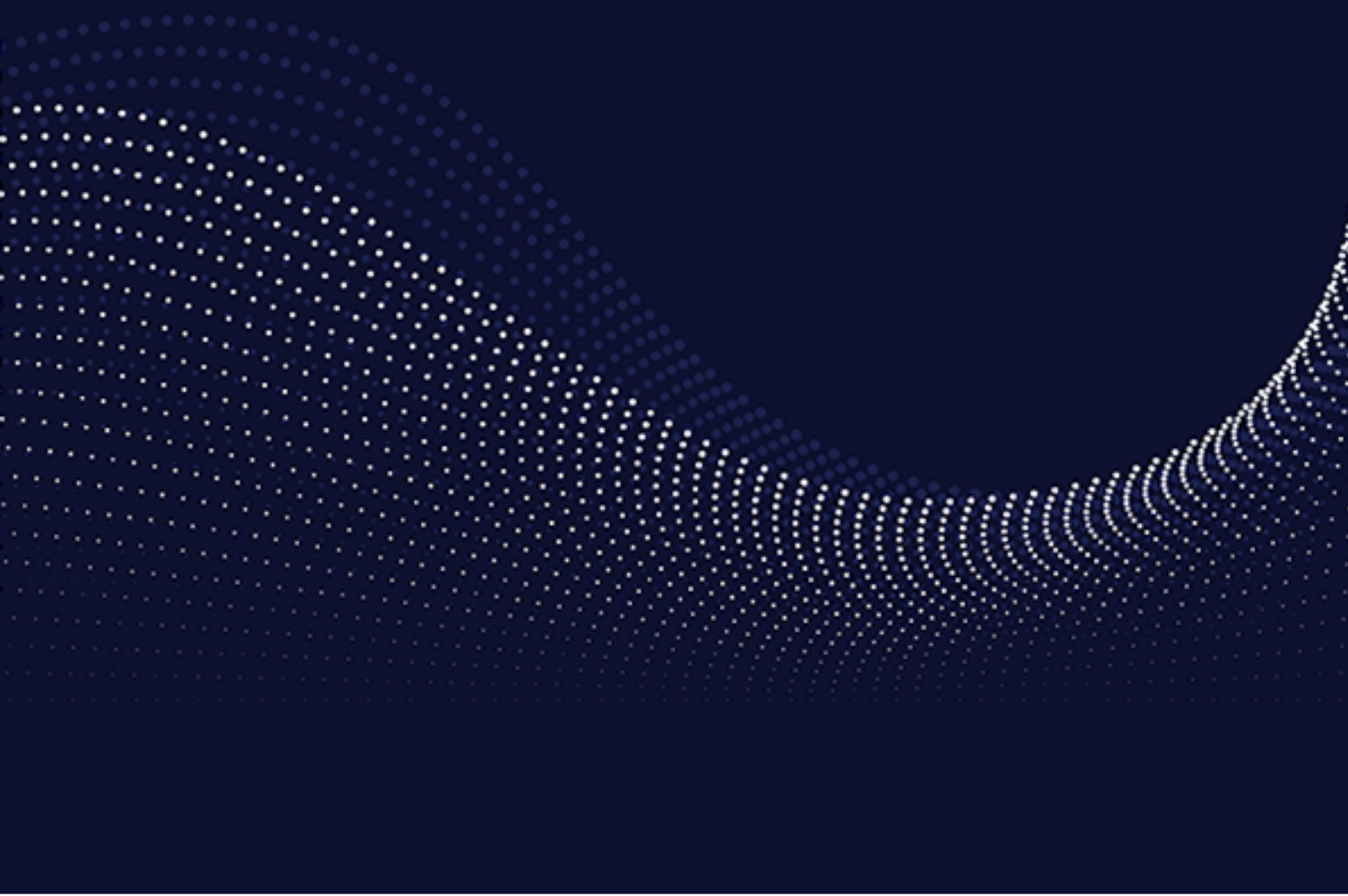


INSOLVENCY LITIGATION 2023



Insolvency Litigation 2023

Quick reference guide enabling side-by-side comparison of local insights, including into pre-litigation considerations; avoidance actions; claims against directors, officers and shareholders; creditor actions and strategic considerations; pre-insolvency debtor claims; other claims against creditors and debtors; cross-border considerations; remedies and enforcement; settlement and mediation; and recent trends.

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COMMENCING PROCEEDINGS

Litigation climate

- 1 | How would you describe the general climate surrounding insolvency litigation in your jurisdiction? What are the most common sources of dispute? To what extent is litigation used as a pressure or delay tactic?

Until recently, the French insolvency legal system – arguably one of the most debtor-friendly, with strong court control – was not particularly conducive to insolvency litigation, especially regarding challenging restructuring arrangements.

Most disputes historically related to protecting creditor rights (eg, pre-petition claim recognition, proprietary asset recovery, executory contract termination and contract interpretation) or preserving the debtor's estate (eg, fraudulent transfer avoidance and liability claims against directors – including de facto directors – or shareholders).

Disputes about restructuring plans were infrequent and rarely successful, particularly because of creditors' limited causes of action, debtor companies' ability (irrespective of their size or the level of their difficulties until the 2021 Insolvency Law Reform) to term out all dissenting creditors and the insolvency law's paramount goals of ensuring continued business operations and preserving as many jobs as possible.

Nevertheless, a major recent legislation reform took effect to incorporate Directive (EU) 2019/1023 on preventive restructuring frameworks into French law and has significantly changed the insolvency litigation landscape. [Ordinance No. 2021-1193](#), dated 15 September 2021, is applicable to insolvency proceedings commenced as of 1 October 2021. This new system marks a fundamental change in French insolvency law by assigning a major role to subordination and valuation in determining the rights and treatment of creditors and equity holders of larger French companies in an insolvency. This shifts the balance of power in a restructuring and has already fuelled new litigation in which affected stakeholders challenged either how their rights were taken into account to set up the various classes of affected parties called to cast a vote on the restructuring plan or the restructuring plan's terms and the underlying value pursuant to which the plan was established, in the event of a cross-class cram down because the restructuring plan had not received sufficient support from all classes of affected parties.

For instance, the *Orpea* case (2023) illustrates this shift. In brief, the restructuring draft plan provided for debt (unsecured) to equity swaps (including claims held by shareholders), the restructuring of the group's financial secured loans, new secured financings, as well as new shareholders' equity investments. Litigation was brought to challenge the setting up of the classes of affected parties, the terms of the restructuring plan and the underlying value of the group (since the restructuring draft plan was adopted via the cross-class cram-down mechanism). To date, disputes arising from the group's valuation appraisals have been dismissed after the courts ruled that the specific conditions for the application of the cross-class cram-down mechanism were met. The challenge regarding the setting up of the classes of affected parties was partially successful, which resulted in a new class having to be set up to better take into account the rights of certain affected parties.



Sources of law

- 2 | What key sources of law form the basis of claims arising from insolvency? How does the insolvency regime interact with other laws?

Under French law, a specific legal regime may provide for a special set of rules that departs from the general regime, subject to public policy rules. French insolvency law's procedural aspects, for example, to a certain extent derogate from other areas of French law (eg, the automatic stay on pre-petition claims and enforcement actions, claim filing and recognition, organisational and majority rules applicable to creditors when voting on a restructuring plan and the grounds for avoidance actions).

However, liability claim actions stem from contract law, tort liability or general corporate law. For example, case law has derived asset shortfall liability claims against directors from traditional corporate mismanagement and the concept of corporate interest.

In general, insolvency-related liability claims must satisfy the three cumulative criteria of any civil liability suit: a tort, a loss and the direct cause of the loss being the tort.

Procedure

- 3 | What procedural rules govern insolvency litigation in your jurisdiction? What common procedural hurdles arise in practice?

Rules that govern ordinary civil procedure apply to insolvency proceedings, with three main differences that aim at reducing insolvency litigation's duration and volume in an effort to reduce the corresponding uncertainty.

First, the bar period within which a party must lodge a claim, whether it is an initial challenge to a decision or an appeal, is often shorter than in other civil or criminal litigation (in most cases, 10 days). The 2021 Insolvency Law Reform goes a step further by providing for the full judicial resolution of certain disputes ahead of the confirmation of the restructuring plan by the court. In the same spirit of limiting insolvency litigation, the reform also further limits which parties may bring certain legal actions (usually court-appointed insolvency practitioners or parties involved in the restructuring process).

Second, the supervisory judge acts as the gatekeeper for most insolvency litigation by being its first jurisdictional body.

Third, the supervisory judge and the insolvency court can be amenable to settling insolvency-related litigation, the supervisory judge having exclusive power to authorise important settlements with the insolvent company, some of which also require insolvency court ratification. The main procedural hurdle is the time required for the court of appeal to hand down a decision on appeal. This is relevant because, with respect to insolvency litigation, the supervisory judge is often the first to decide an issue; their decision is subject to challenge before the insolvency court, and the insolvency court's decision is appealable before the court of appeal.



In practice, insolvency courts tend to confirm supervisory judges' orders; therefore, most litigants expect to have to escalate to the court of appeal to challenge a supervisory judge's decision effectively.

Courts

4 | Which courts hear insolvency claims? How experienced are they with insolvency litigation?

The commercial courts, composed of non-professional judges (as opposed to the professional magistrates who sit in the civil and criminal courts, including at the appeal level), hear commercial disputes, commence insolvency proceedings involving commercial companies and hear all insolvency-related claims. Commercial court judges are usually peer-elected former or current company managers, entrepreneurs or independent professionals whose background positions them to understand financial and operational difficulties. They are experienced in handling all types of insolvency-related litigation.

The court that has jurisdiction over a company's insolvency proceedings depends on the location of the company's registered office; however, if the debtor company is considered to be large (in terms of employees and turnover) or is a subsidiary of a large group, specialised commercial courts with experience handling complex insolvency matters have jurisdiction to open insolvency proceedings and hear related litigation.

Jurisdiction

5 | Through what law do the relevant courts have jurisdiction to hear insolvency claims? Does jurisdiction differ for domestic and cross-border matters?

Under French law, statute determines each court's subject matter and territorial jurisdiction. Jurisdiction does not differ for domestic and cross-border matters, subject to considerations regarding the centre of main interests (COMI) under Regulation (EU) 2015/848 dated 20 May 2015.

EU insolvency law provides that the courts of the member state in which a debtor's COMI exists have jurisdiction to commence main insolvency proceedings relating to that debtor. Consequently, French courts may have jurisdiction over main insolvency proceedings commenced in respect of a foreign debtor that has its COMI in France and deal with insolvency claims related to its estate, subject to exceptions and limitations under the EU insolvency regulation (especially relating to assets located outside France that are governed by the *lex rei sitae*). Contractual governing laws may also limit French courts' jurisdiction in certain circumstances.

Limitation periods

6 | What limitation periods apply to bringing insolvency-related claims? Are there any notable exceptions?



Although debtor companies must list their various debts towards their creditors, creditors (excluding employees) have the option (which is recommended in practice) to duly file proof of prepetition claims within two months of the opening judgment's publication in a French official legal gazette. This period extends to four months for creditors located outside metropolitan France.

A creditor that retains title to assert ownership of assets in a debtor's possession must initiate recovery actions within three months of the publication of the judgment opening insolvency proceedings in a French official legal gazette.

Liability claims for asset shortfall are time-barred at the end of a three-year period that starts to run when liquidation proceedings end.

Apart from the aforementioned main categories of actions, parties must bring most litigation claims and legal challenges (especially against court decisions) quickly for efficiency purposes, usually within a 10-day period (with other non-notable exceptions).

Interim remedies

7 | What interim remedies are generally available and commonly deployed in insolvency proceedings? How are these used as part of claimants' overall litigation strategy?

As in several other jurisdictions, French insolvency law provides for a built-in interim remedy for debtors' benefit in the form of an automatic stay that applies upon the commencement of insolvency proceedings. The automatic stay prohibits the debtor from paying prepetition claims and creditors from enforcing security interests from the commencement of insolvency proceedings (subject to certain exceptions, such as the set-off of related mutual claims).

Conversely, in certain circumstances, creditors may access some relief. For example, the supervisory judge (or the court) may specifically authorise a debtor to pay a creditor despite the automatic stay in order to secure the surrender (ie, when the debtor is not in possession of the asset) of an asset that is necessary to operate the business as a going concern and pledged, is in a creditor's possession or has been placed in a trust. More specifically, protective interim measures are available:

- in the context of a request to extend the scope of insolvency proceedings to a third party (when two companies' estates cannot be separated or in the presence of shell companies), to seize, on an interim basis pending the action's resolution, the natural or legal persons' assets against which this extension is sought; and
- in reorganisation proceedings against the assets of directors who face a liability claim on the grounds that they contributed to causing the insolvency; the court, on its own initiative or at the request of the party that brought the asset shortfall claim, may renew those measures in liquidation proceedings if a liability claim for asset shortfall is brought.

More generally, the debtor may use interim procedures, and the court may order interim measures when a situation's urgency justifies it. For instance, the French retail group



Camaïeu petitioned for interim measures in 2019 to protect itself when it faced the risk of its secured creditors enforcing a *fiducie* (the French equivalent of a trust) after the commencement of safeguard proceedings.

Evidence

- 8 | What rules and procedures govern the collection and admissibility of evidence in insolvency litigation? To what extent is expert witness testimony allowed? What common evidential issues should claimants be aware of?

French civil procedure governs evidence collection and admissibility in the context of insolvency litigation, with no derogation or specific rules linked to insolvency-related claims. Owing to insolvency law's complexity and specificity, courts frequently use expert opinions from academics, lawyers and other insolvency practitioners, especially regarding a specific rule of law's interpretation.

Expert reports and various types of expertise also prove to be extremely useful in the context of litigation against a restructuring plan (eg, to challenge its fairness). In addition, and pursuant to the 2021 Insolvency Law Reform, the courts may now, in the context of challenges, order a financial expert to determine the debtor company's value to appreciate whether a certain class of stakeholders is 'in the money' or, to a certain extent, whether the plan complied with the 'best interest' test in respect of certain dissenting affected parties. For instance, in the aforementioned *Orpea* case (2023), as part of the accelerated safeguard proceedings, an independent financial expert was appointed and had to determine the valuation of the group as a going concern and the valuation of the group in a liquidation scenario. The corresponding valuation reports were used by the Commercial Court of Paris to dismiss challenges raised against the restructuring plan's terms and to rule that all conditions were met for the cross-class cram-down to be implemented.

The main issue for creditors is that it is very difficult for them to obtain information on the company in insolvency because French insolvency proceedings do not organise information rights for creditors post-petition.

Time frame

- 9 | What is the typical time frame for insolvency claims?

There is no typical time frame for insolvency claims under French insolvency law except for fixed-in-advance periods to introduce challenges, especially the general 10-day period to challenge a court decision or supervisory judge's order and several typical challenges other than to restructuring plans. This is the case, for instance, for proofs of claims (two months) and recovery actions (three months). Courts of appeal must also follow an expedited process to a certain extent and issue their rulings within four months.

The length of litigation proceedings should not be detrimental to the business or a restructuring solution's successful implementation; therefore, for specific legal actions, the

legislature sets short deadlines to avoid delaying the quick adoption of a restructuring solution. For example, pursuant to the 2021 Insolvency Law Reform, stakeholders challenging voting rights or class formation or, at a later stage and provided that they had voted against the draft restructuring plan, challenging the plan's terms on the basis of non-compliance with various tests linked to business valuation (mainly the 'best interest' test and the 'absolute priority' rule) may do so, but the court will hear those challenges before it examines the restructuring plan and within shorter periods than the standard civil procedure rules provide. The appeal on an insolvency court decision adopting the plan is subject to an expedited appeal process (four months).

Appeals

10 | What are the requirements to appeal insolvency-related judgments? What is the typical time frame for appeals?

Efficient restructuring solutions require as little uncertainty as possible. For this reason, appeal periods for supervisory judge's decisions or court decisions are often limited to 10 calendar days, usually starting from the challenging party's notification of the decision.

The limited availability of legal challenges appears key in avoiding disproportionate disruption and creating a stable environment to restructure a struggling company's business. The subsequent termination of a restructuring plan that would have been implemented pending a court decision would have severe consequences on the business and the employees.

For example, French law favours anticipated challenges and limits parties' ability to challenge a plan once a court confirms it to prevent such detrimental consequences. As another example, an unsuccessful bidder for a business in an insolvency sale may not challenge the court decision deciding the sale; only the winning bidder may challenge that decision, and only if it modified the scope of its bid, in addition to the debtor, the judicial administrator, the creditor's representative and the public prosecutor.

Insolvency law enables fast-track appeals, which, in some cases (especially regarding asset sale and restructuring plans), must be resolved within four months.

Finally, a specific challenge process, the *tierce opposition*, is available to third parties in certain circumstances to challenge the commencement of insolvency proceedings or court decisions; however, it is difficult to justify and rarely successful. *Tierce opposition* to a decision that commences insolvency proceedings is only available to creditors who were not parties or deemed to be represented for the purpose of the decision and who can establish that they have a personal interest that is distinct from that of the other creditors.

Although minority creditors regularly attempt to obtain reversals of decisions that commence insolvency proceedings via *tierce opposition*, case law almost systematically rejects those challenges, possibly because of the negative effects that those reversals would have on the continuation of the debtor's activity and chances of recovery.

Costs and litigation funding



- 11** | How are costs handled and how are claims funded? Can claimants obtain third-party funding to finance the prosecution of claims?

Under French civil procedure, each party to a litigation bears its own costs. French insolvency law does not provide for any concept of third-party funding. As is the case in standard civil litigation, claimants may request the court to order the losing party to reimburse the costs that the successful party incurred; however, such requests are not common practice, given the low likelihood of payment.

AVOIDANCE ACTIONS

Fraudulent transfers and undervalue transactions

- 12** | What are the essential elements of avoidance actions seeking to claw back fraudulent conveyances and transfers? Can actions be brought for transfers without fraudulent intent based on undervalue of the transfer?

Under judicial reorganisation and judicial liquidation proceedings, court-appointed insolvency practitioners and the public prosecutor may challenge, and courts may then void, any transaction into which the insolvent debtor entered, as well as certain payments or transfers of rights over assets that the insolvent debtor made during the clawback period.

The clawback period begins on the date the company actually became insolvent within the meaning of French insolvency law (ie, became unable to pay its liabilities that were due and payable with its available assets) – in other words, the date of cessation of payments – and ends on the date of the judgment commencing the proceedings. The court may backdate the insolvency date by up to 18 months before the judgment commencing insolvency proceedings, except where a court decision confirms a conciliation agreement (homologation) before the insolvency proceedings commence, in which case the insolvency date cannot be backdated to a date prior to the homologation judgment.

French law provides for a distinction between automatically void and voidable transactions. Automatically void transactions are listed by statute and include the transfer of movable or immovable assets without consideration, disproportionate agreements in which the debtor's obligations materially exceed those of the other party, payments in any form relating to debts that have not fallen due or made by unusual means, encumbrances perfected over the debtor's assets to secure pre-existing debts, and precautionary and protective measures, subject to certain specific conditions. The law does not require demonstration of the contracting party's or debtor's fraudulent intent.

Voidable transactions include payments relating to debts that have fallen due or agreements entered into for consideration, provided that the contracting party initiated or entered into the transaction knowing that the company was insolvent.

The insolvency court must issue a decision declaring the transaction void. It has discretion to do so in respect of the voidable transactions, but not in respect of transactions that are automatically void.

Clawback avoidances aim to return assets to the debtor's estate that were encumbered, disposed of or sold when the debtor company was already insolvent.



Preference and improvement of position

- 13** | What are the essential elements of avoidance actions seeking to claw back transactions and payments based on preference and improvement of position shortly before insolvency proceedings?

The regime applicable to the clawback of transactions and payments is the same as the one applicable to the clawback of fraudulent conveyances and transfers.

Liens and floating charges

- 14** | What are the essential elements of actions for the avoidance of liens and floating charges on subsequently acquired property?

French law has no equivalent to many common law jurisdictions' floating charge securities. With regard to French law liens in general, no security interest may be perfected after the commencement of insolvency proceedings (subject to specific exceptions), and the 2021 Insolvency Law Reform now prohibits the top-up of security interests post-petition (with the exception of the specific *Dailly* assignment of professional receivables).

The key issues regarding the avoidance of security rights relate to encumbrances perfected after the company ceased payments (ie, became unable to pay its debts that are due and payable out of available assets) to secure:

- pre-existing obligations, which the insolvency court must declare void; or
- new and simultaneous obligations to the extent that the other party knew of the debtor's insolvency, which the insolvency court may void.

Process and resolution of avoidance actions

- 15** | Through what process are avoidance actions litigated? What procedural issues often arise and how are avoidance actions usually resolved?

The court that commences insolvency proceedings has exclusive jurisdiction avoidance actions, which may only be exercised by the judicial administrator, the judicial agent (ie, the creditor representative), the insolvency practitioner appointed to supervise the restructuring plan's implementation or the public prosecutor. There is no noteworthy procedural hurdle to resolving avoidance actions.

CLAIMS AGAINST DIRECTORS, OFFICERS AND SHAREHOLDERS

Breach of fiduciary duty

- 16** |

What are the essential elements of a claim for breach of fiduciary duty against directors and officers in the context of corporate insolvency?

Directors and officers may be held liable, based on mismanagement, for all or part of the debtor's outstanding debts in judicial liquidation proceedings (liability claims for asset shortfall). A similar type of liability claim also exists under judicial reorganisation proceedings (liability claims for contribution to insolvency). It allows the judicial administrator or the creditor representative to request that the court order interim protective measures on the directors' and officers' assets.

For a liability claim for asset shortfall to succeed, the claimant must establish the following elements:

- an act of mismanagement, which the court will assess as a question of fact; and
- a direct causal link between the mismanagement and the asset shortfall: the claimant need not prove a direct link between a specific act and the resulting damage or that the managers' act or omission is the asset shortfall's main or sole cause; it suffices for the managers' act or omission to be just one of the factors that contributed to the asset shortfall, and the claimants do not need to show that the managers intended to cause the insolvency.

This liability extends to both de jure directors and officers and de facto management (any individual or entity that is not officially a director or officer but has repeatedly, in fact, managed the company).

The judicial liquidator, the public prosecutor or the majority of the creditors acting as controllers in the insolvency proceedings (who can demand that the judicial liquidator commence proceedings if they have failed to do so) may bring a liability claim for asset shortfall. They must bring the claim within three years of the commencement of liquidation proceedings. The business's sale, therefore, does not prevent liability suits against management.

The court may sentence one manager or several managers collectively to pay damages equal to all or part of the asset shortfall.

Examples of director behaviour that would typically lead to a finding of liability include the following:

- carrying out loss-making operations while knowing that it would lead to insolvency;
- conducting the company's operations for personal benefit or using its assets as their own;
- using the debtor's assets or credit to their personal interest or favouring another entity in which they have a direct or indirect interest; and
- fraudulently misappropriating or concealing assets, or increasing the company's indebtedness

Individuals the court holds liable may be prohibited from managing a business for up to 15 years and holding a public office for up to five years.



Protection from liability

- 17 | To what extent does the law in your jurisdiction protect directors and officers from liability for decisions made in connection with the restructuring or insolvency?

Concepts such as the business judgment rule and the rejection of the deepening insolvency theory are unknown in France. France essentially focuses on directors' behaviour in the context of conducting the business and, in particular, whether they have acted in the corporate interest. Mismanagement in the form of mere negligence may not be used to attach liability to an insolvent company's directors.

Recourse to preventive restructuring processes, such as the court appointment of an ad hoc agent or a conciliator, may mitigate directors' and officers' liability. However, it does not constitute exoneration in itself.

Converting credit to equity

- 18 | Can credit extended by an insider or shareholder be recharacterised as equity? If so, what is the mechanism by which such an action is brought, and what elements are required to prevail?

Credit extended by an insider or shareholder may not be recharacterised as equity.

Illegal dividends

- 19 | Can dividends received by shareholders be prosecuted as illegal?

Distribution of dividends is governed by French corporate law, with no general principle prohibiting it in the context of insolvency proceedings; nevertheless, the decision to distribute dividends should not be made against the corporate interest of the company. This appears hard to justify in an insolvency scenario.

In the 2020 *Finadvance* case, the French Supreme Court confirmed that the management's decision to recommend to shareholders a dividend distribution to a parent company in a leveraged buyout structure may trigger the directors' liability for asset shortfall if the dividend distribution played a part in the company's subsequent judicial liquidation.

The main restrictions regarding the distribution of dividends come from French courts. Safeguard and reorganisation plans often prohibit dividend distribution for the duration of the plan or at least in the implementation's first years, as in the *Partouche* case (2014), in which the plan provided for the ability to distribute dividends to Partouche's controlling entity as of the fifth annuity and in the sole event that the latter needed those dividends to execute its own safeguard plan, subject to its proper execution.

Trading while insolvent



- 20** | How is trading while insolvent treated in your jurisdiction? If actionable, what mechanisms apply and what are the elements of a successful claim?

Trading is not directly or automatically prohibited or limited during insolvency, nor do the management's duties shift in the zone of insolvency. Before insolvency proceedings commence, directors should continue to act in the corporate interest (especially if the company is on the brink of insolvency, given management's increased liability exposure) and avoid operations or transactions that a court could later void.

Equitable subordination

- 21** | Is equitable subordination of shareholder claims allowed? If so, what requirements and mechanisms apply?

French law does not permit equitable subordination of shareholder claims.

Other claims

- 22** | Are any other claims commonly brought against shareholders, directors and officers in your jurisdiction? If so, what mechanisms are used to raise these claims and what elements are required to prevail?

Apart from criminal claims beyond this contribution's scope, no other claims are commonly brought against shareholders, directors or officers.

Shareholders have also historically faced claims that sought to hold them liable for the amounts due following an employee's termination. Initially, this litigation often stemmed from a finding that the shareholder was a co-employer of its subsidiary's employees; however, this finding has become harder since the French Supreme Court recently raised its requirements for co-employment characterisation: the parent company must now have permanently interfered in the management of the subsidiary to the point that the subsidiary entirely lost its autonomy.

Consequently, such litigation is now based on general tort law, which traditionally requires a person to indemnify another to whom they wrongfully inflicted a loss, provided that the wrongful act or omission directly caused the loss. For example, in the 2018 *Lee Cooper/Sun Capital Partners* case, the French Supreme Court held that, by causing its subsidiary to finance the group for amounts that were out of proportion with its financial means, the parent company had made decisions on the subsidiary's behalf that were contrary to its corporate interest, with such mismanagement leading to its judicial liquidation.

Risk mitigation

- 23** | How can shareholders and sponsors mitigate the risk that claims against them will be successful, and minimise the accompanying financial burden?



There are essentially two areas that may create litigation exposure for shareholders or sponsors:

- interference in the management; and
- support provided to the subsidiary.

Although non-interference in the management may seem simple in principle, it requires, in practice, a careful review of the decisions that require shareholder or sponsor approval to ensure that the subsidiary's management effectively makes independent management decisions.

Support that a shareholder or sponsor provides to a subsidiary is a delicate exercise as it requires striking a balance to provide neither too little nor too much, as either can result in liability. The support can either be granted to the subsidiary itself (eg, in the context of its annual account certification) or granted to third parties to satisfy the subsidiary's obligations (eg, comfort letter). In each case, the shareholder or sponsor must appropriately document the support and actively monitor the subsidiary's situation to act timely as provided therein.

The liability exposure risk increases if the debtor company requests shareholder or sponsor support at a time of financial distress without there being a pre-agreed framework for such support. Managing liability exposure under such circumstances requires that the shareholder or sponsor:

- request that the management provide, in as much detail as possible, a presentation of the difficulties, their causes and their remedies and, to the extent possible, obtain a third-party validation of the presentation; and
- request that the company consider appointing an ad hoc agent or conciliator (court-appointed officers to help the company solve its difficulties outside court-administered insolvency proceedings) if it appears that the situation will likely affect a significant portion of the company's stakeholders.

CREDITOR ACTIONS AND STRATEGIC CONSIDERATIONS

Contesting restructuring plans

- 24** | Can creditors bring actions contesting the restructuring plan? If so, what law governs such actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

The Insolvency Law Reform that came into force on 1 October 2021 has significantly changed the landscape.

Before this reform, creditors could contest a restructuring plan; however, those actions were rarely successful, particularly because there were very few rules that protected minority creditors' and other stakeholders' interests, as the 2017 CGG case illustrates.

As a result of the reform, the judicial administrator now consults stakeholders in classes of affected parties (compared with creditor committees previously). Non-compliance with the



new criteria for class formation and the new rules for plan adoption provide new grounds to challenge the restructuring plan the court adopts, which may include, in particular:

- the absence of verifiable objective criteria for class formation;
- the absence of a sufficient commonality of economic interest among members of the same class;
- the absence of equal treatment in proportion to their claim among members of the same class of creditors;
- the plan's failure to comply with the best interest test (ie, each creditor receives at least as much as it would have in a judicial liquidation, an asset sale plan or a better alternative); or
- if the affected parties adopt the plan via a cross-class cramdown;
 - a single class that was actually 'out of the money' based on a going-concern company valuation adopted the plan; or
 - the plan fails to comply with the absolute priority rule, which provides that no claims that rank lower than those of a dissenting class may receive anything unless the dissenting class receives payment in full.

Historically, the interests of the business and its employees were determining factors in resolving those actions; however, existing case law will likely be of limited use as a reference for how courts will resolve future actions contesting restructuring plans because those actions will fall under the new set of rules.

The *Orpea* case (2023) offers insight as to how shareholders and creditors may challenge the class formation. In this specific occurrence, the Versailles Court of Appeal ruled that unsecured creditors who also held secured debts, and unsecured creditors who did not, did not share a sufficient commonality of interest based on verifiable criteria. As a result, the class of unsecured creditors that initially included them both had to be divided into two separate classes of affected parties, one for each of them.

In addition, as mentioned before, expert's reports on the valuation of the group's as a going concern and in a liquidation scenario were the main basis on which the Paris Commercial Court confirmed that the conditions required to implement a cross-class cram-down (required for the plan to be approved) were met.

Winding-up petitions

- 25** | Do creditors apply for winding-up orders? If so, what law governs these actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

Any unpaid creditor may apply to the court to commence judicial reorganisation or liquidation proceedings against its debtor. The creditor must prove that the company has ceased payments (ie, that it cannot pay its liabilities that are due and payable out of its available assets) and, if the creditor seeks judicial liquidation proceedings, that restructuring the business would be impossible.



To make a successful defence, the debtor must prove that it has not ceased payments or that restructuring via judicial reorganisation proceedings is possible.

Social security and tax institutions usually bring those actions in particular circumstances, often leading to the company's liquidation.

Stays of proceedings – scope and exceptions

26 | Does the insolvency regime stay any creditor collection actions? If so, what are the parameters of such a stay? Are there any notable or commonly used exceptions?

Creditor collection actions are stayed for the proceedings' duration, more specifically:

- up to four months under accelerated safeguard proceedings;
- up to 12 months under safeguard proceedings; and
- up to 18 months under judicial reorganisation proceedings.

The stay protects the company against which the court commenced proceedings from creditor collection or enforcement action regarding the company's obligations or any security interest that the company granted of its or third-party obligations. It also protects the debtor's guarantors (other than corporate guarantors).

There are a few exceptions to the prohibition of payment of pre-petition claims:

- payment by way of set-off of mutual claims, provided that those claims are sufficiently connected; and
- payment that the supervisory judge authorises in the interest of the business's continued operation to:
 - secure the release (ie, when the debtor is not in possession) of an asset pledged to or held (including in trust) by a third party or of a debtor-held asset to which the seller retains title;
 - recover goods or rights transferred into a trust estate; or
 - enable the debtor's exercise of a purchase option regarding assets under a finance lease.

In addition, the court may impose the continuation of executory contracts in safeguard, judicial reorganisation and – during the period when the court orders the continued operation of the business – judicial liquidation proceedings to protect the debtor's ability, despite clauses triggering a termination owing to the commencement of insolvency proceedings (ipso facto clauses, which are unenforceable under French law) or the default of a payment before the commencement of the proceedings. After the commencement of the insolvency proceedings, the debtor must pay amounts due under such continued contracts on their due date.



Stays of proceedings – strategy

27 | How do creditors navigate stays in practice? How do stays generally affect their litigation strategy?

Creditors will plan ahead by, to the extent possible, receiving credit support from a party other than the debtor (eg, a subsidiary or shareholders) that is less likely to become insolvent so they can enforce the corresponding security interests if the debtor becomes insolvent (because the automatic stay does not protect legal entities that are guarantors). Freight carriers or unpaid suppliers in a position to do so will also retain the goods until they receive payment.

Litigation that was ongoing before the proceedings commenced may only be continued to determine the amount of the creditor's claim once the creditor has filed its claim and summoned the judicial administrator and the creditors' representative to participate in such litigation.

Stays of proceedings – effect on emergence from insolvency

28 | How do stays affect the debtor's emergence from insolvency?

Stays do not jeopardise a debtor's emergence from insolvency because the insolvency proceedings will either discharge or restructure the stayed claim. Restructuring the claim also modifies the creditor's collection right because it will only apply in respect of the restructured claim (ie, the restructuring will limit the creditor's right to receive payment of their claim as provided for under the restructuring plan's terms).

Subordination and disallowance of creditor claims

29 | Are the courts in your jurisdiction empowered to punish creditors' bad acts or inequitable conduct by pushing their claims down the priority waterfall? Can they void the claims altogether?

Unless the claim arises from fraud that the creditor committed, in which case the claim would be voided, a creditor's behaviour will not affect its claim.

A creditor's bad acts or conduct creates tort liability exposure if the conditions of such liability are met.

Vote designation

30 | Can creditors be disenfranchised based on bad-faith conduct?

No.



PRE-INSOLVENCY DEBTOR CLAIMS

Available claims

- 31** | To what extent can claims existing before insolvency be pursued against shareholders and their affiliates and agents during an insolvency proceeding – including any contractual, tort and misfeasance claims and claims for the recovery of company property?

Commencing insolvency proceedings does not prevent creditors from pursuing claims against shareholders based on contract, tort or misfeasance, nor does it require any specific elements to exist to succeed in such claims.

Procedure and resolution

- 32** | What procedural mechanisms and issues should be considered when bringing pre-existing claims? How are they usually resolved?

Apart from the fact that – depending on the proceedings involved and the respective powers of the judicial administrator, the judicial agent (ie, the creditor representative) or the judicial liquidator – the person with standing to bring the claim on the debtor company's behalf will differ, there are no procedural specificities to bringing pre-existing claims.

The main element that parties generally take into consideration with regard to such legal actions is their cost and, as a result, their funding.

It is relatively rare for a company to bring pre-existing claims while it is in safeguard or judicial reorganisation proceedings as its funds are primarily tied up in ensuring the company's continued operation.

Judicial liquidators generally bring pre-existing claims to improve the bankruptcy estate's financial situation and, as a result, distributions to creditors. Particularly if they are complex, such claims often ultimately settle out of court.

Conversely, French law provides that creditors may not bring pre-existing claims against companies in insolvency proceedings to obtain payment or to terminate an agreement owing to a payment default. Creditors may only file their claim against the debtor company pursuant to a formal process that will ultimately determine the amount of the creditor's claim.

Standing and assignment of claims

- 33** | Who controls the pursuit of pre-insolvency debtor claims? Can creditors or other stakeholders pursue them derivatively if the debtor or trustee refuses to do so?

The debtor's management continues to manage such legal actions unless:

-



the court appoints a judicial administrator to replace management entirely (this is rare) in a judicial reorganisation; or

- the proceedings are judicial liquidation proceedings, in which case the judicial liquidator is the only one who may bring a claim unless the claim is for mismanagement, in which case, in addition to the judicial liquidator, the public prosecutor or – if the judicial liquidator fails to act within a certain period – a majority of the creditors who have accepted the role of controllers in the proceedings may also do so.

Risk mitigation for creditors

- 34 | How can creditors mitigate the risk that pre-insolvency debtor claims and remedies will be successful?

Commencing insolvency proceedings does not prevent claims against creditors; however, given that the company is generally concerned about preserving its cash, creditors may be better situated to pursue an out-of-court settlement in that circumstance than if the company had not been in insolvency proceedings.

Minimising costs for creditors

- 35 | How can creditors reduce the costs of litigation associated with these claims? What procedures are commonly used?

With the exception of avoidance action litigation, it is unusual for a company to litigate pre-insolvency claims against its creditors while in safeguard or judicial reorganisation proceedings.

Companies settling litigation that the judicial liquidator brings for pre-insolvency claims is fairly common.

OTHER CLAIMS

Other claims against creditors

- 36 | Are there any other major categories of claims that may be pursued against creditors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

No.

Other claims against debtors

- 37 |

Are there any other major categories of claims that may be pursued against debtors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

No.

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments

38 | Are parallel proceedings and international judgments recognised in your jurisdiction? What are the requirements for recognition? Can recognition be challenged? On what grounds?

To be recognised and fully enforceable in France, court decisions from a foreign court that is not located in an EU member state, including those regarding insolvency matters, must receive recognition through a specific process called an exequatur. Obtaining the exequatur of a foreign decision essentially requires that:

- the foreign court has jurisdiction;
- the foreign decision complies with applicable substantive and procedural rules in its country of origin;
- the foreign decision is enforceable in its country of origin; and
- the foreign decision complies with French public policy.

A party may challenge recognition by way of an appeal or a third-party opposition.

Foreign insolvency proceedings are unlikely to receive exequatur in France if they relate to entities with any substantial activity and employees in France. This is because French courts generally prefer to commence French insolvency proceedings against those entities in France to protect French employees or creditors with French insolvency rules. If the foreign entity only has assets in France, it is more likely that an exequatur will be obtained.

The most straightforward example of recognition of parallel proceedings is that resulting from the EU Insolvency Regulation (EU) 2015/848 dated 20 May 2015, as amended by Regulation (EU) 2018/846 of 4 July 2018), which provides not only for automatic recognition in any EU member state (except Denmark) of insolvency proceedings commenced in another but also for an articulation of proceedings commenced in various EU member states based on where the debtor company has its centre of main interests and where it has assets.

Judicial cooperation

39 | To what extent if any will there be judicial cooperation with other courts in relation to insolvency proceedings?



Such cooperation is frequent in the context of the EU Insolvency Regulation, which includes a framework for cooperation between insolvency practitioners and different member states' courts. Brexit, however, raises questions about whether judicial cooperation will develop with UK courts regarding their recognition of French insolvency proceedings that would compromise UK law-governed obligations.

More generally, the recognition of French proceedings abroad usually stems from the general rules of private international law applicable in the country where the French judgment is intended to have effect. Some countries have adopted texts based on the UNCITRAL Model Law 1997, which provides for specific recognition mechanisms for cross-border insolvency proceedings.

In addition, since the last financial crisis, French courts often request the cooperation of US courts to recognise French insolvency proceedings through Chapter 15 cases (eg, *CGG*, *EuropaCorp*, *Technicolor* and *Europcar*). In the *CGG* case (2017), Chapter 11 proceedings commenced regarding the group's US subsidiaries in parallel with the parent company's French safeguard proceedings, and important cooperation among the insolvency receivers and the French and US courts helped to coordinate the timing and various steps of the process and ensure consistency between the parallel restructuring plans.

REMEDIES AND ENFORCEMENT

Remedies for debtors

40 | What legal remedies are broadly available to successful debtor-claimants? Have the courts awarded any notable remedies recently?

Apart from declaratory relief, which is uncommon under French law, successful debtor claimants are entitled to damages, injunctive relief or specific performance; however, in practice, it is rare for a company to initiate substantial litigation before it is in judicial liquidation proceedings, at which point the relief sought is damages.

Remedies for creditors

41 | What legal remedies are available to successful creditor-claimants? Have the courts awarded any notable remedies recently?

Creditor actions aim to:

- obtain recognition of its claim in the insolvency proceedings (which may include a claim owing to the debtor's breach of a prepetition or post-petition obligation, the performance of which is not considered necessary for the continued operation of the business) to receive appropriate payments from the bankruptcy estate; or
- seek the return of a proprietary asset to mitigate its loss.

Creditors are not legally entitled to other relief.



Court enforcement mechanisms

42 | What tools are available to the court to enforce its rulings? Are there any jurisdictional limits to the court's enforcement powers?

A French insolvency court's decision is immediately enforceable, notwithstanding appeal, with a few exceptions, the most notable being decisions regarding management liability for asset shortfall.

The main limit would be foreign countries' recognition of the French court's decision.

SETTLEMENT AND MEDIATION

General court approach

43 | Are the courts in your jurisdiction generally amenable to settlements?

Insolvency courts are generally amenable to settlements during accelerated safeguard, safeguard, and judicial reorganisation proceedings, as well as judicial liquidation proceedings, in which case the supervisory judge or the insolvency court must authorise and approve the settlement.

Timing

44 | When in the course of litigation are settlements most likely to be sought out?

The bulk of litigation in which a settlement is an appropriate outcome is when the claim is for damages. The majority of claims for damages are made in judicial liquidation proceedings.

Settlements are, in practice, sought out some time into the litigation, although the exact timing may vary significantly from case to case.

Court review and approval

45 | How do courts review settlements? What is the legal standard for entry into and approval of a settlement?

Any settlement must have prior approval from the supervisory judge and, in judicial liquidation proceedings, insolvency court approval.

Under French law, a settlement must contain mutual concessions from the parties.

Mediation clauses

46 |



Will courts enforce mandatory or voluntary mediation clauses in pre-existing contracts?

Mediation clauses do not receive any specific treatment in insolvency proceedings. If the clauses gave rise to mediation proceedings initiated before the start of insolvency proceedings, they are stayed until the creditor has filed its claim and may only resume to determine the claim's amount.

If no mediation proceedings are ongoing before the commencement of insolvency proceedings, the stay that the commencement imposes prevents their initiation.

UPDATE AND TRENDS

Recent developments

47 | What have been the most notable recent developments in insolvency litigation in your jurisdiction, including any key cases and legislative changes?

The most notable recent development has been the incorporation into French law of Directive (EU) 2019/1023 dated 20 June 2019 on preventive restructuring frameworks by Ordinance No.2021-1193 dated 15 September 2021 and Decree No. 2021-1218 dated 23 September 2021.

It introduces the economic value of each stakeholder's claim as a key factor of the vote on the reorganisation plan and its adoption, creditor and equity holder classes and a cross-class cramdown mechanism.

Apart from the *Orpea* case, it is very likely that these new elements of French insolvency law will continue to lead to substantial litigation, in particular with respect to the specific rights of action provided by the recent reform to ensure that courts appropriately account for the new economic component of French insolvency law. It has now become essential for restructuring practitioners to prepare the restructuring plan and its implementation (especially the constitution of classes of affected parties and the content of the plan, based on an independent expert valuation) ahead of the insolvency proceeding itself, in pre-insolvency proceedings such as conciliation proceedings for example.

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COMMENCING PROCEEDINGS

Litigation climate

- 1 | How would you describe the general climate surrounding insolvency litigation in your jurisdiction? What are the most common sources of dispute? To what extent is litigation used as a pressure or delay tactic?

Insolvency litigation has been on the rise in Germany for quite some time and is widely expected to increase further in the future. The reasons are manifold, but the most important one arguably is the mechanism that underpins German insolvency proceedings.

During a debtor's insolvency, unsecured creditors can no longer enforce any individual claims against the debtor. Instead, the insolvency court typically appoints an insolvency administrator to commence all promising avoidance actions and damage claims, the proceeds of which the creditors receive on a pro-rata basis. Because insolvency administrators may incur personal liability for failure to ensure the best possible creditor satisfaction, they will examine all possible claims very carefully and typically err on the more litigious side to avoid accusations of not having pursued a meritorious claim.

Other factors that contribute to the recent increase in insolvency litigation include:

- recent legislative changes that have made it easier for insolvency administrators to pursue claims against shareholders and third parties;
- litigation funders' entering the market with tailored solutions for insolvency administrators; and
- legal tech applications that allow the pursuit of claims that may have been considered too small or inefficient to entertain only a few years ago.

Overall, insolvency administrators are more willing and better equipped than ever to pursue meritorious claims. Not all claims end up in litigation, and many reach out-of-court settlements. However, in many cases, insolvency administrators commence court proceedings, which ample and evolving case law demonstrates, especially in the critical areas of clawback claims and damage claims against the debtor's management.

Sources of law

- 2 | What key sources of law form the basis of claims arising from insolvency? How does the insolvency regime interact with other laws?

Insolvency claims stem from a variety of legal concepts, all of which essentially link to the notions of preserving or increasing the distributable estate in the creditors' interest and preventing the preferential satisfaction of individual creditors.

- The [Insolvency Code](#), which serves as the primary statute with regard to insolvency proceedings, governs claims for avoidance against shareholders and third parties, as well as claims for directors' and managers' failure to file for insolvency in due time.



- General corporate rules continue to bind directors, managers and shareholders when a company is approaching insolvency. An insolvency administrator may, therefore, file claims for breach of fiduciary duty, breach of the duty of care and infringement of capital maintenance regulations.
- Insolvency claims may also arise from tort and criminal law, specifically when the management or shareholders acted with intent.

Creditors' claims, on the other hand, are not very common because the insolvency administrator automatically distributes their shares upon the conclusion of insolvency proceedings. Disputes usually concern whether a creditor has sufficiently justified the claim for the insolvency administrator's acceptance or whether the creditor has a preferred security interest.

Procedure

- 3 | What procedural rules govern insolvency litigation in your jurisdiction? What common procedural hurdles arise in practice?

The [Code of Civil Procedure](#) serves as the procedural framework for insolvency litigation and applies to all civil proceedings.

Typical insolvency litigation challenges include:

- determining when the company became insolvent, which may require economic expert evidence;
- dealing with the frequently inadequate accounting records and scarce evidence that can make it difficult for parties to provide full proof – as a result of which very detailed and balanced case law exists on factual and legal presumptions, the necessary pleading requirements and the standard to meet the burden of proof; and
- establishing the required subjective element on the respondent's behalf. For example, many avoidance actions require that the opposing party had actual knowledge of the company's insolvency or knew of circumstances pointing directly to insolvency. Abundant case law explores the required level of circumstantial evidence to prove such knowledge.

Courts

- 4 | Which courts hear insolvency claims? How experienced are they with insolvency litigation?

While designated insolvency courts at the local court level handle insolvency proceedings, ordinary civil courts hear insolvency claims against directors and officers, shareholders and creditors. Each civil court often includes specialised chambers or bodies that hear insolvency litigation cases, especially in the larger district courts that handle most insolvency claims.

Jurisdiction

- 5 | Through what law do the relevant courts have jurisdiction to hear insolvency claims? Does jurisdiction differ for domestic and cross-border matters?

The Code of Civil Procedure primarily governs jurisdiction to hear insolvency claims in domestic matters. Parties may bring most claims at the seat of the insolvent company or at the director's or shareholder's place of residence. Other venues are also possible, depending on the circumstances.

The most important legislation in cross-border matters is the EU Regulation on Insolvency Proceedings. It provides that the courts of the EU member state in which the insolvency proceedings commence will have jurisdiction for all claims that derive directly from the proceedings and are closely linked with them, such as avoidance actions or claims for failure to file for insolvency in a timely manner.

Limitation periods

- 6 | What limitation periods apply to bringing insolvency-related claims? Are there any notable exceptions?

The general limitation period in Germany is three years, beginning at the end of the calendar year in which the claim arises and the claimant obtains actual knowledge of the claim or would have obtained knowledge absent gross negligence. In the context of insolvency litigation, this limitation period applies to avoidance actions and tort claims.

A five-year statute of limitations that begins when the claim first arises governs claims against directors and officers for failure to file for insolvency in a timely manner and other breaches of fiduciary duties (10 years for publicly traded companies).

There are various ways to suspend limitations, and limitation waivers, in particular, are common in the insolvency litigation context.

Interim remedies

- 7 | What interim remedies are generally available and commonly deployed in insolvency proceedings? How are these used as part of claimants' overall litigation strategy?

Once insolvency proceedings formally commence, the court appoints an insolvency administrator, and the insolvent debtor automatically loses its legal authority to act. In some cases, the court may also approve the debtor's self-administration under a custodian's supervision.

In the time between the insolvency filing and the court's formal decision on whether to commence insolvency proceedings, the court may take any interim measures it deems necessary to preserve the insolvency estate.



The primary goal of insolvency proceedings is to preserve or increase the distributable estate in the creditors' interest and to prevent preferential satisfaction of individual creditors. To that end, the insolvency court may:

- appoint a preliminary insolvency administrator;
- appoint a preliminary creditors' committee;
- impose a general ban of disposal on the debtor or order that debtor disposals take effect only with the consent of the preliminary insolvency administrator;
- temporarily suspend any pending enforcement actions against the debtor; and
- as a last resort, subpoena the debtor's directors and detain them

Recent legislative changes have strengthened the role of creditors in those preliminary measures. They now have some influence on whom the court appoints as the preliminary insolvency administrator and the members of the preliminary creditors' committee. Creditors have exerted this influence through preliminary motions in several cases.

Debtor companies may also invoke preliminary remedies, such as when a debtor company files a protective brief to prevent any interim court measures if it has reason to believe that a third party will submit an unjustified request to commence insolvency proceedings.

Evidence

- 8** | What rules and procedures govern the collection and admissibility of evidence in insolvency litigation? To what extent is expert witness testimony allowed? What common evidential issues should claimants be aware of?

The Code of Civil Procedure governs evidence collection and admissibility, and the rules are the same as in any other civil proceedings. The most important ways to proffer evidence are:

- documentary evidence;
- witness testimony;
- expert evidence; and
- the court's visual inspection.

Discovery and witness depositions are not part of the evidential system (ie, each party must generally rely on the documents and witnesses to which it has access); however, there are additional rules on the required pleading level and a reversal of the burden of proof to address situations in which certain facts become relevant and only one party has access.

Common evidential issues in insolvency litigation include the frequent necessity of expert evidence, often sketchy documentary evidence and the need to establish the opposing party's knowledge of certain circumstances.



Time frame

9 | What is the typical time frame for insolvency claims?

The average duration of first instance civil proceedings before a district court is approximately 16 months. Because of regional differences, some district courts average as quickly as 11 months and others more than 30 months; however, many insolvency claims tend to be fairly complex, and the duration of proceedings may exceed these time frames, especially in cases that require expert evidence.

In nearly all cases, an out-of-court letter precedes the initiation of court action. While no statistical data exists to predict the typical time frames of out-of-court discussions, the discussions are either fairly brief (because the parties agree on a settlement or settlement negotiations fail) or they drag on until the statute of limitations forces one party to file a claim in court. Further, in many cases, limitation waivers extend this process.

Appeals

10 | What are the requirements to appeal insolvency-related judgments? What is the typical time frame for appeals?

A party may appeal any district court judgment to the court of appeal without first seeking permission to do so. The average time frame for appellate proceedings is 13 months, but it may range from seven to 24 months depending on different regional averages.

A party may only further appeal an appellate judgment if the court of appeal or – upon further request – the Federal Court of Justice, Germany's highest civil court, grants leave to appeal. The duration of proceedings before the Federal Court of Justice may differ depending on whether the court of appeal has granted leave to appeal, but most cases reach a decision within six to 18 months.

Costs and litigation funding

11 | How are costs handled and how are claims funded? Can claimants obtain third-party funding to finance the prosecution of claims?

To file a claim, the claimant must advance the court fees, which depend on the value in dispute. The current fee cap is €362,000 for claims of €30 million or more. Appeal fees are even higher.

For insolvency administrators, fees may pose a serious challenge, which is why litigation funders – albeit a more recent development – are becoming increasingly common in insolvency litigation. In addition, and more traditionally, insolvency administrators may obtain state legal aid if the estate is insufficient to cover the costs of proceedings, and the insolvency administrator has sufficient prospects of success.

AVOIDANCE ACTIONS

Fraudulent transfers and undervalue transactions

- 12 | What are the essential elements of avoidance actions seeking to claw back fraudulent conveyances and transfers? Can actions be brought for transfers without fraudulent intent based on undervalue of the transfer?

Once the insolvency proceedings commence, the insolvency administrator – or, in the case of self-administration, the custodian – has broad powers to bring avoidance actions for transactions that prefer certain creditors and thereby disadvantage the creditors as a whole, including those for fraudulent conveyances and transfers.

The insolvency administrator may challenge all transactions within four years – and, in some cases, even 10 years – of the commencement of the insolvency proceedings if the debtor acted with the intent to disadvantage other creditors and the other party knew of this intent. The threshold for fraudulent intent is not exceedingly high, and a debtor's knowledge that the transaction disadvantaged other creditors suffices.

Likewise, the counterparty need not have actual knowledge of the debtor's fraudulent intent – only awareness of the imminent illiquidity and the effects of the transactions on the other creditors. Courts will presume such knowledge for all transactions into which the debtor enters with insiders, including close relatives, members of the company's bodies and major shareholders.

Preference and improvement of position

- 13 | What are the essential elements of avoidance actions seeking to claw back transactions and payments based on preference and improvement of position shortly before insolvency proceedings?

In addition to avoidance actions for fraudulent transfers, the insolvency administrator may also seek to avoid myriad other transactions. The exact requirements and the type of transactions that they may challenge depend on the particular case. The most relevant criteria include:

- how long before the application to commence proceedings the debtor made the payment;
- whether it involved an arm's-length transaction and whether the creditor was entitled to the payment;
- whether the debtor was already illiquid at the time;
- the parties' intent and knowledge; and
- whether a special relationship exists between the debtor and the counterparty (eg, close relatives, directors and officers and major shareholders).



Generally speaking, transactions into which the debtor entered within the three months before the insolvency filing are easier to avoid, while transactions or payments that occurred before then require concurrent special circumstances.

Liens and floating charges

- 14** | What are the essential elements of actions for the avoidance of liens and floating charges on subsequently acquired property?

An insolvency administrator may generally pursue avoidance actions against any of the debtor's legal acts, including lien creation or the granting of any other collateral (floating charges do not exist under German law). In general, the same rules apply as in other avoidance actions, and the relevant time frame for transaction challenges is even longer.

Process and resolution of avoidance actions

- 15** | Through what process are avoidance actions litigated? What procedural issues often arise and how are avoidance actions usually resolved?

The insolvency administrator or, in the case of self-administration, the custodian may bring any avoidance action before the ordinary civil courts. Parties will usually attempt to agree on an out-of-court settlement first, and most cases settle before they proceed to court as insolvency administrators are often willing to accept a discount to resolve the dispute quickly.

The cases that proceed to litigation are usually highly complex. The most difficult issues often arise in connection with proving the counterparty's necessary knowledge, which many avoidance actions require. Ample case law on the various presumptions, the burden of proof and the required pleading standard can make the outcome of these proceedings hard to predict. This unpredictability encourages in-court settlements, which are also quite common, leaving only a minority of cases to be resolved by way of final judgment.

CLAIMS AGAINST DIRECTORS, OFFICERS AND SHAREHOLDERS

Breach of fiduciary duty

- 16** | What are the essential elements of a claim for breach of fiduciary duty against directors and officers in the context of corporate insolvency?

Directors and officers must exercise the diligence expected of a responsible businessperson when running the company's affairs. A breach of this fiduciary duty renders the directors and officers jointly and severally liable toward the company. Accordingly, in an insolvency, the insolvency administrator will file any claims for breach of fiduciary duties.



If a company is approaching insolvency, one of the key duties of directors and officers is to closely monitor whether the company has fallen insolvent. A company is insolvent if it is either illiquid or over-indebted.

Once the company becomes insolvent, the directors and officers must file a request to open insolvency proceedings without undue delay, but at the latest within three weeks in case of illiquidity and within eight weeks (six weeks as of 1 January 2024) in case of over-indebtedness, and ensure that the company ceases to effect any further payments, unless they are consistent with a prudent business person's due care. If the directors and officers fail to comply with this obligation, they can face personal liability for any damages that result from this delay, in addition to criminal charges.

Certain additional duties are relevant when a company nears insolvency, and for which a breach can result in civil liability or criminal charges. Namely, the directors and officers:

- must call a shareholders' meeting if the company has spent half or more of the share capital;
- may no longer repay any shareholder loans to the extent that repayment would affect the share capital; and
- must keep up the commercial books and all accounting activities.

Protection from liability

17 | To what extent does the law in your jurisdiction protect directors and officers from liability for decisions made in connection with the restructuring or insolvency?

Directors and officers must exercise the diligence expected of a responsible business person when making decisions. Their meeting this standard can protect them from liability. In connection with a company's restructuring or insolvency, it is widely accepted that a responsible business person would take, among other things, the following measures:

- closely monitor the company's financial situation;
- ensure that the company is not insolvent and prepare a liquidity forecast;
- properly analyse the existing restructuring options;
- provide updates to the shareholders; and
- seek independent outside advice.

Directors and officers must properly document these measures to receive protection from liability.

Limited liability companies may exclude liability for some of these offences in cases of simple negligence; for other offences, such as a violation of the duty to file for insolvency in a timely manner, no such protection exists.

Directors' and officers' insurance policies are another form of protection that has become very common during the past 10 to 15 years. They typically provide protection from liability unless the director or officer acted wilfully.



Converting credit to equity

- 18** | Can credit extended by an insider or shareholder be recharacterised as equity? If so, what is the mechanism by which such an action is brought, and what elements are required to prevail?

By law, most shareholder loans are automatically subordinated in insolvency proceedings. Notable exceptions to this rule involve loans extended by creditors that have acquired company shares in connection with its restructuring or outside shareholders with less than a 10 per cent interest. Credit that other insiders extended may also face recharacterisation, even in the context of unclear rules and evolving case law.

If the company has repaid a shareholder loan in the year leading up to its insolvency, the insolvency administrator may generally contest the repayment.

Illegal dividends

- 19** | Can dividends received by shareholders be prosecuted as illegal?

Dividends or any other distributions from equity capital must meet the test for avoidance actions. In most cases, the insolvency administrator can claw back all dividends that the company had paid in the four years leading up to the debtor's insolvency filing.

Trading while insolvent

- 20** | How is trading while insolvent treated in your jurisdiction? If actionable, what mechanisms apply and what are the elements of a successful claim?

Directors and officers are strictly obliged to file for insolvency as soon as the company becomes insolvent, and they must ensure that the company ceases to effect any further payments, unless they are consistent with a prudent business person's due care.

Directors and officers can face personal liability for any damages resulting from a failure to comply with these obligations, as well as potential criminal charges. In addition, the insolvency administrator may contest certain transactions into which the company entered after it became insolvent.

Equitable subordination

- 21** | Is equitable subordination of shareholder claims allowed? If so, what requirements and mechanisms apply?

All loans by shareholders with at least 10 per cent interest become automatically subordinated in an insolvency. Insider-extended credit may also face subordination under these rules.



In addition, the avoidance action rules contain special provisions for shareholder loans and transactions with related parties. Under these rules, the insolvency administrator may generally claw back any shareholder loan repayment that the company made in the year before it filed for insolvency. Similarly, transactions with insiders are significantly easier to contest than transactions with third parties.

Other claims

- 22** | Are any other claims commonly brought against shareholders, directors and officers in your jurisdiction? If so, what mechanisms are used to raise these claims and what elements are required to prevail?

Navigating the various duties that a nearly insolvent company's directors and officers face can be a minefield and easily result in criminal liability. Under German law, criminal offences automatically give rise to claims under tort law, which directors and officers frequently face. While only the insolvency administrator may assert claims for a breach of fiduciary duties, outside creditors and other third parties may also bring tort claims.

From a shareholder perspective, controlling shareholders may incur liability if they issued a comfort letter or a letter of credit to the debtor (eg, ensuring a going-concern basis for the yearly audit) and are in breach of this undertaking. Under certain circumstances, shareholders may even face tort claims. The Federal Court of Justice has established a liability for destruction of existence, which is an instrument under tort law that allows the company – or, in the event of an insolvency, the insolvency administrator – to bring damage claims against the company's shareholders if they exerted undue influence over the company that resulted in, or aggravated, the insolvency.

Risk mitigation

- 23** | How can shareholders and sponsors mitigate the risk that claims against them will be successful, and minimise the accompanying financial burden?

Shareholder loan subordination and subordination of other financial support directly result from the commencement of insolvency proceedings, and shareholders cannot avoid or mitigate it.

In avoidance actions for shareholder loan repayment or other shareholder transactions, some room exists for risk mitigation as the claim will only succeed if the shareholder knows of circumstances pointing directly to the debtor's insolvency. While the shareholders bear the burden of showing that they lack sufficient knowledge, meeting this threshold may be possible if the shareholders had properly documented the monitoring measures that they used to verify the company's financial health.

CREDITOR ACTIONS AND STRATEGIC CONSIDERATIONS

Contesting restructuring plans



- 24** | Can creditors bring actions contesting the restructuring plan? If so, what law governs such actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

German insolvency law allows the debtor – and, to the extent that the company is already insolvent, the insolvency administrator – to initiate a reorganisation within insolvency proceedings. This reorganisation must rely on a court-approved insolvency plan.

Challenges to an insolvency plan require meeting a high threshold and rarely succeed. To succeed, the creditors must show that the insolvency plan significantly affects their position, outweighing any detrimental effect to other stakeholders if the court does not approve the insolvency plan.

In addition, the EU Directive on Restructuring and Insolvency introduced a new pre-insolvency restructuring procedure that has only recently been transposed into German law. It provides for a very flexible preventive restructuring framework for any companies that face impending illiquidity and offers various instruments to overcome obstructing minority creditors. To the extent that each class of creditors has approved the plan with the necessary majority, an individual creditor may only challenge the restructuring plan if they meet the same requirements as in an insolvency plan challenge (ie, demonstration that the restructuring plan will detrimentally affect their position, outweighing any detrimental effect to other stakeholders absent the restructuring plan).

Winding-up petitions

- 25** | Do creditors apply for winding-up orders? If so, what law governs these actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

All creditors may apply to open insolvency proceedings to the extent that they:

- have a legal interest in commencing the insolvency proceedings;
- have a due claim; and
- can show that the debtor company is insolvent (ie, either over-indebted or illiquid).

If a creditor meets these requirements and insolvency proceedings commence, the debtor will face automatic liquidation upon the conclusion of the insolvency proceedings, with the remaining estate distributed among the creditors.

Creditors may not apply for a winding-up petition under corporate law.

Stays of proceedings – scope and exceptions

- 26** | Does the insolvency regime stay any creditor collection actions? If so, what are the parameters of such a stay? Are there any notable or commonly used exceptions?



As soon as the insolvency proceedings formally commence, there is an automatic stay of all pending civil proceedings until the insolvency administrator resumes them or the insolvency proceedings conclude. Likewise, the enforcement actions of individual unsecured creditors are impermissible, and those creditors may only enforce their claims within the framework of the insolvency proceedings.

In contrast, secured creditors may still pursue enforcement actions. For example, creditors may continue to enforce a right of segregation (if the asset does not belong to the estate) or a right of preferential satisfaction.

From the request to commence insolvency proceedings to the court's decision about the request, the insolvency court may ex officio take any measures necessary to prevent adverse change to the debtor's financial situation, including issuing a stay on any individual enforcement actions against the debtor.

In a pre-insolvency restructuring procedure, the court may – upon the debtor's request – impose a stay of all individual enforcement actions if it appears necessary to achieve the restructuring objective.

Stays of proceedings – strategy

27 | How do creditors navigate stays in practice? How do stays generally affect their litigation strategy?

Because the commencement of insolvency proceedings triggers an automatic stay of all pending litigation proceedings, creditors' options are very limited. Creditors may attempt to prevent or delay insolvency proceedings from opening by filing a protective letter if they believe that grounds for insolvency do not exist. Creditors may also accelerate already pending court proceedings or accept an early settlement if they suspect that insolvency may be imminent (although any payment that the creditors receive may be subject to subsequent avoidance actions).

Stays of proceedings – effect on emergence from insolvency

28 | How do stays affect the debtor's emergence from insolvency?

If a debtor has become insolvent and the insolvency proceedings have commenced, it is rare for the debtor to fully emerge from insolvency. A stay of proceedings may, however, enable the insolvency administrator to sell certain parts of the insolvent company on a going-concern basis, which occurs quite frequently.

A stay is also a powerful tool in pre-insolvency restructuring proceedings, as well as under the protective shield procedure, which is a mechanism that provides for an enforcement moratorium if the debtor requests self-administration and submits a restructuring plan. In some cases, under those circumstances, the stay allowed for or aided in a successful restructuring and enabled the debtor to emerge from its critical financial state.



Subordination and disallowance of creditor claims

- 29 | Are the courts in your jurisdiction empowered to punish creditors' bad acts or inequitable conduct by pushing their claims down the priority waterfall? Can they void the claims altogether?

The courts have no legal authority to push creditor claims down the priority waterfall to punish bad acts or inequitable conduct, nor can they void the claims altogether; however, several estoppel theories in German law (eg, for contradictory behaviour) can serve as a defence in those cases.

Vote designation

- 30 | Can creditors be disenfranchised based on bad-faith conduct?

Both types of reorganisation procedures, the insolvency plan and the pre-insolvency preventive restructuring framework, generally require the approval of all classes of creditors. Under certain circumstances, however, a cramdown may occur (ie, a vote designation of an entire class of creditors).

The requirements differ slightly, but a vote designation may generally occur if:

- the plan likely has no negative effect on this group of creditors as opposed to a scenario without a plan;
- the majority of classes have voted in favour; and
- the group of creditors receives fair treatment in respect of other groups of creditors.

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims

- 31 | To what extent can claims existing before insolvency be pursued against shareholders and their affiliates and agents during an insolvency proceeding – including any contractual, tort and misfeasance claims and claims for the recovery of company property?

A debtor may pursue claims that existed before insolvency without any restrictions after the debtor has become insolvent and the insolvency proceedings commence. This includes claims against shareholders and their affiliates and agents, as well as against any other third party, regardless of the nature of those claims. The elements to succeed are the same as those applicable had the debtor brought the claims before the insolvency.

Procedure and resolution

- 32 |



What procedural mechanisms and issues should be considered when bringing pre-existing claims? How are they usually resolved?

A debtor may pursue claims that existed before insolvency without any restrictions or considering any specific procedural mechanisms.

Standing and assignment of claims

33 | Who controls the pursuit of pre-insolvency debtor claims? Can creditors or other stakeholders pursue them derivatively if the debtor or trustee refuses to do so?

In most cases, the insolvency administrator has the sole authority to pursue pre-insolvency debtor claims, as well as a legal obligation to pursue and enforce all available claims to increase the insolvency estate and to satisfy the creditors to the best extent possible. Creditors and other stakeholders may not pursue a claim derivatively if the administrator decides not to pursue it, and they have no legal remedy to instruct the administrator otherwise.

However, because insolvency administrators may incur personal liability if they do not pursue a meritorious claim, they will usually exercise caution, so there are very few cases in which the creditors and the insolvency administrator disagree. If a disagreement arises, creditors may offer litigation funding, in which case the administrator has no reason not to pursue the claim.

If the court has allowed the debtor to conduct the insolvency proceedings in self-administration, the right to pursue pre-insolvency claims remains with the debtor but under a custodian's supervision.

Risk mitigation for creditors

34 | How can creditors mitigate the risk that pre-insolvency debtor claims and remedies will be successful?

Pre-insolvency debtor claims follow the same rules, regardless of when the debtor pursues them. Accordingly, creditors may not avail themselves of any particular insolvency-related risk mitigation measures.

In avoidance actions for pre-insolvency transactions, creditors that closely monitor the debtor's solvency usually fare better. In addition, a creditor's careful documentation of the circumstances on which they rely regarding the debtor's solvency may also help the creditor fend off avoidance actions.

Minimising costs for creditors

35 | How can creditors reduce the costs of litigation associated with these claims? What procedures are commonly used?



There is no one-size-fits-all strategy to minimise costs. While experience shows that insolvency administrators are often amenable to settlements, the best strategy will depend on the individual case's circumstances, especially regarding the claim's prospects and the estate's financial situation. Accordingly, attempting an early settlement strategy may benefit creditors in some cases, whereas a holdout approach may prove preferable in others.

OTHER CLAIMS

Other claims against creditors

- 36** | Are there any other major categories of claims that may be pursued against creditors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

During the past few years, financial and legal advisers have faced increasing scrutiny for their advice to a debtor in the period leading up to insolvency. Insolvency administrators often pursue recourse claims, as the media widely report.

Two recent and prominent examples are Maple Bank's insolvency, in which a Magic Circle firm agreed to settle for €50 million, and Wirecard's insolvency, in which a Big Four auditing firm became the target of several plaintiffs' law firms and litigation funders and faces lawsuits in countless court proceedings.

Other claims against debtors

- 37** | Are there any other major categories of claims that may be pursued against debtors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

No.

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments

- 38** | Are parallel proceedings and international judgments recognised in your jurisdiction? What are the requirements for recognition? Can recognition be challenged? On what grounds?

Germany automatically recognises EU judgments under the Brussels Recast Regulation. A court may only deny recognition if the judgment:

- would be manifestly contrary to public policy;
- was issued in default of appearance, or if the defendant was not properly served with notice and thus was unable to provide a defence;
- is irreconcilable with a German judgment between the same parties;



- is irreconcilable with an earlier judgment between the same parties that involved the same cause of action, which German courts would recognise; or
- the judgment was rendered by a court that lacked jurisdiction.

German courts also generally recognise other international judgments. The grounds to deny recognition are similar to those for EU judgments, with one additional test: a German court will only recognise an international judgment if reciprocity exists between the jurisdictions (ie, if a court in the country where the judgment originates would generally recognise a German judgment).

For EU insolvency proceedings, the debtor's centre of main interests (COMI) determines which member state has jurisdiction. EU member states will automatically recognise insolvency proceedings in another EU member state under the EU Regulation on Insolvency Proceedings, and a court may only deny recognition if it would violate public policy.

The only exception is for disputes over the debtor's COMI, which became highly relevant in the infamous insolvency of Germany's former second-largest airline Air Berlin. In that case, a dispute arose between the German and Austrian courts about the COMI of Air Berlin's subsidiary NIKI Luftfahrt GmbH, creating two competing insolvency proceedings. The parties finally resolved the dispute, and one of the proceedings was converted into secondary insolvency proceedings.

German courts may also recognise other international insolvency proceedings according to the German rules on international insolvency law and will only deny recognition if the foreign courts lack jurisdiction from a German perspective or the recognition would violate public policy.

Judicial cooperation

39 | To what extent if any will there be judicial cooperation with other courts in relation to insolvency proceedings?

For EU insolvency proceedings, the EU Regulation on Insolvency Proceedings provides the framework for cooperation among the courts and the insolvency practitioners in primary and secondary insolvency proceedings, as well as in insolvency proceedings involving different members of a group of companies. Courts encourage cooperation, especially with regard to information sharing, to the extent that it is not incompatible with the rules in either of the proceedings.

In other international insolvency proceedings, Germany also widely accepts judicial cooperation, although only scarce rules on cooperation among insolvency practitioners exist and none concerning the courts. In practice, courts often handle cooperation informally and outside the official framework for judicial assistance.

REMEDIES AND ENFORCEMENT



Remedies for debtors

- 40** | What legal remedies are broadly available to successful debtor-claimants? Have the courts awarded any notable remedies recently?

Debtor claims generally follow the same rules as before insolvency, and the same available remedies apply; thus, specific performance and damages are as available as injunctive or declaratory relief.

Remedies for creditors

- 41** | What legal remedies are available to successful creditor-claimants? Have the courts awarded any notable remedies recently?

Creditors, in principle, may claim all legal remedies available with limited exceptions, the most important of which concerns claims for payment or pecuniary damages. Creditors can no longer bring those claims in court; instead, they must register their claims in the insolvency table, which is a register of all creditor's claims that ultimately forms the basis for the estate's pro-rata distribution at the conclusion of the insolvency proceedings. If the insolvency administrator contests the claim, the creditor must file a claim for declaratory relief indicating that the claim forms part of the insolvency table.

Court enforcement mechanisms

- 42** | What tools are available to the court to enforce its rulings? Are there any jurisdictional limits to the court's enforcement powers?

Courts will not enforce their judgments automatically as many respondents honour judgments voluntarily, and claimants must initiate the enforcement procedure. The Code of Civil Procedure contains a set of enforcement mechanisms that are tailored to the specific relief, including a court-appointed enforcement officer's attachment of assets or freezing of bank accounts, as well as detention and fines if the respondent will not cooperate.

The court's enforcement measures only apply in Germany. Enforcement in other countries is often possible but requires that the jurisdiction recognise the judgment and that enforcement complies with that country's rules.

SETTLEMENT AND MEDIATION

General court approach

- 43** | Are the courts in your jurisdiction generally amenable to settlements?

The Code of Civil Procedure instructs courts to explore settlement options throughout all stages of the proceedings. Most courts take this responsibility seriously and will



facilitate settlement discussions or even propose a settlement based on their preliminary assessment of the prospects, usually during a court hearing.

Timing

44 | When in the course of litigation are settlements most likely to be sought out?

Parties may agree on settlements at any stage of the proceedings, but the most important touchpoints for a settlement are before a claim's filing with the court or during or after a court hearing at which the court has shared its preliminary view of the case's prospects.

Court review and approval

45 | How do courts review settlements? What is the legal standard for entry into and approval of a settlement?

Courts do not have to review or approve settlements. To the extent that a court suggests a settlement or participates in the settlement negotiations (eg, during a court hearing), it will attempt to moderate a settlement that it considers fair and reasonable.

Mediation clauses

46 | Will courts enforce mandatory or voluntary mediation clauses in pre-existing contracts?

Mediation clauses are uncommon in Germany; however, when a contract contains a mandatory mediation clause, the court will usually enforce it and dismiss any related claims as inadmissible until the mediation has occurred.

Whether the mediation clause binds other non-contractual claims is primarily a matter of construction, and the court will decide this on a case-by-case basis; however, pre-existing mediation or arbitration clauses will not influence certain claims, such as avoidance claims.

UPDATE AND TRENDS

Recent developments

47 | What have been the most notable recent developments in insolvency litigation in your jurisdiction, including any key cases and legislative changes?

As is the case for most other jurisdictions, the covid-19 pandemic had a large impact on the German economy. Lawmakers reacted by easing the filing requirements to mitigate the pandemic's effects and to allow fundamentally healthy businesses to survive. Some of these measures are still in place. Many believe, however, that this effect is only temporary



and that Germany will soon experience a flood of new insolvency proceedings, not least in light of the increased interest rates. Some industries are more affected than others, but real estate projects appear to come under increased pressure, as the widely reported restructuring of the German Adler Group demonstrates.

On 1 January 2021, the EU Directive on Restructuring and Insolvency's transposition into German law implemented a new pre-insolvency restructuring framework. The StaRUG procedure provides for a flexible preventive restructuring framework outside of formal insolvency proceedings that serves as a powerful tool to allow a successful pre-insolvency restructuring. While highly anticipated, the StaRUG procedure took some time to develop traction, and only very recently the first landmark StaRUG case was successfully closed. As part of a restructuring plan, LEONI AG, an international Tier 1 automotive supplier, was significantly deleveraged and delisted from the stock exchange by means of a share capital cut. It was the first restructuring of a listed stock corporation under the application of the cross-class cram-down provisions of the StaRUG and is widely expected to serve as a reference for future pre-insolvency restructurings.

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COMMENCING PROCEEDINGS

Litigation climate

- 1 | How would you describe the general climate surrounding insolvency litigation in your jurisdiction? What are the most common sources of dispute? To what extent is litigation used as a pressure or delay tactic?

In the past three years, major developments related to insolvency litigation have increased optimism among creditors, along with a certain degree of uncertainty.

First, the [Spanish Insolvency Law](#) (SIL) was amended by a recast. Spanish lawmakers tried to reflect the latest scholarship and case law opinions, as well as to implement [European legislation](#). Among other things, this procedure resulted in a new insolvency regime that, for the first time, allowed creditors to file for restructuring plans without the collaboration of the debtor. The SIL changes have given rise to disputes of interpretation.

Second, in response to the covid-19 pandemic, the Spanish government enacted a set of laws and rules as part of its [emergency measures](#). This new legal regime's construction and application serve as another source of dispute.

Other common sources of conflict include:

- whether a situation of indebtedness can qualify as an insolvency under the SIL;
- meeting all the requirements to trigger bankruptcy proceedings;
- contract termination within the insolvency context;
- acknowledgement and ranking of claims;
- directors' liability; and
- challenges to creditors' voluntary arrangements or restructuring plans.

Creditors may use insolvency disputes as a pressure tactic, and debtors may use them as a delay tactic. However, the recent amendment regarding restructuring plans provides an opportunity for creditors to overcome these guerrilla tactics.

Sources of law

- 2 | What key sources of law form the basis of claims arising from insolvency? How does the insolvency regime interact with other laws?

Most claims arising from insolvency derive from contract law and regulatory law (ie, relating to the public administration, the tax administration or social security). The [Spanish Civil Code](#), the [Spanish Commercial Code](#) and the [Spanish Companies Act](#) (SCA) complement and interact with the SIL, which foresees relevant exceptions from the general legal regime that require consideration (eg, directors' liability).



Procedure

- 3 | What procedural rules govern insolvency litigation in your jurisdiction? What common procedural hurdles arise in practice?

The SIL and the [Spanish Civil Code of Procedure](#) generally govern insolvency litigation in Spain. The [Spanish Judiciary Act](#) and Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings also affect international cases, among other relevant acts.

Civil and insolvency procedural rules can be inconsistent, which generates disputes. Additionally, there is still some debate on how to calculate certain legal periods that the SIL stipulates. International insolvency proceedings are fairly uncommon, and some tribunals are unfamiliar with international regulations.

Courts

- 4 | Which courts hear insolvency claims? How experienced are they with insolvency litigation?

The commercial courts hear insolvency-related claims, alongside a variety of other commercial cases (eg, intellectual property disputes, challenges of corporate decisions). These courts are very experienced and have sound knowledge regarding insolvency law.

In certain cases, first instance courts will hear a case related to insolvency proceedings (eg, when the insolvent company brings a contractual claim seeking payment from a third party). First instance courts, broadly speaking, do not have the same insolvency expertise as commercial courts.

In addition, certain territories (eg, Madrid) also have special chambers in the appeal court to decide on commercial law appeals, including those relating to insolvency.

Jurisdiction

- 5 | Through what law do the relevant courts have jurisdiction to hear insolvency claims? Does jurisdiction differ for domestic and cross-border matters?

Under the Spanish Judiciary Act and the SIL, commercial courts have domestic jurisdiction to hear insolvency claims. Territorial jurisdiction depends on the Spanish Code of Civil Procedure, but jurisdiction for cross-border cases also lies with commercial courts, based on the SIL, [Spanish Law 29/2015 on international legal cooperation](#) and Regulation (EU) 2015/848.

Limitation periods

- 6 |



| What limitation periods apply to bringing insolvency-related claims? Are there any notable exceptions?

Limitation periods depend on the type of insolvency claim. For instance, creditors have one month to file a proof of claim, four years for actions seeking payment of damages against insolvency receivers, two years for clawback claims and two years for directors' general liability (which differs from the four-year limitations period under the general civil regime).

Interim remedies

7 | What interim remedies are generally available and commonly deployed in insolvency proceedings? How are these used as part of claimants' overall litigation strategy?

In an insolvency scenario, interim remedies can be of the utmost importance for securing the final relief sought, without which the main proceedings can be rendered ineffective. The possible interim remedies include:

- continuation of the effects of the creditors' voluntary arrangement (CVA) in force during the challenge;
- interim modification of the list of creditors; or
- asset seizure and embargoes.

Forming a strategy is, therefore, crucial.

Evidence

8 | What rules and procedures govern the collection and admissibility of evidence in insolvency litigation? To what extent is expert witness testimony allowed? What common evidential issues should claimants be aware of?

In general, the common rules within the Spanish Code of Civil Procedure govern evidence collection and admissibility, but some particularities apply only in insolvency proceedings. For instance, in some insolvency cases, the parties must propose evidence at the end of the relevant writ or during the hearing (at which the court decides on whether to take the evidence proposed and assess it).

Expert witness testimony is common and generally admissible, provided that it is appropriate and useful. Whether a particular piece of evidence is appropriate and useful can be a matter of debate for a competent court to decide.

Under the new restructuring plan regime, expert reports are crucial to evidence that the plan is feasible and can be approved or judicially sanctioned.

Time frame

|



9 | What is the typical time frame for insolvency claims?

Insolvency proceedings are time-consuming and very lengthy. In general, an insolvency proceeding can take between two and five years. This time frame may vary for cases in which the court approves a CVA within 12 months of the declaration of insolvency. Further, triggering winding-up procedures may extend the time frame.

The new amendment of the SIL has tried to speed up some specific phases of the insolvency proceeding, such as the sale of the production or business units.

Appeals

10 | What are the requirements to appeal insolvency-related judgments? What is the typical time frame for appeals?

There are no specific procedural requirements to appeal, apart from being an 'interested party' and filing the appeal by the deadline (20 days after notification of the first instance decision). Parties may appeal almost any decision on the merits, although there are certain exceptions expressly foreseen in the SIL. The timing for appeal resolution largely depends on the specific appeal court hearing the case and may range from six to 24 months.

Costs and litigation funding

11 | How are costs handled and how are claims funded? Can claimants obtain third-party funding to finance the prosecution of claims?

The legal costs regime in insolvency matters is in line with common civil cases and applies the rule that 'costs follow the event', which means the unsuccessful party most often pays, with very few exceptions (eg, when sound legal doubts exist). Costs include lawyers', court agents' and experts' fees. However, the amount that a party may claim is limited and does not necessarily relate to the amount actually paid as fees. Claimants can seek third-party funding, if necessary.

AVOIDANCE ACTIONS

Fraudulent transfers and undervalue transactions

12 | What are the essential elements of avoidance actions seeking to claw back fraudulent conveyances and transfers? Can actions be brought for transfers without fraudulent intent based on undervalue of the transfer?

Under the Spanish Insolvency Law (SIL), a party may bring an action to claw back any harmful transactions (for the insolvency estate) that a debtor carried out during the two years before the petition for insolvency and during the period between the petition and the insolvency declaration. The SIL expressly excludes fraudulent intent as a requirement to



bring a clawback action. Therefore, harmful transactions can be the subject of avoidance actions even if the debtor did not execute them with manifest fraud.

Courts take the harm for granted when the transaction was free (with very few exceptions) and presume harm when the transaction:

- benefits a related party;
- refers to the establishment of liens that guarantee existing obligations or new obligations in substitution of the latter; or
- relates to payments or any other means of terminating obligations that were secured and whose maturity occurred after the declaration of the insolvency.

A court may consider any other transaction as harmful, but the claimant must provide evidence to support the claim.

Preference and improvement of position

- 13** | What are the essential elements of avoidance actions seeking to claw back transactions and payments based on preference and improvement of position shortly before insolvency proceedings?

An avoidance action may stem from payments based on preference and improvement of position shortly before insolvency proceedings. The insolvency receiver and creditors may bring avoidance actions under certain circumstances. If brought, the avoidance action triggers side proceedings, to be decided by the competent court while the insolvency continues.

Liens and floating charges

- 14** | What are the essential elements of actions for the avoidance of liens and floating charges on subsequently acquired property?

Courts presume that economic harm exists in cases in which liens secure either pre-existing obligations or new obligations that substitute the former pre-existing obligations. Therefore, those transactions may be subject to an avoidance action.

Process and resolution of avoidance actions

- 15** | Through what process are avoidance actions litigated? What procedural issues often arise and how are avoidance actions usually resolved?

Avoidance actions are resolved through side proceedings, in parallel with the insolvency proceedings. The insolvency judge renders a judgment that decides the dispute, which the parties may appeal. These types of actions generally hinge on whether the claimant can



show that the relevant transaction was harmful to the insolvency estate and that the debtor executed the transaction within the two years leading up to the declaration of insolvency.

CLAIMS AGAINST DIRECTORS, OFFICERS AND SHAREHOLDERS

Breach of fiduciary duty

- 16** | What are the essential elements of a claim for breach of fiduciary duty against directors and officers in the context of corporate insolvency?

Under the Spanish Insolvency Law (SIL), directors and general managers, as well as de facto directors or shadow directors, may be liable to the company, the shareholders, the company's creditors and certain third parties for any harmful behaviour they have committed against the insolvent company as a result of negligent or wilfully intentional actions or omissions that were contrary to the law or the company's by-laws or in breach of the duties inherent to their position.

Protection from liability

- 17** | To what extent does the law in your jurisdiction protect directors and officers from liability for decisions made in connection with the restructuring or insolvency?

The Spanish courts and legislation have embraced the common law doctrine of the business judgement rule.

The Spanish Companies Act (SCA) expressly reflects the business judgement rule in its article 226, under which directors fulfil their fiduciary duty when they have acted in good faith, without any personal interest, with enough information and after a reasonable decision-making process.

Although directors and officers may incur liability, the Spanish regime generally tends to protect them unless evidence demonstrates that they engaged in gross negligence or wilful misconduct or that they committed acts contrary to the law.

Converting credit to equity

- 18** | Can credit extended by an insider or shareholder be recharacterised as equity? If so, what is the mechanism by which such an action is brought, and what elements are required to prevail?

Generally, an insider's or a shareholder's claim cannot be recharacterised as equity. Nonetheless, some restructuring plans or creditors' voluntary arrangements (CVAs) foresee credit capitalisation (ie, a claim that becomes equity).

Further, a 'guilty insolvency' (which may trigger liability) occurs when the directors unreasonably failed to propose, or the shareholders failed to accept, the capitalisation



of claims, and that decision resulted in the failure of a restructuring plan or settlement agreement.

Illegal dividends

19 | Can dividends received by shareholders be prosecuted as illegal?

In exceptional cases, dividend distribution can be criminally prosecuted if the company is technically insolvent, even absent a judicial declaration as such, particularly when the distribution only benefited a few parties to the detriment of the company and its creditors. The criminal threshold is very high in any event. The distribution of dividends can also be part of a clawback (civil) action.

Trading while insolvent

20 | How is trading while insolvent treated in your jurisdiction? If actionable, what mechanisms apply and what are the elements of a successful claim?

When trading, directors must ensure, to the extent possible, that the company can fulfil its obligations. If directors sign agreements on the company's behalf while fully aware that the company will not be able to comply with them, they may face personal civil liability.

In very exceptional cases, trading while insolvent can also amount to a criminal offence if the trading is groundless, speculative or unjustifiably implies losses. The criminal threshold is very high.

After the declaration of insolvency, the company receives supervision from an insolvency receiver and a competent judge. If any party wants to file a claim, it must prove the existence of a wilful or negligent action and resulting damage from that action.

Equitable subordination

21 | Is equitable subordination of shareholder claims allowed? If so, what requirements and mechanisms apply?

Immediately after a judicial declaration of insolvency, creditors must address the court-appointed insolvency receiver about their claims and the proposed ranking of claims. The insolvency receiver then issues a list that reflects all the creditors, the acknowledged claims and the corresponding ranking of claims. Creditors that do not agree with the insolvency receiver's determination may challenge the list, triggering side proceedings.

The SIL subordinates related persons' claims. Under the SIL, related persons include the following:

-



shareholders who have unlimited personal liability for corporate debts and those who hold a certain stake percentage (which depends on whether the company is listed) when the claim originated;

- de facto or legal directors, liquidators and general managers with general powers (including those who held the position in the two years before the insolvency);
- companies that are part of the same group as the insolvent corporation (case law generally requires that the company was part of the same group when the relevant claim originated); and
- common partners of the insolvent company or of any company within the same group, provided that those partners held a stake in the company within the same group when the claim originated.

Claims from a creditor that fall within any of the above-mentioned categories would be subject to equitable subordination. The insolvency receiver may directly impose this consequence when issuing the referred list, or the court may impose it if an interested party challenges the ranking.

Other claims

22 | Are any other claims commonly brought against shareholders, directors and officers in your jurisdiction? If so, what mechanisms are used to raise these claims and what elements are required to prevail?

Shareholders do not generally face insolvency claims, although they may be liable in limited cases (eg, return of amounts unduly collected, groundless refusal to capitalise their claims or de facto directorship).

By contrast, directors and officers are more often the targets of insolvency claims for:

- their active involvement in the company's insolvency or in harmful transactions that preceded it; or
- their failure to request a company's insolvency or liquidation when it was due (eg, when the company is insolvent or when it fails to comply with the CVA, the SIL requires directors to request insolvency or liquidation).

In addition, the SCA foresees two actions that directors (including de facto) may face: corporate claims that seek to protect the company's interest; and individual claims that seek to protect a certain claimant's specific interests.

In very exceptional circumstances, shareholders, directors or officers may also face criminal liability.

Risk mitigation

23 | How can shareholders and sponsors mitigate the risk that claims against them will be successful, and minimise the accompanying financial burden?



In contrast to criminal liability, the SIL does not include any mitigating factors, such as a compliance programme. However, parties may mitigate liability by minimising or restoring the damage caused, entering an early settlement or documenting all their discussions, analysis and voting outcomes (eg, in the minutes of the board of directors' or general meetings).

Shareholders and sponsors may also need appropriate legal and financial advice to defend their stance, such as:

- if the dispute relates to a possible shadow directorship, they need to prove that they were not involved in and did not influence management of the directors; or
- when the shareholders must prove that a particular transaction was not sufficiently harmful to the company, its shareholders or third parties.

CREDITOR ACTIONS AND STRATEGIC CONSIDERATIONS

Contesting restructuring plans

24 | Can creditors bring actions contesting the restructuring plan? If so, what law governs such actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

The Spanish Insolvency Law (SIL) expressly allows creditors and shareholders who have not voted in favour to challenge the judicially sanctioned restructuring plan in place (potentially binding dissenting parties).

The judicial sanction of the restructuring plan requires that the creditors are grouped into classes and that these classes approve the plan. However, there are certain cases in which it is possible for the restructuring plan to be approved, even if not all classes have voted in favour.

Therefore, there are two scenarios in which creditors can challenge the plan: when all the classes have voted in favour of the plan or when not all the classes have voted in favour of the plan.

When all the classes have voted in favour of the plan, dissenting creditors may challenge its approval on the following grounds:

- the required communication, content and form requirements have not been complied with;
- the classes of creditors have not been properly formed in accordance with the SIL;
- the debtor is not:
 - likely to become insolvent;
 - imminently insolvent; or
 - currently insolvent;
- the plan does not offer a reasonable prospect of avoiding insolvency and ensuring the viability of the company in the short and medium term;



- the debtor's claims have not been treated equally to others of the same class;
- the reduction in the value of the creditor's claims is manifestly greater than what is necessary to ensure the company's viability;
- the plan does not meet the test of the best interests of the creditors. This will occur when the challenging creditor would have received more money in a hypothetical bankruptcy liquidation two years after the restructuring; or
- the debtor has failed to comply with its obligation to be up to date with its tax and social security obligations.

When not all the classes have voted in favour of the plan, dissenting creditors may challenge its approval on all of the above grounds and, in addition, on the following:

- the plan has not been approved by the necessary class or classes;
- one or more classes will obtain amounts or rights with a value greater than the value of their claims;
- there is no equivalent treatment between classes of the same rank; or
- the members of a lower ranking class receive amounts when the creditor has not received the full amount of their claim. This reason may be disregarded by the judge if the viability of the company requires it and the prejudice to the claims is not unjustified.

Under the SIL's current wording, the creditor's challenge does not stay the restructuring plan's effects and the judgment resolving the challenge cannot be appealed.

Since the restructuring regime has recently been completely modified, there are no decisions on this matter yet. However, the current decisions address certain challenging grounds.

With regard to the formal grounds, the judicial decisions avoid a rigorous and extreme interpretation of the formal requirements as long as there has not been a material breach of effective judicial protection. Therefore, when challenging the approval of the restructuring plan on formal grounds, the dissenting creditor or shareholder must prove that the non-compliance with these requirements has prevented him from exercising his procedural rights properly.

Lastly, it is still disputed whether it is possible under the new legal regime to file competing plans (ie, to file different restructuring plans at the same time). There is one first instance judgment that rejects this possibility, although it has been appealed and the decision from the Appeal Court is pending.

Winding-up petitions

- 25 | Do creditors apply for winding-up orders? If so, what law governs these actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?



The SIL allows creditors to apply for winding-up orders, but only in very limited cases, such as when there is proof that the debtor breached the creditors' voluntary arrangement (CVA) in place. The dispute would be a matter of fact to be resolved by the competent commercial court through an appealable judgment.

In addition, creditors may request the mandatory insolvency of a debtor in certain specific cases foreseen in the SIL.

Stays of proceedings – scope and exceptions

26 | Does the insolvency regime stay any creditor collection actions? If so, what are the parameters of such a stay? Are there any notable or commonly used exceptions?

The declaration of insolvency automatically entails a stay of the pre-existing proceedings:

- against directors who have breached their legal duties to wind up the company, up to the CVA's approval or the procedure's termination in a liquidation;
- in relation to construction agreements for actions, the creditor directly brings against a real estate developer up to the CVA's approval or the procedure's termination in a liquidation; and
- of enforcement addressed against the insolvency estate.

The insolvency judge may also impose a lifting of embargoes granted within enforcement proceedings if they significantly frustrate business continuity.

The stay does not affect in rem enforcement proceedings that creditors trigger against assets that are not considered to be essential to the insolvent company's activity. The competent commercial court may resolve the question of whether an asset is essential at any time after it hears the insolvency receiver.

The court may lift a stay regarding in rem enforcement proceedings after a CVA's approval (which does not impede these types of enforcements) or one year after the insolvency declaration, provided that the company is not in liquidation.

If the company is in liquidation, creditors may not bring in rem enforcement proceedings, and any in rem enforcements that were stayed as a result of the insolvency declaration would continue as side proceedings. However, secured creditors may initiate in rem enforcement proceedings if the secured asset has not been disposed of within one year of the opening of the liquidation.

Stays of proceedings – strategy

27 | How do creditors navigate stays in practice? How do stays generally affect their litigation strategy?



SIL-imposed stays cannot be avoided and, therefore, may drive the litigation strategy, such as when a creditor assesses whether to file a mandatory declaration-of-insolvency petition or negotiates with a pre-insolvent or insolvent debtor.

Stays of proceedings – effect on emergence from insolvency

28 | How do stays affect the debtor's emergence from insolvency?

The stays prevent creditors from securing assets that may be essential for debt reorganisation, such as when enforcement affects assets that are essential for the business. Therefore, a stay of proceedings may affect the debtor's possibility of, and strategy for, emerging from insolvency.

Subordination and disallowance of creditor claims

29 | Are the courts in your jurisdiction empowered to punish creditors' bad acts or inequitable conduct by pushing their claims down the priority waterfall? Can they void the claims altogether?

The SIL does not generally provide for claim subordination or avoidance, and it would only permit those penalties in exceptional circumstances. For instance, the SIL allows the subordination of claims that derive from a clawback action in favour of the person who acted in bad faith and in cases when a contractual party hampers contract fulfilment to the detriment of the insolvent company.

Vote designation

30 | Can creditors be disenfranchised based on bad-faith conduct?

The SIL and Spanish case law very rarely consider disenfranchisement. One exception is for subordinated creditors, who lose voting rights pursuant to the SIL. Creditors who act in bad faith in transactions that are subsequently affected by a clawback action will be subordinated.

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims

31 | To what extent can claims existing before insolvency be pursued against shareholders and their affiliates and agents during an insolvency proceeding – including any contractual, tort and misfeasance claims and claims for the recovery of company property?



Once a company is declared insolvent, the insolvency receiver updates the company balance sheet, including all assets and liabilities. An insolvent company's claims against its shareholders and their affiliates and agents are considered to be assets.

An insolvency declaration may also entail the insolvency receiver replacing the directors, but not necessarily. The company (represented by its directors or the insolvency receiver) may bring a claim against its shareholders, affiliates or agents at any time. In general, insolvency does not limit such claims. The likelihood of success depends on the merits of the case.

A mere declaration of insolvency does not shift liability from the insolvent company to its shareholders, agents or other related companies, but there may be some exceptions after lifting the corporate veil or in the case of shadow directorship.

Procedure and resolution

32 | What procedural mechanisms and issues should be considered when bringing pre-existing claims? How are they usually resolved?

The company may bring proceedings to seek payment of pre-existing claims at any time. There are no particular procedural mechanism in this sense.

The parties generally dispute jurisdiction in these cases. Which court hears the case will depend on the type of action brought. For instance, first instance courts are most likely to hear money claims. Conversely, claims seeking recovery of company property are likely to be framed as clawbacks, which means the commercial court will likely hear the case. The competent court will render a decision that may be subject to appeal.

Standing and assignment of claims

33 | Who controls the pursuit of pre-insolvency debtor claims? Can creditors or other stakeholders pursue them derivatively if the debtor or trustee refuses to do so?

Declaration of insolvency may entail the insolvency receiver replacing the directors. The insolvent company (represented either by its directors or by the insolvency receiver) may bring a claim pursuing pre-insolvency claims at any time.

Creditors may also file a motion requesting to bring a specific claim if they provide all the details, grounds and merits to do so. If they file this motion, the company has two months to bring a claim pursuing pre-insolvency claims. Otherwise, creditors can directly trigger proceedings to pursue the claim. Nonetheless, the dispute will benefit the insolvency estate (ie, it will not benefit the creditor who brings the claim because of *pari passu*). If the claim succeeds, the creditors may recover legal costs from the insolvency estate.

Risk mitigation for creditors

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How can creditors mitigate the risk that pre-insolvency debtor claims and remedies will be successful?

The success of a pre-insolvency debtor claim will depend on the merits of the case. If a debtor brings claims against creditors, the latter generally tries to mitigate the claim via a set-off, although it only applies in the insolvency context in exceptional cases (eg, when the relevant conditions are satisfied before insolvency or when a relationship is liquidated).

Minimising costs for creditors

35 How can creditors reduce the costs of litigation associated with these claims? What procedures are commonly used?

Direct negotiation with the debtor or the insolvency receiver, if possible, is usually the cheapest and quickest alternative. In other cases, creditors may prove simple economic or financial facts without an expert report (ie, through an internal investigation). Mediation is a possibility, although not always effective.

OTHER CLAIMS

Other claims against creditors

36 Are there any other major categories of claims that may be pursued against creditors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

All behaviours must be in good faith and comply with the purpose of the law. If there is proof that a certain behaviour, action or transaction is not in good faith or does not comply with the law, any interested party may file a claim to nullify the relevant behaviour, action or transaction.

Other claims against debtors

37 Are there any other major categories of claims that may be pursued against debtors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

Regardless of (insolvency) clawback actions, a party may challenge a fraudulent transaction under certain circumstances through common claims against fraud in accordance with the Spanish Civil Code.

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments

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- 38** | Are parallel proceedings and international judgments recognised in your jurisdiction? What are the requirements for recognition? Can recognition be challenged? On what grounds?

Spanish law generally does not accept parallel proceedings. International judgments are recognised and enforced in Spain, particularly if they are rendered within the European Union.

Pursuant to Regulation (EU) 2015/848, recognition of insolvency-related judgments falls under Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast). Otherwise, the Spanish Insolvency Law (SIL) and Spanish Law 29/2015 on international legal cooperation (the 29/2015 ILC Act) apply.

To enforce a decision, the interested party must file an authentic copy of the judgment and a certificate that demonstrates that the judgment is enforceable, among other relevant details.

Parties may challenge recognition and enforcement on very limited grounds, particularly if Regulation (EU) No. 1215/2012 applies. Some of the most common grounds for refusal are:

- conflict with public policy;
- violation of exclusive jurisdiction or procedural rights; and
- inconsistency of the foreign decision with an enforceable domestic judgment.

Judicial cooperation

- 39** | To what extent if any will there be judicial cooperation with other courts in relation to insolvency proceedings?

The SIL, the Spanish Recast Insolvency Act and the 29/2015 ILC Act establish the duty of reciprocal cooperation for domestic and foreign administrators. Cooperation essentially focuses on enforcement and recognition, exchange of information, coordination of asset administration and the possibility of enacting concrete cooperation rules. Cooperation depends on the existence of reciprocity, especially when the 29/2015 ILC Act applies (although cooperation can occur even without reciprocity).

REMEDIES AND ENFORCEMENT

Remedies for debtors

- 40** | What legal remedies are broadly available to successful debtor-claimants? Have the courts awarded any notable remedies recently?

Debtors may seek, among others, injunctive remedies, declaratory or constitutive judgments, damages, specific performance, depending on the type of action brought. A



successful debtor may also claim payment of legal costs. In addition, when the dispute involves a creditor-requested declaration of mandatory insolvency and the court dismisses it, the debtor may seek payment of damages from the claimant.

Remedies for creditors

41 | What legal remedies are available to successful creditor-claimants? Have the courts awarded any notable remedies recently?

Successful creditor-claimants, such as successful debtors, may seek payment of damages, acknowledgement of claims, ranking of claims, specific performance, termination of contracts, and declaratory or constitutive relief, among others. It largely depends on the specific type of action that the claimant brought.

Court enforcement mechanisms

42 | What tools are available to the court to enforce its rulings? Are there any jurisdictional limits to the court's enforcement powers?

Court-rendered judgments are binding, and the unsuccessful party must comply with the relief granted. Otherwise, the successful party may trigger enforcement proceedings, which are simple and expeditious, forcing the recalcitrant party to comply through embargoes, judicial declarations of binding statements or penalties in certain circumstances. In exceptional cases, non-compliance with an enforceable judgment may be criminally prosecuted.

SETTLEMENT AND MEDIATION

General court approach

43 | Are the courts in your jurisdiction generally amenable to settlements?

In general, Spanish courts are amenable to settlements. The popularity of alternative dispute resolution in recent years has promoted a positive attitude toward settlement agreements. Courts can judicially sanction these agreements, which gives them the same effect as a traditional judgment (ie, they are binding and enforceable).

Timing

44 | When in the course of litigation are settlements most likely to be sought out?

It depends on the case and the parties' attitudes, but negotiation is generally easier after the parties file their respective submissions.



Court review and approval

45 | How do courts review settlements? What is the legal standard for entry into and approval of a settlement?

Settlement agreements cannot be contrary to public policy, counter to third parties' interests or contrary to the law (including the Spanish Insolvency Law).

Following the parties' petition, the court may confirm that none of the above-mentioned situations occur (it would be rare for a settlement to trigger one of these limitations, but it is possible). If the court concludes that none of the limitations applies, it may sanction the settlement agreement giving it *res iudicata* effect (ie, the disputes that were settled therein cannot be disputed again in the future).

A private settlement may not be subject to the court-sanctioning procedure. In these cases, the parties merely inform the court of the agreement and proceedings conclude, without any publicity of the agreement and without any review from the court. The settlement will not benefit from the same effects though as a judicial judgment (and, therefore, a breach may trigger new judicial proceedings). If the settlement has any impact on the company's assets or liabilities, the court may request that the parties disclose the agreement.

Mediation clauses

46 | Will courts enforce mandatory or voluntary mediation clauses in pre-existing contracts?

Provided that mediation clauses do not conflict with the court's mandatory jurisdiction, the court will enforce these types of clauses.

UPDATE AND TRENDS

Recent developments

47 | What have been the most notable recent developments in insolvency litigation in your jurisdiction, including any key cases and legislative changes?

In the wake of the covid-19 pandemic, the government enacted a set of rules that were deemed controversial.

Recently, the government also implemented [Directive \(EU\) 2019/1023](#) of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

One of the key cases is the restructuring of Celsa Group, where the judge has recently dismissed the challenge against the judicial sanctioning of the restructuring plan filed by



the creditors without the intervention of the debtor or its shareholders. Its relevance lies in the importance of the Celsa Group (one of the main steel groups in Spain), the media exposure of the dispute with the creditors, the legal complexity of the litigation and the fact that it is a leading case that tested the new restructuring plan legal regime recently included in the Spanish Insolvency Law.

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COMMENCING PROCEEDINGS

Litigation climate

- 1 | How would you describe the general climate surrounding insolvency litigation in your jurisdiction? What are the most common sources of dispute? To what extent is litigation used as a pressure or delay tactic?

Insolvency litigation has long been a feature of the dispute resolution landscape in England and Wales. Litigation stemming from the United Kingdom's withdrawal from the European Union (Brexit) and the covid-19 pandemic continues to dominate the space, with the implications of recent financial turbulence in the markets beginning to make an impact.

The most common sources of dispute arise between creditors and debtors (eg, disputes over unpaid debts before or during insolvency proceedings and disputes over creditors' security interests, including protective remedies, such as freezing injunctions). Disputes also arise from the conduct of directors and corporate advisers, both of which are often insured. Insolvency professionals also take action to recover insolvent entities' assets and have extensive information-gathering powers. Litigation funding is increasingly available for all these disputes.

Claimants frequently use litigation as a pressure or delay tactic. Proceedings can be relatively straightforward to commence in England, and the courts can move quickly to assist with enforcement. The threat of litigation can also be effective: litigation is expensive, and the 'loser pays' principle for litigation costs encourages early settlement.

Sources of law

- 2 | What key sources of law form the basis of claims arising from insolvency? How does the insolvency regime interact with other laws?

The [Insolvency Act 1986](#) (the Insolvency Act) and the [Insolvency \(England and Wales\) Rules 2016](#) are the main sources of law, which other legislation support, such as the [Corporate Insolvency and Governance Act 2020](#), the [Company Directors Disqualification Act 1986](#) and the Companies Acts. All these acts are interpreted by binding case law and overlay a vast body of common law in relation to contract, tort, property and trusts.

Procedure

- 3 | What procedural rules govern insolvency litigation in your jurisdiction? What common procedural hurdles arise in practice?

The two primary statutory sources of law governing court procedure in England and Wales are the [Senior Courts Act 1981](#) and the [County Courts Act 1984](#). The [Civil Procedure Rules](#) (CPR) and supporting case law set out detailed procedures. These are supplemented by guidance produced by a number of the constituent courts of the Business & Property



Courts of England and Wales, such as the [Chancery Guide](#) and the [Commercial Court Guide](#).

Insolvency litigation is subject to the CPR, the [Insolvency Proceedings Practice Direction](#) and the [Miscellaneous Insolvency Practice Direction](#).

Courts

4 | Which courts hear insolvency claims? How experienced are they with insolvency litigation?

The Business and Property Courts (a division of the High Court of Justice) may hear all insolvency claims. Within those courts is a specialist insolvency court: the Insolvency and Companies List (formerly known as the Bankruptcy Court).

Outside London, the Insolvency and Companies List has courts in Birmingham, Bristol, Cardiff, Leeds, Liverpool, Manchester and Newcastle. Numerous county courts around England and Wales also have insolvency jurisdiction.

The courts have deep experience in insolvency litigation, particularly the Insolvency and Companies List in London. Most of its judges have extensive experience acting for clients in insolvency matters in private practice prior to judicial appointment.

Jurisdiction

5 | Through what law do the relevant courts have jurisdiction to hear insolvency claims? Does jurisdiction differ for domestic and cross-border matters?

In domestic insolvency matters, the Insolvency Act gives the courts jurisdiction to hear insolvency claims.

The English court has jurisdiction over cross-border matters in several ways.

- The EU Insolvency Regulations (the Insolvency Regulation 1346/2000 for insolvencies opened before 26 June 2017 and the Recast Insolvency Regulation 2015/848 for insolvencies opened on or after 27 June 2017) apply to main insolvency proceedings that began before the end of the EU–UK transition period post-Brexit (31 December 2020). The regulations require that a debtor's principal insolvency proceedings be opened in the member state where the debtor has its centre of main interests (COMI).
- The [Insolvency \(Amendment\) \(EU Exit\) Regulations 2019](#) make UK insolvency processes available post-Brexit if the debtor has either its COMI in the United Kingdom, or its COMI in an EU member state and an establishment in the United Kingdom.
- The EU–UK Withdrawal Agreement transplanted the Insolvency Regulation and the Recast Insolvency Regulation into UK law post-Brexit, albeit in a weakened form. The issues are immensely complex and relatively untested in cases; however, in practical terms it means that UK courts' or insolvency office holders' determinations



regarding COMI will not bind EU member states' courts, and UK insolvency proceedings will not benefit from automatic recognition in EU member states. This leads to the risk of parallel cross-border insolvency processes.

- Insolvencies in the United Kingdom are, in any case, subject to the [Cross-Border Insolvency Regulations 2006](#), based on the 1997 UNCITRAL Model Law that many jurisdictions have adopted and that provides for broad levels of cooperation among their courts.

Claims within insolvencies use the same jurisdictional gateways within the CPR as govern claims outside insolvencies, depending on the nature and circumstances of the relevant cause of action and loss suffered.

Limitation periods

- 6 | What limitation periods apply to bringing insolvency-related claims? Are there any notable exceptions?

The usual statutory rules for limitation periods, which mainly derive from the [Limitation Act 1980](#), apply to claims in insolvency proceedings. For limitation purposes, time effectively stops running when the company goes into liquidation.

Administration does not automatically suspend any limitation period, although the moratorium that applies in administration may prevent a creditor from pursuing proceedings against the company. Accordingly, creditors often issue protective claims potentially combined with a stay of proceedings, having first obtained the necessary consent or permission, or ask the administrator for an acknowledgment of their debt, which restarts the limitation period.

Parties can also agree limitation stand-stills to avoid or postpone disputes over these issues.

Interim remedies

- 7 | What interim remedies are generally available and commonly deployed in insolvency proceedings? How are these used as part of claimants' overall litigation strategy?

Interim remedies typically available in English litigation are also available in insolvency proceedings, including:

- interim injunctions;
- interim declarations;
- orders that authorise entry into any land or building;
- orders to give up goods;
- freezing orders and ancillary orders to provide information about a respondent's property or assets;



- search and seizure orders;
- orders for pre-action document disclosure, against potential defendants or third parties;
- orders for interim payment on account — or payment into court — of any contested damages, debt or other liability;
- orders that direct a party to file an account of relevant dealings; and
- orders regarding the enforcement of intellectual property proceedings.

Some interim remedies apply to particular insolvency processes (eg, the moratorium in administration prevents, among other things, creditor actions and steps to enforce security over the company's property).

Evidence

- 8** | What rules and procedures govern the collection and admissibility of evidence in insolvency litigation? To what extent is expert witness testimony allowed? What common evidential issues should claimants be aware of?

Insolvency litigation follows the same rules set out in the CPR and case law as other litigation.

Parties are responsible for collecting, preserving and disclosing evidence. Parties must take reasonable steps to preserve documents where litigation is reasonably in contemplation, and the court can draw adverse inferences from their failure to do so.

Insolvency office holders have extensive powers to require directors and third parties to disclose documents and provide information.

In interim applications, parties may deploy any evidence on which they intend to rely and have no obligation to disclose relevant evidence; however, the court can draw adverse inferences if they do not. In contrast, claims that will result in trials routinely involve orders that compel parties to search for and disclose relevant documents, even if adverse or confidential.

Parties may file witness statements of fact from individuals, as well as expert reports with the court's permission. An expert's primary duty is to the court, not to the parties, and the parties must therefore take particular care when discussing privileged information with their expert.

Time frame

- 9** | What is the typical time frame for insolvency claims?

This varies greatly depending on the insolvency's complexity and the nature of the claim. Most insolvency claims take 12 to 18 months to complete, from filing and serving a particulars of claim to receiving a judgment.



Appeals

- 10** | What are the requirements to appeal insolvency-related judgments? What is the typical time frame for appeals?

An appellant must obtain permission to appeal, either from the judge being appealed or (if refused) from the appellate judge. A judge will grant permission where the appeal would have a real prospect of success or if there is some other compelling reason for the court to hear the appeal. The appeal court will generally not reopen findings of fact, except in respect of issues of mixed fact and law, such as contractual interpretation; however, it will consider legal issues anew.

Appeals typically take 12 to 18 months, and further appeal to the Supreme Court follows a similar time frame.

Costs and litigation funding

- 11** | How are costs handled and how are claims funded? Can claimants obtain third-party funding to finance the prosecution of claims?

Under the CPR, the general rule is that the unsuccessful party must pay the successful party's reasonable costs (the 'loser pays' principle); however, the court has wide discretion regarding whether costs are payable and in what amount, and it will take into account success or failure on particular issues, the parties' conduct and settlement offers.

Litigation funding is increasingly available in insolvency litigation in the English courts. The United Kingdom has one of the most active litigation funding markets worldwide, and lawyers, funders and insurers offer a variety of funding structures.

AVOIDANCE ACTIONS

Fraudulent transfers and undervalue transactions

- 12** | What are the essential elements of avoidance actions seeking to claw back fraudulent conveyances and transfers? Can actions be brought for transfers without fraudulent intent based on undervalue of the transfer?

Under section 238 of the Insolvency Act, a liquidator or administrator may apply to the court to set aside a transaction that the company entered into in the two years before its insolvency, if it amounted to a gift or a transfer for no consideration or for consideration of significantly less value than the company gave and, at the time of the transaction or as a consequence of it, the company was or became unable to pay its debts (this is presumed if the parties are connected).

Where the company enters a transaction at an undervalue for the substantial purpose of putting assets beyond the reach of, or otherwise prejudicing, a creditor, section 423 of the Insolvency Act allows the court to set aside the transaction and make any order it thinks



fit to restore the position. The company does not need to be insolvent at the time or as a result of the transaction, and a liquidator, an administrator, a victim, the Financial Conduct Authority or the Pensions Regulator may make the application.

Preference and improvement of position

- 13** | What are the essential elements of avoidance actions seeking to claw back transactions and payments based on preference and improvement of position shortly before insolvency proceedings?

Under section 239 of the Insolvency Act, a liquidator or administrator may apply to set aside a preference that a company gave to one of its creditors, sureties or guarantors during the six months or (where the parties are connected) two years before the insolvency's onset. A transaction is a preference if it puts the creditor, guarantor or surety in a better position (in the company's insolvent liquidation) than if they had not entered into the transaction and the company was influenced by a desire to prefer that person (which is presumed when the parties are connected). At the time of the transaction or as a consequence of it, the company must have been or become unable to pay its debts. If the court determines that the transaction was a preference, it may make any order it sees fit to restore the company to its former position.

Liens and floating charges

- 14** | What are the essential elements of actions for the avoidance of liens and floating charges on subsequently acquired property?

Under English law, a lien usually arises by operation of law conferring the right to hold (but not use) another's property until debts are paid. A charge creates an encumbrance over another person's assets, conferring the right to sell the assets to repay debts.

A lien does not need to be perfected and cannot be avoided if it arises. A company registered in England and Wales must register a charge with Companies House within 21 days of its creation (under section 859H of the [Companies Act 2006](#)); otherwise, the charge is void against the company's liquidator, administrator or creditors.

An administrator or liquidator may challenge a charge's characterisation if it has not been perfected in any other way, and the charge may be subordinated to other security. If the chargee does not exercise sufficient control over charged assets, then the charge may be floating rather than fixed and, therefore, be subject to dilution by priority payments.

A floating charge (other than one created or otherwise arising under a 'security financial collateral arrangement' under the [Financial Collateral Arrangements \(No. 2\) Regulations 2003](#)) that a company creates within one year before the insolvency's onset (or two years if the parties are connected) will be automatically invalid, except to the extent that the counterparty provided 'new money' on or after its creation (section 245 of the Insolvency Act), if the company was or became unable to pay its debts when it created the charge (insolvency is assumed if the parties are connected).



Process and resolution of avoidance actions

- 15 | Through what process are avoidance actions litigated? What procedural issues often arise and how are avoidance actions usually resolved?

The procedure for any avoidance action, including who may apply, depends on its statutory basis; however, in general, an applicant must issue an application within the insolvency proceedings, file evidence on which it intends to rely in support of its application, and serve that application on relevant respondents. Respondents may file evidence in response, and the court will hear arguments from interested parties at a public hearing.

CLAIMS AGAINST DIRECTORS, OFFICERS AND SHAREHOLDERS

Breach of fiduciary duty

- 16 | What are the essential elements of a claim for breach of fiduciary duty against directors and officers in the context of corporate insolvency?

The existence of a breach of duty is a question of fact. A liquidator or administrator can institute proceedings in the company's name for a director's breach of duty. A company shareholder may also bring a derivative claim on the company's behalf if the administrator or liquidator does not.

The official receiver or liquidator, or any company creditor or contributory, may commence a claim against a company officer for misfeasance under section 212 of the Insolvency Act. If the court determines that the officer has misapplied or retained company property, become accountable for company property, breached a fiduciary or other duty in relation to the company, or otherwise committed any misfeasance, it may order the officer to repay, restore or account for the property, with interest; or contribute the sum to the company's assets.

Protection from liability

- 17 | To what extent does the law in your jurisdiction protect directors and officers from liability for decisions made in connection with the restructuring or insolvency?

If a director took every step to minimise potential loss to the company's creditors as they ought to have taken when the company could not reasonably avoid insolvent liquidation or administration, those actions could constitute a defence to a wrongful trading action under section 214 of the Insolvency Act. There is no equivalent defence to a fraudulent trading action.

In the context of implementing a restructuring, a scheme of arrangement under Part 26 of the Companies Act, a restructuring plan under Part 26A of the Companies Act or a company voluntary arrangement (CVA) under Part 1 of the Insolvency Act will commonly release officers from liability in connection with negotiating the restructuring proposal.



Converting credit to equity

- 18** | Can credit extended by an insider or shareholder be recharacterised as equity? If so, what is the mechanism by which such an action is brought, and what elements are required to prevail?

English law has no general doctrine that a court may recharacterise credit that an insider or shareholder advanced to a company as equity. A shareholder may agree that its debt ranks behind the other creditors' debts or a restructuring proposal that a debtor company and its creditors negotiate may implement a debt-for-equity swap to deleverage the company's balance sheet, converting certain indebtedness into one or more classes of the company's share capital. This can be effected contractually, if affected creditors demonstrate sufficient (typically unanimous) support, or through a restructuring procedure, such as a scheme of arrangement under Part 26 of the Companies Act, a restructuring plan under Part 26A of the Companies Act or a CVA under Part 1 of the Insolvency Act.

Illegal dividends

- 19** | Can dividends received by shareholders be prosecuted as illegal?

Under Part 23 of the Companies Act, a company can only make a distribution out of profits available for that purpose. A shareholder who knew or had reasonable grounds to believe at the time that the distribution contravened Part 23 is liable to repay it. Even if the dividend is lawful under Part 23, it may nevertheless constitute a transaction at an undervalue under section 238 of the Insolvency Act or a transaction defrauding creditors under section 423 of the Insolvency Act.

Trading while insolvent

- 20** | How is trading while insolvent treated in your jurisdiction? If actionable, what mechanisms apply and what are the elements of a successful claim?

A director may be liable for wrongful trading under sections 214 and 246ZB of the Insolvency Act or fraudulent trading under sections 213 and 246ZA of the Insolvency Act. To pursue a claim against directors, a liquidator or administrator must apply to the court for an order that the directors should make such contributions to the company's assets as the court thinks proper.

For a successful wrongful trading claim, the directors must have known or ought to have concluded that there was no reasonable prospect that the company would avoid an insolvent liquidation or administration. A director's action of having taken every step to minimise potential loss to the company's creditors could constitute a defence.

For a successful fraudulent trading claim, the court must believe that:

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the company had carried out its business with intent to defraud company creditors or any other person, or for any fraudulent purpose;

- the respondent was knowingly party to carrying on such business; and
- the respondent acted dishonestly.

Other parties to the fraud may also be liable to make contributions.

Equitable subordination

21 | Is equitable subordination of shareholder claims allowed? If so, what requirements and mechanisms apply?

English law has no general doctrine of equitable subordination. Shareholder claims may be subordinated based on agreements among the shareholder, other creditors and the company.

A debtor may also propose a scheme of arrangement under Part 26 of the Companies Act, a restructuring plan under Part 26A of the Companies Act or a CVA under Part 1 of the Insolvency Act with its creditors, which provides for certain creditors' claims to be subordinated as part of the restructuring proposal.

In a scheme or restructuring plan, supporters within each class of creditors voting on the proposal must meet the relevant statutory thresholds (75 per cent in value and 50 per cent in number of each class for a scheme; 75 per cent in value for a restructuring plan), followed by a court order sanctioning the scheme or restructuring plan. In a CVA, both the company's shareholders (50 per cent) and creditors (75 per cent by value, with those voting against being less than 50 per cent by value of all the unconnected creditors).

Other claims

22 | Are any other claims commonly brought against shareholders, directors and officers in your jurisdiction? If so, what mechanisms are used to raise these claims and what elements are required to prevail?

The principal claims against directors and officers are for breach of duty or actions that an insolvency office holder brings under the Insolvency Act. In addition, employers can bring claims against an employee for breach of an employment contract or against a director for breach of a service agreement or other contract, and shareholders can bring claims against each other for breaching a shareholders' agreement. All of these claims are subject to usual common law rules that exist outside insolvencies.

Risk mitigation

23 | How can shareholders and sponsors mitigate the risk that claims against them will be successful, and minimise the accompanying financial burden?

Early investigation involves significantly front-loading management time and legal costs; however, it is often highly cost-effective, allowing parties to identify strengths and weaknesses early and develop a strong litigation strategy. This includes collecting, preserving and reviewing relevant documents, which are fundamental to resolving factual disputes at trial and will likely have to be disclosed at some point.

Parties should also ensure that they identify and contact witnesses of fact and expert witnesses: their evidence can have a profound early impact on prospects of success.

The Civil Procedure Rules (CPR) encourage an open approach, and resolving issues early reduces costs and uncertainty. This includes effective early mediation, which is highly advisable and may be difficult to avoid. Most proceedings in England settle, so parties should shape their litigation strategy accordingly.

CREDITOR ACTIONS AND STRATEGIC CONSIDERATIONS

Contesting restructuring plans

- 24** | Can creditors bring actions contesting the restructuring plan? If so, what law governs such actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

A creditor may challenge a proposed scheme of arrangement under Part 26 of the Companies Act or a restructuring plan under Part 26A of the Companies Act at the convening hearing, the sanction hearing or both. Challengers often argue that the debtor's proposal incorrectly categorises the classes for voting on the proposal.

At the sanction hearing, the court will consider whether the proposal is objectively fair, by reference to creditors' existing rights as varied by the restructuring plan or scheme, in the context of the relevant comparator. If the court agrees with the creditor or considers that the proposal is otherwise not fair, it will not sanction the restructuring plan or scheme.

In a company voluntary arrangement (CVA) process, a creditor may challenge the CVA proposal only by filing an application to court within 28 days of the proposal's approval, on grounds of material irregularity or unfair prejudice. If the court agrees, then it may make such order as it sees fit, including overturning the CVA.

Winding-up petitions

- 25** | Do creditors apply for winding-up orders? If so, what law governs these actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

A creditor (including contingent or prospective creditors), the company or its directors (among others) may make an application to wind up a company. Section 122 of the Insolvency Act specifies when the court may wind up a company, such as when the company cannot pay its debts, which section 123 of the Insolvency Act defines as when a company is insolvent either on a cash flow basis (unable to pay its debts as they fall due)



or on a balance sheet basis (the value of its assets is less than its actual, contingent and prospective liabilities). A court may deem a company unable to pay its debts if the company fails to satisfy either a creditor's statutory demand for a debt exceeding £750 within 21 days of service or a judgment debt (or similar court order).

A creditor should not present a winding-up petition if the debt is genuinely disputed, the debtor has a counterclaim or set-off against the creditor that reduces the debt to below the statutory threshold or the company has a reasonable excuse for not paying. In those circumstances, the company may seek an injunction to prevent the creditor from issuing a winding-up petition.

Stays of proceedings – scope and exceptions

26 | Does the insolvency regime stay any creditor collection actions? If so, what are the parameters of such a stay? Are there any notable or commonly used exceptions?

Not all English insolvency processes trigger an automatic stay. The statutory moratorium in administration (which courts also impose on an interim basis pending an administration application's determination or when an applicant with standing files a notice of intention to appoint administrators) prevents the enforcement of security or continuation of legal process against the company or its property without the administrator's consent or court's permission. The administrators are likely to consent to enforcement when they do not require the use of the secured property. The court is likely to give permission when the prejudice that the relevant creditor would suffer as a result of the stay is greater than the impact on the creditors as a whole of lifting the stay.

When a court issues a winding-up order, a stay of all proceedings against the company comes into force automatically, except for security enforcement or lease forfeiture. There is no equivalent stay in a voluntary winding-up, although the liquidator or any creditor or contributory may apply for one.

Separately, a debtor may seek to impose a stay on its creditors through a moratorium under Part A1 of the Insolvency Act. As a debtor-in-possession procedure, the directors remain in charge of running the company's day-to-day business under the supervision of a monitor, who must be an insolvency practitioner reporting to the court. Eligible companies incorporated in England, Wales or Scotland, as well as certain eligible overseas companies, may seek a Part A1 moratorium if:

- in the directors' view, the company is or is likely to become unable to pay its debts; and
- in the monitor's view, the moratorium will likely result in the company being rescued as a going concern.

A scheme, restructuring plan or CVA may also impose a moratorium on claims or proceedings if a court approves it.

Stays of proceedings – strategy



27 | How do creditors navigate stays in practice? How do stays generally affect their litigation strategy?

Stays of proceedings (or moratoriums) are not unusual. Creditors should prepare for and monitor them so they can recommence proceedings immediately once the stay is lifted or their conditions expire, always mindful of the expiries of limitation periods. They should also consider interim protection, such as freezing orders.

A stay can provide a creditor time to marshal evidence and strengthen their case, and it does not prevent settlement discussions from taking place: stays are often designed to encourage them.

Stays of proceedings – effect on emergence from insolvency

28 | How do stays affect the debtor's emergence from insolvency?

By design, Part A1 moratoriums and moratoriums on administration (in which the administrators pursue the first objective of rescuing the company as a going concern) provide debtors with 'breathing space' for them to reorganise their affairs, negotiate with creditors and secure a viable rescue. If a debtor emerges from its Part A1 moratorium or administration solvent, the moratorium terminates.

Subordination and disallowance of creditor claims

29 | Are the courts in your jurisdiction empowered to punish creditors' bad acts or inequitable conduct by pushing their claims down the priority waterfall? Can they void the claims altogether?

No.

Vote designation

30 | Can creditors be disenfranchised based on bad-faith conduct?

While there is no general implied duty of good faith as a matter of English law, where a contract incorporates such a duty and a party breaches it, creditors may enforce such duties unless general principles of insolvency law preclude it.

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims

31 | To what extent can claims existing before insolvency be pursued against shareholders and their affiliates and agents during an insolvency proceeding –



| including any contractual, tort and misfeasance claims and claims for the recovery of company property?

Parties may pursue pre-existing claims during insolvency proceedings, subject to any moratoriums in place, and the elements will depend on the nature of the claim.

Procedure and resolution

32 | What procedural mechanisms and issues should be considered when bringing pre-existing claims? How are they usually resolved?

In addition to the usual considerations that claimants should evaluate before bringing a claim, in an insolvency context, claimants should carefully consider whether allowing the insolvency office holder to bring the claims within the insolvency process may better achieve their objective, including the expected return, the comparative difficulties of obtaining evidence and enforcement. The insolvency process may allow for greater cost-sharing opportunities and may allow claimants to rely on findings of fact made through the insolvency process. Claimants considering holding back on pre-existing claims should propose stand-still agreements and potentially issue a protective claim pending the proceedings' outcome.

Standing and assignment of claims

33 | Who controls the pursuit of pre-insolvency debtor claims? Can creditors or other stakeholders pursue them derivatively if the debtor or trustee refuses to do so?

Claims remain with the debtor, and insolvency office holders do not adopt them. If a creditor considers that a claim against a third party exists, the creditor may be able to bring claims for breach of duty, misfeasance or where assets have been put beyond the reach of creditors.

Risk mitigation for creditors

34 | How can creditors mitigate the risk that pre-insolvency debtor claims and remedies will be successful?

A company in administration or liquidation may pursue all claims and remedies to which it was previously entitled. Similarly, creditors may avail themselves of all remedies and defences. When mutual claims for breach of contract exist, parties may agree a mutual stand-still agreement. A well-drafted credit agreement may also give the creditor a right of set-off or cap the creditor's liability to the borrower for breach of contract.

Minimising costs for creditors



- 35** | How can creditors reduce the costs of litigation associated with these claims? What procedures are commonly used?

A defendant creditor may consider leveraging the debtor company's weak financial position by making a settlement offer when an insolvent company holds a meritorious claim against the creditor. An administrator or liquidator may be readily amenable to a settlement that provides a significant return on the potential claim, realising funds for the insolvency estate while avoiding the need for potentially lengthy and costly litigation.

A creditor may also seek at an early stage to pursue alternative dispute resolution, such as mediation. When the insolvency office holder is amenable to this, the process may reduce legal costs and result in a quick resolution of the claim.

If proceedings commence, a creditor may apply under Rule 25.12 of Part 25 of the Civil Procedure Rules (CPR) for security for its costs in the relevant proceedings (ie, an order that the claimant pay money into court or provide a bond or guarantee as security for the creditor's costs). The prospect of a security-for-costs order may deter the debtor from proceeding with a speculative claim or lead to an early resolution of the proceedings.

In addition, a defendant creditor may consider making an offer in accordance with Part 36 of the CPR, in which case the claimant faces increased risk of liability for the defendant's costs and interest if it does not accept the offer.

OTHER CLAIMS

Other claims against creditors

- 36** | Are there any other major categories of claims that may be pursued against creditors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

No.

Other claims against debtors

- 37** | Are there any other major categories of claims that may be pursued against debtors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

No.

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments

- 38** |



Are parallel proceedings and international judgments recognised in your jurisdiction? What are the requirements for recognition? Can recognition be challenged? On what grounds?

Generally, courts in England and Wales will give effect to a validly obtained foreign judgment and will not enquire into errors of fact or law in the original decision. Litigants can rely on a number of tools for recognition and enforcement of foreign judgments in England and Wales.

Three main EU regimes apply to EU member state courts' judgments in proceedings that began before the end of the Brexit transition period (31 December 2020) relating to civil and commercial matters:

- the Brussels Regulation (EU) No. 44/2001 applies to judgments in proceedings commenced before 10 January 2015;
- the Brussels I Recast Regulation (EU) No. 1215/2012 applies to judgments in proceedings commenced on or after 10 January 2015 and before 31 December 2020; and
- the Brussels Convention 1968 applies to certain other judgments in Gibraltar and some dependent territories of EU member states.

The [Administration of Justice Act 1920](#) applies to judgments from courts of most Commonwealth countries and British overseas territories, as well as the EU member states of Cyprus and Malta.

The [Foreign Judgments \(Reciprocal Enforcement\) Act 1933](#) applies to judgments from courts in Australia, Canada, Guernsey, India, the Isle of Man, Israel, Jersey and Pakistan. It also applies to some European countries (Austria, Belgium, France, Germany, Italy, the Netherlands and Norway), although it is uncertain whether those judgments have effect post-Brexit.

The common law applies to judgments from courts of other jurisdictions, most notably Brazil, China, Russia and the United States. At common law, a foreign judgment is not directly enforceable in the United Kingdom but is treated as a contract debt. Enforcement must meet certain criteria, including that:

- the judgment is:
 - final and conclusive and on the merits of the action;
 - not procured by fraud or contrary to public policy or the requirements of natural justice; and
 - not in breach of a valid choice of court or arbitration agreement (unless the defendant submitted to the foreign jurisdiction); and
- the foreign proceedings satisfy UK conflict-of-law rules on jurisdiction.

Judgment creditors can seek recognition using summary judgment procedures, and any judgment obtained will be enforceable in the same way as any other UK court judgment.



Generally, recognition and enforcement are subject to challenge in the same court (if the applicant obtained either without notice) and on the basis that the grounds for recognition and enforcement did not apply.

Regarding the EU regime, the EU instruments expressly prohibit UK courts from reviewing the merits of a judgment from another EU member state but permit challenges on strictly limited grounds, including those relating to public policy and conflicting judgments.

Under the Administration of Justice Act 1920, the court's power to register a judgment is discretionary, which provides some scope for a merits-based review stemming from specific grounds set out in section 9(2).

The Hague Convention on Choice of Court Agreements 2005 sets out limited grounds on which a court may refuse recognition or enforcement (article 9). It expressly prohibits the review of the merits of judgments (article 8(1)).

The Foreign Judgments (Reciprocal Enforcement) Act 1933 permits setting aside registration when the original court lacked jurisdiction, the judgment was obtained by fraud, an appeal is pending or a judgment debtor intends to file one, the judgment is contrary to UK public policy, or the judgment is for multiple damages.

At common law, recognition is discretionary. Courts in England will rehear the application if it was obtained without notice and will consider new evidence from the applicant; however, an English court is unlikely to refuse to recognise a foreign judgment on grounds that could have been raised in the foreign proceedings.

Judicial cooperation

39 | To what extent if any will there be judicial cooperation with other courts in relation to insolvency proceedings?

The United Kingdom has adopted the UNCITRAL Model Law in the Cross-Border Insolvency Regulations 2006, and ordinarily grants recognition for foreign proceedings. A foreign insolvency office holder can seek recognition in England of the relevant insolvency proceedings as either foreign main proceedings (insolvency proceedings opened where the debtor has its centre of main interests (COMI)) or foreign non-main proceedings (where the debtor has an establishment but not its COMI). In practice, the English court is willing to support foreign insolvency proceedings and their office holders.

When an English court recognises foreign insolvency proceedings as main proceedings, English civil proceedings against the debtor are stayed, and the court may entrust the foreign insolvency office holder with the administration or realisation of all or part of the debtor's estate that is in England. The foreign insolvency office holder also receives many powers of a British insolvency office holder, such as information-gathering and transaction-avoidance laws, including transactions at an undervalue and preferences.

A court in a relevant territory may apply to the English court for assistance under section 426 of the Insolvency Act, and the English court also has an inherent common law power to recognise and grant assistance to foreign insolvency proceedings.

REMEDIES AND ENFORCEMENT

Remedies for debtors

40 | What legal remedies are broadly available to successful debtor-claimants? Have the courts awarded any notable remedies recently?

The principal remedies in English law for breach of contract, torts and unjust enrichment are an award of damages and specific performance (ie, compelling performance of the obligation). The court may issue injunctions requiring a party either to perform a specified act or to refrain from doing a specified act at its discretion.

Other remedies are available in equity at the court's discretion, including an account of profits, equitable compensation, declaratory relief, rescission, rectification and subrogation.

Rules 14.24 and 14.25 of the Insolvency (England and Wales) Rules 2016 provide that, where there have been mutual dealings between the company and a creditor before the company enters liquidation or administration, respectively, the insolvency office holder must take an account of what is due from the company and that creditor to each other in respect of their mutual dealings, and the sums due from one must be set off against the sums due from the other. The creditor may then only prove for the balance of its claim, or the office holder may only claim the balance owed to the company.

Remedies for creditors

41 | What legal remedies are available to successful creditor-claimants? Have the courts awarded any notable remedies recently?

The same remedies are available to creditors as to debtors.

Court enforcement mechanisms

42 | What tools are available to the court to enforce its rulings? Are there any jurisdictional limits to the court's enforcement powers?

The main methods of enforcing a money judgment include:

- taking control of goods by writ or warrant of control, which commands an enforcement officer to take control of and sell a judgment debtor's goods to satisfy a judgment debt;
- a third-party debt order, under which sums owed to a judgment debtor that are in a third party's possession are payable to the judgment creditor;
- a charging order, which imposes a charge over a judgment debtor's beneficial interest in land, securities or certain other assets, preventing its sale, albeit subordinated to prior security; and



- an attachment-of-earnings order, pursuant to which an employer deducts a proportion of a judgment debtor's earnings and pays it to the judgment creditor in instalments. It is only available against individuals.

SETTLEMENT AND MEDIATION

General court approach

43 | Are the courts in your jurisdiction generally amenable to settlements?

Yes. The English courts actively encourage settlements and support them through case management, and there is a possibility of adverse costs orders for a party's refusal to participate.

Timing

44 | When in the course of litigation are settlements most likely to be sought out?

Parties can initiate settlement discussions at any point after a dispute arises, even after a trial or during appeal processes.

Court review and approval

45 | How do courts review settlements? What is the legal standard for entry into and approval of a settlement?

In general, the courts do not review settlement agreements but will make and enforce orders based on them, although creditors may challenge settlements that insolvency practitioners reach on insolvent entities' behalf if they cannot be justified.

Mediation clauses

46 | Will courts enforce mandatory or voluntary mediation clauses in pre-existing contracts?

Yes. When parties have agreed to follow a mandatory mediation process, the court can enforce that agreement; however, mediation clauses are often optional, and courts cannot easily enforce them.

UPDATE AND TRENDS

Recent developments

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- 47 | What have been the most notable recent developments in insolvency litigation in your jurisdiction, including any key cases and legislative changes?

BTI 2014 LLC v Sequana SA and others

On 5 October 2022, the UK Supreme Court handed down its judgment in *BTI 2014 LLC v Sequana SA and others*, in which the court considered at what point in a company's financial descent its directors must prioritise the interests of the company's creditors over those of its shareholders.

The company in question had paid two dividends to its parent when the company was solvent on both a balance sheet and cash flow basis, but had ceased trading and was subject to contingent liabilities in respect of indemnities for clean-up costs and damages arising from environmental liabilities. Though the Supreme Court unanimously agreed with the Court of Appeal's finding that the solvency of the company at the time that the dividend was paid meant that the creditors' interest rule was engaged, it was determined that the creditors' interest rule arises 'when the directors know or should know that the company is or is likely to become insolvent'.

The directors' fiduciary duty to act in the company's interests must reflect the fact that both the shareholders and the creditors have an interest in the company's affairs. Where those interests are in conflict, a balancing exercise will be necessary to reflect their respective weight in the light of the gravity of the company's financial difficulties and this should be seen as a sliding scale rather than a cliff edge.

A minority of the court left open the question of whether it is essential that the directors know or ought to know that the company is insolvent or bordering on insolvency, so this remains open to further argument in future cases.

Proposed adoption of Article x

On 7 July 2022, the Insolvency Service, an executive agency sponsored by the UK Department for Business and Trade, published a consultation seeking views on its proposal to implement part of the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments (MLIJ) into English law.

The MLIJ is intended to provide a standalone framework under which foreign insolvency-related judgments can be recognised and enforced. Notably, if the MLIJ were implemented in England and Wales in full, it would be mandatory (subject to specific provisions for refusal) for foreign insolvency-related judgments from foreign courts to be recognised, which would be a departure from the discretion currently afforded to England and Wales courts under the UNCITRAL Model Law.

The Insolvency Service has instead recommended only introducing the following article (article x) to the Cross-Border Insolvency Regulations (CBIR): 'Notwithstanding any prior interpretation to the contrary, the relief available under [... article 21 of the UNCITRAL Model Law on Cross-Border Insolvency] includes recognition and enforcement of a judgment.'



The aim of doing so is to remove the uncertainty about whether article 21 of the UNCITRAL Model Law (as adopted in schedule 1 to the CBIR includes the recognition and enforcement of insolvency-related judgments from foreign courts. In conjunction with the above amendment, the Insolvency Service also proposes additional amendments to the CBIR to refer to the updated guidance on the enactment of the UNCITRAL Model Law on Cross-Border Insolvency and to provide a list of discretionary, illustrative, and non-exhaustive grounds of refusal to which court in Great Britain can refer to in deciding whether to recognise and enforce an insolvency-related judgment from a foreign court.

In July 2023, the Insolvency Service called for further responses to the proposals:

- to partially implement the MLIJ through the adoption of article x;
- to provide a non-exhaustive list of factors for the court to consider when deciding whether to recognise an insolvency-related judgment;
- on the required approach to meet the Insolvency Service's aims; and
- to update the list of guidance to which the court can refer. It is at present unclear on what timescale any implementation will take place.

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Litigation climate

- 1 | How would you describe the general climate surrounding insolvency litigation in your jurisdiction? What are the most common sources of dispute? To what extent is litigation used as a pressure or delay tactic?

Distress-focused players have been more active and aggressive recently, as the turbulent economy has presented more opportunities for those players to deploy capital and pursue returns that otherwise may not be available in the market.

Parties often use litigation to pressure and delay. Out-of-the-money claimants in particular use litigation in this way as they have nothing to lose and hope that litigation will lead to a settlement or that a delay will lead to a change in their economic position.

Additionally, sponsors have been aggressive in engaging in transactions based on disputed interpretations of credit documents, which often results in litigation before or during bankruptcy.

Sources of law

- 2 | What key sources of law form the basis of claims arising from insolvency? How does the insolvency regime interact with other laws?

The primary sources of insolvency-based claims are:

- the [Bankruptcy Code](#) (particularly Chapter 5, which governs avoidance actions regarding fraudulent transfers and preferences);
- state fraudulent conveyance statutes; and
- state statutes and common law regarding breaches of fiduciary duties.

These sources often interact with other laws, especially corporate law. For example, the success of claims involving an officer's or a director's breach of fiduciary duty could depend on the company's state of incorporation and governing law.

Procedure

- 3 | What procedural rules govern insolvency litigation in your jurisdiction? What common procedural hurdles arise in practice?

In the event of bankruptcy, the [Federal Rules of Bankruptcy Procedure](#) govern litigation. Outside of bankruptcy, the [Federal Rules of Civil Procedure](#) govern federal court litigation, and the individual civil procedure rules of each state govern court litigation in the respective state.



The Bankruptcy Rules (which, for example, allow for process service by mail) may eliminate some of the customary hurdles that exist in state court litigation regarding service of process or personal jurisdiction.

Courts

4 | Which courts hear insolvency claims? How experienced are they with insolvency litigation?

Both state courts and federal courts (including bankruptcy courts) hear insolvency-related claims. Federal bankruptcy courts are specialised courts that have been established as a division of the US district courts to oversee bankruptcy proceedings and related litigation. Parties may appeal bankruptcy court decisions to the corresponding district court or, in some jurisdictions, special appellate panels that comprise bankruptcy judges.

The courts that are most experienced with insolvency-related litigation are New York's federal and state courts, Delaware's federal and state courts and the federal bankruptcy courts nationwide.

Jurisdiction

5 | Through what law do the relevant courts have jurisdiction to hear insolvency claims? Does jurisdiction differ for domestic and cross-border matters?

[Title 28, section 1334 of the US Code](#) gives federal district courts jurisdiction over all cases arising under the Bankruptcy Code or in a bankruptcy case, as well as those related to bankruptcy.

Claimants must establish personal jurisdiction for non-US defendants; however, a non-US defendant's filing of a proof of claim in a bankruptcy case satisfies the consent requirements for jurisdiction for 'core' proceedings within the meaning of section 157 of the Bankruptcy Code.

Limitation periods

6 | What limitation periods apply to bringing insolvency-related claims? Are there any notable exceptions?

Fraudulent conveyance claims outside of bankruptcy typically have a three- to six-year statute of limitations, depending on the applicable state's law. In a bankruptcy case, federal fraudulent conveyance claims have a two-year statute of limitations (ie, parties must bring actions within two years of the commencement of the case) and may stem from transactions that occurred in the two years before bankruptcy (ie, the 'lookback period'). The trustee can often avail itself of longer lookback periods available under non-bankruptcy state law.



Claims for breach of fiduciary duty typically have a three- to four-year statute of limitations, depending on the applicable state's law.

Preference actions under the Bankruptcy Code have a two-year statute of limitations, as well as a 90-day lookback period for claims against non-insiders and a one-year lookback period for insiders.

Outside of bankruptcy, the parties' agreement can toll these periods; however, section 546(a) of the Bankruptcy Code prohibits avoidance actions (ie, fraudulent conveyances and preferences) from being tolled. Additionally, section 108 of the Bankruptcy Code provides for the automatic tolling of various debtor and third-party prepetition rights, claims and causes of action for varying periods after the filing of a bankruptcy petition.

Interim remedies

7 | What interim remedies are generally available and commonly deployed in insolvency proceedings? How are these used as part of claimants' overall litigation strategy?

Parties commonly seek and litigate stays of bankruptcy court orders pending appeal, pursuant to Rule 8007 of the Federal Rules of Bankruptcy Procedure. The entry of the stay may require a party to file a bond with the bankruptcy court.

While parties may seek stays and temporary restraining orders, creditors usually seek them to prevent an insolvent obligor from transferring assets.

Evidence

8 | What rules and procedures govern the collection and admissibility of evidence in insolvency litigation? To what extent is expert witness testimony allowed? What common evidential issues should claimants be aware of?

For insolvency litigation in a bankruptcy court or another federal court, the [Federal Rules of Evidence](#) govern evidence collection and admissibility.

For insolvency litigation in a state court, the state's individual rules of evidence govern evidence collection and admissibility.

Courts generally allow expert witness testimony in insolvency litigation. The two most litigated issues are solvency and valuation.

As is the case in most jurisdictions, email communications can pose evidential issues.

Time frame

9 | What is the typical time frame for insolvency claims?



Pursuing an insolvency claim to final judgment could take years (approximately one to two years), from pre-filing discovery and negotiations to a final judgment. Any appeals would extend that time frame by approximately another one to three years.

Insolvency litigation within a bankruptcy case generally proceeds more quickly. If the parties cannot resolve the dispute themselves, a bankruptcy court will likely order mediation.

Appeals

10 | What are the requirements to appeal insolvency-related judgments? What is the typical time frame for appeals?

Generally, to appeal a bankruptcy court's judgment:

- the judgment must be a final judgment;
- if the judgment is not a final judgment, it must involve an injunction, a receiver or an admiralty issue; or
- if the judgment is neither final nor one that involves an injunction, a receiver or an admiralty issue, the appellant must obtain court permission.

Pursuant to Bankruptcy Rule 8004, parties must file a notice of appeal of a bankruptcy judgment within 14 days of the initial judgment, order or decree, which is significantly shorter than the 30 days allowed for other federal court appeals.

Costs and litigation funding

11 | How are costs handled and how are claims funded? Can claimants obtain third-party funding to finance the prosecution of claims?

The debtor's estate often funds litigation indirectly by paying for an official committee of unsecured creditors to investigate and litigate claims.

Individual parties generally pay their own litigation costs, but third-party litigation finance is an emerging industry in which third-party investors fund litigation in exchange for a share of the proceeds if the litigation succeeds (or purchase litigation claims outright).

AVOIDANCE ACTIONS

Fraudulent transfers and undervalue transactions

12 | What are the essential elements of avoidance actions seeking to claw back fraudulent conveyances and transfers? Can actions be brought for transfers without fraudulent intent based on undervalue of the transfer?



Under federal bankruptcy law (which is generally similar to state laws) avoidance actions can claw back fraudulent transfers if actual fraud exists (Title 11, section 548(a)(1)(A) of the US Code) or constructive fraud (Title 11, section 548(a)(1)(B) of the US Code).

To demonstrate actual fraud has occurred (and to avoid the transfer), the movant must show that the defendant had an 'actual intent to hinder, delay, or defraud' creditors. While the ultimate inquiry focuses on the defendant's actual intent, the courts have identified various 'badges of fraud' that may evidence that a defendant made a transfer with such intent. The badges include:

- a lack or inadequacy of consideration;
- a family, friendship or close associate relationship between the parties;
- the retention of possession, benefit or use of the property in question;
- the defendant's financial condition, both before and after the transaction in question;
- the defendant's course of conduct after incurring the debt, the onset of financial difficulties or the pendency or threat of creditor suits; and
- the general chronology of events and transactions under inquiry.

To demonstrate constructive fraud has occurred (and to avoid the transfer), the movant must show that the defendant made a transfer, received less than reasonably equivalent value in exchange for the transfer and:

- was insolvent when the transfer occurred or became insolvent as a result;
- engaged in business or a transaction (or was about to engage in business or a transaction) for which its capital was not sufficient;
- intended to incur, or believed that it would incur, debts that exceeded its ability to pay as those debts matured; or
- made the transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

Preference and improvement of position

13 | What are the essential elements of avoidance actions seeking to claw back transactions and payments based on preference and improvement of position shortly before insolvency proceedings?

Section 547 of the Bankruptcy Code governs the avoidance of preferential payments that a debtor made before a bankruptcy filing. That section allows the trustee to avoid (ie, claw back) any transfer that the debtor made to a creditor on account of an antecedent debt while the debtor was insolvent, on or within 90 days of the bankruptcy date or within one year of the bankruptcy if the creditor was the debtor's insider when the transfer occurred, that allows the creditor to receive more than it otherwise would in Chapter 7 or if the transfer had not been made.



The Bankruptcy Code also provides certain defences to preference actions. The three most common are the 'ordinary course of business' defence, the 'contemporaneous exchange for new goods or services' defence and the 'new value' defence.

Liens and floating charges

- 14** | What are the essential elements of actions for the avoidance of liens and floating charges on subsequently acquired property?

Section 544(a)(1) of the Bankruptcy code provides that, after the bankruptcy filing, a trustee can avoid any transfer that the debtor made or obligation that the debtor incurred that a judgment lien creditor could void under non-bankruptcy law; thus, a trustee or debtor in possession can avoid an unperfected lien, leaving the creditor's claim unsecured.

In certain cases, to the extent that inventory or receivables subject to a lien increase in value within the 90 days before a bankruptcy filing (or one year, if the creditor is an insider), the lien may be avoidable as a preference pursuant to section 547(c)(5) of the Bankruptcy Code for the net improvement in position.

Additionally, floating liens do not continue on property acquired by the debtor after the filing, pursuant to section 552 of the Bankruptcy Code (although, the lien would continue with regard to proceeds of collateral).

Process and resolution of avoidance actions

- 15** | Through what process are avoidance actions litigated? What procedural issues often arise and how are avoidance actions usually resolved?

Parties litigate avoidance actions through adversary proceedings, ancillary to the debtor's main bankruptcy case. Those actions usually resolve through settlement and rarely litigate to judgment, because such litigation is extremely fact-intensive and, thus, time-consuming and expensive; however, the spectre of such litigation – particularly colourable fraudulent transfer claims – serves as an important source of leverage in restructuring negotiations.

Issues relating to discovery and standing often arise in avoidance action litigation, especially when non-debtor parties, such as a committee of unsecured creditors, seek to bring avoidance actions when a debtor refuses to do so (or has waived the ability to do so, which is often a bargained-for term of case financing arrangements with secured creditors).

CLAIMS AGAINST DIRECTORS, OFFICERS AND SHAREHOLDERS

Breach of fiduciary duty

- 16** | What are the essential elements of a claim for breach of fiduciary duty against directors and officers in the context of corporate insolvency?



A claim for a breach of a fiduciary duty against directors and officers generally has four elements:

- the directors and officers owed a fiduciary duty;
- they breached that duty;
- the plaintiff suffered damages as a result of the breach; and
- the breach caused those damages.

Protection from liability

17 | To what extent does the law in your jurisdiction protect directors and officers from liability for decisions made in connection with the restructuring or insolvency?

Certain legal protections for directors and officers limit potential liability for the decisions they make, including the business judgement rule, which creates a strong presumption in directors' and officers' favour that, in making business decisions that do not involve direct self-interest or self-dealing, they act on an informed basis, in good faith and in the honest belief that their actions are in the corporation's best interest. A court will generally not substitute its own notions of sound business judgement if the directors and officers acted on an informed basis, in good faith and in the honest belief that the action they took was in the company's best interests.

Additionally, the advice-of-counsel defence allows a director or officer to seek to limit or eliminate any decision-making liability by arguing that they reasonably relied on the advice of counsel.

Finally, state laws often permit a limited liability company or corporation in its formation documents to waive or reduce certain fiduciary duties that directors and officers owe, which may protect directors and officers from decision-making liability.

Converting credit to equity

18 | Can credit extended by an insider or shareholder be recharacterised as equity? If so, what is the mechanism by which such an action is brought, and what elements are required to prevail?

Yes, state and federal courts (including bankruptcy courts) can recharacterise as equity any credit that an insider or shareholder extends. In bankruptcy, the defendant may bring a recharacterisation claim as an objection to the claimant's alleged debt claim; it does not require an adversary proceeding.

When evaluating a recharacterisation claim, the court will look at the following factors to determine whether the alleged debt is actually debt or equity:

- how the debt is labelled;
- the presence or absence of a fixed maturity date;



- the interest rate and schedule of payments;
- whether the borrower is adequately capitalised;
- any identity of interest between the creditor and the stockholder;
- whether the loan is secured; and
- the corporation's ability to obtain financing from outside lending institutions.

No single factor is controlling; the court will evaluate all of them in connection with the circumstances of the case.

Illegal dividends

19 | Can dividends received by shareholders be prosecuted as illegal?

A dividend may constitute a fraudulent conveyance if the debtor was insolvent when it made the distribution. In addition, state laws, including in Delaware, require that a corporation meet certain financial tests before making lawful dividends.

Trading while insolvent

20 | How is trading while insolvent treated in your jurisdiction? If actionable, what mechanisms apply and what are the elements of a successful claim?

In general, the United States does not impose personal liability on directors or officers for trading while insolvent or deepening insolvency. Directors and officers incur personal liability for certain withholding taxes and under the employee wage laws of certain states.

Equitable subordination

21 | Is equitable subordination of shareholder claims allowed? If so, what requirements and mechanisms apply?

Section 510(c) of the Bankruptcy Code allows the court to subordinate all or part of a claim based on equitable considerations. To equitably subordinate a claim, the court must find that:

- the claimant engaged in inequitable conduct;
- the misconduct resulted in injury to the debtor's creditors or conferred an unfair advantage to the claimant; and
- the subordination is not inconsistent with the Bankruptcy Code.



Whether the claimant's conduct is 'inequitable' will depend heavily on the case's facts and circumstances. If subordination applies, it applies to the extent of the injury that the relevant claimant caused and not necessarily to its entire claim.

Additionally, section 510(b) of the Bankruptcy Code automatically subordinates claims that arise from the rescission of, or damages that arise from, the purchase or sale of a debtor's security.

Other claims

- 22** | Are any other claims commonly brought against shareholders, directors and officers in your jurisdiction? If so, what mechanisms are used to raise these claims and what elements are required to prevail?

Avoidance actions, equitable subordination and breach of fiduciary duties are the most common claims that shareholders, directors and officers face.

Risk mitigation

- 23** | How can shareholders and sponsors mitigate the risk that claims against them will be successful, and minimise the accompanying financial burden?

Shareholders often appoint independent directors before the bankruptcy filing and have the independent director conduct an internal investigation before a Chapter 11 case. Once a case commences, many matters proceed to mediation, often with a retired judge as mediator.

CREDITOR ACTIONS AND STRATEGIC CONSIDERATIONS

Contesting restructuring plans

- 24** | Can creditors bring actions contesting the restructuring plan? If so, what law governs such actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

The Bankruptcy Code governs the confirmation of restructuring plans. To confirm a plan, the debtor must meet the requirements of section 1129 of the Bankruptcy Code. Some of those requirements are fairly generic and not typically an issue. Some of the more substantive requirements include those under:

- section 1129(a)(7): each holder of an impaired claim must either accept the plan, or receive or retain under the plan, property that is at least equal in value to what they would receive in a liquidation (the best interests test); and
- section 1129(a)(11): liquidation or the need for further financial reorganisation will not likely follow the plan's confirmation (feasibility).



Creditors can contest the plan by arguing that the debtor has not satisfied the necessary requirements. Because a confirmation dispute can be very expensive to the debtor's estate – as it pays for the fees of the debtor's professionals and any appointed committee's professionals (eg, a committee of general unsecured creditors) – confirmation disputes often resolve through a settlement, under which the objecting creditors receive an additional distribution in return for their support of the plan.

If confirmation disputes do not settle, debtors often invoke the cramdown provisions of section 1129(b) of the Bankruptcy Code, which allow the confirmation of a plan, even if not all impaired classes of claims have voted to accept the plan, provided that the plan does not discriminate unfairly and is fair and equitable with regard to each impaired class that has not accepted the plan.

Winding-up petitions

- 25** | Do creditors apply for winding-up orders? If so, what law governs these actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

The entity may commence liquidation and reorganisation cases voluntarily, with no insolvency requirement, or creditors may commence them involuntarily.

Involuntary case commencement requires three bona fide creditors who establish insolvency (generally, through a balance sheet test). The bankruptcy court will resolve a disputed involuntary petition through an evidentiary hearing. If the court dismisses an involuntary petition, the petitioning creditor may be liable for the corporation's legal fees.

Stays of proceedings – scope and exceptions

- 26** | Does the insolvency regime stay any creditor collection actions? If so, what are the parameters of such a stay? Are there any notable or commonly used exceptions?

The Bankruptcy Code automatically provides for a stay of collection actions against the debtor upon the bankruptcy's filing, including with regard to secured creditors (section 362(a)). The automatic stay is one of the Bankruptcy Code's most fundamental protections, and, accordingly, courts interpret it very broadly.

The automatic stay generally prevents direct actions against the debtor (eg, commencing or pursuing a lawsuit, as well as secured creditors' enforcing of liens); however, it can also prevent actions against third parties in some circumstances, if those actions would interfere with the debtor's reorganisation.

The Bankruptcy Code provides several exceptions to the automatic stay (section 362(b)). The most commonly used exception is the 'police power' exception (section 362(b)(4)), which permits a government unit to enforce its police and regulatory power, including the enforcement of a judgment other than a monetary judgment. The exception often leads to disputes about whether the government unit is actually exercising police or regulatory powers or is instead trying to collect a debt.



Additionally, sections 362(b)(6) and (7) of the Bankruptcy Code provide safe harbours that allow non-debtor counterparties to exercise their rights under various derivatives contracts.

In addition, debtors often seek stays of other proceedings pursuant to section 105 of the Bankruptcy Code, which allows a bankruptcy court to issue orders necessary or appropriate to carry out the provisions of the Bankruptcy Code.

Stays of proceedings – strategy

27 | How do creditors navigate stays in practice? How do stays generally affect their litigation strategy?

Undersecured creditors may file a motion for relief from the automatic stay to foreclose on property securing the claim. The court must decide the motion within 30 days (subject to extension by the court or the parties). The creditor must establish that it is not adequately protected and that the debtor does not require the property for a reorganisation (ie, the debtor has no prospects of reorganisation).

Parties to lawsuits can seek to lift the automatic stay; however, those requests rarely succeed because bankruptcy courts recognise the importance of stays to a debtor's restructuring process.

Creditors who cannot proceed with litigation because of the automatic stay frequently object to the relief the debtors request, or seek other permissible means of relief from the bankruptcy court, to gain leverage in negotiations.

Additionally, parties commonly structure transactions outside of bankruptcy in a way that allows them to exercise rights pursuant to one of the safe harbours to the automatic stay if a bankruptcy petition is later filed.

Stays of proceedings – effect on emergence from insolvency

28 | How do stays affect the debtor's emergence from insolvency?

Stays help the debtor emerge from insolvency by providing a 'breathing spell' that allows the debtor to focus on restructuring efforts, while reducing defence costs and preserving cash.

Subordination and disallowance of creditor claims

29 | Are the courts in your jurisdiction empowered to punish creditors' bad acts or inequitable conduct by pushing their claims down the priority waterfall? Can they void the claims altogether?



Yes, section 510(c) of the Bankruptcy Code allows the court to subordinate all or part of a claim (for purposes of distribution) based on equitable considerations. To equitably subordinate a claim, the court must find that:

- the claimant engaged in inequitable conduct;
- the misconduct resulted in injury to the debtor's creditors or conferred an unfair advantage on the claimant; and
- the subordination is not inconsistent with the Bankruptcy Code.

Whether the claimant's conduct is 'inequitable' depends heavily on the case's facts and circumstances. If the court applies subordination, it will apply it to the extent of the injury that the relevant claimant caused and not necessarily to its entire claim.

Vote designation

30 | Can creditors be disenfranchised based on bad-faith conduct?

Yes, section 1126(e) of the Bankruptcy Code states that 'the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of [the Bankruptcy Code].' Vote designation means that the court disqualifies or disallows the vote.

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims

31 | To what extent can claims existing before insolvency be pursued against shareholders and their affiliates and agents during an insolvency proceeding – including any contractual, tort and misfeasance claims and claims for the recovery of company property?

Yes, a debtor can pursue pre-insolvency claims against shareholders and their affiliates and agents, provided that the claims are within the statute of limitations as of the date of the bankruptcy petition. If the statute has not expired as of the date of the bankruptcy petition, the debtor in possession or trustee has two years to bring the claim.

Non-debtors can also continue to pursue prepetition claims against shareholders and their affiliates unless the debtor succeeds in staying those actions against non-debtors pursuant to sections 362 or 105 of the Bankruptcy Code.

Procedure and resolution

32 | What procedural mechanisms and issues should be considered when bringing pre-existing claims? How are they usually resolved?



Typically, parties focus on bringing the claim within the two-year statute of limitations. Those types of claims are often contributed to a trust for the creditors' benefit in a reorganisation plan. An action that such a trust brings usually proceeds like a typical derivative-type action and often implicates available insurance.

Standing and assignment of claims

33 | Who controls the pursuit of pre-insolvency debtor claims? Can creditors or other stakeholders pursue them derivatively if the debtor or trustee refuses to do so?

Before bankruptcy, the company controls the pursuit of its claims, but shareholders generally may pursue them derivatively if the company chooses not to. If the company is insolvent (generally under a balance sheet test), the company's creditors may have the ability to pursue them derivatively, although the law varies widely based on jurisdiction.

Whether a creditor has derivative standing depends on the company's state of incorporation and legal structure. For example, a Delaware corporation's creditors generally have derivative standing upon insolvency, but creditors of a Delaware LLC or LP generally do not.

Upon filing for bankruptcy, the trustee (either an appointed trustee or the debtor in possession) controls the pursuit of claims. If the trustee refuses to pursue a claim, a creditors' committee can seek standing to do so on the estate's behalf.

While the requirements to establish derivative standing of a creditors' committee vary among jurisdictions, one seminal case, *In re STN Enterprises*, requires a court to consider whether the trustee unjustifiably failed to initiate suit and the claim would likely benefit the estate.

Courts have also granted derivative standing even when the trustee does not unjustifiably refuse to pursue the claim, so long as:

- the trustee or debtor consents; and
- the court finds that the litigation is:
 - in the estate's best interests; and
 - necessary and beneficial to the fair and efficient resolution of bankruptcy proceedings.

These claims are often contributed to a trust for creditors' benefit in a reorganisation plan.

Risk mitigation for creditors

34 | How can creditors mitigate the risk that pre-insolvency debtor claims and remedies will be successful?



Most pre-insolvency debtor claims against creditors involve alleged impermissible or unreasonable conduct. Many creditors engage in pre-workout agreements with debtors to clarify the roles and obligations of the parties and to waive pre-insolvency claims.

Minimising costs for creditors

- 35** | How can creditors reduce the costs of litigation associated with these claims? What procedures are commonly used?

Pre-workout agreements can minimise risk. To the extent that the parties negotiate stipulations early in the case (eg, for use of cash collateral), specific challenge periods are negotiable but remain subject to court approval.

OTHER CLAIMS

Other claims against creditors

- 36** | Are there any other major categories of claims that may be pursued against creditors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

No.

Other claims against debtors

- 37** | Are there any other major categories of claims that may be pursued against debtors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

While debtors generally remain in control during Chapter 11 proceedings, creditors may move, pursuant to section 1104 of the Bankruptcy Code, for appointment of:

- a trustee 'for cause', including for current management's fraud, dishonesty, incompetence or gross mismanagement of the debtors' affairs; or
- an examiner to conduct an investigation of the debtor, including allegations of fraud, dishonesty, incompetence, misconduct, mismanagement or irregularity in managing the debtor's affairs.

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments

- 38** | Are parallel proceedings and international judgments recognised in your jurisdiction? What are the requirements for recognition? Can recognition be challenged? On what grounds?



Yes, Chapter 15 of the Bankruptcy Code governs parallel, cross-border proceedings. After a debtor commences insolvency proceedings in a non-US jurisdiction, the foreign debtor's representative can petition a US bankruptcy court to recognise the foreign proceedings.

Section 1517 of the Bankruptcy Code provides that a US bankruptcy court should recognise foreign proceedings if:

- the proceedings are foreign main proceedings or foreign non-main proceedings;
- the foreign representative is a person or body; and
- the petition meets the requirements of section 1515 (eg, accompanies certain statements and certificates).

The above is all subject to section 1506 of the Bankruptcy Code, which states that 'nothing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States.'

Section 1506, thus, provides one of the most common grounds on which to challenge recognition. Challengers typically argue that recognition would be inconsistent with US policy, which often requires the court to analyse the foreign country's insolvency laws to see whether they are generally consistent with the Bankruptcy Code and its overarching principles.

Judicial cooperation

39 | To what extent if any will there be judicial cooperation with other courts in relation to insolvency proceedings?

If a US bankruptcy court recognises foreign proceedings, the court will generally cooperate with the foreign court. Fostering that type of cooperation is the primary purpose of Chapter 15 of the Bankruptcy Code.

Arguably one of the most notable examples of cooperation is [Nortel Networks'](#) 2014 Chapter 15 case, in which the US Bankruptcy Court for the District of Delaware and a court in Canada jointly oversaw a cross-border trial in Nortel's bankruptcy.

REMEDIES AND ENFORCEMENT

Remedies for debtors

40 | What legal remedies are broadly available to successful debtor-claimants? Have the courts awarded any notable remedies recently?

A debtor's (or trustee's) most fundamental remedy is to recoup property or its value from an avoided transaction's initial or subsequent transferee, or from an entity for whose benefit the transfer was made, pursuant to section 550(a) of the Bankruptcy Code. This is a flexible remedy, and debtors (or trustees) and bankruptcy courts have discretion regarding the person or entity from whom to recover and the form of recovery.



Recovery is not unlimited, as section 550(d) provides that a debtor (or trustee) may only recover a single satisfaction on avoided transfers. Section 550 is intended to restore the estate to the financial condition that would have existed had the transfer never occurred.

Remedies for creditors

41 | What legal remedies are available to successful creditor-claimants? Have the courts awarded any notable remedies recently?

Usually, a debtor or a trustee on the debtor's behalf seeks a creditor's right to recover value that the debtor transferred before filing, and for the benefit of all creditors. If a debtor does not pursue those actions, creditors may be able to appoint a trustee or seek standing to sue on the estate's behalf.

Additionally, a creditor can seek payment of attorneys' fees from the debtor's estate by showing that the creditor has made a substantial contribution, pursuant to section 503(b)(3) of the Bankruptcy Code.

Court enforcement mechanisms

42 | What tools are available to the court to enforce its rulings? Are there any jurisdictional limits to the court's enforcement powers?

Generally, bankruptcy courts retain jurisdiction over the interpretation and enforcement of their prior orders, including outside its own district; however, recent circuit court rulings have clarified that a bankruptcy court cannot retain jurisdiction over matters for which it did not have subject-matter jurisdiction in the first place.

Under Title 28, section 1334(b) of the US Code, bankruptcy courts have original jurisdiction over civil proceedings arising under, arising in or related to cases under the Bankruptcy Code. To the extent that a prior order purports to exercise jurisdiction over a matter beyond its jurisdiction, it cannot retain authority to enforce those orders.

Pursuant to section 105 of the Bankruptcy Code, bankruptcy courts have broad authority to enforce their rulings by, for instance, ordering sanctions; however, Title 28 of the US Code limits the extent of a bankruptcy court's authority in specific instances. For example, certain circuit courts have recently held that a bankruptcy court cannot issue punitive sanctions.

SETTLEMENT AND MEDIATION

General court approach

43 | Are the courts in your jurisdiction generally amenable to settlements?



Yes, US courts generally favour settlements because they reduce costs, risks and the burden on the court. Most bankruptcy districts have incorporated mediation proceedings in their local rules.

Timing

44 | When in the course of litigation are settlements most likely to be sought out?

Generally, parties are most likely to seek settlements at the beginning of the dispute; however, the parties' settlement positions are often far apart. As the dispute nears trial or adjudication, a settlement becomes more likely when the parties are eager to avoid the risks and costs inherent in trial or adjudication.

Court review and approval

45 | How do courts review settlements? What is the legal standard for entry into and approval of a settlement?

To approve a bankruptcy settlement, the bankruptcy court must determine that the settlement is fair, equitable and in the best interests of the debtor's estate. To make that determination, the bankruptcy court will look at whether the settlement falls below the lowest point in the range of reasonableness.

Mediation clauses

46 | Will courts enforce mandatory or voluntary mediation clauses in pre-existing contracts?

Bankruptcy courts usually enforce mandatory and voluntary mediation clauses in pre-existing contracts, provided that the provision is enforceable under the law of the jurisdiction governing the contract. Even if the provision is unenforceable, bankruptcy courts regularly order mediation before litigating the issue if the parties cannot resolve the disputes among themselves.

Separately, whether a court will enforce arbitration clauses in pre-existing contracts depends on whether the parties' disputes are core or non-core bankruptcy court proceedings. Generally, bankruptcy courts will likely enforce arbitration provisions if the disputes are non-core proceedings and the arbitration provision is enforceable under the applicable law governing the contract; however, bankruptcy courts are often reluctant to order arbitration when the disputes are within the court's core jurisdiction.

UPDATE AND TRENDS

Recent developments



47 | What have been the most notable recent developments in insolvency litigation in your jurisdiction, including any key cases and legislative changes?

In 2021, certain members of Congress proposed a bill that would amend the Bankruptcy Code to:

- prohibit non-consensual third-party releases in Chapter 11 plans; and
- limit section 105 injunctions to stay lawsuits against third parties to a period of up to 90 days after the commencement of a bankruptcy case.

Non-consensual third-party releases are a tool employed in Chapter 11 plans to release claims against non-debtors:

- who have an identity of interests with the debtors or have made a substantial contribution to the reorganisation;
- when the release is deemed essential to the reorganisation; or
- when the impacted classes of claims have overwhelmingly voted to accept the Chapter 11 plan.

Section 105 injunctions are employed during a Chapter 11 case to stay litigation against similar non-debtor parties to facilitate the debtor's reorganisation efforts. The bill remains subject to the discussion and vote of both the House of Representatives and the Senate before it may become law.

These hotly contested issues (particularly non-consensual third-party releases) are frequently litigated and have recently drawn increased scrutiny from courts, with some courts allowing them but others refusing to do so.

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