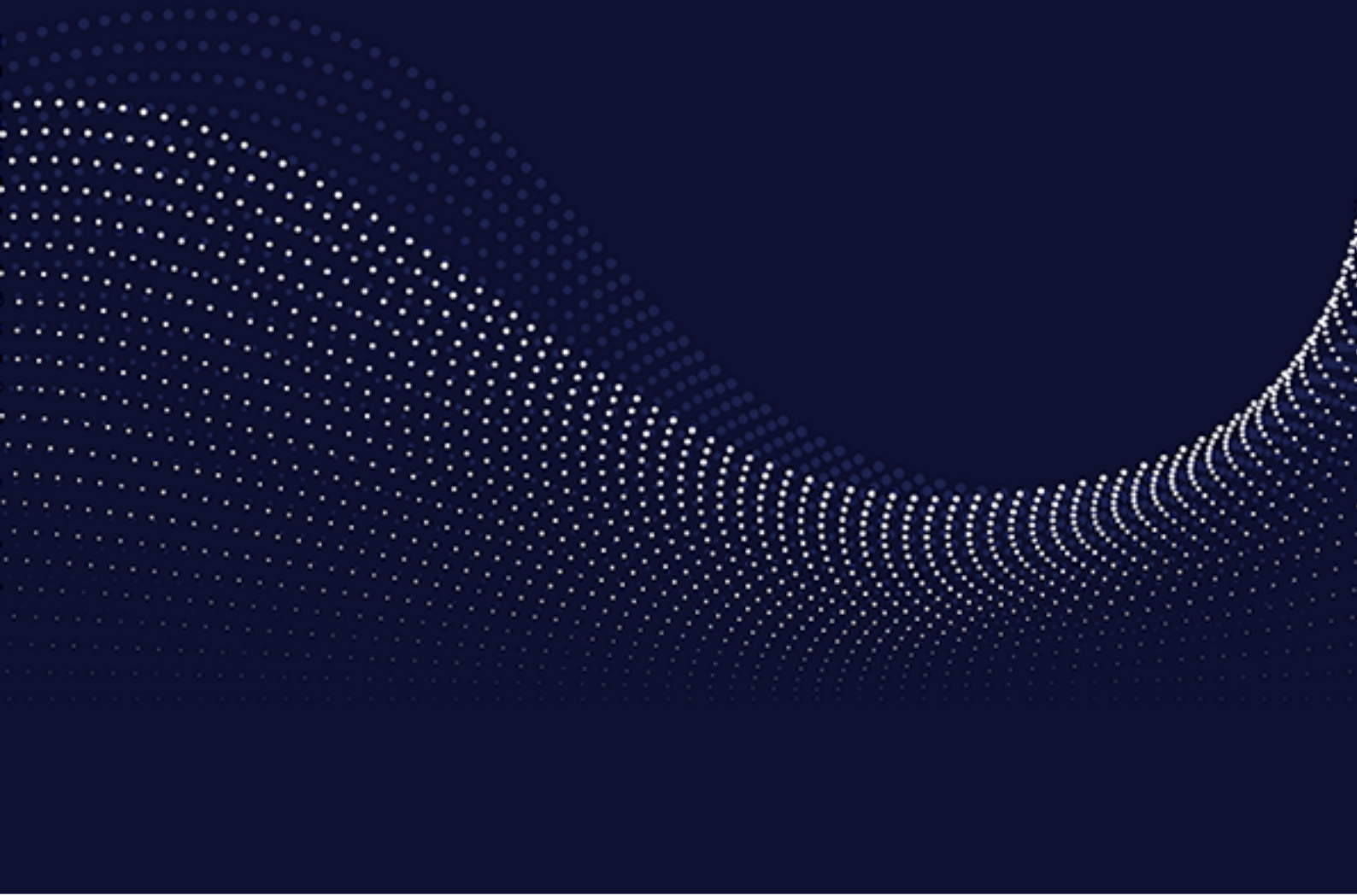
LEXOLOGY
Getting The Deal Through

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.

Generated on: November 13, 2023

LEXOLOGY
Getting The Deal Through

Contents

South Korea

Sangjae Lee, **Sukjae Hong**

Bae, Kim & Lee LLC

Spain

Óscar Franco Pujol, **Roberto Muñoz Rojo**, **Eduardo García**

Latham & Watkins LLP

United Kingdom

Jessica Walker, **Oliver Browne**, **Jonathan Akinluyi**, **Robin Spedding**

Latham & Watkins LLP

USA

Suzzanne Uhland, **Andrew Sorkin**, **Jonathan Gordon**, **Liza Burton**

Latham & Watkins LLP

Australia

Trevor Withane
Ironbridge Legal

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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 is ubiquitous in Australia, with the most common sources of dispute falling into three categories as follows:

- Proceedings by creditors seeking to force a debtor into liquidation or bankruptcy: while invariably brought in the hope that the debtor will be pressured to pay, such proceedings can generally only be brought in respect of undisputed debts. It is, however, not unheard of for debtors to defend such proceedings as a delay or negotiation tactic.
- Disputes regarding the beneficial ownership of, and security interests in, assets held by an insolvent debtor: these claims often turn upon general law principles not limited to insolvency but are by their nature of most relevance to a debtor that cannot otherwise pay their debts.
- Proceedings brought by a liquidator or bankruptcy trustee to recover assets for the benefit of the insolvent estate, either by recovering assets dissipated to third parties or (in the case of corporate insolvency) by pursuing a breach of duty or 'insolvent trading' claim against a company director with the goal of having them held liable for some of their company's losses.

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?

Personal insolvency is governed by the Bankruptcy Act 1966 (Cth) and Bankruptcy Regulations 2021 (Cth). Corporate insolvency is governed by the Corporations Act 2001 (Cth) and Corporations Regulations 2001 (Cth).

Other aspects of Australian law that often arise in insolvencies include the following:

- In the case of debtors who are trustees, common law principles are applied – rather than the insolvency laws – to determine what rights (if any) the insolvent debtor and its creditors have to that property.
- In respect of security interests in the property of a debtor, different regimes apply in respect of interests in real property (which are principally governed by a mix of common law principles and state-based land title legislation) and interests in personal property (which are principally governed by the Personal Property Securities Act 2009 (Cth)).

Procedure

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

Insolvency litigation is governed by the rules of the court in which the matter is being heard. While each court has its own different procedural rules, in the case of corporations litigation (including corporate insolvency) there is a degree of harmonisation by way of a set of uniform corporations rules applied across all superior courts when exercising corporations jurisdiction.

A common procedural hurdle relates to companies that traded as a trustee of a trust (being a commonly used structure for tax reasons), where it has been held that the liquidator will generally have no power to deal with the company's assets unless they obtain court orders appointing them as 'receiver' of the trust (see *McLean v Hill, in the matter of TMC Plumbing & Drainage Pty Ltd (in liq)*[2019] FCA 1439). As a separate application to the court is generally required to obtain such orders, it gives rise to both costs and delays.

Courts

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

Personal insolvency matters can be heard in either the Federal Court or the Federal Circuit Court. While their jurisdiction is concurrent, it is generally the case that larger and more complex proceedings are brought in the Federal Court, while simpler matters are brought in the Federal Circuit Court as it is lower in Australia's judicial hierarchy.

In relation to corporate insolvency:

- most matters, including all applications to bring about an involuntary insolvency, must be brought in either the Federal Court or in state supreme courts, with those courts having a concurrent jurisdiction and being equivalent in Australia's judicial hierarchy; but
- some purely monetary claims available to liquidators can be brought in lower courts so long as the claim is within that court's usual jurisdictional limit for money claims.

Where an insolvency proceeding relevantly overlaps with a family law proceeding, the Family Court of Australia can also exercise jurisdiction in either personal or corporate insolvency.

There are no specialised 'insolvency courts' in Australia but, within the superior courts, insolvency matters are typically case-managed separately from other litigation by judges with appropriate expertise.

Jurisdiction

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

Section 1337B of the Corporations Act empowers the Federal Court and state supreme courts to deal with matters arising under the corporations legislation.

Section 27 of the Bankruptcy Act gives the Federal Court and the Federal Circuit Court jurisdiction over bankruptcy matters.

Section 10 of the Cross-Border Insolvency Act 2008 (Cth) also gives the Federal Court and the Federal Circuit Court jurisdiction in cross-border insolvencies under the UNCITRAL Model Law on Cross-Border Insolvency, save that in personal insolvency only the Federal Court is given jurisdiction.

Limitation periods

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

While the precise limitation periods vary depending on the cause of action, the most common limitation period in Australian law is six years. Most insolvency-related claims can be brought within six years of the commencement of the insolvency (though that commencement may be deemed to be a date earlier than the liquidator or the bankruptcy trustee's actual appointment).

A notable exception applies in corporate insolvency, where most claims to recover assets (or the value of assets) transferred by the company in the lead up to its insolvency must be brought within three years, unless a proceeding is brought before then seeking an extension of time.

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 involuntary insolvencies, there is provision for a petitioning creditor to seek interim relief taking control of a debtor's property pending determination of the proceeding. While not unheard of, in practice this is relatively rare – if there is a well-founded fear that a debtor may dissipate assets then that is more commonly dealt with by freezing orders in general law proceedings to vindicate the creditor's underlying claim, which would typically occur well before any 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?

While not yet adopted by all Australian jurisdictions, a uniform Evidence Act has been adopted by the federal government and by Australia's largest states, such that it applies to most insolvency litigation.

Expert witness testimony is widely used in insolvency litigation, particularly in providing a retrospective assessment of a debtor's solvency. A common issue arising is that, in Australia, solvency is assessed on a 'cash flow' – this means that proving a company's solvency or insolvency generally requires a broad examination of many factors rather than purely an examination of its balance sheet, which can be very difficult in practice.

One of the notable difficulties associated with a cash flow test is the relevance of future payable debts to a company's immediate solvency. The New South Wales Court of Appeal recently held that the test of insolvency is prospective in outlook and that, therefore, future debts may be considered to establish insolvency where there is no expectation that the company will be able to pay upcoming debts when they fall due. However, the Court expressed that restraint should be exercised and this analysis must take into account how far into the future these debts are due. Consequently, the further away the debt, the less likely it will factor in determining solvency on a debt payable in the future.

Australian courts can order public examinations (a court process where the examinee gives evidence) of company officers and others who can talk to the examinable affairs of the company. Such examinable affairs include, but are not limited to, exploring potential claims and recoverability. The court can also order the production of documents to be made. These processes can take place before litigation is started and are thus powerful tools in the hands of a liquidator (and some others) to gather evidence – which often leads to early settlement of claims. A similar process exists in personal bankruptcy proceedings.

In relation to mandatory public examinations under section 596A of the Corporations Act, the High Court of Australia has recently confirmed in *Walton v ACN 004 410 833 Limited (formerly Arrium Limited) (in liquidation)* [2022] HCA 3 that the scope of this process is not confined to examinations that will confer a benefit on the company or its creditors. Rather, the examination of an officer for the purpose of pursuing a private claim against the corporation in external administration can be a legitimate use of the power conferred by section 596A. Therefore, the practical effect of this judgment is now that public examinations are available even in proceedings that only have a tenuous connection with the examination of a company.

Time frame

9 What is the typical time frame for insolvency claims?

Applications for the involuntary insolvency of a company are usually dealt with expeditiously and within a matter of months even when opposed. However, there is a greater degree of

leniency and tolerance for delay shown in respect of personal debtors, such that bankruptcy proceedings may be much slower if defended.

Where an insolvency has occurred and claims are brought by a liquidator or bankruptcy trustee against third parties, those claims are dealt with by the courts in much the same way as any other claim by a litigant in Australia and progress at the same pace. Simple defended matters may be dealt with in a matter of months, while especially complex matters can take up to several years.

Appeals

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

Insolvency-related judgments are generally subject to the same requirements and time limits for appeals as any other judgment in the court in which they were made, such that those requirements and limits vary from court to court. However, generally, appeals are typically required to be brought within 21 or 28 days of the original judgment, though in some courts, that period may be extended by serving notice of an intention to appeal.

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?

Costs in insolvency proceedings are dealt with in a similar 'loser pays' fashion to ordinary litigation. In that respect:

- claims in personal bankruptcy, and some corporate insolvency claims, are brought on behalf of the insolvent estate in the name of the appointed insolvency practitioner personally such that they may be personally liable for costs ordered; and
- in those corporate insolvency claims that do not have the liquidator as a party, the court will commonly order as a condition of the claim progressing that the liquidator put up a sum of money as security to ensure the defendant may recover costs if the claim fails.

For relatively strong and straightforward claims, it is common for the claims to proceed without funding, with lawyers acting on the basis that they are only to be paid out of any recovery and the insolvency practitioner accepts the risk of personal liability for the defendant's costs.

In respect of larger and more complex claims, third-party litigation funding is commonly used, in respect of which Australia has a thriving market. However, in corporate insolvency, it is generally a requirement that the approval of creditors or the court be obtained before any third-party funding agreement is entered into.

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?

Transfers of property with the intention to defeat creditors can generally be avoided based on that intention alone (unless the recipient was a purchaser in good faith without notice of the intention), both as a matter of insolvency law and under the general law of each state in Australia.

Both the personal and corporate insolvency regimes permit the avoidance of undervalued transfers without fraudulent intention but with material differences between the regimes.

In personal insolvency, undervalued transfers can be avoided in the two years before the bankruptcy (for transfers by a then-solvent debtor to an unrelated recipient) up to five years before the bankruptcy (for transfers by insolvent debtors).

In corporate insolvency, the regime is significantly more complex, but in general terms, a transaction that was 'uncommercial' having regard to its benefits and detriments to the company can be avoided in the two years preceding the liquidation (for unrelated counterparties) or four years (for related counterparties), but unlike in personal bankruptcy:

- the liquidator must be able to prove the company was insolvent at the time of the transaction (unless it was in favour of a director or a close relative); and
- a defence is available to counterparties (again, other than directors or close relatives) who can prove they gave value under the transaction in good faith and without grounds to suspect insolvency.

Separately, claims could exist for unreasonable director-related transactions under section 588FDA of the Corporations Act.

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?

A liquidator can avoid 'unfair preferences' given to unsecured creditors under section 588FA of the Corporations Act. The key requirements for a payment or other transaction to be an unfair preference are the following:

- it was given in respect of an unsecured debt (with debts that exceed the value of their security being treated as unsecured to the extent of that excess);
- it was made at a time when the company was insolvent or became insolvent as a result; and

- it was made within the limitation period (generally six months before the commencement of the liquidation).

Further, there is also a longstanding principle in Australian insolvency law known as the 'running account principle' (enshrined in section 588FA(3) of the Corporations Act). The effect of this principle is that if a transaction is considered part of a 'continuing business relationship' between a debtor and a creditor, then *all* transactions forming part of that relationship will be treated as constituting a single transaction for the purposes of an unfair preference claim.

There is no requirement to prove any intention on the part of the debtor to prefer the creditor. However, a defence is available to a creditor if it can show that it received the preference in good faith and with 'no reasonable grounds for suspecting that the company was insolvent'. This defence is the focus of most unfair preference disputes.

A broadly similar regime applies in bankruptcy, albeit with some differences. However, in practice, most unfair preference litigation in Australia relates to corporate insolvencies.

Liens and floating charges

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

Security given over real property is generally enforceable in insolvency unless it was given as an unfair preference, regardless of whether the security was registered.

Security taken over other property must generally be recorded in the Personal Property Securities Register. If not registered, improperly registered (eg, by misidentifying the security), or registered too late (within the six months preceding the insolvency appointment, unless it was a newly granted security), the security will be unenforceable in insolvency without any need for the liquidator or bankruptcy trustee to bring any avoidance action.

While not a matter of 'avoidance', the holders of floating charges are also subordinated to most employee entitlements.

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?

In personal bankruptcy, avoidance actions are litigated at the suit of the bankruptcy trustee through proceedings in the Federal Court or the Federal Circuit Court.

In corporate insolvency, avoidance actions are litigated at the suit of the liquidator through proceedings that can be brought in the Federal Court, a state supreme court or any inferior court so long as the monetary value of the claim is within that court's jurisdiction.

Insolvency practitioners tend to take a commercial approach to litigation, such that most contested avoidance actions are resolved by way of settlement.

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?

Claims for breach of duty against directors and officers in the context of insolvency are based upon the same fundamental principles as apply in the absence of insolvency. In that respect, the common law duties of directors and officers have been partly codified to include statutory duties to:

- exercise due care and diligence;
- act in good faith in the best interests of the company; and
- not use their position, or information obtained by way of their position, for personal benefit.

While the common law duties have not been extinguished by these statutory duties, the statutory duties are particularly significant in that it has been held that breaches of them cannot be ratified by shareholders even when a company is solvent (*Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52). Accordingly, pre-insolvency breaches of duty can be litigated in insolvency even where the directors are the company's shareholders.

Recent developments in this area have suggested that these statutory director duties might extend to the company's creditors in certain circumstances (particularly if the company is close to liquidation). In a landmark judgment, the UK Supreme Court confirmed the existence of such a duty to creditors in *BTI 2014 LLC v Sequana SA and others* [2022] UKSC 25. In that decision, the Supreme Court held that the long-established fiduciary duty to act in good faith in the interests of the company should be modified such that the company's interests are taken to also include those of the company's creditors as a whole. The Supreme Court also held that the precise nature of the duty to creditors is a question of fact and degree that will need to be balanced with shareholders' interests where conflict arises. Although the decision has not been adopted in Australia, its status as a judgment of the UK Supreme Court will be of significant persuasive value to Australian courts, especially in understanding the scope of historic common law duties.

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?

While Australia recognises the business judgment rule in the context of a director's ordinary duty of due care and diligence, a modified version of the rule applies in connection with insolvency.

Specifically, in determining whether a director may have liability for causing their company to incur debts or dispose of assets while insolvent, a safe harbour applies where the director:

- after starting to suspect the company may become or be insolvent, develops a course of action 'reasonably likely to lead to a better outcome for the company'; and
- the debt was incurred, or asset disposed of, in connection with that course of action while it remained reasonably likely to lead to a better outcome for the company.

The company must, however, pay employee entitlements and continue to comply with its tax lodgement obligations (even if those taxes are not actually paid) for that safe harbour to apply.

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?

There is no mechanism for this to occur in Australian law without the consent of the creditor.

Illegal dividends

19 Can dividends received by shareholders be prosecuted as illegal?

Yes. A dividend must not be paid if:

- immediately before the dividend is declared, the company's assets do not exceed liabilities, or the excess is insufficient for the dividend payment;
- the payment of the dividend is not fair and reasonable to the company's shareholders as a whole; or
- the payment of the dividend materially prejudices the company's ability to pay its creditors.

If a dividend is paid contrary to these requirements, then the dividend itself is not invalidated, but any person knowingly involved in the contravention may be required to compensate the company or be subjected to civil penalties, or both. If the contravention was dishonest, criminal penalties may also apply.

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?

Australia imposes a duty on company directors to prevent their company from incurring further debts when:

- their company is insolvent or becomes insolvent by incurring the debt;
- there are 'reasonable grounds for suspecting' insolvency; and
- they are aware of those grounds, or a reasonable person in similar circumstances would be so aware.

However, there is a safe harbour exception to this duty, which does not prohibit dealings in connection with a course of action formulated in response to an insolvency or potential insolvency that is 'reasonably likely to lead to a better outcome for the company'.

Where a director breaches this duty, any liquidator appointed to the company may bring an action against the director to recover from the director an amount reflecting the losses suffered by creditors whose debts were incurred during the period of insolvent trading.

In such proceedings, the director may avoid liability if they can prove (with the onus resting on them) that:

- they reasonably suspected that the company was and would remain solvent;
- they reasonably relied on information provided by another regarding the company's financial position and believed the company was solvent based on that information;
- the director was absent when the debt was incurred due to illness or good reason; or
- the director can prove they took all reasonable steps to prevent the debt being incurred.

The court also has general discretion to relieve a director from liability if they acted honestly and in 'all the circumstances of the case' it would be appropriate.

Equitable subordination

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

Unlike in the United States, there is no concept of equitable subordination in Australian law. However, claims by shareholders arising out of their holding or dealing with shares are subordinated to all other creditor claims in insolvency.

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?

No. The primary claims brought in practice are avoidances of pre-insolvency dispositions, and breach of duty and insolvent trading claims against directors.

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 is minimal scope under Australian law for claims to be made against shareholders in the insolvency context. The liability of shareholders, absent involvement in some other capacity, is limited to the value of any unpaid share capital.

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 primary form of restructuring plan in Australia is a deed of company arrangement (DOCA), which a company may enter into without the involvement of a court following a liquidator-supervised restructuring process. To be effective, the DOCA must be approved at a meeting of creditors by two out of three of the following:

- a majority of creditors by value;
- a majority of creditors by number; and
- in the case of a split between the above, a casting vote exercised by the registered liquidator supervising the restructuring process.

Even if approved in that way, a creditor may apply to have the DOCA terminated (effectively setting it aside) under section 445D of the Corporations Act. There are numerous grounds upon which a DOCA may be terminated, including:

- where informational deficiencies were provided to creditors prior to their voting on the DOCA;
- where the restructuring would operate oppressively or unfairly prejudicially to one or more of the creditors; or
- where the restructuring cannot be implemented without some form of injustice.

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?

Creditors may apply for orders winding up debtor companies under section 459A of the Corporations Act.

For the action to succeed, the creditor must show that it is owed at least A$4,000 and that the company is insolvent.

The usual way in which this is done is by the creditor serving a 'creditor's statutory demand for payment of debt' upon the debtor company, outlining the debt it says it is owed and requiring the debtor to either pay the debt or apply to the court for an order setting the demand aside within 21 days. If the debtor fails to do either of those things within 21 days, then the company is presumed insolvent and will generally be barred from denying the creditor's standing as a creditor in any subsequent winding-up proceedings, such that for the debtor to avoid being wound up it must either reach an agreement with the creditor or prove its solvency.

Due to the relative ease with which a statutory demand may be set aside if there is a genuine dispute, and the difficulty of proving solvency if a statutory demand has not been complied with, it is relatively rare for a winding-up application to be resolved by the debtor proving solvency without paying the petitioning creditor. Instead, most applications are resolved either by an agreed payment to the creditor or by winding up the company.

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?

All unsecured claims are stayed in insolvency, subject to court approval being obtained to continue the claim (such leave is not lightly granted).

While secured claims may generally be enforced in a liquidation, they are subject to limitations in a voluntary administration (Australia's principal business rescue procedure), where secured creditors are generally prohibited from enforcing their securities unless:

- they hold security over all, or substantially all, of the company's assets and enforce their security (usually by appointing a receiver) within 13 business days of the commencement of the administration;
- enforcement of their security had already begun before the administration; or
- the approval of the court or the administrator is obtained.

Further, while a voluntary administration is on foot:

-

lessors generally cannot repossess property being used by the insolvent company without the consent of the voluntary administrator appointed to oversee the administration, though the voluntary administrator is personally liable to ensure rent continues to be paid during the administration;

- inventory subject to retention of title interests also generally cannot be repossessed, and may be sold by the debtor in the ordinary course of business, though the creditor is entitled to be preferentially paid out of the sale proceeds; and
- claims cannot be brought against directors or their relatives pursuant to personal guarantees, though this does not prevent the continuation of claims commenced before the administration or after the administration period ends.

Stays of proceedings – strategy

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

In practice, unsecured creditors usually accept the stay that follows from an insolvency appointment, as they may instead simply lodge their claim with the appointed liquidator without the need for further legal process. Most ordinary unsecured creditors have little to gain from evading that process.

Perhaps the most common exception in respect of unsecured claims is those that are wholly insured and so being defended in substance by the insurer – in such cases, the creditor may seek leave of the court to proceed notwithstanding the stay, as the insurer would ultimately pay any judgment in any event.

Stays of proceedings – effect on emergence from insolvency

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

Aside from the stay upon enforcement of ordinary unsecured claims, in voluntary administration (Australia's primary corporate rescue regime), stays apply to the enforcement of most secured claims and repossession of property under leases or 'retention of title' arrangements is generally prohibited without the permission of the voluntary administrator or court.

These stays ensure that not only the property but the 'going concern' business of the insolvent debtor is able to be preserved while a restructuring plan is formulated and considered.

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?

No. However, if a restructuring plan or other resolution is approved by creditors acting for ulterior purposes, this may be taken into account by a court in any application by a creditor seeking to challenge that approval.

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?

The existence of an insolvency proceeding generally does not stay or otherwise prevent the pursuit of pre-existing claims against parties other than the insolvent debtor. Indeed, a liquidator or bankruptcy trustee might well pursue claims against third parties in realising the assets of the insolvent estate.

Where a company is in voluntary administration (being Australia's primary business rescue procedure), creditors are generally prohibited from taking action to enforce personal guarantees given by directors or their relatives until the end of the voluntary administration.

Claims may be brought against shareholders for any unpaid share capital.

Procedure and resolution

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

In relation to claims by the liquidator or bankruptcy trustee of the insolvent estate, the usual procedural rules of the relevant jurisdiction apply.

Where a company is in liquidation or voluntary administration, leave of the court is usually required for a claim to be proceeded with or brought against the debtor company.

Liquidators should consider using public examinations and orders for production to obtain evidence and investigate the efficacy of bringing claims before launching proceedings. Recoverability should also be considered carefully.

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?

As Australia generally does not operate on a debtor-in-possession basis, ultimate control of any pre-insolvency claims will pass – along with control of all other debtor assets – to the liquidator or voluntary administrator appointed to the debtor (though, as voluntary administration is only a short-term process used for business rescue, it is rare for a voluntary administrator to embark on substantial litigation).

If a liquidator is not prepared to pursue causes of action, they may sell them to creditors or any other interested purchaser. The ability to assign claims in insolvency extends to most (but not all) causes of action, even claims unassignable at general law or arising under the insolvency legislation itself.

Further, in respect of claims against directors for breaching their duty not to trade while insolvent, while such claims are ordinarily brought by the liquidator on behalf of all creditors, if the liquidator does not bring a claim then a creditor may (either with the consent of the liquidator or court approval) bring the claim on their own behalf in respect of any debt owed to them.

Risk mitigation for creditors

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

In relation to a potential claim for a voidable unfair preference (commonly a payment of funds or a transfer of assets), creditors sometimes avoid creating documents (including correspondence with the debtor), betraying any suspicion that the creditor suspects the debtor is insolvent. This is because it can form part of a defence to an unfair preference claim for the creditor to prove that, at the time of the transaction, the creditor had no reason to suspect that the company was insolvent.

If insolvency of the debtor is suspected, creditors could require that payment for past debts come from a third party – further supply could be used as an incentive for this. Cash on delivery for future supply and taking security for supply on credit are also common strategies, but these do not assist with mitigating the risk of payment for past unsecured debts being clawed back.

There are various tactics that can be deployed to mitigate the risk that claims by a liquidator will be successful. By way of example, absent funding, creditor defendants sometimes apply a scorched earth policy to litigation, taking every possible point, to exhaust the liquidator's appetite (and resources) to continue the litigation.

Minimising costs for creditors

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

Liquidators and bankruptcy trustees are often amenable to negotiation and mediation for early settlement. Indeed, acting in the interests of the creditors of the insolvent estate, the time value of money is often a factor that prevails in their thinking and can lead to a substantial discount on the claim value.

The court may also order compulsory mediation.

Making a formal offer (the form of which has prescribed rules) can make early settlement more attractive, as rejection of the offer can have adverse cost consequences for the party that rejects the offer if the offer is matched or is not bettered at trial.

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?

The primary claim pursued against creditors during an insolvency proceeding in Australia is a claim to recover an unfair preference received by the creditor before the insolvency appointment. Such a claim is available to recover the benefit received by a creditor from a payment or other transaction by a debtor company:

- in respect of an unsecured debt (with debts that exceed the value of their security being treated as unsecured to the extent of that excess);
- at a time when the company was insolvent or became insolvent as a result of the transaction; and
- within the limitation period (generally six months before the commencement of the liquidation).

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?

All major categories are outlined in the preceding sections.

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?

The Foreign Judgments Act 1991 (Cth) provides for a system of registration of foreign civil judgments by Australian courts, so that they may be enforced as debts in Australia. The Act extends only to jurisdictions for which the Governor General recognises there to be substantial reciprocity in judgment recognition (as listed in the Foreign Judgments Regulations 1992 (Cth), regulations 4 and 5).

Judgment debtors may challenge registration on several bases, including where:

- the foreign court lacked jurisdiction over the debtor;
- the judgment has been reversed on appeal;
- the judgment was obtained by fraud;
- the judgment has already been satisfied;
- the debtor had not received notice of the proceedings; and
- the enforcement of the judgment would be contrary to public policy.

Judgments from other jurisdictions may be registered at common law where the court is satisfied that:

- the foreign court exercised a jurisdiction that Australian courts recognise;
- the foreign judgment is final and conclusive;
- there is an identity of parties; and
- the judgment is for a fixed debt.

The grounds on which registration can be challenged at common law are substantially similar to those under the Foreign Judgments Act.

Judicial cooperation

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

Australia has adopted the UNCITRAL Model Law on Cross-Border Insolvency by way of the Cross-Border Insolvency Act 2008 (Cth), which includes provisions for cross-border cooperation in insolvency matters.

While most applications for cross-border assistance in insolvency are now made under the Model Law, Australian courts also have a general power to aid foreign insolvency courts pursuant to section 581 of the Corporations Act and section 29 of the Bankruptcy Act. Such aid is mandated to be given to the courts of certain specified countries (including the United Kingdom, Canada and the United States) and may be given on a discretionary

basis to courts of other countries. These powers may be exercised where, for some reason, the Model Law is unsuited to use in a particular case.

In practice, Australian courts are prepared to exercise these powers and provide aid and cooperation with the courts of other countries in relation to 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 usual remedy for most claims in insolvency is a money judgment that may be enforced in the same way as any other judgment obtained through litigation.

However, particularly in cases involving assets improperly dissipated to directors or their related parties in the lead up to an insolvency, proprietary relief may be sought to recover the asset (or anything the asset has been converted into) in specie. This can be beneficial where the defendant is of questionable solvency, as such proprietary claims will usually give priority over unsecured creditors.

Remedies for creditors

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

Australian insolvency law has a collective focus and generally does not provide remedies to individual creditors other than the liquidation or bankruptcy of the debtor.

One notable exception is in respect of claims against directors for breaching their duty not to trade while insolvent. While the liquidator ordinarily brings such claims on behalf of all creditors, if the liquidator does not bring a claim then a creditor may (either with the consent of the liquidator or court approval) bring the claim on their own behalf in respect of any debt owed to them. If the claim succeeds, a money judgment would be given in favour of the creditor.

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?

Most enforcement of money judgments is governed by state law, with each state having different regimes, though where a judgment is obtained in any Australian court, it may be enforced throughout Australia. However, for larger money judgments, the most common means of enforcement is insolvency action against the debtor, which (as with the remainder of Australia's insolvency laws) is governed by federal legislation.

Where there is reason to believe that a defendant or judgment debtor intends to dissipate assets to avoid the enforcement of a judgment, Australian courts may grant freezing orders prohibiting the improper dissipation of assets.

SETTLEMENT AND MEDIATION

General court approach

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

Yes. Insolvency-related litigation, as with all litigation in Australia, is most commonly resolved by way of a settlement rather than a judgment. Generally, there is no need for the court to approve any compromise reached – the commercial merits of the settlement are left to the liquidator or bankruptcy trustee pursuing the litigation.

However, in corporate insolvency, liquidators do not have the power to compromise debts owed to the company in excess of A$100,000 without the approval of creditors or the court. This only applies to money debts and, in particular, does not extend to proceedings to avoid pre-insolvency transactions, which may be compromised on without any approval.

Even when not required, liquidators and bankruptcy trustees will sometimes seek the approval of creditors before compromising major litigation to minimise the risk of creditors later alleging that the settlement was inappropriate and entered into in breach of duty.

Timing

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

Most settlements occur prior to litigation being commenced, arising from a negotiation following the issue of a demand. Some Australian courts have rules requiring steps to be taken to resolve a dispute before proceedings are issued; all have rules requiring litigants to avoid the unnecessary recourse to the courts. Any failure to do so may have adverse costs consequences.

Otherwise, settlements can be reached at any stage of proceedings, though it could be fairly said that settlements are particularly common in insolvency (and all other) litigation:

- very shortly after proceedings are commenced, once the claimant has proven itself to be serious by suing;
- at mediation, with it being common for a mediation to be ordered by the court in larger-scale litigation; and
- ‘on the courthouse steps’ shortly before the hearing, when all parties are confronted with the relative uncertainty and risk of putting their dispute in the hands of the court.

Court review and approval

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

Most settlements in insolvency litigation do not require the approval of the court.

The primary exception is in relation to compromises by liquidators of debts of more than A$100,000, which require either approval by a vote of creditors or from the court. If the court is asked to approve such a compromise, it will generally defer to the liquidator's commercial judgment 'unless there can be seen to be some lack of good faith, some error in law or principle, or real and substantial grounds for doubting the prudence of the liquidator's conduct' (see *Re The Bell Group Ltd (in liq); Ex parte Woodings as Liquidator of the Bell Group Ltd (in liq)* [2009] WASC 235 [47]).

Mediation clauses

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

Compulsory mediation clauses in contracts can be enforced in Australia, with parties prohibited from progressing legal proceedings until they comply with their obligation to mediate. There is no reason such a clause cannot be enforced in respect of a claim brought by an insolvent entity, so long as the claim is under the contract concerned.

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?

A new statutory regime has been introduced regarding 'creditor-defeating dispositions', being, generally, undervalued transfers of property by an insolvent company in the lead-up to an insolvency appointment. Both criminal and civil liability is imposed not only upon directors for such dispositions but any other person 'procuring, inciting, inducing or encouraging' such dispositions, with the objective of discouraging unscrupulous pre-insolvency advisers from encouraging directors to engage in pre-appointment asset-stripping.

A safe harbour regime has also been introduced, whereby directors and others will generally not be liable for insolvent trading or even transactions that would otherwise be considered creditor-defeating dispositions if carried out in connection with a course of action 'reasonably likely to lead to a better outcome for the company'.

The ability of liquidators and bankruptcy trustees to sell or otherwise assign causes of action has been expanded. It now includes the ability to assign statutory causes of action (eg, pre-insolvency transaction avoidance actions and insolvent trading actions), which were previously vested in the insolvency practitioner personally and could not be assigned.

The Australian Taxation Office can issue director penalty notices to company directors for unpaid superannuation guarantee charges, pay-as-you-go and (introduced recently) goods and services tax liabilities. If payment or a formal insolvency appointment is not made within 21 days, directors become personally liable for those payment obligations.

The peak indebtedness rule, which was used to calculate the quantum of an unfair preference claim within a running account by taking the difference between the peak indebtedness owed during the relevant preference period and the final amount owing at the date of liquidation or at the end of relevant period, has been abolished in *Badenoch Integrated Logging Pty Ltd v Bryant, in the matter of Gunns Limited (in liq) (receivers and managers appointed)* [2021] FCAFC 64 (Badenoch). This was later confirmed by the High Court in *Bryant v Badenoch Integrated Logging Pty* Ltd [2023] HCA 2 (8 February 2023)[2022] HCA 2. The decision also firmly laid down the principle that

- the start date for a continuing business relationship would be that of the first transaction capable of being a voidable transaction (ie, a transaction that occurs within the relation-back period and is an insolvent transaction); and
- the test for whether a transaction is part of a continuing business relationship under section 588FA(3)(a) of the Corporations Act is one that requires the 'objective ascertainment of the business character of the relevant transaction'.

The effect of this decision is that the abolition of the peak indebtedness rule is likely to result in a reduction in the quantum of unfair preference claims.

The recent case of *Morton as Liquidator of MJ Woodman Electrical Contractors Pty Ltd v Metal Manufacturers Pty Limited* [2021] FCAFC 228 (MJ Woodman) has confirmed that set-off under section 533C of the Corporations Act is not available to unsecured creditors of an insolvent company in respect of unfair preference claims. This result was also later confirmed by the High Court in *Metal Manufactures Pty Limited v Morton [2023] HCA 1 (8 February 2023)* [2023] HCA 1. The rationale for this decision is that, at the relevant time (immediately before the winding up), there was nothing to be set off as between the creditor and the liquidator.

In September 2022, the Parliamentary Joint Committee on Corporations and Financial Services commenced an inquiry into the effectiveness of Australia's corporate insolvency laws. The report was published in July 2023, making a series of recommendations. Among these, the Committee recommended the following:

- there should be an independent, comprehensive review of Australian insolvency law;
- the government should implement the recommendations made by the Safe Harbour Review, which would enable SMEs to access the insolvent trading defence better-, address phoenixing and fix issues with the current regime that enable the exploitation of creditors; and
- the government should amend the Corporations Act so as to take account of trusts in insolvency. The Committee determined that the current lack of statutory clarity surrounding trusts in insolvency has led to a lack of protection for stakeholders and

the ability for trust deeds to complicate the insolvency process to the detriment of creditors, forcing liquidators to incur legal costs in applying to the courts.

The Australian government has also recently issued draft regulations that it plans to implement in order to streamline the current regulatory provisions surrounding the personal property securities system. The draft regulations propose amendments to implement the majority of the 394 recommendations made by the 2015 Whittaker Review to reduce the framework's complexity and improve its functionality and consistency. On 22 September 2023, the government announced that it had entered into a consultation phase with respect to these draft regulations.

Trevor Withane trevor.withane@ironbridgelegal.com.au

Ironbridge Legal

Read more from this firm on Lexology

Belgium

Vanessa Marquette, **Jens De Winne**, **Caro Van den Broeck**
Loyens & Loeff

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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 Belgium, insolvency litigation usually emanates either from the appointed bankruptcy trustees who seek to increase the bankruptcy estate (eg, by bringing claims against creditors based on fraudulent conveyance or liability claims against former directors, including shareholders acting as de facto directors, for mismanagement), or from creditors who seek to protect their rights in the bankruptcy proceeding (eg, to obtain confirmation of the amount or the secured nature of their claim). As bankruptcy trustees are paid out of the proceeds of the assets they realise for the benefit of the bankruptcy estate, they may be open to amicable settlement where the outcome of a court proceeding is uncertain.

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?

In Belgium, substantive insolvency law is mainly governed by Book XX of the Belgian Code of Economic Law. Book XX includes, in particular, rules on judicial reorganisation (which is a rescue proceeding) and bankruptcy (which is a liquidation proceeding).

Book XX is the legal basis for various insolvency-related claims, such as claims for fraudulent conveyance or directors' liability for gross and manifest negligence having contributed to the bankruptcy or for wrongful trading. In addition to Book XX, claimants can also base a claim on certain provisions contained in the Belgian Civil Code (eg, article 5.243 (*actio pauliana*) or article 1382 (tort liability)) or in the Belgian Code of Companies and Associations (eg, founders' liability or liability of the liquidator). Finally, the Belgian Criminal Code provides for various criminal offences related to the state of bankruptcy (eg, misappropriation of company assets).

Procedure

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

Insolvency litigation is mainly subject to the general rules of civil procedure as laid down in the Belgian Judicial Code. Book XX of the Belgian Code of Economic Law, however, provides for certain procedural rules specific to insolvency litigation and that prevail over the general rules of civil procedure. The main aim of such deviations is to promote the speed at which court proceedings are settled and to avoid certain parties unlawfully impeding the court process. These deviating procedural rules include, among others, restrictions to

the possibility to appeal, shortened appeal time limits, the mandatory involvement of the trustee, the filing of procedural documents in the digital insolvency register (RegSol) and specific jurisdictional rules.

Courts

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

In principle, insolvency claims are heard by the enterprise courts. In each enterprise court, there are specialised insolvency chambers. These chambers are chaired by a professional magistrate and two lay judges with relevant professional experience. Lay judges do not necessarily hold a law degree. They often come from the business world and may pursue both activities in parallel. They assist the professional magistrates by imparting their relevant know-how and field insights.

Jurisdiction

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

A court's subject matter and territorial jurisdiction are determined by statute law (ie, Book XX of the Belgian Code of Economic Law or the Belgian Judicial Code). In cross-border insolvency matters, the Belgian courts may have international jurisdiction through Regulation (EU) 2015/848 dated 20 May 2015 or, when Regulation (EU) 2015/848 is not applicable, the Belgian Code of Private International Law.

Jurisdiction to open main insolvency proceedings does not differ for domestic and cross-border matters. In both cases, the court having jurisdiction is the enterprise court of the place of the centre of main interests (COMI) of the debtor. For companies and legal entities, the COMI is presumed to be the place of the registered office.

The enterprise court also has jurisdiction to hear all claims and disputes arising directly from insolvency proceedings and for which the rules applicable for their resolution are laid down in the specific insolvency laws. These claims and disputes include, among others, disputes regarding the admission of creditors' claims in the bankruptcy proceedings and their ranking and claims from bankruptcy trustees to declare certain acts unenforceable against the general body of creditors. A claim for directors' liability, on the other hand, follows the ordinary jurisdiction rules insofar as the claim is based on ordinary liability law or company law. A similar rule applies under Regulation (EU) 2015/848, which provides that the courts of the member state where insolvency proceedings have been opened also have jurisdiction for any action that derives directly from the insolvency proceedings and is closely linked with them.

Limitation periods

'

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

Creditors must file their claims within the time limit indicated in the bankruptcy judgment that is published on the digital insolvency register RegSol and in the Belgian Official Gazette. If a creditor fails to file their claim within this time limit, they may still file later, but they have no right to the distributions that, in the meantime, have already been ordered. The right for a creditor to file a declaration of claim in the bankruptcy estate becomes time-barred one year from the date of the bankruptcy judgment.

Contractual claims become time-barred after 10 years. Tort claims become time-barred five years after the day on which the injured party became aware of the damage or the aggravation thereof and the identity of the liable party and, in any event, 20 years after the event causing the damage. The Belgian Code of Companies and Associations provides for a shortened limitation period of five years for claims provided therein against, for example, founders, shareholders and (de facto) directors.

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 general litigation proceedings are also available in insolvency proceedings and include, for example, the investigation by an accountant or expert, the appointment of an interim administrator, or the appointment of a judicial custodian, usually a bailiff, who takes possession of particular assets to ensure they are not disposed of, used or dissipated. In Book XX of the Belgian Code of Economic Law, some specific interim remedies are provided for in an insolvency context, all with a focus on the (interim) management of a company in financial difficulties, such as the request from interested parties to appoint, under certain circumstances, a judicial or interim administrator.

Finally, creditors can also take measures to safeguard their debtors' (secured) assets for future enforcement in a pre-insolvency stage (ie, when financial difficulties arise but no formal insolvency proceedings have been opened yet). This is typically done by way of laying a conservatory attachment, which can be done by a creditor who has a due, certain and fixed claim and when the financial situation of the debtor is critical.

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 collection and admissibility of evidence in insolvency litigation is not governed by specific insolvency laws but rather by the general rules of procedure in civil matters. Expert witness testimony may be allowed but is uncommon as litigation in Belgium is highly

dependent on written evidence. The Belgian rules of civil procedure do not provide for discovery. It is, in principle, up to each party to submit evidence to substantiate its claims, although there is a general obligation to cooperate in the production of evidence. In certain exceptional cases, the court may reverse the burden of proof. A party who has reason to believe its opponent possesses a document relevant to the resolution of the dispute may request the court to order its opponent to submit that document, as the case may be, under penalty payments.

Time frame

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

In general, first instance court proceedings on the merits relating to insolvency claims take around 12 to 18 months. The actual timing will, however, depend on many factors, such as the number of parties involved, the complexity of the matter, the cross-border nature of the dispute and the workload of the court. It is generally possible to obtain within a relatively short time frame urgent protective or conservatory measures.

Appeals

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

Under the ordinary rules of civil procedure, a party may, in principle, appeal any court decision to the extent it was grieved by the first judge's decision and within one month of the service thereof. It does not need to obtain leave to appeal. Both the creditor and the debtor can appeal decisions, as well as, in some cases, the public prosecutor. The Belgian Code of Economic Law, however, provides for certain restrictions to the possibility of appeal and shortened appeal time limits. For example, the time limit to appeal against a judgment opening a bankruptcy proceeding is 15 days from the publication in the Belgian Official Gazette. The time frame for appeals is similar to first instance court proceedings. In some cases, appeal proceedings can, however, take up to several years.

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?

A claimant must only pay limited costs when bringing a claim. These costs include the costs for the service of the summons and limited court fees.

The prevailing party is entitled to a lump sum compensation for its legal fees at the expense of the unsuccessful party. The amount of the compensation depends on the value of the claim. The law provides for a base amount that, under certain conditions, can be increased or decreased. The maximum amount that a prevailing party could currently claim is limited

to €45,000 (ie, for claims exceeding €1 million). Prevailing parties are not entitled to the reimbursement in full of their costs and legal fees.

Although legal scholars generally accept that third-party funding is valid under Belgian law, the validity has so far not been reviewed by Belgian courts, and the use has remained limited.

The costs and fees to which bankruptcy trustees are entitled are calculated as a percentage of the assets they realise for the benefit of the bankruptcy estate. In addition, bankruptcy trustees are entitled to a separate fee if, due to their actions, real estate encumbered with a mortgage or immovable privileges was sold.

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?

Pursuant to the Belgian Code of Economic Law, certain acts may (and sometimes must) be declared unenforceable by the enterprise court if they were performed by the company at a time when it had already ceased its payments (ie, during the hardening period). A hardening period, which is the exception and not the rule, can only be put in place by the court when there are clear indications that the debtor has already persistently ceased its payments before the date of the court decision opening the bankruptcy proceeding. The date of cessation of payments can be brought back a maximum of six months prior to the bankruptcy judgment, except if a company was wound up more than six months before the bankruptcy order. In that case, the date of cessation of payments can be brought back to the date of the winding-up of the company if the winding-up was done to the prejudice of its creditors.

The following actions must be declared unenforceable if performed during the hardening period:

- transactions without consideration or sub-value transactions;
- payments of undue debts;
- payments in kind of due debts; and
- security interests granted for pre-existing debts. All other payments for outstanding debts and all acts for valuable consideration that took place during the hardening period may be declared unenforceable if the debtor's contractor knew of the cessation of payments.

Preferential rights, mortgages and pledges registered in the Belgian pledge register may be declared unenforceable if they were registered during the hardening period and more than 15 days have lapsed between the deed creating the preferential right, mortgage or pledge, and the date of their registration.

Finally, any acts or payments, whenever performed and even outside the hardening period, that are fraudulent may be declared unenforceable (*actio pauliana*).

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?

A debtor not facing any financial difficulties may differentiate between its creditors and prioritise payments to certain creditors over others. If a debtor is, on the other hand, in a state of bankruptcy, it is no longer allowed to privilege certain creditors to the detriment of the general body of creditors. The regime applicable to actions seeking to claw back transactions and payments based on preference and improvement of position is essentially the same as the one set out under 'Fraudulent transfers and undervalue transactions'. As a consequence, payments made by the debtor in the hardening period set by the court, may be declared unenforceable if the receiving party was aware of the situation of cessation of payment. Fraudulent payments may be declared unenforceable whenever performed.

Finally, it should be noted that the selective payment of creditors could, under certain circumstances, be an indication that a debtor is in a state of bankruptcy, in particular when the selective payment is arbitrary.

Liens and floating charges

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

No security interests may be perfected once a bankruptcy proceeding is opened. Avoidance actions for security interests are subject to the same rules as outlined above. As such, bankruptcy trustees may pursue the following avoidance actions:

- a security interest granted for pre-existing debt during the hardening period shall be declared unenforceable against the body of creditors;
- a security interest granted during the hardening period can be declared unenforceable if the creditor knew of the cessation of payments;
- security interests can be declared unenforceable if they were registered during the hardening period and more than 15 days have lapsed between the deed creating the security, and the date of registration; and
- a security interest, whenever granted and irrespectively if it is granted for pre-existing or new debt, can be declared unenforceable if considered fraudulent.

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 opens a bankruptcy proceeding also has jurisdiction for avoidance actions. Once a bankruptcy proceeding is opened, avoidance actions may, in principle, only be exercised by the bankruptcy trustee.

Unlike in some other jurisdictions, Belgian insolvency law has no automatic hardening period. As most avoidance actions can only be made in relation to acts performed during the hardening period (except for fraud), in practice, those actions are often preceded by litigation in relation to the putting in place of a hardening period by the bankruptcy court. This requires evidence that the company had already persistently ceased its payments before the date of the court decision opening the bankruptcy proceedings.

One of the most disputed issues in avoidance action litigation relates to the evidence of the counterparty's knowledge of the cessation of payment or of the adverse impact of the transaction on the debtors' solvability. In addition, procedural issues may also arise in relation to the law applicable to avoidance actions. Pursuant to Regulation (EU) 2015/848 and the Belgian Code of Private Internal Law, avoidance actions cannot be brought in respect of acts or transactions that are subject to the law of a state other than Belgium if the law of that state does not allow any means of challenging that act or transaction in the relevant case.

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 must exercise their role with due care and diligence. Their conduct will be compared to what can be expected from a normally careful and diligent director put in the same situation. Unlike in other legal systems, directors are not to be considered representatives of the shareholders by whom they were appointed. In making any decision, they must therefore act in the best interest of the company and not of a specific shareholder.

Directors can, in general, be held liable:

- as an agent of the company on a contractual basis; or
- for violations of the company's articles of association or the Belgian Code of Companies and Associations.
- on the basis of tort.

In addition, there are specific grounds for directors' liability in the case of insolvency.

First, in the event of bankruptcy of a company and shortfall of its assets, its directors, former directors, managing directors or any other person who had de facto authority to manage the company can be held personally liable for all or part of the company's debts up to the shortfall, if that person committed a gross and manifest negligence that contributed to the

bankruptcy. Courts have discretionary power to order the directors jointly or individually to pay part or all of the company's debts. Gross and manifest negligence is an error that a normally careful and reasonable director would not have committed and that violates the essential rules of conduct of business. A strict causal connection between the negligence and the company's bankruptcy does not have to be proven; it is sufficient to demonstrate that the negligence contributed to the bankruptcy.

Second, directors, former directors, managing directors and de facto directors can also be held personally liable for all or part of the social security contributions due at the moment of opening of bankruptcy proceedings if:

- during a period of five years before the bankruptcy, they were involved with at least two bankruptcies or winding-up proceedings of companies where social security contributions remained unpaid; and
- they held management positions in those companies.

Finally, failure to make the appropriate and timely bankruptcy filing constitutes a criminal offence.

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 general regime regarding directors' liability also applies in connection with restructuring or insolvency decisions. No safe haven or specific protection is provided in the context of restructuring or insolvency procedures. On the contrary, additional grounds for liability exist in case of bankruptcy. This being said, for certain liability grounds, the court will need to take into account all relevant circumstances of the matter, which may include circumstances complicating the judgment of certain actions or choices made by the directors. Directors of a distressed company will not be exempt from liability for past decisions if they resign. In recent years, directors' and officers' insurance policies have become very common. They typically provide coverage for liability unless the insured acted fraudulently, including in the context of insolvency. Finally, directors can also seek discharge of liability by the annual general meeting of shareholders.

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 will, in principle, not be recharacterised as equity in the event of bankruptcy. The court is, however, not bound by the qualification given by the parties to their contract. A recharacterisation of credit into equity therefore remains possible.

Finally, as part of a collective restructuring plan, the debtor may propose a debt-to-equity swap. However, such forced debt-to-equity swaps can only be imposed on secured creditors in specific situations and under strict conditions.

Illegal dividends

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

As such, the rules in respect of dividend distributions are laid down in the Belgian Code of Companies and Associations, and insolvency law does not specifically deviate from this. However, if dividends were distributed during the hardening period or fraudulently, the bankruptcy trustee could try to have them declared unenforceable. Furthermore, the company's directors could be held criminally liable if the purpose of the dividend distribution is to make the company insolvent or to misappropriate or disguise part of the assets.

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 the event of bankruptcy of a company and shortfall of its assets, its directors, former directors, managing directors or any other person who had de facto authority to manage the company (which could be the case for a majority shareholder) can be held personally liable for all or part of the company's debts up to the shortfall, if:

- at any given time prior to bankruptcy, this person knew or should have known that there was manifestly no reasonable prospect of maintaining the enterprise or its activities and avoiding bankruptcy;
- this person was a director at that time; and
- this person did not act as a normally careful and reasonable director would have acted in the same circumstances.

Courts have discretionary power to order the directors jointly or individually to pay part or all of the company's debts.

Equitable subordination

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

Belgian law does not provide for automatic subordination of shareholder loans. This was discussed during the preparation of the new Belgian Code of Companies and Associations but was eventually not introduced. In a number of exceptional and rare cases, courts have, however, accepted the subordination of claims, particularly about sanctioning creditors who

wrongfully increased the bankruptcy estate's liabilities and hence reduced the recovery chances of other 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?

Shareholders can be held liable on the basis of founders' liability if, in the first three years following its incorporation, a company is declared bankrupt, and the invested capital was manifestly insufficient. They can also be held liable as de facto directors for trading while insolvent.

Further, shareholders can be held liable on the basis of tort. In this respect, case law has already accepted the liability of a parent company in circumstances where it:

- continued to finance in an unreasonable manner the loss-making activities of its subsidiary;
- attributed to its subsidiary an unlawful appearance of creditworthiness; or
- manifestly undercapitalised its subsidiary.

Shareholders may also incur liability if they issue a letter of comfort to the debtor (eg, to ensure a going-concern basis for the yearly audit) and are in breach of this undertaking. Shareholders also can bring claims against each other for breaching a shareholders' agreement. Likewise, claims may be brought by creditors against directors, officers or shareholders who provided guarantees for the debts of the bankrupt company.

Finally, depending on the circumstances, criminal offence claims could also be filed. Certain general offences may also apply in an insolvency context, such as misuse of company assets, forgery of documents (including annual accounts) and money laundering. In recent years, Belgian prosecutors have opened criminal investigations against insolvent companies and their (former) directors, officers or shareholders on suspicion of such criminal offences. In addition, the company, its (former) director, officers or shareholders can be exposed to specific bankruptcy-related criminal liability claims. These include, among others, failure to make the appropriate and timely bankruptcy filing or asset misappropriation.

Risk mitigation

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

To mitigate the risk of successful claims and minimise the corresponding financial burden, shareholders (in particular controlling shareholders) would be well advised to regularly monitor and document the financial situation of the company or subsidiary to avoid acting

as de facto directors (by respecting the decision process at the level of the insolvent company), and to carefully consider any new credit or guarantee or the early termination of any credit or guarantee.

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 collective restructuring plan is subject to the approval of the meeting of creditors and the homologation by the court. Those rules are organised by the Belgian Code of Economic Law. In general, creditors can contest the plan either by voting against it or by requesting the court to refuse homologation. Creditors can also contest the amount or the nature of their claims, or both, as included in the restructuring plan.

The Belgian Code of Economic Law provides for two different sets of rules applicable to the content, voting and homologation of the collective restructuring plan.

- If the debtor is an SME (which has not opted-in for the below large company regime), the restructuring plan will only be approved if the majority of creditors attending the meeting of creditors vote in favour of the plan and they represent a majority of the value of the claims. Court homologation can only be refused if the process has not been complied with or in case of violation of public policy.
- If the debtor is a large company (or an SME which opted in), a more complex regulation applies regarding the voting (based on classification and voting per class of creditors) and homologation of the restructuring plan. A restructuring plan is adopted if a simple majority is obtained in each class of affected parties. If the latter threshold is not met in each class, the court may homologate the restructuring plan if the conditions for a cross-class cram down are complied with. Under this 'large company regime', the homologation can, among others, be refused if the classification of affected parties has not been applied correctly. In addition, a dissenting creditor may also contest that, in relation to its position, the best-interest-of-creditors test is not met (ie, the dissenting creditor cannot be manifestly worse off under the collective restructuring plan than in a liquidation scenario). If new financing is provided in the restructuring plan, homologation of the plan is also subject to the condition that this new financing is necessary and does not prejudice the other creditor's rights.

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 Belgian Code of Economic Law allows creditors to initiate bankruptcy proceedings provided they can demonstrate the conditions for bankruptcy are met (ie, (1) the debtor has persistently ceased payments and (2) has lost the trust of its creditors). Both conditions must be met.

Cessation of payments occurs when a debtor can no longer repay its due and payable debts. It is not necessary that it has stopped all payments; it is sufficient that some important debts remain unpaid, such as social security or tax liabilities, but the cessation must be persistent. To the extent the situation of the company can still be redressed or the company still has access to sufficient credit, the company is not in a state of bankruptcy. To successfully defend against a claim in bankruptcy, the debtor must demonstrate that it has not persistently ceased payments or it has not lost its creditors' trust (or both).

For reorganisation proceedings, the Belgian Code of Economic Law allows creditors to file for a private judicial reorganisation proceeding with the aim of restructuring via a private amicable agreement or private collective agreement. Public judicial reorganisation proceedings in view of a restructuring via a public amicable agreement or public collective agreement, on the other hand, can, in principle, only be opened at the request of the company in distress. None of these proceedings, however, is as such considered a winding-up procedure.

Finally, only in certain exceptional circumstances may a creditor or interested third party request a court-supervised forced transfer of (part of) the debtors' activities. To succeed, the claimant must demonstrate:

- that the company is in a state of bankruptcy and has not filed for judicial reorganisation proceedings; or
- that previous judicial reorganisation proceedings have failed.

Following such a forced transfer procedure, the remaining company must be wound up in a subsequent bankruptcy or judicial liquidation procedure.

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?

A bankruptcy judgment has the effect of suspending the enforcement of individual creditors' rights. There are, however, certain exceptions to this general principle:

- for creditors holding a security interest on specific movable assets (eg, a pledge) and for mortgagees, the suspension of their enforcement rights will usually be lifted when the first minutes of verification of claims are filed by the bankruptcy trustee, a maximum of 60 days after the bankruptcy judgment. The suspension can, however, be extended to a period of one year from the date of the bankruptcy judgment; and
- pledges or security assignments of bank accounts and financial instruments that are subject to the Belgian Financial Collateral Law of 15 December 2004, as well

as close-out netting agreements, will, in principle, not be affected by the opening of a bankruptcy proceeding and can thus be enforced immediately.

Public judicial reorganisation proceedings offer protection to the insolvent company against its creditors during the stay period. During this stay period, enforcement measures against the company's assets for debts incurred before the judgment opening the proceedings are suspended. Co-debtors and personal guarantors are not protected by the opening of judicial reorganisation proceedings. The court can suspend payments for up to four months (extendable to up to 12 months). There are, however, certain exceptions to this general principle as follows:

- pledges on receivables that have been specifically pledged to the benefit of third parties will not be affected by a judicial reorganisation; or
- pledges or security assignments of bank accounts and financial instruments that are subject to the Belgian Financial Collateral Law of 15 December 2004, as well as close-out netting agreements, will, in principle, not be affected by the opening of judicial reorganisation proceedings in the case of a default, and can in such context be enforced immediately.

Private judicial reorganisation proceedings, on the other hand, do not trigger an automatic stay on creditors' rights but only allow for an ad hoc stay once the proceedings are opened. If granted by the court, this ad hoc stay will only apply in relation to (some of the) creditors involved in the private judicial reorganisation procedure.

Stays of proceedings – strategy

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

Creditors can try to avoid a stay altogether by negotiating that their claim is secured by:

- a co-debtor or a personal guarantor, which is less likely to file for insolvency (eg, a shareholder); or
- a security interest that is not impacted by a stay.

In addition, a stay does not prevent the debtor from making a voluntary payment to the extent that such payment is required for the continuity of the business or from granting the creditor a security interest. A creditor with a certain negotiating power could therefore try to improve its position in this way. A creditor may also invoke the right to set off, provided the claims are connected.

The opening of judicial reorganisation proceedings does not change the conditions of existing agreements. A supplier-creditor can, therefore, not request to be paid in full before delivery is made if this is not possible under the terms of the existing agreement.

Stays of proceedings – effect on emergence from insolvency

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

In public judicial reorganisation proceedings, the automatic stay provides debtors in distress with 'breathing space' to reorganise their business by negotiating with their creditors or potentially interested buyers. During the stay, the debtor cannot be summoned in bankruptcy and its obligation to file for bankruptcy is suspended. However, the stay does not protect against debts incurred after the judgment opening the proceedings.

With respect to bankruptcy proceedings, the (temporary) suspension of enforcement of individual creditors' rights allows the bankruptcy trustee to sell (certain) parts of the insolvent company on a going-concern basis and, as such, still safeguard (a part) of the company's continuity.

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 court is not authorised to push creditor claims down the priority waterfall. However, in certain cases, creditors' security interests can be affected by avoidance actions. If successful, the sanction of such action is the unenforceability of the relevant security interest resulting in a (partial) downgrade of secured to unsecured claims.

In addition, a creditor's bad acts or conduct could expose a creditor to tort claims if the conditions of such liability are met.

Vote designation

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

A creditor's bad-faith conduct does not disenfranchise creditors but can be used to demonstrate an abuse of rights by the creditor. In Belgian law, the theory of abuse of rights allows the court to place limitations on the exercise of a right that has been abused and may even refuse the exercise of that right altogether. This is, for example, the case when the use of the right is made with the sole intention of harming someone or when the use is disproportionate. A creditor's bad-faith conduct may also give rise to liability if the conditions thereto are met.

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?

An insolvency procedure shall, in principle, only impact a creditor's claim against the debtor itself. As such, the opening of insolvency proceedings does not prevent creditors from pursuing claims against shareholders and their affiliates or agents, nor are any specific elements required for such claims to succeed.

Procedure and resolution

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

As such, there are no procedural specificities to bringing pre-existing claims. In the event a defendant is declared bankrupt during an ongoing litigation, the creditor-claimant must file its claim in the bankruptcy proceedings. If the bankruptcy trustee accepts the claim, the litigation becomes without object and will be discontinued. If, on the other hand, the claim is disputed, the bankruptcy trustee must continue the court proceedings.

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 purpose of bankruptcy proceedings is to place the debtor's assets under the trustee's jurisdiction, who is charged with managing and liquidating the assets and distributing the proceeds to creditors. As a result, it is no longer possible for the debtor to act as a plaintiff in proceedings that involve the assets over which the management has been transferred to the trustee. It is up to the trustee to decide to continue (or initiate) court proceedings. Under judicial reorganisation proceedings, on the other hand, the debtor remains in possession. Therefore, pre-insolvency debtor claims are, in principle, managed by the debtor itself, except if the court would have appointed a judicial administrator.

Although pre-insolvency debtor claims will thus, in principle, be managed by the trustee or the debtor itself, Belgian law knows a general legal mechanism under which creditors can pursue claims of their debtors when the latter is reluctant to do so. In that event, the claims are, however, brought on the debtor's behalf, meaning that the proceeds accrue to the debtor's assets and will thus not be directly distributed to the creditor who initiated the proceedings. Although the application of this legal mechanism is generally accepted in the event of judicial reorganisation proceedings, it is disputed in the event of bankruptcy.

Risk mitigation for creditors

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

Like the bankrupt company, a creditor may also avail itself of all remedies and defences available in the pre-insolvency context. A well-drafted agreement may give the creditor additional contractual rights, such as the right to set off, to terminate the agreement or to claim default interest or damages in case of an event of default, which typically includes the opening of an insolvency procedure.

To mitigate the risk of avoidance action claims for pre-insolvency acts, creditors are advised to properly document the circumstances and considerations of all parties entering into transactions with a (potential) debtor in distress.

Minimising costs for creditors

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

The main way creditors can try to reduce the cost of litigation is by entering into settlement discussions with their debtors. Whether that is an opportune strategy will, of course, depend on the circumstances, in particular the creditor's prospects for recovery and its position within the ranking of claims. The parties can also jointly appoint an independent and neutral mediator to assist them in the settlement discussion process.

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?

Recognition of court decisions from courts of EU member states (except Denmark) is subject to the EU Insolvency Regulation (EU) 2015/848 dated 20 May 2015. This Regulation provides for an automatic recognition of court decisions in any EU member state (except Denmark). Recognition can only be challenged if the effects thereof would be manifestly contrary to the public policy of the member state where recognition is sought.

Recognition of court decisions from courts located in a non-EU member state (or in Denmark) is subject to the general rules of the Belgian Code of Private International Law. Main insolvency proceedings are recognised if they are opened in the country of the main establishment. Secondary insolvency proceedings are recognised if they are opened in the country where the debtor has an establishment. In the latter case, recognition applies only to assets located in the State where the proceedings were opened at the time of opening. In addition, recognition can be challenged on the following general grounds:

- recognition would be contrary to Belgian public policy;
- the rights of defence were violated;
- the decision was only obtained to evade the application of the law designated by the Belgian Code of Private International Law;
- the decision is still subject to an ordinary recourse;
- the decision is irreconcilable with a Belgian decision or with an earlier decision of another country and this decision is amenable to recognition in Belgium;
- the claim was brought first in Belgium between the same parties and involving the same cause of action and is still pending;
- the Belgian courts had exclusive jurisdiction;
- the jurisdiction of the foreign court was only based on the presence of the defendant or of goods; or
- the decision violates the rights of the parties according to the conflict of laws rules that are applicable to certain claims according to the Belgian Code of Private International Law (eg, set-off, retention of title or claims for fraudulent conveyance).

Judicial cooperation

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

The EU Insolvency Regulation (EU) 2015/848 dated 20 May 2015 explicitly provides for judicial cooperation. More specifically, cooperation may take place by any means the court deems appropriate. In particular, it may concern:

- coordination in the appointment of insolvency officers;

- communication of information by any means the court deems appropriate;
- coordination of the management and supervision of the debtor's property and business;
- coordination of hearings; and
- coordination of the adoption of protocols.

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?

Successful debtor claims generally follow the same rules as before insolvency, meaning that the same available remedies apply. In other words, depending on the claim at hand, the debtor-claimant may seek specific performance, damage, injunctive and declaratory relief. Courts may also impose penalty payments where possible.

Remedies for creditors

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

Creditors will aim to obtain recognition of their claims in the insolvency proceedings (which may include, inter alia, damages and interest) and to receive appropriate payments from the bankruptcy estate. However, just as with successful debtor claims, creditor claims follow the same rules as before the insolvency, meaning that all remedies may also apply depending on the claim at hand. Courts may also impose penalty payments where possible.

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 first instance judgment is, in principle, enforceable despite appeal. A bailiff can exercise an attachment on movable or immovable property, or a garnishment based on such judgment. As the case may be, a successful claimant will, however, need to take into account the consequences of a stay. Whether the judgment could be enforced abroad, will essentially depend on the rules of private international law of the state where enforcement would be sought.

SETTLEMENT AND MEDIATION

General court approach

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

Yes. For example, the Belgian Code of Economic Law explicitly provides the possibility for a debtor to request the court to appoint a court-mandated mediator to facilitate the reorganisation of all or part of its assets or activities.

Timing

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

Parties may enter into settlements at any stage before or after the introduction of the merits court proceedings, including on appeal, and before or after the opening of formal insolvency proceedings. The timing of parties' willingness to settle highly depends on the circumstances of the matter and the disputed claims.

Court review and approval

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

Bankruptcy trustees can only enter into settlements of disputes concerning the bankruptcy estate with the prior authorisation of the supervisory judge. If the value of the subject-matter of the settlement exceeds €50,000, the settlement can only become binding after being homologated by the court. The bankruptcy trustee must summon the debtor so that he can be heard, but the debtor has no veto power.

Mediation clauses

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

If a mediation process has been initiated before the opening of the bankruptcy proceedings, the creditor-claimant must file its claim in the bankruptcy proceedings. If the bankruptcy trustee accepts the claim, the mediation becomes without object and will be discontinued. If, on the other hand, the claim is disputed, the case will be heard by the bankruptcy court. The creditor and the bankruptcy trustee may, however, in common agreement decide to continue the mediation process. The court can, however, not force the parties to enter into or continue a mediation process as mediation is voluntary and hence requires the consent of both parties to the dispute.

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?

On 1 September 2023, the reformed Belgian insolvency framework entered into force. This reform amends Book XX of the Code of Economic Law by introducing new reorganisation proceedings and amending the conditions for the application of certain existing procedures. This reformed framework implements Directive (EU) 2019/1023 on restructuring and insolvency in Belgium.

Some of the most significant novelties are as follows:

- Increased flexibility for (out-of-court) amicable settlements.
- Introduction of a new 'private' (or confidential) judicial reorganisation proceeding to allow the debtor to faster obtain an agreement with creditors on all or part of its debt without any general publicity of the opening of such procedure.
- The introduction of a new regime for collective restructuring plans if the debtor is a large company (or SME which opted in). Under this new regime – if strict conditions are met - the rights of secured creditors may be subject to a haircut. Also, the use of a debt-to-equity swap is facilitated by allowing shareholders to be included in a collective restructuring plan.
- Introduction of a confidential bankruptcy preparation procedure ('pre-pack') that allows insolvent companies to discreetly prepare for the transfer of assets and activities under court supervision before formal bankruptcy proceedings are opened.

LOYENS & LOEFF
Law & Tax

Vanessa Marquette vanessa.marquette@loyensloeff.com
Jens De Winne jens.de.winne@loyensloeff.com
Caro Van den Broeck caro.van.den.broeck@loyensloeff.com

Loyens & Loeff

Cyprus

Katerina Philippidou, **Ioannis Malachtos**
Patrikios Pavlou & Associates LLC

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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 accordance with the records kept by the Insolvency Service of Cyprus there was a decrease in the number of voluntary liquidation proceedings from 2,161 in 2021 to 1,772 in 2022. Within the same period, the number of involuntary liquidation proceedings decreased from 74 to 57. Moreover, a limited number of applications were filed seeking an examiner's appointment to look into a company's affairs.

As established by Cypriot case law a winding-up or bankruptcy petition can be filed on the basis of an undisputed debt. Insolvency proceedings cannot be used for the purpose of deciding a disputed debt and there is no mechanism available to put pressure on a debtor to pay sums that it disputes in good faith and on substantial grounds.

Cypriot case law provides that the term 'creditor' does not include 'a person whose debt is substantially disputed even if the company is in fact insolvent'. It is settled case law that in cases where there is a substantial *bona fide* dispute over the claim for payment, the winding-up petition cannot succeed because a winding-up petition is not the procedure offered for adjudication of a disputed debt.

So where there is a material dispute about a debt then the correct procedure would be to bring an action. In fact, if a creditor has reason to expect that the company will raise a plausible defence to its claim, its best course is to sue the company by action and to file a winding-up petition once it has obtained a court judgment against the claim. The debtor will then be estopped by the judgment from disputing the petitioner's claim on its merits.

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 Bankruptcy Law, Chapter 5 (Chapter 5) relates to personal insolvency. In addition, the Law on the Insolvency of Natural Persons (Personal Repayment Plans) and the Debt Relief Order (DRO) L.65(I)/2015, as amended, provide additional provisions for the handling of insolvent individuals. The Companies Law, Chapter 113 (Chapter 113), as amended, governs corporate insolvencies and reorganisations.

Procedure

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

Insolvency proceedings are governed by the Procedural Rules for Companies 396/1944 as amended (the Companies Rules), the Procedural Rules for Companies Under Liquidation 1933-2013, the Bankruptcy Rules (368/1931), the Procedural Rules on the Insolvency of Natural Persons, the DRO of 2016 and the Civil Procedural Rules.

On 1 September 2023, the new Civil Procedure Rules came into force and apply to all cases filed after that date. However, the new Civil Procedure Rules do not explicitly provide what applies to the winding-up petitions and to what extent the new Civil Procedure Rules apply for winding-up petitions. Therefore, the issue of the type of claim to be used to commence a winding-up procedure and the procedure to be followed remains controversial. There are two different approaches as to that; one opinion that has been expressed is that the alternative procedure under Part 8 of the new Civil Procedure Rules applies and the claim form No. 7 should be used.

We tend to adopt the opposite view as the winding up proceedings appear to be a 'specified' type of proceedings, thus not falling under the proceedings regulated under Part 8. The wording and form of the claim form No. 7 provided by Part 8, appears to be suitable and to be employed whenever a claim is raised to be adjudicated by a claimant or applicant against a defendant or respondent, whereas in the winding up process, the object or purpose is quite different since such proceedings relate to the Company but, strictly speaking, are not addressed against a person.

Courts

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

The district court where the company has its registered office (for at least six months before the filing of the petition) and where the individual has its residence is the applicable court to hear insolvency claims. When determining whether the procedure falls within the jurisdiction of a senior district judge or district court judge, the amount of the paid-up share capital of the company shall be taken into account.

Appeals may be submitted to the Supreme Court of Cyprus. Although there are no specific courts that hear winding-up and bankruptcy petitions, Cypriot judges are experienced with insolvency 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?

The district courts have jurisdiction to adjudicate insolvency proceedings, pursuant to the Companies Law, Chapter 113, the Bankruptcy Law, Chapter 5, the Courts Law, 14/1960, the common law as well as the relevant case law. Foreign creditors are entitled to bring a claim in the same way as domestic creditors.

Limitation periods

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

The law that currently regulates limitation periods for promoting actionable rights in Cyprus is the Limitation of Actionable Rights Law 2012 (66(I)/2012). The general limitation period within which an action must be brought is 10 years.

In relation to civil offences, section 7 of the Limitation Law specifies that no claim in relation to a contract shall be brought after a period of six years from the date of completion of the claim.

Section 7(3) of the Limitation Law states that the limitation period does not commence before the date of service of the written demand from or on behalf of the lender, or where there are joint lenders, from one or on behalf of one of them, to the debtor for the repayment of the debt in the case of contracts derived from loan agreements that:

- do not provide for the repayment of debt on a specific or determinable date or until a specific or determinable date; and
- do not establish as a condition for repayment of the debt the provision of a prior notice to the debtor.

Provided that, in the cases referred to above, where in relation to the loan agreement, the borrower provides a mortgage or pledge as collateral to it, no claim in relation to a contract shall be brought after a period of 12 years from the date of completion of the claim.

According to section 3 of the Limitation Law, the limitation period shall be counted from 1 January 2016.

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?

f it is deemed necessary and appropriate, the claimant can file an application for the issue of interim orders, for example, a freezing order, to prevent a respondent from putting assets beyond the reach of creditors. Such an application can be promoted either by summons or, in exceptional or urgent circumstances, without notice to the other party.

If the applicant secures a freezing order, it may request the issuance of disclosure orders requesting the respondent to provide information on its assets to ensure that it complies with the freezing order. In addition to disclosure orders, the Cyprus courts can also issue orders for the appointment of a provisional liquidator to ensure the protection of the company's 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?

The Evidence Law, Chapter 9 provides the relevant rules and procedures in relation to the collection and admissibility of evidence in all litigation procedures, including liquidation. Evidence can be given either orally or in writing. A winding-up petition is supported by an affidavit accompanied by relevant exhibits. The affidavit must be signed by the creditor and where the creditor is a company by the director or an employee of the company who has knowledge of the facts of the case. The affiant must swear and sign the affidavit before the registrar of the relevant district court. Expert witness testimony is also allowed in insolvency litigation.

Time frame

9 What is the typical time frame for insolvency claims?

Where the insolvency claim is based on the inability of the company to settle its debt, it is a prerequisite for the claimant to serve upon the debtor a written demand requesting the settlement of its debt within 21 days of the service. As soon as the 21 days from the service of the statutory demand lapses and provided that the amount due is still outstanding, the claimant may proceed with the filing of a petition.

The petition is fixed before the court approximately one month after the date it is filed. The petition will be served upon the company, the Registrar of Companies (ROC) and all the relevant authorities. If no one contests the proceedings on the date fixed for the first appearance of the petition before the court, the court shall set a new date on which the applicant will have to appear at the court and prove the content of the petition (approximately two months after). At the same time, directions are given by the court that a copy of the petition be published in the Official Gazette and usually in one or two newspapers with a daily circulation a few days prior to the date fixed for proof of the petition.

On the proof date, the court will proceed with issuing the winding-up order, provided that no one contested the petition and provided that the court is satisfied with issuing the order. A copy of the order should be delivered no later than three days from the date of its issuance (or as otherwise directed by the court) to the ROC, which shall register and publish the same on its official website.

The time frame for issuing the final judgment depends on whether the petition is contested and on the judge's workload. If the petition is not contested, the final judgment will be issued within three to six months; if the petition is contested, the final judgment is normally issued within two years.

Appeals

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

The time frame for filing an appeal against an insolvency-related judgment is six weeks from the issuance of the judgment. In general, an appeal can be supported by, among others, the following grounds of appeal:

- the court misinterpreted and misapplied the relevant provisions of the law and case law in reaching the judgment, or
- the relevant conditions of the law were not fulfilled, and, as such, it was not just and fair for the court to issue the judgment.

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 costs of winding up, including disbursements and the fees of the liquidator and any other appointed persons in the process, will rank in priority over any other unsecured claims save for preferential debts, which are mandatorily preferred by law. Third-party funding is not prohibited by the law.

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 309 of the Companies Law, Chapter 113 (Chapter 113), if an individual commits one of the following offences, and at the time of the commission of the alleged offence was an officer of a company that is subsequently ordered to be wound up by the court or subsequently passes a resolution for voluntary winding-up, he or she will be held guilty and will be liable on conviction to imprisonment not exceeding two years:

- by false pretences or by means of any other fraud, induced any person to give credit to the company;
- with intent to defraud creditors of the company, made or caused to be made any gift, transfer of or charge on, or caused or connived at the levying of any execution against, the property of the company; or
- with intent to defraud creditors of the company, concealed or removed any part of the property of the company since, or within two months before, the date of any unsatisfied judgment or order for payment of money obtained against the company.

In addition, under the Fraudulent Transfers Avoidance Law, Chapter 62(Chapter 62), any judgment creditor may initiate proceedings against a debtor on the ground of an alleged fraudulent transfer.

According to section 3(1)of Chapter 62:

> every gift, sale, pledge, mortgage or other transfer or disposal of any movable or immovable property made by any person with intent to hinder or delay his creditors or any of them in recovering from him, his or their debts shall be deemed to be fraudulent, and shall be invalid as against such creditor or creditors; and, notwithstanding any such gift, sale, pledge, mortgage or other transfer or disposal, the property purported to be transferred or otherwise dealt with may be seized and sold in satisfaction of any judgment debt due from the person making such gift, sale, pledge, mortgage or other transfer or disposal.

Furthermore, under section 3(3)of Chapter 62:

> no sale, mortgage, transfer or assignment made in exchange for money or other property of equivalent value shall be voidable under the provisions of this Law, unless the purchaser, mortgagee, transferee, or assignee shall be shown to have accepted it with knowledge that such sale, mortgage, transfer, or assignment, was made by the vendor, mortgagor, transferor, or assignor with intent to delay or defraud his creditors.

The procedure that must be followed to set aside such a transaction is set out in section 4of Chapter 62. Where any gift, sale, pledge, mortgage or other transfer or disposal of any movable or immovable property is deemed to be fraudulent under the provisions of section 3*,* regardless ofwhether it is made before or after the commencement of an action or proceeding wherein the right to recover the debt has been established, it'may be set aside by an order of the court, to be obtained on the application of any judgment creditor made in such action or other proceeding, and to the court before which such action or other proceeding has been heard or is pending'.

Actions may be brought against a director for an undervalue transfer even where there is no fraudulent intent on the basis of negligence, depending on the circumstances within which such a transfer was effected and provided that the transfer deteriorated the financial position of the company.

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 Chapter 113, the following transactions may be set aside when an insolvent party goes into liquidation:

- fraudulent preference;

- voidable floating charge;
- disclaimer of onerous contracts; and
- fraudulent transfer.

In each case, a liquidator may apply to the court to have the transaction set aside. If security was set aside under any of the above circumstances, the creditor must prove its debt in the course of the winding-up as an unsecured creditor.

Section 301 of Chapter 113 extends the fraudulent preference provisions of bankruptcy law to companies. Any transaction (including any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company) that the company enters into within six months before the commencement of its liquidation may be deemed a fraudulent preference against its creditors and be set aside.

For a transaction to be voided:

- the person preferred must be a creditor (including a contingent creditor) of the company when the transaction occurred;
- there must be a preference – where the company does something that has the effect of putting that person into a position, which in the event of the company going into insolvent liquidation, would put him or her in a better position than he or she would have been if that had not been done; and
- the company was influenced by a 'desire to prefer' – the burden of proof is on those who wish to establish fraudulent preference (in this case, the liquidator) to prove, on the balance of probabilities, that the dominant or real intention of the counterparty was to prefer the particular creditor.

Section 302 of Chapter 113creates an obligation for all and any creditors who benefited from a fraudulent preference to repay any benefit they obtained therefrom and the same are considered to be sureties of the company for an amount equal to the value of such benefit.

Liens and floating charges

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

Pursuant to section 303 of Chapter 113, a floating charge on the undertaking or property of the company created within 12 months of the commencement of winding-up is valid only to the extent of any cash paid to the company at the time of, or subsequently to, the creation of and in consideration of the charge. This is unless it is proved that, immediately after the creation of the charge, the company was solvent. The onus of proving the company's solvency is on the holder of the floating charge. Solvency requires not only an excess of assets over liabilities, but also the ability to pay debts as they become due.

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?

A liquidator may request the court to set aside transactions if they are found to relate to any of the following:

- fraudulent preference;
- voidable floating charge;
- disclaimer of onerous contracts; and
- fraudulent transfer.

Furthermore, the liquidator or any contributory or creditor may apply to the court to determine, among other things, any questions that arise in the winding up of a company. The court, if satisfied that the determination of the question will be just and beneficial, may accede wholly or partially to the application on such terms and conditions as it thinks fit or may make another order on the application as it thinks just.

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 will be held personally liable to the company for damages and injunctive relief may be issued against them if they breach the duty of acting in good faith and in the best interests of the company (fiduciary duty) and the duty of skill and care.

For example, directors may be found to be in breach of their fiduciary duties if they pay dividends in relation to a company with insufficient distributable reserves and may be held personally liable and be ordered to repay the amount representing the unlawfully paid dividends. Moreover, if a director has made a secret profit, they will be liable to pay that profit to the company.

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 are protected from liability for decisions made in connection with the restructuring or insolvency to the extent that such business decisions are taken after due consideration and without self-interest but for the benefit of the company as a whole. Where the company is insolvent or nearly so, the directors should not act in a manner that may be considered to

be fraudulent trading or committing fraud with regard to the creditors; they owe the creditors a special duty to be careful not to put the company further into debt by questionable business decisions.

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 a shareholder may be recharacterised as equity by way of the shareholder's capital contribution, provided that the contributing shareholder is willing and able to make a payment or contribution to the company that will not be refundable and that such an arrangement is in the best interests of both the contributing shareholder and the company.

Illegal dividends

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

Dividends received by shareholders may be prosecuted as illegal if the company is insolvent or nearly so and such distribution caused the deterioration of the financial position of the company.

Where the company is under liquidation, shareholders may receive dividends or proceeds of liquidation only after all liquidation expenses, taxes and creditors' debts are fully settled.

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?

If it appears that any assets of the company were unlawfully disposed of prior to the commencement of the company's liquidation or that the directors of an insolvent or near-insolvent company proceeded with any trading that caused the company's financial position to deteriorate further, the directors may be found liable.

Under the Companies Law, Chapter 113, directors might also be held liable if they proceeded with a fraudulent transfer within 12 months prior to the commencement of the liquidation of the company. However, this limitation period (for a claim based on tort) can be extended to up to six years prior to the commencement of the liquidation.

Any creditor, or the liquidator, may apply to the court requesting a director's personal contribution to the company's assets as compensation for the damage suffered by the creditors.

Equitable subordination

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

If a shareholder appears to have provided a loan to the company then they can also be considered a creditor of the company, and as such, they can also be included in the list or register of creditors, provided that they have proved their debt within the time frame required in accordance with the provisions of section 251(2)(a) of Chapter 113.

If the loan provided is a subordinated loan that is evidenced by supporting documentation, then it will be placed below the unsecured creditors in the ranking of distribution. If it is not a subordinated loan, it will rank pari passu with the unsecured 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?

Under section 313 of Chapter 113, if, in the course of a winding-up by a court or under the supervision of a court, it appears to the court that any past or present officer, or any member of the company, is guilty of any offence in relation to the company for which they are criminally liable, the court may, either on the application of any person interested in the winding-up or of its own motion, direct the liquidator to report or refer the matter to the Attorney General. If the Attorney General considers that a prosecution is necessary, they will institute proceedings accordingly, and it will be the duty of the liquidator and every officer and agent of the company, past and present (other than the defendant in the proceedings), to give the Attorney General all the assistance it is reasonable to give in connection with the prosecution.

Risk mitigation

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

The liability of the shareholder is limited to the issued share capital. The shareholders have no obligation to cover the liabilities of the company unless there is unpaid share capital.

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?

Unsecured creditors may contest a restructuring proposal on the basis that such a proposal unfairly prejudiced their interests.

Where the court deems that a company is (or is likely to be) unable to pay its debts, no resolution for the winding up of the company has been passed and published in the Official Gazette of the Republic
and no order has been issued for the winding up of the company, the court may
following a petition
appoint an examiner to the company for the purpose of examining the state of the company's affairs and performing such duties in relation to the company as may be imposed by or under the provisions of the law.

The examiner shall, as soon as practical after they are appointed, formulate proposals for a compromise or scheme of arrangements in relation to the company concerned. Upon receipt of the report of the examiner, the court shall examine the same as soon as practically possible. A creditor whose interest or claim would be impaired by the proposals may object to their confirmation by the court on any of the following grounds:

- there was some material irregularity at or in relation to a meeting to which section 202KA (Cap 113) applies;
- the acceptance of the proposals by the meeting was obtained by improper means;
- the proposals were put forward for an improper purpose; or
- the proposals unfairly prejudice the interests of the objecting person.

Another popular method of restructuring the liabilities of distressed companies is a scheme of arrangement as provided for under section 198 of the Companies Law, Chapter 113 (Chapter 113). Under a scheme of arrangement, companies can promote an arrangement between their creditors and members (or any class of them) that, if agreed to by a majority in value in the case of creditors or a majority in number in the case of members, and subsequently sanctioned by the court, will bind all creditors and members whether they consented to the arrangement or not. A reorganisation plan is agreed upon based on the compromises made by both the company and its creditors, and it is subject to implementation.

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 creditor may apply to the district court where the registered office of the debtor company is located and request its liquidation, and the court will grant such an order if, among other things, it is proved that the company is unable to pay its debts (section 211(e) of Chapter 113).

Specifically, under section 212 of Chapter 113, the company will be deemed to be unable to pay its debts if:

- the company fails to settle or secure a liquidated debt or obligation in excess of €5,000 within 21 days of receipt of a written demand from a creditor delivered to the registered address of the company requesting that the outstanding amount owed be settled;
- an order for execution or any other proceeding is issued by a court on any judgment, decree or order in favour of a creditor of the company and that order is returned either fully or partially without being satisfied;
- to the satisfaction of the court, it is proven that the company is unable to pay its debts at the time these fall due (at the time they are payable) and, in determining whether a company is unable to pay its debts as they fall due, the court shall take into account the contingent and prospective (future) liabilities of the company; or
- to the satisfaction of the court, it can be proven that the value of the assets of the company is less than the value of its liabilities, taking into account the contingent and prospective (future) liabilities of the company.

A creditor promoting a winding-up petition must prove that: its debt is partially or wholly unsecured; the company is unable to settle or secure the debt it owes; the company does not have a bona fide or a substantial dispute to the debt it owes; and that it is proper and just to wind up the company.

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?

During examinership, a moratorium is put in place preventing creditors from promoting any insolvency proceedings against the company. A receiver cannot be appointed and no attachment or execution may be put into force against the company's property. Additionally, during the moratorium, secured creditors are not allowed to proceed with the realisation of their security except with the consent of the examiner. In addition, no steps may be taken to repossess goods in the company's possession under any hire-purchase agreement.

Where a winding-up order is issued or a provisional liquidator is appointed, no action or proceeding shall be promoted against the company without prior leave of the court and upon such terms that the court may impose (section 220 of Chapter 113).

Following the filing of a petition and before the issuance of an order, the company or any creditor or contributory may:

- where any action or proceeding against the company is pending in any district court or the Supreme Court, apply to the court in which the action or proceeding is pending for a stay of proceedings therein; and
- where any action or proceeding is pending against the company, apply to the court with jurisdiction to wind up the company to restrain further proceedings in the action or proceeding and the court to which an application is so made may, as the case may be, stay or restrain the proceedings accordingly on such terms as it thinks fit (section 215, Chapter 113).

Where any company is being wound up by the court, any attachment, sequestration, distress or execution put in force against the estate or effects of the company after the commencement of the winding-up shall be void to all intents (section 217, Chapter 113).

Stays of proceedings – strategy

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

Where a winding-up order is issued, no action can be promoted against the company without the leave of the court (section 220 of Chapter 113). Therefore, a creditor whose action is pending or who is willing to file a new action on the basis of an unprovable debt can only do so following the relevant leave of the court. If the creditor's debt is provable, they should proceed with the submission of relevant proof of debt to the Registrar of Companies within the prescribed period of 35 days from the publication of the order.

Stays of proceedings – effect on emergence from insolvency

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

Examinership is a rescue process providing for the financial reorganisation of a viable company with liquidity problems. Its aim is to keep the business alive and to give the company time to reorganise its financial affairs. With the submission of an application for the appointment of an examiner, the company is entered under court protection (moratorium) for a period of four months, which can be extended under certain circumstances. During this period, no proceedings can be promoted against the company without the permission of the court. Moreover, a receiver cannot be appointed and the company cannot be placed under liquidation.

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?

Under Chapter 113, the following transactions may be set aside when an insolvent party goes into liquidation:

- fraudulent preference;
- voidable floating charge;
- disclaimer of onerous contracts; and
- fraudulent transfer.

In each case, a liquidator may apply to the court to have the transaction set aside. If security was set aside under any of the above circumstances, the creditor must prove its debt in the course of the winding-up as an unsecured creditor.

Vote designation

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

There are no specific provisions under Cypriot law.

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?

If, during liquidation, a person is proved to be involved in fraudulent trading under section 311 of the Companies Law, Chapter 113 (Chapter 113) or some other offence (such as misappropriation of assets under section 312 of the Law), such person may be found personally liable for the company's debts or ordered by the court to pay compensation.

Procedure and resolution

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

The liquidator will take all necessary steps to promote any pre-existing claims on behalf of the company.

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?

Undersection 234 of Chapter 113, if any person is aggrieved by an act or omission of the liquidator, that person may apply to the court, and the court may confirm, reverse or modify the act or decision complained of, and make such order in the premises as it thinks just. Such an application may be promoted by a creditor or other stakeholder if, for example,the liquidator refuses to promote pre-insolvency debtor claims.

Risk mitigation for creditors

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

Where a pre-insolvency debtor claim is promoted against the creditors, defending such a claim is a method of mitigation.

If a pre-insolvency debtor claim is promoted against any third persons, other than creditors, such a successful claim will benefit unsecured creditors as the value of the estate of the company under liquidation will be increased and, therefore, there will be more assets for distribution.

Minimising costs for creditors

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

Creditors can reach an out-of-court settlement, which will avoid the accumulation of litigation costs.

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?

The liquidator will take all necessary steps to promote any claim (on behalf of the company) against its debtors. A possible claim can be promoted by the liquidator under section 246 of Chapter 113, requesting the court to order any contributory included in the list of contributories to pay to the company in liquidation, in the manner specified in the order, any money due from any contributory to the company.

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?

Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (the Recast Regulation) is applicable in Cyprus and, as such, where the foreign proceedings are capable of recognition under the Recast Regulation, they will be recognised in Cyprus. As of 1 February 2018, the archive of the Insolvency Service of Cyprus was able to interconnect with the European e-Justice Portal, facilitating cross-border insolvency proceedings.

Judicial cooperation

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

Cyprus has not entered into any cross-border insolvency protocols that enable the court to coordinate insolvency proceedings with other countries. Articles 41 to 43 of the Recast Regulation provide for cooperation between courts across EU member states. Cyprus is not a member of the UNCITRAL Model Law on Cross-Border Insolvency.

The Recast Regulation sets out comprehensive rules regarding the recognition of main insolvency proceedings within the European Union.

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 may challenge a petition or an action filed against it on the basis that the debt is disputed. If successful, such a petition or action will be dismissed and the costs of the procedure will be awarded in favour of the debtor-claimant. A debtor may also file an application requesting the court to set aside a judgment that has been issued against it.

Remedies for creditors

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

A creditor who has obtained a judgment against a company that is not under liquidation or examinership may proceed with the enforcement of the judgment in accordance with the tools provided by the relevant legislation, such as:

- writ of execution for the sale of movables;
- charges over immovable property;
- orders for the delivery or possession of goods and liquidation or bankruptcy proceedings;
- garnishee proceedings;
- writ of delivery of goods;
- possession of land; and
- writ of sequestration.

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?

If a debtor (upon whom an order was served) refuses to comply with the provisions of the order, the applicant may file an application for contempt of court.

SETTLEMENT AND MEDIATION

General court approach

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

Cypriot courts are always ready to accept an amicable settlement between the parties provided that the settlement was reached within the parameters of the relevant legislation.

Timing

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

An out-of-court settlement is most likely to be reached after the conclusion of the pleadings, followed by the mutual disclosure of documents or evidence between the parties and before the commencement of the hearing of the case.

Court review and approval

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

An out-of-court settlement is usually accepted by the court provided that it is reached within the parameters of the relevant legislation and the pleadings submitted by the parties.

Mediation clauses

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

An insolvency process is itself a public process that affects the rights of third parties that have contractual relations with the company or the individual. Therefore, these rights cannot be enforced through an arbitration process that requires consent and is usually private. In addition, under the Companies Law, Chapter 113, the courts have jurisdiction over corporate and individual insolvencies, and only the courts may order liquidations. In the event of a shareholder dispute that leads to an application for liquidation before a court, it may be possible to resort to arbitration if all parties consent to it prior to the court ordering the liquidation of the company. In these cases, shareholders' disputes may be arbitrated. If this does not occur, a winding-up order will not be issued by the arbitration tribunal or body.

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 development regarding insolvency litigation was enacted with the amending Law 80 (I)/2023, which tends to remove powers and responsibilities that were exclusively related to the official receiver so that they are received/undertaken by the respective liquidator or temporary liquidator as another person (by the official receiver) appointed upon application to the court, while the official receiver for these acts will be informed by notifications of the liquidator or provisional liquidator appointed from time to time in connection with the winding-up proceedings pending in the court. By the amending law, in several sections of the Law (Chapter 113), the term 'official receiver' has been substituted with 'liquidator or provisional liquidator'.

Specifically:

- Regarding section 224 (Chapter 113), additions were made so that the content of the section regulates (generally) the preparation and submission of a statement of affairs of the company not only to the official receiver but also to the liquidator or temporary liquidator who is a person other than the official receiver.
- Regarding section 225 (Chapter 113), the corresponding additions were made so that the liquidation report submitted to the court is carried out and undertaken by the respective liquidator in the event that he is a person other than the official receiver.
-

Regarding section 228 (Chapter 113), the amendment regulates the procedure for the appointment of an independent liquidator other than the official receiver in the court by application under the winding-up petition, which may be filed either at the outset or subsequently to the winding-up proceedings in question and that the Court for the appointment of such person may hear the positions and wishes of creditors, applicant, company and company contributions. However, the appointed liquidator, upon request under section 213(1) (Chapter 113), is not required to convene and preside over separate meetings of creditors and contributors for the purpose of electing a new liquidator unless the company has funds or funds are available to cover the relevant costs of convening meetings.

Katerina Philippidou kphilippidou@pavlaw.com
Ioannis Malachtos imalachtos@pavlaw.com

Patrikios Pavlou & Associates LLC

Read more from this firm on Lexology

France

Hervé Diogo Amengual, **Thomas Doyen**, **Célia Jiquel**, **Hugo Bodkin**, **Eeva Bernard**
Latham & Watkins LLP

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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 ligation, 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.

** The authors wish to thank Alexandra Bigot for her assistance in the preparation of this chapter.*

LATHAM & WATKINS LLP

Hervé Diogo Amengual	herve.diogoamengual@lw.com
Thomas Doyen	thomas.doyen@lw.com
Célia Jiquel	celia.jiquel@lw.com
Hugo Bodkin	hugo.bodkin@lw.com
Eeva Bernard	eeva.bernard@lw.com

Latham & Watkins LLP

Germany

Stefan Patzer, **Frank Grell**
Latham & Watkins LLP

Summary

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.

LATHAM & WATKINS LLP

Stefan Patzer stefan.patzer@lw.com
Frank Grell frank.grell@lw.com

Latham & Watkins LLP

Indonesia

Theodoor Bakker, **Ulyarta Naibaho**, **Bilal Anwari**
ABNR

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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?

The general climate of insolvency litigation in Indonesia is dependent on many factors, such as debtor cooperation and whether the proposed composition plan is reasonable and fair. Also significant are whether a court-appointed administrator or receiver in bankruptcy has a reasonable commercial and legal approach, whether the supervisory judge plays their role properly, and whether the law is implemented and interpreted strictly and reasonably in the interests of creditors.

The willingness of a debtor to treat creditors fairly in a composition plan is also important. Although most creditors would usually influence the process, this is sometimes insufficient to drive bankruptcy and suspension of payment proceedings towards a deal that is commercially satisfactory to the creditors. The law generally allows a debtor to control the process to a greater extent than in developed jurisdictions (regardless of the fact that it may appear to favour creditors).

Given the complexities of court-sanctioned insolvency (which also includes restructuring), procedures for Indonesian insolvency can be divided into litigation:

- for pre-insolvency or restructuring;
- post-restructuring; and
- during insolvency.

Pre-insolvency litigation or restructuring involves the filing of a petition for bankruptcy or suspension of payments (PKPU) by creditors and a petition for cassation or case review of a commercial court decision.

Post-restructuring litigation includes the following:

- challenge to the debtor's composition plan approved by the creditors and homologated by the commercial court (Homologated Plan) by dissenting creditors via a cassation or case review petition to the Supreme Court; or
- filing of a petition to nullify a Homologated Plan by a creditor due to the debtor's subsequent default in performing its obligations cited in the Plan.

Litigation during insolvency includes the following:

- verification of claims;
- lifting of stay period;
- continuation of executory contract performance;
- distribution of liquidation proceeds;
- third-party opposition to confiscation;

- liability of the receiver;
- other disputes that concern the bankruptcy estate, to which the bankrupt debtor, creditor or receiver is a party; and
- receiver's initiated legal process to preserve or maximise the debtor's assets that include:
    - asset-related disputes;
    - contract-related disputes;
    - avoidance of fraudulent transfer; and
    - liability claim against directors, commissioners or shareholders of the debtor (of a limited liability company) arising from their action, which constitutes the fault or negligence that caused the debtor's bankruptcy.

Disputes over restructuring plans in insolvency or restructuring, other than challenges to a Homologated Plan, are infrequent, particularly due to the absence of a route for (dissenting) creditors to challenge restructuring plans under Law No. 37 of 2004 on Bankruptcy and Suspension of Payments, as replaced by Law Number 4 of 2023 on the Development and Strengthening of the Financial Sector (IBL) other than outright rejection, which, following a quorate decision, may cause a debtor to be declared bankrupt.

Disputes that most often arise between creditors and debtors in the pre-insolvency litigation or restructuring phase are over unpaid debts before insolvency proceedings commence.

Creditors frequently use pre-insolvency or restructuring litigation to force a debtor to settle its outstanding debt during litigation (a fast-paced, maximum of 60 days) so that the debtor, if making payments, can avoid entry into the insolvency or restructuring process.

While the strategy can be successful, in some instances, the debtor succeeds in having the petition rejected over technicalities; in another instance, a debtor, surprisingly, agrees to enter into the insolvency or restructuring process.

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?

Law No. 37 of 2004 on Bankruptcy and Suspension of Payments, as replaced by the IBL, is the key source of law. Law No. 40 of 2007 on Limited Liability Companies as amended by Law No. 6 of 2023 on the Ratification of Government Regulation No. 2 of 2022 (in lieu of Law No. 11 of 2020 on Job Creation) into Law (Indonesian Company Law (ICL)), the Indonesian Civil Code (ICC), the Indonesian Commercial Code and the Indonesian Penal/Criminal Code complement and interact with the IBL as there are cross-references between this legislation.

Procedure

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

The IBL clearly stipulates that unless it specifically regulates otherwise, the general civil procedural law, which includes Supreme Court Decree No. 109/MA/SK/IV/2020 on the Guidebook for Resolving Bankruptcy and PKPU Cases, dated 29 April 2020 (Supreme Court Manual), is applicable. Pending the enactment of a new civil procedural law still under discussion in the parliament, the Indonesian Civil Procedure Law consists of the Indonesian Procedural Code for the Islands of Java and Madura (HIR), the Procedural Code for the Outer Islands (RBG) and general ICC provisions on evidence. In addition, the colonial Code on Civil Procedure (RV), various Supreme Court Regulations and Circular Letter provide further guidance on implementation.

For certain proceedings specifically stipulated by the IBL, the short timeline provided may overcome the customary hurdles that exist under general civil procedural law, especially as most general civil procedural law timelines are not strictly specified.

Courts

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

The Commercial Court has jurisdiction over the legal domicile of the debtor. Currently, there are five Commercial Courts in Indonesia including the Commercial Court at the District Courts of Central Jakarta, Medan, Semarang, Surabaya and Makassar.

The Commercial Court was established to handle commercial law issues, and at the moment only handles cases relating to insolvency or restructuring, intellectual property and antitrust (at objection level).

While the judges sitting in the Commercial Court are provided with special training, they also handle other general matters dealt with by district courts. In addition, judges sitting in the Commercial Court are promoted to serve other courts (not necessarily commercial) periodically.

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 Commercial Court has jurisdiction to hear insolvency claims based on the IBL and ICL. Cross-border matters are not specifically covered. In addition, Indonesia does not recognise or provide other relief in connection with restructuring or insolvency proceedings overseas, as it has not adopted the UNCITRAL Model Law, and it has not ratified an international treaty that would enable Indonesian courts to recognise restructuring or insolvency proceedings commenced or decisions issued in other jurisdictions.

Limitation periods

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

As the IBL does not stipulate a limitation period, the ICC rules on statute of limitations apply, which for claims in general is 30 years.

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?

The IBL provides creditors with the opportunity to request the Commercial Court to:

- impose an attachment over a debtor's estate in part or entirely; or
- appoint a provisional receiver to oversee the debtor's business management and payment to creditors, debtor's estate transfer or securitisation (which in bankruptcy falls within the receiver's authority) prior to the bankruptcy declaration being rendered. (However, we are not aware of a precedent to indicate that this feature has become Commercial Court policy.)

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 rules and procedures are stipulated in the IBL, Supreme Court Manual, HIR/RBG and general ICC provisions on evidence.

According to article 1886 ICC, the following constitute evidence:

- written evidence;
- testimony of factual witnesses;
- inferred matters;
- confessions; and
- sworn statements.

While expert witness testimony is allowed on the basis of article 154(2) HIR and article 229 RV, formally it does not constitute evidence. Interestingly, however, based on the Supreme Court Manual, expert witness testimony is deemed as evidence. In practice, the panel of judges is free to decide whether or not to admit expert witness testimony and the expert

witness testimony functions to clarify the case under examination or may complement or strengthen other means of evidence.

All documents submitted to the court must be in Bahasa Indonesia or be accompanied by a Bahasa Indonesia translation. Therefore, unless the documents are already in English (or another foreign language) – Bahasa Indonesia bilingual format, documents written only in a foreign language or English must be translated into Bahasa Indonesia by a sworn translator.

With respect to pre-insolvency litigation, in accordance with IBL, a bankruptcy or PKPU petition must be granted if it can be summarily proven that the bankruptcy or PKPU requirements have been met. Often a bankruptcy or PKPU petition is rejected because the evidentiary requirements involved cannot be met.

To prove that more than two creditors exist (which is a bankruptcy or PKPU petition requirement), the petitioner may prove it with pre-existing evidence or request that other creditors attend court hearings (with the fee for summoning other creditors borne by the petitioner).

Creditor data obtained from the Financial Services Authority through the Financial Information Service System website (SLIK) is not considered to have sufficiently strong evidentiary value to prove the existence of creditors unless supported by other evidence that indicates the existence of the debt.

Time frame

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

IBL provides the following time frame. For pre-insolvency or restructuring litigation:

- for a creditor-filed bankruptcy petition: 60 calendar days until the Commercial Court renders its decision (but in practice, 60 business days may apply); and
- for a creditor-filed PKPU petition: 20 calendar days, but in practice, more than 20 calendar days (which are of longer duration than business days).

For post-restructuring litigation:

- for a creditor-filed petition to nullify a Homologated Plan: 60 calendar days, but in practice, 60 business days may apply.

Litigation during insolvency:

- IBL clearly requires that the timeframe applicable in the IBL mentioned above is also applicable. Therefore, 60 calendar days is applicable.

Appeals

10 |

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

The requirements to appeal insolvency-related judgments are as follows:

In cassation relating to a homologation plan, a Commercial Court decision can be appealed against on the following grounds:

- the estate of the debtor, including goods for which a right of retention is exercised, is much larger than the amount agreed in the composition;
- implementation of the plan is not sufficiently guaranteed; or
- the plan was concluded fraudulently or under the undue influence of certain creditors.

For case review, an appeal can be made against a final and binding decision that is either:

- a Commercial Court decision not appealed against within the Cassation Filing Period; or
- a Supreme Court decision in cessation.

Case review may only be filed with the Supreme Court on the following limited grounds:

- When decisive evidence is discovered after a final and binding decision has been rendered, which, at the time of the proceeding at the Commercial Court or Supreme Court in cassation, had not yet emerged. Here, a case review petition may be filed within 180 days of the date on which the court's decision being appealed against becomes final and binding.
- if an obvious mistake or error has been made by the judges in their decision. Here, the case review petition can be filed within 30 days of the court's decision being petitioned becomes final and binding.

The typical appeal time frame:

- for cassation: within 60 calendar days of the Supreme Court receiving the dossiers; and
- for case review: within 30 calendar days of the Supreme Court receiving the dossiers.

In practice, the timeline between registration of a cassation or case review petition being registered until the Supreme Court receives the dossiers is not clear.

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?

Normally, the receiver will impose costs on the bankruptcy estate. It is still uncommon for third-party funding to be involved in this type of claim.

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 articles 41 and 42 of the Indonesian Bankruptcy Law (IBL), and in the interests of bankruptcy assets, the receiver could request nullification of a transaction carried out by the debtor before declaring bankruptcy if the transaction was considered detrimental to creditors. To nullify the transaction, the receiver must prove the following:

- the transaction was completed by the debtor before it was declared bankrupt;
- the debtor was not obligated by contract (an existing obligation) or by law to perform the transaction;
- the transaction was prejudicial to creditors' interests; and
- the debtor and third party had (or should have had) knowledge that the transaction would prejudice creditors' interests.

Furthermore, the IBL provides that if the transaction was concluded within one year of the bankruptcy declaration (when the transaction was not mandatory on the debtor unless it could be proven otherwise), both the debtor and the third party with whom the transaction was concluded would be deemed to know that the transaction was detrimental to the creditors if:

- the consideration that the debtor received was substantially less than the estimated value of the consideration given;
- a payment or grant of security for a debt that was not yet due; and
- a transaction entered into by the debtor with a relative or related party (eg, a member of the board of directors or commissioners (BoD or BoC), majority shareholder).

The IBL does not stipulate a specific period within which a claim can be made. However, a request for nullification of a transaction must be made by the receiver.

Payment of a debt that has become payable can only be nullified if it can be proven that:

- the recipient of the payment (the creditor) already knows that the bankruptcy petition against the debtor has been registered; or
- payment was made because the debtor and creditors conspired to provide the creditors in question with greater privileges than other creditors.

The practical effect of a successful challenge is nullification of a related legal action or transaction in question (some court decisions have also included unlawful acts based on a receiver's petition) and, thereby, restoration of the conditions that pertained prior to their execution.

The IBL specifically stipulates the following consequences after a successful challenge:

- anyone who receives property or goods that constitute part of those assets of the debtor covered by the nullified legal action must return them to the receiver and report it to the supervisory judge; if that person is unable to return the goods or property before the legal action is taken, they must pay compensation to the bankruptcy estate; and
- the rights of third parties over property or goods obtained in good faith and not free of charge (including the holder of security rights imposed on them) should be protected.

For goods under nullification received by a debtor, they or their value should be returned to the party with whom the debtor conducted the legal action, to the extent that the bankruptcy estate is not jeopardised. If there remains an outstanding difference that needs to be returned to that other party, it may verify the discrepancy as an unsecured claim.

Action brought for transfers without fraudulent intent based on an undervaluation of the transfer from the time the intent was assumed to exist, unless it can be proven otherwise by the debtor or that third party.

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?

There is no specific differentiation under the IBL on the essential elements of avoidance actions based on fraudulent transfers and undervalued transactions and on the basis of preference and improvement of position. One may rely on articles 41 and 42 of the IBL.

Payment of a debt that has become payable can only be nullified if it can be proven that:

- the recipient of the payment (the creditor) already knows that the bankruptcy petition against the debtor has been registered; or
- payment was made because the debtor and creditors conspired to provide the creditors in question with greater privileges than other creditors.

If the transaction were considered detrimental to creditors, the receiver must prove the following to nullify the transaction:

- the transaction was completed by the debtor before it was declared bankrupt;
- the debtor was not obligated by contract (an existing obligation) or by law to perform the transaction;

- the transaction was prejudicial to creditors' interests; and
- the debtor and third party had (or should have had) knowledge that the transaction would prejudice creditors' interests.

if the transaction was concluded within one year of the bankruptcy declaration (when the transaction was not mandatory on the debtor unless it could be proven otherwise), both the debtor and the third party with whom the transaction was concluded would be deemed to know that the transaction was detrimental to the creditors if:

- the consideration that the debtor received was substantially less than the estimated value of the consideration given;
- a payment or grant of security for a debt that was not yet due; and
- a transaction entered into by the debtor with a relative or related party (eg, a member of the board of directors or commissioners (BoD or BoC), majority shareholder).

Liens and floating charges

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

In general, in rem security rights (in the form of mortgage, pledges, hypothec, fiduciary security) may not be perfected after insolvency proceedings have commenced, unless approved by the court-appointed administrator in suspension of payments or the court-appointed receiver in bankruptcy.

Should a debtor, after commencement of insolvency proceedings, take action to perfect the in rem security right for the benefit of a specific creditor, the action cannot be imposed on the debtor's assets and would be subject to 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?

In insolvency proceedings, avoidance action is litigated in the Commercial Court and initiated by the court-appointed receiver in bankruptcy. The receiver will need to file a lawsuit against the party whose legal action with the bankrupt debtor is requested to be voided. The Commercial Court decision is subject to appeal in cassation and case review at the Supreme Court level.

The receiver normally would focus on avoiding legal action taken by the debtor during the year before the bankruptcy is declared because the burden of proof to establish the 'knowledge' would lie with the debtor's counterparty. If the legal actions were taken by the debtor in a period longer than one year before the bankruptcy declaration, the burden of proof to establish the knowledge would lie with the receiver.

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 Indonesian Company Law (ICL) states that in the event the bankruptcy of a company resulting from fault or negligence by the board of directors or commissioners (BoD or BoC), and the assets of the company are insufficient to cover the damage caused by the bankruptcy, each member of the BoD or BoC is jointly and severally liable for the damage unless a director or commissioner can prove that:

- the bankruptcy is not attributable to their fault or negligence;
- they managed (for a director) or supervised (commissioner) in good faith, with prudence, and full responsibility in the interests of the company and within the objectives and purposes of the company;
- they do not have a conflict of interest either directly or indirectly over the management actions that have been performed (by the BoD); and
- they have taken measures to prevent bankruptcy occurrence (for director) or advised the BoD to prevent bankruptcy (for commissioner).

This provision also applies to former members of the BoD or BoC proven at fault or negligent who were appointed within the five years prior to the bankruptcy declaration.

In order to substantiate the culpability or negligence of the BoD, the lawsuit must be filed with the commercial court under Indonesian Bankruptcy Law (IBL) provisions and initiated by the court-appointed receiver.

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 judgement rule and rejection of the deepening insolvency theory are unfamiliar in Indonesia.

Under Indonesian law, directors and officers may be held liable toward third parties, jointly and severally, for tort if they act beyond their authority and capacity (which would also be determined by the objectives and purposes of the company under its articles of association).

Further, under the ICL, every member of the BoD or BoC is fully *personally liable* for the losses of the company if a director or commissioner is at fault or negligent in the performance of their duty to manage the company in good faith and with full responsibility as a director; and supervise and advise the BoD (for a commissioner). In the event that the

BoD or BoC contains two members or more, personal liability and responsibility is jointly and severally applicable to every board member.

A member of the BoD may not be held liable for losses if they can substantiate that:

- the losses are not attributable to their own fault or negligence;
- they managed the company in good faith and prudence in its interests and within its objectives and purposes;
- they have no conflict of interest, directly or indirectly, in management action that resulted in losses; and
- they took preventive measures against the occurrence or continuation of losses. (This also includes steps to ensure access to information about management action that resulted in losses, inter alia, via a BoD meeting.)

A member of the BoC may not be held liable for losses if they can substantiate that:

- they supervised with good faith and prudence in the interests of the company and within the objectives and purposes of a subsidiary;
- they had no personal interest, directly or indirectly, in management action by the BoD that resulted in losses; and
- they advised the BoD to prevent the occurrence or continuation of losses.

Based on the above, apart from shareholders, creditors may also bring a lawsuit against directors and officials personally, including for breach of a contract (entered into by the company) that contains breach of fiduciary duties provisions.

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?

In essence, a loan from an insider or shareholder will not automatically be re-characterised as equity. Nonetheless, in a court-sanctioned or restrictive petition for bankruptcy or suspension of payments situation, the composition plan may contain provisions to convert an insider or shareholder loan into equity. However, this is subject to approval from the creditors based on the requisite quorum under the Indonesian Bankruptcy Law (IBL) and the shareholders on the implementation of the plan. The interest on the loan or other associated fees, however, may not be converted. (Only the loan principal may be converted into equity.) The conversion of the loan must also be published in two newspapers.

Illegal dividends

19 Can dividends received by shareholders be prosecuted as illegal?

The ICL identifies various circumstances under which dividends may be distributed to the shareholders:

- the company records a profit in the financial year in which the dividend is distributed;
- the company maintains a positive balance of profit or retained earnings;
- the mandatory reserve has been established from the profit; and
- the distribution of dividends is approved by the company's shareholders.

A company may distribute interim dividends before the company's financial year-end, provided that it is stipulated in the company's articles, determined by the BoD, and approved by the BoC.

Interim dividend can be distributed if the net assets of the company are not less than the issued and paid-up capital plus mandatory reserves. It must not disrupt or lead to the company's failure to fulfil its obligations to creditors or disrupt the activities of the company. If, after the financial year has ended, the company suffers losses, the distributed interim dividends must be refunded by the shareholders to the company in the amount at which retained earnings could not cover the losses. If the shareholders fail to return interim dividend, BoD and BoC members will be jointly and severally liable.

Dividends paid to shareholders that breach the above requirements would therefore be challengeable on grounds of non-compliance.

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?

No specific rules govern this matter. Before formal insolvency proceedings can commence, the BoD is still fully active and continues to manage in good faith, prudence, and with full responsibility in the interests of the company, and within its objectives and purposes. Although not explicitly stipulated, the BoD should avoid transactions that might be subject to preferential transfer or render them personally liable.

The IBL recognises 'insolvency' (also known as insolvent at law) as a certain moment in bankruptcy proceedings at which a debtor is declared bankrupt. Not all bankruptcy declarations automatically render a bankruptcy estate insolvent. However, under the IBL, bankruptcy arising from nullification of the homologation of the composition plan would automatically render a bankruptcy estate insolvent.

Insolvency under the IBL is defined simply as an inability to repay a debt. Therefore, the state of insolvency is not concerned with whether or not a bankruptcy estate is sufficient to settle all creditors' claims.

Equitable subordination

21

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

Indonesian law does not recognise the concept of equitable subordination of shareholder claims, although, in practice, a restructuring plan proposed may incorporate the concept.

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?

Under Indonesian law, shareholders, directors and officers may be held liable toward third parties, jointly or severally, based on a tort claim, if each acts beyond the limits of their authority, capacity and competence or acts not in a good faith and prudence or beyond the objectives and purposes of the company.

The ICL further provides the following:

- any shareholder has the right to file a lawsuit against a company with the court for damage caused by an act of the company that is considered to be unfair and unreasonable, and results from decisions of a general meeting of shareholders, the directors, or the commissioners.
- shareholders representing at least one-tenth of the total number of issued shares with valid voting rights may, on behalf of the company, file a lawsuit with the district court against a member of the BoD or BoC, whose fault or negligence has resulted in a loss to the company.

Risk mitigation

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

Under the ICL, the liability of the shareholders is limited to the capital injection for the shares that they own and should not cover their personal assets. Nevertheless, the concept of piercing the corporate veil is recognised under the ICL – albeit applied in very rare circumstances only – in the following situations:

1. the requirements for company's existence as a legal entity have not been or are not fulfilled, for example, in the event the company's deed of establishment has not been approved by the Minister of Law and Human Rights;
2. a shareholder, directly or indirectly, in bad faith uses the company solely for personal purposes;
3. a shareholder is involved in an unlawful act committed by the company; or
4.

a shareholder, directly or indirectly, unlawfully uses the company's assets, which causes the company's assets to be insufficient to settle company's debts.

5. in (2), (3) and (4) above, the ICL provides that the burden of proof lies with the third party intending to raise a claim against the shareholders of the company concerned.

Further, the ICL also provides that upon a company receiving legal entity status and its shareholders becoming less than two persons, within six months of that occurrence, the relevant shareholder must transfer part of their shares to other people, or otherwise the company must issue new shares to other people. If the period expires, and the shareholders remain at less than two, the remaining shareholder will be personally liable for any binding agreement and loss of the company, and, at the request of an interested party, the district court may dissolve the company.

Based on the foregoing, the shareholders should ensure that none of the above occurs in order to mitigate the risk that claims against them would be successful.

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?

Under Indonesian law, creditors can bring an action to contest a restructuring plan by filing a cassation petition against a homologated plan.

In a scenario featuring cassation related to a homologation plan, an appeal can be made against a Commercial Court decision on the following grounds:

- the estate of the debtor, including goods for which a right of retention is exercised, is much larger than the amount agreed in the composition;
- implementation of the plan is not adequately assured; or
- the plan was concluded fraudulently or under undue influence of certain creditors.

Most petitions for cassation on this issue are rejected by the Supreme Court, as evidence to prove the issues above is difficult to produce.

In another scenario, a creditor may file a nullification petition upon the homologation of the composition plan based on the debtor's negligence causing subsequent default in fulfilling the content of the plan. The debtor must show that the allegation has no ground. Under the Indonesian Bankruptcy Law (IBL), the Commercial Court may grant the debtor with a 30-day grace period to fulfil its obligation. If the debtor fails, the Commercial Court would nullify the plan and declare bankruptcy of the debtor.

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 IBL enables a creditor to file a petition either for bankruptcy or for suspension of payments (PKPU). Creditors must prove that the debtor has more than one creditor and at least one due and payable debt, and the foregoing must be summarily proven. The debtor must be able to prove either that it does not have due and payable debt or that the petitioner's arguments cannot be summarily proven.

Apart from the bankruptcy and PKPU process under the IBL, the Indonesian Company Law (ICL) also recognises dissolution and liquidation. Pursuant to article 146 ICL, the district court may dissolve a company based on the following:

- a District Attorney's request, for the reason that the company has violated the public interest or the company has committed acts that violate law and regulations;
- an application from interested parties due to legal defects alleged in the Deed of Incorporation; and
- a request from the shareholders, the board of directors or commissioners (BoD or BoC) on the grounds that the company's existence is unlikely to continue.

In a court decision, the appointment of a liquidator is also stipulated.

However, a creditor may try to request dissolution of a company by the court, alleging a defect in the company's deed of incorporation.

The company must contest the challenge by proving that the deed of incorporation is not legally defective and made in accordance with applicable law and regulation.

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?

A bankruptcy declaration triggers the automatic stay of the bankruptcy estate upon issuance of a Commercial Court decision declaring the bankruptcy of the debtor. The rights of secured creditors to enforce security (and the rights of a third party to claim its assets that are under the control of the bankrupt debtor or the receiver) are subject to an automatic stay of up to 90 days (article 56 (1) IBL). Under bankruptcy proceedings, the automatic stay period may be less than 90 days if they are terminated earlier, or if the debtor enters a state of insolvency.

The automatic stay in this provision is aimed at:

- increasing the possibility of composition;
- increasing the possibility of optimising the bankruptcy estate; or
- enabling the receiver or curator to perform its duties optimally.

During the stay period, no legal action to obtain payment in respect of receivables may be brought before a court, and the creditor and third parties are prohibited from executing or requesting attachment in respect of collateral.

The stay above, however, is not applicable to a creditors' claim that is secured with cash and the right of creditors to apply for set-off. This should include the right of creditors to apply for a set-off that is part of or results from a transaction that occurs in the Stock Exchange and Futures Trading Exchange.

During the stay period, the receiver may use movable or immovable assets from the bankruptcy estate or sell movable assets under the control of the receiver to continue the business of the bankrupt debtor, once the interests of secured creditors or relevant third parties have been reasonably protected.

The elucidation of the IBL further provides that the bankruptcy estate's assets that can be sold by the receiver are limited to the inventory or current (movable) assets, although these are encumbered by in rem security rights. Further, 'reasonable protection' means what must be provided to protect the interests of secured creditors or other third parties whose rights are stayed. The transfer of such assets by the receiver results in a condition in which an in rem security right over assets is deemed as terminated by the operation of law.

The protection may include:

- compensation for a decrease in the value of the bankruptcy estate;
- net proceeds from the sale;
- replacement of in rem security rights; or
- reasonable and fair compensation, as well as other cash payments (of the debt being secured).

The bankrupt estate will be in a state of insolvency if:

- no composition plan is submitted at a creditors' meeting for verification of claims;
- the composition plan is rejected after voting by the creditors;
- the composition plan is approved by the creditors but not confirmed by the Commercial Court; or
- a final and binding confirmed composition plan is nullified by the Commercial Court.

Once the bankruptcy estate is declared to be in a state of insolvency, secured creditors must complete the exercise of their privileged right over the collateral within two months of the bankruptcy estate being declared in a state of insolvency. Otherwise, the appointed receiver is required to request delivery of the collateral to be sold by the receiver.

If the receiver has enforced the collateral, the proceeds that will be distributed to secured creditors need first to be reduced by not only the amount of the mandatory preferred claims (which will also apply if the secured creditors enforced the collateral themselves) but also the bankruptcy costs (including the receiver's fee).

Further, the IBL provides secured creditors with a set of procedures for seeking relief from an automatic stay. Article 57 of the IBL provides creditors or third parties whose rights have been stayed the opportunity to file a petition to the receiver for lifting of the stay or to amend the conditions of the stay (a Lift of Stay Petition). If the receiver rejects a Lift of Stay Petition, that creditor or the third party may file the Lift of Stay Petition with the supervisory judge.

The Supervisory Judge must, no later than one day after receipt of the petition, order the receiver immediately, by registered mail or courier, to summon the creditor and third party to be heard at the hearing on the Lift of Stay Petition. The supervisory judge must render a decision upon the lift of the stay petition within 10 days of its submission to the supervisory judge. in rendering the decision, the supervisory judge must take into consideration the following:

- the length of the stay period that has already elapsed;
- the protection of the interests of the creditor and any related third party;
- the possibility of the composition being reached; and
- the impact of the stay on the operation and management continuity of the debtor's business and the settlement of claims against the bankrupt estate.

The elucidation of article 57 of the IBL further provides that the matters to be considered by the Supervisory Judge do not preclude them from considering other matters to the extent it is necessary to safeguard and optimise the value of the bankruptcy estate.

The decision of the supervisory judge on the Lift of Stay Petition may take the form of either the lifting of the stay for one creditor or more or the imposition of conditions concerning:

- the length of the stay period; or
- one or more security rights that may be enforced by the creditors.

If the supervisory judge refuses to lift or amend the conditions of the stay, they are obligated to order the receiver to take adequate measures to protect the interests of the petitioners. Against this decision of the supervisory judge, the creditors or the third parties submitting the Lift of Stay Petition, or the receiver, may submit an objection to the Commercial Court within five days of the rendering of the decision.

The Commercial Court is obligated to decide on this objection within 10 days of the date of the objection being received. No appeal (either for cassation or a case review petition) may be submitted against a decision of the Commercial Court.

Further to the above, within the framework of the continuation of the bankrupt debtor's business (as a going concern), the receiver may utilise or sell the assets within the bankruptcy estate that are under the receiver's possession during the stay period. The assets concerned may be as follows:

- movable assets (for usage and sale) or immovable assets (for usage only, sale not permitted); or
- in the form of inventory or other current assets, irrespective of whether or not these assets are encumbered by security rights.

In so doing, the receiver must provide adequate protection of the interests of creditors or other third parties. 'Adequate protection' means the protection required to be given to protect the interests of creditors or third parties whose rights are stayed. Upon the transfer of the assets concerned, the in rem rights will be deemed to expire by operation of law.

The protection intended may, inter alia, consist of:

- compensation for the diminution in value of the bankruptcy estate;
- the net proceeds of a sale;
- replacement in remrights; or
- fair and reasonable remuneration and other cash payments.

Stays of proceedings – strategy

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

In court-supervised restructuring or insolvency proceedings, secured creditors' rights to enforce their security and the rights of third-party owners of assets in the possession of the debtor are subject to a stay of up to 90 days from a bankruptcy declaration being rendered in bankruptcy proceedings, and during the entire period of the PKPU proceedings, which can be up to 270 days from a PKPU decision being granted.

Upon expiry of the stay period in bankruptcy, a secured creditor may initiate enforcement of their security right over collateral, but must be able to complete enforcement within two months of the bankruptcy estate being declared in a state of insolvency. Otherwise, the receiver will take over security enforcement, and the bankruptcy costs (including the receiver's fee) will need to be deducted from the sale proceeds. The automatic stay in this provision is aimed at:

- increasing the possibility of composition;
- increasing the possibility of optimising the bankruptcy estate; or
- enabling the receiver or curator to perform its duties optimally.

During the stay period, legal action to obtain payment in respect of receivables may not be put before a court.

In practice, there is some uncertainty and conflicting views as to whether a secured creditor holding collateral that is provided by a non-debtor third party would be considered a secured creditor in PKPU proceedings, given the lack of clarity on the term 'secured creditors' in the IBL and conflicting practice in different PKPU case precedents.

Normally, the creditors navigate stays in practice by amicably reaching a commercial arrangement between the receiver or administrator and the debtor.

Stays of proceedings – effect on emergence from insolvency

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

During the stay period, the debtor cannot be forced to make payment upon outstanding debt obligation without the approval of administrator or receiver, unless the payment is made to all creditors pro-rata. Secured creditors are also not permitted to enforce their security rights against a debtor's encumbered assets. Therefore, the stay would preserve the debtor's enterprise as a going concern and provide the debtor with time and breathing space to prepare a draft composition plan that contains comprehensive restructuring terms, either in bankruptcy or PKPU proceedings, to be offered to and voted on by the creditors.

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, the criminal court has the authority to punish a creditor's bad act. In article 400 of the Indonesian Penal/Criminal Code, a creditor who is found guilty of filing a false claim or whose amount is increased in bankruptcy proceedings can be sentenced to five years and six months' imprisonment. This is separate to commercial court bankruptcy or PKPU proceedings.

During the examination of PKPU or bankruptcy proceeding, if the claim is not agreed during a verification meeting, the decision on the amount to be acknowledged by the administrator in PKPU or the receiver in bankruptcy will be determined by the administrator or receiver and ultimately, at the request of the creditor, the supervisory judge.

The administrator or receiver will examine the creditor's claim and decide whether it:

- is valid and enforceable; and
- can be verified as correct against the debtor's book and records.

If it is not valid, the claim can be rejected. Therefore, the claim might not be included in the restructuring plan of the debtor.

Aside from the foregoing, the Indonesian courts are not empowered to punish a creditor's bad acts or inequitable conduct by pushing their claims down the priority waterfall, unless the claims are not recognised.

Vote designation

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

Unless the underlying agreement between relevant creditor and debtor raising the creditors' claims are nullified by a final and binding court decision that results in the claim no longer being admissible, no rules exist that would disenfranchise 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?

In bankruptcy proceedings

Pursuant to article 28 of the Indonesian Bankruptcy Law (IBL), claims initiated by a debtor against any party, including shareholders, affiliates and agents as defendant, prior to the commencement of bankruptcy proceeding and during the course of the bankruptcy proceeding, must be suspended, at the defendant's request, to allow the defendant to summon the receiver and request that they take over the case, within a time period determined by the judges.

If the receiver fails to appear in response to the summons, or if the receiver refuses to take over the case, the defendant may submit a petition for the claim to be dismissed. If the defendant does not request dismissal of the claim, the case between the debtor and defendant may be continued beyond the scope of the debtor's estate. The receiver, at any time, is authorised to take over the case and request that the debtor be expelled from the case.

In PKPU proceedings

Pursuant to article 243 IBL,commencement of a petition for bankruptcy or suspension of payments (PKPU) proceeding would not prevent the continuation of an existing ongoing claim or the commencement of a new claim, provided that the debtor did not become an applicant or defendant in a (new) claim regarding a right or obligation that relates to its assets, without the administrator's approval.

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 the commencement of PKPU or bankruptcy proceedings subject to the mechanism provided in the provisions of articles 28 and 243 of the IBL.

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?

Prior to a Commercial Court judgment that declares the debtor bankrupt or under PKPU, control pursuit of debtor claims remains with the debtor.

While there is no prohibition on creditors or other stakeholders from trying to pursue a claim derivatively if a debtor or the receiver or administrator refuses to do so, the lack of direct nexus between the claim against the shareholders and the pursuing creditors or other stakeholders may cause the attempt to be dismissed by an Indonesian court.

Risk mitigation for creditors

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

Commencement of bankruptcy or PKPU proceedings would not prevent a debtor from initiating claims and remedies against any party, including creditors. However, as the debtor would usually be in an unfavourable financial situation, a debtor, receiver or administrator would usually prefer to avoid full-blown litigation against a creditor (due to their substantial legal costs) and debtors would usually be more open to an out-of-court settlement with creditors.

Minimising costs for creditors

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

The cheapest and easiest way to reduce litigation costs would be to negotiate directly with the debtor or receiver (in bankruptcy proceedings) or the administrator (in PKPU proceedings). Creditors could also consider pursuing alternative dispute resolution methods, such as mediation, hopefully, to resolve the claim and avoid costly litigation.

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?

Parallel proceedings are not recognised under Indonesian law. Judgments of foreign courts are generally not recognised in Indonesia unless the government of the state where the judgment was rendered has entered into a bilateral or multilateral agreement on reciprocal recognition of court judgments with the government of Indonesia.

However, in recent key developments, an Indonesian court, in a suspension of payments petition case, rendered a decision by referring to and basing it on foreign court judgment in its considerations. In May 2021, PT Pan Brothers Tbk (Pan Brothers) was the subject of a suspension of payments petition filed by Maybank Indonesia in the Jakarta Commercial Court. Responding to the petition, Pan Brothers filed a moratorium application in the Singapore High Court (SHC) in early June 2021. The SHC issued an order to grant a moratorium to Pan Brothers and its subsidiaries on debt settlement for syndicated creditors. In July 2021, the Commercial Court rejected the suspension of payments petition because the SHC moratorium order bound Pan Brothers, and there would be an overlap in the debt settlement process if the suspension of payments petition were granted. Maybank filed a bankruptcy petition against Pan Brothers in August 2021. However, the Jakarta Commercial Court rejected the petition because the case could not be summarily proven because of the Singapore moratorium process.

Another case that followed the SHC decision was the suspension of payments of a Central-Java-based group of textile companies, PT Sri Rejeki Isman, Tbk((Sritex Group). On 19 April 2021, Sritex Group was the subject of a suspension of payments petition filed in the Semarang Commercial Court by a trade creditor. The court granted the petition.

On 21 April 2021, a Singapore subsidiary of Sritex Group, Golden Mountain Textile and Trading Pte Ltd (Golden Mountain) submitted an application to the SHC for a moratorium. Golden Mountain was an intercompany creditor of Sritex Group, under Senior Notes due 2023 (Notes) issued by Golden Legacy Pte Ltd (Golden Legacy), another Singapore subsidiary of Sritex Group, guaranteed by Sritex Group. Upon receiving the proceeds from the Notes, Golden Legacy used them as a capital injection in Golden Mountain, and Golden Mountain then lent those proceeds to Sritex Group.

In May 2021, the SHC issued a moratorium order that included a requirement that Golden Mountain lodge a claim in the suspension of payments proceedings and exercise its right to vote in the suspension of payments proceedings of Sritex Group before the Indonesian court. The submission of claim submitted by Golden Mountain was accepted by the court.

In the absence of an agreement, if a creditor wishes to enforce a judgment of a foreign court in Indonesia, the creditor must re-litigate it by initiating a separate legal proceeding in Indonesia. In this instance, a judgment of a foreign court could be submitted as evidence in a separate legal proceeding at the Indonesian court.

Judicial cooperation

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

Indonesian law operates on a generally exclusive territorial basis, so there is virtually no scenario in which an Indonesian court would be required to have any form of judicial cooperation with a foreign court. Consequently, there are no precedents of judicial cooperation with other courts in relation to 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 available remedies would depend on the type of claim filed by debtor-claimants. Indonesian law recognises two types of claims: contractual and tort.

The generally available remedies for contractual claims are compensation for losses, interests and costs incurred. Compensation for loss of expected profits or opportunity costs may be claimed if the debtor-claimant can provide sufficient evidence to substantiate the amount claimed.

For tort claims, remedies are compensation for material and non-material losses.

Remedies for creditors

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

The remedies available to debtor-claimants are also available to creditor-claimants. Alternatively, creditors could also file a bankruptcy or petition for bankruptcy or suspension of payments (PKPU) against their debtor, provided the creditor manages to satisfy the requirements for submission of a bankruptcy or PKPU petition.

However, enforcement rights that creditor-claimants obtain from legal proceedings would be relinquished when a bankruptcy declaration is rendered. Creditor-claimants would need to submit their claims during the bankruptcy proceedings.

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?

Once a judgment becomes final and binding, the winning party must submit an application for execution at the district court with jurisdiction over the losing party's legal domicile. An application for execution must be specific with regard to the assets, their nature and location.

The district court will then issue a written warning that orders the losing party to carry out the final and binding judgment within eight days. The court will typically issue up to three warnings to allow sufficient opportunity for the losing party to comply with the judgment.

If the losing party still fails to comply with the judgment, the court may proceed to enforce its ruling by issuing an execution order on the losing party's assets or property identified in the judgment or application for execution. The court will then confiscate the assets or property with police assistance. Liquidation of assets would finally be achieved via an auction, carried out in accordance with Indonesian Civil Procedural Law.

SETTLEMENT AND MEDIATION

General court approach

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

Yes, and they could even be said to encourage parties to agree to a settlement instead of litigation. This is most clearly illustrated in the enactment of Supreme Court Regulation No. 1 of 2016 on Procedure for Mediation in Courts, which requires disputing parties to initially undergo court-supervised mediation prior to proceeding to court hearings in the hope that mediation will produce a settlement. However, insolvency proceedings are excluded from the mediation requirement.

Timing

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

Disputing parties are encouraged to settle at any time before a judgment is rendered by the court. As stated above, disputing parties in a contractual or tort lawsuit are required by law to initially undergo court-annexed mediation prior to proceeding with court hearings. However, there is often a wide gulf between the parties' stances at this point.

As litigation proceeds, the parties might consider settling to avoid costs escalating too much. The disputing parties may also seek settlement at any time during litigation. If this is successful, the claimant may withdraw the lawsuit unilaterally at any time before the defendant submits their statement of defence. Should settlement only be reachable after submission of the defendant's statement of defence, the claimant may still withdraw the lawsuit with the defendant's approval.

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, all agreements entered into under Indonesian law must satisfy the general requirements for the validity of an agreement under the Indonesian Civil Code. There must be:

- consent of the individuals who are bound by them;
- adequate capacity to conclude an agreement;
- a specific subject; and
- admissible cause.

If a settlement is reached during court-annexed mediation, the court will also check and ensure that the settlement agreement:

- does not violate law, public order or decency;
- does not harm or prejudice a third party; and
- is enforceable.

Mediation clauses

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

Disputing parties are required to undergo court-annexed mediation prior to proceeding with court hearings. Therefore, the existence of a mediation clause would not have an impact on the requirement to mediate.

However, the requirement to mediate does not apply to disputes that fall within the jurisdiction of the Commercial Court (which includes bankruptcy or suspension of payments proceedings).

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?

On 15 December 2021, the Indonesian Constitutional Court held, in decision No. 23/PUU-XIX/2021 (Judgment), that articles 235 (1)['No legal remedy can be raised in respect of a PKPU decision'] and 293(1) Indonesian Bankruptcy Law (IBL) ['In respect of a court decision based on Chapter III (PKPU), no legal remedy is available, except as otherwise regulated by the IBL'] were against the meaning intended in the 1945 Indonesian Constitution, and did not have binding effect, to the extent that they were not imbued with the following meaning: 'the filing of a cassation petition is permissible against a PKPU decision filed by a creditor and rejection of the composition plan offered by a debtor.'

According to article 285(4) IBL, filing for cassation by a creditor is only possible when the composition plan is approved by creditors and confirmed by the Commercial Court. Should the composition plan be rejected by creditors, no cassation filing is possible. Under article 290 IBL, should the Court have declared a debtor bankrupt, all bankruptcy provisions, as stated in Chapter II (Bankruptcy), except for the cassation filing provision, would apply.

Further, article 293(1) IBL provides that in respect of a court decision based on Chapter III (petition for bankruptcy or suspension of payments (PKPU), no legal remedy is available, except as otherwise regulated by the IBL. Based on the foregoing, the provision in article 285(4) IBL is effectively an exception to article 293(1) IBL.

It is viewed that the judgment indirectly caused the provision under article 285(4) and 290 IBL to be amended such that a petition for cassation may be filed against a court decision that declares a debtor in PKPU bankrupt following rejection of a proposed composition plan. How the Supreme Court might decide contrariwise and how a final settlement would be reached for all creditors, given that the new norm set out in the judgment has not yet been tested, may give rise to some uncertainty.

Key cases

PT Pan Brothers Tbk (Pan Brothers) PKPU and Sritex Group PKPU cases, as mentioned above, are examples of recent key cases where the Indonesian court tends to be more open and follow foreign court decisions (the Singapore High Court (SHC)). The decision taken by the Commercial Court in these cases is a breakthrough and unusual from the conservative approach taken by Indonesian judges that judgments of foreign courts are generally not recognised in Indonesia. It is expected that similar cases will be available in the future, considering that many debtors and creditors are involved in cross-border transactions.

New Indonesian Criminal Code

Law No. 1 of 2023 on the Indonesian Criminal Code (Law 1/2023) was promulgated on 2 January 2023. Law 1/2023 replaces the previous Criminal Code, which dates back to the Dutch colonial era.

One of the key features of Law 1/2023 is the recognition of the concept of corporate crime. The former Criminal Code did not recognise corporations as legal subjects that can be liable for crimes: previously, the definition of criminal perpetrators covered individuals only. Law 1/2023 will enter into force three years after 2 January 2023.

Omnibus Law in the Financial Sector

On 12 January 2023, Law No. 4 of 2023 on Financial Sector Development and Reinforcement, dubbed the Omnibus Law for the Financial Sector (Omnibus Financial Law), was enacted. The Omnibus Financial Law amended Law Number 21 of 2011 on the Financial Services Authority (OJK Law) and the IBL and provides the authority to file bankruptcy and suspension of payment petition to:

- the Otoritas Jasa Keuangan (OJK) against a debtor that is in the following forms:
    - banks
    - securities companies
    - stock exchanges
    - alternative market organisers
    - clearing and guarantee institutions
    - depository and settlement institutions
    - fund organisers protection of investors
    - securities funding institutions
    - securities pricing agencies
    - insurance companies
    - sharia insurance companies
    - reinsurance companies or sharia reinsurance companies
    - pension funds
    - guarantee institutions
    - financing institutions
    - microfinance institutions
    - organisers of electronic systems that facilitate the collection of public funds through offerings of securities
    - information technology-based co-funding service organisers
    - special purpose vehicles (financial instrument management institution) or trustee
    - other financial services Institutions which are registered and supervised by the OJK insofar that their dissolution or bankruptcy are not regulated separately in other laws
- Bank Indonesia against a debtor that is in the following forms:

- a provider of payment services and an organiser of payment system infrastructure
- an organiser of rupiah currency processing services
- money market brokers
- providers of trading facilities
- clearing facility for over-the-counter interest rates and exchange rate derivative transactions
- other institutions that are granted licences or stipulations by Bank Indonesia as long as the dissolution or bankruptcy is not regulated otherwise by provisions of other laws and regulations

Further, the Omnibus Financial Law also provides confirmation that the close-out netting mechanism in financial transactions (termination) can be performed prior to or after bankruptcy (event). This provision would provide legal certainty the close-out netting mechanism would be recognised during the bankruptcy process.

Theodoor Bakker tbakker@abnrlaw.com
Ulyarta Naibaho unaibaho@abnrlaw.com
Bilal Anwari banwari@abnrlaw.com

ABNR

Read more from this firm on Lexology

Japan

Dai Katagiri , **Wataru Ishida**
Mori Hamada & Matsumoto

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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?

Although it is difficult to make a general statement as each case is significantly different, it is not uncommon for litigation to be filed in connection with insolvency proceedings.

The most common types of litigation related to insolvency proceedings concern:

- the right of avoidance;
- the right of offsetting;
- determining insolvency claims (bankruptcy, rehabilitation and reorganisation claims);
- the existence or non-existence of preferential claims;
- the existence, enforcement and valuation of security interests; and
- the liability of directors and officers of debtor companies.

In some cases, these lawsuits, especially those brought by creditors, delay the progress of insolvency proceedings.

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 Civil Code (contract and tort law) and the Companies Act form the basis of claims arising from insolvency. In addition, insolvency laws (the Bankruptcy Act, the Civil Rehabilitation Act and the Corporate Reorganisation Act) may affect rights and obligations under substantive laws, such as contract and tort law, and may also impose procedural restrictions.

Procedure

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

The Bankruptcy Act, the Civil Rehabilitation Act and the Corporate Reorganisation Act provide detailed procedural rules depending on the type of insolvency litigation. For example, litigation regarding the existence or non-existence of preferential claims is an ordinary civil lawsuit without the specific procedural restrictions of insolvency laws.

However, in litigation to determine insolvency claims, the following steps are provided by the above-mentioned insolvency laws:

- The claim holders must file a proof of claim during the claim filing period designated by the court.
- If the claim is not approved by the company or trustees (as applicable) or other creditors file an objection, the claim holder may file a petition to commence special assessment proceedings to determine the details of the claim with the court by the legally stipulated deadline. The court will make an assessment specifying the existence or non-existence and the content of the disputed claim.
- If the claim holder is dissatisfied with the assessment decision, it may file a civil lawsuit against the decision with the court within a month of the day on which the claim holder receives it.

Courts

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

For court procedures to determine insolvency claims, the court composed of judges with experience in insolvency proceedings shall preside over the assessment proceedings. Litigation against an assessment decision will be heard before an ordinary court.

Jurisdiction

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

Statutes regarding insolvency proceedings (the Bankruptcy Act, the Civil Rehabilitation Act and the Corporate Reorganisation Act) define the jurisdiction to hear insolvency claims. Jurisdiction does not differ for domestic and cross-border matters.

Limitation periods

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

For court procedures to determine insolvency claims, the claim holders must file a proof of claim during the claim filing period designated by the court. If the claim is not approved by the company or trustees (as applicable) or other creditors file an objection, the claim holder may file a petition to commence special assessment proceedings to determine the details of the claim with the court within a month of the last day of the period of investigation of the filed claims designated by the court. If the claim holder is dissatisfied with the assessment

decision of the court, it may file an action against the decision within a month of the day on which the claim holder receives it.

These limitation periods may be extended if the filing is delayed due to circumstances beyond the claim holder's control.

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?

The Bankruptcy Act, the Civil Rehabilitation Act and the Corporate Reorganisation Act make interim remedies available for insolvency litigation depending on the type of litigation. For example, in litigation regarding the right of avoidance, the court may order interim remedies such as provisional seizure, provisional disposition or other necessary temporary restraining orders if it finds it necessary to preserve the right of avoidance. These interim remedies enhance the effectiveness of exercising the right of avoidance.

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 the collection and admissibility of evidence and there are no rules of evidence specific to insolvency litigation in Japan. Expert witness testimony is generally allowed if it is necessary to prove the alleged facts constituting the elements of the claim or the defence.

Time frame

9 What is the typical time frame for insolvency claims?

Although it is difficult to make a general statement as each case is significantly different, a decision is made promptly, usually within a few months, for the assessment procedure. However, in litigation against the assessment decision, it may take much longer depending on the complexity of the case. In Japan, on average, it generally takes about one-and-a-half to two years from the commencement of the lawsuit until the judgment is rendered by the court of first instance.

Appeals

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

If a party to insolvency litigation is dissatisfied with the judgment rendered by the court of first instance, it may appeal to a high court. The grounds for appeal are broad, and the party may allege an error of fact or law. Generally, an appeal must be filed within two weeks of the judgment. In typical cases, it will take around one year from the appeal until the high court renders the judgment.

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?

There are no rules for the costs specific to insolvency litigation. In commencing the litigation, the plaintiff must pay a filing fee, which is determined based on the amount of the claim. If the plaintiff is successful, it may recover the filing fee and other litigation costs from the defendant. Each party will bear its own attorneys' fees, and the unsuccessful party is generally not liable to pay the successful party's attorneys' fees.

There are no rules directly restricting third-party funding in Japan.

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?

The trustee or the examiner (as applicable) has the right to nullify:

- an act that the company commits knowing that such act will harm the holders of insolvency claims provided that the counterparty to the act is aware of the harm when it is committed;
- an act that will harm the holders of insolvency claims carried out by the company after (1) the company has suspended payments or (2) a petition for commencement of insolvency proceedings has been filed with regard to the company (an event falling under points (1) or (2) is called an avoidance event), provided that the counterparty to the act is aware of the avoidance event or the harm when it is committed; and
- any gratuitous or equivalent act of the company within six months before or after any avoidance events.

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 trustee or the examiner (as applicable) has the right to nullify an act if:

- the company has provided security for existing debts or repaid them after the insolvency or the filing of the petition for commencement of insolvency proceedings; and
- the creditor knew of the insolvency or the filing of such petition.

Liens and floating charges

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

The trustee or the examiner (as applicable) has the right to nullify security interests if:

- the company has provided security for existing debts after the insolvency or the filing of the petition for commencement of insolvency proceedings; and
- the creditor knew of the insolvency or the filing of such petition.

In addition, perfection of the security interests may be set aside if the security interests are perfected after:

- an avoidance event of the company occurs;
- 15 days have passed since the date of creation of the security interests; or
- the beneficiary knew the fact of the occurrence of the avoidance event of the company.

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 trustee or the examiner (as applicable) may exercise the right of avoidance by filing a lawsuit for avoidance, asserting it as a defence in a lawsuit, or filing a request for avoidance with the court. A significant number of avoidance cases have been resolved by settlement.

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?

There is no specific law in Japan that imposes enhanced duties on directors or an obligation to file for insolvency proceedings. As in ordinary circumstances, directors owe a duty of care to the company.

In addition, under the Companies Act, directors can be held liable to third parties (including shareholders and creditors) if such third parties incur any losses due to a breach of duty of care by the directors and the directors are regarded as being grossly negligent or intentional. In the context of corporate insolvency where creditors are likely to incur losses, the directors should not only pursue shareholder interests but also consider the interests of creditors.

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?

Whether directors are deemed to fulfil their duty of care is determined based on the business judgment rule (ie, whether there is any significantly unreasonable aspect of the process or the content of the directors' decisions).

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?

No.

Illegal dividends

19 Can dividends received by shareholders be prosecuted as illegal?

It is illegal to make dividend payouts greater than that permitted under the Companies Act. If such illegal dividends are paid, in principle, the shareholders who receive them and the directors who approved them are liable to pay restitution to the company.

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?

The debtor's pre-insolvency transactions may be challenged. The trustee or the examiner (as applicable) must exercise this right within two years of the commencement of the insolvency proceedings.

There are two elements that form the grounds for such challenges. The first pertains to the timing of the transactions, which must be conducted after the debtor falls into financial crisis; the second pertains to the harmfulness of the transactions to the debtor.

If such challenges are successful, the subject transactions basically become null and void. Bona fide third parties, however, may be protected from such challenges.

Equitable subordination

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

Under civil rehabilitation and corporate reorganisation proceedings, it is permissible to subordinate certain claims, such as shareholder claims, in the proposed plan if that treatment would not be detrimental to equity. In contrast, under bankruptcy proceedings, there is no specific rule regarding the 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?

It is common for directors of debtor companies to guarantee the debtor's obligations jointly. In such cases, the creditor can demand that the guarantor fulfil the guaranteed obligation.

Risk mitigation

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

Since shareholders and sponsors are separate legal entities from the debtor, in general, they will not be held liable for the commencement of insolvency proceedings. In cases where shareholders or sponsors are legally liable for the debt, the risk may be mitigated by reaching a settlement through consultation with the claimant.

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?

If the restructuring plan is approved and an order of confirmation is made by the court, any creditor who is dissatisfied with the order of confirmation may file an immediate appeal and seek revocation of the order. For the appeal to succeed, the creditor is required to allege and prove the grounds for immediate appeal as follows:

- there is a serious violation of law in the restructuring proceedings or restructuring plan, and the deficiency cannot be corrected;
- the restructuring plan is unlikely to be executed;
- the resolution for the restructuring plan was adopted by dishonest means; or
- the resolution for the restructuring plan is contrary to the general interests of creditors.

It is rare for an immediate appeal to be filed as the debtor generally consults with the creditors and obtains their understanding in advance.

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?

Creditors can place a debtor company into bankruptcy proceedings if it proves that:

- the debtor company is characterised as being 'unable to pay its debts' – that is, where the company is generally and continuously unable to pay its debts as they become due; or
- the debtor company is characterised as 'insolvent' – that is, where the company's debts exceed its assets.

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?

Once the court decides to commence insolvency proceedings, creditors are prohibited from receiving payments in respect of any claims arising due to anything that has occurred before the commencement of the proceedings, or otherwise acting in any manner that has the effect of satisfying their claims outside the proceedings.

Civil actions or civil execution proceedings with respect to such claims are suspended. However, exercising security interests is not prohibited and secured creditors may collect

their claims regardless of the commencement of insolvency proceedings, except for corporate reorganisation proceedings, which prohibit secured creditors from exercising their security interests.

There are no notable or commonly used exceptions.

Stays of proceedings – strategy

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

Once the court decides to commence insolvency proceedings, creditors are prohibited from receiving payments in respect of any claims arising due to anything that has occurred before the commencement of the proceedings, or otherwise acting in any manner that has the effect of satisfying their claims outside the proceedings.

Civil actions or civil execution proceedings with respect to such claims are suspended. However, exercising security interests is not prohibited and secured creditors may collect their claims regardless of the commencement of insolvency proceedings, except for corporate reorganisation proceedings, which prohibit secured creditors from exercising their security interests.

Creditors may exercise the above-mentioned security interests, which are not subject to stays, as a bargaining chip (eg, for the terms of settlement in any litigation).

Stays of proceedings – effect on emergence from insolvency

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

Stays have the effect of significantly improving the debtor's cash flow. Eventually, the debtor will emerge from insolvency based on the reduction of claims in the rehabilitation or reorganisation plan. Bankruptcy proceedings are designed for liquidation and not 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?

No.

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?

It is impossible to pursue claims existing before insolvency against shareholders or their affiliates or agents during insolvency proceedings as they are separate legal entities from the debtor.

However, there may be exceptional cases where the independence of the corporate personality of the debtor company is denied and the above claims are allowed by considering the debtor company and the shareholders behind it to be the same on the grounds that it may be contrary to justice and equity to maintain the independence of the corporate personality of both parties ('denial of corporate personality'). Denial of corporate personality may be applied when:

- the legal personality is controlled by the shareholders as an instrument at will and the controlling party has 'illegal or improper purposes'; or
- the company is, in effect, the sole business of the shareholders, or the subsidiary is only a division of the parent company's business.

Under Japanese law, the requirements for the application of denial of corporate personality are strictly interpreted, and the situations in which claims against shareholders are allowed are extremely limited.

Procedure and resolution

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

For pre-existing claims, the claim holders must file a proof of claim during the claim filing period designated by the court. If the claim is not approved by the company or trustees (as applicable) or other creditors file an objection, the claim holder may file a petition to commence special assessment proceedings to determine the details of the claim with the court by the legally stipulated deadline. The court will make an assessment specifying the existence or non-existence and the content of the disputed claim. If the claim holder is dissatisfied with the assessment decision, it may file civil litigation against the decision with the court within a month of the day on which the claim holder receives it.

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?

Upon the commencement of bankruptcy proceedings or corporate reorganisation proceedings, in general, a trustee is appointed by the court and takes over control and possession of the company's property, including the pursuit of pre-insolvency debtor claims.

In civil rehabilitation proceedings, in general, the debtor has the right to control the proceedings, including the pursuit of pre-insolvency debtor claims (if the trustee is appointed by the court, the trustee has such rights).

The debtor (or the trustee) owes a duty of diligence to interested parties, including creditors, and failure to comply with this duty may result in it being liable for damages. If creditors are dissatisfied with the debtor's (or the trustee's) decision regarding the pursuit of pre-insolvency debtor claims, creditors may point out and insist on breaches of such duty and encourage the debtor's (or the trustee's) pursuit of pre-insolvency debtor claims.

Risk mitigation for creditors

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

The debtor (or the trustee) owes a duty of diligence to interested parties, including creditors, and failure to comply with this duty may result in it being liable for damages.

If creditors are dissatisfied with the debtor's (or the trustee's) decision regarding the pursuit of pre-insolvency debtor claims, creditors may point out and insist on breaches of such duty and encourage the debtor's (or the trustee's) pursuit of pre-insolvency debtor claims.

Minimising costs for creditors

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

For pre-existing claims, the claim holders must file a proof of claim during the claim filing period designated by the court. If the claim is not approved by the company or trustees (as applicable) or other creditors file an objection, the claim holder may file a petition to commence special assessment proceedings to determine the details of the claim with the court by the legally stipulated deadline. The court will make an assessment specifying the existence or non-existence and the content of the disputed claim.
There is no cost to file a petition to commence special assessment proceedings. In terms of reducing litigation costs through early resolution, it is common and reasonable to reach a settlement during the above assessment proceedings.

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?

Exercising security interests is not prohibited, and secured creditors may collect their claims regardless of the commencement of insolvency proceedings, except for corporate reorganisation proceedings, which prohibit secured creditors from exercising their security interests. However, if a stay order on collateral execution is issued as a temporary restraining order upon petition by the debtor, the exercise of security interests will be exceptionally restricted.

In practice, if security interests are established on assets necessary for the continuation of business, the debtor shall attempt to conclude an agreement not to exercise those interests under certain conditions with the interest holder.

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?

Creditors may pursue common benefit claims against debtors during insolvency proceedings, which, unlike pre-existing claims, may be paid at any time in advance of other claims.

Common benefit claims are mainly claims that arise after the commencement of insolvency proceedings and benefit all creditors (eg, judicial costs for the common benefit of creditors, costs related to the debtor's business after the commencement of insolvency proceedings, insolvency proceeding expenses).

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?

Local courts in Japan may recognise foreign insolvency proceedings. The process is initiated by a debtor’s filing with the Tokyo District Court, which has exclusive jurisdiction over such recognition proceedings. The test for recognition is based mainly on the necessity of such recognition. For example, if foreign restructuring or insolvency proceedings are obviously ineffective over assets in Japan, such recognition would be denied.

With regard to judgments rendered by foreign courts, they may be enforced in Japan by obtaining another judgment permitting the enforcement of the foreign judgment in a Japanese court.

Judicial cooperation

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

Assistance or recognition of foreign insolvency processes generally is governed by the Act on Recognition of and Assistance for Foreign Insolvency Proceedings (2001). The Judicial Insolvency Network's cross-border cooperation guidelines are not adopted in Japan.

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?

For debtor claims, all legal remedies are available (eg, damages, injunctive relief, specific performance, declaratory relief), the same as for ordinary claims. The award collected by the debtor through such procedures will be used to fund payments to creditors. There have not been any recent notable remedies.

Remedies for creditors

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

In principle, remedies available to creditor-claimants in insolvency proceedings are in the form of cash. The timing of such remedies varies depending on the type of claim: pre-existing claims are paid based on the final payment plan (restructuring plan); common benefit claims are paid at any time. There have not been any recent notable remedies.

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?

There are no jurisdictional limits to the court's enforcement powers. Judgments and decisions of the court regarding insolvency proceedings or insolvency litigation have the same enforceability as ordinary judgments and decisions.

SETTLEMENT AND MEDIATION

General court approach

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

In principle, court approval is required for settling litigation in insolvency proceedings. The court determines the validity of a settlement by focusing on its necessity and permissibility (fairness among creditors).

Generally, Japanese insolvency courts are amenable to smooth dispute resolution, such as settlement between debtors and creditors.

Timing

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

There are no legal restrictions or standards regarding the timing of settlement, which is possible at any time by agreement between the parties.

For pre-existing claims, the claim holders must file a proof of claim during the claim filing period designated by the court. If the claim is not approved by the company or trustees (as applicable) or other creditors file an objection, the claim holder may file a petition to commence special assessment proceedings to determine the details of the claim with the court by the legally stipulated deadline. Creditors and debtors may reach a settlement during the assessment proceedings.

Court review and approval

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

In principle, court approval is required for settling insolvency proceedings. There are no clear legal standards. The court determines the validity of a settlement by focusing on its necessity and permissibility (fairness among creditors).

Mediation clauses

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

For court procedures to determine insolvency claims, the insolvency laws (the Bankruptcy Act, the Civil Rehabilitation Act and the Corporate Reorganisation Act) provide detailed rules and do not recognise any mediation or other such clauses agreed by the parties.

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?

Out-of-court informal restructurings ('out-of-court workouts') are preferable over formal corporate reorganisation or civil rehabilitation proceedings since they are not disclosed publicly nor detrimental to the continuation of the debtor company's business. Recently, there have been discussions about making out-of-court workouts more efficient and effective.

The new guidelines for out-of-court workouts for small and medium-sized business revitalisation after the covid-19 pandemic, issued in 2022, have been utilised in more cases recently.

In addition, at present, restructuring plans submitted in out-of-court workouts must be approved by all creditors, which makes it difficult at times to achieve a successful restructuring of the debtor. The Headquarters for the Realisation of New Capitalism established by the Japanese government indicates that while European countries have certain systems in place (eg, the Scheme of Arrangement in the UK and StaRUG in Germany) to restructure businesses by amending certain rights of creditors, including debt forgiveness by a majority vote with court approval and without requiring the consent of all lenders, there is no such system in Japan.

Further, the government has formally commenced discussions regarding the new legislation, including the introduction of the principle of majority rule in out-of-court workouts.

MORI HAMADA & MATSUMOTO

Dai Katagiri dai.katagiri@mhm-global.com
Wataru Ishida wataru.ishida@mhm-global.com

Mori Hamada & Matsumoto

Mexico

Antonio Mañón , **Gerardo Quintana Pineda** , **Darío Jandette**, **Alberto Quintana Pineda**, **Emmanuel Magaña**
Mañón Quintana Abogados

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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?

Despite the fact that the isolation measures regarding covid-19 have been relaxed throughout the world, the lack of support from the Mexican government for companies during the covid-19 pandemic; the potential global economic recession that is looming for 2023; and the rise in the interest rates by central banks to mitigate inflation have driven up prices to levels not seen in at least four decades. This has begun to cause effects in the Mexican market in 2022, mainly in the financial sector, leading Alpha Credit, Unifin and Credito Real to insolvency. This is also the case for Interjet, which was just declared insolvent, and Altán Redes, in whose procedure a restructuring agreement has been approved.

As in 2021, in 2022 several Mexican companies have turned to Chapter 11 of the US Bankruptcy Code to restructure their liabilities, mainly due to the benefits of accessing to debtor-in-possession financing; the protection and business measures for the debtor's operation; and a less litigious and expeditious procedure. This alternative to access Chapter 11 is not available to all Mexican companies and depends on tax, labour, regulatory and debt structure factors.

Finally, according to public information, 41 insolvency proceeding were filed in Mexico during 2021 and 26 were filed by 31 May 2022. A total of 872 insolvency proceeding have been filed between 2000 and 31 May 2022.

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 main statute in Mexico for insolvency proceedings is the Insolvency Law (LCM), which expressly enlists the supplementary application of:the Commercial Code; other commercial statutes, such as the General Business Company Law and the General Negotiable Instruments and Credits Operations Law; the Federal Code of Civil Procedure; and the Federal Civil Code. Additionally, the LCM makes reference to some other laws, such as the Mexican Constitution, the Federal Labour Law, the Federal Tax Code and their regulations.

The insolvency regime interacts with other laws in different situations, such as in the ranking of privileged credit, the execution of pending contracts and the liquidation of interests, depending on the nature of the credit.

Procedure

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

The procedural rules that govern insolvency proceedings in Mexico are established in the LCM. If the LCM does not regulate a certain legal stage or concept of the procedure, the Commercial Code or the Federal Code of Civil Procedure will apply.

Some of the hurdles that arise in insolvency proceedings in Mexico are:

- the admission of the insolvency request as some courts are dismissing insolvency claims, under the pretext of missing formalistic requirements;
- the omission of debtors to pay certain expenses for the continuity of the insolvency proceeding, such as publication of edicts of the declaration of insolvency and its registration in the commercial folio of the debtor in the Commercial Public Registry;
- the excessive time to resolve the appeals against the ranking and priority of creditors judgment and the restructuring plan approval ruling; and
- the lack of interested parties to acquire the assets of the debtor in the liquidation stage, which extends this stage indefinitely without verifying any payment to the creditors.

Courts

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

As a rule, the competent courts to hear insolvency proceedings are the federal courts located at debtor's domicile, specifically the domicile of its incorporation; in the absence of such domicile, it is the location of the company's administration (the main seat of business). In the case of corporate groups, regardless of whether they are subsidiaries or holding companies, the competent court will be the one at the domicile of the holding company or subsidiary that first entered insolvency.

However, due to the creation of the specialised courts for bankruptcy matters by the Federal Judiciary Council on 4 March 2022, these courts will process all bankruptcy proceedings in the country regardless of the debtor's domicile.

Jurisdiction

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

According to article 17 of the LCM, the competent courts to hear insolvency proceedings are the federal courts located at debtor's domicile, specifically the domicile of its incorporation; in the absence of such domicile, it is the location of the company's administration (the main seat of business), according to article 33 of the Federal Civil Code.

In cross-border insolvency cases, specifically in the event of a recognition of a foreign insolvency proceeding, when the debtor has an establishment in Mexico, the competent court will be the court where the establishment is located. If there is no establishment in Mexico, but the debtor owns assets that are located in Mexico, the competent court will be the court where the assets are located.

Following the creation of the specialised courts for bankruptcy matters by the Federal Judiciary Council on 4 March 2022, these courts will process all bankruptcy proceedings in the country regardless of the debtor's domicile, including cross-border matters.

Limitation periods

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

There is no limitation period to bring an insolvency claim. However, once the conciliation stage of the insolvency proceeding is open, the creditors will only have three opportunities to request for recognition of their credit:

- during the 20 calendar days following the publication of the debtor's declaration of insolvency in the Federal Official Gazette;
- during the five-day term for objections to the provisional list of creditors; or
- through an appeal against the ranking and priority of creditors judgment, on the understanding that once the term to challenge the judgment has elapsed, no credit recognition may be requested.

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?

The LCM provides, among others, the following precautionary remedies:

- suspension of any payment of debts;
- prohibition to sell or encumber the debtor's principal assets;
- suspension of any seizure of enforcement of a judgment over assets or cash;
- prohibition to transfer resources or stocks to third parties;
- a restraining order on the debtor's administrator from leaving the place where the company is located without appointing a representative with sufficient funds to attend the insolvency proceeding; and
- any other relief of similar nature.

These interim remedies are granted to the debtor at the time of admitting the insolvency request or lawsuit. Such measures are also part of the debtor's declaration of insolvency.

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 insolvency proceeding is governed by the rules and procedures contained in the LCM. If this law does not regulate any concept or part of the insolvency proceeding, including requirements and formalities of evidence, the provisions of the Commercial Code and Federal Code of Civil Procedure will be applied.

During the inspection stage of the insolvency proceeding, the debtor or the claimant may exhibit and offer all evidence that they consider appropriate to demonstrate or disaffirm the debtor's insolvency, as applicable.

The debtor may voluntarily request a declaration of insolvency or any creditor may bring a lawsuit for the same. The debtor must attach to its request, as evidence: financial statements; a list of facts that brought the debtor to insolvency; a list of creditors and debtors; a list of assets; and a list of procedures to which the debtor is a party, among other formal requirements. The creditor or creditors must provide all available evidence that demonstrates their status as creditors and the condition of the debtor as insolvent. When answering the lawsuit, the debtor may file all kinds of evidence, including expert opinions in writing, to demonstrate that it is not insolvent. The debtor or demanding creditors must be aware that if their request or lawsuit is denied, they will have to pay legal fees to their counterparty.

Time frame

9 What is the typical time frame for insolvency claims?

Inspection stage

The pre-stage of an insolvency proceeding – the *visita* – may take between two and six months, depending on how fast the court:

- admits the request or the lawsuit;
- accepts the appointment from the Federal Institute of Bankruptcy Experts(IFECOM) of an accountant specialist *(visitador);* and
- sets the date for the inspection at the debtor's office for the review of the accounting records, financial statements and any document or electronic records demonstrating the debtor's financial situation, including the possibility to interview the management and administrative staff of the debtor.

The *visitador* shall render his or her report regarding the financial situation of the debtor within 15 days of the date the inspection started. If there is a justified reason, the *visitador* may request that the term be extended by another 15 days.

Conciliation stage

Once the court issues the declaration of insolvency, the proceeding will advance to the conciliation stage, where a bankruptcy referee *(conciliador)* appointed by the IFECOM will aim to restructure the debtor's liabilities and start the recognition of credit procedure.

Bankruptcy or liquidation stage

If the debtor and creditors do not reach a restructuring agreement within a maximum period of one year, the insolvency proceeding will advance to the bankruptcy stage, which provides for liquidation of the debtor's assets by the bankruptcy trustee *(síndico)* also appointed by the IFECOM. This stage will last until the debtor's assets are totally liquidated.

Appeals

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

The only resolutions that may be challenged through an appeal within the insolvency proceeding are: the declaration of insolvency; the ranking and priority of creditors judgment; the restructuring plan approval ruling; or the bankruptcy declaration. When the LCM does not expressly allow for an appeal, it is possible to file a motion for revocation.

Depending on the resolution, the debtor, creditors (recognised or not), the federal prosecutor and the specialists appointed in the insolvency proceeding may challenge the resolution through an appeal. The appeal must be filed within nine days following the date of issuance of the resolution, expressing the grievances and, if applicable, providing the corresponding evidence. The counterparty may respond to the appeal within nine days following the date of the admittance of the appeal, answering the grievances and offering the corresponding evidence. Once the court of appeal receives the case records, it will open a production of evidence stage for 15 days. If there is no evidence to produce, the court of appeal will grant the parties a 10-day period to express closing arguments. After this period expires, the court of appeal will render its ruling within the following five business days. The ruling for an appeal may be challenged through a constitutional proceeding (*amparo*).

Although the terms to resolve appeals are relatively quick, in practice the resolution of appeals can take anywhere between six months and one year, depending on the complexity and volume of appeals, and the workload of the court of appeal.

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?

As a rule, each party funds its own claims. As an exception, in the case of dismissal of a request or lawsuit for declaration of insolvency, the court will require the payment of legal fees, including the fees of the *visitador*. Creditors are allowed to obtain third-party funding to finance the prosecution of claims, but it is not common practice in Mexico.

The debtor may also obtain credit to keep the company as a going concern and maintain the necessary liquidity during the insolvency proceeding, the terms and conditions of which will be approved by the *conciliador* and the judge. The person who grants the credit will have a preferential priority over the other creditors; however, this practice has not been successful in Mexico as banking regulations prevent institutions from assuming this kind of risk.

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?

Creditors are entitled to challenge fraudulent transactions that occurred before the debtor's insolvency declaration. The Insolvency Law (LCM) provides for a 270-day reach-back period as of the date of the declaration of insolvency (the clawback period). In case of transactions between companies of the same corporate group, the time frame is extended to 540 days prior to the declaration of insolvency. Upon request from the bankruptcy referee (*conciliador*), the bankruptcy trustee (*síndico*) or any creditor, the court may extend the clawback period to a maximum of three years, as long as the request is submitted prior to the issuance of the ranking and priority of creditors judgment.

There is an irrebuttable presumption that the following transactions are fraudulent when performed during the clawback period:

- free transactions;
- acts in which the debtor receives in return something of significantly lower value compared to what the counterparty received;
- acts with terms and conditions that do not adequately reflect market circumstances;
- debt forgiveness by the debtor;
- payment of non-matured debts; and
- the discount of the debtor's business assets and negotiable instruments.

Also, there are rebuttable presumptions of fraudulent transactions on the following debtor's acts, when committed during the clawback period:

- executing or increasing a guarantee when the original act does not call for one;
- paying debts in a different way than provided for in the contracts; and
- executing transactions with its own managers, directors, relevant employees, relatives or companies belonging to the same corporate group.

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?

For the nullity of fraudulent acts, it is necessary to demonstrate that:

- the debtor performed an act that is not simply material but legal, as it is subject to being annulled;
- the execution of the act of alienation results in or worsens the debtor's insolvency (so as long as the debtor does not fall in insolvency and the creditors' guarantee is sufficient, the creditors will lack the interest to challenge the legal acts carried out by the debtor, even if they imply a decrease in assets); and
- the execution of the act damages creditors, because if there is no damage the creditor would not have any interest in filing an ancillary proceeding for nullity of the fraudulent act.

In this context, according to the LCM, fraudulent acts are those that the debtor has committed before the declaration of insolvency with fraudulent intention. In addition, if a third party intervened in the act, it is considered fraudulent if the third party had knowledge of the fraud. This last requirement will not be necessary in acts of a free nature.

Liens and floating charges

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

Mortgages and pledges should be registered in public registries to have effect against third parties. If they are not properly registered, creditors will face the risk of losing their ranking and priority before secured and unsecured creditors of the same class regarding a certain asset. To prevent actions for the avoidance of liens, creditors must confirm that their liens are properly registered before the Registry of Real Estate Property, the Public Commercial Registry or the Secured Transactions Registry.

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?

Affected creditors can file avoidance actions for the annulment of fraudulent acts through an ancillary motion within the insolvency proceeding. Once the ancillary motion has been filed, the related parties have five days to answer the motion, considering that all related

evidence must be exhibited together with the initial motion or the answer to the motion. In such a case, the court shall set a date for a hearing to produce evidence. After the hearing, the court will issue the ancillary judgment within three days. This time frame may be extended depending on the workload of the court. The parties can also challenge the ancillary judgment through an ordinary remedy (motion for revocation), within three days of the issuance of the ancillary judgment, and the ruling that resolves the motion for revocation may be challenged through an *amparo* (constitutional proceeding) within the following 15 days.

In some cases, it is difficult to locate the third parties that participated in the fraudulent act to notify them of the ancillary motion. Furthermore, when these ancillary motions are resolved ordering the nullity of the fraudulent acts, the parties involved are required to restore things as they were before the fraudulent act; however, in many cases this is not possible because the assets have disappeared or the third parties that participated in the act are also insolvent.

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?

Claims for breaching fiduciary duties against directors or officers may be brought within the insolvency proceeding through an ancillary motion. The board members, directors and relevant employees will be responsible for compensating for the damage they caused to debtor, if they led it to insolvency by doing the following: adopting decisions that had a conflict of interest; benefiting a specific group of shareholders; committing bribery; providing false statements; and committingother offences and wrongful actions that affected the debtor financially.

The responsibility to compensate for the damage will be carried jointly and severally between the responsible officials, without prejudice to the criminal responsibility they have incurred, on the understanding that the action may be filed by the debtor or the shareholders representing at least 25 per cent of the voting rights shares. The statute of limitations for filing the responsibility action is five years as of the date on which the liability assumption occurred.

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 will not incur liability when they cause damage to the debtor derived from the acts, omissions or conduct that they execute or the decisions they adopt, if they act as a bona fide third party and the following exculpatory circumstances apply:

- they comply with the law or the by-laws;

- they take decisions or vote based on information provided by relevant employees, external auditors or independent experts;
- they have selected the most appropriate alternative to the best of their knowledge and belief; and
- they comply with the agreements of the shareholders' meeting, as long as they do not violate the law.

The debtor is prohibited from agreeing or foreseeing in its by-laws any benefits or exclusions of liability that limit, release, substitute or compensate the obligations of the board members, directors and relevant employees. The debtor may only contract insurance, bonds or guarantees that cover the amount of compensation for damage caused, except in the case of illicit fraudulent acts or acts in bad faith.

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?

According to the congressional declaration of purpose of the Insolvency Law (LCM), there is no limitation on the schemes that can be adopted in a restructuring agreement, so it is possible that credit can be converted to equity, as long as the restructuring agreement that establishes such capitalisation:

- applies for all creditors who have the same ranking and priority;
- is approved by the majority of unsecured creditors; and
- is not contrary to public policy, among other requirements.

There are non-mandatory precedents that consider the credit capitalisation a violation of the fundamental right of free association interpreted in the contrary sense, regarding those creditors who have not voted or have voted against the restructuring agreement that proposes the capitalisation.

Consequently, if the restructuring agreement does not foresee credit capitalisation, the insiders' and shareholders' credit will be maintained in the ranking and priority of subordinated credit.

Illegal dividends

19 Can dividends received by shareholders be prosecuted as illegal?

Payments to creditors, including shareholders, must be made in accordance with the order of ranking and priority provided for in the LCM, on the understanding that creditors of a lower rank cannot be paid unless the higher-ranking creditors have been paid in full.

One of the main effects of the declaration of insolvency is the prohibition on making payments of debts prior to the issuance of such declaration, except those that correspond to the debtor's ordinary operation. Therefore, the payment of dividends to shareholders can be prosecuted as illegal through an ancillary motion for annulment, since such payments are not part of the debtor's ordinary operation, and they contravene the effects of the declaration of insolvency.

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?

After the filing of the insolvency request or lawsuit and during the conciliation stage, the administration of the debtor's company will correspond to the debtor, except when the bankruptcy referee (*conciliador*) requests the court to remove the debtor from the administration of his or her company for the protection of the bankruptcy estate.

Trading during inspection stage (before declaration of insolvency)

After the filing of the insolvency request or lawsuit and during the inspection stage, the debtor may request the court's authorisation for the immediate contracting of essential credit to maintain the company's ordinary operation and obtain the necessary liquidity to attend the insolvency proceeding, including the authorisation for granting guarantees. The account specialist (*visitador*) may express any relevant arguments regarding the financing request.

Trading during conciliation stage (after insolvency judgment)

All agreements pending completion must be fulfilled by the debtor, unless the *conciliador* opposes it for the best interests of the bankruptcy estate. The *conciliador* will monitor the accounting and all the operations carried out by the debtor during its administration.

Any creditor who has contracted with the debtor has the right to request the *conciliador* to declare whether he or she will oppose the fulfilment of the contract. If the *conciliador* states that he or she will not oppose, the debtor must comply or guarantee compliance with the creditor. If the *conciliador* opposes or does not respond within 20 days, the creditor who contracted with the debtor may at any time terminate the contract by notifying the *conciliador* thereof.

In fact, the *conciliador* will decide on the termination of pending contracts and will approve, with the prior opinion of the creditors' representatives, if they exist, the execution of new credit, the constitution or substitution of guarantees and the disposal of assets when they are not related to the ordinary operation. The *conciliador* must report any of these

operations to the court for any creditor's objection, which will be processed as an ancillary proceeding.

Equitable subordination

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

The LCM establishes the following as subordinated: creditors who have agreed to subordinate their rights with respect to unsecured creditors; and unsecured credit of the spouse and relatives of the debtor, including unsecured credit of those family members who are shareholders, directors or officers, or have the power to take decisions, as well as unsecured credit of companies of the same corporate group, except for the holding company.

Although the subordinated creditors can vote on the restructuring agreement, when the participation of the subordinated creditors is equal to or greater than 25 per cent of the total debtor's liability, the majority required to approve the restructuring agreement will only be counted with the favourable vote of unsecured creditors and secured 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?

In addition to actions for the annulment of fraudulent acts incurred by shareholders, as well as the responsibility actions against directors and officers, the LCM provides for criminal offences for acts or omissions incurred by board members, managers or relevant employees. The main grounds of such crimes are:

- voting in the board of directors' meetings or make determinations related to debtor's assets with a conflict of interest;
- favouring certain shareholders to the detriment of the other shareholders;
- generating, disseminating, publishing, providing or ordering false information about the debtor;
- acting intentionally to aggravate the breach of the debtor's obligations (eg, omitting, altering, destroying or falsifying the accounting records); and
- in general terms, carrying out illegal acts or acting in bad faith in accordance with the Insolvency Law or other laws.

Risk mitigation

23

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

Acts carried out by shareholders, directors, managers or relevant employees in a malicious way or in bad faith, or that form any of the assumptions of liability or fraud against creditors, cannot be mitigated, so the best alternative is to verify through an internal investigation that these events have not occurred. If these acts are confirmed, and depending on the particular case, it may be necessary to reverse the operation to avoid affecting the bankruptcy estate.

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?

There are some actions that creditors can take against the restructuring agreement.

Right to veto the agreement

The restructuring agreement may be vetoed without any cause by the unsecured creditors that have not signed the agreement, whose recognised credit jointly represents more than 50 per cent of the total amount of the credit recognised by such creditors. The creditors who comply with this majority must file the motion for veto within five days of the date on which the court made the restructuring agreement available to creditors.

Challenge the agreement

As the restructuring agreement requires the court's approval on non-violation of public policy, as well as on the majority vote of unsecured creditors, subordinated creditors (as long as they do not exceed 25 per cent of the total debt) and, if they agree to sign, secured creditors and privileged creditors, any creditor could file an appeal against the restructuring agreement approval judgment if it considers that such requirements were not satisfied. This appeal may be resolved by a court of appeals, whose resolution may be also challenged through an *amparo* (constitutional proceeding). If the challenge is declared well founded, the debtor may file a new restructuring plan if the maximum period of the conciliation stage has not elapsed (if it has, the debtor will be declared bankrupt).

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?

Voluntary request of the debtor

The debtor may request that the insolvency proceeding begins directly in the bankruptcy stage (skipping the conciliation stage) derived from the unfeasibility of restructuring the company.

Lawsuit of a creditor

The debtor may be declared directly bankrupt (skipping the conciliation stage) when a creditor has filed an insolvency lawsuit and, when answering the claim, the debtor agrees that the insolvency proceeding should start directly at the bankruptcy stage. If the debtor denies or fails to agree that the insolvency proceeding should begin at the bankruptcy stage, then the proceeding will start at the conciliation stage.

Regardless of whether the debtor agrees to start the insolvency proceeding at the bankruptcy stage, to declare the debtor's insolvency, creditors must demonstrate:

- the debtor has defaulted in its payment obligations with two or more creditors;
- the debtor's defaulted obligations that have been in default for more than 30 days represent at least 35 per cent of all its obligations; and
- the debtor does not have sufficient liquid assets to pay at least 80 per cent of its due and payable obligations on the date of filing the insolvency lawsuit.

Motion from theconciliador

The bankruptcy referee (*conciliador*) may request the court for early termination of the conciliation stage if he or she considers that the debtor or its creditors are not willing to negotiate a restructuring agreement or that it is impossible to do so. The *conciliador*'s request will be processed through an ancillary motion.

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?

All legal actions and lawsuits filed by or against the debtor that are in progress at the time of the declaration of insolvency will not be accumulated to the insolvency proceeding, but will be attended separately by the debtor under the supervision of the *conciliador*.

After the declaration of insolvency, other actions and lawsuits may be initiated separately against the debtor, which will be processed before the competent courts under the supervision of the *conciliador*; however, the enforcement of embargos or final judgments of any actions will be suspended over the rights and assets of the debtor due to the effects of the insolvency judgment, except for labour claims based on two years' accrued wages, which can continue the enforcement process.

Secured creditors with guarantees on assets that, according to the court and the *conciliador*'s opinions, are not strictly indispensable for the debtor's ordinary operation may initiate or continue an enforcement procedure over such guarantees.

Stays of proceedings – strategy

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

Taking into consideration that stays affect claims against the debtor, creditors must change their strategy from filing independent actions to requesting the recognition of their credit within the insolvency proceeding. Another action that creditors can normally use to adjust their strategies is requesting the *conciliador* to declare whether he or she will oppose the fulfilment of the contract.

Stays of proceedings – effect on emergence from insolvency

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

Stays could affect debtors because creditors may not be willing to execute new contracts, or extend them, particularly with regard to those that are required for the ordinary operation of the business. Normally, stays protect debtors and make creditors willing to negotiate a reorganisation plan; however, in some cases the creditors affected by stays do not negotiate – much less support – restructuring plans.

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?

If the debtor obtains new credit to maintain the company's ordinary operation or to have liquidity during the insolvency proceeding, without the authorisation of the *conciliador* or the *síndico*, or against the court's approval, the creditor will lose its privilege or preference.

Also, creditors that execute private agreements with the debtor will lose all their rights within the insolvency proceeding and the court must declare the nullity of the private agreement.

Vote designation

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

Once the declaration of insolvency has been issued, if creditors execute private agreements with the debtor, they will lose all their rights within the insolvency proceeding and the court must declare the nullity of the private agreement.

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?

If the debtor executes acts to become insolvent, prior to the insolvency proceeding and in separate actions, creditors may claim the nullity of such fraudulent acts, to the effect that, if there has been an alienation of property, the property will be returned by the person who acquired it in bad faith with all its profits. For the annulment of fraudulent acts it must be demonstrated that:

- the debtor performed an act that is not simply material but legal, as it is subject to being annulled;
- the execution of the act of alienation results in or worsens the debtor's insolvency (so as long as the debtor does not fall in insolvency and the creditors' guarantee is sufficient, the creditors will lack the interest to challenge the legal acts carried out by the debtor, even if they imply a decrease in assets); and
- the execution of the act damages creditors, because if there is no damage the creditor would not have any interest in filing an ancillary proceeding for nullity of the fraudulent act.

Also, when the debtor uses the company to carry out abusive or fraudulent acts, or with the intention of avoiding legal or contractual responsibilities, creditors may ask the court to pierce the corporate veil that protects shareholders who brought claims against them, in addition to filing criminal actions against shareholders for fraud.

Procedure and resolution

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

As a universal proceeding, to restructure or liquidate the debtor's company, the insolvency proceeding considers all the debtor's liabilities.

The Insolvency Law does not limit creditors' access to jurisdiction; thus, they may start judicial actions before competent courts. In this case, depending on the stage, either the bankruptcy referee (the *conciliador*) or the bankruptcy trustee (the *síndico*) must monitor all proceedings where the debtor is involved. The obligation to monitor does not oblige the *conciliador* or the *síndico* to take on the debtor's defence, except when the *síndico* decides to do so for reducing expenses.

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 controls the pursuit of its own pre-insolvency claims; however, the *conciliador* during the conciliation stage or the *síndico* during the liquidation stage must monitor all proceedings against debtors of the debtor, to obtain a favourable ruling that helps to increase the bankruptcy estate.

Courts have wide power to protect the bankruptcy estate in favour of creditors' interests, therefore, in some cases courts have ordered debtors of the debtor to pay due amounts, as well as granting injunctive relief to enforce rulings.

Derivative actions are not common in Mexico, but shareholders or creditors can file such actions according to certain provisions set forth in the Federal Civil Code.

Risk mitigation for creditors

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

Even though there is no way to assure a creditor of the result of a pre-insolvency debtor claim, once the declaration of insolvency is issued, the *conciliador* during the conciliation stage or the *síndico* during the liquidation stage assumes the responsibility and obligation to monitor the debtor's claim; thus, creditors may ask both specialists to further explain the actions they have taken to monitor and guarantee the recovery of the claims. If the *conciliador* or the *síndico* fails to monitor the debtor's claims, the creditors may claim compensation for damage caused due to breach of their obligations, in addition to administrative sanctions that may be imposed by the Federal Institute of Bankruptcy Experts, including the withdrawal of their register as bankruptcy experts.

Minimising costs for creditors

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

The *conciliador* or the *síndico* may monitor the actions taken by the debtor to increase the bankruptcy estate; creditors may request additional information from both experts regarding such actions and, if appropriate, object to the expenses incurred for them.

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?

If a creditor files a credit recognition request with false information or through criminal simulation, they could be punished with a penalty of one to nine years' imprisonment.

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?

The owners of identifiable assets that are in the possession of the debtor and whose property has not been transferred to it by irrevocable legal title, may be separated from the bankruptcy estate.

The assets separation action has the following elements:

- that assets or rights are in the debtor's possession at the time of issuance of the declaration of insolvency;
- such assets or rights must be well determined;
- assets must be identifiable, except for consumables, which are identified by their weight, quality and quantity; and
- the property of such assets or rights has not been transferred to the debtor by legal and irrevocable title.

The assets separation action will be processed alongside the insolvency proceeding through an ancillary motion. Once the separation claim has been filed, if the debtor, the bankruptcy referee (*conciliator*) and the bankruptcy trustee (*síndico*) do not oppose, the court will order the separation outright in favour of the plaintiff. In case of opposition, the separation process will continue as an ancillary proceeding.

Assets or rights that are in the following situations, or in any other situations of a similar nature, may be separated from the bankruptcy estate:

- those that can be vindicated;
- real estate properties sold to the debtor whose price has not been fully paid, when the sale has not been duly registered in the corresponding public registry;

- goods or movable property acquired in cash, if the debtor has not paid the full price at the time of the issuance of the insolvency judgment; and
- those that are in debtor's possession as a deposit, lease or usufruct, or that have been received in administration or consignment, as well as for sales commissions or amounts received by the debtor for the sale of goods or assets owned by the separatist and assets whose property have been transferred to a trust, among other cases.

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?

The Mexican Insolvency Law (LCM) adopted the UNCITRAL Model Law on Cross-Border Insolvency (1997), establishing the procedure for cooperation in international insolvency proceedings, which is applicable when:

- a foreign court or a foreign representative requests assistance in Mexico regarding a foreign insolvency proceeding;
- a Mexican court or any specialist requires assistance in a foreign state regarding a proceeding that is being processed in accordance with the LCM;
- a foreign insolvency proceeding and a Mexican insolvency proceeding are being processed simultaneously with respect to the same debtor; or
- creditors or other interested persons, who are in a foreign state, have an interest in opening or participating in an insolvency proceeding that is being processed in Mexico.

A foreign insolvency proceeding will be recognised by a Mexican court when (1) the requesting party is a foreign representative and (2) the foreign representative exhibits authentic copies of the ruling that opened the foreign insolvency proceeding, together with their official translation into Spanish, as well as of the certificate issued by the foreign court proving the existence of the foreign insolvency procedure and the appointment of the foreign representative, on the understanding that if such documents are not available in the foreign country, any other evidence will be admissible to demonstrate the existence of the foreign insolvency proceeding and the appointment of the foreign representative. Also, the foreign representative must indicate the debtor's domicile for processing the request, which will be processed as an ancillary motion between the foreign representative and the debtor, with the participation, if applicable, of the account specialist (*visitador*), the bankruptcy referee (*conciliador*)or the bankruptcy trustee (*síndico*).

As general provisions of the insolvency proceeding are applicable to the request for recognition of a foreign proceeding, the foreign insolvency proceeding recognition judgment may be challenged through an appeal, whose resolution may also be challenged

through an *amparo* (constitutional proceeding). The grounds of such appeal or *amparo* depends on the applicable facts – for example, the effects that are intended with the application, objections to the documents exhibited by the foreign representative regarding the existence of the foreign insolvency proceeding or his or her appointment, the determination of which of the two procedures will be considered as the debtor's main insolvency proceeding.

Judicial cooperation

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

The provisions of the International Cooperation Title in the LCM shall apply when there is no provision to the contrary in any treaty to which Mexico is a party, except where there is no international reciprocity. Therefore, the court, the *visitador*, the *conciliador* or *síndico* shall cooperate to the extent possible with the foreign courts and representatives. The court and such specialists will be empowered to communicate directly with the foreign courts or foreign representatives, without the need for letters rogatory or other formalities.

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?

From the point of view of asset protection, the debtor may request for provisional measures such as:

- prohibition to sell or encumber the principal debtor's assets;
- suspension of any seizure or judgment enforcement over the debtor's assets;
- prohibition to transfer resources or stocks to third parties;
- a restraining order on the debtor's administrators, so they do not abandon the debtor's domicile without appointing a representative with sufficient funds; and
- any other relief of a similar nature.

In recent bankruptcy proceedings, the courts have extended the effects of precautionary measures to joint obligors.

From the point of view of the ordinary operation, the debtor may terminate early, with *conciliador*'sapproval, those agreements that are not necessary for keeping the business as a going concern, which will help the debtor's restructuring.

Remedies for creditors

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

Creditors that file an insolvency lawsuit may also request precautionary measures, such as the appointment of a judicial administrator on the debtor's bank accounts or assets. Also, the rights to veto and to challenge, through remedies or *amparos*, the approval of the restructuring agreement provides recognised creditors with an important remedy against the debtor. Finally, creditors may have relatively agile alternatives with respect to certain contracts, as they may request the *conciliador* to declare whether they will oppose the fulfilment of the corresponding contract.

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?

To enforce its rulings, the court may use, at its sole discretion, any of the following enforcement measures: impose fines; use police force; break doors and remove fastenings of houses or buildings; impose administrative arrest for up to 36 hours; and inform the Attorney General of contempt.

SETTLEMENT AND MEDIATION

General court approach

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

As the Insolvency Law's (LCM) main purpose is to keep companies running, the courts are normally more amenable to approve reorganisation plans than to declare debtors bankrupt; however, this depends on the financial situation of the debtor, its business plan and whether its restructuring agreement meets the applicable requirements.

Timing

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

The initial term of the conciliation stage is 185 days after the publication of the declaration of insolvency in the Federal Official Gazette. The initial term may be extended for 90 days through a motion filed by the bankruptcy referee (the *conciliador*)or creditors representing 50 per cent of the total debt. Prior to expiration of the extended period, the debtor together with creditors representing 75 per cent of the total debt may request for an additional extension of 90 days.

Therefore, the approval of the reorganisation agreement is more likely to happen close to the end of the extension periods of the conciliation stage, otherwise the debtor will be declared bankrupt, and creditors will only be paid with the liquidation of the debtor's assets.

Court review and approval

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

The reorganisation agreement will be approved (1) when the court confirms that it does not violate public policy and (2) it is approved by the majority vote of unsecured creditors, subordinated creditors (as long as they do not exceed 25 per cent of the total debt) and, if they agree to sign, secured creditors and privileged creditors, among other requirements.

Mediation clauses

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

Taking into consideration that the insolvency proceeding has a universal nature and that any agreement reached in a mediation procedure would be null and void while the insolvency proceeding is still pending, it would not make sense to enforce mediation clauses.

The LCM establishes a pretrial mediation procedure, so that a person is appointed to act as an *amiable compositeur* between the debtor and its creditors; however, there is no precedent for this mediation procedure being used.

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 Insolvency Law was amended in January 2020, mainly to include state-owned companies in the catalogue of entities that can be declared insolvent or bankrupt; however, the latest, most relevant reforms were those of January 2014, in which the precedents generated in the insolvency proceedings of Mexicana de Aviación and Vitro were included in the law, among other issues. Additionally, on 4 March 2022, the Federal Judiciary Council created two specialised bankruptcy courts based in Mexico City with jurisdiction throughout the country, which have processed all bankruptcy proceedings filed since 16 November 2020.

Antonio Mañón antonio.manon@mqsc.mx
Gerardo Quintana Pineda gerardo.quintana@mqsc.mx
Darío Jandette dario.jandette@mqsc.mx
Alberto Quintana Pineda alberto.quintana@mqsc.mx
Emmanuel Magaña emmanuel.magana@mqsc.mx

Mañón Quintana Abogados

Read more from this firm on Lexology

Nigeria

Abubakar Anafi, **Kanzullahi Hibatullahi**, **Favour Ogini**, **Khadijah Abdulwahab**
G Elias

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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 Nigeria, insolvency litigation has progressed rapidly in complexity and is catching up with developments in the rest of the world. For example, we now have a statutory buyer of toxic bank debts, business rescue regime statutory provisions and netting-off provisions when derivative counterparties become insolvent.

The most common sources of dispute are outstanding bank loans and trade credits.

Litigation is often used as a pressure or delay tactic in insolvency proceedings.

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?

Typically, claims initially come into existence at common law in tort, contract, restitution or a statute, with a focus outside insolvency law and prior to insolvency (rather than arising from insolvency). Ordinarily, the creditor seeks to recognise and enforce existing claims using insolvency law tools.

In Nigeria, the primary sources of law that form the basis of most claims arising from insolvency – through invoking insolvency law tools – are:

- the Constitution of the Federal Republic of Nigeria 1999 (as amended) (the Constitution);
- the Companies and Allied Matters Act 2020 (as amended) (CAMA);
- the Bankruptcy Act 1990 (BA);
- the Banks and Other Financial Institutions Act 2020 (BOFIA);
- the Asset Management Corporation of Nigeria Act 2010 (as amended) (the AMCON Act);
- the National Insurance Commission Act 1997 (the NAICOM Act);
- the Business Facilitation (Miscellaneous Provisions) Act 2023 (the Business Facilitation Act);
- the Insurance Act 2003 (IA);
- the Pension Reform Act 2014 (PRA); and
- the Nigerian Deposit Insurance Corporation Act 2006 (the NDIC Act).

The insolvency provisions in the CAMA, the BA and the Business Facilitation Act are of general application, and apply to entities and individuals regardless of the sector of the economy in which they operate. The statutes that are sector-specific are the BOFIA, the NAICOM Act, the IA, the PRA, the AMCON Act and the NDIC Act.

These laws interact with other laws and procedural rules to govern insolvency litigation in Nigeria. In the event of a conflict:

- the Constitution prevails over all other legislation;
- insolvency-specific provisions prevail over provisions with general application;
- insolvency-specific provisions prevail over earlier provisions on insolvency; and
- all legislation prevails over rules based on convention or the common law.

Procedure

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

The procedural rules that govern insolvency litigation are:

- the Companies Winding-up Rules 2001;
- the Companies Proceedings Rules 1992;
- the Insolvency Regulations 2022;
- the Federal High Court (Civil Procedure) Rules 2019; and
- the Federal High Court Asset Management Corporation of Nigeria Rules 2018.

The broad species of insolvency proceedings include personal bankruptcy, receivership, administration and winding up. Winding up may be carried out voluntarily, by the court or under the supervision of the court.

A common procedural hurdle in Nigerian insolvency practice is the slow pace of litigation and the lack of a specialised court dealing exclusively with insolvency matters. The Federal High Court, which has exclusive jurisdiction to hear and determine insolvency claims, is inundated with numerous other kinds of claims (including tax, administrative law and election-related claims). Furthermore, all decisions of the Federal High Court on insolvency matters are appealable to the Court of Appeal and ultimately to the Supreme Court of Nigeria.

Courts

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

According to sections 251(1)(e) and 251(1)(j) of the Constitution, the Federal High Court is vested with exclusive jurisdiction to hear and determine insolvency claims, and it is experienced in dealing with insolvency litigation.

Under section 851 of the CAMA, the Corporate Affairs Commission established the Administrative Proceedings Committee (the Committee) responsible for resolving disputes or grievances arising from the CAMA's operations. The decisions of the Committee are appealable to the Federal High Court.

Constitutionally, the Committee cannot hear or determine matters within the exclusive jurisdiction of the Federal High Court. On 18 April 2023, the Federal High Court in Suit No. FHC/ABJ/CS/1076/2020 – *Emmanuel Ekpenyong v National Assembly et al* declared section 851 of the CAMA, establishing the Committee void for being inconsistent with section 251(1)(e) of the Constitution.

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 laws conferring jurisdiction on the Federal High Court to hear and determine insolvency claims are:

- the Constitution;
- the Federal High Court Act 1973 (as amended); and
- the CAMA.

The Federal High Court's jurisdiction does not differ with respect to domestic and cross-border matters. In appropriate cases, for instance, Nigerian courts will enforce final and conclusive foreign judgments awarding monetary claims against insolvent Nigerian debtors. Nigerian courts are specifically empowered to do this based on the principles of reciprocity established under the Foreign Judgments (Reciprocal Enforcement) Act 1961 and the Reciprocal Enforcement of Foreign Judgments Ordinance 1922.

Limitation periods

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

There is no specific limitation period for instituting insolvency proceedings. The applicable limitation period depends on the claim and the statutory period stipulated for the underlying claim that came into existence prior to and outside insolvency under pertinent statutes and procedural laws. Actions founded on contract or quasi-contract cannot be brought after a period of six years from the date on which the cause of action accrued. After the expiration of 12 years from the date on which the cause of action accrued, action must not be brought to recover:

- a sum due to a company by a shareholder under the articles of association of the company;
- land; or
- a principal sum of money secured by a mortgage or other charge.

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?

Orders of injunction are preservatory remedies commonly used in insolvency proceedings. Such orders may last until either:

- the end of the proceedings, once the other side has been given notice of and heard by the court on the motion for the order; or
- on an emergency basis, the other side can be given notice and heard by the court (interim and interlocutory injunctions, respectively).

A debtor typically seeks the orders as part of a strategy to buy time and delay being declared insolvent or to stop or delay the sale of assets (where the debtor contends that it, in fact, owes nothing or owes less than it is alleged to owe), or when the collateral would otherwise be sold at an undervalue.

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 Evidence Act 2011 (as amended by the Evidence (Amendment) Act, 2023) and the Federal High Court (Civil Procedure Rules) 2019 are the main laws that govern the collection, admissibility, and disclosure of evidence to the court. Other laws may also apply, such as the Stamp Duties Act 1939 (as amended) (according to which a document that should be, but is not, stamped cannot be admitted as evidence in court).

The testimony of an expert witness may be required when the court must form an opinion on which the evidence of an expert is needed. Nigerian insolvency law itself is law, not fact, and therefore no question about it can be submitted to a witness, expert or not.

Common evidential issues that the claimants must take into consideration fall into two broad groups. One group includes issues as to the admissibility of documents that are not original, are public or stored on computers. Nigerian law tends to allow photocopies of private documents only where it can be shown that the original is lost and unobtainable. Public documents are admissible only to the extent that true copies certified by a public authority can be presented in court. Evidence stored on computers is allowed only to the

extent that the storage device is certified to be functioning properly and has not been tampered with.

The second group of issues pertains to the burden and standard of proof. Under Nigerian law, the burden is on the claimant and there must be proof on the 'balance of probabilities' test. Exceptionally, where claims involve allegations of dishonesty, proof beyond reasonable doubt is required.

Time frame

9 What is the typical time frame for insolvency claims?

The typical duration of an insolvency proceeding from the commencement of the insolvency action to final judgment (including winding-up proceedings) is up to three years, depending on the complexity of the matter.

Appeals

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

A notice of appeal must be filed within 14 days from the date of an interlocutory decision, and within three months from the date of a final judgment, if it challenges a final judgment. The decision of the Court of Appeal can be appealed to the Supreme Court within 30 days as of right and, after 30 days, with the leave of either the Court of Appeal or the Supreme Court. Where the appeal is against an interlocutory decision of the Court of Appeal, it must be filed within 14 days from the date of such decision.

Most appeals to the Court of Appeal, whether final or interlocutory, take more than 18 months to resolve. This period is at least doubled for the typical appeal from the Court of Appeal to the Supreme Court.

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 cost of insolvency proceedings is awarded at the discretion of the court on a case-by-case basis and, in practice, at rates that are heavily below real-world rates. The object of awarding costs in Nigeria is not to punish the unsuccessful litigant but to compensate, nearly always inadequately, the successful party for the time and expenses spent on having to come to court.

There are no specific codes and regulations on third-party funding in Nigeria. Third-party funding of claims is generally frowned upon based on established and existing common law principles prohibiting champerty and maintenance. There are, however, exceptions

of still-evolving scope to this position including, but not limited to, bona fide commercial assignments of the benefits of contracts and other arrangements, and permissible contingent fee arrangements between legal practitioners and their client.

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?

There are two broad rules, one grounded on fraud and the other on undervaluation.

For an action to clawback a fraudulent conveyance to succeed, the following conditions must be fulfilled:

- the conveyance must have:
    - had the effect of giving an undue advantage to the company's creditors or guarantors (for instance, by concluding the conveyance at a highly undervalued price); and
    - been entered into less than three months prior to the time of the presentation of a petition for winding up or the passing of a resolution for winding up; and
- the action must have been instituted after the company went into liquidation or administration.

A transfer made without fraudulent intent may be reversed based on the undervaluation of the transfer, where it was entered into by the company within two years of an administrator being appointed or of the company going into liquidation. However, such a transfer will be saved where it was made in good faith and for the purpose of carrying on the business of the company. If the transfer is not saved, the court will make such orders as it deems necessary to restore the company to the position where it would have been had it not made the transfer.

Thus, 'reversals for fraud' differ from 'reversals for undervalue' in the following ways:

- reversals for fraud must be brought in relation to a transaction entered into with the company's creditor, surety or guarantee, while undervalue actions are not restricted in this manner;
- a reversal for fraud may succeed even where the conveyance was made for full value, while the reversal for undervalue rule does not apply to a transfer that is made for full value; and
- the reversal for fraud rule applies only to conveyances entered into less than three months from the onset of insolvency, whereas the reversal for undervalue rule applies only to transfers made less than two years from the onset of the insolvency.

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 essential elements for the avoidance of clawback transactions based on preference are that the transaction must have:

- put one of the creditors or guarantors in a position of undue advantage; and
- taken place in the period of three months ending with the time of the beginning of the winding up.

The transaction will be declared invalid by the court upon the satisfaction of the above-listed elements.

Liens and floating charges

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

A floating charge on a company's undertaking or property created within three months of the commencement of the winding-up proceeding is void unless it can be proven that the company was solvent immediately after the charge was created. There are no specific provisions under Nigerian law for avoidance actions on liens on properties acquired – as distinct from charges, whether fixed or floating – and the general law applies. A charge will be void against the liquidators and creditors of a company where the charge is not registered with the Corporate Affairs Commission.

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 litigated in compliance with the Federal High Court (Civil Procedure) Rules 2019, the Companies Proceedings Rules 1992 and the Companies Winding-up Rules 2001. Under Rule 2 of the Companies Proceedings Rules 1992, all applications brought pursuant to Companies and Allied Matters Act 2020 (as amended), except for winding-up applications, must be initiated by an originating summons.

This is the procedure that is ordinarily employed in avoidance actions, and it contemplates the submission of documentary evidence with no oral examination of witnesses. Where the facts are in dispute, a writ of summons will be the appropriate document to file. Under proceedings initiated by a writ of summons, it is anticipated that witnesses will be examined orally.

Some of the procedural issues that often arise include:

- the extent to which the proper mode for instituting the action was followed;
- the standing of the claimant to sue; and
- the lack of formally correct service of the originating papers on the debtor.

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 essential elements of a claim aiming to remedy an alleged breach of fiduciary duty are:

- proof of a breach of duty; and
- proof of economic loss suffered by the claimant.

The most obvious fiduciary duties are:

- compliance with the mandate
- diligence
- loyally acting in the company's best interests (including the avoidance of conflicts of interest and secret profits)
- care and skill
- keeping and disclosing accounts
- honesty
- confidentiality

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?

Nigerian law does not impose strict liability for economic loss caused by a director or an officer. To be held liable, the director will also need to have:

- exceeded their literal mandate;
- acted without care and skill or with dishonesty; or
- otherwise violated one or more of the fiduciary duties.

Moreover, the law does not impose collective liability (each person is liable only for their own breach). However, the law imposes higher standards of care and skill on directors and officers than on other employees. The law also allows companies to provide liability insurance cover for directors and officers.

No provision in the company's memorandum and articles of association or contracts can relieve a director or an officer from liability. Any provision of the articles of association or contract that stipulates otherwise is void.

There are general law rules that limit the extent to which officers and directors may be sued. For example, statutes of limitation bar common law money claims after five or six years, depending on the limitation law of the state where the cause of action in question arose (Nigeria has 36 states and a federal capital territory), and equitable claims are subject to the doctrines of laches and acquiescence.

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 can be re-characterised by the liquidator in the event of insolvency, without a need for a formal procedure. Except for fraud or a sham transaction or any debts mandatorily preferred by law, and to the extent that shareholders give credit to the company, they will rank equally with other creditors.

Illegal dividends

19 Can dividends received by shareholders be prosecuted as illegal?

Yes, dividends paid illegally and received by a shareholder (for example, dividends paid out of capital rather than profits) can be recovered using civil remedies, even where the payee has received the dividends in good faith. Criminal sanctions will apply where the payment was made not only illegally but also in bad faith.

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?

Once a company winds up or goes into administration or receivership, the directors' power to run the business of the company ceases. During a winding-up process, any person who knowingly carries on the business of the company in a reckless manner or with intent to defraud creditors, or for any fraudulent purpose, may be declared by the court as personally responsible, without any limitation of liability for all or any of the debts or other liabilities

of the company. Such a person commits an offence and is liable on conviction to a fine or imprisonment for a term of two years, or both, as the court deems fit. They may also be liable to make whatever contributions the court deems proper to the company's assets. The main elements of a successful claim are that the person:

- knowingly carried on the business while the company was winding up; and
- acted in a reckless manner, with intent to defraud creditors or towards a fraudulent aim.

Equitable subordination

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

There is no equitable subordination of shareholder's claims in Nigeria in the US-law sense. Shareholders' claims rank behind those of creditors, but the claims of one creditor will not be subordinated to those of another simply because the former also happened to be a shareholder.

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?

Trustees, liquidators, administrators and receivers (trustees) can sue officers, directors and shareholders (who also happen to be debtors of the company). Trustees can sue to 'lift the veil' of incorporation where there has been fraud or a transaction for private benefit rather than for the sake of the company.

These claims are typically for the breach of fiduciary duty to, or breach of contract with, the company. (A shareholder is not a fiduciary ipso facto, even where it has a majority of the shares.) There are no special mechanisms or elements for trustees to raise or prevail on such claims.

Before insolvency, a shareholder may, in exceptional circumstances where the board is unwilling to act, act on behalf of the company to derivatively sue errant directors, shareholders and officers. Once insolvency begins, the right to start or continue a derivative action passes to the trustee, since that right belongs to the company and not to the shareholder.

Risk mitigation

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

Internal investigations, mediation and early settlement are tools that shareholders and sponsors widely use to mitigate the risk of being sued when the company becomes insolvent. Other strategies include:

- appointment of risk officers and consultants by the company prior to the onset of insolvency to develop and nurture policies to address risk;
- providing regular training to guide the directors and officers to observe good governance practices; and
- giving directors and officers information only on a strict need-to-know basis.

Among the good governance practices are for directors and officers to always make disclosure and recuse themselves whenever there is a semblance of a conflict of interest, ensuring that they contract with the company only where they can do so clearly on arm's-length terms.

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 can sue to challenge a restructuring plan on the grounds that it is either unfair or that the procedural steps set out in the legislation have not been followed. By statute, the court must be 'satisfied as to the fairness of the plan'. The key procedural steps needed are that:

- at least 75 per cent of the creditors must have approved of the plan; and
- the court must have sanctioned it.

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?

Creditors may apply for winding-up orders where the company:

- is unable to pay its debts as they come due; or
- passes a resolution for voluntary wind-up and the creditor petitions that the wind-up should proceed under the supervision of the court.

The laws governing these actions are:

- the Companies and Allied Matters 2020 (as amended);

- the Companies Winding-up Rules 1992;
- the Federal High Court Act 1973 (as amended); and
- the Federal High Court (Civil Procedure) Rules 2019.

Under the Companies and Allied Matters 2020 (as amended), the inability to pay debts as they come due is critical. Under the Companies Winding-up Rules 1992, the critical factors are that the resolution to wind up has been passed and the presentation of a petition that the wind-up be conducted under the supervision of the court.

For a debtor to successfully defend an action, it must dispute the fact that a resolution has been passed for the voluntary winding up of the company. These actions will be resolved in favour of the party that can prove its claims.

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?

In Nigeria, the general primary effect of insolvency procedures (except for receivership) is that once commenced, they stay the creditors' actions against the company. During winding up or liquidation, no action or proceeding can progress or be commenced against the company except by leave of the court.

For companies in administration, the consent of the administrator or the court is required for legal proceedings by a creditor to be continued or instituted. Any petition for the winding up of a company will also be dismissed or suspended on the commencement of an administration.

However, the appointment of a receiver or a receiver-manager does not stay creditor collection actions. Therefore, a company under receivership must continue with the cases against its creditors.

The stay of creditor collection actions will be lifted where:

- the creditor obtains leave from the court or administrator to proceed with the action;
- a claim is brought that the administrator is:
    - acting or has acted so unfairly as to harm the interests of the applicant; and
    - proposes to act in a way that unfairly harms the interests of the creditors; or
- a claim is brought that the insolvency procedure is not effective or as quick as reasonably practicable.

Stays of proceedings – strategy

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

Creditors navigate stays through:

- exercising rights of set-off;
- acting swiftly to achieve advantages in fact before the onset of insolvency (eg, getting factual control of disputed assets);
- seeking and obtaining partial lifting of stays from courts or trustees; and
- pursuing their claims expeditiously before the trustees.

Stays of proceedings – effect on emergence from insolvency

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

The stay gives the company the opportunity to resolve its financial difficulties by exploring restructuring models; if successful, the company can recover. Creditor claims may also be amicably negotiated and resolved. This is more possible in the case of an administration where the purpose is not to bring an end to the business of the company, but to ensure that it continues as a going concern.

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?

Courts are empowered to punish creditors' bad acts or inequitable conduct to the extent that estoppel, negligence, delay, fraud and other reprehensible conduct are grounds for denying or curtailing equitable relief (eg, injunctions), both in insolvency and outside it.

Vote designation

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

No. However, courts are empowered to punish creditors' bad acts or inequitable conduct to the extent that estoppel, negligence, delay, fraud and other reprehensible conduct are grounds for denying or curtailing equitable relief (eg, injunctions), both in insolvency and outside 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?

Trustees (such as liquidators and administrators) are empowered to pursue claims brought before insolvency against shareholders and their affiliates and agents, even during insolvency proceedings. The same rules that ordinarily apply before insolvency persist after insolvency.

Procedure and resolution

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

The procedural mechanisms and issues are the same as those that apply prior to insolvency: compliance with the regular court acts and civil procedure rules.

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?

It is the trustees who generally pursue pre-insolvency debtor claims.

Risk mitigation for creditors

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

Creditors should take steps to ensure that provisions governing stays of pre-insolvency claims are complied with and enforced. Creditors can:

- set off their claims;
- adopt amicable settlement of the claims; and
- ensure that priority clauses are in their favour and are upheld and complied with.

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 fixed procedure through which creditors can reduce the costs of litigation associated with pre-insolvency claims against them. However, based on the power of the

liquidator and administrator to compromise all claims and remedies against a person liable to the company, creditors can enter into negotiations leading to amicable resolutions of claims. By resolving these claims out-of-court, parties can reduce the associated expenses of litigation. Similarly, alternative dispute resolution options other than negotiation can be explored by the creditors.

Another option available to creditors is ensuring that sufficient due diligence is conducted before advancing a loan to a company to help identify whether there are any indications that, in the future, the company may be unable to pay its debts and must initiate insolvency proceedings by opening its creditors to the possibility of pre-insolvency claims. Creditors can also use terms of contract to ensure that their priority is retained in the event of insolvency and subsequent insolvency claims.

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?

Trustees are generally at liberty to sue creditors even when insolvency is ongoing. They have powers to disown or cease to perform onerous contracts and other obligations, and thereby compel the counterparty to sue in insolvency.

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?

Parallel proceedings are not permitted under the Nigerian legal system. The court will dismiss the more recently filed case where two cases are on the same subject and between the same parties. Courts regularly do this on the ground that filing and prosecuting the more recent case is an abuse of court process.

Foreign money judgments are generally recognisable and enforceable in Nigeria. In principle, the legal regimes for the enforcement of foreign judgments are stipulated in:

- the Reciprocal Enforcement of Judgments Ordinance 1922 (the Ordinance);
- the Foreign Judgments (Reciprocal Enforcement) Act 1961 (the Act); and
- the common law.

For now, in practice, the only applicable regimes are the Ordinance and the common law. This is because the order required to make the provisions of the Act operative has not yet been made by the Minister for Justice.

Under the Ordinance, money judgments of the High Court of England and a number of former British colonies may be enforced in Nigeria upon an application brought by a judgment creditor within 12 months from the date of the judgment. The practice under the common law is for a judgment creditor to file an action in Nigeria for the enforcement of a judgment of a foreign country with the foreign judgment as the cause of action.

The recognition of foreign judgments may be challenged on the following grounds:

- the foreign court had no jurisdiction to try the case;
- the judgment debtor did not receive notice in time to enable it to defend the proceedings and did not appear in court;
- the judgment was obtained by fraud; and
- the enforcement of the judgment would be contrary to Nigerian public policy.

Judicial cooperation

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

The legal system in Nigeria recognises foreign insolvency only in part. Where the insolvent is a Nigerian entity, applicable Nigerian law will govern the insolvency process throughout the country. However, Nigerian law does recognise and enforce foreign claims and judgments. In contrast, where the entity is foreign, the insolvency process will be regulated by the applicable laws of the foreign country where the entity is domiciled.

Nigeria has neither acceded to nor otherwise passed into law the contents of the UNCITRAL Model Law on Cross-Border Insolvency 1997. Insolvency provisions under Nigerian law apply only to companies incorporated in the country.

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 legal remedies broadly available to successful debtor-claimants include damages, specific performance, declarative and injunctive reliefs, rectification, rescission, set-off and judicial sale.

Remedies for creditors

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

The legal remedies available to successful creditor-claimants include specific performance, damages, accounting, injunctions, declarations, company wind-up, appointment of trustees, restitution, out-of-court sale of assets to enforce claims, judicial orders to sell assets to satisfy creditors, set-off and the setting aside or rescission of the transaction. In *Dematic (Nig) Ltd v Utuk* (2022] 8 NWLR (Pt 1831) 71, the Supreme Court of Nigeria recognised the right of a creditor to restrain the company from acting ultra vires and to enforce rights that are personal to him or her.

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 rulings can be enforced by way of the attachment and sale or other realisation of goods, receivables, other intangibles and land belonging to the insolvent, as well as committals to prison where the debtor is recalcitrant. The courts can also make declarations and order persons who are subject to its jurisdiction to do specific acts even where the asset in question is abroad (for example, injunctions and specific performance orders to sell or transfer assets).

SETTLEMENT AND MEDIATION

General court approach

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

Yes, the courts are amenable to settlement at every stage of the proceedings. Indeed, rules of civil procedure encourage and empower judges to grant the parties time to explore the amicable settlement of their disputes. When parties settle out-of-court, the terms of settlement may be entered as consent judgments of the court.

Timing

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

In many cases, settlement is explored before substantive claims are tried or heard, rather than afterwards.

Court review and approval

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

Courts ordinarily do not review the terms of settlements voluntarily entered into by the parties unless the terms are illegal. Where there is evidence of fraud, duress or misrepresentation, the court will set aside the terms of settlement. Unless any of the vitiating elements are present and brought to the attention of the court, courts in Nigeria rarely conduct a detailed study of the terms of settlement agreed to by the parties.

Mediation clauses

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

Courts in Nigeria enforce mandatory and voluntary mediation clauses in contracts. They also stay proceedings to enable the parties to explore mediation. Rules of civil procedure have provisions on how disputes can be amicably resolved using alternative dispute methods, including mediation.

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?

Among the most notable developments in insolvency litigation in recent times in Nigeria are the enactment of the Companies and Allied Matters Act 2020 (as amended) (CAMA) and the Insolvency Regulations 2022.

The CAMA enhances business recovery and rescue by providing for the restructuring of insolvent companies. This is a fundamental change of approach from the previous statute. New set-off and netting regimes have also been introduced recently for insolvency in qualified financial contracts and administration, similar to the US. This manner of administration is aimed at either recovering the company from its financial problems or securing a better result for creditors than would have been obtainable if the company had gone straight to wind-up.

Section 705 of the CAMA sets out the categories of persons qualified to act as insolvency practitioners in Nigeria. In addition to other requirements, persons will be qualified to act as insolvency practitioners only if they are certified members of the Business Recovery

and Insolvency Practitioners Association of Nigeria. Persons can also qualify as insolvency practitioners if they are members of any professional body recognised by the Corporate Affairs Commission (eg, a chartered accountant).

Other notable developments are the immunising provisions introduced by amendments to the Asset Management Corporation of Nigeria (AMCON) Act 2010 on tracing the hidden funds of debtors. They allow AMCON to commence debt recovery actions at the supposedly fast-track Special Tribunal for the Enforcement and Recovery of Eligible Loans. It remains to be seen how effective the recent changes are in practice. Also, there are discussions by the Federal Government of Nigeria to wind up the affairs of AMCON.

Finally, the recent decision of the Federal High Court in Suit No. FHC/ABJ/CS/1076/2020 – *Emmanuel Ekpenyong v National Assembly et al* is also a notable development. In this case, the Federal High Court held that section 851 of the CAMA that established the Administrative Proceedings Committee (the Committee) and vested the powers to resolve disputes arising from the operations of the CAMA on the Committee is inconsistent with section 251(1)(e) of the Constitution that vests the exclusive jurisdiction over disputes arising from the CAMA on the Federal High Court. To that extent, the Federal High Court struck down section 851 of the CAMA for being inconsistent with the provisions of the Constitution.

Abubakar Anafi abubakar.anafi@gelias.com
Kanzullahi Hibatullahi kanzullahi.hibatullahi@gelias.com
Favour Ogini favour.ogini@gelias.com
Khadijah Abdulwahab khadijah.abdulwahab@gelias.com

G Elias

South Korea

Sangjae Lee, **Sukjae Hong**
Bae, Kim & Lee LLC

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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 Korea, insolvency litigation cases that frequently arise in practice are as follows:

- application for a decision in claim allowance proceedings (decision) to seek the allowance of unsecured rehabilitation claims, secured rehabilitation claims or bankruptcy claims, and lawsuit objecting to such decision (judgment);
- avoidance action (claim for avoidance, lawsuit objecting to a decision, lawsuit for avoidance);
- immediate appeal relating to rehabilitation proceedings (immediate appeal against a decision on commencement of rehabilitation proceedings or dismissal of an application for commencement of rehabilitation proceedings, or on confirmation of a rehabilitation plan); and
- lawsuit of objection against distribution or lawsuit for restitution. If the rehabilitation proceedings are discontinued and converted to bankruptcy proceedings after the confirmation of a rehabilitation plan, a lawsuit objecting to distribution or a lawsuit for restitution is filed with respect to the amount distributed to a secured rehabilitation creditor in the procedures for an auction of the collateral.

In Korean rehabilitation proceedings, upon commencement of repayment according to a rehabilitation plan under the Debtor Rehabilitation and Bankruptcy Act (DRBA), the debtor is to be emerged from the rehabilitation proceedings in principle (early emergence from rehabilitation proceedings). Provided, however, that if an immediate appeal against the decision confirming the rehabilitation plan is pending, certain courts tend to be prudent in rendering a decision on the debtor emerging from rehabilitation proceedings and, in some cases, unsecured or secured rehabilitation creditors or shareholders, etc, file an immediate appeal against the decision confirming the rehabilitation plan with an intent to delay the debtor emerging from the rehabilitation proceedings.

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 key source that forms the basis of claims in Korean insolvency proceedings is the Civil Act, especially the law of obligations (Civil Act, Part III – Claims). There are not many claims that arise in the course of insolvency proceedings, and the most frequently occurring cases are disputes over the law of obligations, which governs the causes resulting in unsecured or secured rehabilitation claims or bankruptcy claims.

Procedure

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

In Korea, insolvency proceedings include rehabilitation proceedings (equivalent to Chapter 11 of the US Bankruptcy Code), reorganisation-type procedures and bankruptcy proceedings (equivalent to Chapter 7 of the US Bankruptcy Code), and liquidation-type procedures. These proceedings are governed by the DRBA, the Enforcement Decree of the DRBA, the Rules on Debtor Rehabilitation and Bankruptcy, and the practical rules of each court. If there is no applicable provision in the DRBA, the Civil Procedure Act and the Civil Execution Act apply mutatis mutandis. The types of insolvency litigation that commonly arise in practice are an application for decision in claim allowance proceedings and a lawsuit for objection to the decision (explained below), an avoidance action, an immediate appeal relating to rehabilitation proceedings, a lawsuit for objection to distribution and a lawsuit for restitution.

Rehabilitation proceedings include the inspection procedures to review and allow the existence of, details of and causes for the unsecured or secured rehabilitation claims to be noted in the list of unsecured or secured rehabilitation creditors submitted by the trustee, and the claims filed by these creditors (to the court) and the authenticity of the amount thereof. The inspection procedures are commenced based on an objection filed by the trustee or the unsecured or secured rehabilitation creditors, etc, during the inspection period or in the special inspection hearing.

With respect to the unsecured or secured rehabilitation claims to which an objection has been filed, the claimant who holds the claims may file an application for a decision in claim allowance proceedings against all the objectors within one month of the last day of the inspection period or the special inspection hearing. The purpose of a decision in claim allowance proceedings is to determine the existence and scope of the unsecured or secured rehabilitation claims to which an objection has been filed in simplified and prompt 'decision' procedures (rather than litigation procedures, which are lengthy and costly).

Anyone who is dissatisfied with a decision in claim allowance proceedings may file a lawsuit objecting to such decision within one month of the date of service of the written decision thereon.

The procedures for a lawsuit objecting to such decision are identical to those for general civil cases from the first instance trial to a trial on appeal (the first instance trial, appellate trial and the final appellate trial of a lawsuit objecting to a decision in claim allowance proceedings are held).

It is understood that the procedures for bankruptcy proceedings are the same as the above proceedings except for the submission by the trustee of the list of bankruptcy creditors (ie, in the bankruptcy proceedings, the trustee is not required to submit the list of bankruptcy creditors).

Courts

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

The Seoul Bankruptcy Court, the first specialised insolvency court in Korea, was established on 1 March 2017 to meet the national demand for a specialised court to handle insolvency cases based on the recognition that there is a constant need for the restructuring of debtors due to a rapid increase of insolvency cases. The Seoul Bankruptcy Court is acknowledged to have jurisdiction over corporate entities with liabilities of 50 billion won or more against 300 creditors or more as well as debtors whose principal office or place of business is located in Seoul. Once a judge is assigned to Seoul Bankruptcy Court, he or she handles insolvency and relevant civil cases for a minimum of three years, which enhances the expertise.

In general, a decision in claim allowance proceedings is handled by the judicial bench that handles rehabilitation and bankruptcy cases, and the judges are expected to have a good understanding of the issues relating to insolvency. The first instance of a lawsuit objecting to a decision in claim allowance proceedings is subject to the exclusive jurisdiction of the court where the rehabilitation or bankruptcy case is pending. In the case of district courts other than Seoul Bankruptcy Court, the civil division (not the bankruptcy division) handles such lawsuits.

There are several types of avoidance actions, including claims for avoidance and lawsuits objecting to such decisions, and lawsuits for avoidance. Claims for avoidance and lawsuits for avoidance are subject to the exclusive jurisdiction of the court where the rehabilitation or bankruptcy case is pending, and the judges are expected to have a good understanding of issues relating to insolvency. The first instance trial of a lawsuit objecting to a decision of avoidance and the appellate trial of a lawsuit for avoidance are handled by the civil division (not the bankruptcy division), in the case of district courts other than Seoul Bankruptcy Court.

An immediate appeal trial against a decision on commencement of rehabilitation proceedings, dismissal of the application for commencement of rehabilitation proceedings or confirmation of a rehabilitation plan is submitted to the civil division of the court superior to the court where the rehabilitation case is pending.

A lawsuit objecting to distribution is handled by the civil division.

Jurisdiction

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

Whether a court has jurisdiction to hear insolvency claims is determined under the DRBA (or the Civil Procedure Act or the Civil Execution Act, if there is no relevant provision in the DRBA).

The DRBA has adopted an egalitarian approach, which ensures that foreigners and foreign entities are not discriminated against and meets the principle of universality by acknowledging the exercise by foreign creditors of their rights in insolvency proceedings.

Therefore, we believe that the jurisdiction of the court is not affected by whether a creditor is a foreigner or foreign entity. The latter will be able to exercise their rights in claim allowance proceedings and in lawsuits for objection to judgments, avoidance actions, immediate appeals relating to rehabilitation proceedings or lawsuits for objection to distribution, etc.

Limitation periods

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

The limitation periods for claims are 10 years for civil claims and five years for commercial claims.

In the case of rehabilitation claims (secured and unsecured), a creditor may suspend the limitation period by participating in the rehabilitation proceedings by means of being noted in the list of unsecured or secured rehabilitation creditors submitted by the trustee or filing its report of unsecured or secured rehabilitation claims. In the case of bankruptcy claims, a creditor may suspend the limitation period by participating in the bankruptcy proceedings by means of filing its report of bankruptcy claims. Provided, however, that the limitation period is not suspended upon withdrawal by the creditor or dismissal of such filing.

If a rehabilitation plan is confirmed in rehabilitation proceedings, the limitation period for the unsecured or secured rehabilitation claims recognised under the provisions thereof is extended to 10 years.

After confirmation of a rehabilitation plan, the remaining limitation period for unsecured or secured rehabilitation claims is suspended. It will be resumed if a decision on discontinuation or emergence from rehabilitation proceedings becomes final and conclusive.

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?

To our knowledge, there are no interim remedies in Korean rehabilitation or bankruptcy proceedings.

Unsecured rehabilitation claims are mostly claims on property arising for any cause that occurred prior to the commencement of rehabilitation proceedings, and secured rehabilitation claims are rehabilitation claims secured by any security interest established on the debtor's property at the time of commencement of rehabilitation proceedings. Bankruptcy claims are mostly claims on property arising for any cause that occurred prior to the declaration of bankruptcy.

In principle, no repayment may be made with respect to unsecured or secured rehabilitation claims after the commencement of rehabilitation proceedings except as set forth in the

rehabilitation plan. No bankruptcy claim may be exercised without resorting to bankruptcy proceedings.

In case of unsecured or secured rehabilitation claims, 'when a small and medium business entrepreneur who is the counterparty to the debtor is likely to face hardship in the continuation of his/her business unless he/she receives the repayment of a small-sum claim that he/she holds' or 'when it is recognised that the repayment of unsecured or secured rehabilitation claims is necessary for the rehabilitation of the debtor', the court may grant approval to pay back such small-sum claim (DRBA, article 132). However, as such cases are exceptional, we find it difficult to strategically use such approval for repayment in insolvency litigation.

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 rehabilitation or bankruptcy cases, as the court may conduct a necessary inspection ex officio as set forth in the DRBA (the principle of judicial investigation), it may also conduct an inspection of evidence ex officio with respect to any materials not submitted by the relevant party. A strict verification process is not required in any lawsuit for a decision in claim allowance proceedings or immediate appeal cases relating to rehabilitation proceedings.

However, only the materials collected and submitted by the parties can be used for pleadings and underlie the trial (pleading principle) in lawsuits objecting to a decision in claim allowance proceedings, lawsuits objecting to a decision of avoidance, lawsuits for avoidance or lawsuits objecting to distribution conducted outside the insolvency proceedings.

In rehabilitation cases, an accounting firm must be appointed as an examiner to file an examiner's report after conducting an investigation on the matters concerning the property of the debtor, such as the value thereof, the going concern value and the liquidation value. The appraised value in the examiner's report is significant in that it serves as a basis to establish a plan for repayment of unsecured or secured rehabilitation claims under the rehabilitation plan, and the opinion of an expert examiner is respected unless it goes against the facts.

It is not common for an expert to give testimony in insolvency litigation as a witness. An appraisal firm is sometimes appointed to appraise the value of the collateral in a lawsuit objecting to a decision in claim allowance proceedings with respect to secured rehabilitation claims.

Time frame

9 What is the typical time frame for insolvency claims?

The time frame for insolvency claims differs for each case.

Decisions in claim allowance proceedings and claims for avoidance are simplified and, therefore, are made in a relatively short period of time. This in contrast to pleading procedures, which require a lot of time and money. However, as the procedures for a lawsuit objecting to a decision in claim allowance proceedings, a lawsuit objecting to a decision of avoidance, a lawsuit for avoidance and a lawsuit objecting to distribution, etc, are identical to those for general civil cases, it is our understanding that it will take the same amount of time as required for civil cases.

Appeals

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

Any party objecting to a judgment or a decision may file an appeal. However, the winning party may not be able to appeal even if it is not satisfied with the reasoning of the judgment.

Any party objecting to a decision in claim allowance proceedings or claims for avoidance may file a lawsuit for objection thereto within one month of the date of service of the decision thereof.

As the procedures for a lawsuit objecting to a decision in claim allowance proceedings, a lawsuit objecting to a decision of avoidance and a lawsuit for avoidance are identical to those for civil cases from the first instance to a trial on an appeal, the objecting party is required to file an appeal within two weeks of the date of service of the first instance judgment or within two weeks of the service of the judgment of the court of appeal.

An immediate appeal must be filed (1) within 14 days of the date of announcement of a decision on commencement of rehabilitation proceedings, (2) within one week of the date of service or notification of a decision on dismissal of an application for commencement of rehabilitation proceedings, or (3) within 14 days of the date of announcement of a decision on confirmation of a rehabilitation plan. A re-appeal against a decision of immediate appeal must be filed within one week of the date of service.

In case of a lawsuit objecting to distribution, an objection to distribution must be filed at the hearing of distribution and documents evidencing the filing of the lawsuit must be submitted to the court of execution within one week therefrom.

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?

In principle, the costs incurred in a rehabilitation or bankruptcy case are to be borne by the creditor and the debtor, respectively. The court may render an order that the costs incurred for the appointment of experts, as required for the activities of the creditors' council, shall be borne by the debtor.

It is not impossible for unsecured or secured rehabilitation creditors or bankruptcy creditors to obtain third-party funding with respect to confirmation of claims, but to our knowledge there has been no case of this. Unsecured or secured rehabilitation claims held by financial institutions are frequently bundled up and sold off as non-performing loans to a special purpose company established by an asset manager.

If an unsecured or secured rehabilitation creditor or a bankruptcy creditor is successful in claim allowance proceedings, a lawsuit for objection to such decision, an avoidance action, an immediate appeal relating to rehabilitation proceedings or a lawsuit objecting to distribution, it will seek the payment of the costs of litigation, including the lawyers' fees (up to the amount set forth by the Supreme Court Regulations), stamp costs and service charges, from the losing party as set forth in the relevant judgment or decision with respect to the payment of litigation costs.

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?

Fraudulent conveyances and transfers may be subject to avoidance actions. The essential elements of avoiding intentionally fraudulent acts are as follows:

- as an objective requirement, there should be an act that is detrimental to the unsecured or secured rehabilitation creditors or bankruptcy creditors; and
- as a subjective requirement, the debtor should be aware that such act is detrimental to the rehabilitation creditors or bankruptcy creditors at the time of the act.

Notwithstanding the satisfaction of the above requirements, if the beneficiary (the counterparty to the act) did not know that the act would be detrimental to the unsecured or secured rehabilitation creditors or bankruptcy creditors the act cannot be subject to avoidance.

We believe that where the debtor did not intend to engage in fraudulent conveyances and transfers by exercising the avoiding power on the grounds of bargain sale of its property, such action should constitute gratuitous avoidance. The requirements for gratuitous avoidance are as follows:

- as an objective requirement, the act performed by the debtor should be a gratuitous act or act for consideration that can be deemed identical to the former; and
- as a temporal requirement, the act should be performed by the debtor after or within six months of (or within one year before, if the counterparty is a specially-related person) the suspension of payment, or filing an application for commencement of rehabilitation proceedings or bankruptcy.

In other words, upon any bargain sale of the debtor's property, gratuitous avoidance is acceptable only if the consideration contributed by the counterparty as a benefit in return is so insignificant that the sale is no better than a gratuitous act.

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?

Preference is subject to avoidance of transfer in crisis with respect to any act that constitutes the debtor's obligations. The requirements for such avoidance are as follows:

- as an objective requirement, the act should be related to an act detrimental to unsecured or secured rehabilitation creditors or bankruptcy creditors, or an act of furnishing any security interest or extinguishing any debt;
- as a temporal requirement, the act should be performed by the debtor after the suspension of payments or filing an application for commencement of rehabilitation proceedings or bankruptcy; and
- as a subjective requirement, the beneficiary should be aware of the suspension of payments or filing an application for commencement of rehabilitation proceedings or bankruptcy at the time of the act.

Furthermore, preference may be subject to avoidance of an intentionally fraudulent act. The requirements for such avoidance are as follows:

- as an objective requirement, there should be an act that is detrimental to unsecured or secured rehabilitation creditors or bankruptcy creditors; and
- as a subjective requirement, the debtor should be aware that such act is detrimental to unsecured or secured rehabilitation creditors or bankruptcy creditors at the time of the act.

Notwithstanding the satisfaction of the above requirements, if the beneficiary (the counterparty to the act) did not know that such act would be detrimental to the unsecured or secured rehabilitation creditors or bankruptcy creditors the act cannot be subject to avoidance.

Liens and floating charges

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

The requirements for avoidance of perfection of establishment, transfer, alteration of rights (including notification or consent relating to registration of real property), delivery of movable assets, transfer of claims or establishment of the right pledge, are as follows:

- as an objective requirement, an act of establishing, transferring or altering of rights should be performed by the debtor;
- as a temporal requirement, the act of perfecting rights, etc, should be performed after 15 days have lapsed from the date of establishment, transfer or alteration of rights (the date of effectuation of the act of cause); and
- as a subjective requirement, the beneficiary should be aware of the suspension of payments or filing of an application for commencement of rehabilitation proceedings or bankruptcy at the time of the act.

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?

A trustee may exercise the avoiding power as a means of filing a claim for avoidance, a lawsuit for avoidance or an affirmative defence. No unsecured or secured rehabilitation creditors or bankruptcy creditors may exercise the avoiding power by subrogation, and the court may only order a trustee to exercise the avoiding power at the request of any unsecured or secured rehabilitation creditor or bankruptcy creditor, or ex officio.

In many cases, an unsecured or secured rehabilitation creditor or bankruptcy creditor will file an application with the court for an order to have the trustee exercise its avoiding power. There seems to be no tendency to resolve avoidance actions; it depends on the circumstances of each case.

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?

If a corporate debtor becomes subject to a decision on commencement of rehabilitation proceedings or is declared bankrupt, the court may, at the request of the rehabilitation trustee or ex officio, render a decision in claim allowance proceedings. It will determine the existence and details of the right to seek damages based on the responsibility of directors, if deemed necessary.

The right to seek damages arises when a director of the debtor engages in any misconduct intentionally, conducts any act in violation of the laws or the articles of incorporation or neglects to perform his or her duties, or breaches contract due to failure to perform a delegation contract rather than being liable for a tort.

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 business judgement rule is applicable. If a director collected and reviewed necessary information sufficiently and made a business judgement in good faith with a reasonable belief that the decision would be to the benefit of the company based on the foregoing, and the decision is not substantially unreasonable, even if the decision caused damage to the company afterwards, the director's act is within the scope of his or her discretion in making a business judgement. Therefore, the director does not bear any liability for damage to the company. If the director engages in any act in violation of the laws, the business judgement rule is not applicable.

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?

In rehabilitation proceedings, any unsecured or secured rehabilitation claims can be converted into equity as set forth in the rehabilitation plan, and in cases where the principles of equity are not undermined even if creditors are differentiated (on the grounds of liability for poor management or any torts such as embezzlement or malpractice). Any claims held by a specially-related person may be treated adversely as compared to any other rehabilitation claims, and, therefore, it is possible to set forth conversion of claims into equity in entirety.

It is our understanding that there is no method whereby any particular unsecured or secured rehabilitation claims can be recharacterised as equity in rehabilitation or bankruptcy proceedings other than being set forth in a rehabilitation plan.

Illegal dividends

19 Can dividends received by shareholders be prosecuted as illegal?

Under the Debtor Rehabilitation and Bankruptcy Act (DRBA), after the commencement of rehabilitation proceedings, the debtor is prohibited from distributing profits or interest without resorting to a rehabilitation plan until the discontinuation of rehabilitation proceedings or emergence from the proceedings thereof.

In practice, a rehabilitation plan specifies that no profit will be distributed to any shareholder until the termination of rehabilitation proceedings in accordance with the DRBA. There is no regulation on criminal penalties for any act in violation of the foregoing, but distributing profits to shareholders prior to the discontinuation or emergence is in violation of the DRBA.

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?

It is common to conduct business in the course of rehabilitation proceedings and reorganisation-type procedures. However, it is prohibited, in principle, to conduct new business in the course of bankruptcy proceedings and liquidation-type procedures, though the court may grant approval to do so in exceptional circumstances.

Commercial transaction creditors usually enter into an executory contract with the debtor at the time of commencement of rehabilitation proceedings or declaration of bankruptcy against the debtor, and the DRBA grants the authority to elect to perform or terminate the executory contract to the debtor's trustee. If the trustee elects to perform the contract, the claims held by a commercial transaction creditor (counterparty to the executory contract) against the debtor constitute common benefit claims, and, therefore, such claims may be repaid from time to time without resorting to a rehabilitation plan or bankruptcy proceedings. If the trustee elects to terminate the executory contract, the commercial transaction creditor (counterparty to the executory contract) may exercise the right to damages as a rehabilitation or bankruptcy creditor.

In rehabilitation proceedings, a trustee may elect to perform or terminate the executory contract prior to the end of the interested parties' meeting held to review the proposed rehabilitation plan, and in bankruptcy proceedings, there is no limit to the period during which the trustee may exercise such option. The commercial transaction creditor as the counterparty to the executory contract may demand the trustee to confirm whether to perform or terminate the executory contract.

Provided that the DRBA grants the above option to a trustee, a commercial transaction creditor as the counterparty to the contract has no other choice but to persuade the trustee to elect to perform the contract by convincing the trustee of the necessity for continued performance thereof for business.

Equitable subordination

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

Under the DRBA, upon commencement of rehabilitation proceedings due to an act substantially attributable to any director of the debtor company, the rehabilitation plan shall include that the capital is to be reduced by retiring not less than two-thirds of shares held by the shareholders and specially-related persons who have exercised substantial influence over the act, or by consolidating not less than three shares into one share. Upon confirmation of the rehabilitation plan, the capital is reduced on a differential basis as set forth therein.

Sometimes, the shares of the controlling shareholders and specially-related persons who have exercised influence over poor management are retired in entirety, in consideration of:

- the purpose of the DRBA;
-

the degree of the liability of the shareholders and specially-related persons; the property value of the shares of the debtor, the debtor's financial condition;

- the debt-equity swap ratio for unsecured or secured rehabilitation creditors; and
- the remaining shareholding ratio of the shareholders and specially-related persons after the punitive capital reduction.

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?

To our knowledge, no other claims are commonly brought against shareholders, directors and officers. Any shareholder responsible for poor management is subject to disadvantages through differentiated treatment of claims under a rehabilitation plan or capital reduction on a differential basis, etc.

Risk mitigation

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

Even in the case of a controlling shareholder, if such a shareholder is responsible for poor management, they will be treated differentially under a rehabilitation plan. There is a possibility, however, that the shareholder will not be treated differentially if they successfully convince the court of the fact that they were not responsible for poor management by collecting evidentiary materials prior to the confirmation of rehabilitation.

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?

Under the Debtor Rehabilitation and Bankruptcy Act (DRBA), any creditors who object to a rehabilitation plan may vote against such plan at the interested parties' meeting held to resolve the matter. Notwithstanding such objection, if the rehabilitation plan is approved and confirmed by the court, such creditors may file an immediate appeal against the decision on confirmation of the rehabilitation plan. In such case, the creditors will assert that at least one of the requirements for confirmation of the rehabilitation plan as set forth below was not sufficiently satisfied and the debtor will assert, in defence, that there is no issue with the requirements for confirmation:

- the rehabilitation plan shall conform to the provisions of the DRBA;
- the rehabilitation plan shall be fair, equitable and feasible;
- the rehabilitation plan shall be resolved on the basis of good faith and fairness; and
- according to the rehabilitation plan, repayment methods shall be geared towards making repayments more advantageous than they would be if made to each creditor when the debtor's business is liquidated.

If the immediate appeal is found to have merit, in principle, the decision on the confirmation of the rehabilitation plan will be revoked and remanded to the original court by the appellate court. However, sometimes, the appellate court renders a decision on confirmation of the rehabilitation plan with additional clauses for protection of the rights of objecting creditors instead of revoking the confirmation decision in view of the social and economic effects of the revocation thereof. If the immediate appeal is found to have no merit, the appeal is dismissed and any objecting party may file a re-appeal with the Supreme Court.

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?

Under the Commercial Act, a creditor may file an application for an order to wind up a company. The creditor should refer to at least one of the following reasons set forth in the Commercial Act as the reason for the winding-up order: where the company was incorporated for an illegal purpose; where the company, without good cause, failed to commence its business within one year of its establishment or discontinued its business for one year or more; or where a director or a member managing the affairs of the company violated the laws or the articles of incorporation of the company, as a result of which it is deemed impermissible for the company to continue its existence.

If a company receives a winding-up order, the court appoints a liquidator and the liquidation procedures are commenced. The duties to be performed by a liquidator under the Commercial Act include winding up pending affairs; collecting debts and repaying obligations; disposing of assets for realisation; and distributing residual property. Upon completion of the liquidation duties, the liquidation process comes to a close and the corporate personality of the company ceases to exist.

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?

In Korean insolvency proceedings, as a secured or unsecured rehabilitation creditor is prohibited from exercising their right individually without resorting to rehabilitation proceedings while such proceedings are pending, no compulsory execution or preservative

measure can be newly conducted and any ongoing procedures are suspended. While bankruptcy proceedings are pending, no bankruptcy creditor may exercise his or her right individually; however, a security interest holder may exercise their right to foreclose outside bankruptcy, irrespective of the bankruptcy proceedings.

Stays of proceedings – strategy

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

Upon commencement of insolvency proceedings, it is prohibited to exercise rights individually and, therefore, creditors will make efforts to preserve their rights and maximise the repayment of claims by participating in insolvency proceedings.

Stays of proceedings – effect on emergence from insolvency

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

The prohibition on individual exercise of rights is required to maximise the interest of multiple creditors and proceed with insolvency proceedings efficiently by preventing creditors and other interested persons from exercising their rights indiscreetly and preserving the debtor's property.

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?

In rehabilitation proceedings, when it is deemed that any unsecured or secured rehabilitation creditor with a voting right has acquired his or her right for the purpose of making unfair gains, including the giving and taking of property benefits in exchange for any resolution, considering the time the right is acquired, the price that has been paid and other circumstances, the court may render a decision prohibiting them from exercising their voting right.

Commonly in rehabilitation and bankruptcy proceedings, if the debtor conducts any act, makes any repayment or provides any security interest with the knowledge that such an act will undermine the equality of the creditors prior to the commencement of the insolvency proceedings, the trustee may avoid (invalidate) the effects of such act and seek to recover the wrongfully taken property through a lawsuit after the commencement of the rehabilitation or bankruptcy proceedings. The court may order the trustee to exercise its avoiding power. As a result of the avoiding power being exercised, the property will be restituted to the debtor and the creditor will recover their original creditor status. However, as the purpose of the avoiding power is to reinstate the debtor's property to its original

state before the act subject to avoidance is conducted, only the act subject to avoidance is invalidated, and the claims of the creditor are not treated subordinately (as compared to other claims) or invalidated.

In rehabilitation proceedings, it is possible to treat the claims held by the existing management, controlling shareholders or other specially-related persons that have influenced the poor management of the debtor differentially by subordinating them to other creditors in repayment under a rehabilitation plan.

Vote designation

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

If a creditor has acted in bad faith, the court may render a decision prohibiting him or her from exercising his or her voting right.

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?

In Korean insolvency proceedings, the authority to manage and dispose of the debtor's property is exclusively vested in the trustee in rehabilitation proceedings or after the declaration of bankruptcy. Therefore, if any specially-related person, such as a shareholder or affiliate, or director, bears liability to the debtor, the trustee has a duty to exercise due diligence to hold him or her to account. The trustee may proceed with any civil and criminal procedures as required.

If any director or executive of the debtor bears liability for contributions or damages to the debtor, in both rehabilitation and bankruptcy proceedings, it is possible to obtain a decision in claim allowance proceedings to hold the director or executive to account promptly. The trustee has the obligation to commence the above proceedings to confirm the liability of the director or executive and the court may commence the proceedings ex officio.

The examiner appointed at the time of commencement of rehabilitation proceedings should conduct an examination and file a report with the court with respect to whether the controlling shareholders, etc, are part of the cause resulting in filing an application for commencement of rehabilitation proceedings and whether there exists the right to seek damages against the director or executive, etc.

Procedure and resolution

32 |

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

If any specially-related person, such as a shareholder or affiliate, or director, bears liability to the debtor, the trustee has a duty to exercise due diligence to hold him or her to account. The trustee may proceed with any civil and criminal procedures as required.

If any director or executive of the debtor bears liability for contributions or damages to the debtor, the trustee has the obligation to commence claim allowance proceedings to confirm the liability of the director or executive. The court may commence the proceedings ex officio.

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 the course of rehabilitation proceedings or after the declaration of bankruptcy, the authority to manage and dispose of the debtor's property is exclusively vested in the trustee and, therefore, the authority to exercise pre-insolvency debtor claims is vested in the trustee. If the trustee refuses to exercise its authority, the other creditors or shareholders may consider requesting the court to order it to do so.

Risk mitigation for creditors

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

To our knowledge, creditors do not have any special method to mitigate such risk other than actively responding to the relevant lawsuit or making a settlement judicially or extrajudicially.

Minimising costs for creditors

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

In Korean insolvency proceedings, there are no special litigation procedures that can be used by creditors to reduce the costs of litigation with respect to pre-insolvency debtor claims. If a creditor wins a relevant lawsuit, he or she may seek the payment of the costs of litigation, including the lawyers' fees (up to the amount set forth by the Supreme Court Regulations), stamp costs and service charges, from the losing party as set forth in the relevant judgment or decision with respect to the payment of litigation costs.

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?

The Debtor Rehabilitation and Bankruptcy Act (DRBA) sets forth a regime whereby foreign insolvency proceedings can be recognised in Korea, subject to obtaining court approval. An application for approval of the proceedings must be filed with the court and the following requirements must be met:

- the documents required under the law should be submitted and the establishment and contents thereof must be acknowledged as bona fide;
- the expenses required for the procedures should be paid to the court; and
- approving the international insolvency proceedings should not be contrary to the public morals and social order of Korea.

Korean courts generally approve foreign insolvency proceedings unless there is an issue – for example, where the proceedings do not substantially guarantee the participation therein by creditors, or certain creditors are adversely treated under the insolvency plan in the proceedings without any evident grounds.

Before making such decision, the court may render an order, at the request of the representatives of the foreign insolvency proceedings or ex officio, for supportive measures, such as:

1. suspension of a lawsuit involving the debtor's business and property;
2.

suspension or prohibition of compulsory execution, an auction for the exercise of security interest or preservation procedures; or

3. prohibition of the disposal of the debtor's property.

In addition to the measures set forth in points (1) to (3), the court may take the following supportive measures at the time of, or after, rendering a decision approving the foreign insolvency proceedings at the request of an interested person or ex officio:

- appointment of international bankruptcy trustees; and
- other supportive measures necessary to preserve the debtor's business and property and to protect the interest of creditors.

If domestic and foreign insolvency proceedings for the same debtor are pending simultaneously, the Korean court will attempt to make an adjustment by taking appropriate supportive measures with a focus on the domestic insolvency proceedings.

Judicial cooperation

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

Under the DRBA, the court shall cooperate with any foreign court and the representative of foreign insolvency proceedings with respect to the following matters to ensure the smooth and fair execution of domestic insolvency proceedings, foreign insolvency proceedings or multiple foreign insolvency proceedings that are ongoing over the same debtor and other debtors related to the former:

- exchange of opinion;
- management and supervision of the debtor's business and property;
- coordination of the progression of multiple proceedings; and
- other necessary matters.

For the purpose of such cooperation, the court may exchange information or opinions directly with any foreign court or the representatives of foreign insolvency proceedings. The trustee in the domestic insolvency proceedings may also exchange information or opinions or make a settlement on adjustment directly with any foreign court or the representatives of the international insolvency proceedings under the supervision of the court.

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 trustee may proceed with any and all civil and criminal proceedings necessary for debtor-claimants regardless of any procedures. Furthermore, in both rehabilitation and bankruptcy proceedings, if any director or executive of the debtor bears liability for contributions or damages to the debtor, it is possible to obtain a decision in claim allowance proceedings to hold the director or executive to account promptly. For the purpose of securing the above claim of the debtor, the court may render an order for preservative measures with respect to the property of the director or executive.

Remedies for creditors

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

If an application for commencement of rehabilitation proceedings is filed, the court may issue preservative measures prohibiting the debtor from making repayment of debts with an aim to prevent dissipation of property. In practice, preservative measures are issued in most cases. Upon commencement of rehabilitation proceedings subsequently, the debtor may not repay any unsecured or secured rehabilitation claims without resorting to a rehabilitation plan or obtaining approval from the court, and repayment of any common benefit claim in an amount exceeding that determined by the court is also subject to approval from the court.

If an application for bankruptcy is filed, the court may issue preservative measures prohibiting repayment of debts. If the trustee violates such a measure, he or she may have to bear liability for damages.

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 court exercises the right to make a decision on the main aspects of insolvency proceedings, including the commencement, progression and termination thereof.

The Debtor Rehabilitation and Bankruptcy Act (DRBA) recognises, in principle, the external effects of domestic insolvency proceedings and the internal effects of foreign insolvency proceedings. Thus, the authority to manage and dispose of the debtor's property covers any property located in a foreign country. Provided, however, that to bring such property into Korea, the external effects of domestic insolvency proceedings should be recognised under the insolvency law of the foreign country.

SETTLEMENT AND MEDIATION

General court approach

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

Korean courts tend to respect the result of the settlement made by the parties in civil lawsuits. Generally, various regimes, including compromise, mediation and arbitration, are used. For instance, if a settlement is made on waiver of claims extrajudicially, any lawsuit filed contrary thereto is dismissed, and if a judicial compromise is made, the lawsuit is closed without resorting to a judgment.

Even in insolvency litigation, like other civil litigation, various regimes, such as compromise and mediation, can be used in a lawsuit objecting to a decision in claim allowance proceedings, a lawsuit objecting to a decision of avoidance, a lawsuit for avoidance, a lawsuit objecting to distribution and a lawsuit for restitution, etc, which are proceeded with as civil litigation proceedings, and the courts will show the tendency of respecting the result of the settlement made by the parties. If a debtor subject to rehabilitation or bankruptcy proceedings intends to close a lawsuit by a settlement with the opposing party, the debtor's trustee should obtain prior approval from the court where the rehabilitation or bankruptcy proceedings are pending.

However, in claim allowance proceedings in the course of insolvency litigation proceedings under the Debtor Rehabilitation and Bankruptcy Act (DRBA), if the parties reach an agreement on the amount of claims, the debtor will withdraw the objection and the applicant will withdraw the application. Furthermore, any appeal relating to rehabilitation proceedings is a judicial proceeding with respect to a court decision, not a structure of conflict between two parties, and, therefore, such an appeal cannot be closed by a settlement between the parties.

Timing

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

If the litigation proceedings can be closed by a settlement made by the parties, such proceedings can be closed by a settlement in the entire course thereof. However, a final appeal, being an examination of legal applications, is rarely closed by a settlement, and a settlement is usually made in the course of the first trial and appeal case, being fact-finding proceedings.

Court review and approval

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

In the case of a compromise made extrajudicially (a compromise contract under the Civil Act), there is no restriction on the methods used based on the liberty of contract, and if a settlement is made on a waiver of claims, any lawsuit contrary thereto will be dismissed. A judicial compromise is a proceeding established with a court participating therein and if a compromise is made, such compromise has the same effects as those of a definite judgment and the lawsuit is closed without resorting to a judgment.

Court-supervised mediation is presided over by a judge or a mediator appointed by the court and is established by describing the matters agreed by the parties in the mediation protocol.

There is no particular legal standard for approval of a settlement by the court where rehabilitation or bankruptcy proceedings are pending, and the court will make a decision in view of the necessity for the settlement and its legality, and the contents of the settlement agreement.

Mediation clauses

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

Even upon commencement of rehabilitation or bankruptcy proceedings, as long as pre-existing contracts are effective, the parties are required to comply with the mediation clauses thereof. However, upon commencement of Korean insolvency proceedings, the debtor and creditors are procedurally bound by the insolvency proceedings; therefore, even if a substantive decision has been made with respect to the existence of claims and the details thereof in accordance with the mediation clauses, to exercise such claims in Korean insolvency proceedings, claim allowance proceedings should be conducted. The claims will be repaid in accordance with the rehabilitation plan or distribution will be made in bankruptcy proceedings.

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?

There are no updates at this time.

Sangjae Lee sangjae.lee@bkl.co.kr
Sukjae Hong sukjae.hong@bkl.co.kr

Bae, Kim & Lee LLC

Read more from this firm on Lexology

Spain

Óscar Franco Pujol, **Roberto Muñoz Rojo**, **Eduardo García**
Latham & Watkins LLP

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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 or 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 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 voidance, 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

34

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

.

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 Actestablish 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.

LATHAM & WATKINS LLP

Óscar Franco Pujol oscar.franco@lw.com
Roberto Muñoz Rojo roberto.munoz@lw.com
Eduardo García eduardo.garcia@lw.com

Latham & Watkins LLP

United Kingdom

Jessica Walker, **Oliver Browne**, **Jonathan Akinluyi**, **Robin Spedding**
Latham & Watkins LLP

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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:

-

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

.

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.

LATHAM & WATKINS LLP

Jessica Walker jessica.walker@lw.com
Oliver Browne oliver.browne@lw.com
Jonathan Akinluyi jonathan.akinluyi@lw.com
Robin Spedding robin.spedding@lw.com

Latham & Watkins LLP

USA

Suzzanne Uhland, **Andrew Sorkin**, **Jonathan Gordon**, **Liza Burton**
Latham & Watkins LLP

Summary

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims
Procedure and resolution
Standing and assignment of claims
Risk mitigation for creditors
Minimising costs for creditors

OTHER CLAIMS

Other claims against creditors
Other claims against debtors

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments
Judicial cooperation

REMEDIES AND ENFORCEMENT

Remedies for debtors
Remedies for creditors
Court enforcement mechanisms

SETTLEMENT AND MEDIATION

General court approach
Timing
Court review and approval
Mediation clauses

UPDATE AND TRENDS

Recent developments

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?

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 prefiling 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 andany 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.

LATHAM & WATKINS LLP

Suzzanne Uhland suzzanne.uhland@lw.com
Andrew Sorkin andrew.sorkin@lw.com
Jonathan Gordon jonathan.gordon@lw.com
Liza Burton liza.burton@lw.com

Latham & Watkins LLP