by number be binding upon all the lenders. Additionally, the inter-creditor agreement may, *inter alia*, provide for rights and duties of majority lenders, duties and protection of rights of dissenting lenders, treatment of lenders with priority in cash flows / differential security interest etc. In particular, the resolution plan shall provide for payment of not less than the liquidation value due to the dissenting lenders. The resolution plan may involve reorganisation, regularisation of the account by payment of all overdue liabilities by the borrower entity, sale of the exposures to other entities / investors, and change in ownership or restructuring. The review period above shall be in addition to the timeline prescribed under this framework of 180 days within which a resolution plan has to be implemented.

In addition, for micro, small and medium enterprises (MSMEs), the RBI has prescribed a framework for revival and rehabilitation. This framework covers loan accounts of MSMEs with limits up to INR25 crore under consortium or multiple banking arrangements. The framework has been made applicable to all scheduled commercial banks. It requires banks to identify insipient stress in the accounts by classifying them as a special mention account (SMA) under three categories: namely, SMA-0, SMA-1 and SMA-2, based on the number of days that the principal or interest is overdue. It also requires banks to constitute standing committees at each district, division or regional level depending on the number of MSMEs being financed. In the case of a consortium of banks, the consortium leader or the bank having the largest exposure shall refer the account having insipient stress to its standing committee for a suitable corrective action plan (CAP). The committee is also mandated to coordinate with other consortium members or other banks in the case of a multiple banking arrangement. The committee is to be comprised of an independent external expert and nominee of the concerned state government in addition to high-ranking officers from the interested banks. The regional or zonal head of the lead bank is the chair of the committee. The decision of the committee will be by simple majority, but, in case of a tie, the chair will have the casting vote. In the case of a consortium or multiple banking arrangement, the lenders should enter into an inter-creditor agreement. Both lenders and stressed borrowers can initiate a proceeding under the framework. The CAP may envisage:

- restructuring of the debt if it is *prima facie* viable and the borrower is not a wilful defaulter, i.e. there is no diversion of funds, fraud or malfeasance etc.;
- rectification by obtaining a commitment, specifying actions, and timelines from the borrower to regularise the account so that the account comes out of its current classification of SMA status or does not slip into the non-performing asset category; and
- recovery by legal recourse.

[7] Fund based facility is where money is made available for withdrawal by a borrower such as term loan of credit facility. Non fund-based facility is where no money is made available but an assurance is given by a bank such as bank guarantee / letter of credit etc.

Detailed timelines are given for carrying out various activities under the framework. If the committee decides that the enterprise requires financial resources to restructure or revive, it may draw up a plan for provision of such finance. Any additional finance should be matched by contributions by the promoters of the company in appropriate proportion, and this should not be less than the proportion at the time of the original sanction of loans. Additional funding provided under restructuring / rectification as part of the CAP will have priority in repayment over repayment of existing debts. If the existing promoters are not in a position to provide additional funds, the committee may allow the enterprise to raise secured or unsecured loans with third parties. The committee may, with the consent of all creditors, assign such loans a higher priority than any existing debt. The management of the borrower remains in control during the CAP.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceedings?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

The IBC provides the framework for insolvency proceedings in India.[8] The framework under the IBC covers both incorporated and unincorporated entities and individuals. However, the provisions of the IBC relating to unincorporated entities and individuals have not yet been given effect. The IBC is a comprehensive piece of legislation and a self-contained code in itself. The procedures under the IBC can be utilised by any financial creditor or operational creditor (OC) of a corporate debtor or the corporate debtor itself. The prerequisite for initiating proceeding under the IBC for a corporate debtor is the existence of a default in payment of minimum INR1.00 lakh (now INR1 crore[9]) to any financial creditor or OC by the corporate debtor. The IBC defines a financing creditor as any person to whom the corporate debtor owes a financial debt.[10] A financial debt is defined as a debt with interest which is disbursed against consideration for the time value of money including any guarantee or indemnity or counter indemnity obligation in respect thereto.[11] Even the amount raised from a real estate allottee under a real

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8 Insolvency and Bankruptcy Code 2016 (Act 31 of 2016).

9 Vide amendment by notification dated 24 March 2020.

10 Section 5(7) IBC: "'financial creditor' means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to".

11 Section 5(8) IBC: "'financial debt' means a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes–

(a) money borrowed against the payment of interest;

(b) any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent;

(c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;

estate project is considered as financial debt. An OC is defined as a person to whom the corporate debtor owes an operational debt.[12] An operational debt is defined as a claim in respect of the provision of goods and services, including employment and taxes due to governments.[13] The corporate debtor is defined as a corporate person who owes a debt to any person.[14]

Under the IBC, the process is initiated by filing an application for initiation of the corporate insolvency resolution process (CIRP) in respect of the corporate debtor before the Adjudicating Authority. The financial creditor or the corporate debtor can file the application straightaway for initiation of the CIRP under section 7 or section 10 of the IBC, respectively. The OC, however, is required to send a demand notice under section 8 of the IBC to the corporate debtor for unpaid operational debt in default before filing the application under section 9 of the IBC. On receipt of a demand notice, the corporate debtor is required to either point out the existence of a dispute over the invoice or show proof of payment within 10 days. The National Company Law Tribunals (NCLTs), constituted under the Companies Act 2013, have been conferred the jurisdiction to act as Adjudicating Authority under the IBC. Currently, 15 NCLT benches with territorial jurisdiction by state have been established and are functioning in India.

The actors involved in the CIRP are the interim resolution professional / resolution professional appointed for the corporate debtor, the committee of creditors (CoC) formed by the interim resolution professional / resolution professional of the corporate debtor and the Adjudicating Authority. Interim resolution professionals / resolution professionals are qualified insolvency professionals who are registered with the regulator established under the IBC, i.e. the Insolvency and Bankruptcy Board of India (IBBI).[15] While admitting application under section 7/9/10 of the IBC, the Adjudicating Authority is required to appoint the interim resolution professional for conduct of the CIRP in respect of the corporate debtor. On admission, the Adjudicating Authority also passes a moratorium order in respect of the corporate debtor in terms of section 14 of the IBC.[16] On appointment, the interim resolution professional makes a public

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(d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;
(e) receivables sold or discounted other than any receivables sold on non-recourse basis;
(f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing:
Explanation – For the purposes of this sub-clause,–(i) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and (ii) the expressions, 'allottee' and 'real estate project' shall have the meanings respectively assigned to them in clauses (d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016 (16 of 2016)".

[12] Section 5(20) IBC: "'operational creditor" means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred".

[13] Section 5(21) IBC 2016: "'operational debt' means a claim in respect of the provision of goods or services including employment or a debt in respect of the [payment] of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority".

[14] Section 3(7) IBC: "'corporate person' means a company as defined in clause (20) of section 2 of the Companies Act, 2013 (18 of 2013), a limited liability partnership, as defined in clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008 (6 of 2009), or any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service provider".

[15] Section 3 (19) IBC: "'insolvency professional' means a person enrolled under section 206 with an insolvency professional agency as its member and registered with the Board as an insolvency professional under section 207".

[16] Section 14 IBC: Moratorium–"(1) Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:–
(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority;
(b) transferring, encumbering, alienating or disposing off by the corporate debtor any of its assets or any legal right or beneficial interest therein;
(c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);
(d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

announcement inviting claims from the creditors of the corporate debtor. If the interim resolution professional finds that certain financial debt is owed to a class of financial creditors exceeding more than 10 in number, such as real estate allottees, then in the public announcement the interim resolution professional is required to provide the names of three independent insolvency professionals registered with the IBBI for election of one of them as their authorised representative by such financial creditors belonging to that class. On receipt of proofs of claim from the creditors, the interim resolution professional is required to verify and collate the same and constitute the CoC, comprising all the financial creditors of the corporate debtor, and assign voting share to each one of them based on their debt. In case any financial creditor is a related party to the corporate debtor, as defined in the IBC, then no right of representation, participation, or vote is assigned to such financial creditor. If the interim resolution professional finds that there is no financial creditor for the corporate debtor, then the interim resolution professional constitutes the CoC, comprising the 18 largest OCs, one elected representative of "workmen" of the corporate debtor and one elected representative of employees of the corporate debtor, and assigns a voting share to them. Each representative is assigned the voting share of aggregate debt of workmen and employees, respectively. The interim resolution professional is required to convene the first meeting of the CoC within seven days of its constitution with due notice to all members of the CoC, the suspended board of directors of the corporate debtor, and the OCs or their representative if the amount of aggregate operational debt is more than 10 per cent of the total debt of the corporate debtor. However, such OCs or their representative are provided only the right to participate without any voting right. In the first meeting of the CoC, the CoC is required to either continue and appoint the interim resolution professional appointed by the Adjudicating Authority as the resolution professional, or appoint some other insolvency professional of their choice as resolution professional by a vote of a minimum of 66 per cent of the voting share. Pursuant to such a decision, the CoC is also required to obtain approval of the Adjudicating Authority for the same. It is the duty of the interim resolution professional / resolution professional to conduct the entire CIRP, including preparation of an information memorandum of corporate debtors, inviting resolution applicants to submit resolution plans for corporate debtors, getting approval of a resolution plan for the corporate debtor by a minimum of 66 per cent of the voting share of the CoC, and thereafter getting the resolution plan approved by the Adjudicating Authority. The IBC stipulates that the resolution plan must provide for the payment of the insolvency resolution process costs in priority to payment of other debts of the corporate debtor. It must also provide for payment of debts of OCs in such a manner as may be specified by the IBBI. Those payments shall not be less than the amount to be paid to such creditors in the event of a liquidation of the corporate debtor under section 53 of the IBC, or the amount that would have been paid to such creditors, if the amount to be distributed under the

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Explanation – For the purposes of this sub-section, it is hereby clarified that notwithstanding anything contained in any other law for the time being in force, a licence, permit, registration, quota, concession, clearance or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law for the time being in force, shall not be suspended or terminated on the grounds of insolvency, subject to the condition that there is no default in payment of current dues arising for the use or continuation of the license or a similar grant or right during moratorium period.

(2) The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.

(2A) Where the interim resolution professional or resolution professional, as the case may be, considers the supply of goods or services critical to protect and preserve the value of the corporate debtor and manage the operations of such corporate debtor as a going concern, then the supply of such goods or services shall not be terminated, suspended or interrupted during the period of moratorium, except where such corporate debtor has not paid dues arising from such supply during the moratorium period or in such circumstances as may be specified.

(3) The provisions of sub-section (1) shall not apply to–

(a) such transactions, agreements or other arrangement as may be notified by the Central Government in consultation with any financial sector regulator or any other authority;

(b) a surety in a contract of guarantee to a corporate debtor.

(4) The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process:

Provided that where at any time during the corporate insolvency resolution process period, if the Adjudicating Authority approves the resolution plan under sub-section (1) of section 31 or passes an order for liquidation of corporate debtor under section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be."

resolution plan had been distributed in accordance with the order of priority in section 53(1) (discussed in detail in section 7), whichever is higher. The payments must also provide for the payment of debts of financial creditors who do not vote in favour of the resolution plan, in such manner as may be specified by the IBBI, which shall not be less than the amount to be paid to such creditors in accordance with section 53(1) in the event of a liquidation of the corporate debtor. The IBC also requires that the distribution shall be fair and equitable to such creditors. The IBC and the regulations framed thereunder provide the framework and time frame within which various steps are to be taken by interim resolution professionals / resolution professionals. Section 29A of the IBC provides for various ineligibility criteria. If the existing management of the corporate debtor falls under or suffers from any ineligibility under section 29A, it is barred from submitting a resolution plan for the corporate debtor. For MSMEs, certain ineligibility conditions under section 29A of the IBC do not apply. Originally, IBC prescribed a total maximum time period of 270 days for completion of the CIRP, comprised of an initial time period of 180 days and an additional period of 90 days, subject to the approval of the CoC and further approval of the Adjudicating Authority. However, pursuant to an amendment made to the IBC in 2019,[17] the maximum time period was extended up to a maximum period of 330 days from the date of admission of application by the Adjudicating Authority inclusive of time spent in legal proceedings. If no resolution plan is approved within the CIRP period, or the resolution plan is rejected by the Adjudicating Authority, then the Adjudicating Authority orders the initiation of a liquidation process in respect of the corporate debtor under the IBC. If the resolution plan is approved by the Adjudicating Authority, it becomes binding on all stakeholders of corporate debtor, including creditors, employees, government, guarantors and shareholders etc. On approval of the resolution plan, the moratorium order passed in respect of corporate debtor is also lifted.

In terms of section 17 of the IBC, on initiation of the CIRP and appointment of an interim resolution professional, the powers of board of directors of the corporate debtor are suspended and the powers of management over the affairs of the corporate debtor vest in the interim resolution professional. It is the interim resolution professional's duty to manage and continue the business of the corporate debtor as a going concern during the CIRP. It is the duty of the interim resolution professional / resolution professional appointed for the corporate debtor to take control and custody of all the assets of the corporate debtor, monitor the same and make every endeavour to protect and preserve the value thereof during the CIRP. The interim resolution professional / resolution professional is also empowered under the IBC to act on behalf of the corporate debtor with third parties and exercise rights for the benefit of the corporate debtor in judicial proceedings.

On account of the moratorium order passed by the Adjudicating Authority, during the CIRP no secured and unsecured debts can be adjusted. However, the CoC can permit transfer of rights or financial debt or operational debt under material contracts other than in the ordinary course of business of the corporate debtor with the approval of a minimum of 66 per cent of the voting share. Although it is permissible for interim resolution professionals / resolution professionals to enter into contracts or amend or modify existing contracts as part of management of the corporate debtor in the ordinary course of business, no material contract can be altered without prior approval of the CoC with a minimum of 66 per cent of the voting share.

As stated above, any resolution plan envisaging restructuring of a corporate debtor is required to be approved by a minimum of 66 per cent of the voting share of the CoC under the IBC.

[17] Insolvency and Bankruptcy Code (Amendment) 2019 dated 5 August 2019.

The explanation to section 30(2)(e)[18] of the IBC provides for deemed approval of shareholders under the Companies Act 2013, or any other law, for implementation of a resolution plan approved under the IBC.

5. Could the grant of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

Under section 43[19] of the IBC, the resolution professional has a duty to examine transactions undertaken by the corporate debtor and form an opinion, if the corporate debtor has given a preference to any person at the relevant time, and apply to the Adjudicating Authority for avoidance of such preferential transactions undertaken by the corporate debtor. A corporate debtor is deemed to have given a preference if: (a) there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor; and (b) the transfer under clause (a) has the effect of putting such creditor or a surety or a guarantor in a better position than it would have been in the event of a distribution of assets being made in accordance with section 53 of the IBC. However, transfers made in the ordinary course of the business or financial affairs of the corporate debtor, or any transfer creating a security interest in property acquired by the corporate debtor, to the extent that such security interest secures new value and was given at the time of or after the signing of a security agreement that contains a description of such property as a security interest, and was used by the corporate debtor to acquire such property and such transfer was registered with an information utility on or before 30 days after the corporate debtor receives possession of such property may not be considered as preferential transactions. Transfers made in pursuance of the order of a court shall not preclude such transfer to be deemed to be giving a preference. A preference is deemed to be given at a relevant time, if it is given to a related party, during the period of two years preceding the insolvency commencement

[18] Section 30(2)(e) IBC: "Explanation — For the purposes of clause (e), if any approval of shareholders is required under the Companies Act, 2013(18 of 2013) or any other law for the time being in force for the implementation of actions under the resolution plan, such approval shall be deemed to have been given and it shall not be a contravention of that Act or law."

[19] Section 43 IBC: "Preferential transactions and relevant time.

(1) Where the liquidator or the resolution professional, as the case may be, is of the opinion that the corporate debtor has at a relevant time given a preference in such transactions and in such manner as laid down in sub-section (2) to any persons as referred to in sub-section (4), he shall apply to the Adjudicating Authority for avoidance of preferential transactions and for, one or more of the orders referred to in section 44.

(2) A corporate debtor shall be deemed to have given a preference, if—

(a) there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor; and

(b) the transfer under clause (a) has the effect of putting such creditor or a surety or a guarantor in a beneficial position than it would have been in the event of a distribution of assets being made in accordance with section 53.

(3) For the purposes of sub-section (2), a preference shall not include the following transfers—

(a) transfer made in the ordinary course of the business or financial affairs of the corporate debtor or the transferee;

(b) any transfer creating a security interest in property acquired by the corporate debtor to the extent that – (i) such security interest secures new value and was given at the time of or after the signing of a security agreement that contains a description of such property as security interest, and was used by corporate debtor to acquire such property; and (ii) such transfer was registered with an information utility on or before thirty days after the corporate debtor receives possession of such property:

Provided that any transfer made in pursuance of the order of a court shall not, preclude such transfer to be deemed as giving of preference by the corporate debtor.

Explanation. – For the purpose of sub-section (3) of this section, 'new value' means money or its worth in goods, services, or new credit, or release by the transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the liquidator or the resolution professional under this Code, including proceeds of such property, but does not include a financial debt or operational debt substituted for existing financial debt or operational debt.

(4) A preference shall be deemed to be given at a relevant time, if—

(a) It is given to a related party (other than by reason only of being an employee), during the period of two years preceding the insolvency commencement date; or

(b) a preference is given to a person other than a related party during the period of one year preceding the insolvency commencement date."

date or given to a person other than a related party during the period of one year preceding the insolvency commencement date.

Section 44 of the IBC provides for the orders that can be passed by the Adjudicating Authority upon application by a resolution professional which include the avoidance of such transaction and vesting of such property back to the corporate debtor, the release / discharge of a security interest, or payment of money for the benefits received by such person etc.

6. Is enforcement of security rights treated differently in each type of proceeding?

The principles of enforcement of security rights remains the same in all the proceedings. The rights of secured creditors are always protected, and they are given priority. Upon the initiation of the moratorium of the CIRP under the IBC, no enforcement of any security right is permitted against the corporate debtor during that period by the secured creditors of the corporate debtor.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

In a pre-insolvency situation, unless restrictions are imposed or priorities are provided by the lenders by way of loan documents, there are no general priorities in distributions among creditors and shareholders. During the pre-insolvency proceedings, the lenders can impose priorities in the resolution plan that has been framed or the CAP that has been agreed, as detailed above (see section 4).

Section 53[20] of the IBC provides a waterfall mechanism for the distribution of the assets of the corporate debtor. As stated above, the priorities as specified in section 53 are also required to be adhered to in a resolution plan for the corporate debtor in the CIRP.

However, in the case of liquidation, section 52 requires the secured creditor to choose whether it would enforce and realise its security interest outside of the process or relinquish its security interest to the

[20] Section 53 IBC: "Distribution of assets.

(1) Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period as may be specified, namely:—

(a) the insolvency resolution process costs and the liquidation costs paid in full;
(b) the following debts which shall rank equally between and among the following: (i) workmen's dues for the period of twenty-four months preceding the liquidation commencement date; and (ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52;
(c) wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date;
(d) financial debts owed to unsecured creditors;
(e) the following dues shall rank equally between and among the following:—(i) any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date; (ii) debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;
(f) any remaining debts and dues;
(g) preference shareholders, if any; and
(h) equity shareholders or partners, as the case may be.

(2) Any contractual arrangements between recipients under sub-section (1) with equal ranking, if disrupting the order of priority under that sub-section shall be disregarded by the liquidator.

(3) The fees payable to the liquidator shall be deducted proportionately from the proceeds payable to each class of recipients under sub-section (1), and the proceeds to the relevant recipient shall be distributed after such deduction.
Explanation.—For the purpose of this section—(i) it is hereby clarified that at each stage of the distribution of proceeds in respect of a class of recipients that rank equally, each of the debts will either be paid in full, or will be paid in equal proportion within the same class of recipients, if the proceeds are insufficient to meet the debts in full; and (ii) the term 'workmen's dues' shall have the same meaning as assigned to it in section 326 of the Companies Act, 2013 (18 of 2013).

liquidation estate to be formed by the liquidator for the corporate debtor and receive the proceeds in the manner as specified in section 53 of the IBC. If the secured creditor opts for enforcement of its security interest outside of the liquidation and realises amounts which are in excess to its debts, such excess is to be transferred to the liquidator. If the realisation from enforcement is less than its debts, the secured creditor can claim such unpaid debt from the liquidator. In terms of the waterfall mechanism specified in section 53 of the IBC, the CIRP costs and liquidation costs are paid in full and in priority over all other debts. Thereafter, unpaid workmen's dues for the period of 24 months (preceding the liquidating commencement date) and debts owed to secured creditors if such a secured creditor has relinquished security are paid on *pari passu* basis. Wages and unpaid liabilities owed to employees for the 12 months preceding the liquidation commencement date are paid next. After that, unsecured financial creditors are paid next, followed by amounts due to central or state government for two years preceding the liquidating commencement date and then unpaid debts owed to secured creditors post-enforcement of security on a *pari passu* basis. Any remaining debts and dues of the corporate debtor are paid next. And, finally, preferred shareholders are paid ahead of equity shareholders, who are paid last.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

In a pre-insolvency situation, the secured creditors can protect their interest in collateral by issuing notice under section 13(2) of the SARFAESI Act. Section 13(13) of the SARFAESI Act states that after receipt of notice under section 13(2) of the Act, the borrower shall not transfer by way of sale, lease or otherwise (other than in the ordinary course of its business) any of its secured assets referred to in the notice, without the prior written consent of the secured creditor. The Supreme Court of India has held that the notice under section 13(2) operates as an attachment / injunction restraining the borrower from disposing of the secured asset. The secured creditor can also approach the DRT to initiate recovery proceedings and seek interim orders for protection of the collateral by way of injunction, attachment and appointment of a receiver under the DRT Act. Similar actions and relief can be sought by the secured creditor by filing suit before the Civil Court if the quantum of debt due to it is less than INR20 Lakhs (INR2 Million).

As stated above, on commencement of the insolvency proceedings under the IBC, all the assets and collateral in the ownership of the corporate debtor come under the control of the Interim resolution professional / resolution professional and are required to be protected during the CIRP. Invariably, since most of the secured creditors also happen to be the financial creditors of the corporate debtor, they become part of the CoC constituted by the interim resolution professional / resolution professional during the CIRP and thus can protect their security rights as members of the CoC. However, if the collateral on which the secured creditors have security rights is not in the ownership of the corporate debtor, then the moratorium applicable to the corporate debtor does not apply to such collateral, and the secured creditors remain entitled to protect and enforce the same.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

In India, the law in this regard has been well settled. The right of the creditor against the guarantor is always considered as co-extensive with that of the borrower or primary obligor. Some confusion arose as a result of the IBC regarding the right of the creditor to proceed against the guarantor to the corporate debtor. This confusion came about on account of the fact that if a resolution plan approved by the NCLT under section 31 of the IBC in respect of the principal borrower / corporate debtor is made binding on the guarantor as well, then the moratorium order passed under section 14 of the IBC also ought to apply to the guarantor during the CIRP of the corporate debtor. The said confusion has since been addressed by the law laid down by the Supreme Court of India, wherein the court held that the moratorium order passed in respect of the principal borrower / corporate debtor shall not apply to a surety in contract to the corporate debtor. Thus, in India, the rights of a creditor against the guarantor are not affected during the insolvency proceeding of the primary obligor / corporate debtor.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

Non-registration / perfection of the charge created in favour of secured creditors makes such secured rights void against the liquidator in terms of section 77 of the Companies Act 2013, and such secured rights cannot be enforced by secured creditors against the liquidator. However, it does not prejudice the rights of secured creditors to enforce the contract or obligation for repayment of money secured by the charge.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged?

As stated earlier, during pre-insolvency proceedings, it is permissible for the secured party to foreclose or take other enforcement action against the collateral. However, in insolvency proceedings under the IBC, on account of operation of the moratorium during the CIRP, it is not permissible for any creditor, either secured or unsecured, to foreclose or take any enforcement action against the corporate debtor because the moratorium applies to all claims.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

Unless specifically restricted under the loan and security documents or restrained by any order passed by the court / DRT, it is permissible for the debtor to use the collateral as part of its ordinary course of business. The sale of collateral is not permissible without consent of the secured party. In the case of a charge on current assets by way of hypothecation, no restriction is placed on sale; however, upon the occurrence of an event of default, restrictions on sale / disposal come into play and thereafter the debtor cannot sell the current assets without the consent of the secured party. If the debtor is not in default and no restrictions on sale have been triggered, the current collateral sold remains "free and clear" of the liens of the secured party. Cash collateral cannot be used without the consent of the secured party. Other than current assets, if collateral is sold without the consent of the secured party, the charge of the secured party on the sold collateral continues to subsist.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditors?

No additional liens on a secured creditor's collateral can be created without the consent of such secured creditor. If it is done without such consent, the additional lien can be voided and cannot bind the secured creditor.

14. What distribution will a secured creditor receive if a company is reorganised?

As explained above, the IBC does not provide a straight-jacketed formula for any particular distribution to a secured creditor. In terms of the statutory requirement, any resolution applicant who is proposing a resolution plan for the insolvency resolution of a company only needs to comply with the requirement as specified in section 30(2) of the IBC. In so far as the distribution is concerned, the resolution plan must provide for payment of the corporate insolvency resolution costs as priority payment and thereafter payment of debts of the OCs prior to payment of any financial creditor and dissenting financial creditors of the corporate debtor who did not vote in favour of the resolution plan, which shall not be less than the amount payable to them in the event of distribution on liquidation of the corporate debtor. In addition, the law requires that the distribution proposed should be fair and equitable.

Under section 30(4)[21] of the IBC, the CoC of the corporate debtor has the freedom to decide and approve, *inter alia*, the manner of distribution proposed under a resolution plan for the corporate debtor or to negotiate the same. The law only provides guidance to the CoC to the extent that, while taking a decision on the distribution, the CoC may take into account the order of priority amongst creditors as laid down in section 53(1) of the IBC, including the priority and value of the security interest of a secured creditor. However, ultimately the decision lies with the CoC and, if a resolution plan contemplating distribution that ignores the order of priority as provided under section 53 of the IBC is proposed and approved by the CoC with 66 per cent of the votes and thereafter further approved by the NCLT, it becomes binding on all creditors including secured creditors of the concerned corporate debtor.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

Survival of the right of the secured creditors over the assets of a debtor depends on the nature of the resolution plan approved by the CoC under the IBC. As elaborated above, if a resolution plan varying or extinguishing the rights of secured creditors over the assets of the corporate debtor is approved by the CoC with more than 66 per cent of the voting share and thereafter further approved by the NCLT, it becomes binding on all.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

In terms of the DRT Act and SARFAESI Act, a secured creditor is entitled to realise and recover only to the extent of its secured debt, and any amount realised or recovered over and above that has to be returned to the debtor. However, in the event of under-recovery, the secured creditor is entitled to realise and recover its remaining secured debt from other assets of the debtor.

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[21] Section 30(4) IBC: "The committee of creditors may approve a resolution plan by a vote of not less than sixty-six per cent. of voting share of the financial creditors, after considering its feasibility and viability, the manner of distribution proposed, which may take into account the order of priority amongst creditors as laid down in sub-section (1) of section 53, including the priority and value of the security interest of a secured creditor and such other requirements as may be specified by the Board:
Provided that the committee of creditors shall not approve a resolution plan, submitted before the commencement of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 (Ord. 7 of 2017), where the resolution applicant is ineligible under section 29A and may require the resolution professional to invite a fresh resolution plan where no other resolution plan is available with it:
Provided further that where the resolution applicant referred to in the first proviso is ineligible under clause (c) of section 29A, the resolution applicant shall be allowed by the committee of creditors such period, not exceeding thirty days, to make payment of overdue amounts in accordance with the proviso to clause (c) of section 29A:
Provided also that nothing in the second proviso shall be construed as extension of period for the purposes of the proviso to sub-section (3) of section 12, and the corporate insolvency resolution process shall be completed within the period specified in that sub-section:
Provided also that the eligibility criteria in section 29A as amended by the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 shall apply to the resolution applicant who has not submitted resolution plan as on the date of commencement of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018.

The IBC also postulates a similar scenario in the event of the liquidation of the corporate debtor. If the secured creditor opts for realisation of its security interest and realises over and above its secured debt claim, then the surplus has to be refunded to the liquidator. If the secured claim is under-secured, then the unpaid debts of such secured creditor are paid as per the waterfall mechanism specified in section 53 of the IBC along with the government debts.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

The courts in India do respect and give full force and effect to a foreign restructuring of contractual arrangements subject to fulfilment of certain conditions as explained below. Currently, the IBC has limited provisions relating to cross-border situations. Section 234 of the IBC provides that the central government may enter into an agreement with the government of any other country for enforcing the provisions of the IBC. However, it does not provide any mechanism for the enforcement of foreign restructuring of contractual arrangements.

In order to give effect to any foreign restructuring of contractual arrangements, an order for recognition of foreign restructuring of contractual arrangements will have to be obtained from an Indian court under the provisions of the CPC dealing with the execution of decrees passed by courts in "reciprocating territories". A "reciprocating territory" means any country or territory outside India, which the government of India may, by notification in the Official Gazette, declare to be a reciprocating territory.

Judgments passed by the superior courts[22] of reciprocating territories can be enforced directly by filing an execution before the relevant Indian court having jurisdiction. This is done under the aegis of section 44A[23] of the CPC, which provides that a decree of any of the superior courts of any reciprocating territory is executable as a decree passed by the domestic court. In such a case, an execution petition is required to be filed in the relevant district court having original jurisdiction along with a certified copy of a decree of the superior court of any reciprocating territory. When a foreign judgment is sought to be executed under section 44A, it will be open to the judgment-debtor to make all objections, which would have been open to the judgment-debtor under section 13 of CPC (discussed later) if a suit had been filed on such judgment. The relevant Indian court will proceed forthwith to enforce the foreign judgment, provided it is not subject to any of the exceptions enumerated in section 13 of the CPC.

A "reciprocating territory" is defined in Explanation 1 to section 44A of the CPC as "any country or territory outside India which the Central Government may, by notification in the Official Gazette, declare as a reciprocating territory". The central government issues notifications from time to time to recognise countries as reciprocating territories.

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[22] Such courts as may be specified in the notification listing the reciprocating territories.

[23] Section 44A: "Execution of decrees passed by Courts in reciprocating territory–(1) Where a certified copy of decree of any of the superior Courts of any reciprocating territory has been filed in a District Court, the decree may be executed in India as if it had been passed by the District Court. (2) Together with the certified copy of the decree shall be filed a certificate from such superior Court stating the extent, if any, to which the decree has been satisfied or adjusted and such certificate shall, for the purposes of proceedings under this section, be conclusive proof of the extent of such satisfaction or adjustment.
(3) The provisions of section 47 shall as from the filing of the certified copy of the decree apply to the proceedings of a District Court executing a decree under this section, and the District Court shall refuse execution of any such decree, if it is shown to the satisfaction of the Court that decree falls within any of the exceptions specified in clauses (a) to (f) of section 13.
Explanation I- 'Reciprocating territory' means any country or territory outside India which the Central Government may, by notification in the official Gazette, declare to be a reciprocating territory for the purposes of this section; and "superior courts', with reference to any such territory, means such Courts as may be specified in the said notification.
Explanation 2- 'Decree' with reference to a superior court means any decree or judgment of such Court under which a sum of money is payable, not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty, but shall in no case include an arbitration award, even if such an award is enforceable as a decree or judgment".

Presently, the following countries feature in the list of countries which have been declared as reciprocating territories.

- United Kingdom
- Aden
- Fiji
- Republic of Singapore
- Federation of Malaya
- Trinidad and Tobago
- New Zealand, the Cook Islands (including Niue) and the Trust Territories of Western Samoa
- Hong Kong
- Papua and New Guinea
- Bangladesh
- United Arab Emirates
- Canada

A non-reciprocating territory is one which is not recognised as a reciprocating territory by the central government in the Official Gazette. Judgments from such territories can be enforced only by filing a fresh lawsuit in an Indian court for a judgment / decree based on the foreign judgment or a decree. The foreign judgment in this case will be of evidentiary value.

Section 14[24] of the CPC provides that the court shall presume, upon production of any document purporting to be a certified copy of a foreign judgment, that such judgment was pronounced by a court of competent jurisdiction, unless the contrary appears on the record. Such presumption may, however, be displaced by providing want of jurisdiction. In other words, the presumption under section 14 of the CPC is derived by the court on production of a certified copy but can be displaced.

In both categories discussed above, the foreign decree has to pass the test of section 13[25] of the CPC, which specifies certain exceptions under which the foreign judgment can be treated as inconclusive and therefore not executable or enforceable in India.

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[24] Section 14: "Presumption as to foreign judgments–The Court shall presume, upon the production of any document purporting to be a certified copy of a foreign judgment, that such judgment was pronounced by a Court of competent jurisdiction, unless the contrary appears on the record; but such presumption may be displaced by proving want of jurisdiction."

[25] Section 13: "When foreign judgment not conclusive–A foreign judgment shall be conclusive as to any matter thereby directly adjudicated upon between the same parties or between parties under whom they or any of them claim litigating under the same title except–

(a) where it has not been pronounced by a Court of competent jurisdiction;
(b) where it has not been given on the merits of the case;
(c) where it appears on the face of the proceedings to be founded on an incorrect view of international law or a refusal to recognise the law of India in cases in which such law is applicable;
(d) where the proceedings in which judgment was obtained are opposed to natural justice;

In terms of section 13 of the CPC, a foreign judgment is considered conclusive by an Indian court if such judgment:

- has been pronounced by a court of competent jurisdiction;
- has been given on the merits of the case;
- is founded on the correct view of international law;
- is contained in proceedings that followed the principles of natural justice;
- has not been obtained by fraud; and
- does not sustain a claim on a breach of any law in force in India.

On a reading of the provisions of section 13 of the CPC, it can be summarised that, for a judgment of a foreign court to be conclusive between the parties, it must be a judgment pronounced by a court of competent jurisdiction. Such a judgment must have been directly adjudicated upon the “matter” which can be pleaded as *res judicata* in the Indian courts and must have been given on the merits of the case after taking evidence and upon application of mind regarding the truth or falsity of the plaintiff’s case.

Further, the foreign court passing the judgment must be competent to hold trial in the suit. It is well established that the following circumstances would confer jurisdiction to the foreign courts:

- where the person is a subject of the foreign country, in which the judgment has been obtained against them on prior occasions;
- where the person is a resident in the foreign country when the process was served on them;
- the person was temporarily present in the foreign country when the process was served on them;
- where the person in their character as plaintiff in the foreign action selects the foreign court as the forum for taking action in the capacity of plaintiff, in which forum the person is sued later; or
- where a person has contracted to submit themself to the forum in which the judgment is obtained.

However, the Indian courts are not bound in all cases to recognise the suit, and they may refuse to entertain it on grounds of expediency. The time limit to file such a suit in India is within three years of the foreign judgment. The pendency of an appeal in the foreign country will not bar a suit on a foreign judgment. If such a suit is dismissed by the Indian court, no subsequent application to execute that judgment will lie, for it has become merged in the decree dismissing the suit.

(e) where it has been obtained by fraud;
(f) where it sustains a claim founded on a breach of any law in force in India.

ITALY

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

1.1 Personal or movable property

The most common types of security rights for movable property are pledges and liens.

With a pledge, the debtor typically transfers the possession of the pledged assets to the creditor or to a jointly appointed custodian as security for a debt. The ownership usually remains with the debtor but, failing the fulfilment of the secured obligation, the pledged assets may be sold in compliance with applicable law. However, if an irregular pledge (*pegno irregolare*) is executed, the ownership is transferred to the creditor as a guarantee and it is re-transferred once the debt is paid.

Stocks of companies (listed or unlisted), rights, patents, trademarks and credit instruments, such as promissory notes or written evidence of debt, can also be offered as a pledge.

A lien is a charge over the debtor's movable assets granted to a creditor depending on the source of the creditor's right. Liens can be either general (*privilegio generale*), taken over all the debtor's movable assets, or special (*privilegio speciale*), taken over only certain of the debtor's assets. The lien allows the creditor to satisfy its right with priority towards the other creditors, in respect of priorities set out in section 6 below.

A special type of lien is provided for by Article 46 of the Banking Law (Legislative Decree 385/1993). It can be granted by the debtor only, not by a third party, to secure a loan that has a maturity of at least 18 months. This form of lien can apply to any of the following assets, if they are financed by a secured loan:

- existing and future equipment, licences, and instrumental goods produced by the debtor;
- raw materials, inventory, goods in course of production, finished goods, fruits, animals and livestock;
- goods purchased through the loan; and
- proceeds, present or future, of the sale of the items indicated in the points above.

Such a special lien does not require the transfer of the possession of the relevant assets but only written evidence of its filing.

1.2 Real or immovable property

According to Italian Law, security rights over immovable property are mainly granted through a *mortgage* (*ipoteca*). A mortgage is a security right over the immovable property and grants the mortgagee the right to expropriate the property subject to the mortgage and to satisfy the mortgagor's obligations to it by application of the proceeds of the sale of the mortgaged property. A mortgage can be created by law (*ipoteca legale*), by a judicial decision (*ipoteca giudiziale*) or by a private initiative through notarial deed (*ipoteca volontaria*).

A mortgage can also be created over specific types of movable assets, such as aircraft, ships and motor vehicles (registered movables).

Mortgages are perfected through the registration in the real estate property register of the place where the immovable property is located, or in the relevant register for registered movables.

2. How are security rights enforced? Is a court process or out-of-court procedure required, or are both methods available? What are the practical difficulties experienced when security is enforced?

Generally speaking, security rights are enforced through the intervention of the court.

In fact, pursuant to the Italian legal system, a covenant whereby secured assets become the creditor's property in case of the debtor's default is null and void (Article 2744 of Civil Code – *patto commissorio*). The creditor is not entitled to use the secured assets without the authorisation of the debtor.

In case of default, the secured assets must be sold through a public auction in order to enhance the competition among possible purchasers and maximise the sale proceeds.

Therefore, in order to proceed with the sale of secured assets upon default, the creditor must first formally demand payment of the amount due in accordance with Article 2797 of the Civil Code.

The debtor may challenge such demand of payment in court. In any case, the execution must take place by way of a public auction. The creditor may seek a judicial order in accordance with Article 2798 of the Civil Code, by which secured assets are assigned to it for an amount up to the sum due for principal, plus interest. This is the only way that a secured creditor can obtain ownership of the secured assets without bidding in a public sale.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

After the recent reform of the Italian Insolvency Law, adopted by Legislative Decree No 14 of 12 January 2019 (which for most of the Articles should have entered into force in August 2020 but has been postponed until 1 September 2021,[1] one of the most relevant innovations is the insertion of two pre-insolvency proceedings, the "alert procedure" and the procedure for the "settlement of the company's crisis", summarised below.

3.1 The alert procedure *(procedura di allerta)*

According to the new law, the alert procedure has been introduced to review the financial activity of the corporate entity whereby the auditor or auditing company warns the management that the accounting indicators are outside of the required parameters and informs the management to take adequate measures promptly to overcome the crisis situation.

The obligation to report an alert also falls to some qualified public creditors (Revenue Agency, National Social Welfare Institution etc.) in the event that the company's debt exposure exceeds diverse thresholds defined by law.

Such reports must be addressed to the Corporate Crisis Settlement Body (hereafter the "OCRI"), set up at each Chamber of Commerce, Industry, Craft and Agriculture.

After receiving the report, a board of three experts is appointed by the OCRI, which provides, in agreement with the company's supervisory bodies, a solution to the crisis by adopting measures that envisage the reorganisation of the business activity.

The different types of obligations are activated in the presence of the so-called "crisis indicators" that are specific economic indices which, with reference to each type of business activity, allow the identification of the existence of a state of crisis in the company in an easier, homogeneous and objective way.

3.2 Settlement of the company's crisis

Within the category of pre-insolvency proceedings, the new law foresees the creation of the settlement of the company's crisis. Unlike the alert procedure, this procedure provides for debt restructuring as an essential and indispensable element because the solution is sought through negotiation with creditors and is favoured by the intervention of the OCRI which acts as a sort of intermediary between the parties.

The initiative to activate this procedure lies solely with the debtor, who can make a request to OCRI in this regard.

Within the shortest possible time, an updated report on the company's equity, economic and financial situation and a list of creditors and holders of property and private rights must be drawn up by the board of experts appointed by the OCRI contact person or by the debtor itself.

Following the negotiations, the agreement reached with creditors is formalised in writing.

If such a procedure does not end successfully or the legal deadlines for its implementation expire without any result, the board invites the debtor to submit a request for access to an insolvency procedure within 30 days.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

[1] See 'Important disclaimer due to COVID-19 Emergency' at the end of this chapter.

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Following the recent reform of the Italian Insolvency Law, insolvency proceedings in Italian law can be explained as described in sections 4.1 to 4.6 below.

4.1 Composition agreement *(concordato preventivo)*

The entrepreneur can resort to a composition agreement in order to satisfy creditors through business continuity or through the liquidation of assets.

To propose a composition agreement, the entrepreneur must be in a state of crisis or insolvency and propose a plan of activities to be carried out for the satisfaction of creditors, drafted according to the forms required by law, which has concrete possibilities of achievement. Along with the plan, the entrepreneur must also file the report of an independent professional certifying the truthfulness of the company's data and the feasibility of the plan.

After filing the composition agreement proposal and the plan, the court verifies the legal ground of the proposal and the economic feasibility of the plan and appoints the delegated judge and judicial commissioner and sets the terms for the expression of the creditors' vote.

The court can declare the composition agreement proposal inadmissible if it ascertains the absence of the conditions for admissibility and feasibility of the plan and can order the opening of judicial liquidation at the request of the debtor, creditors and public prosecutor.

The request for access to the composition agreement procedure can be re-proposed, provided that a change in circumstances has occurred.

In the period between the submission of the request for access to the composition agreement and its approval, the debtor maintains the administration of its assets and the exercise of the company's business under the supervision of the judicial commissioner. In any case, acts of extraordinary administration are ineffective when performed without the authorisation of the delegated judge.

With respect to pending contracts, the debtor can request authorisation to suspend or terminate one or more contracts when their continuation is not consistent with the forecast in the plan and the plan does not allow for their execution. In any case, the possibility of opposition by the counterparty is reserved and in that case the court or the delegated judge will rule on the matter.

The satisfaction of creditors with privileges, pledges or mortgages can also be incomplete, provided, however, to an extent not less than the level required by law, as described in the remainder of this section.

In order to be approved, the composition agreement must obtain the favourable vote of the creditors who represent the majority of the admissible claims to the vote.

If the majorities required for the approval of the composition agreement are not reached, the delegated judge must immediately notify the court, which then provides a judgment opening the judicial liquidation.

If, on the other hand, the plan is approved, a judgment approving the composition agreement is issued and the plan implementation phase begins according to the procedures drafted by the court.

4.2 Judicial liquidation *(liquidazione giudiziale)*

Judicial liquidation is the procedure that replaces bankruptcy, of which it retains the essential characteristics. Liquidation is aimed at liquidating the assets of the insolvent entrepreneur and distributing the proceeds in favour of creditors based on the value of their security interests.

The judicial liquidation is applicable to the commercial entrepreneur, operating as an individual person, or other collective body, group of people, or public company, with the exclusion of the state and qualified public bodies indicated by law.

Minor entrepreneurs, as characterised by the failure to exceed certain dimensional thresholds of assets, revenues and debts, are excluded from judicial liquidation.

The objective requirement for the opening of judicial liquidation is the existence of a state of insolvency as defined by law.[2]

The bodies responsible for the judicial liquidation procedure and their functions are as follows.

- The insolvency court is the main body responsible for the procedure and operates in collective composition. It has decision-making, appointment and supervisory tasks.
- The delegated judge is the other body with jurisdictional functions. This individual supervises and controls the regulation of the procedure.
- The receiver holds the position of public officer with the task of administering the assets included in the judicial liquidation and the execution of all the operations of the procedure under the supervision of the delegated Judge and the creditors' committee.
- The creditors' committee is composed of three or five members, chosen from among the creditors with the aim of demonstrating a balanced quantity and quality of the credits. It has the fundamental task of supervising the work of the receiver, authorising its acts and expressing opinions in circumstances provided for by the law or at the request of the court or the delegated judge.

With the opening of the judicial liquidation, the debtor is deprived of the management and availability of its assets which are entrusted to the receiver. The receiver is vested with the power to dispose of the assets that would have been subject to judicial liquidation.

[2] Insolvency is defined as the financial position of a debtor that is regularly unable to satisfy its obligations.

Following the opening of this procedure, effects arise in relation to detrimental acts against creditors. Indeed, in such a case, the assets to be liquidated must be restored to the situation pre-existing the opening of the procedure, and that goal can also be achieved through the legal concept of the ineffectiveness, towards the mass of creditors, of the acts that have changed *in peius* the consistency or quality of the debtor's assets.

In general, the law provides that contracts which at the opening date of the judicial settlement are not yet fully performed are suspended until the receiver decides to dissolve the contract or, with the authorisation of the creditors' committee, to take over the debtor's obligations. There are specific provisions for the individual types of contract.

4.3 Over-indebtedness procedure *(procedura da sovraindebitamento)*

In the event of a state of crisis or insolvency, the parties not subject to judicial liquidation (consumers, professionals, minor entrepreneurs, agricultural entrepreneurs, innovative start-ups etc.) can resort to three different procedures:

4.3.1 The debt-restructuring procedure

This procedure is reserved for the consumer and is a particularly favourable procedure for the debtor, as it allows the debtor to avoid the judgment and approval of creditors and be subject only to the evaluation of the judge. The debtor, with the help of a crisis composition body (hereafter "OCC"), presents a debt-restructuring plan to be submitted to the judge for approval. The judge evaluates whether to approve the plan or not: creditors only have the ability to make observations and lack the power of veto.

4.3.2 The minor composition (concordato minore)

This procedure is aimed at professionals, minor entrepreneurs, agricultural entrepreneurs and innovative start-ups and is a simplified form of the composition agreement. The debtor submits, through an OCC, the composition agreement proposal accompanied by the documents required by law. The proposal can provide for the partial satisfaction of privileged loans, as long as it is not less than the threshold established by law. After a preliminary examination by the judge, the proposal for a composition agreement is submitted to the creditors' vote. If approved by a majority of creditors, the composition agreement is also approved by the court and carried out. In the event that, for the reasons provided by law, the composition agreement is revoked, the procedure is converted into a controlled winding-up.

4.3.3 Controlled winding-up (liquidazione controllata)

This procedure is reserved for consumers, professionals, minor entrepreneurs, agricultural entrepreneurs and start-ups and represents a simplified procedure for judicial liquidation. The conversion into liquidation can be proposed upon request of the debtor, a creditor, or a public prosecutor (in the case of acts of fraud or default).

4.4 Compulsory administrative winding-up *(liquidazione coatta amministrativa)*

Compulsory administrative winding-up is an administrative insolvency procedure for particular entities and categories of companies determined by law, such as financial companies, banks and financial intermediaries.

The procedure can be opened due to the presence of serious irregularities in management or administration, for serious or repeated violations of laws or regulations or provisions dictated in the public interest, for the non-compliance of the activity carried out with respect to the institutional purpose or in the general interest, or for a state of insolvency.

After the liquidation is ordered and the debtor's state of insolvency ascertained, the administrative authority appoints a liquidator – or three in cases of particular importance – and a supervisory committee made up of three or five members, chosen from among particularly experienced people in the company's business field, possibly from among its creditors.

As a result of the initiation of the liquidation procedure, the company loses procedural power in disputes and ongoing relationships relating to property law, which power is transferred to the liquidator.

From the date of the provision ordering liquidation, the same provisions for judicial liquidation shall apply with reference to creditors and pre-existing legal relationships.

The liquidator, after having drawn up the list of creditors, carries out the liquidation of the assets and the distribution of the proceeds to creditors, according to the order established by law.

4.5 Debt-restructuring agreements *(accordi di ristrutturazione dei debiti)*

According to Italian Insolvency Law, the debtor can also file a request for a debt-restructuring agreement which has already been approved by the creditors.

The agreement must be entered into by the debtor and the creditors representing at least 60 per cent of all debts, regardless of the nature of the credit, secured or unsecured. This agreement is called ordinary. However, reform of the Italian Insolvency Law has resulted in the addition of the facilitated agreement, which may be reached with 30 per cent of the creditors, secured or unsecured, and the extended agreement, with 75 per cent of the homogeneous credits, belonging to the same category.

Furthermore, a report drafted by an expert concerning the feasibility of the agreement has to be submitted to the court. Such a report is essential, and the approval of the debt-restructuring agreement by the court is mainly based on its contents. In particular, the report must demonstrate the ability of the agreement to ensure full payment of the so-called "external creditors", i.e. the creditors who are not signatories of the agreement.

A debt-restructuring agreement must be published in the Companies Register at the Chamber of Commerce and is effective as of the date of its publication. The creditors and any other interested parties are entitled to challenge the debt-restructuring agreement within 30 days from the date of the publication.

The court then decides the merits of any challenging petitions and, assuming such challenges are rejected, approves the agreement.

The law provides that any act, payment, or guarantee performed in order to implement and execute the debt-restructuring agreement approved by the court cannot be subject to claw-back action (*azione revocatoria*).

The debt-restructuring agreement is a flexible legal instrument and the main players are the debtor and the creditors, while their advisers and the legal counsel also play a role. In most cases, a single agreement will be entered into by the debtor and its creditors. However, the performance of more than one agreement with creditors may also be allowed. Furthermore, the agreement may provide for a particular role for some creditors. In particular, major creditors could exercise a surveillance power over the debtor's business, as well as management or control rights.

Such an agreement contains different terms and conditions for payment of the relevant claims and provisions concerning the re-funding of the business in order to allow the continuation of the business activities by the debtor and its restructuring.

4.6 Extraordinary administration *(amministrazione straordinaria)*

As a result of recent financial difficulties involving important Italian companies, Law of No 39 of 18 February 2004 was enacted in order to improve the pre-existing procedure concerning extraordinary administration for large insolvent companies, provided by Legislative Decree No 270 of 8 July 1999.

An insolvent company may institute an extraordinary administration by filing a request with the Minister for Economic Development and, at the same time, filing a petition with the Bankruptcy Court in order to ascertain its insolvency status. According to the provisions of the new law, insolvent companies may apply to the minister for immediate admission to extraordinary administration if they have, either individually, or as a group, established for at least one year that: (a) there were no fewer than 500 employees in the previous year; and (b) there are debts, including those arising from the guarantees issued, for an aggregate amount of not less than EUR300 million.

Once admitted to extraordinary administration, the insolvent company is managed by the extraordinary administrator (*commissario straordinario*) who continues to carry on the company's ordinary business activity pending the outcome of the extraordinary administration.

The outstanding debts of the insolvent company are frozen at the date of declaration of insolvency and paid at the end of the proceeding, during which the creditors are not entitled to start or to continue any execution proceedings upon the debtor's assets.

A surveillance committee of five members, with supervision and control duties, is also appointed by the minister as a consultative body. Two members of the surveillance committee are chosen from among unsecured creditors and three from among experts in the company's business activity or in insolvency law.

Within 180 days of being appointed, the extraordinary administrator is required to file the restructuring plan with the Minister for Economic Development, as well as to file a report with the Bankruptcy Court containing the description of the causes of the company's insolvency, together with an estimate of the relevant assets and a list of the creditors, indicating the respective amounts and priority rights.

The restructuring plan is subject to the approval of the minister. If the minister rejects implementation of the proposed plan, the extraordinary administrator may ask the minister to approve a sale plan, otherwise, the extraordinary administration is converted into an ordinary bankruptcy proceeding.

The restructuring plan can provide for satisfaction of the creditors' claims, both secured and unsecured, through a composition with creditors, which is part of the plan. The composition must detail any relevant clause and condition for the satisfaction of the creditors, as well as any possible guarantee for its performance.

The composition shall be approved if it is passed by the creditors representing the majority of the claims admitted to vote; any creditors who do not deliver their vote to the court are deemed to vote in favour of the composition. If the majority is reached, the court approves the composition.

The debtor does not remain in possession of the business under this proceeding. The extraordinary administrator is appointed by the minister, takes possession of the company's assets and is entrusted with the management of the business.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

According to Article 165 of the Italian Crisis and Insolvency Code, the following transactions are voidable by the receiver, provided that the receiver can prove that the other contracting party was aware of the debtor's state of insolvency:

- transactions at an undervalue;
- payment of receivables due and payable, which have been satisfied by any means other than cash and other usual instruments of payment, if made within one year before the declaration of judicial liquidation by the court;
- pledges and mortgages granted in the year before the judicial liquidation to secure pre-existing debts not yet due and payable; and
- pledges and mortgages granted in the six months before judicial liquidation to secure debts due and payable.

Transactions, if entered into in the six months before the declaration of judicial liquidation, may also be voided if the receiver proves that the other party was aware of, or could have been aware of, the debtor's insolvency. Further payments of debts due and payable and grants of security interests to secure contemporaneous loans are also voidable. These provisions are intended to render suspect pre-bankruptcy transactions ineffective towards the creditors. The receiver's action is *in personam*, although they may affect third parties' interests by granting a right to trace the debtor's assets, wherever they are located.

There are two requirements to be satisfied for the avoidance of transactions. The first is objective, consisting of the actual loss of the debtor's assets which are to be recovered by the debtor's estate, and the second is subjective, i.e. the knowledge of the insolvency by the non-debtor party. The receiver bears the burden of proving a non-debtor's knowledge of state of insolvency.

6. Is enforcement of a security right treated differently in each type of proceeding?

According to Italian law, the provisions concerning the enforcement of security rights are the same for each insolvency proceeding. In the legislator's view, in case of default, the secured assets must be sold by public auction in order to enhance competition among possible purchasers and ensure that the maximum price is paid for the benefit of the debtor and of the other creditors.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

Pursuant to Article 153 of the Italian Crisis and Insolvency Code, secured credits (mortgage, pledge, lien) entitle the repayment of principal, interest (pre and post-filing in judicial liquidation) and costs. If the secured creditors are not satisfied in full, their residual claims may share as unsecured creditors for the difference. The order of priority is established by Article 2777 *et seq* of the Italian Civil Code.

The order of priority in respect of movables is as follows:

- expenses incurred by the insolvency procedure take priority over any other claim, including those secured by mortgage or pledge: such expenses include, for example, payments necessary to continue the debtor's business (suppliers, staff etc.), receivers' fees and lawyers' fees – all such items are commonly defined as "pre-preferential claims" (*crediti in prededuzione*);
- wages and salaries as well as employees' allowances (Article 2751*bis*, 1, Civil Code) and damages for lack of payment of social security contributions by the insolvent company;
- professional fees for the previous two years, commercial agents' commission and indemnities relative to the year prior to declaration of judicial liquidation (Article 2571*bis*, 2, 3, Civil Code);
- claims having the rank of priority according to special laws;
- claims secured by pledge, including by irregular pledge where necessary formalities have been complied with;
- claims secured by special privilege;
- claims for social security contributions and compulsory insurance;
- claims for taxes due on income of immovable property; and
- claims for income taxes and indirect taxes.

The order of priority in respect of immovables is as follows:

- expenses incurred by the insolvency procedure;
- claims having the rank of priority according to special laws;
- claims for taxes on real property;
- claims for indirect taxes;
- claims secured by special privilege on immovables; and
- claims secured by mortgage.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

In all the proceedings foreseen by the Crisis and Insolvency Code, the realisation of secured claims is granted to their holders in the same way: creditors who believe their claims to be of a secured nature must advise the bodies responsible for the pre-insolvency or insolvency proceeding. However, for this purpose, the creditors must seek a judicial authorisation. After having heard the bodies responsible for the pre-insolvency or insolvency proceeding and the creditors' committee, the specialised court can establish if, when and how the secured assets can be sold. Thus, even a secured creditor wishing to enforce its rights must file a claim. This rule is applicable to each type of pre-insolvency and insolvency proceeding.

The sale of secured assets takes place within the proceeding and under the control of the judge or, in the case of judicial liquidation, the receiver. The proceeds of the sale are assigned to secured creditors up to the amount of their claims for principal and interest. The difference, if any, must be returned to the estate.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

Protection for the creditor granted by the Italian legal system towards the guarantor corresponds to that granted towards the debtor. Therefore, information in section 7 above is also applicable to the present question.

In fact, except for specific legal claims, the creditor can start a proceeding against the debtor or the guarantor with the aim of improving the chances of collection.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

If the secured creditor were to fail to comply with the formalities set forth by the law, the security interest would not be enforceable against third parties. This means that the secured creditor would not be given any priority over other creditors.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged?

In the event of the insolvency of an Italian collateral provider, in accordance with general principles of law and the provisions of Article 152 of the Italian Crisis and Insolvency Code, the creditor must file a petition with the court, asking for authorisation to sell the secured assets according to the forced sale procedure as described in section 2 above.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

Under an ordinary pledge of collateral, the debtor remains the owner of the assets transferred to the secured party, although the debtor no longer possesses the collateral as a result of the transfer to the secured party. Therefore, the debtor may not use the property pending the insolvency proceedings, nor can the debtor transfer the pledged assets.

The secured party has an obligation to protect the assets granted to it under the pledge, is responsible for any deterioration or loss of the assets, cannot use them without the debtor's prior consent, and cannot re-pledge them or let third parties use them.

An irregular pledge overcomes the above difficulties. This type of pledge may apply when cash is given as collateral and enables the pledgee to dispose of the assets. In this case, the ownership of the assets passes to the secured party which has an obligation to return equivalent assets to the debtor when it receives payment. However, any payment and the value of the collateral can be netted so that the secured party has only a duty to return the difference.

With regard to the lien, it is not technically a security and does not convey a right *in rem* to its holder but merely qualifies the type of claim.

Under a mortgage, the debtor can grant other guarantees to different creditors. The order of priority among various mortgages issued by the same debtor to different creditors on the same property depends on the date of registration of the document whereby the charge is established according to the rule of "first in time, first in priority".

Regarding special provisions about cash collateral, according to Article 4 of Legislative Decree No 170 of 21 May 2004, a pledge, as well as an assignment of claims or of financial assets, is defined as a "security financial collateral agreement". According to the new rules, when the pledge is granted to a bank, the pledgee is entitled to directly satisfy its claim on the financial assets given as security, and its sole obligation is to immediately inform the debtor or, in case of insolvency, the liquidator thereof in writing and return to the liquidator the proceeds of sale of the financial assets in excess of its claim.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

According to Italian law, during the course of a pre-insolvency and insolvency proceeding, no further security rights can be created with respect to property subject to an insolvency proceeding.

14. What distribution will a secured creditor receive if a company is reorganised?

According to Italian law, the reorganisation of a company is executed through a composition agreement, a debt-restructuring agreement and, in case of companies meeting certain requirements, an extraordinary administration.

With regard to a composition agreement, even if it is not expressly stated, the debtor is required to pay its secured creditors in full because the secured creditor will not otherwise vote for the composition proposal. In the debt-restructuring agreement, the secured creditors may approve the debtor's proposal but, in any case, they have a priority right in the distribution.

In case of extraordinary administration, the secured creditors are paid after the expenses and the debts arising from the activities of the debtor during the proceedings (*crediti prededucibili*).

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

Since they are rights *in rem*, i.e. securities on the real property, they follow the asset within the reorganised company.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

If a secured claim is over-secured, the creditor will receive an amount up to the principal amount of the debt, plus interest (pre and post-petition) and costs, while the difference must be returned to the estate.

If a claim is under-secured, the creditor will not receive the whole amount of its debt, and the negative difference will become an unsecured claim.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

To be recognised to have full force and effect in Italian jurisdiction, a foreign contractual restructuring arrangement must be made in respect of the requirements set by law for the *debt-restructuring agreements* as described in section 4 above.

* **Important disclaimer due to COVID-19 Emergency:** the preceding report on treatment of secured claims in insolvency and pre-insolvency proceedings in Italy has been written in the context of the reform of the Italian Insolvency Law, adopted by the Legislative Decree No 14 of 12 January 2019. The reforms should have entered into force in August 2020 for most of the Articles. In the current macroeconomic emergency situation, the Italian Law Decree No 23 of 8 April 2020, consisting of massive financial interventions to help companies, has determined that the entry into force of most of the rules of the reform will be postponed until 1 September 2021.

MEXICO

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

Under Mexican law the most common forms of security rights taken in respect of movable or personal property are the commercial pledge and the non-possessory pledge, which are governed by federal law. The most common form of security taken in respect of immovable or real property is the mortgage, which is governed by law of each state of the Mexican Republic. Along with the security rights mentioned above, there is the industrial mortgage which can be created over movable and immovable property, and the security trust which can include both, immovable and movable property.

1.1 Movable property

1.1.1 Commercial pledge

The pledgor creates a security interest over tangible movable property. Generally, the pledged assets are delivered to the pledgee or a third party, acting as a depositary, who retains possession of the pledged assets until the secured obligations are fulfilled.

The commercial pledge is granted through the execution of an agreement between the pledgor and the pledgee and the delivery of the pledged assets to the pledgee or the depositary. There might be additional requirements depending on the type of assets, for example, negotiable instruments or stock certificates must be duly endorsed "in pledge" in favour of the pledgee before the registration of the pledge in the corresponding registry, such as the shares' registry book, and their delivery to the pledgee. In order to be enforceable against third parties the pledge must be registered in the corresponding public record office.

1.1.2 Non-possessory pledge

The non-possessory pledge is granted through the execution of an agreement between the pledgor and the pledgee, in which a security interest is created over tangible movable property, but contrary to the commercial pledge, the pledgor remains in possession of the pledged assets and can use and sell such assets in the ordinary course of business, subject to certain rules. If the amount pledged is greater than a specified threshold (currently, approximately USD$85,000)[1] the pledge must be ratified by a public notary. In order to be enforceable against third parties the pledge must be registered in the corresponding public record office.

1.2 Immovable property

1.2.1 Mortgage

The mortgage creates a security interest over immovable property in order to secure the obligations of a debtor to a creditor. It is governed by the law of each state of the Mexican Republic. The mortgage is

[1] 250,000 Mexican investment units (unidades de inversión (UDIs)) as of 10 February 2020.

granted by means of an agreement which is executed through a public deed issued by a notary public and, in order to be enforceable against third parties, it must comply with public notice requirements by way of registration in the corresponding public record offices.

A mortgage is also utilised to secure an interest in certain types of movable property, such as a ship or other type of vessel, for which registration of a maritime mortgage in the National Maritime Public Registry is required.

1.3 Movable / immovable property

1.3.1 Industrial mortgage

The industrial mortgage extends to all assets, operational cash and receivables of an industrial or commercial unit, thus creating a security interest over movable and immovable property. It is granted by means of an agreement which is executed through a public deed issued by a notary public. It must be registered in the corresponding public registry to be enforceable against third parties.

When talking about industrial mortgages, it is important to mention the working capital loan (*crédito de habilitación y avío*) and the fixed asset loan (*crédito refaccionario*). A working capital loan is extended by a bank for the purchase of raw materials and supplies, or for the payment of wages and direct expenses which are essential for the operation of the business of the debtor. A working capital loan is secured by the raw materials and supplies that were purchased with the loan and by the inventory resulting from the processing of the supplies and raw materials. A fixed asset loan is extended by a bank for the purpose of financing the purchase of equipment and machinery or for the construction of buildings needed for the debtor's business. A fixed asset loan is secured by the buildings or equipment that are acquired with the proceeds of the loan and additionally by any inventory that includes the new equipment and machinery located in the buildings.

The facilities described in this section are not commonly used because it is more practical to guarantee the debtors' obligations through a security trust or a non- possessory pledge, since both of these security rights contemplate extrajudicial enforcement methods, as further explained in section 2.

1.3.2 Security trust

Through this structure, the debtor transfers title of the secured assets, which can be movable and / or immovable property, to a trustee, to be held in trust to the benefit of the lender, who is the first beneficiary. The trust must be documented in a notarial instrument, if immovable property is incorporated to the trust or if movable property is transmitted to the trust which exceeds the amount provided by law (approximately USD $85,000).[2]

The security trust is considered a bankruptcy remote vehicle. When the assets enter into the trust they are transferred to the patrimony of the trust, thus isolating and protecting the assets and minimising the risk in bankruptcy. The foregoing, in principle, means that the assets are not considered to be part of the estate of the debtor in a bankruptcy proceeding.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

[2] 250,000 Mexican investment units (unidades de inversión (UDIs)) as of 10 February 2020.

2.1 Enforcement of security rights

In most instances, the collateral structures mentioned above are foreclosed by means of a judicial procedure.

However, regarding the non-possessory pledge and the security trust, there is a legal exception in which they can be foreclosed through an extrajudicial foreclosure procedure. This procedure is available subject to the terms agreed in the corresponding agreement and only if there are no disputes among the parties respecting:

- the enforceability of the security obligations;
- the amounts claimed; and
- the delivery of the possession of such assets.

The procedure will commence with the formal request to the debtor for the possession of the assets by the trustee or creditor, as applicable. Such notification must be made through a notary public. Once the assets are delivered to the creditor or trustee, as applicable, the sale of the assets will proceed, subject to the procedure established by the Commercial Code. In the event there is no agreement between the parties, they must request the foreclosure of the assets through a judicial procedure.

In the case of the security trust, the parties may also agree to the way in which the trustee can proceed to dispose of the assets subject to certain requirements provided by law, including the notification to the debtor, who will have a right to respond and object to the foreclosure.

2.2 Practical difficulties

Among the practical difficulties experienced when the security is enforced is the time and cost of the judicial procedure, which as in many other jurisdictions, tends to be lengthy and costly. This is due to lawyers' fees and possible delays resulting from various available legal challenges that can be made by the debtor, including the right to challenge any court decision by bringing a constitutional proceeding called *amparo*, questioning the constitutionality of the decision.

The delays are not exclusive to the judicial procedures. Even when the creditor or trustee can request the possession of assets in extrajudicial procedures, by means of a notification made by a public notary, there can be significant delays resulting from difficulties in locating and notifying the debtor.

The lack of registration may also represent a practical issue when enforcing a security, since as stated above, the registration in the corresponding public record office make the security interests enforceable against third parties; registration also determines the priority of the claims over the assets.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***

- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Mexican insolvency law (*Ley de Concursos Mercantiles*, LCM) provides for a single insolvency proceeding known as *concurso mercantil*. This procedure consists of two main stages: i) the conciliation stage (a pre-insolvency stage); and ii) the bankruptcy stage (an insolvency stage).

3.1 *Concurso mercantil*

In accordance with the LCM, the following persons can file an insolvency proceeding:

- the debtor;
- any creditor;
- the district attorney (*ministerio público*);
- a judge; and
- tax authorities in their capacity as creditors.

An insolvency proceeding may be commenced if the debtor has not complied with its obligations with two or more different creditors, and the following conditions are met:

i) a debtor has defaulted on its payments to two or more different creditors of obligations that represent at least 35% of all the debtor's obligations and that have been due for more than 30 days; and / or

ii) the debtor does not have sufficient assets to pay at least 80% of its obligations due on the date of the filing of the claim.

The petition to initiate the proceeding may be filed by the debtor itself if either of the conditions referred to in i) and ii) above are met. The petition may also be filed by any creditor or by the district attorney when both conditions in i) and ii) above are met.

According to the LCM, eligibility for bankruptcy according to the specified conditions is presumed when, among others: i) the debtor does not have sufficient assets to attach after a default; ii) the debtor is in default with two or more of its creditors; or iii) the judge determines that the debtor is fraudulently conveying its assets to avoid the payment of obligations. This presumption is subject to rebuttal in certain cases.

3.1.1 Commencement of the concurso mercantil

A *concurso mercantile /* insolvency proceeding is commenced by the filing of a petition by the debtor or the filing of a claim by one or more creditors before the Federal District Judge with jurisdiction for the location where the debtor is domiciled.

The petition must request, among other things:

- an insolvency declaration; and
- that the proceeding move to the conciliation stage (which is a period for the debtor to attempt to agree on a restructuring with its creditors) or directly to the bankruptcy stage (in which a receiver is appointed to liquidate the debtor, which may be effected by selling the business as a going concern) without first going through a conciliation stage.

Title One, Chapter IV of the LCM governs the process for determining whether the insolvency conditions are satisfied. Once a petition or claim is filed, the judge controlling the insolvency proceeding will instruct the Federal Institute of Business Reorganisation Specialists (*Instituto Federal de Especialistas en Concursos Mercantiles*) (IFECOM) to designate a visitor (*visitador*) within five days.[3] The purpose of the visit is to inspect the debtor's financial situation in order to provide information for the judge to determine if the requirements for the initiation of the proceeding and a declaration of insolvency are satisfied. It is worth noting that, in the case of a claim submitted by the creditors, the visit will take place after the debtor replies to the claim.

The visitor appointed by IFECOM, which is typically an independent accountant, reviews the books and records of the debtor and reports to the judge. Within 15 calendar days of the visit, the visitor will issue and deliver to the judge a report regarding the debtor's financial situation. The judge will give five calendar days to the debtor (in case of a petition) or the creditors (in case of a claim) to challenge the visitor's report. Five calendar days after the previous term, the judge will determine if the applicable insolvency condition(s) are satisfied and will issue an order declaring the debtor's insolvency, the retroactivity date (the date to which the effects of the insolvency proceeding will be applied retroactively) and instruct the notification of the debtor, the IFECOM, the visitor, the creditors (whose addresses are known), the district attorney (if applicable), and the union's representative or the Labour Defence Attorney (*Procurador de la Defense del Trabajo*).

The proceeding will then move to the conciliation stage, unless the petitioner expressly requests that the proceeding moves directly to the bankruptcy stage. If the petitioner requests that the proceeding moves directly to the bankruptcy stage, and the judge so authorises, a receiver (*sindico*) will be appointed by IFECOM. Otherwise, if the proceeding moves to the conciliation stage, a conciliator (*conciliador*) will be appointed by IFECOM.

3.1.2 Claim process and priorities

Within five calendar days of his / her designation, the conciliator will request the registration of the judgment in the corresponding public record offices and will publish an excerpt of the judgment in the Federal Official Gazette (*Diario Oficial de la Federación*) and in one of the highest circulation newspapers in the locality where the proceeding are being commenced. Within 30 days of the publication of the judgment, the conciliator is required to submit to the judge a provisional list of claims using the information derived from the debtor, the data included in the conciliator's report, and filed proofs of claims.

Creditors must file proofs of claim against the debtor at one of the following stages of the proceeding: i) within 20 days after the date of the publication of the insolvency order; ii) within five days after the

[3] IFECOM is the federal administrative arm of the Mexican insolvency process and has specialists in business administration, financial, legal and accounting advice.

filing of a provisional list of creditors; or iii) within nine days of issuance of the order recognising and ranking the claims (after this term no credit recognition can be requested).

Proofs of claim must contain, among other information, a description of any collateral, as well as a description of the claim generally, stating whether the claim is entitled to preferential or priority status. After a five-day objection period, the judge sends copies of all objections to the conciliator, who then prepares the proposed final list of claims for submission to the judge. After the judge has made a determination regarding the proposed list and priorities, the judge issues an order of recognition and ranking of claims.

In cases where the insolvency proceeding goes directly to the bankruptcy stage, the powers and duties granted to the conciliator will be exercised by the receiver.

3.1.3 Conciliation (reorganisation)

Unless the petitioner has requested that the proceeding goes directly to the bankruptcy stage (without going through conciliation), once the debtor is declared insolvent, the conciliation stage begins and the IFECOM appoints a conciliator to conduct a conciliation process between creditors and the debtor aimed at developing a restructuring plan.

The LCM provides for a period of 185 calendar days for the reorganisation stage overseen by the conciliator. However, two 90-day extensions can be granted (for a maximum of 365 days). If no conciliation and reorganisation agreement is agreed upon within such period, the bankruptcy stage will begin.

During the conciliation stage, the debtor’s management may remain in control of the business, with authority to continue to conduct the ordinary operations of the company, including paying any essential expenses. The conciliator may, however, request the removal of the debtor’s management, in which case, the conciliator would assume the authority for the debtor’s day-to-day operations. Even if the debtor’s management remains in control, the conciliator has the obligation to monitor the debtor’s books and records and transactions carried out by the debtor, with a goal of preserving the business enterprise as a going concern. The debtor requires the conciliator’s consent to dispose of assets outside the ordinary course of business. Therefore, transactions such as entering into or termination of material contracts, including new financing arrangements and the assumption, granting or substitution of guarantees or security interests, and the transfer of material assets would require the conciliator’s approval.

The restructuring agreement may be signed by all recognised creditors without the need for those creditors to hold a meeting to vote in favour of the agreement. In order for the agreement to be effective, it has to be signed by the insolvent entity or person and the creditors who represent more than 50% of the amount of unsecured and subordinated recognised liabilities and more than 50% of the amount of secured or privileged liabilities. As the insolvent entity must sign the agreement, it is understood that shareholder consent is required, and the quorum needed for such approval will depend on the debtor’s by-laws and the laws applicable to such entity.

If the required majorities are achieved, the restructuring agreement will be binding on all recognised unsecured creditors, so long as it contains certain provisions that protect their interests, such as provisions requiring inflation-indexing of the debt, payment of all amounts that were due between the date of the judge’s order declaring insolvency and the date of the agreement, and payment of all amounts that become payable after the date of the agreement.

In addition, the LCM imposes certain limitations on and conditions for certain changes affecting unsecured recognised creditors who do not sign the agreement. By way of example:

- payment deferrals may have a maximum duration only equal to or lower than the deferral applicable to creditors who did sign the agreement and who represent at least 30% of the total recognised amount due of the same class of liabilities;

- reductions of principal or interest must be in the same or lower amounts as reductions affecting recognised creditors who did sign the agreement, and who represent at least 30% of the same class of liabilities; and

- a combination of a payment deferral and a reduction must be on the same terms as are applicable to at least 30% of the amount of liabilities held by creditors who did sign the agreement.

With respect to secured creditors who did not sign the restructuring agreement, they may initiate or continue with the foreclosure of their collateral, unless the agreement provides for the payment of their claims up to the value of their collateral.

Once the restructuring agreement is signed by the debtor and the required majorities of creditors, the conciliator files it with the judge. The judge then submits it to the recognised creditors. The recognised creditors then have five days to present any objections with respect to the authenticity of their consent, or a veto of the agreement. In this regard, under the LCM, the agreement may be vetoed by the ordinary recognised creditors that:

- have not signed the agreement;

- the full payment of their credits are not established in the agreement; and

- their recognised credits jointly represent more than 50% of the total amount of the credits recognised to said creditors.

If the agreement is vetoed then the insolvency proceeding will pass to the bankruptcy stage, which is further explained in section 4.

Once the agreement has been sanctioned by the judge, the insolvency proceeding (*concurso mercantil*) is concluded.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***

- ***What are the criteria used for opening the proceeding?***

- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***

- ***Does the debtor's management remain in control of the business during the proceeding?***

- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***

- ***What is the level of creditor consent that is required to effectuate a restructuring?***

- ***Is shareholder consent required in order to effectuate a restructuring?***

4.1 Bankruptcy stage

For the initiation of the insolvency proceeding, its main actors and the specific requirements and conditions of the restructuring agreement, see section 3.

Under Title Six of the LCM, if the debtor and the creditors are not able to agree to a restructuring plan within the specified time period, or if the debtor or creditor requests that the proceeding move directly to the bankruptcy stage and the judge so authorises, a bankruptcy proceeding (*quiebra*) is declared and, within the following five calendar days, a receiver (*síndico*) (who can be the conciliator or other person) is appointed by the IFECOM. Once this liquidation process begins, the legal capacity of the debtor to manage its business is suspended. The *síndico* assumes control of the debtor and begins the process of selling assets (as a general rule, such sale will be made through a public auction) and paying the recognised creditors. The *síndico* can, however, decide to transitionally continue operations of the bankrupt company during the bankruptcy stage.

In cases where the business is sold as a going concern, so that the debtor's contracts would be assigned to the acquirer as part of the sale, the counterparties to the contracts would have the right to reject the assignment of their respective contracts. This right must be exercised within 10 business days after the receiver provides notice of the proposed assignment. A counterparty that does not respond within 10 business days will be deemed to have consented to the assignment of its contract.

The *síndico* must file bimonthly reports to the judge on the status of the process, including the remaining assets and the identification of the creditors that have not yet been paid. Only when all the recognised creditors have been paid will the proceedings be terminated.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

In order to protect creditors from fraudulent transactions, the LCM provides that transactions which are not in the ordinary course of business and which occur during a "retroactive period" will be ineffective. Transactions potentially subject to invalidation include gratuitous transactions, transactions at excessively low or high prices relative to the market value, transactions with related parties, payments of obligations not yet payable, remittance of debts, and the granting of new security interests or guarantees.

The LCM establishes a "retroactive period" of at least 270 days. This period is doubled for creditors who are "related parties", such as:

- holding companies or individuals who jointly or severally hold 50% or more of the corporate capital of the debtor;

- companies that are controlled by the debtor;

- directors and officers of the debtor or of the controlling or controlled companies of the debtor; and

- companies that share the same directors or officers.

The retroactive period can also be extended, for a maximum of three years, if requested by the conciliator, the receiver or by creditors, so long as the request is filed before the date the judge issues its order concerning recognition and priority of credits.

As explained above, certain transactions with related parties, such as officers and directors of the debtor, may be considered fraudulent as against creditors. Under the LCM, any person, including directors and officers, that might have acquired assets from the debtor in a transaction that is considered fraudulent will be responsible for the damages and losses that the debtor's estate may suffer if the assets in question have been lost or transferred to a *bona fide* third party. Claims against an officer or director in this respect may be brought by one-fifth of the recognised creditors or recognised creditors representing jointly at least 20% of all recognised credits or by the representative of the creditors (*interventor*).

Any creditor or group of creditors representing 10% or more of the value of the credits owed by the debtor set forth in the provisional list of credits has the right to request the judge to appoint an intervener in the proceeding. The intervener can represent the interests of creditors and be assigned the responsibility of overseeing actions of the conciliator, the receiver and the debtor (regarding the operation of its business).

6. Is enforcement of security rights treated differently in each type of proceeding?

6.1 Conciliation stage

From the moment the judge pronounces the sentence declaring the commercial insolvency of the debtor, no seizure or enforcement order can be executed against the assets and rights of the debtor, except for those that are carried out to ensure the payment of accrued salaries and severance payment to workers for the two years prior to the declaration of the insolvency.

The secured recognised creditors that had not participated in the restructuring agreement will be able to initiate or continue the enforcement of their security interests in the collateral securing their credits, unless the agreement contemplates the payment of their credits up to the value of their collateral and the creation of an ordinary credit for the amount exceeding the value of the collateral.

6.2 Bankruptcy stage

In the bankruptcy stage, the enforcement of security rights is not stayed, and the secured creditors may initiate or continue an enforcement proceeding. However, they must notify the receiver, who may participate in the proceeding to protect the interests of the estate.

During the first 30 calendar days, the receiver can prevent the separate enforcement of security rights over the assets:

- that are related to the ordinary course of the business; and
- that the receiver considers would benefit the estate to sell with other assets.

In order to prevent such enforcement, the receiver must make a valuation of the assets pursuant to the LCM and pay the secured creditor within the following three calendar days of the sale of such assets.

In principle, Mexican law does not contemplate accelerated procedures for secured creditors under the *concurso mercantil*. However, it is worth noting that, if certain assets were transferred into a separate trust agreement (which, as explained above, is a bankruptcy remote vehicle, in favour of a certain creditor), then such assets, in principle, can be separated from the debtor's estate, and the beneficiary thereunder might then follow a special procedure to enforce its claim, which will depend on the nature and specific characteristics of the trust.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

According to the LCM, there are two types of creditors, insolvency creditors (*acreedores concursales*) and creditors against the estate (*acreedores contra la masa*).

7.1 Creditors against the estate

Credits against the estate have priority over insolvency creditors, and, according to the LCM, the proceeds obtained from the sale of the assets will be used to pay the credits in the following order:

- labour credits (accrued salaries in the two years[4] prior to the insolvency declaration (*declaración de concurso*);
- credits regarding the administration of the estate (acquired by the debtor with the authorisation of the conciliator or by the receiver);
- credits for the security, repair, conservation and administration of the assets of the estate and those acquired to maintain the ordinary operations of the company; and
- credits regarding costs and expenses derived from judicial and extrajudicial proceedings for the benefit of the estate.

7.2 Insolvency creditors

After credits against the estate are paid, the following order is implemented to pay the insolvency creditors:

- singularly privileged creditors – those whose expenses derive from burial or illness that has caused the death of the debtor, if applicable;
- secured creditors which, according to the LCM, are the creditors whose credits are secured by a pledge or a mortgage duly constituted;
- unsecured labour (different to those described above) and tax creditors;
- privileged creditors under Mexican commercial laws, for having a special privilege under such legislations or having a retention right (for example, creditors that are entitled to retain an asset until payment is made);

[4] The Supreme Court has established that the term of two years is unconstitutional since it violates the guarantee of equality before the law. It has determined that the term that should be applicable is a one-year period in accordance with the Mexican Constitution; however, this determination is not yet binding. See Tesis Aislada 1a VIII/2012 (9A), Semanario Judicial de la Federación y su Gaceta, Novena Época, Libro VI, Marzo de 2012, Tomo 1, p. 271.

- ordinary creditors – those who are not part of any of the classifications above; and
- subordinated creditors – those who had agreed to the subordination of their credit, or are related parties of the insolvent entity and are unsecured.

Notwithstanding the foregoing, claims of secured creditors would be paid up to the amount of the respective collateral, after the following claims are paid:

- labour claims for salaries and severance for the two calendar years preceding the insolvency declaration;
- litigation expenses related to the defence or recovery of secured assets; and
- expenses necessary for the reparation, conservation and disposition of the secured assets.

Shareholders are not treated in the proceeding and, thus, may not recover prior to creditors being paid in full.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

In order to ensure that they are considered among the recognised creditors, secured creditors need to file a proof of claim (as established in section 3).

It is also important to register the security rights in the corresponding public record offices, since such registrations will be used to determine the priority of the creditors in respect of specific collateral, and the registration makes the security rights of a creditor enforceable against third parties.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

No, unless it is expressly consented by the affected recognised creditor.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

If the creditors do not register their security rights in the corresponding public record offices, their rights will not be enforceable against third parties. Furthermore, according to the LCM, the priority of the secured creditor will be determined according to the date of registration.

As established above, creditors must file proofs of claim against the debtor at one of the following stages of the proceeding:

- within 20 days after the date of the publication of the insolvency order;
- within five days after the filing of a provisional list of creditors; or
- within nine days of issuance of the order recognising and ranking the claims (after this term no credit recognition can be requested).

If the creditors do not submit their proof of claims and they are not listed in the conciliator list or in the order recognising and ranking the claims, they will be precluded from requesting the recognition of their credit.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor?

As established above (see section 6), after the sentence declaring the commercial insolvency of the debtor is issued, no seizure or enforcement order can be executed against the assets and rights of the debtor for the entire conciliation stage, except for those that are carried out to ensure the payment to workers of accrued salaries and severance for the two years prior to the declaration of the insolvency. After the execution of the restructuring agreement, the secured recognised creditors that had not participated in such agreement will be able to initiate or continue the enforcement of their guarantees, unless the agreement contemplates the payment of their credits or the payment of the value of their guarantees and the constitution of a credit for the amount exceeding the value of the guarantee.

In the bankruptcy stage, the enforcement of security rights is not stayed; however, the enforcement is subject to certain restrictions, including the receiver's power to challenge the enforcement.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

In a bankruptcy scenario, all assets should be transferred free and clear of claims and liabilities. In a restructuring agreement, it will depend on the terms of the agreement.

In principle, the creditor's consent is needed to sell collateral over which he / she has a security interest. However, as established below (see section15), the security rights of a creditor can be affected in the following scenarios:

- by the execution of the restructuring agreement, as long as the conditions explained in section15 are met;
- in the event that a labour resolution establishes the foreclosure of a collateral of a secured creditor which cannot be replaced by a surety agreement, the collateral can be foreclosed, and the conciliator will have to register the amount of the execution of the collateral as a credit against the estate in favour of the secured creditor, and, in cases where the amount resulting from the foreclosure of the collateral is less than the credit, the difference will be considered as an ordinary credit; and
- the receiver can prevent the enforcement of a security by establishing the convenience of selling the guarantees with other assets, as long as the receiver pays the value of the collateral to the secured creditor and, in cases where the value of the collateral is lower than the credit, registers the difference as an ordinary credit.

Regarding cash collateral, in accordance with Mexican commercial law, the creation of cash collateral transfers the property of the cash to the creditor, unless otherwise agreed. In the cases in which the parties have agreed the transfer of ownership of the cash, when there is a default of the guaranteed obligations, the creditor can keep the cash, up to the amount due without the need of an enforcement proceeding or judicial resolution. In cases where the cash collateral exceeds the amount due, the debtor is entitled to preserve its rights to any amount of cash collateral exceeding the amount of the secured obligation. In the event that the cash collateral is less than the amount due, the secured creditor preserves its rights against the creditor for the difference.[5]

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

As a general rule, the entity during the insolvency proceeding must continue to comply with its obligations under existing agreements; thus, it should not violate its contractual arrangements. An exception to this rule is if the conciliator opposes the performance of such obligations in order to protect of the estate.

14. What distribution will a secured creditor receive if a company is reorganised?

As a general rule, the restructuring agreement must ensure the payment of the credit to the secured creditor, unless otherwise consented by such creditor. In the event the secured creditor does not participate in the restructuring agreement, the creditor will be able to take enforcement actions against the collateral, unless the agreement sets forth the payment of:

- the credit; or
- the guarantee and the constitution of an ordinary credit for the amount exceeding the value of the guarantee.

It is worth noting that the payment of the credit to the secured creditors will be subject to the order established in section 7.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

No. It will depend on the specific restructuring agreement. Notwithstanding the foregoing, the law sets forth certain protections to the secured creditors that do not sign the agreement, including their right to take enforcement actions against the collateral, if the agreement does not: i) establish the payment of the credit owed to the creditor pursuant to the provisions of the LCM; or ii) include the payment of the guarantee and the constitution of an ordinary credit for the amount exceeding the value of the guarantee.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

In a case where the claim is over-secured, the secured creditor will have a right over the amount owed for the secured obligations, and the debtor will be entitled to preserve its rights to any amount exceeding the amount of the secured obligations. In a case where the claim is under-secured,

[5] General Law on Securities and Credit Operations (Ley General de Títulos y Operaciones de Crédito), Article 336.

the secured creditor will have a right over the collateral, and the amount still owed to the creditor will constitute an ordinary credit against the estate.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

The LCM provides that foreign restructuring or insolvency proceedings may be recognised by a Mexican tribunal, provided that the following requirements are met:

- the proceeding is a foreign collective proceeding (judicial or administrative), carried out by means of a law regulating the insolvency, bankruptcy or reorganisation of entities and in which the assets and business of such entities are controlled or surveilled by a foreign tribunal for their restructuring or liquidation;
- the request is submitted by a person or corporate body duly appointed in a foreign proceeding to act as a representative of the foreign proceeding or to manage the restructuring or liquidation of the assets or business of the entity;
- the request is submitted before the competent tribunal; and
- the request must meet certain requirements provided by the LCM, such as the submission of the foreign tribunal's resolution which started the foreign proceeding, a certificate issued by the foreign tribunal confirming the existence of the foreign proceeding etc.

NIGERIA

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

Under Nigerian law, the principal types of security interests that may be created over movable and immovable property include mortgages, charges, pledges and liens.

1.1 Mortgages

A mortgage refers to a transfer or conveyance of title to an asset to secure the payment of a debt or the performance of an obligation, subject to the condition that title will be re-conveyed to the mortgagor (i.e. the owner of the property) by the mortgagee (the grantee of the mortgage or creditor) upon the repayment of the debt or the discharge of the relevant obligation. Nigerian courts have stated that the conveyance of a legal or equitable interest in an asset and the reconveyance of title to that asset upon the discharge of the underlying secured obligation are the most important features of a mortgage.[1] Mortgages are usually created consensually (i.e. by contract), although a purported legal mortgage may be deemed an equitable mortgage by a court due to the failure of the parties to comply with applicable formalities.[2] A mortgagor has the right to have title to the asset over which a mortgage has been created re-conveyed to the mortgagor if the underlying debt is repaid[3] by an agreed date – this is referred to as a *mortgagor's contractual right to redeem*. Nevertheless, where the mortgagor fails to repay the secured debt by an agreed date, the mortgagor retains, in equity, a right to redeem the property until enforcement of the mortgage. In addition, upon the creation of a mortgage, the mortgagor retains an equitable estate (known as the equity of redemption) in the property. While mortgagees may be created over both movable and immovable property, it is more commonplace to find mortgages created over immovable property in Nigeria.

A mortgage may be legal or equitable. A legal mortgage results in the transfer of a legal estate to the mortgagee and must be in writing (and by deed),[4] while an equitable mortgage merely creates an equitable interest in favour of the mortgagee. In Nigeria, legal mortgages over immovable property are generally created over *rights of occupancy*[5] or leasehold interests, and, while various state laws specify certain formalities relevant to their creation, legal mortgages are broadly created by: (a) the assignment of the whole of the unexpired term of the mortgagor's leasehold interest or right of occupancy; or (b) a sublease / sub-demise of the mortgagor's lease or right of occupancy for a term of years absolute

1 *BON Limited v Akintoye* (1999) 12 NWLR (Pt 631) 392, p 403, per Amiazu JCA.
2 Please see our discussion below on the creation of equitable mortgages.
3 Or the secured obligation.
4 Legal mortgages are required to be in writing due to the requirements of the Statute of Frauds (29 Car 2 c 3) (1677). In Nigeria, certain statutes enacted and in existence in England as of 1 January 1900 were received into Nigerian law. These statutes are referred to as Statutes of General Application. The Statute of Frauds and the Conveyancing Act 1881, 44 & 45 Vict Ch 41 (Conveyancing Act) are Statutes of General Application. See section 32(1) of the Interpretation Act 1964 and Chapter A2, Laws of the Federation of Nigeria, 2004.
5 As a matter of Nigerian law, all land comprised in the territory of a state of the Nigerian federation is vested in the relevant State Governor from which "rights of occupancy" (in effect, leasehold interests), typically with a term of between 50 to 99 years, derive.

(usually a few days shorter than the underlying right of occupancy or lease), subject to the mortgagor's equity of redemption.[6]

Furthermore, certain state laws permit the creation of legal mortgages using specific statutory devices. For instance, the Property and Conveyancing Law 1959[7] (which applies in a number of states in western Nigeria) and the Mortgage and Property Law of Lagos State 2010 permit the creation of *charges by deed expressed to be by way of a legal mortgage*. In effect, a legal mortgage may be created by way of a charge, provided the security interest is created by deed and the deed contains a statement that the charge is made by way of a legal mortgage. Thus, a charge is imbued with the attributes of a common law mortgage while the mortgagor remains protected against a breach of any covenants in the security instrument against assignment or sub-leasing.[8]

Equitable mortgages may be created orally, in writing or by conduct and are generally created when:

- the parties intend to create a legal mortgage but have failed to comply with certain legal formalities (for instance, failure to obtain the consent of the State Governor to the creation of a legal mortgage over land);
- the mortgagor's interest in the property is equitable;
- a mortgage is created over property in respect of which a legal mortgage subsists;
- delivery of possession of relevant title documents[9] is combined with the intent and agreement to create a security interest;[10] and
- parties have merely entered into an agreement to create a mortgage.

A mortgage entitles a mortgagee to a proprietary interest in the relevant property which will prevail against the mortgagor's creditors upon insolvency. While a mortgagee may obtain possession of the property subject to a mortgage upon its creation, possession is not a precondition to the existence of a valid mortgage.

In terms of formalities, pursuant to section 22 of the Land Use Act 1978,[11] the creation of a legal mortgage over land requires the consent of the relevant State Governor.[12]

1.2 Pledges

A pledge is the actual or constructive delivery of possession of property as security for a debt or the performance of an obligation and may be created over movable or immovable property.[13] The pledgor (i.e. the party in whose favour the security interest is created) only has the right to possession of (not title to) the

[6] See the Property and Conveyancing Law 1959, Chapter 100 of the Laws of Western Region of Nigeria 1959 and the Conveyancing Act.
[7] Chapter 100, Laws of Western Region of Nigeria 1959; section 110 of the Property and Conveyancing Law 1959.
[8] See section 15(1) of the Mortgage and Property Law of Lagos State, 2010. Legal mortgages may also be created by a demise for a term of years absolute subject to a cesser (i.e. termination) on redemption. In Lagos State, a legal mortgage may also be created as a charge by deed expressed to be by way of statutory mortgage.
[9] This is considered an act of part-performance.
[10] *BON Limited v Akintoye*, p 403.
[11] Chapter L5, Laws of the Federation of Nigeria, 2004.
[12] Failure to obtain the consent of the Governor would render the contract void. See section 26 of the Land Use Act 1978; See *Savannah Bank v Ajilo* (1989) 1 NWLR (Pt 97) 305.
[13] Pledges of land are not commonplace in Nigeria except to extent granted under customary law.

relevant property. Pledges have been described by Nigerian courts as "more than a mere lien and something less than a mortgage".[14] A pledgee is not entitled to "do any act which would render [the land] irredeemable by the pledgor and time never clogs the pledgor's right to recover [the land]",[15] and, for this reason, a pledge does not entitle a pledgor to ownership of the property subject to the security interest.

Thus, title to the property in question remains with the pledgor during the subsistence of the pledge, and the pledgor may recover possession of the property subject to the pledge upon the discharge or performance of the secured obligation. Unlike a mortgage, the pledgor always has the right to recover possession once the secured obligation is performed or discharged.

1.3 Liens

A lien is a right to retain property which is rightfully in a party's possession but owned by another until the accrued claims of the party in possession are satisfied.[16] Different kinds of liens exist under Nigerian law, including legal liens and statutory liens etc.[17] Legal liens have been described by Nigerian courts as rights arising generally by operation of law as an incident of a contract.[18]

A significant amount of the case law in Nigeria with respect to liens relates to the existence (or otherwise) of a lien in favour of an unpaid seller pursuant to the provisions of the Sale of Goods Act 1893 (Sale of Goods Act).[19] In this respect, the Sale of Goods Act provides that an unpaid seller of goods, notwithstanding that title to the goods may have passed to the buyer, has by implication of law, a lien on the goods and the right to retain the goods for the price while it is in possession of them.[20] If an unpaid seller elects to re-sell the goods and notifies the buyer of its intention to resell, and the buyer fails to pay the contract price within a reasonable time, the unpaid seller may sell the goods and recover damages for any loss caused by the buyer's breach.[21] The subsequent buyer would secure good title to the goods against the original, defaulting buyer.[22]

A lien arises if: (a) a seller is unpaid; (b) the goods have been sold without any stipulation as to credit, the stipulated period of credit has expired, or the buyer has become insolvent; and (c) the seller remains in possession of the goods.[23] A lien does not create a right of action but affords the party in possession a defence to an action for recovery of the goods by a person who, but for the subsistence of the lien, would be entitled to immediate possession of the property in question.[24]

1.4 Charges

A charge is an equitable security interest that arises from an agreement to have a particular asset or class of assets owned by a party (chargor) appropriated to the satisfaction of a debt such that the beneficiary of the security interest (charge) has a specifically enforceable right to look to the asset or class of assets for the discharge of the debt. Charges are considered encumbrances and do not involve the transfer of title

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14 *Braimah Suleman v Mallam Sani Musa* (2017) LPELR-42647 (CA), pp 8–9, per Bada JCA.
15 *Vihishima Igbum v Alhaji Baba Nyarinya & Another* (2000) LPELR-9938 (CA), p 49, per Nzeako, JCA.
16 *Afrotec Technical Services (Nigeria) Limited v Mia & Sons Limited & Afcon Engineering Limited* (2000) LPELR-219 (SC), p 57, per Iguh JSC; *Livestock Feeds plc v Okezie* (2000) 10 NWLR (Pt 775) 341, p 354.
17 *Jagal Pharma Limited v Alhaji Salisu Hussaini & the Deputy Sheriff of the High Court of Kaduna* (2013) LPELR-21871 (CA)
18 Ibid pp 28–29, per Aboki JCA.
19 Sale of Goods Act, Ch 71 56 & 57 Vict. The Sale of Goods Act is a Statute of General Application.
20 Sale of Goods Act, section 39(1)(a).
21 Ibid section 48(3).
22 Ibid section 48(2).
23 Ibid section 41(1). See also *Afrotec Technical Services (Nigeria) Limited v Mia & Sons Limited*, p 57, per Iguh JSC.
24 *Jagal Pharma Limited v Alhaji Salisu Hussaini*, pp 28–29, per Aboki JCA.

or possession of the underlying property. Rather, charges involve the creation of a new interest that follows the property into the hands of any third-party purchasers *except* a *bona fide* purchaser for value without notice.

Under Nigerian law, two types of charges are recognised – fixed charges and floating charges. A floating charge is defined in section 203(1) of the Companies and Allied Matters Act 2020 (CAMA)[25] as an equitable charge over the whole or a specified part of a company's undertaking and assets, including cash and uncalled capital of the company (both present and future).

Conceptually, an asset subject to a floating charge is not immediately appropriated to the satisfaction of a debt (also referred to as attachment) upon the creation of a charge; rather, it is deferred until the occurrence of a future event (crystallisation). With a fixed charge, the asset is immediately appropriated to the satisfaction of the debt, thus limiting the extent to which the chargor may utilise the asset in the ordinary course of its business. Under section 203(1) of CAMA, a floating charge "crystallises" and becomes a fixed charge when: (a) the security interest becomes enforceable and the chargee enters into possession of the asset or appoints a receiver in respect thereof pursuant to a power under the relevant security document; (b) the court appoints a receiver or manager over the asset on the application of the chargee; or (c) the company goes into liquidation.

Pursuant to section 222 of CAMA, charges created over certain assets of a debtor-company must be registered with the Corporate Affairs Commission (CAC or Commission) within 90 days of the date of the creation of the charge[26] in order to be effective against a liquidator or any creditor of a debtor-company. These include (but are not limited to) charges over a company's uncalled share capital, land, book debts, ships, aircraft, goodwill, intellectual property and floating charges over the undertaking or property of a debtor-company. This registration requirement extends to mortgages created over the assets listed in section 222 of CAMA.[27]

1.5 Retention of title clauses

Retention of title clauses are contractual provisions that provide for legal and beneficial title to goods to be retained by the seller until full payment for the goods has been received by the seller. Retention of title clauses do not strictly create security interests, rather the buyer never secures title to the goods in question until the seller has been paid. Retention of title clauses are often adopted as a means for a seller of goods to secure priority over secured and unsecured creditors of the buyer in relation to the goods in question, if the buyer fails to pay for the goods prior to its insolvency.

Section 19(1) of the Sale of Goods Act states as follows:

> "where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, *the seller* may by the terms of the contract or appropriation, *reserve the right of disposal to the goods until certain conditions are fulfilled* [emphasis added]. In such case, notwithstanding the delivery of the goods to the buyer … the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled."

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25 Please note that the CAMA, which was signed into law in August 2020, repealed an earlier 30-year-old company law statute which did not contain a number of the insolvency and pre-insolvency procedures discussed in these responses. As a result, a number of the provisions in the statute discussed here have not been the subject of judicial interpretation and scrutiny.

26 See CAMA, section 222(1).

27 See ibid section 222(2).

However, while section 19(1) of the Sale of Goods Act provides a statutory basis for the adoption of retention of title clauses in sales contracts under Nigerian law, the "recharacterisation risk" associated with retention of title clauses, i.e. the possibility that a purported retention of title clause may be construed by the courts as creating a registrable security interest which, due to lack of registration, would be void against a liquidator and other creditors of a debtor-company, limits the value of such provisions in insulating a seller (and its contractual relationship with a buyer) from the consequences of a buyer's insolvency.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

Security interests, depending on their type, may be enforced in a number of ways – some of which involve a court process. However, these modes of enforcement are largely set out in statutes, and references to mortgages in such statutes (as well as in the paragraphs below) also apply to charges.[28]

2.1 Possession

A mortgagee may immediately take possession of any property subject to a legal mortgage (with or without the occurrence of a default).[29] However, mortgagees-in-possession are required to account to the mortgagor for their actions while in possession.[30] Consequently, mortgagees rarely take possession of property subject to a mortgage, unless there has been a default in the payment of the debt or performance of the underlying secured obligation.

2.2 Foreclosure

Foreclosure is a judicial process that may be utilised by a mortgagee to enforce its security interest. An order of foreclosure extinguishes the equity of redemption and the equitable right to redeem and vests the property subject to the mortgage absolutely in the mortgagee. In essence, an order of foreclosure makes absolute the transfer of title implied by the creation of a mortgage.

Upon an application for an order of foreclosure, the court would usually issue an order of foreclosure *nisi*, the effect of which is that the mortgagor / debtor-company has a period of six months from the order to repay the debt secured by the mortgage. If the mortgagor fails to make payment during that period, the order of foreclosure becomes an order *absolute*, and the mortgagor stands absolutely barred (foreclosed) from all rights and interests in the property.

2.3 Sale

A mortgagee is also entitled to realise its security interest by selling the property subject to the mortgage by a private sale or a public auction, free of any interests in the property to which the mortgage has priority.[31] However, for a mortgagee to sell the property subject to a mortgage, the power of sale must have *arisen* and must be *exercisable*.

A mortgagee's power of sale *arises* when the underlying debt has become due and payable, i.e., when the debt is not paid at any time fixed for payment; and is *exercisable* when any of the following conditions has been satisfied: (a) notice requiring payment of the debt has been served on the mortgagor and the

[28] For instance, see section 2(vi) of the Conveyancing Act.
[29] See ibid section 19(1) and section 123 of the Property and Conveyancing Law 1959.
[30] See also section 19(1)(iv) of the Conveyancing Act.
[31] Ibid.

debt remains unpaid for a period of three months after the service of such notice; (b) interest on the debt is in arrears and remains unpaid for two months after becoming due; or (c) there has been a breach of any provisions of the mortgage deed or applicable statutes[32] (other than a covenant for payment of the debt secured by the mortgage (or any interest thereon)).[33]

However, the aforementioned conditions may be varied or extended by the terms of the mortgage deed and apply only to the extent a contrary intention is not expressed in the mortgage deed.[34] In exercising its power of sale, a mortgagee may conduct the sale in a manner conducive to its interests, provided it acts in good faith. The mortgagee has no obligation to secure the best price for the property – in fact, evidence that the property subject to a mortgage was sold at undervalue is not, by itself, sufficient to invalidate the exercise of a mortgagee's power of sale.[35] It must be shown that the sale was fraudulent.

It is commonplace for creditors to elect to exercise their power of sale in enforcing their security interests, especially with respect to mortgages and charges created over movable and immovable property in Nigeria, including land and shares. Enforcement of charges over shares of Nigerian private companies by exercising the chargee or mortgagee's power of sale can be challenging in circumstances where the board of the relevant company is not under the control of the mortgagee because, as a matter of Nigerian law, a party is only deemed a member of a company once the name of such party is entered in the company's register of members[36] – a process largely within the control of the company's board.

2.4 Appointment of a receiver

A mortgagee or chargee may, when the debt secured has become due, appoint a receiver or a receiver / manager of the property subject to a mortgage or a charge.[37] This appointment may be made either pursuant to a power stipulated in the relevant security document or upon an application to the courts (please refer to the discussion in section 3.3.2 on receivership).

2.5 Winding-up proceedings[38]

Although criticised, it is not unusual for creditors in Nigeria to enforce their security interests over the assets of debtor-companies by initiating winding up proceedings against such debtor-companies. The threat of winding up proceedings is often deployed as a means of getting defaulting debtor-companies to pay the underlying debt. Sections 233(2)(b)(ii) and 573(1)(b) of CAMA provide that a holder of a debenture (subject to any conditions set out in the debenture deed) and a creditor, respectively, may realise their security by commencing winding up proceedings (please refer to the discussion on winding up proceedings in sections 4.1 to 4.4).

2.6 Administration

A debtor-company may also be placed in administration and an administrator be[39] appointed to manage its affairs, business and property,[40] by a holder of a qualifying floating charge over the assets of a debtor-

32 These statutes include the Conveyancing Act and the Property and Conveyancing Law 1959.
33 See section 20 of the Conveyancing Act; section 125 of the Property and Conveyancing Law 1959.
34 Section 19(2)(3) of the Conveyancing Act and 123(2) of the Property and Conveyancing Law 1959.
35 Fraud may nonetheless suffice. See *Segun Babatunde & Another v Bank of the North Limited & Others* (2011) SC 350A/2002, SC.350/2002 (Consolidated), pp 46–47, per Adekeye JSC.
36 Section 176(2), (3) of CAMA.
37 Section 19(1)(iii) of the Conveyancing Act and section 123 of the Property and Conveyancing Law 1959.
38 CAMA, section 209(2)(b)(ii).
39 Only insolvency practitioners are qualified to act as administrators of debtor-companies. See ibid section 447(1).
40 Ibid section 549(1).

company, which is enforceable, and a creditor or a group of creditors[41] of the debtor-company by initiating a court process (please refer to the discussion on administration in section 3.4).

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Pre-insolvency proceedings include the entire array of proceedings or workouts available to creditors and debtor-companies prior to the initiation of formal insolvency proceedings before the courts and fall somewhere between contractual debt restructurings and formal insolvency proceedings. Nigeria's principal company law statute, the CAMA, provides a number of procedures that do not fall squarely on either end of the pre-insolvency and insolvency divide but are nonetheless available prior to insolvency. These procedures include the following.

3.1 Company voluntary arrangements

At any time prior to winding-up, or an administration order being made in relation to a debtor-company, the directors of a debtor-company may make a proposal to the debtor-company's creditors for a composition in satisfaction of the debtor-company's debts or a scheme of arrangement of its affairs (a company voluntary arrangement or CVA).[42] A CVA proposal may also be made by an administrator of a debtor-company when an administration order is in force, or by a liquidator when the debtor-company is being wound up.[43] Where a CVA is proposed, or the debtor company is in administration or being wound up, the court may order a stay of all proceedings in the winding-up or provide for the appointment of the administrator to cease to have effect.[44]

A CVA proposal would typically provide for an insolvency practitioner[45] (described as a nominee prior to

[41] "Creditors" includes prospective and contingent creditors. See ibid section 450(4).
[42] Ibid section 434(1).
[43] Ibid section 434(3).
[44] Ibid section 439(4)(a).
[45] An "insolvency practitioner" is defined in CAMA, section 868(1) as "a legal practitioner within the meaning of the Legal Practitioners Act or a member of the Institute of Chartered Accountants of Nigeria or such other professional bodies of accountants as are established by an Act of the National Assembly". Other relevant qualifications are set out in section 705 of CAMA.

approval of the CVA proposal, and a supervisor, once approved)[46] to act as a trustee or otherwise, in relation to such arrangement and supervise its implementation.[47]

The nominee is required to submit a report to the court stating whether, in his or her opinion, meetings of the debtor-company and of its creditors should be called to consider the CVA proposal and, if so, the time and the place at which he or she proposes the meeting should be held.[48] Where a nominee in its report to the court has opined that meetings of the debtor-company and of its creditors should be called, the nominee shall, unless the court otherwise directs, call the meetings for the time, date and place proposed in his or her report.[49] Where the nominee is the liquidator or administrator, the nominee may convene the meeting for such time, date and place as the nominee thinks fit.[50]

Each meeting shall decide whether to approve the CVA proposal with or without modifications.[51] The security interest of a secured creditor may not be modified through a CVA proposal raised at a meeting called to consider a CVA proposal, without the consent of the secured creditor whose interest is to be affected.[52] A CVA proposal must allow for the settlement of any preferential debts in priority to other unsecured creditors and permit payment of preferential debts on a *pari passu* basis, unless the affected preferential creditor or creditors otherwise agree.[53] A CVA proposal is approved and deemed in effect after the proposal is approved at the debtor-company and creditors' meetings.[54] If the decision taken at a creditors' meeting differs from the decision taken at the debtor-company meeting, a member of the debtor-company may apply for a court order on the issue. In such circumstances, the court may order into effect the decision made at the debtor-company meeting or make such other order it deems fit.[55]

A CVA binds every creditor who was entitled to vote at the creditors' meeting (whether or not such creditor was present or represented at the meeting) or would have been entitled to vote at the meeting if it had notice of it.[56] If a CVA ceases to have effect and does not come to an end prematurely, a debtor-company will remain liable to pay any amounts yet to be paid under the CVA to the creditors entitled to vote at the creditors' meeting if they had notice of it.[57]

A CVA may be challenged by an application to the court on the grounds that: (a) it unfairly prejudices the interests of a creditor, member or contributory of the debtor-company; or (b) there has been some material irregularity at or in relation to either of the debtor-company or creditors' meetings.[58] Such an application may be filed by:

- any person entitled to vote at either the debtor-company or creditors' meetings called in relation to the relevant CVA proposal;[59]

46 Ibid section 442(2).
47 Ibid section 434(2).
48 Ibid section 435(2). This report must be submitted by the nominee within 28 days (or such longer period as the court may permit) after being given notice of the CVA proposal. See ibid section 435(2).
49 Ibid section 436(1)(a).
50 Ibid section 436(1)(b).
51 Ibid section 437(1).
52 Ibid section 437(3).
53 Ibid section 437(4).
54 Ibid section 438(2).
55 Ibid section 438(5).
56 Subject to applicable winding-up rules. Ibid section 439(2)(b).
57 Ibid section 439(3).
58 Ibid section 440(1).
59 Subject to applicable winding-up rules.

- any person who would have been entitled to vote at a creditors' meeting if he or she received notice of it;
- nominees (or their replacements);
- the debtor-company's liquidator, or
- its administrator.[60]

If the court is satisfied that either of the aforementioned grounds has been established, it may revoke or suspend any decision approving the CVA, give directions to call further meetings to consider any revisions to the initial CVA proposal or, where there was a material irregularity at the original meeting(s), give a direction to call a further debtor-company or creditors' meeting to reconsider the initial CVA proposal and such supplemental directions as it deems fit.[61]

After a CVA proposal has been approved, if a debtor-company's creditors or any person is dissatisfied with the acts or omissions of the supervisor, such person may apply to the court and the court may confirm, reverse or modify any act or decision of the supervisor, give the supervisor directions or make such other orders as it deems fit.[62]

3.2 Schemes of arrangement (compromise)

Schemes of arrangement (or compromise) generally refer to any change in the rights and liabilities of members, debenture holders or creditors of a company (or any class of each of these categories of corporate stakeholders) or in the regulation of a company, other than a change effected under any other provisions of CAMA or by the unanimous agreement of all parties affected by such change.[63]

Schemes of arrangement (or compromise) may be deployed in achieving a compromise between a debtor-company to be wound up and its creditors or a class of its creditors. In this respect, section 715(1) of CAMA provides that, if a compromise or arrangement is proposed between a debtor-company and its creditors (or any class of its creditors), the debtor-company, any of its creditors, or its members may apply to the court for an order summoning a meeting of the creditors (or the relevant class of creditors) or members (or class of members) of the debtor-company as the court may direct.[64]

Every notice of the court-ordered meeting distributed to the relevant creditors or members is required to be accompanied by a statement explaining the effect of the proposed compromise, the material interests of any of the directors of the debtor-company (whether as directors, members or creditors to the company), and the effect of such compromise on such directors' interests to the extent such effect would be different from the effect on the interests of other stakeholders.[65]

If at such court-ordered meeting, not less than three-quarters in value – i.e. 75 per cent of the shares of members, or of the interest of creditors, present and voting either in person or by proxy at the meeting – agrees to such compromise, the compromise may be referred to the Securities and Exchange Commission, which will in turn appoint inspectors to investigate the fairness or otherwise of the

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60 CAMA, section 440(2).
61 Ibid section 440(4), (5) and (6).
62 Ibid section 442(3).
63 Ibid section 710.
64 This application may also be filed by the liquidator of the debtor-company.
65 CAMA, section 716(1)(a).

compromise and prepare a report for review by the court within a period of time set by the court.[66]

If the court is satisfied as to the fairness of the compromise, it will sanction the compromise and the compromise will be binding on the creditors (or the class of creditors) and the debtor-company. This procedure may also be adopted by a debtor-company already in the process of being wound up, and, in such instance, the court-sanctioned compromise will be binding on the liquidator and contributories of the debtor-company.[67]

Generally, the board of a debtor-company undertaking a scheme of arrangement remains in place, unless the debtor-company is undertaking a scheme of arrangement with its creditors while being wound up. However, no winding-up petition or enforcement action by a secured or unsecured creditor will be entertained against any debtor-company or its assets, if the debtor-company has commenced a scheme of arrangement (or compromise) with its creditors, for a period of six months after the debtor-company files with the court, and provides a document setting out the terms to be proposed to creditors in such scheme, a statement of the debtor-company's affairs (including particulars of its assets, liabilities and creditors), a statement that the debtor-company desires protection from a winding-up process pending the completion of the scheme, and such other information as the court may require.[68] A secured creditor may nonetheless apply for this moratorium to be discharged if the asset of the debtor-company sought to be enforced by the creditor does not form part of the debtor-company's pool of assets to be considered under the scheme, or if the assets are perishable and may depreciate or dissipate before the end of the moratorium. The moratorium will also not apply if the secured creditor enforces its security interest before receiving notice of the proposed scheme, or if the debtor-company consents in writing to the secured creditor enforcing its rights during the moratorium.[69]

Schemes of arrangement (or compromise) may thus be utilised as a means of avoiding insolvent winding-up and as an alternative to the normal rules for the distribution of assets on winding-up. A scheme of arrangement may also be employed to complete a sale of a debtor-company's business as a going concern or property in the course of a members' voluntary winding-up[70] (please refer to the discussion on winding-up proceedings in sections 4.1 to 4.4).

3.3 Receivership

Generally, a receiver is a natural person,[71] appointed by a holder of a charge or mortgage over the assets of a debtor-company to take custody of the property subject to the security interest; receive income from the property; in certain instances, manage the property; and, ultimately, realise the security. A receiver has the power to sell the property subject to the security interest and apply the proceeds of sale in satisfaction of the underlying debt.

A person appointed as a receiver of any property of a debtor-company shall, subject to the rights of any secured creditors with priority, take possession of the property, but shall not have the power to carry on the business of the debtor-company unless he or she is also appointed a manager over the property subject to the relevant security interest.[72]

[66] Ibid section 715(2).
[67] Ibid section 715(3).
[68] Ibid section 717(1).
[69] Ibid section 717(2).
[70] Ibid section 714(1).
[71] As a matter of Nigerian law, a corporate entity cannot be appointed as a receiver. See ibid section 550.
[72] Ibid section 556(1).

If appointed a manager over the whole or a substantial part of the debtor-company's property (in addition to any powers set out in the security documents pursuant to which she or he was appointed), the receiver will be entitled to exercise a raft of powers set out in the Eleventh Schedule of CAMA. These powers include the power to bring or defend any action in the name of, or on behalf of, the debtor-company, the power to sell or otherwise dispose of the property of the debtor-company by public auction or private contract, and the power to raise or borrow money and grant security over the property of the debtor-company.[73]

3.3.1 Appointment of a receiver

Under Nigerian law, a receiver may be appointed out of court pursuant to the relevant security document or by the court.

A receiver or manager may be appointed by the holder of a mortgage or charge pursuant to a power to make such an appointment in the relevant security document.[74] A receiver appointed in this manner is deemed to be an agent of the holder of the security interest. However, if the receiver is also appointed a manager over the whole or any part of the undertaking of the debtor-company, the receiver is deemed a fiduciary of the debtor-company.

The court may also appoint a receiver or a receiver and manager over the property or undertaking of a debtor-company on the application of an interested person if the principal or any interest payments on a debt granted to a debtor-company is in arrears or the security or property of the debtor-company is in jeopardy.[75] In this respect, CAMA permits a holder of a floating charge over the assets of a debtor-company to apply to the court to have a receiver or manager appointed over the assets of the debtor-company when the charge has not yet become enforceable, provided it is demonstrated that the security interest is in jeopardy. In such circumstances, the court must be satisfied that events have occurred or are about to occur which render it unreasonable in the interest of the secured creditor for the debtor-company to retain the power to dispose of its assets.[76] A receiver or manager of any property or undertaking of a debtor-company appointed by the court is deemed an officer of the court,[77] and not of the debtor-company, and must act in accordance with the directions of the court.[78]

A receiver who is appointed as a manager over the whole or any part of the undertaking of a debtor-company is required to act in the best interests of the debtor-company so as to preserve its assets, further its business and act as a careful and ordinarily skilful manager would act. In determining the "best interest" of the debtor-company, a receiver manager is required to consider the interests of the debtor-company's employees and its members and shall give special but not exclusive consideration to the interests of the receiver's appointee.[79]

Generally, the appointment of a receiver suspends the powers of the directors of the debtor-company or a liquidator (in a members' voluntary winding-up) to deal with the property subject to the security interest unless the receiver or manager is discharged or the security is realised.[80]

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73 Ibid Eleventh Schedule.

74 Ibid section 553(1); section 19(1)(iii) of the Conveyancing Act.

75 CAMA, section 552(1).

76 Ibid section 205(2).

77 In sanctioning the appointment of a receiver or manager, the court will have regard to what it considers right and proper in the interest of all the parties. See *Intercontractors Nigeria Limited v UAC of Nigeria Limited* (1988) LPELR-1521 (SC), p 33 per, Karibi-Whyte JSC; *Viola v Anglo-American Cold Storage Company* (1912) 2 Ch 305, p 311.

78 CAMA, section 552(2).

79 Ibid section 553(2).

80 Ibid section 556(4).

3.3.2 AMCON receivership

The Asset Management Corporation of Nigeria (AMCON) was established pursuant to section 1(1) of the Asset Management Corporation of Nigeria Act 2010 (as amended) (AMCON Act)[81] to, amongst other things, acquire eligible bank assets from eligible financial institutions,[82] and realise and dispose of such assets in accordance with the provisions of the aforementioned statute.[83] Eligible bank assets are essentially non-performing loans designated as such by the Central Bank of Nigeria.[84]

Pursuant to section 48(1) of the AMCON Act, AMCON is empowered to act as or appoint a receiver (an AMCON receiver) for a debtor-company whose assets have been charged, mortgaged or pledged as security for an eligible bank asset acquired by AMCON. An AMCON receiver is entitled to realise the assets of the debtor-company and manage the affairs of the debtor-company.[85]

Receivership under the AMCON Act differs from receivership under CAMA as an AMCON receiver may exercise its powers over all of the assets and entire undertaking of the debtor-company, even though only a part of the assets of the debtor-company is subject to the security interest provided as security for the eligible bank asset.[86]

An AMCON receiver may elect to manage the business and affairs of the debtor-company, and, if it elects to do so, it is required to give notice to the public of such intention by publication in at least two newspapers with nationwide circulation.[87] In taking over management of the debtor-company, an AMCON receiver is required to manage the debtor-company upon the publication of the requisite notice, for the benefit of the debtor-company and the debtor-company's creditors. An AMCON receiver stands as a fiduciary of the debtor-company and its creditors and shall in paying off any debts owed by the debtor-company adhere with the priority rankings applicable during the winding-up of the debtor-company.[88]

Once notice of an AMCON receiver's intention to take over management of a debtor-company is published, all existing judgments, claims and debt enforcement procedures are automatically suspended and unenforceable against the debtor-company for a period of one year from the date of the publication of the notice (this period may be extended by an additional year on an *ex parte* application to the court).[89] No other secured creditor is permitted to appoint or apply to appoint a receiver or liquidator over any asset of the debtor-company or take any steps towards realising any security interest which it may hold over the assets of the debtor company during the aforementioned period.[90]

The AMCON receiver is also required, within 90 days of publication of the notice, to prepare a detailed and comprehensive plan for the rehabilitation of the debtor-company.[91] Failure to prepare this plan results in the reactivation of all claims and debt enforcement proceedings suspended by the AMCON

81 The AMCON Act 2010 has been amended twice – pursuant to the AMCON (Amendment No 1) Act 2015 and the AMCON (Amendment No 2) Act 2019.

82 "Eligible financial institutions" mean banks duly licensed by the Central Bank of Nigeria to carry on the business of banking in Nigeria under the Banking and Other Financial Institutions Act 1991, Chapter B3, Laws of the Federation of Nigeria, 2004, including financial institutions that have had their licences revoked. See section 60 of the AMCON Act.

83 AMCON Act, section 4(a), 5(a), (c).

84 Ibid section 24.

85 Ibid section 48(2) (as amended by the AMCON (Amendment No 2) Act 2019).

86 Ibid section 48(3).

87 Ibid section 48(4).

88 Ibid section 48(6).

89 This suspension does not extend to claims for wages, salaries and other entitlements of existing employees of the debtor-company. See ibid section 48(7). See also ibid section 48(10).

90 Ibid section 48(7)(b).

91 Ibid section 48(8).

receiver's election to take over management of the debtor-company, and secured creditors will regain the right to take steps towards realising their security interests in relation to the assets of the debtor-company.[92]

Generally, an AMCON receiver managing the affairs of a debtor-company is obliged to manage the debtor-company's affairs in the interest of the debtor-company and its creditors, with the objective of securing the debtor-company's existence as a going concern or achieving a "better result" for the debtor-company's creditors than would be the case if the debtor-company were to be wound up.[93] In this respect, AMCON may, acting in consultation with other secured creditors of a debtor-company, direct an AMCON receiver to appoint any advisory committee consisting of "persons with industry knowledge and expertise in the business being undertaken by the debtor-company" to advise the AMCON receiver.[94]

However, if an AMCON receiver determines that securing the debtor-company's existence as a going concern or achieving a "better result" for the debtor-company's creditors cannot be achieved, in addition to realising the assets of the debtor-company for the purpose of making distributions to secured and preferential creditors, the AMCON receiver may, on behalf of the debtor-company's secured creditors, restructure the debtor-company via a hive down. This would involve the transfer of the assets of the debtor-company over which security interests (AMCON's or otherwise) subsist, up to the value of the indebtedness of the debtor-company to all its secured creditors, to a new company.[95]

The AMCON receiver may operate or lease the transferred assets through this new entity or sell the new company as part of the hive down. However, the AMCON receiver shall not operate the new company for more than one year from the date of the transfer of the assets of the debtor-company over which security interests exist without the unanimous approval of all the secured creditors of the debtor-company.[96]

The assets of the debtor-company transferred to the new company shall be independently valued, and the new company will be deemed to be capitalised to the value of the debtor-company's assets transferred to the new company. Shares of the new company will be allotted among the debtor-company's secured creditors in proportion to the value of the assets of the debtor-company over which they held security interests, taking into account the nature of the security interest, and any other security interests that may be held by other secured creditors in the same assets.[97] The security interests of the debtor-company's various secured creditors are discharged following the allotment of shares in the new company to such creditors.[98]

3.4 Administration

A debtor-company may also be placed in administration, with an administrator[99] appointed to manage its affairs, business and property.[100] In performing his or her functions, an administrator acts as an agent of the debtor-company[101] and is, in all cases (whether appointed in or out of court), considered an officer of the court.[102]

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[92] See ibid section 48(9).
[93] Ibid section 48(11).
[94] Ibid section 48(16).
[95] Ibid section 48(12)(b).
[96] Ibid.
[97] Ibid section 48(13).
[98] Ibid section 48(14).
[99] Only insolvency practitioners are qualified to be act as administrators of debtor-companies. See CAMA, section 447(1).
[100] Ibid section 549(1).
[101] Ibid section 506.
[102] Ibid section 446.

An administrator is obliged to perform his or her functions as quickly and efficiently as is reasonably practicable,[103] with the objective of: (a) rescuing the debtor-company, the whole or any part of its undertaking, as a going concern; (b) achieving a better result for the debtor-company's creditors as a whole than would be likely if the debtor-company were wound up without first being in administration; or (c) realising property in order to make a distribution to one or more secured or preferential creditors.[104] However, the rescue of the debtor-company is the administrator's *primary* objective unless in his or her opinion that result is not reasonably practicable or a better result can be achieved for the debtor-company's creditors by pursuing the objective stated in (b) above.[105] Furthermore, if neither the rescue of the debtor-company nor achieving a better result for the debtor-company's creditors as a whole is, in the opinion of the administrator, reasonably practicable, only then can the administrator begin realising property to make a distribution to one or more secured or preferential creditors, provided doing so does not unnecessarily harm the interests of creditors of the debtor-company as a whole.[106]

Generally, an administrator may be appointed by: (a) an administration order; (b) by a holder of a qualifying floating charge (i.e. a charge that was floating at its creation);[107] or (c) by the debtor-company or its directors.[108]

3.4.1 Administration by court order

A debtor-company, its directors,[109] one or more of its creditors,[110] the official receiver (or combination of the foregoing persons), the liquidator[111] or a supervisor of a CVA[112] may file an application in court for an administration order (i.e. an order appointing a person as an administrator).[113]

Upon filing an administration application, the applicant is required to promptly provide notice of the application to any court that has appointed a receiver and any person who has appointed a receiver in respect of the debtor-company, any person who has, is or may be entitled to appoint a receiver in respect of the debtor-company, and any person who is or may be entitled to appoint an administrator of the debtor-company.[114]

Generally, a court may make an administration order after hearing an administration application where the court is satisfied that the debtor-company is or is likely to become unable to pay its debts *and* the administration order is likely to achieve the purpose of administration.[115] In addition to a number of orders a court may make upon hearing an administration application (including making an administration order or dismissing the application), the court is at liberty to treat the administration application as a winding-up

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[103] Ibid section 446.
[104] Ibid section 444(1).
[105] Ibid section 444(4).
[106] Ibid section 444(5).
[107] Ibid section 549(1).
[108] Ibid section 443.
[109] The reference to "directors" extends to a majority of the directors of a debtor-company. See ibid section 543.
[110] "Creditors" includes prospective and contingent creditors. See ibid section 450(4).
[111] Ibid section 475(1).
[112] Ibid section 442(4).
[113] Ibid section 450(1).
[114] This notification requirement is stated as extending to any other persons as may be prescribed, presumably in administration rules made by the Chief Judge of the Federal High Court pursuant to CAMA. See ibid section 450(2).
[115] Ibid section 448 and 449. However, in specific circumstances, the court may nonetheless make an administration order where it is not satisfied that the debtor-company will be unable to pay its debts on the application of a holder of a qualifying floating charge. See ibid section 472(2).

petition.[116] The appointment of an administrator pursuant to an administration order takes effect at the time specified in the order, or, if not specified, on the date of the order.[117]

3.4.2 Administration out of court

A debtor-company,[118] its directors[119] and, subject to meeting certain qualifying requirements, a holder of a floating charge over the property of the debtor-company, may appoint an administrator out of court.[120]

For a holder of a floating charge to qualify to appoint an administrator of a debtor-company (i.e. a qualifying floating chargee or QFC), the floating charge on which the appointment relies must be enforceable[121] *and* the holder of the holder of the floating charge must hold:

- one or more debentures of the debtor-company secured by a floating charge which relates to the whole or substantially the whole of the debtor-company's property;
- floating charges which together relate to the whole or substantially the whole of the debtor-company's property; or
- charges and other forms of security which together relate to the whole or substantially the whole of the debtor-company's property and at least one of which is a floating charge.[122]

In addition, the instrument that created the relevant floating charge must empower the holder of the floating charge to either: (a) appoint an administrator of the debtor-company; (b) appoint a receiver; or (c) state that the applicable sections of CAMA relating to out-of-court appointment of administrators by QFCs apply to the floating charge.[123]

QFCs are precluded from appointing administrators unless written notice is given to the holder of a *prior* floating charge[124] which would otherwise qualify as a QFC, or if the holder of the prior floating charge consented to the appointment in writing.[125] In addition, if a provisional liquidator has been appointed, a QFC is prohibited from appointing an administrator.[126] When an administrator is appointed out of court and the administration has a "cross-border element", an application shall be made *ex parte* to the court for its approval.[127]

Upon his or her appointment, the administrator is required to make a statement setting out proposals for achieving the purpose of administration, and these proposals may be proposals for a CVA or a scheme of

[116] Ibid section 451(1)(e).
[117] Ibid section 451(2).
[118] Generally, where a petition for winding-up, or an administration application in respect of, a debtor-company has been presented and is not yet disposed of, or a receiver of the debtor-company is in office, the debtor-company and its directors are prohibited from appointing an administrator out of court. See ibid section 462.
[119] Ibid section 459.
[120] Ibid section 452(1).
[121] Ibid section 454.
[122] Ibid section 452(3).
[123] Ibid section 452(2).
[124] A floating charge qualifies as a "prior floating charge" if it was created first or is to be treated as having priority pursuant to a subordination agreement to which the holders of the floating charges in question are parties. See ibid section 453(2).
[125] Ibid section 453(1).
[126] See ibid section 454. In addition, QFCs are not permitted to appoint administrators if a receiver appointed in respect of a debtor-company prior to the enactment of the CAMA remains in office.
[127] Ibid section 443(2).

arrangement (or compromise).[128] Copies of the administrator's statement must be delivered to the CAC and every member and creditor of the debtor-company (of whose claim and address the administrator is aware) within 30 days of the debtor-company's entry into administration.[129]

Other than in exceptional circumstances, the administrator is subsequently required to call a meeting of the debtor-company's creditors within 42 days after the debtor-company's entry into administration.[130] The administrator is also required to summon an initial and subsequent creditors' meeting if requested by the creditors of the debtor-company whose debts amount to at least 10 per cent of the total debt of the debtor-company.[131]

At the initial creditors' meeting, the creditors may approve the administrator's proposals without modification or with modifications if the administrator consents,[132] or the creditors may reject the proposal(s). A creditors' committee may also be established at a creditors' meeting.[133] The administrator is required to report any decision taken at the creditors' meeting to the CAC and the court.[134] If the administrator's proposals are rejected at the creditors' meeting, the court may make a number of orders including providing that the appointment of the administrator shall cease to have effect.[135]

Generally, while a debtor-company is in administration:

- no resolution may be passed, or order made for the winding-up of the debtor-company;[136]
- no step may be taken to enforce security over the debtor-company's property, repossess goods in the possession of the debtor-company under a hire-purchase agreement, or exercise a right of re-entry by a land owner in respect of property leased to the debtor-company; and
- no legal process, including legal proceedings, execution or distress, may be instituted or continued against the debtor-company or its property,[137] without the consent of the administrator or the permission of the court.

A debtor-company in administration or an officer of a debtor-company shall not exercise management powers without the consent of the administrator.[138] The administrator is also entitled to remove or appoint a director of the debtor-company whether or not the appointment is to fill a vacancy.[139]

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128 Ibid section 486(1).
129 Ibid section 486(5).
130 Ibid section 487(1). The creditors' meeting may not be required where the administrator's statement detailing his or her proposal(s) for administration includes a statement that the debtor-company has sufficient property to enable each creditor of the debtor-company to be paid in full, neither of the administration objectives of a rescue of the debtor-company or achieving a better result for the debtor-company's creditors as a whole can be achieved, or the company has insufficient property to enable a distribution to be made to unsecured creditors other than by virtue of the provisions. See ibid section 489(1).
131 Ibid sections 489(2) and 493.
132 Ibid section 490(1).
133 Ibid section 494(1).
134 And such other persons as may be prescribed by law. See ibid section 490(2).
135 Ibid section 492(2).
136 Ibid section 479(2). This rule may not apply if a debtor-company is being wound up on grounds of public interest or under special banking and financial services statutes. See ibid section 479(3).
137 Ibid section 480(1)–(4).
138 Ibid section 501(1).
139 Ibid section 498.

The administrator may make distributions to the creditors of the debtor-company;[140] however, the administrator may not make distributions to unsecured and preferential creditors without permission from the court.[141]

Generally, an administrator's proposals must not include actions which: (a) may affect the right of a secured creditor to enforce its security interests; (b) would result in a preferential debt of the debtor-company being paid other than in priority to non-preferential debts; or (c) would result in one preferential creditor being paid in a smaller proportion to its debts than another preferential creditor[142] unless the consent of the relevant creditors has been obtained.[143]

Furthermore, the administrator of a debtor-company may dispose of or take action relating to property which is subject to a floating charge as if it were not subject to the charge.[144] However, the holder of such floating charge will be entitled to the same priority over any replacement property acquired as a result of such disposal.[145] Similarly, an administrator may, empowered by a court order, dispose of property which is subject to a security interest (other than a floating charge) as if it were not subject to such security interest.[146] The court order authorising the disposal must, however, be subject to the condition that the net proceeds of the disposal and any additional money required to be added to the net proceeds, so as to produce the amount determined by the court as the market value of the property, shall be applied towards discharging the sums secured by the security interest.[147]

Creditors of a debtor-company are entitled to apply to the court for relief on the grounds that the administrator is acting, has acted or proposes to act unfairly as to harm their interests (alone or in common with other creditors),[148] or if the administrator is not performing his or her functions as quickly and efficiently as is reasonably practicable.[149]

An administrator's appointment generally lasts for one year but may be extended for a period not exceeding six months, solely with the consent of: (a) each secured creditor of the debtor-company; (b) if the debtor-company has unsecured debts, creditors whose debts amount to more than 50 per cent of the debtor-company's unsecured debts;[150] and, (c) if distributions will be made to preferential creditors, preferential creditors whose debts amount to more than 50 per cent of the debtor-company's preferential debts.[151] An administrator's appointment may also be extended by court order, for a period specified in the relevant order.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***

140 Ibid section 502(1).
141 Ibid section 502(3).
142 Ibid section 510(1).
143 Or the action envisaged forms part of a voluntary arrangement, a scheme of (arrangement and compromise) or cross-border merger. See ibid section 510(2).
144 Ibid section 507(1).
145 Ibid section 507(3).
146 Ibid section 508(1).
147 Ibid section 508(3).
148 Ibid section 511(1).
149 Ibid section 511(2).
150 Ibid section 513 and 515(1).
151 Ibid section 515(2).

- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

4.1 Winding-up

Winding-up (also referred to as liquidation) is a procedure by which the assets of a debtor-company are realised and distributed to the debtor-company's creditors in satisfaction of its debts and in the order of priority stipulated by law. Winding-up has been described as "a process whereby the life of a company is ended, and its property is administered for the benefit of its creditors and members".[152] Following the winding-up process, the company stands dissolved.

A company may undergo the winding-up process under Nigerian law both in circumstances where the company in question remains solvent and upon insolvency. A company may be wound up:

- by the court;
- voluntarily (either a creditor's voluntary winding-up or a members' voluntary winding-up); or
- subject to the supervision of the court.[153]

Generally, the property of a debtor-company being wound up is applied in satisfaction of its liabilities *pari passu* and subject to certain preferential debts stipulated by statute (including taxes and wages and salaries). Unless the articles of association of the debtor-company provide otherwise, the rest of the property shall be distributed among the members in accordance with their rights and interests in the debtor-company.[154]

4.2 Winding-up by the court

A company may be wound up by the court in a number of circumstances including where:

- the company has by a special resolution, i.e. a resolution of members (or a class of members) of a company passed by a majority representing not less than 75 per cent of the total voting rights of the members who vote in person or by proxy, resolved that the company be wound up by the court;[155]

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152 *Ini Okon Udo Utuk v The Liquidator (Utuks Construction Marketing Co Limited) & Another* (2009) LPELR-4322 (CA), p 24, per Omokri JCA.

153 CAMA section 564(1).

154 Ibid section 643.

155 Ibid section 517(a). A company may also be wound up by the court if the number of members of the company drops to below two, in the case of a company with more than one member, or the condition precedent to the operation of the company has ceased to exist. Ibid section 517(c), (e).

- the company defaults in holding a statutory meeting or fails to deliver a statutory report to the CAC;
- the company is unable to pay its debts;[156] or
- the court is of the opinion that it is just and equitable that the company should be wound up.[157]

Only one of the grounds for winding-up of a Nigerian company by the court directly relates to the solvency of the company in question. Section 572 of CAMA provides that a company shall be deemed unable to pay its debts if:

- a creditor, by assignment or otherwise to whom the debtor-company is indebted in a sum exceeding NGN200,000 then due, has served on the debtor-company by leaving at its head office or registered office a demand under hand (i.e. a written, signed demand by the creditor *not* from its counsel)[158] requiring the debtor-company to pay the sum due, and the debtor-company has for three weeks failed to pay the sum or secure or compound for it to the reasonable satisfaction of the creditor;
- execution or other process issued on a judgment, act or any order of a court in favour of a creditor of the debtor-company, is returned wholly or partly unsatisfied; or
- the court, after taking into account any contingent or prospective liability of the debtor-company is satisfied that the debtor-company is unable to pay its debts.[159]

In order to establish that a debtor-company is unable to pay its debts: (a) there must be an existing debt; (b) the debt must be due; and (c) the debtor-company must be unable to pay such debt.[160] Any challenge to a petition for winding-up where the petition was filed on the grounds that the debtor-company is unable to pay its debts must directly contest the existence of a debt, its being due or rest on the grounds that the debtor-company is able to pay the debt in question.[161]

Generally, a winding-up petition may be presented by either:

- the company;
- a creditor (including a contingent or prospective creditor) and a trustee in bankruptcy to or a personal representative of such creditor;
- the official receiver – usually the deputy chief registrar of the Nigerian Federal High Court or such other official appointed for this purpose by the Chief Judge of the Federal High Court;[162]
- a contributory, including a trustee in bankruptcy to or a personal representative of such contributory – a contributory means a person liable to contribute to the assets of company in the event of its being wound up;[163]

156 Ibid section 571(d).
157 Ibid section 571(f).
158 *Mobitel Limited v Main One Cable Company Limited* (2018) LPELR-45305 (CA), pp 13–16, per Ogakwu JCA.
159 CAMA, section 572.
160 *Air Via Limited v Oriental Airlines* (2004) LPELR-272 (SC), per Uwais JSC, interpreting a section of previous company law statute in pari materia with section 572.
161 See *Air Via Limited v Oriental Airlines*.
162 See CAMA, section 582(1).
163 See ibid section 868.

- the CAC in certain instances specified in CAMA;[164]
- a supervisor of a CVA in respect of the debtor-company;[165]
- a receiver, if authorised to do so by the instrument under which she or he was appointed; and
- any or all of these parties together or separately.[166]

In circumstances where a winding-up petition is presented by a contingent or prospective creditor of a debtor-company, the creditor shall provide sufficient security for costs and must establish a *prima facie* case for winding-up before its application may be considered by the court.[167]

4.2.1 *Powers of the court in winding-up proceedings*

The court is empowered, in hearing a winding-up petition, to dismiss the petition, adjourn the hearing conditionally or unconditionally, or make an interim order or any order it thinks fit, but it is precluded from declining to make a winding-up order on the grounds that the assets of the company have been mortgaged to an amount equal to or in excess of its assets or that the company has no assets.[168]

4.2.2 *Effect of commencing winding-up proceedings*

In addition, where winding-up proceedings have been commenced against a company, the company or a contributory may, before a winding-up order is made, apply for an order staying any other proceedings pending against the company, and the court hearing such other proceedings may stay or restrain proceedings or refer the matter to the court hearing the winding-up petition, if it deems fit.[169] The disposition of the property of a company, including the transfer of shares or alteration of the status of its members, made after the commencement of winding-up proceedings before the court shall be void.[170] In addition, any attachment of, or execution against, the assets of a company after the commencement of winding-up is void unless such proceedings relate to a fixed charge or other validly created and perfected security interest other than a floating charge.[171]

Winding-up is deemed to have commenced when a resolution is passed by the company for voluntary winding-up or when the winding-up petition is presented to the court.[172]

4.2.3 *Effect of a winding-up order*

A winding-up order shall be filed with the CAC, and, once made, no proceedings may be commenced against the company except with the leave of the court.[173] When the court has made a winding-up order

[164] See ibid section 366.
[165] Ibid section 442(4).
[166] A winding-up petition may also be filed by the CAC if it appears from a report of an inspector appointed pursuant to ibid section 363 that it would be expedient and in the public interest for the company to be wound up. See ibid section 366.
[167] Ibid section 573(2)(c).
[168] Ibid section 574(1).
[169] Ibid section 575.
[170] Ibid section 576.
[171] Ibid section 577.
[172] Ibid section 578(1) and (2).
[173] Ibid section 580.

or appointed a provisional liquidator, a statement of the affairs of the company,[174] and such other information as may be requested by the official receiver or otherwise prescribed, shall be submitted to the official receiver,[175] unless the court orders otherwise.[176] As soon as practicable after the submission of the statement of affairs of the company (or if the court orders that no statement be prepared, after the winding-up order), the official receiver is required to submit: a preliminary report as to the amount of the company's capital issued, subscribed and paid up; if the company has failed, reasons as to the causes of the failure; and the estimated amount of the company's asset and liabilities and whether further inquiry should made into the formation or failure of the company.[177]

4.2.4 *Appointment of a liquidator*

The court may also appoint a liquidator (or liquidators) in winding up proceedings to perform such duties as the court may direct. Any such appointment made before a winding up order is made shall be provisional and the court may, in its order in such circumstances, restrict the powers of the liquidator.[178]

If a provisional liquidator is not appointed by the court, the official receiver shall act in that capacity and in this respect, shall summon a meeting of creditors and contributories of the company for the purpose of determining whether an application should be made to the court for the appointment of a liquidator in place of the official receiver.[179] In making this application, the creditors and contributories may also separately determine if a committee of inspection should be appointed.[180]

A committee of inspection is usually made up of creditors and contributories of the company holding general powers of attorney from creditors or contributories in such proportion as may be determined by the contributories and the creditors or in the case of a difference of determinations, by the court, and provides directions to the liquidator on the wishes of the creditors and the contributories with respect to the management and distribution of the company's estate.[181]

4.2.5 *Powers of a liquidator*

Once a liquidator is appointed, all the powers of the board of the company shall cease except in so far as the court may otherwise direct.[182] Where a company is being wound by the court, the court may on the application of the liquidator direct that all or any property belonging to the company shall vest in the liquidator. The liquidator shall then be entitled to bring or defend any action which relates to such property, or which is required to complete the winding up of the company and recover its property.[183]

Furthermore, section 588(1) of CAMA provides that a liquidator in a winding up by the court, shall with the sanction of the court (or the committee of inspection), pay any class of creditors in full, carry on the business of the company to the extent beneficial for its winding up, or make any compromise with the

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[174] The statement of affairs is required to show the company's assets, debts and liabilities, the names, addresses and occupations of its creditors, the securities held by such creditors, the dates those securities were given, the list of members and list of charges, and shall be submitted by one or more directors and the company secretary. See ibid section 583(2).

[175] Within 14 days from the date of the winding-up order or the date of the appointment of the provisional liquidator or such extended time as the official receiver or the court may appoint. See ibid section 583(3) and (8).

[176] Ibid section 583(1) and (2).

[177] Ibid section 584(1).

[178] Ibid section 585(1) and (2).

[179] Ibid section 585(3)(c).

[180] Ibid section 596(1).

[181] Ibid sections 590. The CAC may exercise the powers of the committee of inspection where a committee of inspection has not been appointed. See section 598 of CAMA.

[182] Ibid section 585(9) of CAMA; *Nigeria Deposit Insurance Corporation vs. Financial Merchant Bank Limited* (1997) LPELR-2001 (SC).

[183] Sections 586 and 587 of CAMA.

company's creditors. More generally, a liquidator in a winding up by the court is empowered to, sell the property of the company, prove, rank, claim in the bankruptcy or insolvency of a contributory, or raise financing on the security of the company's assets as required.[184]

Subject to the provisions of CAMA, a liquidator is entitled to use his or her discretion in exercising his or her powers and managing the estate of the company and its distribution. The Liquidator shall have due regard to the directions provided by resolutions of the company's creditors and contributories in general meetings or by the committee of inspection (the former will prevail in the event of a conflict), and may ascertain the wishes of the company's contributories and creditors by summoning general meetings at such times as may have been directed at the meeting where the liquidator was appointed (in the case of a voluntary winding up) or when requested in writing by one tenth in the value of the (claims) of the creditors or contributories of the company.[185]

4.2.6 *Release of the Liquidator*

Where the liquidator of a company being wound up by the court has realised all the property of the company and made final distributions, if any, to the creditors, adjusted the rights of the contributories and made a final return, if any, to the contributories, the Commission will, on the application of the liquidator, cause a report on the accounts of the liquidator to be prepared.[186]

The CAC will consider any such report and objections that may be made against the release of the liquidator and may grant or withhold the release of the liquidator subject to an appeal to the court.[187] If the release of a liquidator is withheld, the court may, on the application of any creditor, contributory, or person interested, make such order as it deems just, charging the liquidator with the consequences of any act or default which he or she may have done or made contrary to his or her duties.[188] An order of the CAC releasing the liquidator will discharge the liquidator from all liability in respect of any act or default in the administration of the affairs of the company. Any such order may nonetheless be revoked if established that such order was obtained by fraud, suppression or concealment of any material fact.[189]

4.3 Voluntary winding-up

A company may be wound up voluntarily in circumstances where the company remains solvent:

- if any period fixed for the duration of the company's existence by its articles of association has elapsed;
- upon the occurrence of an event which its articles of association state should trigger the dissolution of the company; or
- if the company has in a general meeting passed a special resolution that the company be wound up voluntarily.[190]

If a company passes a special resolution to be wound up voluntarily, it shall, within 14 days of passing the

[184] Ibid section 588(2).
[185] Ibid section 590.
[186] Ibid section 594(1).
[187] Ibid section 594(2).
[188] Ibid section 594(3).
[189] Ibid section 594(4).
[190] Ibid section 620(1).

resolution, give notice of the resolution by advertisement in two daily newspapers (or the Federal Government Gazette) and to the CAC.[191] A voluntary winding-up is deemed to have commenced on the date the company passes the special resolution that the company be wound up.[192]

Once the resolution is passed, the company shall not carry on its business except to the extent required for the beneficial winding-up of its affairs; although, the corporate powers of the company shall continue until dissolution, and any transfer of shares (made without the sanction of the company's liquidator) and any alteration of the status of the members of the company will be void.[193]

4.3.1 Creditors' voluntary winding-up and members' voluntary winding-up

Prior to passing a special resolution to wind up a company, the company's directors are required to make a statutory declaration that they have made a full inquiry into the affairs of the company and, having done so, they believe the company will be able to pay its debts, in full, within such period not exceeding 12 months from the commencement of winding-up.[194]

The declaration must include a statement of the company's assets and liabilities[195] and must be made within 5 weeks immediately preceding the date the special resolution is passed to voluntarily wind up the company and must be registered with the CAC.[196] Where this statutory declaration is made by the company's directors, the winding-up process is considered a members' voluntary winding-up. In cases where the statutory declaration is not made, the winding-up process is described as a creditor's voluntary winding-up.

In addition to the general meeting of the debtor-company at which the special resolution is passed for the debtor-company to be wound up, with respect to a creditors' voluntary winding-up, the debtor-company must also summon a meeting of its creditors for the same day or the days following the general meeting.[197] A liquidator is also required to summon a creditors' meeting if at any time he or she is of the opinion that the company will not be able to pay its debts in full within the period stated in the directors' statutory declaration.[198] At the creditors' meeting, the directors are required to present a full statement of the position of the debtor-company's affairs together with a list of creditors and the estimated amount of their claims.[199]

The debtor-company and the creditors may nominate one or more liquidators to wind up and distribute the assets of the debtor-company.[200] Upon the appointment of such liquidator(s), the powers of the board of the debtor-company cease except in so far as the committee of inspection[201] (if one is appointed) or the creditors permit the continuance of such powers.[202] Where the creditors and the members nominate different persons to act as liquidator, the creditors' nominee(s) shall be appointed.[203] In a members'

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191 Ibid section 621(1).
192 Ibid section 622.
193 Ibid sections 623 and 624.
194 Ibid section 625(1).
195 Assets and liabilities of the debtor-company as at the latest practical date before making the declaration.
196 CAMA, section 625(2).
197 Ibid section 635(1).
198 Ibid section 629(1).
199 Ibid section 635(3).
200 Ibid section 636(1).
201 The committee of inspection is usually made up of creditors' representatives and representatives of the members of the company.
202 CAMA, section 636(2).
203 In the case of different persons being nominated, any director, member or creditor of the company may, within seven days after the date on which the nomination was made by the creditors, apply to the court for an order directing that the persons nominated as

voluntary winding-up, all the powers of directors shall cease except in so far as the company, in a general meeting, sanctions the continuance of such powers.[204]

When the affairs of the debtor-company[205] have been fully wound up, the liquidator shall prepare an account of the winding-up process and present same to the debtor-company at a general meeting[206] and, in the case of a creditors' voluntary winding-up, at a meeting of the creditors.[207] The final accounts / records may then be sent to the CAC for registration.[208] Three months following registration, the debtor-company stands dissolved.[209]

4.4 Winding-up subject to the supervision of the court

The voluntary winding-up of a company does not prevent any creditor or contributory from filing a petition to the court to have the winding-up process supervised by the court.[210]

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

The grant of a security interest to a creditor may be challenged and declared invalid on the grounds explained in the following subsections.

5.1 Hardening period

A security interest over the property of a debtor-company created by way of a floating charge may be deemed invalid if it is created within three months of the commencement of the winding-up of such debtor-company, unless it is proved that the debtor-company was solvent immediately prior to the creation of the charge. This three-month period is referred to as the "hardening period".[211] However, such floating charge may be valid to the extent of any amount of cash paid to the debtor-company at the time of, after the creation of, or in consideration for, the creation of the charge and any interest on that amount.[212]

5.2 Fraudulent preference

Where a debtor-company, during a period of three months prior to the onset of insolvency,[213] [214] does anything or procures to be done anything which has the effect of putting one of its creditors (or a surety or guarantor) at an undue advantage and intended to produce that effect, the act shall be deemed a

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liquidator by the company shall be liquidator instead of or jointly with the person nominated by the creditors, or appointing some other person to be liquidator instead of the person appointed by the creditors. See ibid section 636(1).

204 Ibid section 627(2).

205 The liquidator is required to summon a meeting at the end of each year of liquidation to account for the conduct of the winding-up process during the preceding year. See ibid sections 630 and 640(1).

206 Ibid section 632(1).

207 Ibid section 641(1).

208 Ibid section 633(4).

209 Ibid section 614(4).

210 Ibid section 649.

211 This generally applies to companies being wound up and companies in administration. See ibid section 658(8)(a).

212 Ibid section 662.

213 This period may stretch into years in relation to preferences granted to persons connected to the debtor-company (other than its employees). See ibid section 658(6).

214 Ibid section 658(6).

preference and thus invalid.[215] Likewise, the conveyance of a debtor-company's property to trustees for the benefit of all of its creditors, in furtherance of the preference, will also be void.[216]

6. Is enforcement of security rights treated differently in each type of proceeding?

Enforcement of security interests is treated as described above (see section 2) and in accordance with their relative priorities described below.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

7.1 Unsecured creditors

The *pari passu* principle applies to the distribution of a debtor-company's property during the winding-up process under Nigerian law. As earlier indicated, by section 643 of CAMA, the property of a company being wound up is required to be applied in satisfaction of its liabilities *pari passu* and subject to certain preferential debts specified by statute (including taxes, wages and salaries). Unless the articles of association of the debtor-company provide otherwise, the rest of the property shall be distributed among the members in accordance with their rights and interests in the debtor-company. Put simply, the *pari passu* principle allows creditors of a debtor-company to share in the pool of the debtor-company's assets available for distribution in accordance with the size of their admitted claims.[217]

Section 656 of CAMA extends the principles applicable to bankruptcy (of natural persons and firms) under the Bankruptcy Act, 1979 to the respective rights of secured and unsecured creditors. This includes insolvency set off, which permits mutual credits between a creditor and a debtor-company, with any sum due from one party set off against the other, and only the balance of the amounts owed provable in winding-up or paid to the liquidator as part of the assets of the debtor-company.[218] However, this shall not affect the power of any secured creditor to realise or otherwise deal with its security interest during the winding-up of an insolvent Nigerian company.

7.2 Secured creditors

The *pari passu* principle expressed in section 656 of CAMA does not, as a matter of principle, extend to the interests of secured creditors and the interests of unpaid sellers that have reserved title to the goods.

In general, and provided equities are equal, a security interest ranks ahead of any security interests created later in time. As between a legal security interest and an equitable security interest, the legal security interest would generally rank ahead of the equitable security interest, even in circumstances where the legal security interest is later in time. As between, a fixed charge and a floating charge, a fixed charge will have priority over a floating charge affecting any property of the debtor-company being wound up, unless the terms of the floating charge prohibited the grant of any later charge having priority over the floating charge, and such subsequent chargee had notice of the prohibition at the time the charge was granted.[219] The holder of a later charge is deemed to have notice of such prohibition if a notice indicating the existence of the prohibition is registered with the Commission.

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215 Ibid section 658(1) and (2).

216 Ibid section 658(5) and (2).

217 See *Captain Tito Omaghoni (JP) & Others v Nigeria Airways Limited (in Liquidation) & Others* (2006) LPELR-7609 (CA), p 21, per Rhodes Vivour JCA.

218 See section 33 of the Bankruptcy Act, 1979.

219 Section 204 of CAMA.

A term in an instrument creating a floating charge prohibiting the creation of a later charge with priority over the floating charge is referred to as a negative pledge. A negative pledge does not in principle confer priority on the holder of the floating charge, but a breach of the covenant may provide the holder of the security interest with grounds to enforce its security interest.

Furthermore, pursuant to section 222 of CAMA, charges or mortgages created over certain assets of a debtor-company must be registered with the CAC within 90 days of the date of the creation of the charge or mortgage[220] in order to be effective against a liquidator or *any other creditor* of a debtor-company.[221]

These charges include mortgages and charges over a company's uncalled share capital, land, book debts, ships or aircraft, and floating charges over the undertaking or property of a debtor-company. While this registration requirement is a perfection formality conceptually, and thus does not itself confer priority on a holder of a security interest, the stipulation in section 222 of CAMA that an unregistered charge registrable under section 222 of CAMA will be void against "any creditor" raises some doubt as to the existence of a valid security interest in such circumstances. The unregistered security interest would in all events remain enforceable against the debtor-company.

Furthermore, where two security interests of the same type are registrable under section 222 of CAMA and are both registered thereunder, priority will be accorded based on the date of the creation of the security interest and not the date the security interest was registered. Section 657(6) of CAMA provides that a fixed charge is deemed to have "priority" over other debts of the debtor-company, including preferential debts.

7.3 Preferential debts

As a matter of statute, certain debts are required to be paid immediately and in priority to all other unsecured debts if the assets of the debtor-company are sufficient to discharge them and subject to the retention of funds required to meet the costs and expenses of the winding-up process.[222] They include but are not limited to local rates and charges, assessed property and income taxes, and wages and salaries in respect of services rendered to the debtor-company.[223]

These debts rank equally and are required to be paid in full unless the assets of the debtor-company are insufficient; otherwise, such debts should be settled in equal proportions. To the extent the general pool of assets available for distribution to unsecured creditors is not sufficient to discharge them, these preferential debts are accorded priority over any claims of holders of debentures secured by a floating charge and paid out of any property subject to such floating charge.[224]

7.4 Movable property and special property

In relation to security interests created over movable property, the Secured Transactions in Movable Assets Act 2017 (STMA Act)[225] applies to all security interests in movable assets created by an agreement that secures the payment or the performance of an obligation. The statute provides for the registration of financing statements embodying the grant of a security interest over movable property with the National

220 See ibid section 222(1).
221 Ibid section 222(1) does not apply to security financial collateral arrangements or any charge created or otherwise arising under a security financial collateral arrangement. See ibid section 222(13) and 14.
222 Ibid section 657(5).
223 See ibid section 657; section 36(1) of the Bankruptcy Act, 1979.
224 Section 657(4) of CAMA.
225 Act No 3 of 2017.

Collateral Registry warehoused with the Central Bank of Nigeria. Section 23 of the STMA Act states that the priority between perfected interests in the same assets shall be determined by the order of registration with the National Collateral Registry, and this priority extends to the proceeds derived from such property.[226]

Similarly, under Article 29 of the Cape Town Convention,[227] a registered interest has priority over any interest subsequently registered and over an unregistered interest (regardless of the time of its creation).

7.5 Netting arrangements

The provisions of netting agreements (including any margin, collateral, or security arrangement forming part of a netting agreement) which provide for the determination of a net balance of the close-out values calculated in respect of accelerated or terminated payment or delivery obligations or entitlements under qualified financial contracts (principally derivative contracts) are generally enforceable and may not be avoided by the actions of liquidators or due to insolvency proceedings.[228] Any power of the liquidator to assume or repudiate individual contracts or transactions will not prevent the termination, liquidation or acceleration of such payment or delivery obligations or entitlements and applies (if at all) only to the net amount due in respect of such qualified financial contracts. Furthermore, a liquidator of a debtor-company may not avoid any transfer, substitution or exchange of cash, collateral or any other interests under or in connection with a netting agreement from the debtor-company to its counterparty under the netting arrangement, unless there is clear and convincing evidence that its counterparty made such transfer and incurred such obligation with the intent to defraud, delay or hinder any subsequent creditor of the debtor-company.[229]

7.6 AMCON as a secured creditor

Pursuant to the AMCON Act, AMCON enjoys certain special statutory rights as a secured creditor to a debtor-company.[230] Upon the acquisition of an eligible bank asset, AMCON is vested with a legal title to any property by which the eligible bank asset is secured.[231] For instance, if an eligible bank asset was originally secured by an equitable mortgage, its transfer to AMCON would result in the automatic conversion of the equitable mortgage to a legal mortgage.

Furthermore, AMCON becomes immediately vested with the power, to the exclusion of all other secured creditors, to take possession of, manage, foreclose, sell, transfer, assign or otherwise dispose of the debtor-company's asset subject to AMCON's security interest, in full or partial satisfaction of the debt represented by the eligible bank asset, notwithstanding that its security interest in such asset is merely equitable.[232]

Section 34(2) of the AMCON Act states that the vesting of an eligible bank asset in AMCON or its exercise of the foregoing rights takes effect notwithstanding the pendency of an action before the courts with respect to the eligible bank asset. Indeed, section 34(6) of the AMCON Act prohibits the grant of any preservative, interim, interlocutory, perpetual or similar order against AMCON in any court action relating to AMCON's exercise of any of the rights identified above, including its right to a "higher" form of security

226 Section 24(1) of the STMA Act.
227 Convention on International Interest in Mobile Equipment on Matters Specific to Aircraft Equipment. See Schedule V(a) of the Civil Aviation Act 2006.
228 CAMA, section 721(1).
229 Ibid section 721(6).
230 See our discussion on AMCON receiverships above.
231 See section 34(1)(a) of the AMCON Act (as amended by the AMCON (Amendment No 2) Act 2019).
232 Ibid.

interest than was initially granted by the debtor-company. The remedy of a claimant in any such action is limited to monetary compensation.

While the AMCON Act provides that the proceeds of the exercise of the powers mentioned above must, first, be used to pay any secured creditor with a valid prior ranking interest in the relevant asset and, next, *pro rata* with other secured creditors that rank equally with AMCON in view of AMCON's acquisition of the Eligible Bank Asset,[233] the statute effectively disrupts the priority of existing security interests upon AMCON's subsequent acquisition of a debt and any security interests created by a debtor-company to secure that debt obligation to AMCON's benefit.

However, AMCON shall, without prejudice to the rights of other secured creditors with security interests in the asset(s) of a debtor-company which rank prior to or equally with AMCON's security interest (*as recharacterised by statute*), be paid out of the proceeds of any realisation or receipts of the management of such assets.[234]

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

In general, creditors can protect their security interests by ensuring the valid creation and perfection of such interests prior to the onset of insolvency. Secured creditors may protect their position in the event of a debtor-company's insolvency by complying with applicable perfection formalities including:

- obtaining the consent of the State Governor (and registration at the relevant lands' registry) in relation to security interests granted over land;
- registration of a charge or mortgage with the CAC if such mortgage or charge is registrable pursuant to section 222 of CAMA; and
- complying with other special registration requirements in creating security interests over certain special assets including ships, aircraft and movable property.

In addition, creditors with security interests over movable property should endeavour to have their security documents registered with the National Collateral Registry established pursuant to section 10(1) of the STMA Act. Under this statute, a security interest will have the same priority in respect of all secured obligations, whether existing or future.[235] Furthermore, a creditor with a security interest registered under the STMA Act may enter into an agreement to subordinate its security interest in favour of another creditor.[236]

Likewise, creditors to a debtor-company may agree (under a subordination agreement) to vary the order of priority of or subordinate their security interests to those of other creditors.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

The rights of creditors against non-debtor guarantors are generally not affected by the insolvency of the debtor-company.

233 See ibid section 34(1)(d).
234 Ibid section 34(1)(c)(i).
235 Section 24(2) of the SMTMA Act.
236 Ibid section 26(2).

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

Generally, compliance with relevant security attachment and perfection formalities under Nigerian law ensures creditors obtain security interests that "fasten" to the relevant asset or group of assets, are enforceable against the relevant debtor-company (*attachment*), and, in respect of which, third parties have or are deemed to have notice (*perfection*).

Creditors that fail to comply with these formalities lose the preference they would otherwise have obtained over other secured and unsecured creditors or are left with void or otherwise invalid security interests (please refer to the discussion on the creation of various forms of security interests above).

In particular, failure to comply with perfection formalities may result in: purported legal security interests being rendered equitable security interests capable of being overreached by third-party purchasers for value without notice; certain security interests being unenforceable against specific classes of persons (other than the debtor-company); the relevant creditor losing its priority over other secured creditors; and, in some cases, the creditor being rendered an unsecured creditor. For instance:

- a debtor-company's purported creation of a legal mortgage in favour of a creditor without the satisfaction of relevant perfection formalities may result in the creation of an equitable mortgage;
- security interests that are otherwise registrable under section 222 of CAMA and are not registered would be void against the debtor-company's liquidator and the debtor-company's creditors; and
- registrable security interests created over special classes of assets such as aircraft, that are not registered, may not be afforded priority. For example, by Article 29 of the Cape Town Convention (Schedule V of the Civil Aviation Act 2006), a registered interest has priority over any unregistered interest (regardless of the time of its creation).

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged? If so, how?

Generally, prior to the commencement of the winding-up of a debtor-company, a secured creditor may be entitled to foreclose or take enforcement action, provided that another secured creditor with priority has not commenced enforcement proceedings with respect to the asset or class of assets covered by the first creditor's security interest.

Secured creditors are thus mostly unaffected by the winding-up process and may pull the assets of the debtor-company subject to their security interests from the pool of the debtor-company's assets available for distribution for the purpose of realising their security interests.[237] Indeed, while any attachment of, or execution against the assets of a company after the commencement of winding-up is void, this prohibition does not extend to proceedings relating to fixed charges or other validly created and perfected security interests other than floating charges.[238]

However, a few limitations to enforcement actions during pre-insolvency and insolvency proceedings exist under Nigerian law. Where winding-up proceedings have been commenced against a debtor-company,

[237] Any surplus of the realisation of a security interest over a debtor-company's asset(s) must be paid to the liquidator.
[238] Section 577 of CAMA.

the debtor-company or a contributory may, before a winding-up order is made, apply for an order staying any other proceedings pending against the debtor-company (including any enforcement processes initiated before the courts), and the court hearing such other proceedings may stay or refer the matter to the court hearing the winding-up petition.[239]

Also, as noted above, a debtor-company may secure a moratorium of six months with respect to any winding-up petitions or enforcement actions, where it has commenced a scheme of arrangement (or compromise) with its creditors and files a document setting out the terms to be proposed to creditors in such scheme of arrangement (or compromise) and other prescribed information with the court.[240] This moratorium may be discharged by a secured creditor on a number of grounds, including that the asset of the debtor-company sought to be enforced by the creditor does not form part of the debtor-company's pool of assets to be considered under the scheme of arrangement (or compromise).[241]

Relatedly, if a creditor levies execution against any assets of a debtor-company and the debtor-company is subsequently wound up, the creditor shall not be entitled to retain the benefit of the execution against the liquidator unless the creditor has completed the execution before the commencement of winding-up.[242] But, the rights of the liquidator in this respect may be set aside by the court in favour of the creditor to such extent and subject to such terms as the court thinks fit.[243]

Furthermore, a security enforcement process / action may be impacted by a subsisting AMCON receivership. As noted above, once notice of an AMCON receiver's intention to take over management of a debtor-company is published, all existing judgments, debt enforcement procedures and claims shall be automatically suspended and unenforceable against the debtor-company for a period of one year from the date of publication of the notice.[244]

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

For any form of security interest created under Nigerian law for which possession of the asset in question is granted to the secured creditor, the consent of the creditor would, generally, be required for the debtor-company to sell and transfer possession of the asset to a third party.

Generally, assets subject to any form of fixed security interest (e.g. a legal mortgage) may not be sold "free and clear" of the subsisting security interest without the consent of the secured creditor, and, if the debtor-company sells the asset without the consent of the secured creditor, the security interest would carry through into the proceeds of the asset sold. While conceptually equitable security interests may be overreached by the transfer of the underlying asset to a *bona fide* third-party purchaser for value without notice of the security interest, applicable perfection formalities (particularly registration under section 222

239 Ibid section 575.
240 Ibid section 717(1).
241 Ibid section 717(2)(a).
242 Ibid section 666(1).
243 See ibid section 666(1)(c).
244 This suspension does not extend to the claims for wages, salaries and other entitlements of existing employees of the debtor-company. See section 48(7) of the AMCON Act (as amended by the AMCON (Amendment No 2) Act, 2019). See also ibid section 48(10).

of CAMA) render this of minimal significance as third-party purchasers are, more often than not, deemed to have notice of registered equitable interest over a debtor-company's assets.

On the other hand, a debtor-company is generally entitled (if permitted by the terms of the instrument creating the security interest) to transfer any asset (part of a class of assets) subject to a floating security interest, free of the security interest, at any time prior to the crystallisation of the floating security interest. This is because, as a matter of law, the security interest is not deemed to have "attached" to the relevant asset or assets until the occurrence of a crystallisation event (please refer to the discussions above on crystallisation, section 1.4, and disposal of assets subject to different forms of security interests during administration, section 3.4).

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

This may constitute a breach of a negative pledge, if one exists in the relevant security instrument, which would entitle the creditor to maintain an action in damages against the debtor-company. Likewise, it may constitute a breach of a term prohibiting the creation of subsequent security interests over the secured assets, which may provide grounds for the creditor to enforce its security interest.

A fixed charge created over an asset in breach of a negative pledge under an instrument creating a subsisting floating charge over that asset shall not have priority over such floating charge if the subsequent creditor (i.e. the beneficiary of the fixed charge) had notice of the negative pledge. A debtor-company is also precluded from dealing with or creating further security interests over assets subject to a creditor's security interest if such creditor has enforced its security interest.

The risk of security interests created in the course of enforcement and pre-insolvency proceedings being deemed a preference, or in the case of a floating charge, being created during the hardening period, discourages creditors from creating additional security interests in such circumstances.

14. What distribution will a secured creditor receive if a company is reorganised?

A reorganisation may be achieved under Nigerian law via schemes of arrangement (and compromise). As earlier noted, schemes of arrangement (and compromise) result in a change in the rights and liabilities of members, debenture holders or creditors of a company or in the regulation of a company. Schemes of arrangement (or compromise) can be used to avoid insolvent winding-up, by achieving a compromise between a debtor-company liable to be wound up and its creditors or a class of its creditors.
The scope of what a secured creditor will receive after a scheme of arrangement (and compromise) has been approved by the courts depends on the specific terms of the compromise adopted (please refer to the discussion on schemes of arrangement (or compromise) at section 3.2).

In addition, and as noted above, in the event of a reorganisation of a debtor-company (by way of a hive down) in the context of an AMCON receivership, a secured creditor would only be entitled to its proportionate share of the equity interests in the new company to which the debtor-company's assets have been transferred.[245]

[245] Ibid section 48(13) and (14).

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

This will depend on the specific terms of the scheme of arrangement (and compromise) adopted by the creditors and approved by the courts. In the context of a reorganisation of a debtor-company (by way of a hive down) in the context of an AMCON receivership, a secured creditor's rights will be discharged following the allotment of shares in the new company to the secured creditor.[246]

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

If a claim is over-secured and the security interest is enforced by the exercise of a power of sale, the balance of the proceeds of the enforcement of the creditor's security interest, after payment of the secured creditor's claim together with interest and costs incurred in exercising the power of sale, will be returned to the debtor-company or form part of the pool of a debtor-company's distributable assets when winding-up commences.[247]

On the other hand, if the claim is under-secured, the unpaid portion (or deficiency) of the secured creditor's claim after the sale of the asset over which the creditor's security interest was granted will be treated as an unsecured claim, and the creditor shall be entitled to prove such claim in the debtor-company's winding-up as an unsecured creditor, commence a debt recovery action against the debtor-company (if insolvency proceedings have not been initiated), file an administration application, or file a petition for the winding-up of the debtor-company.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

We are not aware of any basis for which a Nigerian court would give effect to a foreign restructuring of contractual arrangements governed by Nigerian law, in respect of a Nigerian company, to the extent that, as a matter of Nigerian law, the restructuring process adopted for that purpose requires the imprimatur of a Nigerian court. The foregoing notwithstanding, if a foreign restructuring takes the form of a court judgment mandating the payment of a certain sum by a Nigerian company in the settlement of subsisting claims of a secured creditor, such judgment may, subject to the satisfaction of certain statutory conditions, be registered and enforced by the Nigerian courts.

[246] Ibid section 48(14).

[247] See section 21(3) of the Conveyancing Act.

RUSSIA

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

The Civil Code provides for several forms of security rights in respect of property, including pledges and liens. Retention of title and other title-based security arrangements are also available.[1]

1.1 Pledge

A pledge creates a security over property, shares, contractual and intellectual property rights and other types of assets. The benefit of having a pledge is that, if a debtor fails to perform or improperly performs a secured obligation, the pledgee is entitled to obtain satisfaction from the value of the pledged assets in priority to other creditors of the pledgor (save for cases envisaged by law). In order to obtain satisfaction, the pledgee would need to enforce the pledge (see section 2 below). The pledgee is a secured creditor in insolvency, enjoying a certain priority in the satisfaction of its secured claims (as described further in section 7).

Debtors under secured obligations or third parties can provide a pledge. It is not necessary for the pledged assets to be transferred to the pledgee in order for the pledge to be effective.

Although Russian law does not include the concept of a floating charge, it provides for a somewhat similar form of security called a pledge of goods in circulation.[2] The pledgor is entitled to change the composition and natural form of the pledged goods (e.g. to sell and acquire new goods and to process them), provided that the overall value of such goods does not fall below the agreed value. This type of pledge is used with respect to generic goods, such as raw materials, trade stock, etc.

Generally, a pledge needs to be either registered or recorded to be effective against the pledgor and / or third parties. Registration formalities vary depending on the type of asset.[3]

For example, a pledge of movable property and receivables needs to be recorded in the Register of Notices of Pledges of Movable Property (Pledge Register). Otherwise, it will not be effective against third parties (save for cases in which a third party is otherwise aware or should otherwise have been aware of the pledge).[4,5]

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[1] The Supreme Court of Russia (the SC) and the Supreme Commercial Court of Russia (the SCC) (which merged with the SC in 2014) have issued various interpretations and clarifications on the treatment of the secured interests. The lower courts generally follow the legal precedents set by the SC and the SCC.

[2] Article 357 of the Civil Code.

[3] Article 339.1 of the Civil Code.

[4] A pledge which is recorded in the Pledge Register has a priority over a pledge of the same assets which is not recorded or is recorded later. In addition, the pledge so recorded survives in the event of the sale of the pledged property by the pledgor (Articles 339.1(4), 342.1(10), 352(1)(2) and 353(1) of the Civil Code).

[5] Pledgors which are Russian companies are also required to file information on all the pledges over their movable property with the Unified Federal Register of Data on Certain Facts of Activity of Legal Entities (Article 7.1(7)(n1) of Federal Law "On the State Registration of Legal Entities and Individual Entrepreneurs" No 129-FZ, dated 8 August 2001 (Law on the State Registration of Legal Entities)). The legal effect of such filing on pledges is not clearly specified in the law.

To become effective, pledges of non-documentary securities (e.g. shares in relation to joint stock companies) need to be registered in the relevant register of securities holders maintained by the registrar or, if they are held by a depositary, with the depositary; whereas pledges of participation interests (in relation to limited liability companies) must be registered in the Unified State Register of Legal Entities to become effective.[6]

Pledges of intellectual property rights (e.g. exclusive rights to trademarks, inventions, utility models or industrial designs) need to be registered with specialised registers for the relevant intellectual property rights to become effective.[7]

A pledge of rights under a bank account (being a special pledge account) does not need to be registered. It becomes effective once a bank is notified of the pledge and is provided with a copy of the pledge agreement. If the bank is also the pledgee, the pledge becomes effective upon the parties' entry into the pledge agreement.[8]

The law does not expressly require that pledge agreements be notarised to be valid except those relating to participation interests. However, notarisation should be considered if a pledge agreement provides for out-of-court enforcement (see further section 2).

1.2 Mortgage

Security over immovable property (such as land, buildings, etc.) is created by way of a mortgage. The benefit of having a mortgage is the same as described above with respect to pledges.[9]

Mortgages become effective upon registration in the Unified State Register of Immovable Property.[10] Generally, mortgage agreements do not need to be notarised. However, if a mortgage agreement contains an out-of-court enforcement procedure, it should be notarised to enable out-of-court enforcement.

Mortgages of assets that the Civil Code treats as immovable by operation of law (such as vessels and aircraft) are to be registered with specialised registers.

1.3 Creating security

Pledges can arise by virtue of contract or law. Some examples of pledges arising by operation of law are as follows:[11]

- assets sold on credit are deemed to be pledged in favour of the seller until they are fully paid (unless the parties to the contract of sale have agreed otherwise);
- a building constructed or purchased with borrowed funds is deemed to be mortgaged in favour of the lender (unless a loan agreement provides otherwise);

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6 Article 51.6(2) of Federal Law "On the Securities Market" No 39-FZ, dated 22 April 1996; Article 22(2, 3) of Federal Law "On Limited Liability Companies" No 14-FZ, dated 8 February 1998.
7 Article 1232 of the Civil Code.
8 Articles 339.1(3) and 358.11 of the Civil Code.
9 Generally, Russian law uses the term "pledge" to describe security over movable and / or immovable property, but a pledge of immovable property is specifically referred to by law as a "mortgage".
10 Article 11(2) of Federal Law "On Mortgage (Pledge of Immovable Property)" No 102-FZ, dated 16 July 1998 (Mortgage Law).
11 Article 488(5) of the Civil Code, Article 73(2.1) of the Tax Code and Article 69.1 of the Mortgage Law.

- assets arrested by a tax authority to secure the payment of taxes are deemed to be pledged in favour of the tax authority (subject to conditions specified in the Tax Code).

As a rule, statutory pledges are subject to the same rules as contractual pledges, including those relating to registration.

1.4 Lien

A lien is a possessory form of security. In some cases a creditor can retain a debtor's property to secure its claims against the debtor (for example, for as long as a customer does not pay a contractor for work done, the contractor can retain the works and other items of the customer in its possession).[12]

Recent court practice suggests that, in the event of the debtor's insolvency, the holder of the lien must transfer the retained assets to the debtor's bankruptcy estate, provided that (i) the relevant record (of the lien-holder's security interest) is made in the Pledge Register and (ii) the holder of the lien is considered a secured creditor with rights analogous to those of the pledgee.[13]

1.5 Retention of title

Some transactions that technically do not involve the creation of a security right nevertheless result in a similar outcome for one of the parties. Legal doctrine refers to these transactions as title-based security arrangements. The main example is where a contract for the sale of assets contains a clause by which the seller retains ownership of the assets until they are fully paid or other circumstances occur as agreed.[14] Other types of the title-based security arrangements are security assignments, financial leasing and repo transactions. Russian law generally recognises the validity of these arrangements but remains undeveloped in this area, and the Supreme Court is yet to develop consistent case law in relation to how to treat such transactions in the event of the insolvency of the debtor, the title holder, or the security provider.[15]

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

2.1 Enforcement of pledges and mortgages

Generally, a pledgee can enforce a pledge through a court or, if so agreed (e.g. in a pledge agreement),

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[12] Lien can be recorded with the Unified Federal Register of Data on Certain Facts of Activity of Legal Entities. In that case third parties will be deemed to be notified of the lien (Article 7.1(12)(v) of the Law on the State Registration of Legal Entities and Article 4(5) of Federal Law "On Amendments to Certain Legislative Acts of the Russian Federation" No 377-FZ, dated 12 November 2019).

[13] SC Ruling No 301-ES19-2351, dated 27 June 2019. We note that this position is not free from legal concerns. In particular, Federal Law "On Insolvency (Bankruptcy)" No. 127-FZ, dated 26 October 2002 as amended (Insolvency Law) does not expressly provide for a secured creditor status for a creditor who retains the debtor's property.

[14] Retention of title can be recorded with the Unified Federal Register of Data on Certain Facts of Activity of Legal Entities. In that case third parties will be deemed to be notified of the retention (Article 7.1(12)(g) of the Law on the State Registration of Legal Entities and Article 4(5) of Federal Law "On Amendments to Certain Legislative Acts of the Russian Federation" No 377-FZ, dated 12 November 2019).

[15] The SCC only set out certain relevant rules as far as the insolvency of the lessor in a financial leasing contract is concerned. The SCC held that the title to the leased object may still pass from the lessor to the lessee in the above circumstances if the lessor is undergoing bankruptcy. Therefore, if the lessee has made all the contractual payments, the lessee's claims are not to be included in the creditors' register and the lessee may withdraw the leased object from the bankruptcy estate. When a financial leasing contract concluded with a lessor that later becomes bankrupt is terminated and the balance of reciprocal obligations is in favour of the lessee, the latter may retain the leased object according to the rules of lien, and it acquires the status of a secured creditor. Clause 2 of the SCC Plenum Resolution No 17, dated 14 March 2014, "On Certain Issues Relating to a Buyout Financial Leasing Contract". See also White & Case review, "Regulating buyout financial leasing based on the credit model" https://www.jdsupra.com/legalnews/regulating-buyout-financial-leasing-base-47449.

an out-of-court procedure. A "mixed" option is also possible, if so agreed (i.e. the pledged assets are to be realised in a manner agreed by the parties but based on a court decision).

In certain cases provided by the law, a creditor can only enforce a pledge through a court-based enforcement process, e.g. if the pledged assets are of high cultural importance, or if an individual's sole residential property is mortgaged (unless, in the latter case, the parties agree on an out-of-court enforcement post-default). A pledgee can also apply to court despite the parties having agreed upon an out-of-court enforcement process. However, in this case the pledgee would bear the costs relating to the court-based enforcement process, unless the pledgee were to prove that the out-of-court procedure did not succeed due to the conduct of the pledgor or a third party.[16]

In the case of an out-of-court procedure, pledged assets can be (i) sold at an auction, (ii) directly sold to a third party, or (iii) acquired by the pledgee. Options (ii) and (iii) are possible only if the pledgor is involved in commercial activities and the pledged assets are to be sold or acquired at no less than its market value.[17]

Where there is out-of-court enforcement of a non-possessory pledge, the creditor would need to apply to a notary for a notary's endorsement if the pledgor does not co-operate, e.g. to obtain possession of the pledged assets for their further realisation. A creditor would also need to apply for the notary's endorsement for the out-of-court enforcement of a mortgage. The notary can issue the endorsement only if the pledge or mortgage agreement was notarised.[18]

The notary's executive endorsement entitles the pledgee:[19]

- to seek the assistance of court bailiffs, who may take possession of the pledged assets from the pledgor (or attach it in case of immovable property) and transfer it to the pledgee for its further realisation or, if so instructed by the pledgee, arrange for its public sale); and

- to apply for registration of the transfer of the title to the mortgaged assets upon foreclosure.

In the case of enforcement by way of a court procedure, the pledged property is to be realised through a public sale unless the pledgee chooses the so-called mixed option mentioned above. Notably, the pledgor can ask a court to defer the public sale for up to one year, which the court can grant if there is a good reason to do so.[20]

Overall, any of the above enforcement procedures can be subject to delays if the third-party pledgor or debtor impedes the enforcement. Furthermore, depending on the type of the pledged assets, the acquirer of the pledged assets may need to obtain regulatory approvals in the course of enforcement.[21]

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16 Article 349(1) of the Civil Code.

17 Where rights under a bank account agreement are pledged, the pledgee can enforce the pledge by way of instructing the bank to debit the funds at the pledge account, either based on the terms of the pledge agreement or a court decision (Article 358.14 of the Civil Code).

18 Article 350.1(4) of the Civil Code, Article 55(1, 4) of the Mortgage Law, Article 94.1 of the Fundamentals of the Legislation of the Russian Federation on the Notariate No 4462-1, dated 11 February 1993.

19 Article 78 of Federal Law "On Enforcement Proceedings" No 229-FZ, dated 2 October 2007, Article 50 of Federal Law "On the State Registration of Immovable Property" No 218-FZ, dated 13 July 2015.

20 Article 350(2) of the Civil Code. The application of that rule in respect of mortgages is limited (the deferral is possible if the property is mortgaged by an individual) (Article 54(3) of the Mortgage Law).

21 For example, the approval of the antimonopoly authority, or the approval of the governmental commission in relation to "strategic" investments.

3. **Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:**

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Pre-insolvency proceedings are generally not available in Russia.[22]

An exception is the special regulation on the insolvency of financial institutions (for example, credit institutions and insurance companies).[23] The Central Bank may approve pre-insolvency proceedings aimed at restoring the solvency of financial institutions.[24]

The Central Bank[25] may introduce pre-insolvency proceedings if a financial institution repeatedly, during one month, fails to make a payment within 10 days of it being due, or fails to make a mandatory payment (such as taxes) within 10 days of it being due, or does not have enough funds to make a payment when due.[26]

The Central Bank may appoint a temporary administration of a financial institution for up to six months, with the possibility of a six-month extension provided that the total term does not exceed 18 months.[27] The temporary administration consists of an insolvency administrator and other members selected by the Central Bank.[28]

If a credit institution or an insurance company faces financial difficulties,[29] the Central Bank may decide to use financial rehabilitation measures, including the appointment of temporary administration headed by a

[22] The special legislation designed to mitigate the impact of the COVID-19 crisis for businesses and individuals provides an exception. In particular, the amendments to the Insolvency Law introduced by Federal Law No 166-FZ, dated 8 June 2020 provide for debt-restructuring for protected debtors covered by the insolvency filing moratorium. See White & Case reviews "COVID-19: insolvency filing moratorium in Russia" https://www.jdsupra.com/legalnews/covid-19-insolvency-filing-moratorium-39506, and "COVID-19: Waiver of the Benefit of the Insolvency Filing Moratorium in Russia" https://www.jdsupra.com/legalnews/covid-19-waiver-of-the-benefit-of-the-54493/.

[23] See P Boulatov, *Russia: The Insolvency Review* (7th edn, Law Business Research 2019) 296–300. See https://thelawreviews.co.uk/edition/the-insolvency-review-edition-7/1211479/russia.

[24] Articles 180(4) and 183.1 of the Insolvency Law.

[25] Articles 180(4) and 183.1 of the Insolvency Law.

[26] Article 183.2(1) of the Insolvency Law.

[27] Article 183.12 of the Insolvency Law.

[28] Article 183.6(6) of the Insolvency Law.

[29] Grounds to use financial rehabilitation measures with respect of a credit institution or an insurance company are set by Articles 189.10 and 184.1 of the Insolvency Law and include, *inter alia*, failure to meet criteria of liquidity or sufficiency of its assets and failure to make a payment when due.

representative of the Central Bank.[30] If the Central Bank appoints temporary administration, it may limit or suspend the powers of the credit institution's or the insurance company's management. The temporary administration performs an analysis of the debtor's financial situation to make a decision on rehabilitation measures to be introduced; controls the assets of the financial institution; and gives consent to some transactions by the management of the debtor.[31] There are limitations on performing certain transactions, for example, transactions related to the disposal of property, the book value of which is more than 1% of the book value of the assets of the financial institution. The temporary administration may ask the Central Bank to introduce a moratorium on payments by the credit institution or the insurance company.[32]

If the Central Bank decides to suspend the powers of the debtor's management, the temporary administration assumes its functions.[33] State registration of transactions, transfers, restrictions to / encumbrances over the right to immovable property that a financial institution owns, or exercises other property rights in relation to, are suspended.

The temporary administration may file applications with the court to challenge transactions by the financial institution or to hold the financial institution's controlling persons liable.

Special resolution mechanisms apply to major bank and insurance companies.

The Central Bank established the Fund for Consolidation of the Bank Sector and the Fund for Consolidation of the Insurance Sector. The Central Bank is the 100% shareholder of the management company of these funds (Management Company). The Management Company may decide to finance the resolution of major banks or insurance companies and become the controlling shareholder of the distressed bank or insurance company. If the bank or insurance company has negative net assets, the bank's or insurance company's shareholders must transfer their shares to the Management Company for RUB1. The Management Company finances resolution procedures by way of contributions to the bank's or insurance company's charter capital (from the loans it receives from the Central Bank) and acts as the bank's or insurance company's crisis manager. After resolution measures are complete, the Management Company must sell its shares in the bank or insurance company on the market.[34]

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***

30 Insolvency Law, Articles 189.9 and 184.1.
31 Article 183.10 of the Insolvency Law.
32 Articles 184.3-2, 189.38 of the Insolvency Law.
33 Article 183.11 of the Insolvency Law.
34 Articles 184.3-1, 184.3-3, 184.3-4, 189.49 and 189.50 of the Insolvency Law.

- ***Is shareholder consent required in order to effectuate a restructuring?***

A debtor may file for insolvency if it anticipates that it will not be able to discharge its debts as they fall due.[35] In certain instances (e.g. where the debtor's funds or assets are insufficient to discharge all of its debts), the debtor must file for insolvency.[36] The debtor is required to publish a notice of its intention to file an insolvency petition 15 days in advance.[37]

Creditors, current or former employees (if salary or severance payments to them are in arrears) also have a right to file for insolvency. They must publish a notice of their intention to file an insolvency petition 15 days in advance.[38] Creditors also need to have their claims confirmed by an enforceable Russian court judgment or an arbitral award recognised and enforced in Russia by the Russian court, save for creditors whose claims arise out of banking operations (such as providing credit) and State Corporation VEB.RF.[39] The tax authorities may also file for the insolvency of a debtor without prior confirmation of the tax claims by court judgment.[40]

Generally, the court may initiate insolvency proceedings if the debtor's liabilities are at least RUB300,000 (about USD4,100) and have been overdue for three months.[41]

There is a separate insolvency test for financial institutions.[42] A financial institution may be declared insolvent if: (i) it has failed to perform claims confirmed by a court judgment for more than 14 days, irrespective of the amount of the claim; or (ii) its assets are not sufficient to fulfil its financial obligations; or (iii) it did not become solvent as a result of pre-insolvency proceedings.

A credit institution or a creditor may file an application to declare the credit institution insolvent only after the Central Bank decides to revoke that institution's banking licence. In any event, if the credit institution meets the insolvency criteria at the date of revocation of the banking licence, the Central Bank must file for insolvency within five days of the publication of the revocation of the banking licence, or within five business days of the temporary administration informing the Central Bank about it.[43]

An increased insolvency test also applies to individuals, agricultural enterprises, strategic enterprises and natural monopolies: an individual[44] or agricultural enterprise[45] may be declared insolvent if the amount of outstanding claims exceeds RUB500,000 (about USD6,800); and a strategic enterprise[46] or a natural monopoly[47] may be declared insolvent if the amount of creditors' claims exceeds RUB1 million (about USD13,700), and the claims have been overdue for more than six months.

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35 Article 8 of the Insolvency Law.

36 Article 9 of the Insolvency Law.

37 Article 7(2.1) of the Insolvency Law.

38 Ibid.

39 Article 7(2) of the Insolvency Law. The SC interpreted this rule as giving a right to any person whose claims arise out of banking operations (as defined in Article 5 of Federal Law No 395-1, dated 2 December 1990, on Banks and Banking Activities) to file for insolvency of its debtors using the simplified procedure. This may apply to persons who acquired claims from the banks (SC Ruling No 306-ES16-3611, dated 12 October 2016). The banks, however, cannot use the simplified procedure if their claims do not arise out of banking operations (for example, claims related to lease or construction agreements) (SC Ruling No 305-ES16-18717, dated 27 March 2017).

40 Article 7(2) of the Insolvency Law.

41 Articles 3(2) and 6(2) of the Insolvency Law.

42 Article 183.16 of the Insolvency Law.

43 Article 189.61 of the Insolvency Law.

44 Article 213.3(2) of the Insolvency Law.

45 Article 177 of the Insolvency Law.

46 Article 190 of the Insolvency Law.

47 Article 197 of the Insolvency Law.

More flexible rules apply to mortgage agents.[48] The charter of a mortgage agent may provide that the obligation to file an insolvency petition arises when a certain period lapses and / or a certain event occurs. This charter provision prevails over general insolvency law requirements, i.e. the mortgage agent does not have to file for its insolvency on general insolvency law grounds unless the circumstances set out in its charter take place. Similarly, a creditor of a mortgage agent may not file for insolvency of this mortgage agent on general insolvency law grounds where an agreement (a non-petition clause) between such creditor and the mortgage agent provides that this creditor's right arises when a certain period lapses and / or a certain event occurs and where such circumstances have not arisen.

4.1 Insolvency procedures

4.1.1 Supervision

As a general rule, supervision is the first, and mandatory, stage of insolvency proceedings.[49] It applies to a debtor with a view to preserving its property, analysing its financial position, preparing a register of creditors' claims and holding the first meeting of creditors. It should be completed within seven months of the submission of the insolvency petition.[50]

Once supervision has commenced, creditors' claims for payment other than post-commencement claims may only be filed against the debtor pursuant to the procedures outlined in the Insolvency Law. Enforcement proceedings that have already commenced are stayed (with some exceptions). Court proceedings for recovering funds from the debtor are stayed upon a creditor's petition. In addition, upon commencement of supervision, no contractual interest and penalties shall accrue on any claims that can be registered irrespective of whether they are already registered or not. Rather, "moratorium interest" shall accrue on the principal debt at the Russian Central Bank's key rate[51] applicable at the date supervision is introduced.[52]

When the court orders the commencement of the supervision procedure, it will appoint an insolvency administrator. The insolvency administrator must convene the first creditors' meeting no later than 10 days before the end of the supervision. Only those creditors that have presented their claims within 30 days of the date of making the publication on the commencement of supervision, and were registered in the debtor's register of claims, have the right to take part in the first meeting of creditors.[53] Although missing the aforementioned 30-day deadline will preclude a creditor from participating in the first creditors' meeting, it will not preclude creditors from submitting their claims to the register of creditors' claims at a later stage.

The creditors at the first creditors' meeting are authorised to decide which procedure (financial rehabilitation, external management, or receivership) should be implemented. However, the court takes the final decision on this matter.[54]

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48 Article 230.1 of the Insolvency Law.

49 In some cases, supervision does not apply, and the court commences receivership if it finds that the insolvency application has merit. For example, this happens if the debtor commences voluntary liquidation before the insolvency proceedings or if the debtor is missing at its place of location and no longer operates.

50 Article 51 of the Insolvency Law. The durations of insolvency procedures mentioned herein are for indicative purposes only, and the court may exceed the time limits if necessary and appropriate.

51 The key rate is published at www.cbr.ru. As of 27 July 2020, the rate is 4.25% per annum.

52 See White & Case review "Accrual and payment of interest on creditors' claims in insolvency" https://www.jdsupra.com/legalnews/accrual-and-payment-of-interest-on-credi-10103.

53 Article 72(1) and 72(2) of the Insolvency Law.

54 Article 73 of the Insolvency Law.

4.1.2 *Financial rehabilitation*

Financial rehabilitation is an insolvency procedure that is applied to a debtor for the purpose of restoring its solvency and for discharging its debts in accordance with an approved debt repayment schedule.[55] Financial rehabilitation lasts for no more than two years.[56]

Financial rehabilitation may only commence once a petition of the debtor's shareholders or any third party interested in the restoration of the debtor's solvency is submitted.[57] According to Judicial Department statistics, financial rehabilitation is introduced very rarely (18 cases in 2018,[58] 21 cases in 2019[59]).

Based on the results of financial rehabilitation, the court will decide either to terminate insolvency proceedings (if the debts have been discharged) or commence external management (if the debtor may still become solvent) or receivership.[60]

4.1.3 *External management*

External management is an insolvency procedure applied to a debtor for the purpose of restoring its solvency. As a rule, the court introduces external management on the basis of a decision taken at the creditors' meeting. External management is usually limited to an initial period of up to 18 months and can be extended by a further six months.[61] The aggregate term of external management together with financial rehabilitation cannot exceed two years.[62]

According to Judicial Department statistics, external management is introduced in rare cases (254 cases in 2018,[63] 186 cases in 2019[64]).

Based on the results of external management, the court either terminates insolvency proceedings (if the debts have been discharged), orders settlement with the creditors according to the register of claims (if the debtor's solvency has been restored) or commences receivership.[65]

4.1.4 *Receivership*

The court introduces receivership by way of a judgment declaring the debtor insolvent. The aim of receivership is to satisfy creditors' claims according to the priorities established by law. Receivership lasts for up to six months and may be extended for a further six months.[66]

Pursuant to the Insolvency Law, all of the debtor's assets must be included in the bankruptcy estate.

According to Judicial Department statistics, receivership applies in the vast majority of cases (it was introduced in 13,254 cases in 2018[67] and in 12,378 cases in 2019).[68]

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55 Article 80(3) of the Insolvency Law.
56 Article 80(6) of the Insolvency Law.
57 Article 76 of the Insolvency Law.
58 http://www.cdep.ru/index.php?id=79&item=4890.
59 http://www.cdep.ru/index.php?id=79&item=5257.
60 Article 88(6) of the Insolvency Law.
61 Article 93 of the Insolvency Law.
62 Article 92(2) of the Insolvency Law.
63 http://www.cdep.ru/index.php?id=79&item=4890.
64 http://www.cdep.ru/index.php?id=79&item=5257.
65 Article 119(6) and 119(7) of the Insolvency Law.
66 Article 124(2) of the Insolvency Law.
67 http://www.cdep.ru/index.php?id=79&item=5257.
68 http://www.cdep.ru/index.php?id=79&item=4890.

Based on the results of the receivership, the commercial court orders either the termination of insolvency proceedings (if the debts have been discharged by the debtor's shareholders) or the completion of receivership. The receivership is deemed completed when the liquidation of the debtor is registered with the Unified State Register of Legal Entities.[69] During the course of any of the aforementioned procedures, a debtor and its creditors may terminate the insolvency proceeding at any stage thereof by amicable settlement.

4.1.5 *Insolvency of individuals*

With respect to individuals, the following insolvency procedures may apply: restructuring of debts and a sale of assets.[70] [71]

If the court finds that the insolvency petition has merit, it introduces, as a general rule, the procedure of debt restructuring and appoints an insolvency administrator.[72] In the course of this procedure, the insolvency administrator analyses the financial situation, a moratorium on the payment of debts is introduced, and no interest or penalties accrue on any claims (except for post-commencement claims). The debtor cannot enter into any transactions for a value exceeding RUB50,000 (about USD700) without the consent of the insolvency administrator.[73] The debtor or the creditors may work out a debt-restructuring plan providing for repayment of debts for no more than three years.[74] The court approves this plan if it meets the criteria set by the Insolvency Law, it is realistic and does not breach third parties' rights. In certain cases, the court may approve the debt-restructuring plan without the consent of the debtor or the creditors.[75]

If there is no basis for the approval of a debt-restructuring plan, the court declares the debtor insolvent and commences the procedure for the sale of assets.[76] The aim of this procedure is to have the debtor's assets sold and the creditors' claims repaid.

Certain assets of an individual do not constitute a part of the bankruptcy estate.[77] Such assets include the sole residential property of the individual and land plots on which the premises are situated (provided that the land plots are not mortgaged) and the equipment necessary for the debtor to conduct his or her professional activities worth not more than RUB1,213,000 (about USD16,600).[78]

4.1.6 *Insolvency of financial institutions*

As a general rule, only the supervision procedure and receivership are applied to financial institutions. However, the supervision procedure is not applicable to certain financial institutions, for example, to insurance companies or once the temporary administration of a financial institution has been appointed.[79] If the court finds that an insolvency petition filed by a creditor of an insurance company has merit, the insolvency proceedings will be suspended until the Central Bank or the temporary administration files for insolvency of the insurance company.[80]

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69 Article 149 of the Insolvency Law.
70 Article 213.2 of the Insolvency Law.
71 As of 1 September 2020 amendments to the Insolvency Law entered into force which provide that individuals may undergo a different, simplified out-of-court insolvency procedure, governed by special rules (Federal Law No 289-FZ dated 31 July 2020).
72 Article 213.6 of the Insolvency Law.
73 Article 213.11 of the Insolvency Law.
74 Article 213.14(2) of the Insolvency Law.
75 Article 213.17(4) of the Insolvency Law.
76 Article 213.24 of the Insolvency Law.
77 Article 213.25(3) of the Insolvency Law; Article 446 of the Civil Procedure Code.
78 100 minimum salaries. A minimum salary set by the Russian government is RUB12,130 (about USD166) as of 1 January 2020.
79 Article 183.17 of the Insolvency Law.
80 Article 184.4(3) of the Insolvency Law (as amended by Federal Law No 222-FZ, dated 23 June 2016, effective as of 21 December 2016).

4.2 Role of an insolvency administrator

Under the Insolvency Law, insolvency proceedings are controlled and managed by an insolvency administrator, who is supervised by the court.

The insolvency administrator's powers vary depending on the stage of the insolvency proceedings. In general, its functions include the following:[81]

- to control the debtor's business, assets, accounting and other documents and related information;
- to request information regarding the debtor's activities and operations from third parties;
- to contest or agree with creditors' applications for the registration of claims;
- to hold the register of creditors' claims and distribute the proceeds of the sale of the debtor's assets;[82]
- to arrange for the sale of assets – for this purpose, the insolvency administrator is empowered to make an inventory of assets, prepare draft conditions of sale and select the valuer and auction organiser;
- to challenge the debtor's transactions;
- to prepare and file applications to hold the debtor's controlling persons liable for their actions; and
- to call and arrange creditors' meetings.

During external management and receivership, the insolvency administrator replaces the debtor's management. Given these wide powers, the qualifications and integrity of the insolvency administrator are important for the proper conduct of the insolvency proceedings.

4.3 The creditors' meeting

The creditors' meeting is the primary body through which the creditors exercise control over the insolvency proceedings. At such meetings the creditors may decide upon the strategy of the proceedings (e.g. to choose the insolvency procedures to be applied for), or to enter into a settlement agreement.[83] It is through this body that the creditors control the insolvency administrator. For instance, the terms of sale of the debtor's non-encumbered assets by the administrator must be approved by the creditors' meeting.[84] At the meetings, the creditors are also empowered to nominate the administrator or request that the court removes the current administrator (provided that he or she has breached the law).[85]

The voting rights of secured creditors to control the proceedings are limited. They can vote at the supervision stage. During financial rehabilitation or external management, they can only vote if they decide not to enforce the collateral in the course of the respective insolvency procedures.[86] However, generally, secured creditors have very limited voting rights during receivership unless they prefer to waive their secured rights and register their claims as non-secured.[87] Nonetheless, the secured creditors have

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81 Articles 12(7), 20.3, 66, 67, 71(2), 83, 99 and 129 of the Insolvency Law.
82 The insolvency administrator generally includes claims to the register upon a court decision. The exceptions include employees' claims.
83 Article 12 of the Insolvency Law.
84 Article 139(1.1) of the Insolvency Law.
85 Article 12(2) of the Insolvency Law.
86 Article 18.1(3) of the Insolvency Law.
87 Article 12(1) of the Insolvency Law.

the right of veto with respect to certain matters (e.g. the settlement agreement,[88] substitution of the debtor's assets).[89] Further, secured creditors have voting rights on the nomination of insolvency administrators and their removal.[90]

4.4 The creditors' committee

The role of the creditors' committee is to streamline control of the creditors over the actions of the insolvency administrator. The creditors' meeting may also delegate certain powers to the creditors' committee,[91] such as to request information on the debtor's financial situation and the status of the receivership from the insolvency administrator; to challenge the administrator's actions in court; and to approve conditions for a sale of assets.[92]

4.5 Other persons participating in an insolvency

The following persons may participate in an insolvency:[93]

- a representative of the debtor's employees;
- a representative of the owner of assets of a debtor if the debtor is a state-owned (unitary) enterprise;
- a representative of the debtor's founders (shareholders / participants);
- representatives of the creditors' meeting and the creditors' committee respectively;
- the Federal Security Service, if the exercise of authority of the insolvency administrator is connected with access to data constituting state secrets;
- representatives of the constituent entities of the Russian Federation and municipalities at the location of the debtor;
- other persons in the specific cases provided for by the Commercial Procedural Code of the Russian Federation and the Insolvency Law.

In addition, the following persons have a right to participate in an insolvency: a self-regulated organisation of insolvency administrators and creditors with claims arising out of post-commencement claims.

4.6 Representatives of the Russian Federation

Tax authorities file and present claims for mandatory payment and claims of the Russian Federation relating to monetary obligations of a debtor.

The Federal Service for State Registration, Cadastre and Cartography (*Rosreestr*) supervises the activity of the insolvency administrators, as well as their self-regulated organisations.[94]

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88 Article 150(2) of the Insolvency Law.
89 Article 138(4) of the Insolvency Law.
90 Article 12(1) of the Insolvency Law.
91 Article 17(1) of the Insolvency Law.
92 Article 17(3) of the Insolvency Law.
93 Article 35 of the Insolvency Law.
94 Article 2 of the Insolvency Law.

4.7 Court

Under Russian law, all insolvency cases in Russia may be considered only by commercial (*arbitrazh*) courts – neither civil courts nor arbitration tribunals may administer insolvency proceedings.

The court's discretion and powers to control the insolvency proceedings are wide. The court takes the final decision on which insolvency procedures should be implemented, on the matter of the removal of the insolvency administrator, the registration of creditors' claims, declaring transactions of the debtor invalid and resolving any differences between the insolvency administrator and the creditors (such as in relation to the terms of sale of assets). Any decisions taken by the insolvency administrator, the creditors' meetings[95] and creditors' committee may be challenged in court by the parties to the insolvency proceedings.

During supervision the debtor's management remains in office and continues to perform its functions (although the insolvency administrator is authorised to petition for the replacement of the debtor's current management in court).[96] Once supervision has commenced, the debtor's management is prohibited from engaging in certain types of transactions and from making certain decisions.[97] Decisions on other matters, such as the alienation of assets valued at more than 5% of the balance sheet, granting or receiving loans, issuing guarantees and sureties and assignments of rights, require the prior written approval of the insolvency administrator.[98]

As with supervision, during financial rehabilitation, management retains control of the debtor, but its powers are restricted. The court must appoint an insolvency administrator who is authorised to supervise the implementation of the debt repayment schedule and the financial rehabilitation plan.[99] The consequences of commencing financial rehabilitation are generally similar to those of supervision, where certain actions by the debtor are prohibited, and where other actions require the approval of the administrative manager or of the creditors' meeting.[100]

Upon commencement of external management, the court must appoint an insolvency administrator. The insolvency administrator takes over the management of the debtor's business, may dispose of the debtor's property (subject to decisions to be taken at the creditors' meeting in certain cases, e.g. the alienation of assets valued at more than 10% of the balance sheet value of all assets) and may reject certain transactions concluded by the debtor if such transactions impede the restoration of the debtor's solvency or their performance would cause loss to the debtor. The insolvency administrator maintains and recovers funds due to the debtor and develops and implements an external management plan that is approved by a decision taken at the creditors' meeting and contains measures necessary to restore the debtor's solvency.[101]

During receivership, the insolvency administrator replaces the director general of the debtor.[102] The insolvency administrator draws up an inventory of the debtor's assets and takes measures for their protection, appoints an appraiser to value the debtor's estate, arranges for sale of the debtor's assets, recovers funds due to the debtor, searches for and returns any of the debtor's assets that are in the possession of third parties, informs the debtor's employees of their prospective dismissal, and makes distributions to the creditors according to the register of creditors' claims.

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95 Article 15(4) of the Insolvency Law.
96 Article 69 of the Insolvency Law. In this case the shareholders select a new director according to the general procedure.
97 Including, among others, reorganisation and liquidation of the debtor, establishing or acquiring equity interests in other legal entities, the creation of branches and representative offices, making dividend payments and issuing securities.
98 Article 64 of the Insolvency Law.
99 Articles 82 and 83 of the Insolvency Law.
100 Article 81 of the Insolvency Law.
101 Article 99 of the Insolvency Law.
102 Articles 127 and 129 of the Insolvency Law.

The debtor and its creditors may adjust contracts and secured and unsecured debts by entering into an amicable settlement at any stage of the insolvency proceedings. Third parties may also participate and accept certain rights and obligations according to an amicable settlement. Creditors may take a decision on amicable settlement at a creditors' meeting.

This decision is taken by a simple majority of unsecured creditors' votes in existence provided that all the secured creditors vote for the amicable settlement. Therefore, the secured creditors have a right of veto with respect to settlement agreements. A settlement agreement may provide for a discount on claims of a creditor, lower applicable interest rate, or settlement of claims by way of transfer of assets (rather than monetary funds) only if the relevant creditor agrees.[103]

Any amicable settlement must be approved by the court. The court may withhold approval for a number of reasons, including a failure to make full payment of claims of the first and second priority, a breach of third parties' rights or breach of the rights of creditors who voted against the settlement or did not agree to it.[104] An amicable settlement is not binding on any creditors whose claims were not registered as of the date it was concluded and who did not participate in it for this reason.[105]

A settlement agreement restructuring creditors' claims against the debtor does not affect the position of a creditor whose claims are secured by a third party in the latter's insolvency proceedings provided that the creditor voted against the terms of the settlement agreement of the principal debtor.[106]

Where the restructuring terms are set out in the settlement agreement, they must be approved by a majority of registered creditors and all creditors whose claims are secured by pledges (see section 4.5 above).

Where a restructuring takes the form of substituting the debtor's assets (contribution of the assets to a newly created company in return for its shares) during a receivership or external management, it must be approved by the creditors' meeting and by all creditors whose claims are secured by pledges.[107]

A restructuring in the form of a debt-for-equity swap where additional shares are issued in exchange for debt forgiveness may take place either prior to insolvency proceedings or during supervision, financial rehabilitation or external management. In this event, a decision to increase the share capital requires the approval of the debtor's shareholders.[108]

As the Insolvency Law does not provide for any shareholder cram-down, creditors generally cannot acquire equity without shareholders' consent in the insolvency proceedings.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

The granting of a security right or interest to a specific creditor may be challenged as a transaction

[103] Article 156 of the Insolvency Law.
[104] Articles 150–167 of the Insolvency Law.
[105] According to Article 9.1 (3.1–3.5) of the Insolvency Law introduced to mitigate the impact of the COVID-19 crisis, a protected debtor that has filed an insolvency petition during the insolvency filing moratorium may apply for approval of a restructuring plan after the court introduces the first insolvency procedure and the first creditors' meeting takes place. There is no need for approval of the debt-restructuring plan by the creditors. The restructuring plan concerns all creditors' claims, including those that are not registered on the register of creditors' claims, irrespective of the contract provisions that define an event of default.
[106] SC Rulings No 305-ES18-11645(3), dated 28 May 2020; and No 308-ES16-1443, dated 14 June 2016.
[107] Articles 115(2) and 141 of the Insolvency Law.
[108] Articles 64(5) and 114 of the Insolvency Law.

leading to preferential treatment of certain creditors.[109]

The court may declare such a transaction invalid if it is made: (1) after the court has accepted the insolvency petition or within one month before this date; and (2) within six months before this date, provided that the pledgor knew about the debtor's insolvency, or the insufficiency of the debtor's assets, when the transaction was made.[110]

The court may not declare a transaction of a debtor invalid as a transaction leading to preferential treatment of certain creditors upon a relevant application, if this transaction has been made in the course of usual business of the debtor and the value of this transaction is less than 1% of the assets of the debtor.[111]

The granting of a security right or interest to a specific creditor may also be challenged as a transaction aimed at violating creditors' rights and interests, provided that the other party was aware of such intent by the insolvent entity.[112] The court may declare such a transaction invalid if it is made within three years prior to the registration of the insolvency application by the court or after this date.

A security right or interest can also be challenged on general civil law grounds, in particular, based on Articles 10 and 168 of the Civil Code, which prohibit the abuse of rights and the exercise of civil law rights aimed at evading the law for an illegitimate purpose, as well as other intentional exercise of civil law rights in bad faith.

The Insolvency Law provides the insolvency administrator (at the receivership stage) and major creditors of the debtor (those owning 10% or more of the common value of the debt of the insolvent entity) with a right to challenge such transactions of the debtor.[113]

6. Is enforcement of security rights treated differently in each type of proceeding?

The enforcement of a pledge is not allowed during the supervision stage.[114]

During financial rehabilitation or the external management stages, the court may approve the enforcement of the pledge if (1) such enforcement does not prevent the debtor from restoring its solvency, or (2) there is a risk of damage to the pledged assets, which may result in a significant reduction in their value, as well as the risk of their loss.[115]

During receivership, the enforcement of the pledge is available pursuant to the procedure, discussed below.

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[109] Article 61.3 of the Insolvency Law. This category includes, among others, transactions intended to secure previously existing obligations of the debtor or a third party to a particular creditor; and transactions that have resulted, or may result in, a change in the order of priorities for satisfying creditors' claims. Clause 12 of the SCC Plenum Resolution No 63, dated 23 December 2010. Clause 5 of the Information Letter of the SCC Presidium No128, dated 14 April 2009.

[110] With respect to mortgages, the transaction is considered to be made at the date of registration of the mortgage in the state register (SC Ruling No 307-ES15-17721(4), dated 17 October 2016).

[111] Article 61.4(2) of the Insolvency Law.

[112] Article 61.2(2) of the Insolvency Law, paragraph 6 of clause 8 of the SCC Plenum Resolution No 63, dated 23 December 2010.

[113] Article 61.9(1) of the Insolvency Law.

[114] Article 18.1 (1) of the Insolvency Law.

[115] Article 18.1 (2) of the Insolvency Law.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

Russian insolvency proceedings generally tend to liquidate the debtor and secure the enforcement of pledges. Unsecured creditors rarely get any significant amounts from the insolvency process. In 2019, the rate of satisfied claims of unsecured creditors was 2.4%, and the rate of satisfied claims of secured creditors was 30.7%.[116]

7.1 General order of priorities

The Insolvency Law sets out the following general order of priority for satisfying the claims in the register of creditors:[117]

- claims of compensation for damage to health or loss of life;
- employees' salaries, severance payments, and royalties;
- all other claims (including taxes and other mandatory payments); claims for penalties, financial sanctions and lost profit are recorded separately in the register and are paid after payment of all other third-priority claims.

The Insolvency Law provides that lower priority claims against a debtor cannot be satisfied earlier than higher priority claims. If the debtor's assets are insufficient to satisfy claims of one priority, the claims of this priority will be paid *pro rata*.

7.2 Secured creditors' claims

As a general rule, secured claims against a debtor are third-priority claims. However, the Insolvency Law stipulates a special order of payment for secured claims. Secured creditors get 70% (80% if the secured claim arose out of a loan agreement with a credit institution) of all proceeds of sale of the pledged assets to compensate for the principal debt and any accrued interest. Secured claims for contractual penalties do not have priority over other creditors' claims with respect to the principal debt, but they have priority over other creditors' claims with respect to penalties.[118] If there are no claims of the first and second order of priority, the secured creditor may get up to 90% of all proceeds of sale of the pledged assets (or 95% for claims out of a loan agreement with a credit institution). If the proceeds of the sale of the collateral are insufficient to pay out the secured claim, the balance of the claim will be paid in the same priority as an unsecured claim.[119]

Similar rules will apply for a bank account pledge: the secured creditor's claims must be satisfied by way of debiting funds from the pledge account on the basis of the receiver's instruction and crediting them to the account specified by the creditor. Secured creditors get 70% (80% if the secured claim arose out of a loan agreement with a credit institution) of the funds available in the pledge account, but not more than the amount secured by the pledge.[120]

The order of priority for distributions applicable in the course of the insolvency of individuals differs from the general order of priority. The major difference is that claims in the first order of priority include

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[116] See Statistics of the Unified Federal Register of Information Regarding Insolvency https://fedresurs.ru/news/b0546f18-6128-4806-8cf3-7aea6f4834b3.

[117] For specific types of enterprises, the ranking may differ.

[118] SC Ruling No 301-ES16-17271, dated 30 March 2017.

[119] This does not apply to collateral provided by third parties.

[120] Article 138 (2.2) of the Insolvency Law.

alimony claims and that a secured creditor receives 80% of the proceeds from the sale of pledged assets. In addition, a secured creditor may additionally receive up to 10% of the sale proceeds, if there are no claims of the first and second orders of priority,[121] and may additionally receive up to 10% of the sale proceeds if they are not used for the payment of court fees or the insolvency administrator's expenses.[122]

As noted above, a pledge over a debtor's assets may arise by virtue of law as a result of attachments imposed by the tax authorities.[123] This pledge has no priority over any pledge of the attached assets existing as of the date of the attachment. It is not clear whether this pledge entitles the tax authorities to have their claims registered as secured claims in the event of insolvency. According to the Supreme Court's earlier position, the pledgee's rights arising out of an attachment imposed by bailiffs provide no priority rights in the event of insolvency.[124] At the time of writing, the Supreme Court has not yet had a chance to consider whether this position applies to the above statutory pledge securing tax claims.

7.3 Subordination of claims

The court may subordinate claims arising from the financing of the debtor by affiliated creditors to claims of registered ordinary creditors.[125] The Supreme Court has explained that inter-group creditor claims may be subordinated to other registered claims in the following situations:

- a debtor's controlling person provides financing to the debtor when it is in financial distress (i.e. shows signs of insolvency) – the financing may take various forms, for example, the granting of a loan, abstaining from debt recovery, or providing favourable payment conditions under the debtor's commercial contracts;
- a creditor affiliated with a debtor's controlling person provides financing to the debtor under the influence of the controlling person;
- a debtor's affiliate or controlling person subrogates in the rights of a third-party creditor during the debtor's financial distress, or upon the condition that the debtor compensates its affiliate for the discharge of its obligation;
- a debtor's controlling person is held liable on the grounds that its action or inaction precludes the full satisfaction of creditors' claims;
- a debtor's controlling person grants a loan to the debtor during the initial period of the debtor's business with the sole purpose of allocating risks in the event of insolvency; for these purposes the court may take into account the fact of the intentional thin capitalisation of the debtor's business;
- a debtor's controlling person grants a loan to the debtor while it is distressed based on an agreement between the controlling person and the debtor's major third-party creditor for the purposes of debt restructuring (except in cases where the debtor's minority creditors are parties to this agreement or their rights and interests are not violated by this agreement).

The Supreme Court has also articulated rules for the protection of credit institutions if they are deemed to be controlling persons as a result of their security arrangements. For example, credit institutions providing financing may become controlling persons by virtue of repo or share pledge transactions that provide for

121 SC Ruling No 307-ES19-25735, dated 21 May 2020.
122 Article 213.27 of the Insolvency Law.
123 Article 73 (2.1) of the Tax Code, introduced by Federal Law No 325-FZ, dated 29 September 2019, in force as of 1 April 2020.
124 SC Ruling No 301-ES16-16279, dated 27 February 2017.
125 The Review was approved by the SC Presidium on 29 January 2020 "Review of Court Practice for Resolution of Disputes Related to Establishment of Requirements to a Debtor's Controlling Persons and Affiliates in Insolvency Proceedings".

the transfer of voting rights. In this context, claims of credit institutions may not be subordinated (provided that they do not aim to participate in the distribution of the debtor's profits).[126] This clarification can be potentially extended to other situations where a facility is secured by the transfer of title (title-based financing), e.g. to financial leasing.

7.4 Lowest priorities

The following ordinary claims have the lowest priority:

- claims arising out of the consequences of a transaction aimed at the fraudulent transfer of assets or claims of creditors that are aimed at receiving undue preference (as discussed below);[127]
- claims arising out of perpetual bonds;[128]
- claims of creditors that are obliged to perform their obligations and to transfer assets to the bankruptcy estate only after the latter performs its obligations in favour of the respective creditors.[129]

With a number of exceptions,[130] claims filed after the register of creditors' claims is closed (i.e. two months after the publication of the judgment to declare the debtor insolvent and to open the receivership procedure) would fall to the lowest priority and would only be satisfied after all registered creditors' claims.

Shareholders' claims arising out of participation in the debtor's share capital, including claims for the payment of dividends,[131] may only be satisfied after the bankruptcy estate fully repays creditors' claims.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

Before the insolvency, it is in the interests of the creditor to ensure that the pledge is properly registered. If the debtor does not properly perform the secured obligation, the creditor can consider taking various measures to ensure the safekeeping of the pledged assets, e.g. apply to court for their attachment. In the case of a pledge of receivables, the creditor can send a notice to the pledgor's counterparty so that payments are made directly to the creditor. Also, if the agreement on the pledge of receivables provides that payments from the pledgor's counterparty are to be made to the pledgor's pledge account, the creditor can then enjoy secured creditor status in respect of those funds.[132]

Creditors can also consider enforcing the pledge if the debtor does not properly perform the secured

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[126] Clause 11 of the Review approved by the SC Presidium on 29 January 2020 "Review of Court Practice for Resolution of Disputes Related to Establishment of Requirements to a Debtor's Controlling Persons and Affiliates in Insolvency Proceedings".

[127] Articles 61.6(2) and 134(4) of the Insolvency Law.

[128] Article 134(4) of the Insolvency Law.

[129] SC Ruling No 305-ES18-11840, dated 26 November 2018.

[130] Despite the strict rule that claims filed late will fall in the lowest order of priority, case law has developed a number of *ad hoc* exceptions, such as where application of the strict rule is manifestly unjust or where the claims became due and payable after the time period for filing claims for registration expired. For example, if a bank makes a payment to a beneficiary under a bank guarantee after the register of creditors of the principal had been closed, the bank may file its redress claims for registration in the register of creditors of the principal within two months from the date they became due. In this case, these claims would not fall to the lowest priority (SC Ruling No 307-ES14-100, dated 24 September 2014). Tax inspectorates also have an additional six months after the date the register is closed to file their claims if the decision to collect taxes enters into force after the date the register is closed. The time period for filing claims for compensation of damage that a controlling person caused a legal entity starts running from the date when the limitation period to hold the controlling person liable started running (i.e. from the date the claimant became aware of the grounds to hold the controlling person liable).

[131] SC Ruling No 305-ES20-16, dated 11 June 2020.

[132] SC Ruling No 305-ES18-8062(2), dated 22 November 2018.

obligation. The creditors should bear in mind the term of the pledge agreement, as well as the relevant limitation period for enforcing the pledge.[133]

If the enforcement is later challenged in insolvency as a preferential transaction, it can be set aside only to the extent of the preference provided (i.e. with due regard to the priority rules provided by law: see section 7 above).[134]

If the enforcement is made through the court, the relevant court decision would be a basis for lodging a creditor's secured claims in the register of creditors' claims which the competing creditors and the insolvency administrator may only contest by filing an appeal against the decision outside of the insolvency proceedings.[135]

Once the insolvency proceedings have been initiated, creditors should submit their claims to the register of creditors' claims in a timely manner so as to ensure that they can obtain secured creditor status. If the creditor does not file its secured claims in the pledgor's insolvency proceedings at all, the pledged assets will be sold without the creditor's consent and the pledge will terminate.[136] Also, in the case of a third-party pledge, if the debtor becomes insolvent, the creditor should submit its claims to the pledgor before the debtor is liquidated, otherwise the pledge will terminate once the debtor is liquidated.[137]

It would be in the interests of the secured creditor to submit its claims for recording in the register of creditors' claims as soon as possible, to be able to take part in the first creditors' meeting (which will decide, *inter alia*, on the choice of the insolvency administrator).

In theory, creditors can enforce the pledge during financial rehabilitation or external management (subject to authorisation of the court and limitations mentioned in section 6). However, given these procedures are quite rare in practice, the pledged assets will be most likely sold at an auction in the course of the receivership.

During receivership, the secured creditors are vested with the power to determine the initial sale price for selling the pledged assets at the auction, the procedure and the terms of the auction, as well as the procedure and terms for ensuring the safekeeping of the pledged assets. However, if other creditors or the insolvency administrator disagree with the secured creditor's proposed terms, they can ask the court to amend them.[138]

If the pledged assets may be sold together with unsecured assets of the debtor (e.g. as a single

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133 In particular, in case of a third-party pledge, if the term of the pledge is not specified in the pledge agreement, the pledge will terminate if the pledgee does not submit its claim to the pledgor within one year after the secured debt matures, see Resolution of the Constitutional Court of the Russian Federation No 18-P, dated 15 April 2020. This rule is equally applicable in insolvency proceedings. This approach is based on the application of certain rules on suretyship to third-party pledges (Article 335(1) of the Civil Code). See also section 9 below in relation to suretyship.

134 If pledged assets were transferred to the secured creditor in settlement of a claim, the pledgor does not have to return those assets to the bankruptcy estate in full. Instead, the pledgor may transfer funds in the amount required to discharge higher-ranking obligations whilst an application to challenge the transaction is being considered. In this case, the court will refuse to declare the transaction invalid. Clause 29.3 of the SCC Plenum Resolution No 63, dated 23 December 2010. See also White & Case review "Challenging transactions made by debtors in anticipation of insolvency" https://www.jdsupra.com/legalnews/challenging-transactions-made-by-debtors-13620/.

135 Clause 24 of the SCC Plenum Resolution No 35, dated 22 June 2012 "On Certain Procedural Issues Related to Insolvency Proceedings".

136 SC Ruling No 308-ES16-1368, dated 26 May 2016.

137 SC Ruling No 304-ES18-26241, dated 13 June 2019. This approach is based on application of certain rules on suretyship to third-party pledges. See also section 9 below.

138 Article 138(4) of the Insolvency Law.

production complex), such sale is only possible with the consent of the secured creditor (subject to limited exceptions).[139]

A secured creditor is entitled to appropriate the pledged assets if they are not sold at a second auction or in the course of the public offering which follows the latter (subject to statutory rules as to the price at which the assets can be appropriated).[140]

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

If a debtor fails to fulfil its obligation to a creditor, the creditor is entitled to make a claim against the surety (guarantor). Thus, if a debtor defaults on a creditor's claim, a creditor may look to the surety who is responsible for paying the guaranteed amount.[141] If a surety has reimbursed a creditor's claim for the debtor, the surety shall have the right of subrogation, i.e. the right to seek compensation of its payment under the guarantee from the debtor, including in the debtor's insolvency proceedings (if any).

The liquidation of the primary obligor and the subsequent termination of all of its obligations terminates the suretyship unless the creditor has filed a claim against the surety before the primary obligor is liquidated.[142]

The creditor should file a claim against the surety before the secured obligation terminates as a result of the completion of the personal insolvency proceedings of the principal obligor (which would release the insolvent individual from his or her obligations).[143]

Also, if the creditor missed the time limit for filing claims in the insolvency proceedings of the primary obligor, its claims to the surety will fall in the lower order of priority in the insolvency proceedings of the surety.[144]

In addition, the suretyship terminates one year after the expiry date of the secured obligation unless the suretyship agreement provides for other terms. Therefore, a creditor's claim arising out of a suretyship agreement may not be satisfied in the course of the insolvency proceedings of the surety if the creditor has missed the relevant time limits.[145]

As addressed above,[146] if a settlement agreement is reached in the principal debtor's insolvency proceedings where it changes the terms of the principal debtor's obligations and excludes the debtor's late performance, the secured creditors' claims may not be excluded from the register in the surety's insolvency proceedings.

It should be noted that the insolvency of the primary obligor does not affect the currency of the surety's obligation, the surety continues to be liable in the currency specified in the agreement.[147] However, if the surety is subject to insolvency proceedings, the claims are registered in its register at the rate established at the date of the introduction of the insolvency proceedings of the primary debtor.[148]

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[139] Article 138(4) of the Insolvency Law; SC Ruling No 305-ES16-10852(3), dated 20 November 2017.
[140] Article 138(4.1, 4.2) of the Insolvency Law.
[141] *See* Articles 363 and 323 of the Civil Code.
[142] Article 367 (1) of the Civil Code.
[143] SC Ruling No 46-KG19-14, dated 9 July 2019, and No 304-ES18-26241, dated 13 June 2019.
[144] SC Ruling No 303-ES16-6738, dated 8 September 2016.
[145] Article 367(6) of the Civil Code; Resolution of the Constitutional Court of the Russian Federation No 18-P, dated 15 April 2020.
[146] See section 4.5 above; SC Ruling No 305-ES18-11645 (3), dated 28 May 2020.
[147] SC Ruling No 305-ES16-19525, dated 20 April 2017.
[148] SC Rulings No 305-ES16-11412, dated 26 September 2016; and No 305-ES16-13148, dated 24 August 2016.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

If a creditor has not taken measures to protect its secured rights, it is at risk of losing the benefits of its secured creditor status.

As noted, it is necessary to register a pledge of movables and receivables in the Pledge Register to ensure that the pledge is effective against third parties. Therefore, in the absence of such registration, the creditor does not have the status of a secured creditor, unless it can prove that the other creditors of the insolvent debtor / pledgor were aware of or should have been aware of the pledge.[149] The creditor can record its pledge after the insolvency proceedings have been initiated. However, there is a risk that such action will be set aside as a preferential transaction. It should also be noted that a creditor loses the right of pledge if the pledged asset is sold to a *bona fide* purchaser (which is more probable in the event that the pledge is not registered).

In the absence of the registration, which is required to make the pledge effective, the creditor will not be considered as a secured creditor.[150]

See also section 8 above for other consequences of the creditor's failure to take measures to protect its secured rights.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged? If so, how?

According to the Insolvency Law,[151] from the date when the supervision procedure commences, all monetary claims as well as claims for foreclosure of the pledged assets must be brought against a debtor in the insolvency proceedings. Likewise, as of the same date, enforcement proceedings against a debtor are stayed.

This does not prevent the court from rendering a decision on foreclosure of the pledged assets if a claim has already been filed with a court before the commencement of the supervision procedure and the creditor has not applied for a stay. However, such a court decision may be enforced only during the course of the insolvency.[152]

See also section 6 above.

11.1 Challenging the stay

The stay is automatic and takes effect by operation of law. Therefore, it may not be appealed separately from appealing the court ruling on the introduction of the supervision procedure.

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[149] Clause 8 of the Recommendations of the scientific advisory board of the Commercial Court of the West Siberian Circuit approved on 26 April 2019.

[150] Although, there was a case where the status of a secured creditor was recognised in relation to unregistered immovable property (an unfinished construction, provided that the lease rights to the underlying land plot were mortgaged); see SC Ruling No 306-ES17-3016(2), dated 14 August 2017.

[151] Articles 18.1(1), 63(1) of the Insolvency Law.

[152] Clause 6 of the SCC Plenum Resolution No 58, dated 23 July 2009.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

In the case of a non-possessory pledge, the pledgor can generally continue using the pledged assets in its business operations. At the same time, as a rule, an insolvent debtor is not allowed to sell, lease, or otherwise dispose of, or encumber the pledged assets without the secured creditor's consent.[153] If the pledged asset is nevertheless sold without the creditor's consent, the pledge should still survive (unless the asset is acquired by a *bona fide* purchaser who was not aware of the pledge).

Interestingly, if the pledged asset is in the possession of the pledgee (which is not that widespread in practice), and then it is lost against the pledgee's will, the pledge should survive even if the asset has been acquired by a *bona fide* purchaser who was not aware of the pledge.[154]

The following should be noted with respect to cash collateral. In the case of a pledge of a bank account, the creditor can send a notice to the bank to prevent further withdrawals from the pledge account (i.e. effectively freeze the account for the amount which is equivalent to the secured debt).[155] If the pledgee enters into financial rehabilitation or external management (which is rare), the creditor can satisfy its claims by way of the withdrawal of funds from the pledge account – up to the total amount of funds available in the account, but not exceeding the amount of the secured debt, subject to court authorisation (as specified in section 6 above). During receivership, withdrawal of funds from the pledge account is permitted in the amount of up to 70% (or 80%) of the funds available in the account but not exceeding the amount of the secured debt.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

An insolvent pledgor can only grant additional contractual security rights over the secured creditor's collateral with the consent of the secured creditor (unless otherwise provided for by law or in the pledge agreement).[156]

Non-contractual security rights over the secured creditor's collateral may arise by virtue of law, including those arising as a result of an attachment imposed by the tax authorities. However, such security rights should be in a lower order of priority to the existing ones, which are properly registered or known to the non-contractual security rights holder (see also section 7 above).

14. What distribution will a secured creditor receive if a company is reorganised?

Where a reorganisation takes the form of substituting a debtor's assets, the pledge of assets contributed to the share capital of the newly established company is replaced with a pledge over the shares in this company. The value of the shares to be pledged must be equal to the market value of the pledged assets contributed to the share capital.[157] The pledged shares in the newly established company are part of the

153 Article 18.1(4) of the Insolvency Law.
154 Clause 25 of the SCC Plenum Resolution No 10, dated 17 February 2011.
155 Article 358.12(4) of the Civil Code.
156 Article 18.1(4) of the Insolvency Law.
157 Articles 115 and 141 of the Insolvency Law.

bankruptcy estate and secured creditors must receive the proceeds of their sale in accordance with the general rules applicable to pledged assets discussed above.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

As a result of a reorganisation involving the substitution of a debtor's assets (see section 14), a buyer

will be able to acquire shares in the company whose property is unencumbered and attract financing secured by the pledge of such property.

For the purposes of enhancing the guarantee for creditors' rights, the sole executive body of the newly established company will be an external administrator or a receiver. Another person may be appointed to this position following a decision of the creditors at the creditors' meeting. The creation of a collegial management body and approval of the company's articles of association are within the competence of the creditors' meeting or the creditors' committee. The newly established company is not entitled to dispose of property that has been contributed to its share capital until all of its shares are realised in the course of the insolvency procedures.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

The fact that the value of the pledged property significantly exceeds the amount of the creditor's claims *per se* does not mean that it is possible to challenge the transaction. When the court accepts a creditor's claim, it takes into account that the claim is secured by a pledge, regardless of the value of the pledged property.[158] In respect of a third-party pledge, the amount of secured creditors' claims recorded in the register of creditors' claims of the insolvent pledgor is determined based on the value of the pledged property as specified in the pledge agreement or the court decision authorising the foreclosure.[159] Where a claim is over-secured, after the pledged property has been disposed of at an auction as established by law, the amount by which the creditor's claim is over-secured (after payment of principal, interest and costs) must be transferred to the bankruptcy estate to be used to satisfy the claims of the other creditors in the relevant order of priority.[160]

If the secured creditor's claims are under-secured, the unsecured portion of such creditor's claim will be ranked alongside the third-priority unsecured creditors on a *pro rata* basis without any preference.[161]

The Supreme Court clarified that, if a secured creditor's claims are under-secured, the insolvency administrator cannot distribute monetary funds received prior to the enforcement of pledges only among non-secured creditors: these proceeds have to be reserved and distributed among all creditors, including the secured creditors.[162]

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

Russian court practice has not developed any rules similar to the Gibbs Principle. Therefore, if a foreign restructuring of contractual arrangements governed by Russian law was carried out with the consent of the

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158 Resolution of the Commercial Court for the North-Western Circuit No A56-14458/2019, dated 3 March 2020.

159 Although, if the sale proceeds exceed the registered amount of the claims against the third-party pledgor, they are used towards the discharge of the secured creditors' claims in full (Clause 20 of the SCC Plenum Resolution No 58, dated 23 July 2009).

160 Article 138 (2.1) of the Insolvency Law.

161 Ibid.

162 SC Ruling No 310-ES18-17700 (2), dated 11 July 2019.

parties to those arrangements, a Russian court may give them effect subject to a valid choice of foreign law for those contractual arrangements. If a foreign restructuring was carried out in the form of a court-approved restructuring without the consent of the relevant creditor, a Russian court may give it effect only if the foreign decision on the debt restructuring is recognised and enforced by the Russian court.

In general, foreign court judgments are recognised on the grounds of international treaties and, absent such treaties, on the grounds of comity and reciprocity. However, recognition of foreign judgments related to restructuring proceedings in Russia may require proof of mutual recognition of Russian insolvency judgments in the relevant foreign jurisdiction. Generally, a Russian court's approach to recognition of foreign court judgments on restructuring proceedings has been inconsistent. Between 2010 and 2014, Russian courts recognised three Kazakh judgments on restructuring proceedings in respect of Kazakh banks.[163] However, in a more recent case, Russian courts refused to recognise an Azerbaijani court decision on the restructuring of the debts of an Azerbaijani bank upon request from its creditor, a Russian bank. They found, among other things, that (1) unilateral (even partial) write-off of a Russian bank's debt contravened Russian public policy and (2) recognition of foreign judgments on restructuring in Russia required proof of mutual recognition of Russian insolvency judgments in Azerbaijan.[164]

*** Note:** The author would like to thank Julia Lymar (Senior Professional Support Lawyer at White & Case) and Irina Maisak (Professional Support Lawyer at White & Case) for their assistance with this chapter.

[163] Rulings of the Moscow Commercial Court No A40-24334/10-25-170, dated 23 April 2010 (not appealed); No A40-108389/2012, dated 15 October 2012 (not appealed); No A40-53374/14, dated 24 July 2014 (not appealed). The courts granting such relief relied on the multilateral Kiev Treaty on Settling Disputes Related to Commercial Activities (dated 20 March 1992).

[164] See Resolution of the Commercial Court for the Moscow Circuit No A40-185979/2017, dated 8 November 2018 (petition for review by the SC denied).

SINGAPORE

1. **Briefly summarise the types of security rights available and indicate, in each case:**

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

Under Singapore law, there are a number of security devices that can be used to encumber movable, immovable and intangible assets. Singapore adopts the English common law forms of security rights. Although most security rights are created contractually, some can come into existence by operation of common or statutory law.

1.1 Movable property

1.1.1 Pledge

In Singapore, a pledge is created when a debtor (i.e. the pledgor) transfers possession of goods owned by it to the creditor (i.e. the pledgee), with the intention of using the goods as security for the sum owed. In order for a pledge to be created, there has to be transfer of possession of the goods. This is done through actual physical delivery, or notional or constructive delivery, for example by delivering documents of title to goods to the creditor.

The pledgee should not give up possession (whether actual or constructive) of the goods to the pledgor, as doing so may bring the pledge to an end. The redelivery of the pledged goods to the pledgor may cause the pledgee to lose its rights to the pledged goods unless it is for a limited purpose and parties clearly intend for the pledgee to regain possession when that purpose has been met.

The pledgee has the right to retain possession of the pledged goods and use them until the debt is repaid. If the debt is not repaid within the time specified, the pledgee has the right to sell the pledged goods and apply the proceeds of sale in satisfaction of the debt.

1.1.2 Chattel mortgage

A mortgage over movable property is created in the same manner as a mortgage over immovable property (see section 1.2 below). Generally, the same rights and obligations are contractually agreed between the mortgagor and mortgagee. Similarly, mortgages over chattels can be either legal or equitable.

Under the Singapore Companies Act (Cap. 50, 2006 Rev. Ed.), a chattel mortgage created by a company has to be registered within 30 days after its creation. The failure to do so renders the security interest void against the liquidator and any other creditor upon the insolvency of the company. Common law priority rules apply to two or more mortgages created over the same movable property. Registration under the Companies Act also constitutes notice to the world of the existence of the security interest and also determines priority between competing interests in the same property.

Mortgages over certain types of goods are governed by specific statutes instead of the Companies Act. For instance, mortgages of registered ships must conform to the requirements of the Merchant Shipping Act (Cap 179, 1996 Rev Ed).

1.1.3 Fixed and floating charges

A fixed charge is a security interest that attaches itself to a particular charged asset without any transfer of ownership (in contrast to a mortgage) or possession (in contrast to a pledge). A fixed charge follows an asset if transferred, meaning that the transferee will take the asset subject to the fixed charge. If the debtor defaults, the creditor can sell the charged asset and assert a claim over the proceeds of sale in priority to other creditors.

Unlike a fixed charge holder, a floating charge holder cannot assert any proprietary or possessory right to any specific asset under that floating charge even if the disposition of that asset is made outside the chargor's ordinary course of business or in breach of the terms of the debenture creating such a floating charge (*Diablo Fortune Inc v Duncan Cameron Lindsay and Another* [2018] 2 SLR 129). A chargor is usually free to deal with the assets. Therefore, while security over inventory can be taken by means of a fixed charge, a floating charge will probably be more suitable as, in order to generate income, the debtor usually needs to deal with the inventory in the course of its business.

Attachment is deferred as the specific assets secured by a floating charge will only be determined when the floating charge crystallises. Parties may contractually provide for the events that trigger the crystallisation of a floating charge, such as events of default, insolvency or any attempt to dispose of or encumber the charged assets in a manner inconsistent with the terms of the security. Also, automatic crystallisation occurs if a receiver is appointed over the chargor's assets or if the chargor goes into liquidation or ceases to carry on business. The effect of crystallisation is that the floating charge will attach to the assets in the class that it hovers over, such that it will become a fixed charge. The chargor's authority to deal with those assets comes to an end.

Registration of both fixed and floating charges are required under the Companies Act within 30 days after creation. The failure to do so renders the security interest void against the liquidator and any other creditor upon the insolvency of the company.

1.1.4 Lien

When possession of goods is transferred to another for some work to be done upon the goods, and the fee for work done is outstanding, the worker in possession of the goods (the "lienee") obtains, by operation of the law, the right to exercise a lien over the goods. At common law, the rights of the lienee are merely to retain possession of the goods until full payment is made. Unless contractually agreed, no other remedy is available. Unlike a pledge, there is no power of sale or disposition of the goods. The lien is extinguished upon relinquishing possession of the goods.

A lien may arise contractually if expressly provided for in the contract. Also, a lien may be imposed by statute. For example, an unpaid seller of goods may retain possession of goods until payment or tender of price under section 41 of the Sale of Goods Act (Cap 393, 1999 Rev. Ed).

1.1.5 Retention of title or Romalpa clause

To round off the discussion on security in movable property, it is also necessary to take note of transactions that technically do not involve the creation of a security right but that nevertheless achieve a security purpose in that they provide protection for the creditor and can increase the likelihood of a creditor being repaid. These are also known as "quasi-security".

Essentially, security creates an interest in assets, whereas quasi-security creates rights against a person (i.e. it gives the creditor rights against the quasi-security provider). It is common for creditors to deploy both security and quasi-security devices in the same transaction.

An example of quasi-security is when a supplier of goods secures its position in respect of the payment of the purchase price of the goods by contractually providing for title or ownership in the goods to be retained by it until the full purchase price has been paid. This is known as a retention of title or Romalpa clause.

1.2 Immovable property

1.2.1 Mortgage

There are two types of land in Singapore – common law titled land and land under the Land Titles Act (Cap. 157, 2004 Rev. Ed.) (LTA). Virtually all land in Singapore has been brought under the LTA. A mortgage can be either a legal mortgage or an equitable one. A legal mortgage is created when the mortgagor conveys its legal title to the property to the mortgagee in consideration of a loan.

- **Equitable mortgage**

  Where the mortgagor has an equitable title to the land, it can only convey equitable title to the mortgagee. An equitable mortgage can also be created by a mortgagor with legal title either by agreement or where the relevant formalities for the creation of a valid legal mortgage are not fully complied with.

  If the property is still under development, the purchaser will usually only have equitable title to the property. In Singapore, it is common for an equitable mortgage to be created by the mortgagor assigning its rights under the sale and purchase agreement or the building or lease agreement. Notice of the assignment should be given to the developer or lessor who has entered into the sale and purchase agreement, or the building or lease agreement, with the mortgagor.

  Further, a caveat should be lodged at the Singapore Land Authority (SLA) in favour of the mortgagee. This protects the mortgagee's interest during the time between the acceptance of the facility and the registration and perfection of the security. The mortgagor also executes a mortgage-in-escrow so that, when it receives legal title to the property, the mortgage-in-escrow can be completed and registered at the SLA.

- **Legal mortgage**

  A legal mortgage must be created by deed in the English language and is subject to a proviso for redemption on repayment of the secured debt. A legal mortgage under the LTA has to be in a statutorily prescribed form and registered with the SLA. Unless a mortgage over real property has been registered with the SLA, the mortgage will not be effective in vesting any legal interest in the mortgagee. Upon registration, the mortgage will be reflected in any subsequent title searches conducted on the property and will be conclusive proof of the encumbrance of the property created in favour of the mortgagee.

In addition, if the mortgagor is a Singapore company or a foreign company registered in Singapore, any mortgage over real estate must be registered with the Accounting and Corporate Regulatory Authority (ACRA) within 30 days of creation of the security if the document creating the mortgage is executed in Singapore. Registration must be carried out within 37 days of creation of the security, if the document creating the mortgage is executed outside Singapore.

1.2.2 Charge

A charge over land is created when the chargor agrees to appropriate or make available a property towards the satisfaction of the debt so that the chargee is entitled, in the event of default of repayment of the debt, to take possession of the property, sell it and apply the proceeds in satisfaction of the debt. Unlike a mortgage, both ownership and possession of the land remain with the debtor or third party.

In addition, if the chargor is a Singapore company or a foreign company registered in Singapore, any charge over real estate must be registered with ACRA within 30 days of creation of the security if the document creating the charge is executed in Singapore. Registration must be carried out within 37 days of creation of the security if the document creating the charge is executed outside Singapore.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

2.1 Enforcing security

The security documents will typically provide that the security is enforceable on the occurrence of an event of default or if the lender has accelerated the loans (i.e. demanded repayment of a loan before its stated date of maturity). Subject to the ambit of the security documents, a lender can generally enforce its security without court involvement. Enforcement powers may also be implied by statute and common law if not expressly provided for in the security documents.

Security over collateral can be enforced upon default by the borrower by:

- appointing a receiver;
- obtaining possession of the mortgaged property either by consent or by court order and subsequently exercising the power to sell the mortgaged property; or
- obtaining an order for foreclosure.

In Singapore, the second option is the most commonly exercised mode of enforcement. A lender is under a duty to act in good faith and to take reasonable steps to obtain a fair price when exercising a power of sale. The lender has the prerogative to decide when to sell the secured property and need not wait until the potential sale price improves before selling it. However, the lender has a duty to obtain the best price reasonably obtainable at the time of sale. Also, the secured lender would have to act with reasonable care and skill and must act fairly in relation to the charger / mortgagor. Most sales exercised by secured lenders are carried out without the need to obtain a court order to effect the sale.

The purpose of appointing a receiver is to remove the management of the mortgaged property from the hands of the debtor and to place it in the control of an independent party appointed by the secured creditor. The appointment of a receiver must be in writing. There is usually no need for a court order.

In contrast, foreclosure as a remedy may only be effected by an order of the court.

It is possible for a debtor to obtain a moratorium preventing secured creditors from enforcing their security. This is either by applying for a moratorium in support of a scheme of arrangement proposed or to be proposed, or by filing an application for judicial management. If such a moratorium is in force, a secured creditor would need leave of the court to enforce its security or the consent of the judicial manager.

Enforcement powers might also be contractually limited, such as when there are intercreditor arrangements governing enforcement and standstill agreements that restrict enforcement over specified periods of time.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Singapore law provides for a number of pre-insolvency procedures, namely procedures that focus on the "rescue" of an individual or entity via a payment plan or reorganisation instead of the liquidation of assets. The scheme of arrangement procedure can be used as a compromise arrangement between the company and its creditors, under which the creditors agree to forego all or part of their claim against the company, or simply to reschedule their debts, while allowing the company to continue to trade. Such arrangements may be privately arranged or court-sanctioned. Another rehabilitation process in Singapore is judicial management, which is the Singapore equivalent of the English administration.

3.1 Corporate pre-insolvency proceedings

3.1.1 Consensual workouts

It is possible for a company to attempt to enter into a private arrangement with its creditors without the assistance of the court. The Association of Banks in Singapore's Principles and Guidelines for Restructuring of Corporate Debt is indicative in this regard. In doing so, all of the creditors would have to agree to the arrangement. However, obtaining the unanimous consent of all affected creditors is no easy task since the creditors might have diverse expectations. Some may want a quick exit from the company while others might not be averse to a longer-term solution. A deed is usually executed detailing the agreed arrangement. However, problems may arise when a creditor breaches the deed or if creditors that are not parties to the deed subsequently surface.

3.1.2 Court-sanctioned schemes of arrangement

A company may apply to the court to summon a meeting of creditors to approve a scheme of arrangement between a company and its creditors or a class of its creditors. In order for a scheme to be approved more than 50 per cent of the creditors (or a class of creditors) comprising 75 per cent in value must agree to the proposed scheme.

Under the 2017 amendments to the Companies Act and now the Insolvency Restructuring and Dissolution Act 2018 (No. 40 of 2018) (IRDA), a company may now also apply to the court for approval of a pre-packaged scheme, which dispenses with the need to hold a meeting of creditors. In order for such a scheme to be approved by the court, the court must be satisfied that had a meeting of creditors been summoned, each relevant class of creditors would have approved the scheme. Depending on the nature of the proposal, shareholder consent may or may not be required.

Under a scheme, control of the company remains with management, although scheme managers are usually appointed to assist with negotiations and to give effect to the terms of the scheme.

3.1.3 Judicial management

A judicial management application may be brought by the company (pursuant to a members' resolution), its directors (pursuant to a board resolution), or its creditors. The court may make a judicial management order if it is satisfied that the company is or is likely to become unable to pay its debts. Additionally, the court must be satisfied that the order, if made, would be likely to achieve one or more of the following purposes, namely:

- the survival of the company, or the whole or part of its undertaking as a going concern;
- the approval of a compromise or arrangement between the company and its creditors; or
- a more advantageous realisation of the company´s assets than would occur in a winding-up.

Section 94 of the IRDA provides that apart from applying to the court for a judicial management order, a company can also be placed under judicial management if a majority of the creditors (in number and value) so approve after requisite notices and documents have been filed and a creditors' meeting called.

The judicial manager is an independent third party who takes over the running of the company from the management.

Once the judicial management has commenced, the appointed judicial manager has 90 days to prepare a statement of proposals on how the manager intends to achieve the purpose(s) for which the judicial management order was made.

The judicial manager then summons a creditor's meeting and, if more than 50 per cent in number and value of creditors approve, the judicial manager is obliged to manage the company's affairs, business and property in accordance with the proposals. Depending on the nature of the proposals, shareholder consent may or may not be required.

If a scheme is subsequently proposed under the aegis of the judicial management, the requisite threshold of approval is as set out in 3.1.2 above.

3.2 Individual / consumer pre-insolvency proceedings

3.2.1 Individual voluntary arrangement

An individual debtor may explore debt settlement with its creditors by way of an individual voluntary arrangement. Under this scheme, if the court grants an interim order, all proceedings against the debtor would be stayed. The objective is to accord the debtor a respite from legal proceedings in order to give the debtor an opportunity to put forth debt settlement proposals to its creditors. The court may make an interim order if it thinks that the debtor's proposal is serious and viable and that it would be appropriate to do so for the purposes of facilitating the consideration and implementation of the debtor's proposal. The debtor would be able to avoid bankruptcy if a majority of its creditors (and holding at least three-fourths in value of debts owed) accept the debtor's proposal. However, such an arrangement is not available to undischarged bankrupts.

3.2.2 Debt repayment scheme

The debt repayment scheme (DRS) is a repayment scheme to assist debtors who have a regular income and debts not exceeding SGD100,000 to avoid bankruptcy.

The DRS is triggered by a bankruptcy application. When such an application is made to the High Court and the debt owed does not exceed SGD$100,000, the High Court may refer the debtor to the official assignee for an assessment of the debtor's eligibility and suitability to enter into the DRS. If the debtor satisfies the relevant criteria, an administrator will devise a repayment plan requiring regular debt-service payments in respect of restructured debt over a fixed period of time. Debtors who do not comply with the conditions of the scheme will be removed from the DRS. These debtors may subsequently face another bankruptcy application filed against them and be made bankrupt by the High Court.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Singapore law provides for two main categories of insolvency proceedings, namely the bankruptcy of individuals and the winding-up (voluntary or by court order) of companies.

4.1 Corporate liquidation proceedings

Under Singapore law a company may be wound up voluntarily or by the court. Winding-up is basically a process where the company's assets are seized and realised, with the resulting proceeds used to pay off its debts and liabilities. Any surplus is then distributed among the contributories of the company according to their rights and interests, or otherwise dealt with as the constitution of the company directs. The debtor's management is displaced and does not remain in control of the business. Upon the completion of the liquidation, the company goes into dissolution, and it ceases to exist.

It is possible to effectuate a restructuring under the aegis of a liquidation subject to the requisite level of shareholder and / or creditor consent. Any arrangement entered into between a company about to be or in the course of being wound up and its creditors is, subject to the right of appeal, binding on the company, if sanctioned by a special resolution, and on the creditors if acceded to by 75 per cent in value and 50 per cent in number of the creditors, every creditor for under SGD500 being reckoned in value only.

4.2 Voluntary winding-up

A distinction is made between a members' voluntary winding-up and a creditors' voluntary winding-up. In both cases the procedure is commenced by the passing of a special resolution by the shareholders of the company.

4.2.1 Members' voluntary winding-up

The company's contributories (also known as members or shareholders) may pass a resolution that the company be wound up and that a liquidator be appointed. The liquidation commences at the time of passing the resolution. This process is used where the company is able to pay its debts in full within 12 months after the commencement of winding-up. The directors of the company are required to file a declaration of solvency.

4.2.2 Creditors' voluntary winding-up

If the company is not able to meet its liabilities, the company can convene a meeting with its creditors to consider its proposal for a voluntary winding-up of the company. If a resolution is passed in favour of the winding up, the company will appoint a liquidator, subject to any preference the creditors may have as to the choice of liquidator.

4.3 Winding-up by the court

Under the IRDA, the company itself, creditors, contributories, liquidator, directors, judicial manager or the minister may present a winding-up application to the High Court.

The applicant has to pay a winding-up deposit of SGD10,400 to the Official Receiver, and the court may appoint the Official Receiver or an approved liquidator as the liquidator of the company.

The winding-up is deemed to have commenced as at the date of the presentation of the winding-up application.

The IRDA states all the grounds under which the court may liquidate a company. One common ground for a company to be wound up by the court is if the company is deemed unable to pay its debts if a company's creditor, who is owed more than SGD15,000, has served a demand for the sum owing at the registered office of the company, and the company has not paid this sum for three weeks thereafter.

4.4 Personal insolvency

Bankruptcy proceedings are commenced by way of the filing of a bankruptcy application to the High Court. A bankruptcy application can be filed by the debtor itself or a creditor who is owed not less than SGD15,000.00 by a debtor.

A debtor (who is an individual) may file an application to make itself a bankrupt. A statement of affairs must be filed together with the bankruptcy application. If a partnership firm wishes to take out a bankruptcy application, the application must be presented jointly by all the partners of the firm or by a majority of such partners who are residing in Singapore at the time of the making of the application.

A creditor may only file a bankruptcy application against a debtor if, amongst other things, the debt owed is not less than SGD15,000 and the debtor is unable to pay the debt. Under the law, a debtor is presumed to be unable to pay a debt if the debtor does not comply with or apply to set aside a statutory demand. After a statutory demand demanding payment is served on a debtor; and the debtor:

- does not make payment within 21 days; or
- does not apply to the court within 14 days (or 21 days, if the statutory demand was served on the debtor outside jurisdiction) to set aside the statutory demand, the creditor may proceed to file a creditor's bankruptcy application against the debtor.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

In Singapore, both liquidators and judicial managers may unravel antecedent transactions on the basis that they amount to either an unfair preference or a transaction at an undervalue.

A transaction at an undervalue can be set aside if it took place within five years of the commencement of winding-up. A preferential transfer, even if for fair value, may also be set aside if made within six months of the commencement of winding-up, or two years if the transfer was to an associate of the company. These time periods have changed now that the IRDA is in force: the relevant time in respect of a transaction at an undervalue is three years under the IRDA, and the relevant time in respect of an unfair preference is one year (or two years if the unfair preference is given to an associate of the company) under the IRDA.

A floating charge created in favour of a connected person or any other persons, within a period of two years or one year of the commencement of the winding-up respectively, shall be invalid, except to the amount of cash paid to the company at the time of or subsequently to the creation of the charge, together with the interest (if any) pursuant to any agreement.

The floating charge shall remain invalid unless the secured creditor is able to prove that the company was solvent after the creation of the floating charge.

Any floating charge given by the company in the above periods will, unless the company was solvent immediately, be invalid except to the extent that it was given to secure new money. Even if the floating charge is invalid, the debt will remain as an unsecured debt.

Any charge created over a company's property that is registrable but not registered is void against the liquidator and any creditor of that company.

6. Is enforcement of security rights treated differently in each type of proceeding?

The treatment and enforcement of security rights are similar in the available procedures, except that insolvency proceedings are usually aimed at the realisation of assets and distribution of proceeds to the creditors according to their ranking, while pre-insolvency proceedings do not necessarily involve the realisation of assets but can include a reorganisation that might impact on the treatment of secured creditors.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

7.1 Insolvency proceedings: corporate liquidation

In distributing the assets of a company on liquidation, its secured creditors will generally first be paid out of the assets that have been charged or mortgaged in their favour, while the remainder of the assets will be distributed among the other creditors. The order of priority in insolvency proceedings of a Singapore company is as follows:

a. costs and expenses of winding-up, including the taxed costs of applicant and the remuneration of the liquidator;

b. wages or salary including allowance or reimbursement;

c. retrenchment benefits or *ex gratia* payments under employment contracts;

d. all amounts due in respect of workers' compensation under the Work Injury Compensation Act 2019 (No. 27 of 2019) accrued before, on or after the commencement of winding-up;

e. contributions payable by the company as employer;

f. all remuneration payable to any employee in respect of vacation leave, accrued in respect of any period before, on or after the commencement of winding-up; and

g. all tax assessed under any written law before the commencement of the winding-up or assessed at any time before the time fixed for the proving of debts has expired.

After payment of these preferential claims in full, the balance is then paid *pari passu* to all ordinary unsecured creditors. However if the assets of the company available for payment of general creditors are insufficient to meet any preferential debts specified in subsections (a), (b), (c), (e) and (f) above those debts shall have priority over the claims of floating charge holders and shall be paid accordingly out of any property comprised in or subject to that charge.

When all creditors have been paid, the liquidator makes a capital repayment to shareholders with the leave of the court. The shareholders are paid in proportion to their respective interests in the company's share capital.

7.2 Pre-insolvency proceedings: scheme of arrangement and judicial management

For the most part, the relative priority among creditors and shareholders is the same as set out above. This is unless the scheme of arrangement between the company and its creditors sets out an alternative priority ranking.

In the case of business rescue, special provision is made for the priority ranking of post-commencement financiers. Such creditors will rank after the fees of the business rescue practitioner and the other costs relating to business rescue, and thus before any other preferent or concurrent creditors. Post-commencement financing includes funds owed to employees for the period during which the company is under business rescue.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

The laws regarding both pre-insolvency and insolvency proceedings give sufficient protection to the interests of secured creditors. In the first place, secured creditors should ensure that their security is perfected. Perfection refers to the further step that must be taken to give notice to third parties of the security interest over the property so as to enable those creditors to be able to assert / enforce their security rights against the third parties.

In pre-insolvency proceedings, independent financial advisors can be appointed to assist debtors in their negotiations with creditors and lenders, after undertaking a review of the business and its financials. Where restructuring plans have been implemented, a monitoring accountant can be appointed to review the company's adherence to the plan.

In a liquidation or judicial management, secured creditors should participate in the proceedings by, for instance, lodging claims within the stipulated timelines and attending and voting at meetings. The amount of the creditor's secured claim depends on the price at which the property is realised.

Where the company is insolvent, it is common for secured creditors to appoint receivers to dispose of secured assets alongside a liquidator appointed in respect of the company.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

The rights of creditors against a guarantor are not impacted by insolvency or pre-insolvency proceedings against the primary debtor. Where a creditor has several remedies at its disposal, such as whether to realise the security provided by the primary obligor or that provided by a guarantor, it is free to elect how and in what sequence it would pursue those remedies. The guarantor cannot require the creditor to proceed against the primary obligor before proceeding against itself. The creditor does not first have to exhaust its remedies against the primary obligor before proceeding against the guarantor. (See *Pereira, Dennis John Sunny v United Overseas Bank Ltd* [2018] 1 SLR 31; [2017] SGCA 62.)

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

The creditors that have not complied with all the required processes for protecting their potential secured rights will lose the priority they would otherwise have been accorded and will be treated as unsecured creditors.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged? If so, how?

The IRDA provides for an automatic moratorium where a provisional liquidation order or a liquidation order is made. However, secured creditors stand outside this moratorium and may still enforce their security in a provisional liquidation or liquidation.

An automatic moratorium also arises upon the making of an application for a judicial management order as well as upon the court granting a judicial management order. In these situations, a secured creditor may not enforce its security over the company's assets without permission from the court or the judicial manager.

The court may also grant a moratorium order if applied for by a debtor proposing or intending to propose a scheme of arrangement. Generally, the IRDA gives the court the express power to also restrain the enforcement of security over the property of the debtor. However, the secured creditor may ask for a carve-out from the moratorium to allow it to enforce its security. The debtor may accede to this carve-out by consent or the court may allow such a carve-out in certain circumstances.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

In a liquidation, the liquidator typically does not dispose of secured assets. It is more common for the secured creditor to appoint a receiver to take control of and realise the secured assets. The court in *Power Knight Pte Ltd v Natural Fuel Pte Ltd* (in compulsory liquidation) [2010] SGHC 75 held that assets encumbered by a valid security interest are not available for distribution among a company's unsecured creditors upon the winding-up of the company. This suggests that the liquidator does not have the power to dispose of secured assets without the secured creditor's consent.

The judicial manager has the power to dispose of secured assets in accordance with the IRDA. Assets secured by a floating charge may be disposed of at the judicial manager's discretion. However, the floating charge holder must be accorded the same priority in respect of the proceeds. For other secured assets, a court order is needed to authorise the judicial manager to dispose of the assets.

In practice in Singapore, it may be not feasible to obtain a fixed charge over cash collateral unless the bank account is opened with and controlled by the lender. More likely than not, the lender will only take a floating charge over cash collateral.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

For companies undergoing liquidation, a liquidator can raise any money required on the security of the debtor company's assets, subject to the court's control.

Companies under a scheme of arrangement or judicial management can obtain rescue financing. Parties who provide rescue financing may be given security on property of the company that is equivalent in priority, or of higher priority, to an existing security interest. Security may also be given on property of the company that is either not subject to any security interest, or a subordinate security interest on property subject to an existing security interest.

The exact priority accorded depends on the type of orders applied for by the company and granted by the court.

14. What distribution will a secured creditor receive if a company is reorganised?

As mentioned above, companies can be reorganised through the scheme of arrangement mechanism. The scope of what secured creditors will receive will depend on the content of the restructuring proposal accepted by the creditors and others with voting rights. Although the distribution can be done according to the normal rules pertaining to the ranking of creditors, the restructuring proposal may determine otherwise.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

Similar to the above answer, this will depend on the content of the restructuring proposal accepted by the creditors. In essence, the continued existence of the secured creditor's rights will depend on its willingness to agree to a restructuring plan that would amend or remove its rights to the assets.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

If the claim of a secured creditor is over-secured, the balance of the proceeds of the security, after payment of the secured creditor's claim together with interest thereon, will form part of the debtor's estate from which preferential and unsecured claims will be paid.

Secured creditors with claims exceeding the realised security are treated as unsecured creditors for the excess part of the claim.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

If a contract was created under and is governed by foreign law, a Singapore court will respect or give effect to a foreign restructuring of the contractual arrangements. This is because the Singapore High Court in *Re Pacific Andes Resources Development Ltd and Other Matters* [2018] 5 SLR 125 expressly refused to accept the *Gibbs* principle, which is that a discharge of a debt is not effective unless it is in accordance with the law governing the debt.

SOUTH AFRICA

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

South African law provides a number of security devices that can be used to encumber movable, immovable and intangible assets. Although most security rights are created contractually, some can come into existence by operation of common or statutory law.

1.1 Movable property

1.1.1 Pledge

The first form of security that can be taken in respect of movable property in South Africa is the pledge. A pledge entails the contractual creation of a security right in a movable asset or collection of movable assets. However, a mere contract is not enough to make the security right effective against third parties or in the debtor's insolvency. Instead, the creditor will be secured only once the property has been delivered to the creditor. This security right can be referred to as a "possessory pledge" due to the strong emphasis placed on divesting the debtor of and placing the creditor in possession of the asset.

Delivery to the creditor can be achieved in a number of ways – through the actual physical handing over of the asset, but also through constructive delivery. The latter entails situations where, for instance, the creditor is already in possession or where something like a key to a warehouse is handed over to give the creditor possession of the goods in the warehouse. However, no pledge can be created in transactions whereby the debtor remains in possession, even if the debtor purports to hold possession on the creditor's behalf.

Due to the strict delivery requirement, the possessory pledge is not very popular or practical in the modern commercial world. Instead, it is mostly used in smaller, less formal credit transactions, such as with the pawning of goods.

1.1.2 Notarial bond

As a way to bridge the limitations of the possessory pledge, South African law allows the creation of a non-possessory security right over movable assets via the registration of a so-called "notarial bond" in a public registry (the Deeds Registry). However, regarding the legal consequences of such bonds, a distinction is drawn between special and general notarial bonds.

A general notarial bond is one which expressly covers all of the debtor's movable assets, nothing excluded. However, the mere registration of a general notarial bond does not fix the creditor's security with reference to the assets, and in this sense the general bond creates a situation comparable to a "floating charge". For the creditor's security to become fixed, the bond must be perfected. The security is perfected when the debtor voluntarily hands possession of the goods to the creditor or when, in terms of a perfection clause in the bond and on the authority of a court order, the creditor attaches the debtor's goods. The perfection clause should stipulate the circumstances under which the security can be perfected, which typically would be upon the debtor's default or when he or she breaches some other contractual duty. When the creditor receives such control over the goods, the security is perfected, and the creditor is placed in the same position as an ordinary pledgee, and thus it will be a secured creditor for all intents and purposes.

If a general bond is still unperfected at the time when the debtor is formally declared insolvent, the creditor will not be a secured creditor. However, in terms of section 102 of the Insolvency Act 1936 (Insolvency Act), in such instances the bondholder will enjoy a special preference over concurrent (unsecured) creditors when it comes to the proceeds of unencumbered movable assets. Put differently, when it comes to the proceeds of movables not otherwise encumbered with a fixed security, the holder of an unperfected notarial bond is second-to-last in the ranking of creditors, ahead of the unsecured creditors in the last place.

Unlike a general notarial bond, a special notarial bond is one that purports to encumber a specific movable object or objects. Regarding the legal consequences of special notarial bonds, a distinction is drawn between those that comply with the Security by Means of Movable Property Act 1993 and those that do not. The main requirement of the Act is that the encumbered property must be specified and described in the bond in such a manner that renders the exact asset readily recognisable. If the description in the bond complies with this standard, the creditor will be a secured creditor without having to receive physical possession of the property. Thus, registration of the bond alone will grant the creditor a fully enforceable security right, also for insolvency purposes. If the bond does not comply with the Act, it will first have to be perfected (by obtaining possession) before the creditor will be a secured creditor – thus similar to the position regarding general notarial bonds.

Separate unique registries also exist for the taking of security rights in assets like aircraft, ships and certain types of intellectual property (trademarks, designs, and patents).

1.1.3 Cession in security of a debt (in securitatem debiti)

Personal rights with a monetary value (such as receivables, securities and other contractual claims) are regarded as intangible movable property in South Africa. These assets can also serve as collateral for a debt. Because these assets consist of personal rights, a security right in such assets can only be created by ceding (assigning) the personal right to the creditor. However, this cession can take one of two forms.

The first form of cession is referred to as an "out-and-out" (outright or absolute) cession because it entails a full transfer of the personal right to the creditor, except that the transfer is subject to a fiduciary condition that the creditor must retransfer the personal right to the debtor once the secured debt has been discharged.

The second option is a construction in terms of which the cession does not result in a fiduciary transfer of the personal right, but in the creation of a limited security right (pledge) in the creditor's favour. In other words, ownership of the personal right remains with the debtor while the creditor is granted the rights of a pledgee with reference to the intangible asset.

There has been an ongoing debate in South Africa regarding the correct construction of a cession in security of a debt. The current approach is that the pledge construction (option 2) is the default position in any instance where the personal right is used as collateral, and that the fiduciary transfer (option 1) is only accepted if this was the express and clear intention of the parties. In insolvency cases, courts are likely to classify the transaction as a pledge because it results in a more equitable outcome for all parties.

1.1.4 *Landlord's (lessor's) tacit hypothec*

The landlord's hypothec is a security right that comes into being by operation of law when a tenant (lessee) is in default of rental payments. The hypothec covers all movables present on the leased premises. Under certain strict circumstances, the hypothec can also cover goods that do not belong to the tenant but that are present on the premises.

For the landlord to be a secured creditor, the hypothec must be perfected, which happens when the goods are attached on the authority of a court order. However, if the tenant is declared insolvent, the sequestration or liquidation order itself perfects the hypothec. Therefore, in insolvency the landlord will be a secured creditor without having to take possession, but in this instance its secured claim will extend only to an amount specified in the Insolvency Act, depending on the type of lease agreement.

1.1.5 *Lien (right of retention)*

In South African law, the term "lien" refers to the situation where a person (the creditor) has spent money or done work on the property of another. If the property is in the improver's possession, he has a right to retain possession of it until he is reimbursed for his expenses. A lien cannot be actively enforced, and thus it is merely a passive right in terms of which the creditor can resist any claim by any person who claims possession of the property. This right of retention is recognised as a security right in the Insolvency Act and thus the improver's claim will be secured. However, a distinction should be drawn between two categories of lien: a contractual (debtor-and-creditor) lien and an enrichment (salvage or improvement) lien.

A contractual lien comes into existence when the creditor has done work on the property of another based on a valid contract. In this case, the lien is only enforceable against the person with whom the creditor has contracted to do the work, and the amount covered by the lien will be the amount agreed to in the contract.

An enrichment lien is relevant in situations where there is no contractual relationship between the creditor and the owner and where the liability between them is based on the principles of unjustified enrichment. An enrichment lien covers useful and necessary expenses: expenses that improved the market value of the property or that prevented the value from deteriorating. In the case of an enrichment lien, the creditor can enforce its right of retention against any person who claims the property.

Both contractual and enrichment liens are recognised in insolvency, but their ranking differs somewhat. An enrichment lien always outranks other security rights like mortgages and pledges, while a contractual lien always ranks after mortgages and pledges.

1.1.6 *Other statutory security devices*

In addition to the security devices described above, a number of unique security rights are recognised in statutory provisions. For instance, special statutory rules create "silent" pledges for agricultural co-operatives as well as for the Land and Agricultural Development Bank of South Africa as security for loans granted by these institutions. These pledges do not require delivery of the goods, nor are they registered in a public register, but they are statutorily classified as security rights for all intents and purposes. Another example is the security right (called a lien) in favour of the South African Revenue Service over imported goods with respect to which there are outstanding import taxes payable to the state.

1.1.7 Retention of title

To round off the discussion on security in movable property, it is also necessary to take note of transactions that technically do not involve the creation of a security right but that nevertheless achieve a security purpose for one of the parties. The main example of this is where a sale contract contains a clause that reserves ownership of the property with the seller until the full purchase price is paid. In this sense, the reserved ownership (retention of title) fulfils the same function as a security right although it technically qualifies as a full ownership right.

For present purposes, it needs only to be pointed out that, depending on the exact terms of the transaction, section 84 of the Insolvency Act reclassifies such a "reserved ownership" as a security right (called a hypothec) when the buyer (debtor) is declared insolvent. The seller will therefore be a secured creditor for any amounts outstanding in terms of the sale contract.

1.2 Immovable property

1.2.1 Mortgage

The only way in which a debtor can consensually make his or her immovable property available as security for a debt is by registering a mortgage bond in the Deeds Registry. This act of registration affords publicity to the security right and renders it enforceable against third parties, including in insolvency. The registration process is set out in the Deeds Registries Act 1937. A mortgage bond is of a dual nature because it typically includes particulars of the loan agreement as well as of the security right. Mortgage bonds can be registered over land (and the security will include anything attached to the land), limited real rights in land (like servitudes[1] and long-term leases) and sectional title (condominium) units. A mortgage can cover a fluctuating future debt provided that the maximum coverage is stipulated in the bond (a covering bond). Mineral rights, which are classified as limited real rights in land, can be mortgaged in terms of the Mining Titles Registration Act 1967.

The effect of registering a mortgage bond is that the creditor has a hold over the property until the secured debt is discharged. This is manifested in the requirement that the debtor can only dispose of the bonded property if the bond is cancelled, which requires the consent and co-operation of the mortgage creditor. The mortgagee can also foreclose on the bond if the debtor defaults, thereby having the property sold to use the proceeds to the settle the debt.

1.2.2 Lien (right of retention)

The principles explained above regarding the lien over movable property also apply in the case of immovable property.

1.2.3 Special statutory security devices

As is the case with movable property, South African law also contains certain statutory rules that create special security or *quasi*-security rights in favour of certain creditors. For example, the Land and Agricultural Development Bank has a "charge" over land that has had improvements made to it that were financed by the Bank. Also, a local authority (municipal government) has a "charge" over any land with reference to which there are municipal taxes and fees outstanding.

[1] Known as "easements" in other jurisdictions.

The local authority can also embargo the disposal of land if there are any municipal debts outstanding for the preceding two years. Similarly, the governing body of a sectional title (condominium) scheme can embargo the disposal of any unit in the scheme if there are levies outstanding with respect to the unit. In both cases, the power to restrain transfer of ownership is regarded as a *quasi*-security, and, in fact, these amounts must be paid as part of the costs of realising the property in the course of an insolvency proceeding.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

2.1 Enforcing security

In most instances, a court procedure must be followed to enforce a security right in South Africa. The procedure generally entails that the creditor must obtain a money judgment ordering the debtor to pay the claimed amount. This judgment can then be executed by applying for an order authorising the attachment and sale of the encumbered property. In the case of secured debt, the application for the money judgment and the application for the execution order can be brought at the same time. If the execution order is granted, a warrant will be issued to the sheriff, authorising the sheriff to attach the property and conduct a public sale, the proceeds of which will be applied towards the claims of the creditors according to their place in the ranking of creditors. Despite the general rule that a court process must be followed, there are some exceptions whereby the parties can agree to alternative enforcement methods – but extra-judicial enforcement is controversial in South Africa due to the strong policy aversion to any form of self-help.

2.1.1 Movable property

In the case of movable property (whether encumbered via a pledge, notarial bond, or cession) the general rule is as described above, unless the parties agree otherwise. For instance, a clause whereby the parties agree that the creditor can realise the property without court authorisation (a so-called *parate executie*) is valid provided that it is not enforced in bad faith and that the debtor is allowed to approach a court if his or her rights are prejudiced during the private sale.

A clause will be invalid if it allows the creditor to keep the property despite the size of the debt or the value of the property. However, the parties may agree to a so-called "*quasi*-conditional sale" in terms of which the creditor may take over the property at a fair value – thus applying the value of the property towards the outstanding debt and then paying the surplus (if any) to the debtor. The fair value would typically be the market value of the object, but the method of calculation would depend on what makes sense for the particular kind of asset. While the value of some assets can only be obtained via a valuation by an expert, the value of other assets might be ascertainable from something like a public exchange. If the value of the property is less than the creditor's claim, the remaining amount will be unsecured. There is no requirement that the creditor should waive the remaining claim, but it may do so.

2.1.2 Immovable property

In the case of immovable property encumbered with a mortgage, a *quasi*-conditional sale is also permissible but, unlike the rule with movables, a clause that allows a private sale is not valid in a mortgage bond registered over immovable property. Therefore, a formal judicial foreclosure process must be followed to enforce the security. However, after the debtor has defaulted, the parties may agree that the creditor may sell the property on the debtor's behalf; only such a clause may not be included in the bond agreement itself (i.e. prior to default). Regarding residential property, the foreclosure procedure has become exceptionally strict in recent years. Due to the fact that the debtor's constitutionally protected housing rights might be impaired, the court must, before granting an execution order, judge whether the forced sale of the debtor's home would be a proportional remedy in light of all the facts of the case.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

South African law provides for a number of pre-insolvency procedures, namely procedures that focus, via a payment plan or reorganisation, on the "rescue" of an individual or entity instead of the liquidation of assets. The main pre-insolvency proceeding available to companies is the corporate rescue procedure known as "business rescue", which was introduced by chapter 6 of the Companies Act 2008. Individuals also have pre-insolvency procedures to their avail, namely the "administration order" procedure in terms of the Magistrates' Courts Act 1944 and the "debt review" procedure in terms of the National Credit Act 2005. A further pre-insolvency procedure is currently under development, namely the so-called "debt intervention" procedure which, when implemented, will provide a pre-insolvency debt relief mechanism for "no income no asset" or "low income low asset" debtors. However, debt intervention will have no impact on secured creditors or assets encumbered with security rights, and thus it is not necessary to discuss this procedure here.

3.1 Corporate pre-insolvency proceedings

3.1.1 Business rescue

Chapter 6 of the Companies Act 2008 provides for so-called "business rescue proceedings" as the primary pre-insolvency corporate rescue procedure in South Africa. Business rescue proceedings can be commenced in one of three ways:

(1) when a company files a resolution to voluntarily place itself under supervision;

(2) when an "affected person" (defined below) applies to court to place a company under supervision; and

(3) when a court makes an order to place a company under supervision during liquidation proceedings or during any proceeding in which a security interest is enforced.

Under option (1), the board may voluntarily resolve to begin business rescue proceedings if it has reasonable grounds to believe that the company is financially distressed and if there appears to be a reasonable prospect of rescuing the company. (An affected person may apply to a court to have the resolution set aside if it can be shown that either of these requirements have not been met.) The resolution must be filed with the Companies and Intellectual Property Commission. Within five days after the resolution has been adopted and filed, a notice must be published and a business rescue practitioner must be appointed, a notice of which must be filed and published as well.

Under option (2), an affected person may apply to a court to have the company placed under supervision and begin rescue proceedings. Affected persons are shareholders or creditors of the company, registered trade unions, and employees not represented by trade unions. The court may grant the order if it is satisfied that the company is financially distressed; that it has failed to fulfil any financial obligation; or if it otherwise would be just and equitable to place the company under supervision for financial reasons. Upon granting the order, the court may appoint an interim business rescue practitioner, which appointment must be ratified by a majority of the creditors during their first meeting.

During rescue proceedings, there will be a moratorium on most legal proceedings, including enforcement action against the company or in relation to any of its property. Exceptions include, among others, proceedings instituted with the leave of the court or with the rescue practitioner's consent.

The business rescue practitioner is tasked to prepare a detailed business rescue plan (which can include a restructuring or adjustments of contracts and creditors' rights) after consulting with the creditors and other affected persons. Creditors and others with voting interests will then vote on the plan. A creditor's voting interest is calculated with reference to the amount owed by the company to that creditor, whether secured or unsecured. The plan will be approved if it is supported by holders of more than 75% of the value of the claims that were voted and if the votes in support of the plan included at least 50% of the independent creditors that cast votes in respect of the plan. An independent creditor is one that is not related to the company. For instance, a director who is also a creditor will not be regarded as an independent creditor. The business rescue practitioner is also not an independent creditor. For voting purposes, creditors are not divided into classes, and thus the relevant percentage is calculated with reference to the voting interests of the creditors as a whole. The implication of this is that each class of creditors does not necessarily have to approve the plan to be bound by it. If the plan is adopted by the required percentage of creditors as a whole, it is binding on the company, all creditors and all holders of securities, even if they were absent or voted against the plan. Because the business rescue practitioner takes control of the business, business rescue does not entail a debtor-in-possession proceeding.

3.1.2 Compromise with creditors

The Companies Act 2008 also provides for a mechanism in terms of which a compromise can be reached between a company (whether or not financially distressed) and its creditors. The board of the company or its liquidator (if the company is in the process of being liquidated) may propose an arrangement or a compromise of its financial obligations to all its creditors or to a class of creditors. The proposal will be adopted if it is supported by a majority in number, representing at least 75% in value of the claims held by creditors or class present and voting in person or by proxy. A class of creditors refers to those with similar rights and interests, which in practice means that they share the same ranking in insolvency. In other words, the secured creditors will form one class and the unsecured another, while those with the same special statutory preference rights will also be grouped together in a class. Effectively therefore, if the compromise involves the rights of all creditors, the relevant percentage of all creditors must approve it, regardless of class, but if the compromise only involves the rights of a particular class of creditors, then only the relevant percentage of creditors in that class must approve it. After adoption of the proposal, the company may apply to a court for approval of the compromise, which the court may sanction if it considers the compromise just and equitable. The order will be final and binding on all the creditors or all members of the relevant class of creditors. A dissenting creditor has no recourse available whereby it can block the proposal adopted by the requisite majority.

3.2 Individual / consumer pre-insolvency proceedings

3.2.1 Administration order

Section 74 of the Magistrates' Courts Act 1944 authorises a magistrate to grant an administration order, which proceeding qualifies as a pre-insolvency procedure for a consumer–debtor with a relatively small total debt (not more than ZAR50,000). If such a debtor is unable to meet his or her financial obligations and has insufficient assets to satisfy any judgment or other obligations, the court may make an order providing for the administration of the debtor's estate (on such conditions that the court may deem fit). The administration order will typically entail a payment plan in terms of which the debts must be paid in instalments as determined by the court. The court can, for instance, also order the disposal of certain assets. Secured creditors are not specifically excluded from the consequences of an administration plan.

3.2.2 Debt review

Debt review is a consumer debt relief mechanism introduced by the National Credit Act 2005. In terms of this procedure, a consumer who claims to be over-indebted (as defined in the Act) can approach a debt counsellor with an application to be placed under debt review. The debt counsellor must then notify all of the consumer's creditors of the application, from which point there will be a moratorium on all debt enforcement action against the consumer (which moratorium lapses if the review process is not completed within 60 business days). The debt counsellor must investigate the consumer's affairs and make a recommendation on whether the consumer is over-indebted and, if so, recommend a debt rearrangement plan, which could include postponing certain payments and decreasing monthly payments while extending the period of payment. However, the plan may not include any discharge of debts. The recommendation must be referred to a magistrate, who will either reject the recommendation or make it into a debt-rearrangement order.

If a creditor had already commenced with debt enforcement proceedings before the consumer approached a debt counsellor, that debt will not be included in the rearrangement order. However, if during any court proceeding involving a credit agreement the consumer alleges that he or she is over-indebted, the court has a discretion to refer the matter to a debt counsellor or to grant relief, for instance in the form of a debt-rearrangement order. Both secured and unsecured debts can form the subject of debt review proceedings, provided that the debt was created in terms of a credit agreement that falls within the ambit of the National Credit Act 2005's scope of application. Therefore, secured debts can also form part of the debt-rearrangement plan, and no creditor consent is required, although creditors may make representations to the magistrate having to decide whether and, if so, how to rearrange the debt.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***

- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***

- ***What is the level of creditor consent that is required to effectuate a restructuring?***

- ***Is shareholder consent required in order to effectuate a restructuring?***

South Africa law provides for two main categories of insolvency proceedings, namely the sequestration (compulsory sequestration or voluntary surrender) of individuals and the winding-up (voluntary or by court order) of companies.

4.1 Corporate liquidation proceedings

Under South African law a company may be wound up voluntarily or by the court. The winding-up of companies is regulated mainly by the provisions of the Companies Act 2008, although by virtue of section 339 of the Companies Act 2008 the Insolvency Act also finds application to companies that are unable to pay their debts. It should also be noted that the Companies Act 1973 was replaced in 2008, but the provisions in the former dealing with company liquidations are still in force.

4.2 Voluntary winding-up

A distinction is made between a shareholders' voluntary winding-up and a creditors' voluntary winding-up. In both cases the procedure is commenced by the passing of a special resolution by the shareholders of the company. The main parties to the liquidation proceeding are the shareholders of the company, the Master of the High Court, the Companies and Intellectual Property Commission, the creditors (in the case of a voluntary winding-up by creditors) and the liquidator.

A shareholders' voluntary winding-up refers to a voluntary winding-up where the company is solvent. In such a case, there is no need for the holding of creditor meetings because, the company being solvent, the creditors' rights will not be impacted negatively. The company auditor must certify that there are no debts or, if there are debts, security must be provided in order to cover the full value of the liabilities of the company before the resolution to wind up the company will be registered. The resolution normally also includes the nomination of a liquidator and the determination of the person's remuneration.

A creditors' voluntary winding-up (which is also commenced by the passing of a special resolution by the shareholders) refers to a voluntary winding-up where the company is commercially insolvent. Creditor meetings must be held since the creditors' rights are impacted, and, accordingly, they are entitled to give directions to the liquidator regarding the exercise of his or her powers. The resolution must state that the voluntary winding-up is a voluntary winding-up by creditors, and the date of liquidation is the date upon which the resolution is registered. Once the resolution has been registered, the procedure for winding-up the company is the same as in the case of a winding-up by the court.

4.3 Winding-up by the court

A company may be wound-up by the court voluntarily or on the basis of a ground of liquidation provided for by the provisions of the Companies Act 2008. A court application for the winding-up of a company can be brought by the company itself, by one or more of its creditors, by one or more of its shareholders, or by all of these persons jointly. An order for the winding-up of a company may only be granted by the High Court (although in the case of a close corporation a magistrates' court or the High Court may grant a winding-up order). The criteria for the commencement of the proceeding is a duly adopted resolution in terms of which the court will be approached to grant a liquidation order, or the presence of a valid ground of liquidation in terms of the provisions of the Companies Act 2008. The main parties to this type of liquidation proceeding are the court, the creditors, the Master of the High Court and the liquidator.

Since the liquidator takes full control of the company in the case of both voluntary and court-ordered windings-up, corporate liquidation proceedings do not provide for the debtor to remain in control of the business during the proceedings. Liquidation proceedings also do not permit the adjustment of contracts or secured or unsecured debts, since the purpose of the process is to liquidate all the assets and pay all the creditors according to their rankings. Because corporate liquidation proceedings do not involve any restructuring of the company, the question of creditor or shareholder consent does not come into play in this regard.

4.4 Personal / consumer insolvency

Under South African law the Insolvency Act makes provision for the voluntary surrender as well as the compulsory sequestration of a debtor's estate. In both cases (and because the order affects the status of the debtor) the order may only be granted by the High Court.

4.5 Voluntary surrender

In the case of a voluntary surrender, the debtor him or herself brings an *ex parte* application requesting the court to place the debtor's estate under sequestration. Before a court will grant an order of voluntary surrender it must be satisfied that the prescribed formalities have been complied with (dealing mainly with notice to creditors), that there is sufficient free residue in the estate to cover the costs of the application, that the person is factually insolvent (in terms of a balance sheet test) and that the sequestration will be to the advantage of the creditors. Especially the last requirement is problematic in practice, as the courts will not grant a sequestration order if it cannot be proved to be to the advantage of creditors. The main parties to this procedure are the debtor, the court, the Master of the High Court, the creditors and the trustee.

In addition to the above, if the applicant debtor is a partnership, the court will not entertain the application if all the partners simultaneously apply for the voluntary surrender of their own estates.

4.6 Compulsory sequestration

In the case of compulsory sequestration, one or more creditors bring an application on notice requesting the court to place the debtor's estate under compulsory sequestration. In order to obtain the order, the applicant creditor will either have to prove that the debtor is factually insolvent, or that the debtor has committed an act of insolvency as provided for in section 8 of the Insolvency Act. In addition, the applicant creditor will have to provide security for the costs of the application and prove that there is reason to believe that the sequestration of the debtor's estate will be to the advantage of the general body of creditors. The main parties to this procedure are the creditors, the debtor, the court, the Master of the High Court and the trustee.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

In terms of section 88 of the Insolvency Act, if a bond over immovable property or a special notarial bond over movable property in terms of section 1 of the Security by Means of Movable Property Act 1993 is registered within six months of the insolvency of the debtor, and the debt secured thereby was older than two months at the time of the registration of the bond, then the bond will grant no preference or security rights to the creditor in respect of that debt. In such a case the creditor will only obtain security rights in respect of the bond in question if the bond has been registered for at least six months.

Section 29 of the Insolvency Act provides that, if within six months before the sequestration of an estate, the debtor had disposed of his or her property in a way that preferred one creditor over another, this transaction may be set aside by the court if, immediately after such disposition, the debtor was insolvent. Furthermore, section 30 of the Act provides that, if at any time when the debtor was insolvent, the debtor had disposed of his or her property with the intention to prefer one creditor over another, this transaction can be set aside. The granting of a security right in an asset can potentially fall under either of these provisions, and thus a security right created under these conditions can be set aside.

If a creditor perfects its security in terms of a general notarial bond, even if only one day prior to insolvency, the fact that the creditor obtained a valid form of security (pledge) at such a short period prior to insolvency is not a voidable preference if the perfection took place in terms of the provisions of the bond and on the authority of a court order.

6. Is enforcement of security rights treated differently in each type of proceeding?

The treatment and enforcement of security rights are very similar in the available procedures, except that insolvency proceedings are usually aimed at the realisation of assets and distribution of proceeds to the creditors according to their ranking, while pre-insolvency proceedings do not necessarily involve the realisation of assets but can include a reorganisation that might impact on the treatment of secured creditors.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

7.1 Insolvency proceedings: corporate liquidation

7.1.1 Secured creditors

The proceeds of secured assets are firstly applied in paying the administration expenses relevant to the liquidation proceeding. This is the case even if there are unencumbered assets; therefore, administration expenses are recouped from the proceeds of both encumbered and unencumbered assets. The cost of realising, conserving and maintaining the asset are paid first, as are the liquidator’s fees, the master’s statutory fee and a *pro rata* portion of the costs of providing security for the proper administration of the estate. Finally, if the security consists of immovable property, any outstanding taxes owing to a municipality or other local authority have to be paid in priority to the claims of the secured creditors. Secured creditors receive priority treatment in that their claims are paid first from the proceeds of the security that they held prior to liquidation (after the administration expenses referred to above have been paid). If there is any shortfall on their claims, including post-liquidation interest, after the proceeds of their securities have been paid to them, the balance of their claims is treated as unsecured (concurrent) unless such a creditor has elected to rely solely on the proceeds of its security. The main benefit of the latter course of action is that, if there are not enough funds left in the estate (after secured creditors have been paid) to cover the remaining administration costs, the secured creditors who have relied solely on the proceeds of their security do not have to contribute to the outstanding administration costs, while those who have not elected to rely solely on the proceeds of their security can be called upon to contribute towards the shortfall regarding administration costs.

In certain cases, claims by the Land and Agricultural Development Bank of South Africa will receive priority treatment over the claims of normal secured creditors.

7.1.2 *Unsecured creditors*

Unsecured creditors can be divided into two categories, namely statutory preferent and concurrent creditors. Both of these sub-classes of creditors are paid from the free residue of the estate.

7.1.3 *Statutory preferent (priority) creditors*

Statutory preferent creditors are paid in a specific order of preference, and some sections contain a priority within the operation of the section itself. These preferences are dealt with in sections 96 to 102 of the Insolvency Act and can briefly be summarised as follows:

- preference for a maximum amount for funeral and death-bed expenses of the debtor (section 96);
- administration expenses relating to the free residue, such as the taxed bill of costs for the application and the payment of the liquidator's fees on the free residue assets (section 97);
- preference for a maximum amount for attorneys and the sheriff for pre-liquidation execution orders (section 98);
- preferences for a maximum amount regarding employees' claims for arrear salary, wages, leave pay and retrenchment benefits (under South African law employees become entitled to retrenchment benefits where their services contracts are terminated – the amount payable is usually equal to one week's remuneration for every year of service), as well as contributions made to provident and other funds (section 98A);
- payments to certain government institutions, such as the South African Revenue Service, for arrear VAT and customs and excise duty (section 99);
- preference for arrear income tax owing (s101); and
- preference for general notarial bondholders who failed to perfect their security prior to liquidation (this includes a preference for special notarial bondholders whose bonds were registered prior to 7 May 1993) (section 102).

7.1.4 *Concurrent creditors*

Section 103 of the Insolvency Act provides for the balance of the free residue to be distributed *pari passu* amongst the concurrent creditors. If any funds remain after the payment of the concurrent claims plus post-liquidation interest, these funds will be distributed amongst the shareholders in accordance with the share register.

7.2 Personal / consumer insolvency

The priorities regarding personal insolvencies are the same as enumerated above, with the exception of surplus funds after the payment of all creditors' claims. In such a case the surplus funds will be deposited into the Guardian's Fund administered by the Master of the High Court and paid to the insolvent debtor upon his or her rehabilitation.

7.3 Pre-insolvency proceedings: business rescue and compromise

For the most part, the relative priority among creditors and shareholders are the same as set out above, unless the business rescue plan or compromise between the company and its creditors determined an alternative priority ranking.

In the case of business rescue, special provision is made for the priority ranking of post-commencement financiers. Such creditors will rank after the fees of the business rescue practitioner and the other costs relating to business rescue, and thus before any other preferent or concurrent creditors. Post-commencement financing includes funds owed to employees for the period during which the company is under business rescue.

In the case of a debt rearrangement order granted in terms of the debt review procedure under the National Credit Act 2005, payments to creditors are not made according to any set priority but according to the terms of the debt-rearrangement order. Typically, each relevant creditor (whether secured or unsecured) will be paid a reduced portion of the instalments that it would have received otherwise, but with instalments spread out over a longer period than originally stipulated in the credit agreement.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

The laws regarding both pre-insolvency and insolvency proceedings give sufficient protection to the interests of secured creditors. However, creditors should co-operate with the proceedings by, for instance, lodging claims within the stipulated timelines and attending meetings and voting at them. The amount of the creditor's secured claim depends on the price at which the property is realised. If the value of the asset has decreased after the commencement of insolvency proceedings, and this decrease can be attributed to maladministration by the trustee or liquidator, the creditor might be able to claim damages from the trustee or liquidator.

In the case of mortgage bonds registered over immovable property, the creditor is protected by the registration of the bond against the title deed of the property. The property cannot be transferred until such time as the mortgage bond has been cancelled after payment has been made.

In the case of special notarial bonds registered over movables, the Security by Means of Movable Property Act 1993 creates a statutory pledge whereby the bonded property is deemed to be in the possession of the creditor bondholder. These special bonds are registered in the Deeds Office, which provides some measure of protection to the creditor.

In the case of liens, the landlord's legal hypothec and pledge, the creditor must ensure that he or she remains in possession of the property, as loss of possession usually results in the loss of the security right associated with that property. In the case of statutory hypothecs, the creditor is normally protected by the legislation, even if the property is transferred to a *bona fide* third party.

In the case of general notarial bonds over movables, creditors may protect themselves by perfecting their security prior to the commencement of the insolvency proceeding. This must be done in accordance with judicial process. Bondholders who fail to perfect their security prior to the commencement of the insolvency proceeding, will only obtain a statutory preference over the free residue in terms of section 102 of the Insolvency Act.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

The rights of creditors against a guarantor (known as a surety in South Africa) are not impacted by insolvency or pre-insolvency proceedings against the primary debtor. For example, regarding pre-insolvency proceedings, the Companies Act 2008 specifically provides that a compromise between the company and its creditors will not affect the liability of any surety.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

In most cases creditors that have not complied with all the required processes for protecting their potential secured rights will lose the preference they would otherwise have had and will be treated as concurrent (unsecured) creditors. In the case of the holder of a general notarial bond that has not perfected its security prior to insolvency, such creditor will be treated as a preferent (priority) creditor in terms of section 102 of the Insolvency Act. This priority ranks lowest in preference and is the last priority to be paid before concurrent creditors receive a dividend.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be Challenged? If so, how?

Not during any of the pre-insolvency and insolvency proceedings summarised above may a secured creditor foreclose or take any other enforcement action with reference to the asset. For instance, if any property had been attached but not yet sold by the time an insolvency proceeding commences, a sale of the property may not go ahead, unless a court orders otherwise. The pre-insolvency proceedings similarly provide for moratoria on enforcement action.

The above applies to practically all claims, except if a special statutory regime exempts a particular creditor from insolvency laws. The main example is that the Land and Agricultural Bank of South Africa is exempt from the Insolvency Act, which means that this institution can go ahead with the enforcement of its claims, including action against collateral, even if the debtor has entered an insolvency proceeding.

Secured creditors are not entitled to foreclose or take any other enforcement actions once the insolvency proceeding has commenced, and this will apply to all claims against the debtor. Nevertheless, provision is made for certain secured creditors to sell the object of their security during the administration process, subject to the proceeds being paid to the trustee or liquidator once the proceeds have been received. Such sales can only be made by the creditor prior to the second meeting of creditors. After the second meeting has been held, only the trustee or liquidator may sell the property.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

The general rule is that no property encumbered with a security right may be sold or otherwise disposed of without the consent and co-operation of the holder of the security right. In the case of movables where the creditor is in possession of the property, the creditor would have to co-operate with any transfer of ownership to a buyer. And in the case of immovable property, the creditor would have to consent to and co-operate with the cancellation of the mortgage bond before ownership of the property can be transferred to the buyer. In each case, if the property is sold and transferred without such consent or co-operation, the secured creditor will retain its right to the property, even against the innocent purchaser.

The only instance where the property can be sold free of the encumbrance is in the case of a general notarial bond that has not yet been perfected. Because the security in this case is of a “floating” nature before it becomes “fixed” via perfection, the security does not attach to the asset yet, and thus it can be sold freely. When the bond is perfected, the security becomes “fixed”, and henceforth the creditor can prevent disposal of the property. South African law does not include a general rule whereby a security right extends to the proceeds of encumbered assets. However, if encumbered assets (like inventory) are realised during the proceedings, the proceeds will be distributed among the creditors according to their usual ranking.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor’s collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

No further security rights can be created with respect to property subject to an insolvency proceeding, except if the relevant statute itself provides for the creation of further security rights or preferences. The same would apply in pre-insolvency proceedings.

14. What distribution will a secured creditor receive if a company is reorganised?

As mentioned above, companies can be reorganised through the business rescue proceeding provided for in the Companies Act 2008. The scope of what secured creditors will receive will depend on the content of the business rescue plan adopted by the creditors and others with voting rights. Although the distribution can be done according to the normal rules pertaining to the ranking of creditors, the business rescue plan may determine otherwise.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

Similar to the above answer, this will depend on the content of the business rescue plan adopted by the creditors. In essence, the continued existence of the secured creditor’s rights will depend on its willingness to agree to a plan that would amend or remove its rights to the assets.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

If the claim of a secured creditor is over-secured, the balance of the proceeds of the security, after payment of the secured creditor’s claim together with interest thereon, will form part of the free residue of the estate (section 83(12) of the Insolvency Act) from which statutory preferent and concurrent claims will be paid (in terms of sections 96 to 103 of the Insolvency Act).

If the claim of a secured creditor is under-secured, the balance (unpaid portion) of the secured creditor’s claim (including any interest post-liquidation) will be treated as a concurrent claim and such creditor will be paid a dividend on such balance from the free residue of the estate, should there be any. However, should a creditor elect to rely on the proceeds of its security at the time the claim is proved, then such creditor does not become entitled to share in the proceeds of the free residue and will not be treated as a concurrent creditor. In such a case the creditor takes whatever it can from the proceeds of the security and will receive no further payment on its claim.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

If a contract was created under and is subject to local South African law, I do not know of any basis upon which a court will respect or give effect to a foreign restructuring of the contractual arrangements.

SPAIN

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

1.1 Types of securities in Spain

The following securities are available in Spain under Spanish law:

- possessory pledges;
- real estate mortgages;
- chattel mortgages and non-possessory pledges;
- financial guarantees; and
- personal guarantees.

1.1.1 Possessory pledges

Pledges in Spain are divided into two types: (a) possessory pledges, in which the possession of the pledged asset is delivered to the secured creditor; and (b) non-possessory pledges in which possession of the asset remains with the grantor.

Possessory pledges are created over movable assets, and possession over the collateral must be transferred to the pledgee.

Standard possessory pledges used in the Spanish market are (a) pledges over shares / units representing the equity of a corporation; (b) pledges over receivables and credit rights (e.g. those resulting from the balances in bank accounts, ongoing operational agreements, insurance policies or deposits).

- *Pledges over shares / units*

  Taking security over shares and units is commonly used and accepted in Spain. There are two main types of limited liability corporations: (i) a *Sociedad Anónima* (SA) and a *Sociedad Limitada* (SL). Both the shares (*acciones*) of the SA and units (*participaciones sociales*) of the SL represent an equity participation in a Spanish corporation which grants the holder certain established rights, mainly political (voting and representatives' appointment rights) and economic (dividends) rights.

  Pledges over shares / units are granted by contract. The grantor (the registered owner of the share / unit) shall grant a public deed of pledge, note the interest of the secured party on a specific share / unit certificate (in the case of the SA, the share certificate shall be delivered to the secured party), and note the existence of the pledge in the shareholder's registry book of the corporation. The granting procedure of pledges over shares of a listed company is similar, but the noting of the pledge on the share certificate and in the shareholder's registry book is substituted by a notice to the entity in charge of the book-entry registry for the listed company and the issuance by the latter of a certificate evidencing the existence of the pledge.

This security may be considered as a fairly reliable and easy security to obtain, although in certain circumstances (especially when the security is granted over the shares / units representing the equity of the debtor), its real value in insolvency or default scenarios may be limited from a recovery perspective.

- *Pledges over receivables and credit rights*

  Pledges over receivables are also admitted and standard in the Spanish market. The only relevant regulation applying to these types of security is provided for in section 270.6 of the Royal Legislative Decree 1/2020, of 5 May, approving the revised consolidated text of the Insolvency Law (Spanish Insolvency Act) and the Royal Decree 5/2005 of 11 March (RDL 5/2005). The pledge of a credit right is also granted by contract by granting a required public deed of pledge. The required transfer of possession of the credit rights is obtained by giving notice to the debtor of the credit or receivable of the existence of the pledge. As case law in Spain has recognised, a determination will be decisive for the effectiveness of a pledge over receivables and credit rights. For this reason, it will be advisable to set forth in as much detail as possible the origin or contract from which the pledged credit right or receivable arises.

  Pledges over future credit rights are also commonly accepted in Spain, provided the contractual relationship from which the future credit rights will arise are also identified.

1.1.2 Real estate mortgages

Real estate mortgages are created over any real estate property. Real estate mortgages must be executed in a public deed before a Spanish notary public and registered with the specific Spanish Land Registry where the real estate property is located. Real estate mortgages generate notarial fees, stamp duty taxes and registering costs.

Spanish law requires that the real estate mortgage includes:

- a maximum secured amount which is the maximum amount for which the real estate property is charged, meaning that any amount to be obtained beyond such maximum secured amount by the secured creditor upon a foreclosure shall belong not to the secured creditor, but to the grantor (or other subsequent junior secured creditors); and

- a value of the real estate property for auction purposes (to be obtained from an updated third-party expert valuation), which will be the auction value of the real estate property in case of foreclosure.

Spanish law also permits the creation of a floating mortgage, which is a security created over a specific real estate property to secure an indefinite number of liabilities up to a maximum cap.

Floating mortgages are only available to be granted in favour of bank lenders or financial institutions and public authorities (e.g. tax authorities). The floating mortgage deed must in any case provide a detailed description of the secured liabilities and the maximum mortgage liability (which will cover all the obligations without allocating mortgage liability to each of them), the term of the mortgage and the method of calculating the final secured amount and payable balance.

1.1.3 *Chattel mortgages and non-possessory (without displacement) pledges*

- *Chattel mortgages*

Chattel mortgages can only be created over:

- business premises;
- cars, trains and other motor vehicles;
- machinery and equipment;
- planes; and
- intellectual and industrial property (e.g. trademarks).

In addition, there is a specific type of mortgage for ships (the naval mortgage).

The chattel mortgage must also be executed in a public deed before a notary public and registered with the Movable Assets Registry.

- *Non-possessory (without displacement) pledges*

Pledges without displacement can only be granted over:

- harvests (including harvests from agricultural land plots;
- animals on plots;
- harvesting machinery;
- raw materials in warehouses;
- merchandise in warehouses;
- art pieces and collections;
- credit rights held by the beneficiaries of administrative public contracts, licences, awards or subsidies (if legally or under the relevant granting title permitted); and
- receivables (including future receivables) not represented by securities and not qualifying as financial instruments.

Non-possessory pledges must be executed in a notary public deed or policy before being registered with the Movable Assets Registry. Except for pledges without displacement over credit rights and inventories, these security interests are very rarely used in Spain. This is mainly due to the grantor not being able to sell the relevant secured assets without the pledgees' consent, and the fact that most of the assets that can be mortgaged with a chattel mortgage can also be secured by a real estate mortgage granted over the relevant real estate property where targeted secured assets / rights are located, if expressly agreed to by the parties in the real estate mortgage deed.

1.1.4 *Financial guarantees*

Financial guarantees are those granted to secure the fulfilment of principal financial obligations. Financial guarantees can consist of cash or securities and other financial instruments, and certain types of credit rights held by banks and credit institutions. Therefore, the collateral could be made up of shares issued by any limited liability company[1] and credit rights arising from the balances in bank accounts.

A very relevant point to be noted regarding this type of security is that the financial guarantees may benefit from a separate enforcement should the debtor be declared insolvent. Also, a relevant advantage when it comes to financial guarantees construed as pledges over shares is that they can be foreclosed: (a) through a private sale (i.e. not through a public auction, as is the general rule under Spanish law) conducted by the depository of the shares; or (b) by the pledgee's direct appropriation of the secured shares. That is, the financial guarantee may overcome the general limitation under Spanish law for securities, which prevents any contractual agreement permitting the holder of the security interest to directly and immediately acquire the secured asset in payment of its secured credit.

1.1.5 *Personal guarantees*

Personal guarantees securing the fulfilment of the obligations to be provided by third parties are also available under Spanish law. It is common in financing transactions to obtain personal guarantees from the borrower's shareholders, parent or subsidiary companies, to the extent permitted by law, including first demand guarantees.

Personal guarantees can be created by private agreements between the creditor and the guarantor or by operation of law. Additionally, under Spanish law, a guarantor cannot be obliged to pay the secured party until all the debtor's assets have been realised. This general rule of benefit for the guarantor does not apply:

- if the guarantor has waived the benefit;
- if the guarantee has been construed as joint and several; and
- if the debtor has been declared insolvent.

First demand guarantees, which are not regulated by law, are abstract and can be considered independent from the main secured obligation, creating a primary liability on the guarantor, and are not subject to the debtor's assets being realised.

One of the most relevant advantages of personal guarantees is that, under Spanish law, the insolvency declaration of the principal debtor will have no effect, nor will it prevent the enforcement of the personal guarantee against the non-insolvent guarantor. In this regard, first demand guarantees or bank personal guarantees are very effective when it comes to protecting the interests of a creditor who may be affected in a continuing contractual relationship with the insolvent debtor, for example, in the case of first demand guarantees provided as security for the fulfilment of the obligations under a lease agreement of an insolvent lessee.

[1] This is not unanimously recognised, as some scholars contend that this would only be available for listed companies.

1.1.6 Security priority in Spain: prior tempore general principle

Under Spanish law, secured interests are governed by the principle *prior in tempore potior in iure*, which means that the security which was created earlier will have priority over any other security created later over the same asset or right subject to the security.

In real estate mortgages, chattel mortgages and pledges without displacement, priority is determined by the date and time on which they are registered with the public registry, which is deemed to be the date on which the relevant document for registration was submitted.

As to possessory pledges (i.e. not registered), priority is determined by the date on which possession is transferred to the secured creditor.

Spanish law allows creditors to agree on the priority of pledges and real estate mortgages. Therefore, creditors can agree that all the credits have the same priority, or a creditor can decide to assign its priority in favour of another creditor.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

2.1 General rule in enforcement of securities

The general rule under Spanish law in enforcement of any security is that enforcement must be carried out by the realisation or auction sale of the relevant assets. Thus, direct appropriation of encumbered assets is, generally, not permitted.

2.2 Security enforcement procedures

The following are available legal in-court enforcement procedures in Spain:

- the judicial enforcement proceedings set forth in the Spanish Civil Procedure Act for the enforcement of the security interests;
- the notarial mortgage enforcement procedure to be carried out before a notary public (the out-of-court enforcement proceeding set forth in section 129 of the Spanish Mortgage Act);
- the out-of-court notarial pledges enforcement procedure to be carried out before a notary public (out-of-court enforcement procedure) set forth in section 1,872 of the Spanish Civil Code or section 569-20 of the Catalan Civil Code; and
- the special case of the out-of-court enforcement procedure set forth in RDL 5/2005 for financial guarantees (*garantías financieras*) over cash and tradable securities (*valores negociables*).

Pursuant to the terms of the pledges and the mortgages, those securities may be enforced by means of one of the referred procedures, also depending on the applicable law to each security interest.

The out-of-court notarial mortgage and pledge enforcement procedure will only be available if agreed between the parties under the security contract and the specific agreement being registered before the Land Registry in mortgages cases.

2.3 Judicial enforcement proceedings (mortgages and pledges)

2.3.1 General considerations

Judicial enforcement proceedings of mortgages and pledges are intended to be conducted through an auction and award of the secured assets.

An enforcement claim has to be filed, upon a material default of the borrower, before the relevant court where the real estate property is located. Along with the enforcement claim, certain specific documents will have to be attached: (a) an enforceable copy of the public deed of pledge or mortgage; (b) a certificate issued by a notary public certifying on the settlement of the outstanding balance of the loan; and (c) in cases of mortgages, a certificate issued by the Land Registry regarding the encumbrances of the property.

For cash, judicial enforcement will be carried out by directly transferring such cash, at face value, to the enforcing party.

For listed shares, bonds or other tradable securities in an official secondary market, the foreclosure of these assets will be carried out in accordance with the regulations governing such a secondary market. From a practical point of view, this would imply commissioning the sale of the referred assets to a brokerage firm.

For units (*participaciones sociales*) and unlisted shares (*acciones*), the foreclosure of these assets will be carried out in accordance with the statutory and legal provisions governing the sale and transfer of units and shares, including, if applicable, pre-emption rights. From a practical point of view, in the absence of any specific regulation, the sale of units and shares will be entrusted to a notary who shall organise a notarial auction.

Assets other than those referred in sections (i) to (iii) above will be foreclosed by means of (a) an agreement between the parties for the sale of the asset, provided certain conditions are met; (b) sale by qualified agent; or (c) judicial auction (the most common proceeding).

Creditor bidding is allowed in any of the referred proceedings.

The borrower has a very limited range of grounds to challenge foreclosure. In order to suspend the proceeding, the borrower should claim:

- that the security is no longer in full force and effect or that the secured debt has already been satisfied;
- that the assets to be foreclosed had been previously secured by a pledge or a mortgage different to and more senior than the security being enforced;
- that the terms contained in the pledge or mortgage agreements related to the foreclosure are so manifestly unfair that the borrower deserves judicial protection (please note that this is only applicable when a consumer is involved as a borrower); and
- that there is a criminal procedure underway related to the falsity of the document on which the foreclosure has been started.

2.3.2 Mortgage foreclosure auction

Auction of the assets in mortgage foreclosure procedures will be carried out at the registered auction value of the real estate mortgage properties agreed under the mortgage deed (without prejudice to the actual market value of the asset, hence disinviting third-party bidders in off-market auction value cases).

Third parties must deposit 5% of the auction value in order to bid. The secured creditor enforcing its interest does not need to make a deposit and may only participate in the auction if there are other bidders.

The asset shall be awarded free of any junior security or lien to the highest bid above 70% of the auction value. No bid will be accepted by the court if it does not cover at least 50% of the auction value of the secured real estate property.

If there are no bidders, the creditor may be entitled to award the real estate property to itself or to a nominee (*cesión de remate*) within 20 business days following the finalisation of the auction.

Should the award bid for the auctioned asset be insufficient to cover in full the amounts claimed in the foreclosure, the creditor will be entitled to seek satisfaction of such remaining amounts by bringing other ordinary enforcement proceedings against the debtor, seeking the seizure of any other assets or credit rights owned by the debtor.

The award to the creditor of the mortgaged property and subsequent assignment to a third party will not be considered as a second transfer of the awarded asset, including for taxation purposes.

2.4 Enforcement before a notary public: the out-of-court enforcement procedure

Mortgages can also be enforced out-of-court with the intervention of a notary public, who will be in charge of auctioning off the secured asset in a public auction.

Pledges may also be enforced by means of a notarial auction as provided in Article 1,872 of the Spanish Civil Code or Article 569-20 of the Catalan Civil Code.

2.4.1 Notarial pledge enforcement auctions

The governing regulation will depend on which territory the asset to be foreclosed is situated: for Catalonia, the Catalan Civil Code, or, for the rest of Spain, the Spanish Civil Code. Both articles provide the minimum grounds on which the notarial auction for the sale of the asset will have to be carried out. In practice, the regulations provided in both articles are insufficient for enforcing the pledge, so it is customary to further regulate such proceedings in the pledge agreements, stipulating, among others, the following:

- the process for determining the notary who will perform the auction;
- the formalities and periods for holding the auctions;
- the number of auctions and time period elapsing between two successive auctions;
- the requirement to deposit a percentage of the value to place a bid; and

- the time limit for the payment of the price by the successful bidder, etc.

2.4.2 Direct sale

Pledges subject to the Catalan Civil Code can also be enforced by means of a sale to be carried out directly by the pledger, the pledgee, or even a third party. The law only requires that:

- such agreement for a direct sale should be formalised in a public deed before a public notary;
- notice be given to any other pledgers over the same asset; and
- the completion of the sale cannot exceed a six-month period.

2.5 Special case of the enforcement of financial guarantees (garantías financieras): the enforcement procedure set in RDL 5/2005

RDL 5/2005 provides that financial guarantees construed as *garantías financieras* may benefit from a separate enforcement if the debtor becomes insolvent and, as regards pledges over shares, can be foreclosed by a private sale (not in a public auction, as is the general rule under Spanish law) conducted by the depository of the shares or by the pledgee's direct appropriation of the shares. This is a deviation from the general Spanish law principle that prevents any form of foreclosure of a security agreement which permits the holder of the security interest to directly and immediately acquire the secured asset.

Additionally, it should be noted that, in the case of pledges over cash:

- the secured creditor may order the relevant transfers of cash and offset the debt against the cash subject to the pledge; and
- upon reception of such request by the secured creditor, the credit institution where the pledged cash is deposited must immediately (on the same day) execute the necessary measures to carry out the requested transfers.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

3.1 Introduction to the pre-insolvency regime

The Spanish Insolvency Act foresees insolvency proceedings (*concurso de acreedores*) as in-court insolvency proceedings for companies that are in an insolvency situation, legally defined as not being able (or expected not to be able) to regularly pay their debts as they fall due. To protect creditors and prevent insolvent companies from operating in the market, the Spanish Insolvency Act provides that the directors of the debtor company have a legal duty to file for insolvency within two months of the date on which they become aware or should have become aware of the insolvency situation.[2]

Unlike other jurisdictions, the Spanish Insolvency Act does not foresee pre-insolvency proceedings under the supervision of a court or an insolvency receiver, but rather provides specific pre-insolvency tools intended for protection and out-of-court restructurings in pre-insolvency scenarios which are summarised below.

3.2 The section 583 pre-insolvency notice (automatic four-month stay)

The Spanish Insolvency Act provides that, under section 583, debtors in an insolvency situation may receive an additional four-month period to keep negotiating an out-of-court refinancing agreement, an out-of-court payment scheme, or a prearranged composition agreement, setting forth a pre-insolvency safe harbour for directors.[3]

To get this pre-insolvency notice protection, the debtor shall file a simple notice before the court that would be competent for declaring its insolvency proceedings. The court merely acknowledges receipt of this pre-insolvency notice motion (without any contradiction / adversarial effect) and the debtor will be provided, automatically, with three additional months to keep on negotiating to overcome its insolvency situation. Otherwise the debtor shall file for the insolvency proceedings declaration during the fourth month.

The acknowledgment of the pre-insolvency notice by the court shall not imply the appointment of a receiver or trustee by the court, nor shall it have any effect on the normal development of the debtor's business activity and the full capacity of its directors.

As a result of the pre-insolvency notice and during this four-month period:

- the court shall not admit petitions for compulsory insolvency (the debtor has preference to file voluntarily until the end of the fourth month);

- an automatic stay will apply to any enforcement actions over assets necessary to continue the ordinary course of business of the borrower, including enforcement of security interests. However, public claims (taxes, social security claims) will not be affected by this automatic stay. Also, security governed by the financial collateral special regime or granted over assets not located in Spain will also escape this automatic stay. In cases of secured assets located outside the European Union (EU), the automatic stay will rely on local applicable insolvency law.

The Spanish Insolvency Act presumes that all the assets of a debtor who has submitted the section 583

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2 As an exceptional measure intended to mitigate the economic impact of the Covid-19 crisis, the Spanish legislator, under the Royal Decree-Law 16/2020, has temporally and exceptionally suspended the legal duty to file until 31 December 2020.

3 As an exceptional measure intended to mitigate the economic impact of the Covid-19 crisis, the Spanish legislator, under the Law 3/2020 of 18 September, has extended this term from four to six months, applicable to pre-insolvency notices filed before1 January 2021.

pre-insolvency notice are necessary for the course of business, which in practice means that, during the section 583 pre-insolvency notice stay, all enforcements of secured creditors will be suspended.

The effect of the pre-insolvency notice will end after four months and, specifically, enforcement will be resumed after the four months without the debtor having applied for an insolvency declaration.

The debtor is allowed to file one section 583 pre-insolvency notice in any 12-month period.

3.3 The out-of-court pre-insolvency restructuring tools

Spanish bankruptcy law regulates several pre-insolvency tools that are intended to enable debtors to overcome their insolvency situation by reaching agreements to restructure their debt. Pre-insolvency tools available to the debtor are summarised below.

3.3.1 Out-of-court refinancing agreements

Section 597 of the Spanish Insolvency Act regulates the possibility of entering into collective refinancing agreements and non-collective or individual refinancing agreements in a pre-insolvency situation.

Pursuant to section 698 of the Spanish Insolvency Act, entering into a refinancing agreement that meets the requirements under section 597 of the Spanish Insolvency Act will allow both refinancing agreements and their security interests to enjoy immunity to any claw-back action, and lenders' claims will not be equitably subordinated as for old and new money provided as part of the refinancing.

The collective refinancing agreements, which may be subject to section 597 protection, are those entered into by the debtor and its creditors whose claims represent at least 60% of the debtor's liabilities (as evidenced by a certificate issued by debtor's auditor). Likewise, these refinancing agreements shall:

- be supported by a viable business plan allowing the continuity of the business of the debtor within the short and medium term; and
- involve an increase of available credit, or the amendment of existing debt obligations.

Furthermore, these refinancing agreements shall be notarised before a Spanish public notary.

On the contrary and when collective refinancing agreements cannot be achieved, there is the possibility of achieving individual bilateral refinancing agreements that can benefit from the section 698 regime. In accordance with section 604 of the Spanish Insolvency Act, these individual refinancing agreements shall comply with the following requirements:

- the debtor shall improve its assets-over-liabilities ratio as a result of the refinancing as of the date of the refinancing agreement;
- current assets shall not be less than the current liabilities of the debtor as a result of the refinancing;
- the value of the security interests (calculated in accordance with the Spanish Insolvency Act provisions) shall not exceed:

- nine-tenths of the value of the outstanding debt owed to the creditors participating in the individual refinancing agreement; and

- the previous ratio between security interests and the outstanding debt owed to such creditors; and

- the interest rate of the existing debt or debt resulting from the refinancing agreement shall not exceed the interest rate applicable to the previous debt by more than a third.

Again, these individual refinancing agreements shall be notarised before a Spanish public notary.

Additionally, 50% of any new money provided within a collective or individual refinancing agreement will be treated in the event of insolvency as a general privileged claim (ranking senior to ordinary unsecured claims).

3.3.2 The court-sanctioned scheme of arrangements (homologación judicial)

Sections 605 to 630 of the Spanish Insolvency Act regulate the process of obtaining a court-sanctioned scheme of arrangement (*homologación judicial de acuerdos de refinanciación*), which is a fast-track proceeding by virtue of which a collective refinancing agreement supported by at least 51% of the financial claims (i.e. excluding public, labour and commercial creditors) is sanctioned (homologated) by the court to protect it against insolvency claw-back actions. This action also permits the extension of its specific refinancing effects to dissident financial creditors, provided certain majorities have been achieved, which will depend on the type of refinancing measures sought under the refinancing agreement.

Hence, in addition to the protection against the insolvency claw-back actions and the new money incentive, the most relevant effect of the Spanish scheme is that it allows the extension of effects through a cram-down mechanism to dissenting and holdout creditors with unsecured and secured financial claims.[4]

The majority thresholds to extend the refinancing agreement to dissident and holdout financial creditors depend on the content and on whether such holdout claims are secured or unsecured. See Table 1.

Table 1: Majority thresholds and types of financial claims

Type of financial claims	Majority threshold required to extend effects
Unsecured claims	(i) 60% to extend a term deferral up to 5 years; (ii) 75% to extend: (a) a term deferral from 5 to 10 years; (b) unlimited haircuts; (c) debt-to-equity swaps; (d) debt-to-asset swaps; and (e) conversion of debt into profit participation loans (f) with a term from 5 to 10 years, as well as into any (g) other different financial instrument.
Secured claims	(i) 65% to extend a term deferral up to 5 years; (ii) 80% to extend same measures in point (ii) above.

4 Secured claims that exceed 90% of the updated market value of their collateral will be treated as unsecured claims for the deficiency claim (portion not covered by the security).

For purposes of calculating the percentages required for the majority thresholds, claims held by specially related parties to the debtor (i.e. shareholders over 10% or 5% in listed companies, directors and other entities belonging to the same corporate group) shall not be taken into account. Regarding syndicated loans, in order for it to be deemed that 100% of the syndicate has voted in favour of the refinancing agreement, it will be sufficient for 75% of the syndicate to support the refinancing agreement, which will therefore allow a double possibility of cram-down in the event of a syndicated loan.

Dissident / holdout creditors may challenge the commercial judge's homologation ruling based on two limited grounds:

- the failure to meet the majority thresholds; and
- the existence of a disproportionate sacrifice (which should be analysed on a case-by-case basis by the courts).

The debtor can only apply for one homologation process in any 12-month period.[5]

Spanish law does not contemplate a cross-class cram-down mechanism, nor an absolutely priority rule as regulated in other jurisdictions (e.g. the US Chapter 11 proceedings), but, for the purposes of extending the effects of a refinancing agreement to dissenting creditors through the *homologación judicial* proceedings, it only contemplates the differentiation between secured and unsecured claims, which specific relevant amounts will depend on the market value of the asset over which the security was granted.

Additionally, the Spanish law does not contemplate any mechanism to cram down equity holders. However, shareholders of the debtors may be personally liable in the event of liquidation when they reject, without a reasonable cause, a debt-to-equity proposal based on a fairness opinion that frustrates a collective refinancing or a court-sanctioned scheme.

3.3.3 Out-of-court payment agreement schemes

Holdout / dissenting creditors to a restructuring agreement can also be crammed down by means of a fast-track mechanism only applicable to individuals and small companies (companies with liabilities or assets of EUR5 million or less; 50 creditors maximum and for extending write-offs of credits and deferral of terms up to three years). Both extensions of up to 10 years and write-offs are available subject to approval by a 60–75% majority of claims.

This pre-insolvency restructuring tool has rarely been used in practice due to lack of creditors' support.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller,***

[5] As an exceptional measure intended to mitigate the economic impact of the Covid-19 crisis, the Spanish legislator exceptionally allows, under the Royal Decree-Law 16/2020, the application of more than one homologation per year until 14 March 2021.

representative of creditors, state representatives etc.?

- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

4.1 Legal duty to file an insolvency receiver appointment

The Spanish Insolvency Act provides for insolvency proceedings (*concurso de acreedores*) for companies in technical insolvency situations, legally defined as those that are not able (or expect not to be able) to regularly pay their debts as they fall due. The directors of a company or the debtor must file for insolvency within two months of the date on which they become aware or should have become aware of the insolvency situation.[6]

4.2 Types of insolvency proceedings

Insolvency proceedings can be initiated both (i) through the voluntary petition of the debtor (voluntary insolvency) or (ii) through a petition of any creditor (compulsory insolvency).

Depending on the complexity of the insolvency proceeding, the insolvency could be:

- an abbreviated insolvency, when:
  - there are less than 50 creditors;
  - the initial estimate of liabilities does not exceed EUR5 million; and
  - when the valuation of the assets and rights of the borrower is less than EUR5 million; or
- ordinary insolvency, when the insolvency proceedings, as decided by the court, could be complex and the requirements for the abbreviated proceeding are not satisfied.

4.3 Insolvency declaration

An insolvency proceeding will begin with the insolvency order issued by an insolvency judge after examining the petition and confirming that the information provided is complete and sufficiently demonstrates evidence of the debtor's technical insolvency and existence of more than one creditor.

The insolvency order will involve the appointment by the judge of an insolvency receiver, who may have full power of representation and management of the debtor (in the case of a compulsory insolvency order or in a liquidation insolvency scenario) or powers of intervention over the debtor (in general ordinary cases until the entry into the liquidation phase).

[6] As an exceptional measure intended to mitigate the economic impact of the Covid-19 crisis, the Spanish legislator, under the Royal Decree-Law 16/2020, has suspended this legal duty to file for insolvency until 31 December 2020.

The insolvency receiver will play a key role in the insolvency proceedings because the receiver is responsible for preparing a report of the debtor's liabilities and assets and has the legal obligation to ensure the maintenance and preservation of the insolvency estate, as well as to defend and preserve the interests of the creditors in the insolvency.

The insolvency administrator also oversees management of the debtor's business (the default rule in voluntary insolvency proceedings) or will step into the full power of the directors if so determined by the court (the default rule in compulsory insolvency proceedings) in the liquidation phase.

4.4 The insolvency phases

Unlike other jurisdictions, debtors (or creditors) do not have to make a decision between reorganisation or liquidation insolvency upon seeking judicial insolvency proceedings protection.

A voluntary insolvency proceeding commences with the insolvency judge making an insolvency order. Creditors must notify the court of their claims within one month of the date on which notice of the insolvency order is published in the Spanish Official State Gazette.

4.4.1 The common phase

The insolvency court will also appoint an insolvency receiver who will be responsible for drafting a report containing a detailed analysis of the documentation submitted by the debtor (the inventory of assets and list of creditors) and of its financial statements. As of the publication of the insolvency receiver's report, each creditor will be granted 10 business days to object to the report. Objections to the report shall be filed and decided in ancillary proceedings. If no objection is made against the insolvency receiver's report, or if all the objections have been judged and decided, the insolvency receiver will submit final versions of both the inventory and the list of creditors and liabilities. The judge will then make an order to commence the creditors' arrangement phase. All in all, and to speed up the process, where the objections to the report affect less than 20% of the total value of assets or liabilities, the court may rule that the common phase be immediately concluded and that the creditors' arrangement phase or the liquidation phase (see below) be commenced.

4.4.2 The creditors' arrangement phase

A proposal for an arrangement or restructuring plan can be filed at different stages of the insolvency proceedings.

A pre-creditors' arrangement proposal can be made at any time from the petition for insolvency to the deadline for notification of claims. Ordinary proposals can be filed with the court up to 40 days prior to the creditors' meeting date to be scheduled by the court (when opening the creditors' arrangement phase). The advanced or ordinary proposals for a restructuring plan must first be assessed by the court (to check their compliance with all the legal requirements), and also by the insolvency receiver.

As to the majorities and mechanics of voting required for the approval of the creditors' arrangement, the following shall be noted.

- Ordinary unsecured claims are entitled to vote and will be bound by the decision of the majority of the voting claims, whether or not they vote or abstain.

- Subordinated claims cannot vote but are bound by the restructuring plan.

- Secured claims can vote, and, if they do so, they will be affected and counted as unsecured claims only for the purpose of computing the majorities. Likewise, dissenting secured creditors can be crammed down when a certain majority of secured creditors of the same class is achieved.
- The creditors' arrangement can include any of the following proposals:
  - soft restructurings –
    - (i) write-off not exceeding 50% of the claims;
    - (ii) stays of up to five years; or
    - (iii) the conversion of claims into profit-participation loans ("PPLs") for a term of the same length;
  - hard restructurings:
    - (i) write-off exceeding 50% of the claims;
    - (ii) stays of up to 10 years;
    - (iii) the conversion of claims into PPLs or other re-profiling of the claims for a term of the same length;
    - (iv) transfers of assets and rights to the creditors in payment of their claims;
    - (v) debt-for-asset swaps to the creditor that holds a security over the relevant asset (or a third party appointed by said creditor); or
    - (vi) the sale of all or part of the debtor's business to a third party who will have to assume, under the terms agreed in the restructuring plan, the obligation to continue with the business activity of the debtor.
- The restructuring plan will include a detailed repayment schedule and a viability plan if repayment is based on the debtor's future cash flow. The restructuring plan cannot include any form of global liquidation of the debtor's assets (with some exceptions). However, it will entail a change in the ranking of claims and will be subject to conditions as to its validity.
- The approval of a restructuring plan requires the following majorities:
  - for ordinary claims –
    - (i) soft restructurings: at least 50% of the voting claims;
    - (ii) hard restructurings: at least 65% of the voting claims;
  - for secured claims (special privileged claims) –
    - (i) soft restructurings: at least 60% of creditors (with the aggregate value of the collaterals of the same class);

(ii) hard restructurings: at least 75%of creditors (with the aggregate value of the collaterals of the same class);

- for general privileged claims –

  (i) soft restructurings: 60% of the claims with a general privilege of the same class;

  (ii) hard restructurings: 75% of the claims with a general privilege of the same class.

- The restructuring plan must be supported by the relevant majority of the equity holders of the company and subsequently court-approved, after which, if there is a breach of the plan, the court will commence an ancillary proceeding to evidence that breach and, if the breach is demonstrated, may order that insolvency proceedings be resumed for the purpose of liquidating the company.[7]

4.4.3 The liquidation phase

The liquidation phase will commence automatically if no arrangement is proposed, if there is a breach of an arrangement, or where liquidation is applied for directly by the debtor at any time.

In liquidation, the power to manage the business will be vested in the insolvency receiver, who must prepare a liquidation plan to be approved by the judge. The plan is intended to provide for the sale of all of the debtor's assets and subsequent payment of claims to the creditors in the statutory order of priority of payment provided in the Spanish Insolvency Act.

4.4.4 Classification of claims in insolvency

Under the Spanish Insolvency Act, claims are classified in: (a) post-insolvency order claims or claims against the debtor's assets to be paid out of the debtor's assets, normally as they fall due and ahead of pre-insolvency order claims; and (b) claims arising before the date of the insolvency order (pre-insolvency order claims) falling into one of the following categories:

- *special privileged claims (secured claims)* – claims secured by a specific asset or right;
- *general privileged claims* – claims paid ahead of ordinary claims but not secured by any collateral (mainly public claims, e.g. of the tax and social security authorities, and unsecured claims of the creditor filing for compulsory insolvency, up to 50% of the aggregate total);
- *ordinary claims* – claims that are not secured, ranking *pari passu* and to be paid on a *pro rata* basis;
- *subordinated claims* – claims whose holders are not entitled to vote on proposals in a restructuring plan. Such claims forfeit any security interest created to secure the claim. If a restructuring plan is approved, the holders of subordinated claims will (normally) be subject to the same write-offs and deferrals as ordinary creditors. Among them: (a) subordinated claims that are contractually subordinated to all other claims; (b) claims for interest unless secured; and (c) claims held by persons who are "specially related" to the debtor (with some exceptions) – namely, shareholders

[7] As an exceptional measure intended to mitigate the economic impact of the Covid-19 crisis, the Spanish legislator exceptionally allows, under the Royal Decree-Law 16/2020, that any debtor who is aware of its inability to fulfil the approved creditors' arrangement will not be obliged to request liquidation and will be able to request approval of a creditors' rearrangement until 14 March 2021. In this regard, until 14 March 2021, the court will not decide on the opening of the liquidation requested by creditors.

owning at least 10% of the capital of the company when the claim arose (5% if the debtor is a listed company); claims of *de facto* or *de jure* directors, liquidators, persons to whom the debtor has granted a general power of attorney and persons who have held such office in the two years immediately preceding the insolvency order; and claims of entities belonging to the debtor's company group and its common shareholders.

4.4.5 *Other relevant issues related to the insolvency proceedings*

At any time during the insolvency proceedings, the insolvency receiver may directly authorise, without court approval, sales of assets that are essential to ensure the viability of the debtor's business or to meet cash needs, as well as sales of assets that are not necessary to the business. Any sales of personal property or real estate that do not meet those conditions will be approved by the court almost automatically if the price offered does not exceed certain discounted limits.

The commencement of insolvency proceedings has the following effects on the debtor's assets.

- The Spanish Insolvency Act does not permit any creditors who have exchanged all or part of their claims for equity within a refinancing agreement (thus avoiding subordination in relation to the debt exchanged for equity) to be put in the "specially related" class.
- Any pre-existing attachments on the debtor's assets can be lifted and cancelled if they hinder the continuity of the debtor's business.
- Administrative enforcement proceedings are generally stayed.
- And foreclosure proceedings will be stayed and may only resume if the court finds that the collateral is not necessary for the business.

Following the initiation of insolvency proceedings, interest no longer accrues. Interest already accrued is considered a subordinated debt, except if secured by a security interest.

Set-off is applicable, provided that the legal requirements have been met before the company is declared insolvent; set-off will no longer be possible after insolvency proceedings are initiated.

Hedge agreements are subject to specific regulations (allowing close-out netting and enforcement of collateral).

The declaration of insolvency does not, *per se*, allow the parties to terminate a bilateral agreement, notwithstanding what may have been agreed between the parties.

As a general rule, the declaration of insolvency does not alter the general contractual rules on termination, but, under the Spanish Insolvency Act, the judge may decide to remedy an eventual default of the insolvent party by reinstating an agreement, with the effect that any outstanding amounts and further payments under the agreement will be treated as post-insolvency claims. If the court deems it appropriate for the interests of the insolvent party, it is entitled to terminate the agreement, with compensation for damages.

The most important stakeholders in the insolvency are creditors (special privileged secured creditors,

creditors in general, employees and public creditors), the insolvency receiver and the employees.[8]

Creditors play an important role in the sense that, when the debtor does not request its liquidation, either at the time of filing for insolvency or at a later stage during the insolvency proceedings, the continuation of the debtor, under a creditors' arrangement, will basically depend on the creditors' will to approve such a creditors' arrangement, otherwise the debtor will face liquidation and its final dissolution.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

Pursuant to section 226 of the Spanish Insolvency Act, the debtor's acts and contracts detrimental to the estate that were performed within the two years prior to the declaration of insolvency may be avoided, even in the absence of fraud or intent. In this regard, section 226 of the Spanish Insolvency Act establishes certain rebuttable and non-rebuttable presumptions of detriment to the estate. On this basis, any securities perfected two years prior to the insolvency order may be challenged in insolvency through the possibility of initiating a claw-back action under section 226 of the Spanish Insolvency Act.

Without prejudice to the above, the Spanish Insolvency Act provides certain safe harbours for security granting, mainly:

- securities granted within acts and contracts pertaining to the ordinary course of business and at arm's length;
- acts within the scope of special regulations over payment and clearing, and liquidation systems for securities and hedging instruments;
- security interests granted in favour of the salary guarantee public fund (FOGASA) or to secured public claims;
- securities granted or ring-fenced in refinancing agreements gathering specific requirements (see section 3.3 above); and
- acts or transactions subject to foreign law that are unavoidable under the specific applicable law.

In order to avoid the abovementioned claw-back risk, out-of-court refinancing agreements and, in particular, the ring-fencing of security interests as a result of the court-sanctioned homologation proceedings (as explained in section 3.3 above) are highly recommended.

Further to the insolvency law claw-back action regime, generally applicable fraudulent conveyancing actions, which require specific fraudulent intention and securities being granted within four years prior to the insolvency order, will be also be available in insolvency proceedings. In this regard, it shall be noted that, in accordance with the Spanish Supreme Court criteria, a case of intended fraud requires that a diligent creditor would not be able to ignore that the act or contract at issue was detrimental for the rest of creditors.

[8] Employees are the workforce required for the continuation of the company's business activity. If possible, therefore, to maintain employment under the general principle of ensuring the continuity of companies governed by the Spanish Insolvency Act.

6. Is enforcement of security rights treated differently in each type of proceeding?

At pre-insolvency scenarios, the Spanish Insolvency Act limits the possibilities of enforcing collateral required for the continuity of the debtor's professional or business activity, specifically providing that the section 583 pre-insolvency notice provides for an automatic suspension of all enforcement of security rights.

Enforcement of security rights will be treated similarly, following the insolvency declaration and without prejudice to the specific type of insolvency declared. In this regard, see Section 11 below.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

This has been dealt with under in section 4.4.4.

Specifically, claims held by creditors secured by mortgages, pledges, or other security interests will grant the creditors a specially preferred (i.e. secured) status with the effects envisaged in the Spanish Insolvency Act, including:

- the preferential classification of the claim covered by 90% of the updated market value of the collateral as a special privileged claim;
- the right to separate enforcement of their claim, if they commenced foreclosure proceedings before the date of the insolvency order and certain additional requirements were satisfied; and
- priority for collecting their claims in the event of the debtor's liquidation.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

Specific actions must be addressed on a case-by-case basis. In general terms, secured creditors shall protect their interest in accordance with the following.

- In pre-insolvency scenarios and in order to maintain the right to separate enforcement in any potential subsequent insolvency proceedings, the secured creditor should initiate enforcement of the collateral prior to the insolvency declaration. In cases where there is a pre-insolvency scenario and without prejudice to automatic suspension in the case of a section 583 pre-insolvency notice, the secured creditor may initiate separate enforcement.
- Additionally, in the case of the granting of new securities under a refinancing agreement, it is advisable to seek ring-fencing of new securities under the pre-insolvency refinancing mechanisms available under the Spanish Insolvency Act (i.e. refinancing agreements entered into in compliance with the requirements under section 597 of the Spanish Insolvency Act or to obtain court homologations of the refinancing agreement).
- Once the insolvency has been declared, the secured creditor must communicate its secured claim to the insolvency receiver, also disclosing: (a) all required documentation to evidence that its security interest was perfected, as well as, if available, (b) a third independent registered expert valuation providing an updated market value of the collateral. This has the effect of getting the insolvency receiver to classify the creditor's secured claim accordingly. In this regard, if necessary, the holder of the secured claim must timely review and react against the list of creditors and

inventory of assets to be filed by the insolvency receiver.

- To the extent possible, the secured creditor should, as soon as possible, start the process of obtaining a ruling from the insolvency court that the secured asset is not necessary for the continuation of the debtor's business activity. This will enable the secured creditor to continue or initiate separate enforcement and gain leverage in insolvency proceedings.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

Rights of the secured creditor against a non-debtor joint and personal guarantor will not be affected as a result of the insolvency proceedings of the primary obligor, meaning that the secured creditor will be able to enforce personal guarantees without prejudice to the insolvency of the secured obligor.

In cases where the collateralised asset is owned by a third party, the debtor's insolvency will not prevent the secured creditor from initiating or continuing the foreclosure of the collateral.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

Pursuant to the Spanish Insolvency Act, the recognition of all the rights of the secured creditor requires perfection. Hence, the consequence of not having complied with all required processes will be the non-recognition as a secured creditor, and such a creditor's claim will be treated for all purposes as an unsecured claim.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged? If so, how?

During a pre-insolvency situation (the section 583 pre-insolvency notice moratorium), ongoing foreclosures will be automatically stayed and will be resumed provided the debtor has not filed for insolvency within the four-month moratorium term.[9] The literal wording of section 583 does not provide that foreclosures cannot be initiated, but that they will be automatically suspended, meaning that, even if initiated during the moratorium term, the foreclosure will be immediately suspended and the filing will be put on hold by the relevant court.

Upon insolvency declaration, enforcement will be stayed and may not commence until:

- a creditors' arrangement is approved (which does not affect the secured creditors' entitlement to enforce); or

- one-year elapses from the date of the insolvency order without a creditors' arrangement being approved or the liquidation phase of the insolvency being declared.

Security interests that were not enforced prior to the insolvency order will not be available in the event of the opening of the liquidation of the debtor, meaning that the recovery of the secured claim will rely exclusively on the liquidation outcome.

[9] As an exceptional measure intended to mitigate the economic impact of the Covid-19 crisis, the Spanish legislator, under the Law 3/2020 of 18 September, has extended this term from four to six months, applicable to pre-insolvency notices filed before 1 January 2021.

Stay of the enforcement can only be challenged through the obtaining of a ruling from the insolvency court declaring the collateral to be non-necessary for the continuation of the business activity of the debtor, which at the end of the day will depend on the debtor being able to get the court approval of an in-court restructuring without the favourable vote of the secured creditor. In this regard, it shall be noted that most insolvency courts in Spain ultimately have tended to rule that a collateralised asset should be declared non-necessary in the event that the secured creditor evidenced that the debtor would not be able to achieve an in-court restructuring without the favourable vote of the secured creditor, which occurs in the majority of the cases.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

No. This not possible except in a liquidation scenario where the secured creditor does not have the right to a separate enforcement, in which case the collateral may be sold free and clear of any lien under the liquidation and under the provisions of the liquidation plan approved by the court. In this respect, in accordance with the Spanish Insolvency Act, the insolvency receiver must recognise an opposition right of the secured creditor to any direct sale of the collateral below its market value that does not allow the repayment of the entire secured claim covered by the security.

In cases of sale of the collateral in liquidation, the secured creditor will have a preferential right to the collection of the proceeds of the sale up to the amount of the claim covered by the security.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

No.

14. What distribution will a secured creditor receive if a company is reorganised?

See section 4.4.4 on the classification of claims under the Spanish Insolvency Act and specific rights to be recognised in any case in favour of a secured creditor.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

Effects of a restructuring / reorganisation plan of a company will depend on whether the necessary majorities are given under the reorganisation to achieve a cram-down of the secured creditor. In this regard, see section 3.3.2 above, related to the majorities of secured financial creditors required to cram down dissident / holdout secured creditors through the court-sanctioned refinancing agreement in homologation proceedings (*homologación judicial*); and section 4.4.2 related to the secured creditors' majorities required for obtaining the court approval of in-court restructuring agreements (creditors' arrangement) in insolvency proceedings.

Based on the foregoing and in the event of failure to reach the required secured creditors' majority, the restructuring / reorganisation plan shall not affect the secured creditor who, subject to such a creditor's approval / favourable vote, shall be fully entitled to continue or initiate its separate execution.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

Over and under-securitisation are relevant to determine the specific classification of the secured claim under the insolvency proceedings and also the consideration of the secured claim in the framework of the majorities required to obtain a cram-down in a court-sanctioned homologated refinancing agreement.

In this regard, it shall be noted that the Spanish Insolvency Act provides that the specific secured amounts to be qualified as special privileged claims may not exceed the amounts resulting from nine-tenths of the updated market value of the relevant collateral covered under the agreed relevant security agreement. Hence, in cases where the value of the collateral exceeds the amount of the creditor's secured claim, 100% of the secured claim will be classified as a special privileged claim and, in under-collateralisation cases, it is likely that the amount to be recognised as a special privileged claim will be below the secured claim, which could be relevant only for the purposes of controlling / obtaining the necessary voting majorities in the various in-court cram-down restructuring scenarios described above.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

The Spanish Insolvency Act provides that foreign insolvency proceedings will not be recognised automatically in Spain, but provided the corresponding rulings given in a foreign country obtain *exequatu*r, will require that:

- the judgment refers to a collective insolvency proceeding whereby the assets and business activity of the debtor are subject to the control or supervision of an insolvency court;
- the judgment is final;
- competence of the foreign court is based on the same specific rules provided under section 45 of the Spanish Insolvency Act (that is, the corporate domicile of the debtor, the existence of the centre of main interest of the debtor or, at least, a permanent establishment);
- the ruling is noticed to the debtor; and
- the judgment does not violate the public policy of Spain.

Nonetheless, in the case of processes initiated in another EU member state (except Denmark), they would be fully recognised in Spain without any *exequatur*, pursuant to Regulation (EU) 2015/848, of the European Parliament and the Council of 20 May 2015 on insolvency proceedings.

THE NETHERLANDS

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

1.1 Pledges and mortgages

Dutch law distinguishes between registered (*registergoederen*) and non-registered assets (*goederen*), which include both tangible, movable assets and intangible assets such as receivables and intellectual property rights. Security *in rem* over registered assets is taken in the form of a mortgage (*hypotheek*). Security *in rem* over non-registered assets is created by means of a pledge (*pandrecht*). Pledges and mortgages do not lead to a transfer of ownership. While the ownership remains with the debtor, the pledge and mortgage are a mere charge over the secured asset or collateral, which can be enforced in an event of default.

The most common categories of registered assets are real property, aircraft and ships that have been registered in the public land register, ships register and aircraft register respectively; and lease-hold (*erfpacht*) or usufruct (*vruchtgebruik*), building and planting rights (*recht van opstal*) and apartment rights (*appartementsrechten*). A mortgage over these registered assets is created by a notarial deed followed by the registration of the mortgage in the relevant public register. The mortgagor retains full legal title to and possession of the collateral.

Security over non-registered assets, both tangible and intangible, is made in the form of a pledge. Generally, a pledge is created in the same manner that a transfer of ownership of the collateral would be perfected.

Dutch law distinguishes between a possessory pledge and a non-possessory pledge in relation to tangible movable assets (*roerende zaken*) and between a notified pledge and a non-notified pledge[1] in relation to rights. A non-possessory pledge and a non-notified pledge are made by either a notarial deed or a private deed between the parties and the subsequent registration of the deed in a register maintained by the Tax Inspectorate. Certain non-registered rights, such as shares and patent rights, cannot be made subject to a non-possessory / non-notified pledge.

The most common categories of assets over which a pledge can be created are as follows.

- Tangible assets: these can be made subject to a possessory pledge by handing possession to the pledgee or a third party nominated by the pledgee (for instance, a warehouse keeper). They can also be made subject to a non-possessory pledge in the manner described above.
- Existing and future book debts, receivables / rents and other rights against an identified or identifiable debtor (collectively: receivables) can be pledged by means of a notified pledge, i.e. a private deed and the subsequent notification thereof to the receivables debtor provided that the receivables are described in the deed in such manner that they are identifiable. A non-notified pledge of receivables can only validly be created over existing receivables and future receivables

[1] A non-notified pledge is a pledge on rights against third-party debtors of the pledgor which has not been disclosed to such debtors.

that originate directly from a legal relationship that exists at the time of the pledge. When creating a non-notified pledge the parties therefore commonly agree that the pledgor shall periodically (sometimes even daily or by means of a power of attorney to the pledgee pursuant to which the pledgee may for itself create the right of pledge) sign supplemental pledge deeds in order to make sure that any rights that will come into existence after the initial pledge will be pledged.

- Rights and claims against unknown third parties can be charged with a pledge provided that the third-party debtor is notified of the pledge as soon as the third-party's identity has become known.
- A right of conditional ownership can be pledged. A party who purchases and accepts the transfer of a movable asset subject to a retention of title (see section 1.3 below) acquires a right of conditional ownership with respect to that movable asset. This right of conditional ownership can be pledged unconditionally.
- Registered shares in the capital of a Dutch company must be pledged under a notarial deed and the subsequent filing of the deed.
- Intellectual property rights can be pledged. An intellectual property pledge pertaining to registered intellectual property rights will become enforceable only if registered in the relevant intellectual property rights register.

Security is created as a security for the obligations of a debtor. It can be created in relation to a specific debt or obligation or in relation to any existing or future indebtedness of the debtor *vis-à-vis* the secured creditor. It is possible that a party will grant a mortgage or pledge on its own assets as a security for the indebtedness of a third party.

1.2 Right to reclaim goods

By operation of law, vendors also may invoke a right to reclaim the supplied goods (*recht van reclame*), which they can do during a brief period (ranging from a few days to several weeks depending on the nature of the vendor's business) after the vendor has supplied the goods to the debtor. The invocation of the right to reclaim goods can only be made if the goods are unpaid and are still in the same condition as when the goods were supplied. The effect of this invocation is that the title to the supplied goods returns to the vendor irrespective of a subsequent attachment or bankruptcy of the debtor. The right to reclaim may be contracted out.

1.3 Retention of title

Vendors of tangible goods may retain the title to the goods sold and supplied until the purchase price of those goods has been paid by the buyer (*eigendomsvoorbehoud*). This right should be stipulated in the contract of sale. In a typical supply contract, such a provision would ordinarily be included in the general terms and conditions of the supplier.

1.4 Right to hold on to a good

A creditor who has the lawful possession of goods that are owned by the debtor may exercise a right to hold on to the goods until the creditor gets paid (*retentierecht*) by operation of law. By virtue of this right, the creditor may refuse to give up possession of these goods if the debtor does not fully pay its obligations arising out of the contract pursuant to which the creditor holds possession of the debtor's goods.

1.5 Other forms of security

As a consequence of the implementation in the Netherlands of the European Collateral Directive,[2] in cases involving certain types of parties, title to cash and listed securities can be transferred by means of security. In that event, the lender is under an obligation to redeliver a similar amount or equivalent shares (as the case may be) after lapse of the security period.

Outside the scope of application of the European Collateral Directive (as enacted in Dutch law) a security transfer of title is void.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

2.1 Enforcing security

Security rights are generally enforced after an event of default has occurred and after it has been established that the debtor has failed to remedy the default. The pledgee or mortgagee is not required to seek court intervention in order to confirm the indebtedness before commencing foreclosure over the collateral, except in the case of foreclosure over aircraft registered under the Geneva Convention.

2.1.1 Mortgage

A mortgage is enforced by a public sale which is conducted by a notary. The mortgagee may ask the court to approve a private sale following a procedure during which interested parties may submit their bids to the notary. The notary will present a report to the court of all the bids that have been received. The court has discretionary powers to approve a private sale or not.

A mortgage on aircraft registered under the Geneva Convention and ships must always be enforced by a public sale which will be conducted by a notary or by the court (as the case may be).

2.1.2 Enforcement of pledges

If a pledge of tangible goods is a non-possessory pledge, the pledgee may (if required) ask the court for an order that the pledgee may take possession of the pledged goods for the purpose of enforcement. The court may order that the pledgee may enter the pledgor's premises to take physical possession of the goods.

Pledged tangible goods and rights (other than receivables) will as a rule be sold through a public auction under the rules of the Dutch Code of Civil Procedure. After an event of default has occurred and the debtor is in breach of its obligations (*in verzuim*), the debtor and the creditor may agree on a private sale as a means of enforcement.

Moreover, both the debtor and the secured creditor have the right to ask the court to allow a different method of enforcement. This right can be excluded in the pledge agreement. The creditor may also ask the court to transfer the title in the secured asset to the secured creditor against a credit in the amount of the debt.

[2] The aim of the Collateral Directive (2002/47/EC) is to create a uniform EU legal framework to limit credit risk in financial transactions through the provision of securities and cash as collateral. Collateral is the property (such as securities) provided by a borrower to a lender to minimise the risk of financial loss to the lender in the event of the borrower failing to meet its financial obligations to the lender. The Directive reduces the formal collateral requirements and harmonises and clarifies the collateral process.

A pledge of receivables is usually enforced by the collection of the receivable through a notice by the pledgee to the third-party debtor. However, it can also be enforced by selling the pledged receivables. As a result of such notification, which does not require court intervention, the pledgee is entitled to claim payment of the pledged receivables. The receivables debtor's right of set-off will generally not be affected if the debtor's counterclaim arose prior to the notification or if such a counterclaim originates from a contractual relationship with the pledgor that existed prior to the notice of the pledge.

A pledge on cash is enforced by the pledgee taking the monies to satisfy the pledgee's claim.

2.2 Concurrence of secured creditors

Where there is more than one pledge or mortgage or an attachment by an unsecured creditor, the foreclosing creditor must share the proceeds with the other creditors in accordance with the ranking of the other secured creditors' or attachors' claims. If the creditors and the debtor cannot agree on the distribution of the proceeds, any creditor may ask the court to decide.

2.3 Cash collateral, securities collateral

Collateral within the meaning of the European Union (EU) Collateral Directive is enforced by the secured creditor's retaining the collateral and doing whatever the secured creditor sees fit (including public or private sales or retention of goods in satisfaction of debt) in satisfaction of a corresponding amount of the outstanding indebtedness. The obligation to redeliver assets of a similar kind is *cancelled* upon enforcement. No leave from the court is required.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

At the time of writing there are no formal pre-insolvency proceedings available in the Netherlands. However, a Bill has been submitted to Parliament, seeking to introduce a pre-insolvency procedure in the Netherlands: The Act on the Confirmation of Private Plans (*Wet homologatie onderhands akkoord*, the WHOA). This procedure will allow for the presentation of a restructuring plan forestalling the debtor's insolvency. On 6 October 2020 the WHOA was approved by the Dutch Senate and will therefore be signed into law. The WHOA will enter into force on 1 January 2021.

The WHOA will provide for two different tracks:

- a public track which can result in a scheme automatically recognised in each EU member state by virtue of its inclusion in Annex A of the Recast European Insolvency Regulation;[3] or
- a confidential track for more sensitive restructuring projects. Restructuring plans confirmed under the confidential track will fall outside the scope of the Recast European Insolvency Regulation.

3.1 Who can initiate the proceeding?

A debtor who is or can reasonably be expected to become insolvent may propose a plan as long as no restructuring expert has been appointed.

A creditor, shareholder, the works council or the workplace representative may request the appointment of a restructuring expert, who subsequently is entitled to propose a plan to the exclusion of the debtor. If the debtor can be qualified as a small or medium-sized enterprise (SME), the restructuring expert needs the consent of the debtor to propose a plan. Moreover, the debtor retains the right to present a competing plan in response to a plan presented by a restructuring expert.

3.2 What are the criteria used for opening the proceeding?

There is no court test at entry in cases where a plan is proposed by the debtor.

The presentation of a plan by a restructuring expert requires the preceding appointment of such expert by the court. A petition to appoint a restructuring expert will be granted if the debtor is or can be reasonably expected to become insolvent, unless it is readily apparent that the interests of the joint creditors will not be served by allowing the request. An example of a case when the appointment of a restructuring expert would not serve the interest of the joint creditors is when the petition has been filed by a creditor whose sole aim is to frustrate or delay the presentation of a plan in order to improve the creditor's negotiation position. The court is obligated to appoint a restructuring expert when the petition was made by the debtor itself or when the petition is supported by a majority of both secured and unsecured creditors.

3.3 Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?

The main actors are the debtor, the restructuring expert if appointed and the court.

3.4 Does the debtor's management remain in control of the business during the proceeding?

The WHOA will provide for a debtor in possession procedure. The debtor will retain both the possession of its property as well as the authority to dispose of its property during the procedure, enabling the debtor to conduct its business in a normal fashion.

3.5 May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?

The plan can affect contracts. It can bind all types of capital providers, including secured and preferential creditors and shareholders, or it can be limited to a subset of capital providers. It can

[3] Regulation (EU) 2015 / 848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings.

include third-party releases. Additionally, the plan may include a proposal to amend or terminate contracts considered to be onerous. Should the counterparty to the contract refuse the debtor's proposal to amend the contract, the contract can be terminated with previous approval given by the court after reasonable notice has been given. Damages or penalties resulting from the termination of the contract may be amended as part of the plan.

3.6 What is the level of creditor consent that is required to effectuate a restructuring?

The plan can be presented to all stakeholders or limited to a subset of capital providers (creditors and / or shareholders). Voting is done in classes of creditors or shareholders. Creditors and shareholders are placed into classes according to their rank in the debtor's insolvency, or in accordance with the rights they will receive as part of the restructuring plan. A plan is accepted by a class if creditors or shareholders representing at least two-thirds in value have voted in favour of the plan. For this threshold, only the claims of the creditors or shareholder who have exercised their right to vote are taken into account. This majority in value can bind a class's minority. The court has the power to impose the plan on dissenting classes (a cram-down) provided that no creditor is worse off under the plan than in the debtor's hypothetical insolvency and the reorganisation value is distributed in accordance with the rank of the respective classes (the absolute priority rule). The plan may deviate from the absolute priority rule in case of a reasonable justification (i.e. new value provided by one or more shareholders). Additionally, SME creditors are entitled to at least 20% of their claims unless only a lesser percentage or no amount at all can be paid. Unsecured creditors in the money classes can additionally opt for a cash-out to the amount such creditors would have received in case of the debtor's insolvency.

3.7 Is shareholder consent required in order to effectuate a restructuring?

Shareholder consent is not required to effectuate the plan. A cram-down (in the form of a debt for equity swap, for example) can be imposed on a shareholder class, provided the conditions mentioned above are met. If the debtor qualifies as an SME (i.e. the debtor employs less than 250 people, has an annual revenue that does not exceed EUR50 million, and its balance sheet total at the end of the previous financial did not exceed EUR43 million), any plan presented by a restructuring expert does require board consent. In case of an SME-debtor, shareholders may not, in an unduly manner, prevent the board from giving its consent.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***

- ***Is shareholder consent required in order to effectuate a restructuring?***

The Dutch Bankruptcy Act currently distinguishes between two different insolvency proceedings for companies: temporary suspension of payment (*surseance van betaling*) and bankruptcy (*faillissement*). Both are insolvency proceedings within the meaning of the Recast European Insolvency Regulation. The Dutch Bankruptcy Act (Bankruptcy Act). also provides for a debt forgiveness programme for individuals (*schuldsaneringsregeling natuurlijke personen*). This proceeding will not be described further here.

Suspension of payment is designed to give a company an opportunity for recovery and to avoid bankruptcy. Generally, suspension does not affect the rights of secured and / or preferred creditors (mortgagees, pledgees, the Tax Collector's Office, employees etc.). Although suspension of payment is designed as a means for recovery and reorganisation, it has become more and more common for a company (or its (secured) creditors) to elect for bankruptcy to save an insolvent business. The reason for this is that in bankruptcy there are very few restrictions on the dismissal of employees of the company. In the case of a suspension, the business can only be sold by the company under the application of the EU directive regarding the retention of employees' rights. This directive ensures that, with the sale of a business, all employees' rights and obligations are transferred to the purchaser of the business by operation of law. This directive allows EU member states to exclude the transfer of rights in case of a bankruptcy. Dutch law currently includes this exception.

It must be noted, however, that the Dutch government is preparing legislation that will rescind this exception, thereby extending the scope of the transfer of employees' rights provision to bankruptcy proceedings.

A suspension may be converted into a bankruptcy when it is evident that the suspension will not be successful. Bankruptcy cannot be converted into a suspension of payment.

4.1 Who can initiate the proceeding?

Suspension of payment proceedings can only be opened at the request of the debtor. All companies and other legal entities can apply for suspension of payments. Natural persons conducting a business can also apply for suspension of payments. On application, the court immediately grants a provisional suspension of payment. This remains in force until a creditors' meeting takes place (usually within three months). At the creditors' meeting, only the unsecured and subordinated creditors can vote in respect of the application for a suspension of payment up to a maximum of 18 months. The debtor can apply for an extension.

Bankruptcy may be requested by the debtor itself, any creditor who remains unpaid and, where the public interest so requires, the Public Prosecutor's Office. Special provisions apply for financial institutions and insurance companies. The effects of the bankruptcy are the same irrespective of the petitioner.

4.2 What are the criteria used for the opening of the proceeding?

When petitioning for suspension of payment proceedings, the debtor must demonstrate to the satisfaction of the court that it cannot continue to pay its debts as they fall due. The debtor must also demonstrate that it will eventually be able to resume the payment of its debts or that a composition scheme will be offered to its creditors. The petition may require a prior resolution by the shareholders and the supervisory board, depending on the articles of the company. The Bankruptcy Act provides that temporary suspension of payment is granted by the court immediately upon the application by the debtor if the court, on the basis of the petition, is itself satisfied that the criteria will be met.

The test for bankruptcy is a cash-flow test. The petitioner must prove to the satisfaction of the court that the debtor is unable to meet its payment obligations. This is usually the case if more than one creditor remains unpaid. A petition by the debtor requires a prior resolution by the shareholders and, if applicable, by the board of supervisory directors (*raad van commissarissen*) whereby the shareholders will also appoint a representative to file the petition for bankruptcy. The court will decide on the basis of a summary review of documents and arguments whether the debtor has indeed ceased to pay. The court should always apply this bankruptcy test, unless it concerns a request for a Secondary (or non-main) Proceeding (as defined in the Recast European Insolvency Regulation), in which case the court will assume that the debtor is insolvent. Bankruptcy is considered to be an attachment on all assets and liabilities of the company. It takes effect from 0.00 hours of the date of the bankruptcy order, except in the case of certain financial transactions, where it has effect as of the hour of the bankruptcy order. The procedure serves as a preparation for compulsory liquidation of the assets by the liquidator.

4.3 Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?

In the Netherlands there are no special bankruptcy courts. The District Courts of the debtor's domicile will have the jurisdiction to open either a suspension of payment proceeding or a bankruptcy. If the petition concerns a foreign debtor or a debtor without a known registered office in the Netherlands, a Dutch District Court will have jurisdiction if the debtor has a branch office in its district.

As of the commencement of a suspension of payments, the power of the debtor to dispose of its assets, debts and liabilities is shared with the administrator. The powers and, as the case may be, duties of the debtor's directors and shareholders remain otherwise unaffected. The administrator is appointed by the court. The administrator's duty is to manage the assets together with the debtor. In doing so, the interests of the creditors should be protected. The administrator is usually a member of the local bar, although the law does not explicitly require this. An auditor or any other professional may also be appointed as administrator. In certain cases, the court may appoint two or more administrators. The court may also appoint (and it usually does in practice) a supervisory judge, who will give advice to the administrator. In cases with a large number of claims, the court has the discretion to order certain measures, such as the appointment of a committee of representation (*commissie van vertegenwoordiging*) of at least nine members. This committee represents the most important categories of creditors during the voting procedure at the creditors' meetings.

If the court issues a bankruptcy order, it will appoint a liquidator (*curator*), who is usually a member of the local bar. The court will also appoint a bankruptcy judge (*rechter-commissaris*), who supervises the proceedings. The liquidator is charged with the administration and liquidation of the bankrupt estate. The liquidator has full power to represent the bankrupt debtor provided that such representation involves the assets and liabilities of the bankrupt company. The liquidator has the exclusive power to dispose of the debtor's assets. The directors of a bankrupt company remain in place and may represent the company in any other matter (such as representing the company in matters against the liquidator or in case the company offers a composition). Also, the shareholders' powers remain unaffected; however, they cannot make shareholders' resolutions to the detriment of the company's creditors.

In bankruptcy, the court may, immediately or at a later stage, appoint a creditors' committee consisting of an odd number of creditors' representatives of major factions within the group of creditors. The creditors' committee advises the liquidator. It may demand inspection of the books, records and other data-carriers relating to the bankruptcy at any time. The liquidator must provide the creditors' committee with all required information. The creditors' committee has the right to call a creditors' meeting. The liquidator must seek the advice of the creditors' committee before instituting or pursuing any legal proceedings or defending any proceedings. However, the liquidator has the sole right to dispute claims. The liquidator must also obtain the advice of the creditors' committee in relation to the liquidator's policy regarding the liquidation of the company's assets and the time and amounts of any distribution. If the liquidator does not agree with the advice in relation to a certain matter, the liquidator must notify the creditors' committee immediately. The creditors' committee may then request the supervisory judge to grant a decision. The liquidator must then suspend any action in the relevant matter for three days.

4.4 Does the debtor's management remain in control of the business during the proceeding?

As stated above, in suspension of payment proceedings certain powers of the debtor are shared with the administrator. In bankruptcy the debtor's rights to legally dispose of and administer its property, rights and interests are transferred to the liquidator.

4.5 May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?

Generally, contracts are not affected by a bankruptcy. However, most contracts will contain provisions in which a bankruptcy is defined as an event of default or as an event that leads to immediate termination of a contract.

If a contract is not terminated, the liquidator may only perform (or allow the debtor to perform) the debtor's obligations subject to the *pari passu* rule. This means that the liquidator must ensure that the creditor involved is not favoured over and at the expense of other creditors. This also means that a liquidator may ignore a contract if and to the extent that compliance with the terms of the contract would breach the *pari passu* rule.

If under a contract mutual obligation are still to be performed at the date of the bankruptcy, the creditor may require the liquidator to decide whether or not the debtor will perform under the contract. If opting for performance, the liquidator may be required to put up security in favour of the creditor to ensure the proper performance by the debtor.

If the liquidator decides not to perform under the contract or fails to put up the required security, the liquidator will forfeit the right to demand performance under the contract.

The claims of a creditor for damages due to default under an agreement rank *pari passu* with the claims of other unsecured and non-preferred creditors.

The effects of suspension of payments on contracts are virtually the same as during bankruptcy, with a few exceptions (i.e. for lease and employment agreements).

4.6 What is the level of creditor consent that is required to effectuate a restructuring?

In order to effectuate a restructuring, a bankrupt debtor may offer a composition plan to its unsecured creditors. A composition plan is an agreement that may be binding on unsecured creditors by a majority vote of the affected creditor. The debtor and the creditors, who are bound by it, agree on the manner in which the debtor will satisfy the creditors. The proposal must first be accepted by the creditors and then be confirmed (*gehomologeerd*) by the court. The composition passes the vote if 50% or more of the unsecured creditors present at the meeting, representing 50% or more of the total outstanding unsecured debt, vote in favour of the proposal.

Notwithstanding an initial rejection, the supervisory judge (at the request of the debtor and / or the liquidator) may determine that the composition is deemed accepted and the proposal passed, if 75% or more of the unsecured creditors present at the meeting have voted in favour of the proposal and the supervisory judge, at the judge's own discretion, holds that the second test (those in favour must represent 50% or more of the unsecured debt) had not been met as a result of unreasonable voting behaviour of one or more creditors.

A debtor in suspension of payments proceedings may also offer a composition to its unsecured creditors. In order to be adopted, the composition must be approved by a simple majority of the recognised and of the admitted creditors representing not less than one-half of the recognised and admitted claims.

Notwithstanding an initial rejection, the district court or, if appointed, the supervisory judge may adopt an offered composition as if it were accepted at the request of the debtor or the administrator by a reasoned order if: (i) three-fourths of the recognised and admitted creditors who appeared voted in favour of the scheme of arrangement; and (ii) the rejection of the composition results from one or more creditors having voted against it who, taking into consideration all of the circumstances and in particular the percentage which those creditors may be expected to receive in payment of their claim were the estate to be liquidated, could not have arrived at such voting conduct in all reason.

4.7 Is shareholder consent required in order to effectuate a restructuring?

Unless the articles of association provide otherwise, shareholder consent is required for the filing for bankruptcy, but not for the application of suspension of payments proceedings.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

The Bankruptcy Act contains provisions that entitle the liquidator to void certain transactions (including the granting of a security right) between the debtor and third parties that have prejudiced other creditors. If such avoidance takes place before the Dutch court, this right may be limited if the transaction is governed by foreign law. Where only Dutch law applies, the liquidator may void any transaction performed or entered into by the debtor prior to the bankruptcy, provided the liquidator can prove that:

- the debtor did not have a prior obligation under a contract, judgment or the law to enter into or perform the transaction;
- the transaction is detrimental to the creditors' collective interests, which will be the case if the liquidator proves that one or more creditors will receive less from the estate than would have been the case had the transaction not been made; and
- at the time of the transaction both the debtor and the other party knew or should have known that the interests of the creditors would be adversely affected.

The burden of proof as far as the said knowledge is concerned is reversed and shifted to the other party (i.e. that party must prove that it did not know and could not reasonably have known that the transaction was detrimental to the debtor's creditors) if the liquidator in addition to the first two requirements above (i.e. no existing prior obligation and the detrimental effect) proves that:

- the transaction took place within one year before the date of the bankruptcy judgment (or if preceded by a suspension of payments, the date thereof); and
- the value of the consideration paid by the debtor materially exceeds that of the performance by the other party; or
- the transaction consists of a payment of or creation of (additional) security for a debt that was not due and payable; or
- the transaction was entered into with a party that is related to the debtor.

If the voidance action is successful, the transaction is void only as far as the bankrupt estate is concerned. The liquidator may reclaim any transferred assets and the liquidator may otherwise seek damages to make restitution to the estate, as it should have been without the voided transaction. Any consideration or amount paid for any reclaimed assets should in principle be returned to the other party by the liquidator. If a detrimental transaction did not include any consideration in favour of the debtor, the liquidator is only required to prove that the debtor was aware of the detrimental effect thereof to the creditors' interests. Gifts and other gratuitous transactions made within one year before the bankruptcy are presumed to have been made with such knowledge, if the liquidator proves that indeed they were detrimental to the other creditors.

The liquidator may also void pre-bankruptcy payments (which include any other performance) of payment obligations of a debtor to a creditor in the event that such creditor knew, at the time of such payment on the due date, that a petition for the debtor's bankruptcy had been filed with the court or, alternatively, that such payment resulted from a conspiracy (*samenspanning*) between the debtor and the creditor, intentionally aimed at paying the latter to the detriment of the debtor's other creditors.

6. Is enforcement of security rights treated differently in each type of proceeding?

Generally, the rights of secured creditors are neither affected by a suspension of payment proceeding nor by a bankruptcy. However, if the court, of its own motion or on the petition of the liquidator, has ordered a moratorium (which can last up to four months), the secured creditor cannot exercise its rights. It should also be noted that in bankruptcy the liquidator may require that the secured creditor enforces its security right within a reasonable period.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

Generally, all claims rank equally, but claims secured by a mortgage or pledge take priority in the proceeds of the collateral. In addition, certain claims may take priority over the claims of secured creditors including:

- costs of enforcing judgments or deeds of indebtedness;
- costs of the debtor's bankruptcy (if secured creditors fail to sell the collateral separately from the bankruptcy process);
- tax claims, including VAT and wage tax, in the proceeds of certain movable property, to the extent that those claims cannot be paid out of the proceeds of the unsecured assets, unless the pledgor

takes possession of the pledged movable assets before the bankruptcy and before the tax authorities make an attachment;

Preferred claims that do not take priority over security rights include, among others:

- tax and social security premium claims, and wages and certain pension claims with respect to the proceeds of all the debtor's assets

The ordinary creditors only receive payment if all preferred creditors have been paid in full including principal, interest and costs.

It is generally assumed that shareholders' equity claims are subordinated to all other unsecured claims. Shareholders' loans may be characterised as subordinated on the basis of an explicit term of the contract or implied by virtue of interpretation.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

8.1 Secured creditors

In suspension of payment proceedings, a secured creditor may submit its claim with the administrator. It is advisable that the administrator be contacted immediately and be advised of the existence of the secured claims and security interests.

In bankruptcy, a mortgagee or a pledgee must submit its claim in writing to the liquidator prior to the verification meeting (as described below) and specify the nature and amount of its claim. Such secured creditor must also submit a statement in writing in respect of its security interests, accompanied by documentary evidence, i.e. copies of the deeds.

A mortgage or a pledge creates both a right to the proceeds of the assets in the estate and the right of the secured creditor to ignore the bankruptcy or suspension of payment proceeding and foreclose on the asset itself. Mortgages and pledges are generally not affected by bankruptcy or suspension of payment proceedings and mortgagees and pledgees are under no obligation to submit their claims for verification. The mortgagee or pledgee may in the event of default (or if in the security document a bankruptcy is defined as an event of default) enforce its rights against the assets as if there were no insolvency proceedings, subject to the restrictions of a moratorium, if any. If a mortgagee or pledgee fails to exercise its security right in due time, the liquidator may prompt the mortgagee or pledgee by setting a deadline. If the mortgagee or pledgee fails to meet this deadline, the liquidator may enforce the security in their stead. In such case, the mortgagee and pledgee will retain their right of priority. Nevertheless, they will have to contribute to the costs incurred by the liquidator.

Mortgagees and pledgees are entitled to foreclose on the collateral without the cooperation of the administrator or liquidator. Subject to court approval, the secured party may also enforce its security rights via a private sale. Any proceeds in excess of the mortgagee's or pledgee's claim should be transferred to the debtor (or, as the case may be, the liquidator). In bankruptcy, the liquidator must, *vis-à-vis* the secured creditor, exercise the rights of other creditors, which is particularly relevant if the claims of other creditors have a higher ranking. In that case, the liquidator collects from the proceeds the amount corresponding to the higher ranking that can be recovered from the collateral. The proceeds so collected will form part of the bankruptcy estate. The creditor whose rights have been so exercised by the liquidator shall only receive the proceeds when the liquidator makes a distribution and after a deduction of a contribution to the costs of the bankruptcy. The bankruptcy liquidator is at all times entitled to free an asset of a security right by paying the mortgagee or the pledgee the amount owed to it (*inlossing*). If the mortgagee or pledgee does not or cannot (if there is no default) timely foreclose the secured assets, a liquidator in bankruptcy may demand that the secured creditor do so within a reasonable period of time. If the secured creditor does not do so, the liquidator may sell or collect the collateral. In that case, the secured creditor's claim will still be preferred in respect of the proceeds of sale subject to a deduction of a proportional share of the costs of the bankruptcy proceedings.

The debtor (or the officeholder) and the pledgee may agree to a different method to liquidate the pledged assets, in the event of default.

Foreign law security rights may be recognised by virtue of the Recast European Insolvency Regulation or Dutch domestic law, depending on the nature of the right.

8.2 Ordinary creditors

Outside bankruptcy, ordinary unsecured creditors can only recover claims by making an attachment on the debtor's assets before they are sold. In order to receive a distribution in a bankruptcy, the ordinary unsecured creditor should file its claim with the liquidator. Claims should be submitted in writing to the liquidator prior to the verification meeting (*verificatievergadering*) and should set out the nature and the amount of the claim. The claim should be accompanied by documentary evidence. The liquidator must confirm receipt to the creditor. All creditors are entitled, although not required, to attend the "verification meeting". The verification meeting is a formal meeting of creditors. Its purpose is both to discuss, admit or dispute claims and to classify them as preferred or ordinary or subordinated; and to discuss and vote on any composition that is being offered to the ordinary creditors.

A verification meeting will be planned only if it is likely that unsecured creditors will receive a distribution. The supervisory judge will set a date for the verification meeting. Creditors must have filed their claims no later than 14 days before the date of the verification meeting with the liquidator, and the supervisory judge will instruct the liquidator to make the proper publications and to give notice to all known creditors. The date set by the supervisory judge for the filing of claims is a bar date: in bankruptcy proceedings opened on or after 1 January 2019, claims that are submitted late will not be admitted. Not less than seven days prior to the verification meeting, the liquidator must file with the court lists of provisionally admitted, conditionally admitted and disputed claims. The liquidator should try to resolve any disputed claim. The court admits all claims that are not disputed. The admission of a claim recorded in the minutes of the meeting is final. The liquidator may also withdraw any earlier objection. A negative decision by the court on the admissibility and value of the claim does not prejudice any other of the creditor's rights. If a claim is disputed and the supervisory judge is unable to resolve the dispute, the supervisory judge refers the matter to the court for verification proceedings. A creditor whose claim is disputed should ensure that its representative attends the creditors' meeting.

In suspension of payments proceedings, the filing of claims is only made for the purpose of voting at the creditors' meetings. The rejection or admission of claims in those instances shall not prejudice any other of the creditors' rights.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

A suspension of payment proceeding, or a bankruptcy typically does not prevent a creditor from starting an action against a guarantor. In addition thereto, the creditor who has started an action against a guarantor may also, simultaneously, claim against the insolvency estate of the jointly and severally liable co-debtor of the guarantor for the total amount due to such creditor at the time of the declaration of the suspension or bankruptcy until that creditor's claim has been settled in full.

Plans presented in bankruptcy or a suspension of payment proceeding do not release third-party guarantors from their obligations towards creditors. Under the new Dutch scheme, the aforementioned WHOA, the same principle applies. The WHOA will, however, provide for the release of intercompany guarantees.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

As of the commencement of the debtor's suspension or bankruptcy, it is no longer possible to perfect security without the officeholder's consent. A right *in rem*, which is only perfected upon registration or date-stamping by a register, can no longer be perfected and will therefore be deemed non-existent.

This situation should be distinguished from a validly perfected non-notified pledge over receivables. The secured creditor remains in a position to notify the pledge to third-party debtors and, accordingly, to claim payment of the pledged receivables.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor?

For enforcement actions during insolvency proceedings, see section 8 above.

The initiation of a pre-insolvency proceeding under the WHOA in itself does not affect the rights *in rem* of creditors; creditors therefore retain their rights and are able to foreclose or take other enforcement actions against the debtor. It is possible, however, for the debtor to petition the court to grant a stay that can last four months with the option of a one-time extension. When granted, this stay will prevent any creditor, including secured creditors, from taking enforcement actions against the debtor's estate.

11.1 Can the stay be challenged? If so, how?

In order to promote deal certainty, most decisions under the WHOA, including the order granting leave for a stay or the extension of a previously ordered stay, cannot be challenged before a higher court.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

Debtors are typically barred from selling secured assets under the facility agreement / finance documents with their secured creditors.

However, if a stay has been ordered by a court under the WHOA, the debtor can sell secured assets on the condition that selling these assets falls within the debtor's ordinary course of business and that the secured creditor's interests are adequately protected, i.e. additional comfort in the form of alternative collateral is provided.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

In pre-insolvency proceedings it is possible for additional liens or security rights to be granted to third parties, but a previously granted right of a secured creditor will always take priority over posteriorly granted liens or rights.

In insolvency proceedings, the debtor is no longer able to unilaterally dispose of its assets, thereby barring the granting of further security rights. Additionally, it is no longer possible for third parties to be granted security on the debtor's estate during the debtor's bankruptcy. Secured assets can typically only be disposed by a secured creditor. Should the secured creditor not take foreclosure action after having been set a reasonable period of time, the asset may be disposed of by the liquidator.

14. What distribution will a secured creditor receive if a company is reorganised?

This mainly depends on the provisions of a composition plan, although the WHOA provides for minimum standards. For distributions, the courts, upon request of a creditor or shareholder who rejected the plan, employ a "no-creditor-worse-off" test, which provides that creditors, including secured creditors, under a composition plan should not incur more losses than they would have incurred if the debtor's estate had been liquidated. This test aims to ensure that both secured and unsecured creditors will receive no less than the liquidation value, i.e. the value the creditor would receive in case of the debtor's insolvency. Additionally, courts, upon request by a creditor or shareholder whose class voted against the plan, will reject a plan if the plan does not conform to the absolute priority rule, which, in case of the WHOA, provides that the reorganisation value should be distributed in accordance with each creditor's rank unless a deviation from this rule can, under the circumstances, be deemed reasonable.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

This is dependent on the provisions of a plan, although it is unlikely that a confirmed plan will affect a secured creditor's rights *in rem*. Such a plan will, most likely, run afoul of the no-creditors-worse-off test described above.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

If a claim is over-secured, the creditor, once its claim has been satisfied out of the proceeds of the collateral, is expected to return the surplus value to the bankrupt estate. When a secured claim is under-secured, the creditor will rank as an ordinary unsecured creditor for the unsecured part of the debt.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

Foreign restructuring proceedings in an EU member state are recognised in the Netherlands under the Recast EU Insolvency Regulation, provided they are listed in the appropriate annex to the Recast EU Insolvency Regulation. Restructuring proceedings outside of the EU are typically not recognised in the Netherlands. This does not mean that foreign pre-insolvency practitioners are precluded from taking action against assets in the Netherlands; they will, however, have to compete with other creditors.

Additionally, it is possible to initiate a foreign restructuring in the Netherland as "confidential track" WHOA-proceedings (a public track is not possible, for this requires that debtor’s centre of main interest be located in the Netherlands as per the EU Insolvency regulation). In WHOA proceedings concerning a confidential plan, Dutch courts have standing, if the case, i.e. the confirmation of the plan, has sufficient connection with the jurisdiction of the Netherlands. According to the WHOA’s explanatory memorandum, such a connection exists when a (substantial) part of the debts restructured under the plan relate to obligations which are governed by Dutch law or where the parties have selected a Dutch court as the forum by which disputes relating to those obligations shall be resolved.

UNITED ARAB EMIRATES

This chapter addresses the treatment of secured claims in insolvency and pre-insolvency proceedings in relation to entities located within the United Arab Emirates (UAE).

Federal Decree-Law No 9/2016 (Bankruptcy Law)[1] is the primary federal legislation covering insolvency and pre-insolvency proceedings within the UAE.

The Bankruptcy Law applies to: UAE companies created pursuant to UAE Federal Law No 2 of 2015 on commercial companies (Companies Law); government entities that stipulate that they are to be subject to the Bankruptcy Law in their memoranda or articles of association; and companies and establishments located in "free zones" that are not subject to special provisions governing insolvency or which are located in a financial free zone.[2]

This chapter does not cover the treatment of secured claims in insolvency and pre-insolvency proceedings in either the Dubai International Financial Centre (DIFC) or the Abu Dhabi Global Market (ADGM) as separate laws govern secured claims in insolvency and pre-insolvency.

Since its enactment, there have been minimal instances of use of the Bankruptcy Law and, to our knowledge, only one preventative composition procedure (PCP) (as defined below). This lack of testing means the application of the law remains relatively uncertain, and it is difficult to anticipate how UAE courts will apply the provisions of the Bankruptcy Law in practice. In addition, UAE courts are not bound by the principle of stare decisis, and therefore the decisions in one instance will not necessarily be binding in another. There is also only limited judicial decision reporting on the decisions of UAE courts. Therefore, it is not possible to make a conclusive interpretation of how the UAE courts will apply the Bankruptcy Law.

1. Briefly summarise the types of security rights and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

Federal Law No18 of 1993 (Commercial Code), the Companies Law, and Federal Law No 4 of 2020 on Securing the Rights in Movables (Movables Security Law) together form the primary legislation that governs the creation of security interests and associated rights in the UAE.

Security over future property can be taken pursuant to the Movables Security Law. The UAE does not otherwise recognise the concept of future property or contemplate the ability to take a floating charge.

Security within the UAE can be taken over a number of different classes of movable and personal property.

In the UAE, security may be granted either by contract – through the relevant security agreement – or by way of law.

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[1] As at the date of publication the UAE Cabinet has approved amendments to the Bankruptcy Law, but these were yet to be published and have not yet appeared in the Official Gazette.

[2] The UAE contains numerous free zones (being geographic areas that are considered distinct jurisdictions from "onshore" UAE), including the financial and legal free zones of the DIFC and the ADGM.

1.1 Shares in UAE incorporated onshore companies

The Companies Law expressly allows security to be taken over the shares of a public joint stock company or over the ownership interest of a limited liability company incorporated pursuant to the Companies law. In order to be valid, a share pledge must be registered in the commercial register of the relevant Emirate in which the company is incorporated (which in turn requires that the share pledge is in writing and executed before a UAE notary public). While not expressly required under the Companies Law, a local "security agent" may be required to be appointed in order to take a share pledge, due to restrictions on the registration and enforcement processes and as a result of UAE legal restrictions on foreign ownership.

1.2 Tangible movable property

Security over movable property may be taken pursuant to the following.

1.2.1 The Movables Security Law

The Movables Security Law allows for registered security to be taken over certain tangible movable assets (including but not limited to: goods intended for sale or lease; raw materials; work equipment and tools; crop yields, animals and their produce; written bonds and documents, title to which is transferred via delivery or endorsement, including bills of lading; and fixtures (if able to be separated from real estate without causing damage)). The forms of security that can be taken (and registered) under the Movables Security Law are varied, with "security interests" being able to be created by way of a pledge, by registering a lessor's rights under a finance lease, by registering a seller's rights under a contract of sale, by the transfer of title by way of security or by the rights of an assignee under an assignment.

Security will be validly created under the Movables Security Law if it is:

- executed in writing;
- the security provider has the capacity to act in respect of the security or is authorised to create the relevant security interest;
- the security agreement contains a sufficiently clear description of the assets being secured; and
- the security agreement includes a description of the liability secured (for which the security provider has agreed to pay).

Upon fulfilment of the above steps, the security will be validly created; however, until the security is registered with the Emirates Movable Collateral Registry (EMCR) (or any replacement register provided for under the executive regulations which are to be implemented in relation to the Movables Security Law), it will not rank in priority to other security interests created over the same asset which are registered with the EMCR. Priority is established by date of registration.

1.2.2 A "commercial mortgage" in accordance with the Commercial Code

The Commercial Code provides for security to be taken over tangible assets of a business (along with additional intangible assets, as set out below), including over inventory, stores, machinery and tools.

A commercial mortgage will be validly created under the Commercial Code if it is:

- in writing and executed before a UAE public notary;
- registered with the relevant economic department for the Emirate in which the security provider is registered; and
- notification of such security is provided in an Arabic daily newspaper at least two weeks prior to registration.

Security by way of a commercial mortgage is less common following the enactment of the typically more creditor-friendly Movables Security Law. The commercial mortgage is valid for a five-year (renewable) period. In addition, a UAE banking licence is required in order to take security by way of a commercial mortgage, which requires a "security agent" to be appointed to hold the security on creditors' behalf.

1.2.3 Possessory pledge in accordance with the Commercial Code and Civil Code

Pledges may be taken by the relevant pledgor, transferring possession and control of the asset to the secured creditor. Due to the logistical difficulties and expense, and following the non-possessory based regime implemented by the Movables Security Law, possessory pledges are rare.

1.3 Intangible property

Security may be taken over intangible property pursuant to each of the following approaches.

1.3.1 The Movables Security Law

In addition to taking registered security over certain tangible movable assets, the Movables Security

Law also contemplates the ability to take registered security over certain intangibles, including in relation to:

- receivables (being accounts payable owed to the relevant security provider –including any sums deriving from or in relation to any intellectual property and proceeds of any insurance policy), deposits at licensed banks, including current accounts and deposit accounts; and
- "material and moral elements of a business concern" (this is understood to extend to good will and intellectual property).

The Movables Security Law excludes certain assets, including public property and salaries.

1.3.2 A "commercial mortgage" in accordance with the Commercial Code

In addition to taking security over certain tangible assets, a commercial mortgage also contemplates the ability to take security over certain intangible assets of a business, including intellectual property and goodwill.

1.4 An "assignment by way of security"

Assignments under UAE law are absolute (not by way of security) and are not required to be registered in order to be enforceable in accordance with UAE law. While the Movables Security Law expressly contemplates an assignment of rights as being a valid form of security for movable assets (as noted above), absolute assignments remain common in the UAE as a form of "security" over contractual rights, including in relation to receivables and insurances. Assignments are typically taken where:

- the rights of the underlying assignor under a contract are of importance to a secured party (as opposed to where a secured party is only seeking to secure the right to receive any receivables under such contract); or
- the assignment is in relation to rights that are not able to be secured pursuant to the Movables Security Law.

Notice of an assignment is required to be provided to the relevant counterparty, and (while it is unclear if constructive notice would be effective to constitute notice) it is standard practice for secured creditors to require notice to be acknowledged.

1.5 Mortgage

Security is commonly taken over immovable or real property by way of a mortgage (whether over freehold interest, leasehold interest, or a building constructed on leased land).

The mortgagee must hold a UAE banking licence in order to have the benefit of any security over land and interests in real property by way of a land mortgage. A foreign lender can still benefit from such security if it appoints a financial institution with a UAE banking licence to hold the security as its security agent. Such security is required to be registered with the relevant land department.

1.6 Lien

The Civil Code creates a security interest by law, similar to an English "mechanic's lien", in favour of contractors. In particular, the Civil Code does not require a contract for such a security interest to arise and states that "if the contractor's work shall produce some effects on the property, he may have a lien over it until he receives the remuneration due to him".

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

2.1 Enforcing security

Subject to the exceptions set out below, a UAE court order is required to authorise any enforcement action, which then occurs by way of a court-mandated auction process. Exceptions to the court-mandated auction process arise in relation to:

- security provided pursuant to the Movables Security Law, which provides exceptions to the court-based enforcement process in certain circumstances, allowing self-help (including a right of set-off where the relevant secured party has taken security over accounts that are held with it); and
- security taken over UAE shares. An attachment procedure against the relevant secured shares may be separately agreed upon between the relevant security provider and the secured party. Such an agreement can extend to the method and the terms of any sale of the shares on an enforcement scenario.

As a result of the need to obtain a court-mandated auction, enforcing security can be a lengthy process. In addition to the court process being time-consuming, practical difficulties often arise, including a need to obtain governmental processes and approvals in certain circumstances. By way of example, in the Emirate of Abu Dhabi, enforcing a mortgage over real estate requires governmental approval.

2.2 Bankruptcy and liquidation

Upon declaration of bankruptcy and liquidation. The UAE court will, pursuant to the Bankruptcy Law, appoint a trustee to administer the liquidation of the insolvent debtor's assets. The UAE court may permit the debtor to sell its business under the supervision of the trustee for the "best prices possible", provided that the term for the sale does not exceed six months, which may be renewable for a further two months if such continuation is in the best interests of the creditors or in the public interest.

Alternatively, the trustee may elect to proceed with a public auction in order to sell the debtor's assets. This process will be completed under the supervision and control of the UAE court. The proceeds of the auction are applied towards the payment of any claims against the debtor under the supervision of the UAE court. A secured creditor will be paid the proceeds of the sale of the asset which it has valid security over. If the value of the secured asset is insufficient to pay the full amount of the debt secured, the outstanding balance of the debt shall be ranked as ordinary debt.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

3.1 Pre-insolvency proceedings

The only pre-insolvency proceeding available under the Bankruptcy Law is the PCP, which allows a debtor in financial difficulty the opportunity to agree a compromise with its creditors. Upon application by the debtor to commence a PCP, the debtor's obligations are suspended from the date of the filing of the application until the issuance of the UAE court order accepting or rejecting the commencement of a preventative composition procedure plan (PCP Plan). Where the PCP Plan is granted, the suspension shall continue through the period of the PCP.

3.1.1 *Initiating the proceeding*

The application for PCP can only be made by a debtor. The debtor must be in financial distress, but not insolvent (determined by a cash-flow and over-indebtedness test) and must not have already entered bankruptcy proceedings. Creditors are not able to make an application.

3.1.2 *Criteria used for opening proceedings*

A debtor is considered "insolvent" if it has ceased making payments on due debts for more than 30 consecutive business days due to financial instability, or its assets are insufficient to cover its current liabilities. In either of these circumstances, bankruptcy proceedings are mandatory (as set out in section 4 below). A debtor cannot apply for a PCP in such circumstances.

The UAE court evaluates the application submitted by the debtor and verifies that the application includes all necessary documents in order to make a determination.[3] The court may appoint an expert to prepare a report on the financial position of the debtor.[4] The court makes its determination within five days of the application for PCP or the submission of the expert's report (as applicable).[5]

The debtor is required to submit a number of supporting documents when it makes its application for a PCP to the court, including (but not limited to):[6]

- a memorandum, including a brief summary of the economic and financial position of the debtor, with information on its assets;
- copies of certain licences applicable to it and a copy of the commercial or professional register applicable to it;
- a copy of its books of account or financial statements for its financial year preceding the filing of the application;
- a report, including details of the cash-flow and profit and loss projections for the upcoming 12-month period, together with details of known creditors and their entitlements and an asset statement;
- a proposal for the PCP and the security for the implementation thereof;
- nomination of a proposed trustee;
- a shareholder resolution approving the application for the PCP and copies of the incorporation documents and any amendments thereto; and
- a report issued by the competent credit bureau authority in the relevant Emirate.

3.1.3 *Key parties in a pre-insolvency proceeding*

The debtor initiates the PCP proceedings as described above. The court will then appoint an expert who prepares a report on the debtor's financial condition and determines whether to accept or reject the application, or whether to order bankruptcy proceedings instead.

[3] See Article 10 of the Bankruptcy Law.
[4] See Article 13 of the Bankruptcy Law.
[5] See Article 14 of the Bankruptcy Law.
[6] See Article 9 of the Bankruptcy Law.

The court – if it grants the PCP application – will also appoint a trustee. The trustee will publish a summary of the PCP application in two daily newspapers (one in Arabic) and invite creditors to submit proofs of claim within 20 business days from the date of such publication.

Creditors may also make a request for the appointment of a controller, one or more of which may be appointed by the court in order to supervise the implementation of the PCP.[7]

3.1.4 *Debtor in control*

During the PCP application period, the control of the company remains with the debtor, who continues to manage its business. Once the court accepts the PCP Plan, the court will appoint a trustee and the debtor will act under the supervision of the trustee. The trustee has wide powers to preserve assets and may request the debtor to carry out all necessary acts to preserve its interests and those of its creditors.[8] This includes, by way of example, acquiring any of the debtor's assets, requiring investigation of the debtor's ownership of any assets, concluding or maintaining insurance policies, and cancelling the debtor's lease contracts.[9]

Moreover, under the Bankruptcy Law, the court may "decide, at the request of any interested party or *sua sponte*, to take the necessary measures to preserve or manage any of the debtor's assets" and may "decide to take any additional precautionary measures after acceptance of the application for preventative composition procedure".

3.1.5 *Creditors' consent*

The decision to commence the PCP brings with it protection from the termination or cancellation of any ongoing contract between the debtor and a counterparty, unless prior to the decision to commence such PCP the counterparty receives a judgment entitling it not to execute the contract as a result of the debtor's failure to perform its obligations.[10]

Secured and unsecured debts may be adjusted in the proceedings without creditor consent by the trustee (see the trustee's powers at section 3.1.3) and under the supervision of the court. In addition, the trustee, under the supervision of the court, may request the debtor to carry out all "necessary acts to preserve his [the debtor's] interests and those of his creditors during the course of the PCP". The trustee has the power to adjust contracts, such as cancelling the debtor's lease contracts, concluding insurance policies, and "any other works achieving the purpose of preventative composition procedure approved by the UAE court".[11] Secured creditors can also still enforce their security, with the court's permission.[12]

The unsecured creditors will vote on the PCP Plan. For the PCP Plan to be approved, unsecured creditors must vote in favour by a majority in number and two-thirds in value of the total ordinary admitted debts.[13]

[7] See Article 29 of the Bankruptcy Law.
[8] See Article 26 of the Bankruptcy Law.
[9] The debtor retains the right to continue running the business under the supervision of the appointed trustee.
[10] See Article 34 of the Bankruptcy Law.
[11] See Article 26(3)(j) of the Bankruptcy Law.
[12] See Article 32(2) of the Bankruptcy Law.
[13] See Article 47(1) of the Bankruptcy Law.

3.1.6 Shareholders' consent

In order for the debtor to submit the application for PCP, a shareholders' resolution is required.[14] The debtor submits this alongside its application for PCP. Once the PCP Plan has commenced, additional shareholder consent is not required.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

4.1 Insolvency proceedings

The Bankruptcy Law offers two procedures in insolvency:

- the business restructuring procedure (or rescue within bankruptcy) (BRP), which applies only where the court is satisfied that there is a reasonable prospect of restructuring the insolvent entity's business (after hearing evidence from creditors, experts, any creditor committee and the debtor); and
- the declaration of bankruptcy and fair liquidation, which applies when the court is not satisfied that the debtor's business can be rescued, wherein the court will make an order for liquidation.

4.1.1 Who can initiate the proceeding?

The debtor (directors or shareholders), a creditor, group of creditors, the public prosecution, or the competent supervisory authority in the relevant Emirate may initiate a petition for bankruptcy.[15]

- *The debtor*

  The debtor is obliged to make a bankruptcy filing if it is insolvent (i.e. if there have been payment defaults or it has been in a state of over-indebtedness for longer than 30 consecutive business days).[16]

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[14] See Article 9(1)(g) of the Bankruptcy Law.
[15] See Section 1 (Application for Opening Bankruptcy Procedures) of chapter 4 (Bankruptcy) of the Bankruptcy Law.
[16] See Article 68 of the Bankruptcy Law.

- *Creditors*

  In order for a creditor to commence proceedings, the creditor must hold an unpaid debt of not less than AED100,000 and have served a statutory demand on the debtor, and such demand must have remained unpaid for at least 30 consecutive business days.[17]

4.1.2 Criteria for opening the proceeding

Once the bankruptcy application is made, the court will appoint an expert to prepare a report on the debtor's financial position. This report will opine on whether a BRP is viable and whether the debtor's assets can cover the costs of the proceedings.

4.1.3 Key parties involved in the insolvency proceedings

If the court chooses to initiate proceedings, the debtor is placed under the supervision of the court-appointed trustee.[18] The trustee plays a critical role as:

- the trustee is required to prepare a report on the debtor's business that includes an assessment of the possibility of a restructuring taking place and a view on the ability to sell the business in whole or in part as a going concern;[19]
- if the court has initiated a decision to start the BRP, the trustee must submit a draft business restructuring plan to the court, which details the possibility of the debtor's business generating profits and the terms and conditions relating to any settlement of the debtor's liabilities;[20] and
- the trustee must publish a notice of the court's decision to initiate bankruptcy proceedings in two local newspapers, giving the creditors 15 business days to submit their claims.[21]

4.1.4 Debtor in control

The involvement of the debtor's management in the day-to-day business will depend on which proceeding has ultimately commenced.

If the BRP is approved by the court, the court may permit the debtor, upon the request and under the supervision of the trustee, to continue some of the management of the business throughout the BRP. However, the primary control over the management of the debtor will be given to the court-appointed trustee operating under the supervision of the court.[22]

If a declaration of bankruptcy and liquidation is given by the court, the court may permit the debtor, upon request and under the supervision of the trustee, to carry on all or any of the debtor's business for the purpose of selling the business at the best price possible, provided that the sale of the debtor's business occurs within six months. The timeframe may be extended by the court for a further two months, provided that such continuation is in the best interests of the creditors as a whole or is in the public interest.[23]

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[17] See Article 69 of the Bankruptcy Law.
[18] See Article 82 of the Bankruptcy Law.
[19] See Article 96 of the Bankruptcy Law.
[20] See Article 101 of the Bankruptcy Law.
[21] See Article 103 of the Bankruptcy Law.
[22] See Article 114 and 126 of the Bankruptcy Law.
[23] See Article 131 and 132 of the Bankruptcy Law.

In addition, the Bankruptcy Law gives the court broad powers to take any necessary measures to preserve or manage the debtor's assets until the application is settled, including preventing the debtor from participating in the management of the business if appropriate.[24]

4.1.5 Creditors' consent

Contracts, secured, and unsecured debts may be adjusted by the trustee or the court without affected creditor consent. A secured creditor will have the right to object to the adjustment, but the decision of the court in respect of such an appeal or objection will ultimately be binding on it. An unsecured creditor will have the right to vote on the BRP and, if debts are adjusted under the BRP, it will have the right to propose amendments.[25] Once the BRP is approved by a majority of unsecured creditors (creditors representing at least two-thirds of the total debt must vote in favour), unsecured creditors will be bound by its terms.[26]

With respect to interest, the court may deduct from the deferred debt an amount equivalent to the interest payable for the period between the date of the court's order to start the procedures of bankruptcy and liquidation of assets, and the due date of the debt.

If the court deems it appropriate to initiate BRP, the draft BRP Plan must be prepared and voted on by unsecured creditors.[27] For the draft BRP plan to be approved, a majority of unsecured creditors representing at least two-thirds of the total debt must vote in favour.[28] Secured creditors will not vote on the business restructuring plan based on their secured debts, unless they explicitly waive their securities.[29] Once the draft BRP plan is approved, all creditors who were entitled to vote on the plan will be bound by its terms, including secured creditors who "transferred" their secured assets in order to vote on the draft BRP plan.

4.1.6 Shareholders' consent

To effectuate a restructuring the consent of the shareholders is not required.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

5.1 Bankruptcy Law

The Bankruptcy Law provides that certain "dispositions" and interests (including the creation of new security to secure the payment of an earlier debt) are unenforceable if created within two years prior to the date of the commencement of the relevant procedure, unless the court decides to approve the enforceability of such dispositions, taking into consideration the public interest or the interest of *bona fide* third parties.

5.2 UAE courts

In addition, UAE courts have the power to rule not to enforce certain dispositions in addition to those

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[24] See Article 125 of the Bankruptcy Law.
[25] See Article 105(3) of the Bankruptcy Law.
[26] See Article 107 of the Bankruptcy Law.
[27] See Article 106(1) of the Bankruptcy Law.
[28] See Article 107 of the Bankruptcy Law.
[29] See Article 106(2) of the Bankruptcy Law.

listed in the Bankruptcy Law[30] (including, but not limited, to donations or transactions for no value, settlement of debts or payment of guarantees) if such disposition is detrimental to the creditors and the counterparties benefiting were aware – or should have been aware – at the time of such disposition that the debtor had ceased payments of its debt or was in a state of over-indebtedness.

6. Is enforcement of security rights treated differently in each type of proceeding?

Under the PCP or BRP, the enforcement of security rights is treated the same. A secured creditor may file and continue with claims and may foreclose its securities if its debts are due, after obtaining permission from the UAE court.[31]

In addition, if under a PCP Plan or BRP Plan a secured asset is sold, the secured creditors shall be paid the proceeds of the sale of the assets securing such debt. If the value of the secured assets is insufficient to pay the full amount of the debt, the outstanding balance of the debt shall be ranked as an ordinary debt.[32] The outstanding balance will then be distributed from the liquidation proceeds.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

The Bankruptcy Law provides that distributions shall be made pursuant to the list of statutory priorities, in which secured creditors are "ranked higher than other ordinary creditors".[33]

Preferential creditors include (subject to certain restrictions on the level and types of debt) government agencies, employees and judicial creditors and may obtain priority in insolvency over both unsecured creditors and secured creditors. The order of "preferred debts" is further set out in the Bankruptcy Law.[34]

After the court declares the bankruptcy of the debtor, the order of priorities is as follows:

- preferential (or privileged) creditors;[35]
- secured creditors, to the extent of their security;[36] and
- unsecured creditors.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

Secured creditors can protect their interests during a pre-insolvency and insolvency proceeding by submitting a statement of debts (including their security interest(s)) to the trustee within 20 business days of receiving notice of the trustee's appointment. The court will accept (either finally or provisionally) the debts within three business days of receipt of the statement of debts from the trustee.

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[30] See Article 168 (1) of the Bankruptcy Law.
[31] See Article 162 of the Bankruptcy Law.
[32] See Article 137(6) of the Bankruptcy Law.
[33] See Chapter 6 of the Bankruptcy Law.
[34] See Article 189 of the Bankruptcy Law.
[35] See Article 189 of the Bankruptcy Law.
[36] See Article 185(1) of the Bankruptcy Law.

Once a secured creditor's secured interests are accepted (either finally or provisionally) by the court, the Bankruptcy Law protects secured creditors during the pre-insolvency or insolvency proceeding, unless, in accordance with the Bankruptcy Law:

- the secured creditor "transfers" its secured assets in order to vote on either the PCP Plan or the BRP Plan: the law is unclear on what steps are required in order for a secured creditor to make a transfer – note that whilst the transfer is at the discretion of the secured creditor, the law remains untested;
- the trustee may sell the secured assets upon approval of the court – in such circumstance, the secured creditors will be paid out of the proceeds of the sale in order of priority; or
- the court, upon application of the trustee, deems that the secured asset is essential to the continuation of the business of the debtor – the court has the power to provide alternative security to the secured asset provided that the replacement security puts the secured creditor in the same secured position.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

If the guarantee is granted by a non-debtor that is not itself subject to a pre-insolvency or insolvency proceeding, the creditor may enforce the guarantee in accordance with the Civil Code and Federal Law No 11 of 1992 (Civil Procedures Code). Furthermore, the Civil Code provides that, if a debt is due, the creditor should claim the debt within six months from the date on which it fell due, and otherwise the guarantor may be deemed to have been discharged.[37] However, UAE courts have wide discretion under the Civil Procedures Code and the Bankruptcy Law, therefore, we cannot conclusively state how in a bankruptcy the UAE courts would apply their discretion.

The Civil Code only expressly provides for the circumstance that when a debtor becomes bankrupt, a creditor is bound to prove its debt in the bankruptcy, with the penalty of being deprived of its remedy if failing to do so.[38] There is no express provision in respect of a non-debtor guarantor (who is not itself subject to a pre-insolvency or insolvency proceeding) and the enforcement of such guarantee in the suggested circumstance. It can be inferred that as long as a creditor proves its debt in bankruptcy, it may, with leave of the relevant court, proceed with the general guarantee enforcement procedures set out in the Civil Code. However, as enforcement of guarantees in general remains relatively untested in the UAE, it is difficult to predict how a UAE court would proceed in practice.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

The validity of security will be determined by the law under which the security was created. Ultimately, if the perfection requirements have not been met, a creditor will not be treated as a secured creditor under the Bankruptcy Law.

10.1 Movables Security Law

Under the Movables Security Law, the security interest is not enforceable against any third party, if the

[37] See Article 1092 of the Civil Code.
[38] See Article 1089 of the Civil Code.

security interest created is not created in a security agreement that:

- is executed in writing;
- is entered into by a security provider with the capacity to act in respect of the security or who is authorised to create the relevant security interest;
- contains a sufficiently clear description of the assets being secured; or
- includes a description of the liability secured (for which the security provider has agreed to pay).

If the security interest is not registered on the EMCR and a subsequent security interest is created over the same asset that is registered on the EMCR, priority between competing mortgage interests will be determined by the date and time of registration on the EMCR (unless a mortgagee waives their right to priority – such as in a subordination agreement – and registers such waiver with the EMCR).

10.2 Companies law

Under the Companies Law, unless the creditor has complied with the perfection requirements for share pledges, namely the registration with the relevant department of economic development, it shall not have created a valid and enforceable security interest against the debtor or any third party.

10.3 Commercial Code

Under the Commercial Code, a commercial mortgage will not be valid and will not be an enforceable security against third parties unless it has been authenticated and attested by the notary public and entered into the commercial register. The commercial mortgage is effective for five years from the date of registration and must be renewed if the commercial mortgage extends for more than five years.

10.4 Assignment of rights

The assignment of rights by way of security for debt obligations and the means of perfecting such security is not specifically provided for under UAE law. Case law suggests that serving notice on the debtor should be sufficient, although there is no system of binding precedent under UAE law. It is accordingly uncertain that such security would be recognised by the UAE courts.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral?

Does this stay apply to all claims against the debtor? Can the stay be challenged? If so, how?

All judicial proceedings and enforcement actions will be stayed from the commencement of the PCP or the BRP until the approval of the PCP Plan or the BRP Plan (as appropriate).

During a pre-insolvency and insolvency proceedings (under the PCP Plan and BRP Plan), a secured creditor may file and continue with claims and may foreclose its securities if its debts are due, upon obtaining permission from the court.[39] The court may decide that an asset shall not be disposed of without the consent of the court or the debtor, where the debtor’s assets are essential to the

[39] See Article 162 of the Bankruptcy Law.

continuation of its business.[40] Alternatively, during the formation of the restructuring plan, the appointed expert may offer alternative security to any secured creditor, provided that it is in the best interest of the plan's implementation and the value of the alternative security is not less than the value of the secured debt.[41] Any decision by the court to this extent may be appealed within five business days.

A creditor whose debt is secured shall be paid from the proceeds of the sale of the assets securing the debt.[42] If the value of the secured assets is insufficient to pay the full amount of the debt, the outstanding balance of the debt shall be ranked as an ordinary debt.[43] The outstanding balance will then be distributed from the liquidation proceeds by the relevant trustee.

The Bankruptcy Law allows creditors to exercise their foreclosure rights, if approved by the court, even during the stay of proceedings, as a result of the commencement of the PCP Plan or BRP Plan.[44]

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

Once the relevant proceedings have been commenced, secured assets may be sold without the secured party's consent by order of the court, however the trustee will apply the proceeds of the sale to discharge the secured debt. The secured party may appeal the decision of the court to sell the asset and the decision of the UAE appeal court will then be final and binding. The Bankruptcy Law does not expressly confirm or provide that, if collateral is sold without the secured party's consent, it may be sold "free and clear". Any sale of collateral will be done with the court's consent and the court may direct that it is so sold, "free and clear".

As of the date of writing this chapter, we are not aware of any published provisions of the Bankruptcy Law which provide specific rules regarding a debtor's use of "cash collateral" as opposed to other types of collateral.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

During pre-insolvency and insolvency proceedings (with the exception if the court issues an order for bankruptcy and liquidation), the court may permit a debtor to procure new financing with or without security, provided that:[45]

- the new financing shall have priority over any ordinary debt payable by the debtor, as of the date of the decision to commence the insolvency proceedings;

[40] See Article 112 of Federal Decree No 23 of 2019.
[41] See Article 111(1) of the Bankruptcy Law.
[42] See Article 137 of the Bankruptcy Law.
[43] See Article 137(6) of the Bankruptcy Law.
[44] See Article 32 of the Bankruptcy Law.
[45] See Article 181 of the Bankruptcy Law.

- the new financing provided may, if possible, be secured by a mortgage on any of the debtor's assets that are unencumbered; and

- the new financing may, if possible, be secured by a mortgage on any of the debtor's assets that are already mortgaged, provided that the amount of the new mortgage exceeds the amount of the debt secured by the existing mortgage. In this scenario, the new mortgage shall rank lower than the existing mortgage.

During insolvency proceedings (if the court issues the order for bankruptcy and liquidation), the trustee, under the supervision of the court, will evaluate all liabilities and provide a report to the court, which will in turn make the final determination as to whether or not the liabilities are "accepted".[46] As detailed above in Section 5, there are specific circumstances under the Bankruptcy Law in which additional security will be voidable.

14. What distribution will a secured creditor receive if a company is reorganised?

If the UAE court decides that a debtor should be reorganised pursuant to a PCP Plan or a BRP Plan, a restructuring plan will be created. This will not affect the secured creditors' secured rights and, in accordance with the Bankruptcy Law, a secured creditor may file and continue with claims and may foreclose its securities if its debts are due, upon obtaining permission from the court.

If, as part of the PCP Plan, a secured asset is sold, the secured creditor shall be repaid from the proceeds of such sale in accordance with its priority.[47] If the asset is not sold, or the security not enforced during the PCP, the security will remain in place until the debtor has repaid its liabilities to the secured creditors. If the PCP Plan is terminated by the court and the liquidation of the debtor and its assets is ordered by the court, the secured creditor will receive the proceeds from the sale of the secured assets. If the proceeds from the sale of the secured assets are insufficient to repay the relevant secured debt(s), the creditor is treated as an unsecured ordinary creditor for the outstanding debt.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

The Bankruptcy Law provides that, in the case of either a PCP or BRP, the rights of a secured creditor (provided that the debt has been accepted by the UAE court) will not be affected, except for in the case that:

- the secured creditor has not enforced its security right;

- the trustee has not sold the secured asset; and

- the court has replaced the secured asset (as per the further details below).

As at the date of writing this chapter, we are not aware of any published provisions of the Bankruptcy Law, which provide specific rules regarding the secured assets following a reorganisation.

Secured creditors have the ability to enforce security at any time, with permission from the court. If an asset is deemed essential to the continuation of the debtor's business, the court may decide that it

[46] See Article 28 of the Bankruptcy Law.
[47] See Article 162 of the Bankruptcy Law.

shall not be disposed of without the court's or debtor's consent.[48] If a secured asset is sold by the trustee, the trustee will pay the proceeds of the sale to the secured creditors in accordance with their priority.[49] If the UAE court decided that the debtor's assets are essential to the continuation of the debtor's business, the court may decide of its own accord, or at the request of any interested party, that such assets shall not be disposed of. If such assets are subject of security, the court may decide to replace such security.[50]

The trustee may also offer the secured creditor alternative security, equivalent to the existing security. In the event that the secured creditor declines such offer, the UAE court may nevertheless decide to replace the security, if the court is satisfied that the value of the substitute security is not less than the value of the existing security and is not detrimental to the interest of the relevant secured creditor.[51] A secured creditor may appeal such decision, and the appeal decision will be final and binding.[52]

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

If the proceeds from the sale of the secured assets exceed the creditor's secured claim, the remaining proceeds will be applied by the trustee, under the supervision of the court, towards outstanding debt owed to unsecured ordinary creditors. Once all liabilities are paid, any remaining proceeds shall be returned to the debtor.

If the proceeds from the sale of the secured assets is insufficient to repay the relevant secured debt(s), the creditor will be treated as an unsecured ordinary creditor for the outstanding debt.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

There is no specific legislation dealing with foreign insolvencies that have a link to the UAE. Foreign judgments are not automatically enforceable in the UAE, and the reciprocity principle applies (the Civil Procedures Code requires reciprocity of enforcement between the UAE and the country issuing the judgment). In practice, UAE courts are reluctant to enforce judgements from other jurisdictions. UAE courts will generally assume jurisdiction over claims against UAE nationals, UAE corporate entities and foreigners who are UAE residents, irrespective of any agreement between the parties in respect of jurisdiction and applicable laws. A UAE court may, in its sole discretion, decide to impose UAE law to any foreign restructuring order.

The requirements for enforcing a foreign judgment under the Civil Procedures Code are:

- no UAE court has jurisdiction to the dispute and the foreign court did have jurisdiction;
- the parties in relation to which the judgment was issued have been given due notice of the proceedings and were represented;
- the foreign judgment is final; and
- the judgment does not contradict any judgment issued in the UAE and contains nothing that would be a breach of public policy, order or morals.

[48] See Article 112 of Federal Decree-Law No 23 of 2019.
[49] See Article 110 of the Bankruptcy Law.
[50] See Article 112 of the Bankruptcy Law.
[51] See Article 111(1) of the Bankruptcy Law.
[52] See Article 111(2) of the Bankruptcy Law.

UNITED KINGDOM

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

It is relatively straightforward to create security in England.[1] Like other common law jurisdictions, English law draws a distinction between legal and equitable interests in property. As a result, there are two main types of security interest which, in practice, are used in most types of financing – a legal mortgage and an equitable charge.

A legal mortgage involves the transfer by the debtor of legal title to an existing asset of the debtor as security for the payment or discharge of a monetary liability. An equitable charge involves the creation by the debtor of an equitable proprietary interest in a present or future asset of the debtor by way of security for the payment or discharge of a monetary liability. Both types of security interest are, in practice, created by the execution of a document by the debtor. If the debtor is incorporated in the United Kingdom (UK), the document generally requires registration at Companies House (which is the central registry of companies incorporated in the UK).

In the case of an equitable charge, that is all that is required. Since, however, the creation of a legal mortgage requires the transfer of legal title (or, in the case of land, a right equivalent to legal title), further formalities may be required, such as registration at an asset registry in the case of land, ships, aircraft and certain intellectual property rights. Another important distinction between the two types of security interest is that a legal mortgage can only be created over assets owned by the debtor at the time the mortgage is created, but, if an equitable charge is expressed to extend to future assets, they will automatically become the subject of the charge once they become owned by the debtor, without the need for any further documentation or registration.

In practice, legal mortgages are taken over land, ships, aircraft and certain other assets which, in each case, are owned by the mortgagor at the time. Charges are taken over any or all types of present or future asset.

Both types of security interest are effective in the insolvency of the debtor. The advantage of a legal mortgage is in relation to the priority of the security – it generally gives more protection against third parties who claim a competing interest in the asset. The advantage of an equitable charge is that it is very easy to create and can extend to future, as well as existing, assets of the debtor.

An equitable charge can be either fixed or floating. The advantage of a floating charge is that it enables security to be created over assets which are not susceptible to the creation of a fixed charge because they need to be disposed of in the ordinary course of the debtor's business. In practice, a common form of security interest created by corporate debtors is a debenture which creates fixed charges over assets (such as land) which the debtor does not require to dispose of in the ordinary course of its business, and a floating charge over assets (such as stock-in-trade) which it does. Such a debenture can be created very

[1] This chapter contains a broad overview of the treatment of secured claims in insolvency proceedings. For further detail and the statutory and case law authorities on which it is based, see R Calnan, Taking Security (4th edn, LexisNexis 2018), especially chapters 9 (Enforcement) and 10 (The effect of insolvency).

easily over all the present and future assets of the debtor. All that is required is for the debenture to be executed by the debtor and registered at Companies House, although they are often also registered at asset registries (such as the Land Registry) for priority reasons.

Mortgages and charges are not the only type of security interest recognised by English law. A pledge can be taken over tangible movable assets, such as goods and documents of title, but it requires the creditor to obtain, and retain, possession of the assets concerned. As a result, pledges are generally only used to secure short-term financings in the context of international trade or commodity transactions, where possession of a bill of lading can be obtained by the financing bank. Pledges do not require to be registered at Companies House. English law also recognises certain types of common law and equitable lien, which arise by operation of law.

Unlike some common law jurisdictions, English law recognises a clear distinction between security interests and outright ownership. An owner of an asset can lease it to another person, or sell it on reservation of title, without its ownership interest being recharacterised as a security interest. Similarly, an outright sale of receivables will not be recharacterised as a security interest. As a result, these types of transaction are not registrable at Companies House. What is important is the legal nature of the transaction, not its economic effect.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

Enforcement of security in England is also relatively straightforward. The security can generally be enforced by the creditor without the necessity to involve a court; although there are restrictions on enforcement in certain types of insolvency proceeding, which are discussed in section 11.

Security is sometimes enforced by the creditor taking possession of, and then selling, the secured asset, but, in commercial transactions, security is normally enforced by the appointment of a person (usually an insolvency accountant) to enforce the security on behalf of the creditor. The nomenclature in this area can be confusing. If the person concerned is appointed over a particular asset or assets of the company, he or she is called a receiver. If he or she is appointed overall, or substantially all, of the debtor's assets, that person is usually known as an administrator and takes over the management of the debtor company. An administrator must comply with certain statutory objectives but, in practice, whatever the name of the person concerned, their function is broadly the same. In most cases, the person will take possession of the assets which are the subject of the security, continue to trade them if they constitute a business, and then sell them, preferably as a going concern.

A receiver is appointed by the creditor, usually under the terms of the security document. An administrator is appointed by the creditor or the debtor under the terms of the insolvency legislation. In practice, the appointment is relatively straightforward and can be made relatively quickly if necessary.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***

- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

The Corporate Insolvency and Governance Act 2020 has recently introduced into English law two new procedures – a moratorium and a new form of scheme of arrangement. They are intended to assist debtors to avoid formal insolvency procedures and can therefore be described as pre-insolvency proceedings, although they are characterised as insolvency proceedings for many purposes.

3.1 The moratorium

A moratorium can be obtained by the directors of the debtor without the debtor entering into a formal insolvency procedure. It applies to UK companies, and also to overseas companies if the company concerned has a sufficiently close connection with the jurisdiction. There is an exclusion for financial institutions (which are widely defined). The moratorium is not available if the debtor concerned has been the subject of an insolvency procedure or a moratorium in the last year.

The moratorium is obtained simply by the directors filing certain documents with the court, although a court order is required for an overseas company or a company which is subject to an outstanding winding-up petition. There are a number of requirements. In practice, the most important is that the moratorium must be supervised by a monitor (who will generally be an insolvency practitioner), and the monitor must state that in his or her view it is likely that a moratorium would result in the rescue of the company as a going concern.

The effect of the moratorium is that, subject to certain exceptions, it prevents creditors from recovering their debts, secured creditors from enforcing their security, floating chargees from crystallising their charges and lessors from recovering their goods.

The moratorium initially lasts for four weeks. It is extendable for another four weeks and can be extended further if creditors or the court agree.

The company must continue to pay most debts incurred during the moratorium. It must also pay debts due under financial services contracts (which are widely defined) whether they become payable before or during the moratorium.

The Act creates a new priority status for moratorium debts and for debts under financial services contracts. The basic principle is that they rank ahead of all other debts if proceedings begin for the company to enter into an insolvency procedure within 12 weeks after the end of the moratorium. But this priority only applies to financial services debts which fall due in the ordinary course. It does not apply where they are accelerated. It would seem that these debts are also intended to be payable out of floating charge assets in priority to the floating chargee.

3.2 The new scheme of arrangement

Companies can – and frequently do – reach agreements with creditors (including secured creditors) in order to avoid going into an insolvency procedure. This is achieved by contract with the creditors concerned.

For many years, legislation has provided mechanisms to assist companies to obtain the agreement of creditors. If the company can reach agreement with a certain percentage of its creditors (broadly 75% in value of those voting), the agreement will bind all the creditors concerned, even if they did not vote in favour.

This can be done by a scheme of arrangement under the Companies Act 2006 or a company voluntary arrangement under the Insolvency Act 1986. Each has its own particular requirements, but the important point in this context is that, as a general rule, they cannot be used to deprive a secured creditor of its security or alter its substantive rights without its consent. But the 2020 Act has now introduced a new type of scheme of arrangement which might affect secured creditors.

The new scheme of arrangement applies to any company, including overseas companies with a sufficient link with England, if the company is likely to encounter financial difficulties which may affect its ability to carry on business as a going concern.

The process is in many ways similar to that for existing schemes of arrangement. The company or a creditor can propose a compromise or arrangement between the company and its creditors or members or a class of them. The court orders meetings. If 75% in value of the class who vote are in favour and the court sanctions the scheme, it becomes binding.

But there are two provisions which are significantly different from current schemes. The first is that the court can exclude from the requirement for meetings those persons who do not have genuine economic interest in the company. If the proponents of the scheme can persuade the court that certain classes of shareholder or creditor have no real interest in the company, then they will not be allowed to vote.

In addition, if a class does not vote in favour by the requisite majority, it can be disenfranchised if the court is satisfied that the class is no worse off than it would have been under the relevant alternative (being the likely alternative if the arrangement were not sanctioned, for example, liquidation), and the scheme has been approved by a class which does have a genuine economic interest in the company in the event of the relevant alternative.

These provisions are more likely adversely to affect shareholders and junior creditors than secured creditors, but it is conceivable that they could affect even secured creditors in some cases.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- **Who can initiate the proceeding?**
- **What are the criteria used for opening the proceeding?**
- **Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?**
- **Does the debtor's management remain in control of the business during the proceedings?**
- **May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?**

- **What is the level of creditor consent that is required to effectuate a restructuring?**

- **Is shareholder consent required in order to effectuate a restructuring?**

The two main types of corporate insolvency proceeding in England are liquidation and administration. Liquidation is the ultimate, terminal, insolvency proceeding. A liquidator winds up the debtor's affairs, sells its assets and pays the proceeds to creditors. The liquidator will not generally continue the debtor's business. By contrast, the purpose of an administration is to rescue the debtor's business if it is insolvent or close to insolvency. The administrator will normally continue trading the business of the company for a short period, with a view to selling it as a going concern. In practice, the company itself is rarely saved, but the business often is.

Both types of proceeding can be initiated by the debtor or by a creditor if the company is insolvent (or, in the case of administration, likely to become insolvent) on a cash-flow or on a balance sheet basis. The court may be involved in the process, but frequently is not. An important feature of them both is that they result in the debtor's board of directors ceasing to have any real power. Management of the debtor is taken over by the liquidator or administrator, who will be a licensed insolvency practitioner (normally an insolvency accountant). Secured creditors who hold a floating charge (as described above) and security over all or substantially all of the assets of the debtor can appoint an administrator through an "out-of-court" process that simply requires the filing of certain prescribed documents at court (provided the security is enforceable).

It is possible for a company's debts to be restructured in an administration using a scheme of arrangement or a company voluntary arrangement. But the time and cost involved means that they are seldom used for this purpose and that in practice the administrator is more likely to sell the business as a going concern (or to sell the assets if this is not possible) and use the net proceeds to pay the company's debts.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

There are various ways in which security can be set aside in insolvency proceedings, either as a result of insolvency legislation or under the general law. In commercial transactions, the four most important are:

- transactions at an undervalue;

- breach of fiduciary duty;

- voidable preferences; and

- voidable floating charges.

They are all intended to set aside certain types of transaction entered into by the debtor in the period running up to the commencement of the insolvency proceedings if they are detrimental to its general body of creditors. The first two are concerned with transactions by which the debtor loses value which could otherwise be used to pay creditors. The last two are intended to prevent transactions which prefer some creditors over others.

A transaction at an undervalue can be set aside under insolvency legislation if it took place within two years before the commencement of the insolvency proceedings and the debtor was insolvent at the time or became insolvent as a result of the transaction. There is a defence if it can be shown that the debtor entered into the transaction in good faith and for the purpose of carrying on its business and, when it did so, there were reasonable grounds for believing that the transaction would benefit the company.

This provision does not affect security created by a debtor over its own assets to secure its own liabilities – in such a case, there is no depletion of the debtor's assets.

Under the general law, a transaction can also be set aside if it was entered into by the debtor's directors in breach of their fiduciary duty to the debtor and the person dealing with the debtor had actual or constructive notice of that fact. The directors will be in breach of fiduciary duty if they enter into a transaction which they do not believe, on reasonable grounds, to be in its best interests. The time limit is the normal six-year limitation period for actions under English law, but, otherwise, the requirements in this context are similar to those for an undervalue transaction.

The other two types of claw-back provision are concerned to prevent the debtor preferring one creditor, or group of creditors, over its other creditors in the period running up to the insolvency proceedings. These provisions apply to the creation of security, as much as to outright transfers.

A transaction with a creditor who is not connected with the debtor and which has the effect of putting that creditor in a better position will be set aside if it was entered into within six months before the commencement of the insolvency and the debtor was insolvent at the time or became insolvent as a result of the transaction, but only if the debtor was influenced in entering into the transaction by a desire to put the creditor in a better position. The rules are stricter for connected parties. In practice, it is difficult for an administrator or liquidator successfully to attack fixed security granted in favour of an unconnected third party (such as a bank) because of the difficulty of proving that the debtor desired to put the bank in a better position. The debtor will usually grant the security in order to persuade the bank to continue making facilities available, not because it wishes to confer a benefit on the bank.

Floating charges are, however, more vulnerable. A floating charge created in favour of an unconnected person will be invalid if it was created within one year before commencement of the insolvency proceedings and the debtor was insolvent at the time or became insolvent as a result of the transaction, except to the extent of the value of the consideration for the creation of the charge at the time of, or after the creation of, the charge. In the case of a floating charge, therefore, the creditor must ensure that the finance is only made available once the security has been granted. The rules are stricter for connected parties.

In practice, these provisions have only a limited effect on security. In a normal financing transaction, where the debtor is solvent at the time of the transaction and is borrowing money from an unconnected creditor who takes security from the debtor before the facility is made available, none of these provisions will affect the creditor's rights. The danger occurs where the creditor has lent on an unsecured (or insufficiently secured) basis and wakes up to the need for security (or additional security) when the debtor is in financial difficulties. In such a case, a floating charge will be vulnerable, although it will still be difficult for the debtor's insolvency officer successfully to attack fixed charges because of the difficulty of establishing that the debtor desired to prefer the creditor.

6. Is enforcement of security rights treated differently in each type of proceeding?

Liquidation has never affected the ability of a secured creditor to enforce its security, but security cannot generally be enforced during a moratorium or in an administration. This is discussed further in section 11.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

The basic principle is that the secured creditor is entitled to the net proceeds of the secured assets. The main limitation on this principle is that insolvency legislation treats floating charges differently from fixed charges. Whilst the net realisations from fixed charge assets are paid to the secured creditor, realisations from floating charge assets are only available to pay the secured creditor once certain other debts have been paid. They are:

- preferential debts;
- a certain percentage of unsecured debts; and
- the expenses of certain insolvency proceedings.

For over a century, preferential debts have ranked ahead of a floating chargee. The categories of preferential debts have fluctuated over the years, but they are now quite limited in scope. The principal types of preferential debt now consist of claims by employees (up to a very small maximum amount) and certain contributions to pension schemes. This will change. There are plans to reintroduce some type of preference for claims by the state (for instance, taxes).

Unsecured creditors are also entitled to a certain proportion of floating charge realisations (broadly 20% up to a maximum of GBP800,000) in priority to the secured creditor.

Although the basic principle of insolvency proceedings is that the expenses of those proceedings are not payable out of assets which are the subject of security, there are statutory inroads into this principle. Most notably, an administrator can dispose of assets which are the subject of a floating charge and can pay his or her remuneration and expenses out of the floating charge assets in priority to the secured creditor. Certain liquidation expenses are also payable out of floating charge realisations.

For all these reasons, it is preferable for a secured creditor to obtain a fixed charge, rather than a floating charge, although it is only practicable to do so in cases where the creditor can obtain sufficient control over the assets concerned.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

A secured creditor is not subject to time limits in insolvency proceedings, although, in practice, it will want to act quickly to enforce the security if it is possible to do so. If the creditor has security over all or substantially all of the debtor's assets, it will normally appoint an administrator, who will then enforce the security. If the secured creditor only has security over part of the debtor's assets, it will normally appoint a receiver, although, if an administrator is subsequently appointed, the receiver may be required to vacate office.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

As a general rule, the rights of the creditor against a guarantor are not affected by the insolvency of the primary obligor. In practice, the creditor will want to make demand for payment on the guarantor as soon as it is able to do so.

If a scheme of arrangement seeks to amend or release the principal debt, a guarantee or third-party security relating to that debt may be released, provided it is incidental and necessary to the success of the scheme of arrangement.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured right?

If the security interest has not been properly created, it will be ineffective. In practice, as has been seen from the comments in section 1, the creation of security is straightforward. The main reason why a security interest is not properly created is failure to register at Companies House. Most mortgages and charges created by UK companies are registrable within 21 days of the creation of the security interest and, if not registered, are void in an insolvency proceeding.

Land, ships, aircraft and certain types of intellectual property have their own asset registries. Failure to register security in one of these asset registries does not affect the validity of the security, but it does mean that the security is vulnerable to being postponed to other security created over the same asset. The priority of the security depends on the time of registration at the asset registry.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged? If so, how?

As was mentioned in section 6, although liquidation does not affect a secured creditor's power to enforce its security, administration does. The primary purpose of an administration is to save the company or its business, and it is intended to give the debtor company a breathing space within which to enable the administrator to achieve this objective. As a result, no step may be taken to enforce security over the debtor's property except with the consent of the administrator or the permission of the court; and there are similar prohibitions on the ability to repossess goods in the debtor's possession under hire purchase, leasing, conditional sale and reservation of title agreements.

The courts have laid down broad but imprecise requirements as to how the administrator must exercise his or her powers. In deciding whether or not to allow a secured creditor to enforce its security, the administrator must make a decision speedily. The administrator must also act responsibly and reasonably in deciding whether or not enforcement of the security is likely to prejudice the objectives of the administration.

There are similar restrictions in a moratorium, as has been seen in section 3.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

As has been seen in section 7, English insolvency law draws a distinction between fixed and floating charge assets.

A liquidator has no power to deal with fixed charge assets. An administrator does have a theoretical power to sell fixed charge assets without the consent of the secured creditor but requires the authority of the court to do so and must pay the proceeds (or the market value, if higher) to the secured creditor. In practice, this power is rarely used.

An administrator does, however, have much wider powers over floating charge assets. The administrator can use them without obtaining a court order and may pay his or her remuneration and expenses out of them. A liquidator also has a limited power to pay expenses out of floating charge assets. The powers of an administrator or liquidator to use financial collateral (which includes cash) are more circumscribed if the secured creditor has control of the assets concerned.

During a moratorium, the company has similar powers to an administrator.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

In practice, a liquidator will simply wind up the company, and an administrator will try to sell the company's business as a going concern and distribute the net proceeds to creditors. This is not a material issue in practice. If it were attempted, security could not be created which would rank ahead of the existing security.

14. What distribution will a secured creditor receive if a company is reorganised?

It is rare for a company which enters into insolvency proceedings to continue in being. Even when an administrator is appointed, the result will normally be that the company's business is sold, rather than that the company itself is reorganised. Any reorganisation requires the consent of the secured creditor. The secured creditor will therefore receive the distribution it agrees to.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

If there were a reorganisation of the company, the secured creditor's consent would be required, in which event it would be likely to require security over the assets of the reorganised company.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

If the enforcement of the security results in a surplus once the secured creditor has been paid in full (including interest and expenses), as a general rule the surplus is held on trust for the debtor. If the proceeds of enforcement are insufficient to pay the secured creditor in full, the creditor will be entitled to claim in the insolvency proceedings for the balance as an unsecured creditor.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

As a general rule, the restructuring under a foreign insolvency law of the terms of a contract governed by English law will not be effective as a matter of English law.

This is because the basic principle of English law is that, subject to very limited exceptions, a debt can only generally be discharged under its governing law. This is the effect of a long line of case law, the most well-known of which is a decision of a strong Court of Appeal in *Antony Gibbs & Sons v La Societe Industrielle et Commerciale des Metaux*[2] which was approved by the House of Lords in *National Bank of Greece v Metliss.*[3] The principle has been criticised and has been the subject of challenge in the courts, but it has continued to be upheld, and it could only be overturned by legislation or by a decision of the Supreme Court.

English courts may recognise a foreign restructuring of English law contractual arrangements where they are the result of an overseas insolvency procedure recognised under certain statutory and common law rules such as the Recast (EU) Insolvency Regulation or the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (Model Law) implemented in the UK by the Cross-Border Insolvency Regulations 2006.[4] In *Rubin v Eurofinance*,[5] the Supreme Court held that the Model Law deals with procedural matters and does not extend to the recognition and enforcement of foreign judgments. Therefore, where the restructuring of English law contractual arrangements does not form part of an insolvency procedure given recognition by the English courts, a contractual arrangement not governed by English law, to restructure an English law governed debt, would not be effective under English law.

The UNCITRAL Model Law on the Recognition and Enforcement of Insolvency Related Judgments (new Model Law) adopted by UNCITRAL in July 2018 and related guidance indicate that the new Model Law is intended to include the recognition and enforcement of an overseas judgment. However, the New Model Law has not yet been implemented in the UK.

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2 (1890) 25 QBD 399.
3 [1958] AC 509, 523.
4 SI 2006/1030.
5 [2012] UKSC 46.

UNITED STATES OF AMERICA

1. **Briefly summarise the types of security rights available and indicate, in each case:**

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

1.1 Personal or movable property

Generally speaking, in the United States of America (United States or US), security interests in personal property are governed by state law, principally Article 9 of the Uniform Commercial Code (UCC), which has been adopted, with modifications, by every state. Article 9 covers most types of consensual security interests in personal property, including fixtures (personal property attached to real property).

Under Article 9 of the UCC, a security interest arises when a debtor grants to a creditor (the secured party), pursuant to a security agreement, a security interest in specified collateral owned by the debtor to secure obligations owing by the debtor to the creditor. The grant of a security interest to the secured party entitles the secured party, upon default by the debtor on any such obligations, to seize the collateral covered by the security interest to satisfy the secured obligation. The security interest "attaches" to the collateral by the execution of a security agreement by the debtor and the giving of value by the secured party. The secured party may then take steps to give public notice of its interest in the collateral to the debtor's other existing creditors, future creditors, and prospective purchasers of the collateral by "perfecting" its security interest. Without perfection, the collateral is subject to attachment by other creditors, is subordinate to future perfected security interests of other creditors in the collateral and may be cut off by persons purchasing the collateral. Furthermore, without perfection, a secured party's interest in the collateral will not be respected as a secured claim in a bankruptcy case.

Filing a financing statement is the common method of perfection prescribed by Article 9 of the UCC for all forms of security interests. Under certain circumstances, possession, control, or delivery of the collateral are among other methods prescribed in Article 9 that will also allow the secured party to perfect its security interest. In fact, with respect to certain types of collateral, such as investment property (e.g. a certificate evidencing an equity interest in the issuer), a secured party with control over the collateral will have priority over a security interest previously perfected by filing.

Article 9 does not govern all types of movable or personal property. For example, motor vehicles are generally covered by certificates of title issued on a state-by-state basis, and these certificates of title statutes generally cover security interests in automobiles. Perfection of security interests in aircraft, railroad rolling stock, and certain vessels is governed by federal law rather than state law, although the UCC governs most other aspects of a security interest in such property.

1.2 Real or immovable property

A security interest in real property is usually granted through a mortgage. A mortgage involves the transfer of an interest in land as security for a loan or other obligation. In a typical mortgage, regular instalment payments of interest and, in some cases, principal are due pursuant to an agreed-upon schedule. Mortgages are mainly governed by state statutory and common law, although they may also be regulated by federal law or a state or federal agency's regulation, depending on whose law the mortgagee (the provider of the loan or other interest given in exchange for the security interest) was chartered or established under.

1.3 Statutory liens

Liens on personal and real property may also arise statutorily or by operation of law. Such liens are usually neither contractual nor consensual. Examples include federal tax liens, mechanic's liens, carrier's liens and judgment liens. Such liens are typically governed by the individual statute that creates them, but their priority with respect to other security interests is generally dealt with under Article 9 (in the case of personal property) or other state law (in the case of real estate) or federal law (in the case of liens created under federal law such as federal tax liens).

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

The procedure for enforcing security interests varies depending on whether the collateral in question is personal property or real estate. In the case of personal property, upon a default, a lender would typically accelerate the debt and enforce its security interest by sending a default notice to the borrower stating its intention to enforce its security interest. The secured party is entitled to limited use of "self-help", or the right to take possession of the collateral without breach of the peace (i.e. a situation where the lender creates a disturbance). If the lender commits a breach of the peace, the lender may be liable for damages. Often, the lender and the borrower negotiate for the "peaceful possession" of the collateral to be turned over to the lender so as not to breach the peace.

If the secured party is unable to repossess the collateral without breaching the peace, the secured party must proceed with judicial action. In the case of personal property collateral, the secured party could pursue either an action in replevin, or an action for claim or delivery, where the sheriff or similar public official is authorised by the court to repossess the collateral on behalf of the secured party. That judgment would need to be domesticated in all jurisdictions in the United States where collateral is located. After the relevant time period under applicable state law passes, execution on and sale of the collateral can be made to satisfy the lender's claims secured by that collateral. Depending on the jurisdiction, the sheriff may either turn the collateral over to the secured party immediately or hold it in escrow until the conclusion of the disposition process. The secured party may dispose of the collateral in the manner prescribed by Article 9 of the UCC, generally either through public or private sale. Perhaps the most important requirement under state law is that the creditor dispose of the collateral in a "commercially reasonable manner". With the consent of the debtor and of any creditors with a subordinate lien on the collateral, the secured party may also foreclose on its security interest by taking title to the collateral in satisfaction of all or an agreed portion of the outstanding debt owing to the secured party. This is referred to as "strict foreclosure".

With respect to real estate, the failure to make payments or the existence of other defaults under the mortgage permits the mortgagee to accelerate the entire mortgage debt, to declare it immediately due and payable, and to commence legal proceedings to foreclose (enforce) its mortgage. If the mortgage debt remains unpaid after the foreclosure judgment is entered, the mortgaged property may be sold, and the proceeds may be applied to the remaining mortgage debt. The foreclosure process depends on state law and the terms of the mortgage.

The most common processes are court proceedings (judicial foreclosure) or grants of power to the mortgagee to sell the property (power of sale foreclosure). Many states regulate the ability of the mortgagee to accelerate the debt and override the express terms of the mortgage by creating a statutory payment grace period, which grants the mortgagor a right to redeem the property to avoid foreclosure.

3. **Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:**

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

There is no US analogue to formal pre-insolvency proceedings (although a company need not be insolvent to initiate a formal Chapter 11 proceeding). Typically, lenders will engage in a workout with a troubled borrower to evaluate the nature of the borrower's distress, its ability to repay its loans, and the possibility for an out-of-court settlement between the lender and the borrower's other creditors. Depending on the outcome of the lender's analysis, it may make sense to either restructure the outstanding debts between the borrower and the lender alone, together with the debtor's other creditors, or by having the borrower file a pre-packaged or pre-arranged bankruptcy. Neither of the first two options requires the intervention or imprimatur of a bankruptcy court, nor will it bind non-consenting creditors (except as otherwise contractually agreed). A pre-packaged or pre-arranged bankruptcy, by contrast, will bind non-consenting creditors.

4. **Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:**

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Contractual provisions of US financing documents generally provide that certain fundamental creditor rights cannot be modified without the consent of each affected creditor. These provisions typically include increasing the amount of or extending the expiration date of any loan commitment, postponing the payment of principal and interest, reducing the amount of principal or interest owed, and releasing liens on all or substantially all collateral. Under the Bankruptcy Code, these rights may be altered notwithstanding contractual prohibitions to the contrary in the applicable finance documents.

In a bankruptcy proceeding, a class of claims will be deemed to have accepted a plan if a majority of the creditors in the class that actually vote on the plan approve the plan, and if such affirmatively voting creditors hold claims in an amount equal to at least two-thirds of the amount of claims voted in the class. Rejecting and non-voting creditors in such class will be dragged along and compelled to accept the treatment under the proposed plan unless they can establish that they would receive a greater value under a straight liquidation of the debtor than under the plan, or if they can establish that the proposed plan is defective in some other way (such as by establishing that the proposed restructuring of the debtor is not feasible and is likely to fail).

If every impaired class of claims under a proposed plan votes to accept the plan by the requisite thresholds and if certain other conditions are met, the plan will be confirmed on a "consensual" basis. Even where one or more impaired classes of claims reject a proposed plan, however, the plan may still be approved on a "cram-down" basis if at least one class of impaired claims has accepted the plan (without counting the votes of any insider in such class (see section 1129(a)(10) of the Bankruptcy Code) and if certain other statutory requirements are met. In the case of a rejecting class of secured claims, a proposed plan may be approved even where no creditor in the class has accepted the plan so long as the plan provides the secured creditors in the class with a new secured note with a present value equal to the lesser of the amount of the creditors' claims in the class or the value of the collateral securing the claims in the class. Where the secured creditors' claims in a class exceed the value of the collateral securing the claims, the amount of the claims exceeding the value of the collateral will be classified separately from the secured portion of the claims and treated as general unsecured claims.

A proposed plan may be approved over the rejection of the plan by a class of impaired unsecured claims if the plan either provides for the payment of the impaired unsecured claims in the rejecting class in full or (if the plan provides for less than payment in full) if no junior class of claims or equity interests receives or retains any property under the proposed plan.

Shareholder consent is not required in order to consummate a restructuring under the Bankruptcy Code, but, in the case of a restructuring of a solvent debtor, the votes of shareholders will be solicited under a proposed plan.

Unlike the rights of lenders, investors and general creditors, the rights of lessors and counterparties to executory contracts (e.g. contracts where substantial obligations remain unperformed) cannot be modified absent the consent of the non-debtor counterparty. Instead, the debtor's only choice is to "assume" or "reject" the contract or lease in full. If the contract or lease is "assumed", the debtor must cure all defaults under the contract or lease (other than punitive default-related provisions or non-monetary defaults not capable of a cure). If the contract or lease is "rejected", resulting damages will be classified as pre-petition general unsecured claims (in some instances subject to statutory caps as to the amount that may be asserted against the debtor).

Where a debtor is unable to obtain the contractual thresholds required to consummate a restructuring out of court but wishes to minimise the impact of a bankruptcy filing, the debtor will often seek to negotiate a "pre-packaged" or "pre-arranged" bankruptcy. In a "pre-packaged" bankruptcy, the debtor generally files its bankruptcy petition under Chapter 11 of the Bankruptcy Code together with a disclosure statement and a proposed plan of reorganisation that has already been voted on by its creditors, although the debtor may file the case before the solicitation of votes has been completed. Where solicitation has been completed prior to commencing the bankruptcy proceeding, the entire case can often be completed in less than 30 days, and in some recent instances, cases have been completed in a single day (see *In re FullBeauty Brands, Inc* (No 19-22185, Bankr SDNY 2019) and *In re Sungard Availability Servs Capital, Inc* (No 19-22914, Bankr SDNY 2019)).

True "pre-packaged" bankruptcy cases are an option when the debtor seeks to restructure its institutional financial obligations only and does not seek to restructure its operations or impair the claims of customers and vendors. Where a more fundamental restructuring is required, including the need to reject leases and contracts or the need to impair trade claims, and, where circumstances do not require the debtor to commence a proceeding immediately, a debtor may seek to increase certainty and limit the expense of a proceeding by seeking to negotiate a "pre-arranged" bankruptcy. In a pre-arranged bankruptcy proceeding, agreed terms of a plan of reorganisation are ordinarily negotiated between the debtor and all or a substantial portion of its institutional creditors before the bankruptcy filing (and the debtor may have also lined up a plan sponsor to fund the company's exit from bankruptcy), but formal solicitation of votes on the plan may not begin until after the commencement of the case and the approval by the bankruptcy court of the debtor's disclosure statement.

4.1 Who may initiate the insolvency proceeding?

Under the Bankruptcy Code, any individual, partnership, or corporation that resides, has a domicile, a place of business, or property in the United States may file for voluntary bankruptcy protection under either: (i) Chapter 7 of the Bankruptcy Code, which involves liquidation of the debtor's assets and distribution of the proceeds to the debtor's creditors and, for individuals, a discharge of liability; or (ii) reorganisation under Chapter 11 of the Bankruptcy Code, which generally involves the filing of a "plan of reorganisation" pursuant to which the debtor may retain possession of its assets and benefit from a deleveraged capital structure, although ownership of the restructured debtor often shifts from the debtor's pre-petition shareholders to creditors. A debtor may also choose to liquidate its assets pursuant to a plan of reorganisation. When the debtor initiates a bankruptcy proceeding voluntarily, the filing of the petition constitutes entry of an order for relief under the particular chapter of the Bankruptcy Code chosen by the debtor. A bankruptcy estate then arises consisting of the debtor's interest in property wherever located, and an "automatic stay" arises which, with certain limited exceptions, prohibits creditors from commencing or continuing any actions against the debtor or its property (and, from the perspective of US law, extends extraterritorially). An entity need not be insolvent to commence a voluntary case, but it must have some prospect of financial distress.

Creditors may also file an involuntary case against the debtor under both Chapters 7 and 11. There are two grounds to force an entity into bankruptcy: (a) the debtor is insolvent under the equity insolvency test (i.e. inability to pay debts as they become due); or (b) within 120 days before the date of the filing of the petition, a custodian, other than a trustee, receiver, or agent appointed or authorised to take charge of less than substantially all of the property of the debtor for purpose of enforcing a lien against such property, was appointed or took possession. If the debtor has an aggregate of 12 or more creditors, it takes three petitioning creditors with undisputed, non-contingent claims, and who collectively hold unsecured debt of at least USD16,750, to commence an involuntary case. If the debtor has fewer than 12 creditors, there need be only one petitioning creditor with an undisputed, non-contingent, unsecured claim of at least USD16,750. (These dollar amounts are effective for cases filed after 1 April 2019 and are adjusted every three years).

If an involuntary petition is filed, the putative debtor has 20 days from service to either contest the filing or agree to "the entry of an order for relief". The 20-day period may be extended by agreement or by the bankruptcy court. If the putative debtor contests the filing and loses or the debtor consents to the entry of an order for relief, the case will proceed from that point as a voluntary Chapter 7 or 11 would (depending on which chapter the involuntary petition is filed under). An involuntary debtor can convert a Chapter 7 case to Chapter 11 and *vice versa*. If the putative debtor contests the involuntary filing and prevails, the case is dismissed. If the petition is dismissed, the creditors who filed the involuntary may be liable for damages.

Chapter 11 provides a forum for a company to define and resolve its liabilities in a court-supervised process. In a Chapter 11 case, unlike one under Chapter 7, the debtor typically continues its normal business operations and manages its business as a debtor-in-possession. While the officers, subject to board oversight, manage the company's business as usual, any non-ordinary course activity is subject to approval of the bankruptcy court following notice to interested parties and a hearing. Common examples of activity outside the ordinary course include financing the debtor's business and conducting asset sales.

4.2 The bankruptcy court

Jurisdiction under the Bankruptcy Code is initially vested in the United States District Court. The district court is authorised to refer all cases under the Bankruptcy Code and any or all proceedings arising under the Bankruptcy Code or arising in or related to a case under the Bankruptcy Code to the bankruptcy judges for the applicable district. Most or all district courts have entered standing orders which automatically refer cases and proceedings to bankruptcy judges. The reference may be withdrawn from the bankruptcy court, in whole or in part, by the district court "for cause shown".

The powers of the bankruptcy court are broad. Section 105 of the Bankruptcy Code provides that the court may issue any "order, process, or judgment necessary or appropriate" to carry out other provisions of the Code. This broad power can be exercised with respect to, among other things, temporary restraining orders and preliminary and permanent injunctions. Injunctions may be used, for example, to expand the reach of the automatic stay to non-debtor third parties, where claims against such non-debtors could cause an adverse economic effect on the debtor's estate. While the bankruptcy court's power under this provision is broad, however, the court may not ignore or suspend other provisions of the Code.

4.3 The trustee

In cases filed under Chapter 7 of the Bankruptcy Code, a Chapter 7 trustee will be appointed by the regional office of the United States Trustee (subject to the right of unsecured creditors to replace that candidate with their own selection) to administer the debtor's bankruptcy estate and distribute the proceeds of the estate to the debtor's creditors. In cases filed under Chapter 11, however, the debtor's management typically continues in possession of the debtor's property as a "debtor-in-possession" and is authorised to administer the bankruptcy estate. Generally, a reference in the Bankruptcy Code to "trustee" also refers to the debtor-in-possession if a trustee has not been appointed. The appointment of a trustee in Chapter 11 cases is an extraordinary remedy that is granted in rare cases (although, under certain amendments to the Bankruptcy Code, that bar has been lowered significantly). As in the case of a Chapter 7 trustee, a Chapter 11 trustee may be selected by the general unsecured creditors. A Chapter 11 trustee may be appointed: (a) "for cause", including fraud, dishonesty, incompetence, or gross mismanagement by current management, either before or after the commencement of the case; (b) if such appointment is in the best interest of creditors and equity security holders and other interests of the estate; or (c) if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee (or an examiner) is in the best interests of creditors and the estate.

4.4 The United States trustee

United States trustees supervise the administration of cases filed under the Bankruptcy Code, and their responsibilities include, among other things,

- taking legal action to enforce the requirements of the Bankruptcy Code and to prevent fraud and abuse;
- referring matters for investigation and criminal prosecution when appropriate;
- ensuring that bankruptcy estates are administered promptly and efficiently, and that professional fees are reasonable;
- appointing and convening creditors' committees in Chapter 11 business reorganisation cases;
- reviewing disclosure statements and applications for the retention of professionals; and
- advocating with respect to matters under the Bankruptcy Code and rules of procedure in court.

4.5 Official committees

The Bankruptcy Code provides that a committee of unsecured creditors shall be appointed by the United States trustee in every Chapter 11 case, and that the United States trustee may appoint other committees of creditors and equity security holders if necessary to ensure adequate representation of creditors or equity security holders. These committees are allowed to retain professionals and to actively participate in all aspects of the case in which their constituents are interested.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

The Bankruptcy Code grants a trustee or debtor-in-possession the power to avoid a broad range of pre- and post-petition transactions. Moreover, a creditors' committee has standing to exercise the avoidance powers on behalf of the estate either upon: (i) a voluntary transfer by the trustee or debtor-in-possession of its avoidance powers to a creditors' committee; or (ii) unreasonable refusal by the trustee or debtor-in-possession to exercise the avoidance powers.

5.1 Preferential transfers

The elements of transfers that may be avoided because they are deemed preferential are set out in section 547(b) of the Bankruptcy Code. A transfer (broadly defined to include any transfer of an interest in property) of the debtor's property is preferential if:

- the transfer was to or for the benefit of a creditor;
- the transfer was on account of an antecedent debt, that is, one owed before the time of the transfer;
- the debtor was insolvent (in the balance sheet sense) at the time of the transfer;
- the transfer was made to an insider (for example, an owner, officer, or director) within one year prior to the filing date, or to anyone else (i.e. a non-insider) within 90 days prior to the filing date; and
- the transfer had the effect of giving the creditor more than it would have received in a distribution under Chapter 7.

Section 547(e) of the Bankruptcy Code provides that for preference purposes, a transfer (such as the granting of a lien or mortgage) is deemed to occur when the transfer is perfected. A transfer requiring perfection is perfected upon creation of the interest if perfection formalities are completed within 30 days. This will apply even if the petition is filed during the grace period. A transfer perfected before commencement but not within the grace period is perfected when all perfection requirements are completed. A transfer unperfected as of commencement (and not perfected within any applicable grace period) is deemed to have been made the day before the bankruptcy filing. Therefore, the granting of a security interest to a lender on account of an antecedent debt could constitute a voidable preference to the extent the security interest was unperfected on the date of the bankruptcy filing or was perfected outside of the applicable grace period and within the applicable preference period (i.e. one year prior to the commencement of the case, in the case of an insider, or 90 days before the commencement of the case, in the case of a non-insider). By failing to timeously (i.e. contemporaneously or within any applicable grace period) perfect a security interest granted for a contemporaneous advance by a lender (which would ordinarily pose no preference risk), the late perfection could result in the security interest being deemed to be on account of an antecedent debt and thus subject to challenge.

Under section 545 of the Bankruptcy Code, the trustee or debtor-in-possession may avoid statutory liens that first become effective on the insolvency or bankruptcy of the debtor and that are not perfected or enforceable on the filing date against a hypothetical *bona fide* purchaser, excluding liens for rent or distress for rent (i.e. a lien on a tenant's possessions on leased premises where the proceeds are used to reimburse the landlord for any unpaid rent).

5.2 Fraudulent transfers

The trustee may also avoid fraudulent transfers. Section 548 of the Bankruptcy Code provides that the trustee or debtor in possession may avoid any transfer or obligation made or incurred within two years of filing if: (a) the transfer was made, or obligation incurred, with the actual intent to hinder, delay, or defraud any entity to whom the debtor was or became indebted – a so-called "actual fraud"; or (b) the transfer was made, or obligation incurred, for less than reasonably equivalent value and the debtor (i) was insolvent (in the balance sheet sense) at the time of or became insolvent as a result of the transfer or obligation, or (ii) was engaged in or about to engage in business for which its remaining property was insufficient, or (iii) intended to or believed it would incur debts beyond its ability to pay when due – a so-called "constructive fraud".

In general, "reasonably equivalent value" means that the transfer was made, or obligation incurred, for fair consideration. The definition of "value" is fact-specific and can differ from case to case. For example, the Seventh Circuit has held that a lender had provided reasonably equivalent value to the borrower in the form of 11 forbearance agreements, where such agreements eased the repayment terms of the debt and "kept [the debtor] out of bankruptcy for the next four years" (*1756 W Lake St LLC v Am Chartered Bank (In re 1756 W Lake St LLC)*, 787 F 3d 383, 387 (7th Cir 2015)). On the other hand, the Eleventh Circuit found that tax benefits, elimination of negative effects of litigation on day-to-day business operations, continued access to corporate services from the debtors' parent company, access to an enhanced revolving credit facility, and avoiding a parent company bankruptcy were insufficient bases to constitute "value" in exchange for new liens granted by debtor subsidiaries to new lenders (see *Senior Transeastern Lenders v Official Committee of Unsecured Creditors (In re TOUSA, Inc)*, 680 F 3d 1298, 1303 (11th Cir 2012)).

Upstream and cross-stream guarantees (i.e. upstream is a subsidiary's guarantee of its corporate parent's debt, and a cross-stream guarantee is its guarantee of a sister corporation's debt), which usually confer no direct benefit on the guarantor, and leveraged-buyout financings (to the extent that the borrower serves as a conduit to pay out the former shareholders) are common financing transactions which may be subject to challenge as fraudulent conveyances. If such an attack is successful, the lender would not be able to enforce the obligations under the respective guarantee or loan agreement or its rights with respect to any collateral securing such obligations.

In some situations, state law allows perfection within a set time period to relate back to the date on which an interest was created. This allows the holder of the security interest to defeat the rights of an intervening creditor. In addition, as noted above, the preference provisions provide a post-petition grace period to permit perfection of a security interest. In such a case, the trustee may not interfere with the security interest holder's right to post-petition perfection.

6. Is enforcement of security rights treated differently in each type of proceeding?

This question is not applicable because there is no formal pre-insolvency proceeding available in the United States.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

Because a debtor may have more than one obligation to a particular creditor or a single claim may be divided into a secured claim and an unsecured claim, the Bankruptcy Code is organised in terms of "claims" rather than in terms of "creditors".

The Bankruptcy Code generally respects the priorities afforded to secured lenders described in Article 9. After secured claims have been satisfied, the Bankruptcy Code provides that particular types of unsecured claims receive priority in payment over other unsecured claims. Section 507 of the Bankruptcy Code sets out 10 categories of such priority claims, including, for example, the debtor's domestic support obligations (in the case of individuals), expenses of administration of the bankruptcy case (including professional fees), and certain enumerated taxes and amounts due under certain of the debtor's employment obligations. If the priorities are strictly enforced, all claims in a higher priority category must be satisfied in full before payment is made to lower priority categories. The court may not alter the scheme of priorities or create sub-priorities, although pre-petition contractual provisions regarding subordination will be respected. These priorities apply generally in Chapter 7 and Chapter 11 cases, although creditors may agree in a Chapter 11 plan (subject to certain limitations) to different treatment from that provided for in the statute or by contract.

Various sections of the Bankruptcy Code provide that some claims may be given super priority treatment. This means that certain administrative expenses, such as debtor-in-possession financing, may be paid ahead of some or all other administrative expenses.

As noted above, there is no statutory provision for formal pre-insolvency proceedings although it is common for parties to engage in out-of-court workouts. The rules of priorities and classification in the Bankruptcy Code will provide a useful framework for such out-of-court workouts, especially because unsuccessful workouts often find themselves in the bankruptcy court.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

Generally, for a creditor's claim to receive a distribution in a bankruptcy case, the creditor or other appropriate person must file a proof of claim, and an equity security holder may file a proof of interest. Generally, filing a proof of claim is a mandatory prerequisite for the allowance of unsecured claims, including priority claims and under-secured claims (i.e. where the amount of the creditor's claim exceeds the value of the applicable collateral) unless the claim has been correctly listed on a Chapter 11 debtor's schedule of liabilities. Such scheduling constitutes *prima facie* evidence of the validity of the claim in Chapter 11 cases. However, if the claim or interest is not listed, is listed incorrectly, or is listed as disputed, contingent or unliquidated, a proof of claim or interest must be filed.

In a Chapter 11 case, the court will fix the time within which proofs of claim must be filed, the last day of which is called the "bar date". Bar dates are strictly enforced, and creditors should take the utmost care in ensuring that their proofs of claim are timeously filed and received before the bar date. Failure to timeously file a proof of claim often means that the creditor will lose all recourse with respect to its claim.

Note that as discussed below, a secured creditor is stayed from taking any action against its collateral. To enforce its rights, a secured creditor must make a motion in the bankruptcy court for relief from the stay or requesting, in the alternative, adequate protection of its interests. See discussion of adequate protection in section 11 below.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

The commencement of a bankruptcy case by or against a borrower does not affect the liability of a non-debtor guarantor of the borrower's obligations. Section 524(e) of the Bankruptcy Code provides that "the discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt". Therefore, notwithstanding the bankruptcy of a primary obligor, a creditor is ordinarily free to pursue recovery on its claim from a non-debtor guarantor or co-obligor. In cases where a guarantor satisfies the primary obligor's obligations to the creditor in full, the guarantor may subrogate to the rights of the creditor against the debtor and seek recovery of the claim in the debtor's bankruptcy proceeding.

In rare instances, the bankruptcy court may temporarily stay a creditor's collection action against a non-debtor guarantor. Some courts have extended the automatic stay to non-debtor guarantors pursuant to section 362 of the Bankruptcy Code after considering whether a judgment against a non-debtor is a *de facto* judgment against the debtor, whether the stay would contribute to the debtor's reorganisation, and the relationship between the non-debtor and the debtor. Additionally, as noted in section 4 above, other courts have used their equitable powers under section 105 of the Bankruptcy Code to temporarily enjoin actions against non-debtors where continuation of the lawsuit would adversely affect the bankruptcy estate and pressure the debtor through a third party.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

As discussed above in section 5, the trustee (or debtor-in-possession) may have the ability to avoid a security interest as either a preferential transfer or fraudulent conveyance under sections 547 and 548 of the Bankruptcy Code. In addition, the Bankruptcy Code gives the trustee (or debtor-in-possession) rights that certain creditors would have under applicable state law to attack unperfected or unrecorded transfers. This provision, section 544(a) of the Bankruptcy Code, is referred to as the "strong arm" power and gives the trustee the power that a hypothetical lien creditor would have to avoid a transfer under applicable state law.

More specifically, section 544(a) of the Bankruptcy Code specifies that the trustee has the same power to avoid transfers that may be exercised under applicable state law by: (a) a creditor that, as of the commencement of the case, had obtained a judicial lien; (b) a creditor that, as of the commencement of the case, had an execution returned unsatisfied; or (c) a *bona fide* purchaser of real property who had perfected its interest as of the commencement date.

Because the laws of most states allow these persons to prevail over unperfected or unrecorded interests, the trustee may be able to invalidate unperfected or unrecorded transfers or liens. When state law provides that such a person must file a notice of its interest in order to obtain special status, the trustee is deemed to have completed the filing.

In addition, section 544(b) provides that the trustee may avoid any transfer or obligation of the debtor that, under state law, may be avoided by an actual creditor holding an allowable unsecured claim. This section requires that such a creditor actually exists. However, a creditor within this section need not have reduced its claim to judgment or have executed upon it.

When the trustee asserts the avoidance rights of a creditor described in section 544(b), the entire transaction is avoided. For example, the rights of a creditor with a USD1,000 allowable unsecured claim may be exercised to avoid a USD50,000 transaction. The estate will recover USD50,000, not just the USD1,000 that represents the extent of the creditor's claim.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged? If so, how?

Prior to the commencement of an insolvency proceeding, the secured party is generally free to foreclose on or take other enforcement actions against the collateral. The filing of a voluntary or involuntary petition, however, causes an umbrella of protection to open over the debtor and its property. This umbrella is the automatic stay, perhaps the most fundamental of all protections afforded by the Bankruptcy Code. Note that, because the stay is automatic, its provisions are effective regardless of whether a creditor knows of the bankruptcy filing.

The primary purpose of the stay is to protect the debtor from all manner of collection efforts and to provide it with relief from the financial pressures that led to the filing. The stay maintains the status quo while giving the debtor the opportunity to reorganise and restructure its debts, or, if that is not possible, to see that its assets are liquidated and the proceeds are distributed to creditors in an orderly fashion. The collection rights of creditors are not altered, but enforcement is delayed. Despite this negative impact, creditors also obtain some benefits from the stay. By preventing diminution of the estate as a result of the acts of the more aggressive creditors, the stay promotes the Bankruptcy Code policy that equally situated creditors receive equal treatment.

The Bankruptcy Code lists eight broad categories of actions that are automatically stayed upon filing, including: (a) judicial, administrative or other actions or proceedings that were or could have been brought against the debtor before the filing; (b) execution and levy against pre-petition property; and (c) creation, perfection, or enforcement of liens against property of the estate and property of the debtor. The Code also includes a dragnet clause that stays "any act to collect, assess or recover" from the debtor on a claim arising before the filing. This provision is read as prohibiting "informal" collection actions such as harassing phone calls and letters.

The automatic stay provision generally applies only to actions against the debtor and property of the debtor. It does not apply to co-defendants in pending litigation. Nor will the stay apply to corporate affiliates or partners in debtor partnerships or with respect to actions against property of non-debtors. As noted in sections 4 and 9 above, in appropriate circumstances, the bankruptcy court may temporarily enjoin actions against non-debtors to protect the orderly administration of the estate. The Bankruptcy Code expressly prohibits the service of legal papers arising from any proceeding upon the debtor.

The stay can be challenged by parties in interest pursuant to section 362(d)(4) of the Bankruptcy Code.

Under this section, the bankruptcy court shall lift the stay: (1) upon a showing of "cause", including a lack of adequate protection (discussed in detail below); or (2) with respect to a stay of property where (a) the debtor does not have equity in such property and (b) such property is not necessary to an effective reorganisation.

The Bankruptcy Code requires that a secured creditor be provided with adequate protection of its interest in property to protect the creditor from diminution in value of its collateral during the pendency of the stay. Similarly, the concept of adequate protection is important for sections of the Bankruptcy Code dealing with the general authorisation to use, sell, or lease property. Adequate protection must also be provided to existing lienholders whose status would be negatively affected if the trustee obtained post-petition credit secured by a senior or equal lien on the creditor's collateral.

Despite its importance, the concept of adequate protection is not defined by the Bankruptcy Code. Rather, the Code provides a non-exhaustive list of what may constitute adequate protection. It should be noted that the court itself will not provide adequate protection, but rather will decide whether *the trustee or debtor-in-possession* is providing adequate protection, i.e. whether the present circumstances or the measures proposed by the trustee or debtor-in-possession offer sufficient safeguards of the creditor's interest.

Adequate protection may be provided by making single or periodic cash payments to the creditor or by the grant of a lien to the creditor whose interest will be affected by the stay, or by the use, sale or lease powers. Although cash payments are useful in some cases, in many cases the debtor will not have sufficient cash flow to make periodic payments.

An additional or replacement lien is particularly appropriate in situations where, in order to continue the business, the trustee proposes to use or dispose of property subject to a creditor's floating lien, such as inventory or accounts receivables. In such a case, an alternative lien in inventory or accounts receivable equal to the value of the original lien may provide adequate protection.

The Code also provides that a creditor may be granted adequate protection by being given the "indubitable equivalent" of its interest in the property. This alternative, which will apply when cash payments or replacement liens are not feasible, gives the parties great flexibility in fashioning appropriate protection with the sole requirement being the provision of "indubitably equivalent" value.

Except for cash collateral discussed in section 12 below, the burden of requesting adequate protection is upon the creditor, who must prove that the continuation of the stay results in a diminution of the creditor's interest in the property. A creditor will generally petition the bankruptcy court for adequate protection, or, in the alternative, relief from the stay. As noted below, the trustee or debtor-in-possession may use the secured creditor's collateral (other than cash collateral) without the consent of the creditors, thereby placing the burden on the secured creditor to make a motion to protect its security interest. As a practical matter, parties often negotiate a stipulation providing for adequate protection rather than leaving the matter to the discretion of the bankruptcy court.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

As stated above, a trustee or debtor in possession may generally use property subject to a security interest or lien without the consent of the creditor. Moreover, it is the obligation of the secured creditor to monitor its collateral and to seek adequate protection to preserve the value of its secured claim if the creditor believes that the value of its collateral is declining below the amount of its claim during the pendency of the case. If the debtor is unable or unwilling to provide adequate protection of the secured creditor's interest in the collateral, the automatic stay may be lifted in order to permit the creditor to foreclose on its collateral.

The Bankruptcy Code also authorises a debtor to sell collateral free and clear of an interest (including a security interest or lien) of an entity if:

- applicable non-bankruptcy law would permit a sale of such property free of the interest;
- the interested entity consents;
- the interest is a lien, and the sale price is greater than the aggregate value of all liens on such property;
- the interest is in *bona fide* dispute; or
- the entity could be compelled in a legal or equitable proceeding to accept money satisfaction of such interest.

As this language is in the disjunctive, only one of these conditions needs to be satisfied for the sale to occur. Accordingly, the secured party's consent is not always required for the debtor to sell the collateral free and clear of its lien.

That said, there are other limits on a bankruptcy court's ability to authorise a sale of collateral free and clear of a secured party's liens. For example, the court may not authorise a sale free and clear where the property is not property of the estate. In other words, if the estate's ownership of the property is disputed, the ownership dispute must be resolved before the sale can proceed. Additionally, a debtor is prohibited from pursuing a sale that would accomplish what should be accomplished under a plan (i.e. effectuating what is called a *sub rosa* plan) by selling liened assets free and clear of the liens to a new entity and distributing the new entity's securities to the former lienholders.[1]

Cash collateral is the exception to the rule that a debtor may continue to use a secured creditor's collateral during the course of a bankruptcy proceeding without the consent of the creditor with a security interest in the collateral. The Bankruptcy Code defines cash collateral as cash, negotiable instruments, documents of title, securities, deposit accounts or other cash equivalents whenever acquired. It also includes all proceeds, products, offspring, rents or profits of property subject to a security interest existing before or after the petition date. Cash collateral may only be used: (a) when each entity with an interest in the cash collateral consents to its use; or (b) with court authorisation after notice and hearing appropriate to the circumstances. Debtors and creditors with a security interest in cash, inventory and receivables ordinarily agree to a consensual use of cash collateral because, from the debtor's perspective, such agreements help ensure a smooth transition into bankruptcy, and, from the creditor's perspective, the creditors are ordinarily able to negotiate enhanced financial reporting and other protections that

[1] However, in In re Gen Motors Corp, 407 BR 463 (Bankr SDNY 2009), the court approved the sale of substantially all of the debtors' assets to a new entity that was owned by General Motors' creditors, including holders of secured pre-petition and post-petition claims. These secured creditors received common stock in "New" General Motors in exchange for the assignment to the purchaser of their rights to credit bid their secured claims. The court approved the sale notwithstanding a sub rosa plan objection and noted that "it is now well established that a chapter 11 debtor may sell all or substantially all its assets pursuant to section 363(b) prior to confirmation of a chapter 11 plan, when the court finds a good business reason for doing so.": ibid at 491.

generally are available where a court authorised the use of cash collateral over a secured creditor's objection.

If the trustee or debtor-in-possession is unable to obtain unsecured credit for operation during the Chapter 11 case, the court, after notice and a hearing, may authorise the trustee to obtain credit or incur debt: (a) with priority over other administrative expenses (a so-called super priority claim); (b) secured by a lien on unencumbered property of the estate; or (c) secured by a junior lien on property of the estate that is already subject to a lien. The court may also authorise the trustee to obtain credit or incur debt secured by a senior or equal lien on property of the estate that is already subject to a lien. However, the court may only authorise granting such a lien (a priming lien) if (i) the trustee is unable to obtain such credit otherwise and (ii) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is to be granted.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

In the United States, there is no pre-insolvency proceeding.

In an insolvency proceeding, liens on a secured creditor's collateral may be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor. Under US law-governed secured loan facilities, it is typical for a borrower to agree not to encumber its property with any third-party lien other than those specifically agreed in the applicable financing documents. Notwithstanding such contractual obligations, the Bankruptcy Code authorises a debtor to obtain new third-party financing secured by a lien that is junior, equal or superior to existing liens on a pre-existing lender's collateral. However, a bankruptcy court will only authorise a debtor to grant a lien that is superior to existing liens – known as a "priming lien" – if the debtor is unable to obtain credit any other way, and if there is a sufficient "equity cushion" in the collateral such that the pre-existing lien will be "adequately protected".

14. What distribution will a secured creditor receive if a company is reorganised?

If a company is reorganised under Chapter 11 of the Bankruptcy Code, a secured creditor will generally receive a distribution with a present value equal to the value of the collateral securing its claim. To the extent that the secured creditor's claim exceeds the value of the collateral securing the claim, such creditor will receive an additional distribution as an unsecured creditor. This is because the Bankruptcy Code generally bifurcates the claim of a secured creditor whose claim exceeds the value of its interest in collateral into two distinct claims: a secured claim equal to the value of the secured creditor's interest in the collateral securing the claim and an unsecured claim for the balance. The amount of the claim in excess of the value of the collateral is generally called the "deficiency claim". However, the Bankruptcy Code permits the secured creditor to elect (the so-called section 1111(b) election) to receive deferred cash payments equal to the total amount of its claim (including the unsecured portion), although in such case the present value of such deferred cash payments will equal only the value of the collateral securing the claim and the secured creditor will be required to forego any distribution on its deficiency claim.

Assuming that a Chapter 11 plan of reorganisation is otherwise in compliance with the Bankruptcy Code and applicable law, the bankruptcy court will approve the plan on a consensual basis upon acceptance by the holders of two-thirds in amount and more than one-half in number of claims in each class voting on the plan. Acceptance of the plan by the requisite majorities will bind the non-accepting members of the class. Typically, each secured creditor is classified separately with respect to its secured claim (unless two or more secured creditors share the same collateral, in which case they are classified in the same class).

However, the acceptance by each class of claims is not the only means for the confirmation of a plan. Under section 1129(b) of the Bankruptcy Code, the court may also approve the cram-down of a particular class of creditors over their objection, if, among other things: (a) at least one impaired class of claims (excluding the claims of any insiders in the class) has accepted it; and (b) the plan "does not discriminate unfairly" against and is "fair and equitable" to each rejecting class. These cram-down provisions essentially permit the debtor to force a restructured obligation upon a secured creditor under the plan.

A plan does not discriminate unfairly within the meaning of the Bankruptcy Code if a rejecting impaired class is treated equally with respect to other classes of equal rank. A plan is "fair and equitable" as to a class of *secured* claims that rejects such a plan if, among other things, the plan provides:

(a) (i) that the holders of claims in the rejecting class retain the liens securing their claims, whether the property subject to those liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims, and (ii) that each holder of a claim of such class receives on account of that claim deferred cash payments equal to the present value of the holder's interest in the estate's interest in such property; or

(b) for the sale of any property that is subject to the liens securing the claims included in the rejecting class, free and clear of the liens, with the liens to attach to the proceeds of the sale, and the liens on proceeds to be treated under clause (a) above or (c) below; or

(c) for the realisation by such holders of the indubitable equivalent of such claims, such as the return to the secured creditor of the collateral.

In practice, these requirements have generally been understood to mean that a plan must provide for payment of the allowed amount of the secured claim together plus interest. However, the method for deriving the appropriate cram-down interest rate is not statutory and is subject to case law that is not uniform. In the context of a Chapter 13 plan (which provides for the repayment of debts by a wage earner), the Supreme Court has addressed the interest rate required to provide secured creditors with such value. However, to date, the applicability of the Supreme Court's decision (applying a formula for adjusting the national prime rate based on the risk of non-payment) to a Chapter 11 plan of reorganisation remains somewhat unsettled.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

Unless otherwise provided for in the plan or order of confirmation, the confirmation of a plan revests all the property of the estate in the debtor, which property is free and clear of all claims and interests. As discussed above in section 14, a plan may provide for (a) the retention of liens, (b) the sale of the property subject to the lien, or (c) the indubitable equivalent of such lien.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

Claims under the Bankruptcy Code are initially divided into two categories: secured claims and unsecured claims. Allowed secured claims, to the extent of the value of the collateral, are satisfied before unsecured claims. An allowed secured claim is (a) an allowed claim, (b) secured by a lien, (c) on property in which the estate has an interest. The claim is secured to the extent of the value of the creditor's interest in the debtor's interest in the property. Alternatively, if there is a right to a setoff, the amount subject to setoff is treated generally as if it were a secured claim. An unsecured claim is one for which the creditor has not obtained a security interest to protect against default on the underlying obligation or for which the value of the collateral is less than the amount of the claim (the latter being the so-called deficiency claim). See discussion of the bifurcation of secured claims in section 14 above.

If the collateral has a value greater than the allowed claim, the creditor is over-secured. In this situation, the creditor will be allowed post-petition interest and reasonable fees and costs to the extent agreed in the applicable finance documents as part of its secured claim. If the collateral's value is less than the allowed amount of the secured creditor's claim, the creditor is under-secured, and the portion of the claim that is not secured will be treated as an unsecured claim. Unlike secured creditors, unsecured creditors of an insolvent debtor are not entitled to post-petition interest and fees, regardless of what the applicable documentation provides.

Valuation is important for the determination of secured status. A claim can only be secured to the extent of the estate's interest in the collateral and to the extent of the creditor's interest in the estate's interest. As a result, valuation of these interests directly affects the secured status of a claim. Additionally, valuation is of great importance in determining whether adequate protection is required.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

Yes. US courts will respect and give full force and effect to a foreign restructuring of contractual arrangements governed by US law, provided certain requirements are met.

Generally speaking, US courts will defer to foreign insolvency proceedings as a matter of international comity so long as those proceedings are procedurally fair and do not contravene the laws or public policy of the United States (see *JP Morgan Chase Bank v Altos Hornos de Mexico, SA de CV*, 412 F 3d 418, 424 (2d Cir 2005)). US courts favour granting comity to foreign insolvency proceedings under the principle that the equitable and orderly distribution of a debtor's property generally requires assembling all claims against such property in a single proceeding (see ibid; and *In re Schimmelpenninck*, 183 F 3d 347, 365 (5th Cir 1999)). Such reasoning dates to at least 1883, when the US Supreme Court considered a challenge to a Canadian scheme of arrangement in respect of US dollar-denominated bonds payable in New York (see *Canada Southern Ry Co v Gebhard*, 109 US 527 (1883)). In that case, the US Supreme Court found that the Canadian scheme comported with the spirit of US bankruptcy laws and did not conflict with the US Constitution (ibid at 539). Observing no procedural deficiencies in the Canadian proceedings, the court held that "international comity requires that schemes of this character, legalised at home, should be recognised in other countries" (ibid at 539).

Presently and mechanically, a foreign debtor seeking recognition and enforcement of a foreign restructuring must first file proceedings under Chapter 15 of the US Bankruptcy Code. Under Chapter 15, a foreign representative of the foreign debtor must file a petition seeking recognition of the foreign insolvency proceeding as either a "foreign main proceeding" or a "foreign nonmain proceeding" (15 United States Code (USC) § 1517). A foreign main proceeding is one "pending in the country where the debtor has the center of its main interests", and a foreign nonmain proceeding is one pending in a country where the debtor "carries out a nontransitory economic activity" (15 USC § 1502). Subject to certain other sections of Chapter 15 and other sections of the Bankruptcy Code (e.g. the section 109(a) debtor eligibility requirements, the section 1506 public policy exception and the Section 1515 application requirements), the bankruptcy court, upon receiving a petition for recognition, then holds a hearing and subsequently either grants or denies recognition (15 USC § 1507; see generally *In re Ocean Rig UDW Inc*, 570 BR 687 (Bankr SDNY 2017) (outlining requirements for debtor eligibility and recognition under Chapter 15 in greater detail; analysing factors courts consider in determining a debtor's centre of main interests; summarising evidentiary hearing on question of recognition).

If the court grants recognition as a foreign main proceeding, then Chapter 15 provides for certain mandatory relief for the foreign debtor within the territorial jurisdiction of the United States, including the automatic stay (11 USC § 1520). If the court grants recognition as either a foreign main proceeding or foreign nonmain proceeding, then the court may grant other discretionary relief, including certain relief available to a trustee under the Bankruptcy Code (11 USC § 1521). After recognition is granted, a foreign representative may move the bankruptcy court for specific relief, including for an order giving full force and effect to the foreign restructuring plan or scheme within the territorial jurisdiction of the United States, pursuant to various other sections of the Bankruptcy Code (see e.g. 11 USC §§ 105(a), 1507, 1509(b)(2)–(3), 1517(d), 1521(a), 1525(a)).

The recent case of *In re Agrokor dd* (591 BR 163 (Bankr SDNY 2018)) is illustrative. In that case, the foreign representative of Croatian debtors filed Chapter 15 cases in the US Bankruptcy Court for the Southern District of New York, seeking recognition of Croatian insolvency proceedings and enforcement of a restructuring plan (referred to as a settlement agreement) reached in those proceedings within the territorial jurisdiction of the United States (ibid at 165). The debt that was restructured in the Croatian proceedings included EUR625 million in unsecured notes governed by New York law, as well as significant sums in liabilities governed by English law (ibid at 171). The *Agrokor* court first held that the Croatian proceedings qualified as foreign main proceedings under Chapter 15 (ibid at 166). Then, in deciding whether to enforce the Croatian settlement agreement, the court considered whether the Croatian proceedings were procedurally fair and whether the agreement itself contravened the laws or public policy of the United States (ibid at 184). The court analysed procedural fairness pursuant to the following "non-exclusive" eight factors:

- whether creditors of the same class are treated equally in the distribution of assets;
- whether the liquidators are considered fiduciaries and are held accountable to the court;
- whether creditors have the rights to submit claims which, if denied, can be submitted to a bankruptcy court for adjudication;
- whether the liquidators are required to give notice to potential claimants;
- whether there are provisions for creditors meetings;
- whether a foreign country's insolvency laws favour its own citizens;
- whether all assets are marshalled before one body for centralised distribution; and
- whether there are provisions for an automatic stay and for the lifting of such stays to facilitate the centralisation of claims (ibid at 190, quoting *Finanz AG Zurich v. Banco Economico SA*, 192 F 3d 249, 249 (2d Cir 1999)).

Upon finding that seven of these factors were satisfied based on record evidence, the court concluded that the Croatian proceedings were procedurally fair (ibid). The court also determined that no aspect of the settlement agreement contravened US law or public policy, notwithstanding the fact that the agreement contained certain third-party releases that a US bankruptcy court may not have permitted in a plenary bankruptcy proceeding under Chapter 11 of the US Bankruptcy Code (ibid at 189) (relying upon a separate case in which the court found that "even if the law in the U.S. may have provided differing results, this alone did not prevent a recognition of a [foreign] plan under broader principals of comity"; *see also In re Rede Energia, SA* (515 BR 69, 91 (Bankr SDNY 2014): noting the "well-established principle that the relief granted in a foreign proceeding and the relief available in the United States do not need to be identical"). Thus, even though the Croatian settlement agreement modified New York law-governed debt, the court recognised and enforced the agreement within the territorial jurisdiction of the United States, subject only to the final approval of the agreement in the Croatian courts where certain appeals had been lodged (*Agrokor*, 591 BR at 192, 197).

The *Agrokor* decision is also notable for its express rejection of the "*Gibbs* rule" under English law, which provides that, if a contract is made in England and meant to be performed in England, a breach of such contract should be determined by the laws in England rather than discharged in a foreign insolvency proceeding (ibid at 192). The *Agrokor* court noted the "clear territorial slant of the *Gibbs* rule" and observed that the rule is in tension with long-settled US precedent, grounded in universalism principles, permitting foreign bankruptcy proceedings to bind US creditors "even where[, for example,] the debtor entered into a contract governed by New York law and agreed to a New York forum selection clause" (ibid at 196). Referencing the English High Court's recent reaffirmation of the *Gibbs* rule in *Bakshiyeva v Sberbank of Russia, et al* ([2018] EWHC 59 (Ch)), the *Agrokor* court further held:

> "[t]he fact that England applies the *Gibbs* rule and refuses to recognize a discharge or modification of English law debt approved by a court outside of England is not … a basis for this Court to decline to recognize and enforce the [Croatian] Settlement Agreement within the territorial jurisdiction of the United States" (ibid at 192–194).

The case of *In re Vitro SAB de CV* (701 F 3d 1031 (5th Cir 2012)) provides a contrasting example. In that case, Mexican debtors restructured notes governed by New York Law in a Mexican Concurso proceeding and sought recognition and enforcement of the resulting plan of reorganisation through US Chapter 15 proceedings (ibid at 1037–1038). The Concurso plan provided non-consensual releases to non-debtor guarantors, which, as discussed above, are not permitted in many jurisdictions within the United States (ibid at 1068). Unlike in *Agrokor*, however, the Concurso plan also created a single class of unsecured creditors, and the necessary votes to approve the plan were achieved only by counting the votes of insiders holding intercompany debt (ibid at 1068–1069). Although the *Vitro* court acknowledged much of the same precedent that the *Agrokor* court relied upon, it held that the facts before it were distinguishable given that the plan resulted from insider votes (ibid at 1068). Indeed, such a result would not be achievable under US bankruptcy law, which as noted above in section 4, does not count insider votes for purposes of determining whether a proposed plan meets the statutory requirement that at least one class of impaired claims has voted in favour of the plan (11 USC § 1129(a)(10)). The *Vitro* court thus rejected enforcement of the Concurso plan, refusing to "let[] one discrepancy between [United States] law and that of Mexico (approval of a reorganization plan by insider votes over objections of creditors) make up for another (the discharge of non-debtor guarantors)" (ibid at 1067). Significantly, however, and in keeping with other well-established US precedent, the court did not deny enforcement on the grounds that the Concurso plan modified US law-governed debt. Rather, the denial was grounded in other substantive aspects of the plan itself and the process employed to arrive at the plan.

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Finnish Insolvency Law Association
Ghana Association of Restructuring and Insolvency Advisors
Hong Kong Institute of Certified Public Accountants (Restructuring and Insolvency Faculty)
INSOL Europe
INSOL India
Insolvency Practitioners Association of Malaysia
Insolvency Practitioners Association of Singapore
Instituto Brasileiro de Estudos de Recuperação de Empresas
Instituto Iberoamericano de Derecho Concursal
Instituto Iberoamericano de Derecho Concursal – Capitulo Colombiano
International Association of Insurance Receivers
International Women's Insolvency and Restructuring Confederation
Japanese Federation of Insolvency Professionals
Korean Restructuring and Insolvency Practitioners Association
Law Council of Australia (Business Law Section)
Malaysian Institute of Accountants
Malaysian Institute of Certified Public Accountants
National Association of Federal Equity Receivers
NIVD – Neue Insolvenzverwaltervereinigung Deutschlands e.V.
Recovery and Insolvency Specialists Association (BVI) Ltd
Recovery and Insolvency Specialists Association (Cayman) Ltd
Restructuring and Insolvency Specialists Association (Bahamas)
Restructuring and Insolvency Specialists Association of Bermuda
Restructuring Insolvency & Turnaround Association of New Zealand
South African Restructuring and Insolvency Practitioners Association
Turnaround Management Association (INSOL Special Interest Group)
Turnaround Management Association Brasil (TMA Brasil)

INSOL INTERNATIONAL

INSOL International, 6-7 Queen Street, London, EC4N 1SP
Tel: +44(0) 20 7248 3333 | Fax: +44(0) 20 7248 3384
www.insol.org