NO.11 IV/2006

INTERNATIONAL CASELAW-ALERT

27 AUGUST 2006

NEW CASELAW ON THE EUROPEAN INSOLVENCY REGULATION AND FROM COUNTRIES HAVING ENACTED UNCITRAL MODEL LAW ON CROSS BORDER INSOLVENCY

Dear colleagues,

The new International Caselaw Alert informs you about recent developments and trends in international and cross-border insolvencies and restructurings.

Our database at

www.eir-database.com

now contains more than 150 cases. Thanks to the great help by Prof.Bob Wessels, we were able to complete our list of caselaw by a great number of cases. The additional cases will be online soon.

This is the first Alert issued on the **new bi-monthly basis.** Please feel free to further contribute articles on cross-border insolvency and restructuring issues.

Our thanks go to all contributors, but for this issue in particular Natasha Watson, Annemari Õunpuu, Swati Patel, Prof.Jean-Luc Vallens, Prof.Adrian Walters, Dr.Nikolaus Arnold, Nick Hood, Mark Fennessy and Marc Fritze.

We would welcome your comments and/or suggestions to help us continuously improve the database. Furthermore any case comments or English translation of foreign court orders are greatly appreciated.

The next issue (No.12) of the Alert will be mailed end of October 2006. Deadline for submissions is October 15.

Prof. Heinz Vallender
Prof. Adrian Walters
Gordon W. Johnson
Chris Laughton
Michael Martinez Ferber

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Natasha Watson

LIST OF NEW CASELAW ADDED TO THE DATABASE

134 High Court of Justice Chancery Division Companies Court 09.06.2006 [Collins & Aikman III]

135 Cour de Cassation 27.06.2006 [Daisytek France]

136 Higher Regional Court of Dresden 07.02.2006 [Prohibited Trading]

137 Regional Court of Kiel 20.04.2006 [Duties of a Ltd.-Director to file for Insolvency in Germany]

138 Estonia High Court 06.03.2006 [Recognition of Swedish Proceedings]

139 Regional Court of Hamburg 18.08.2006 [Right of appeal if proceedings have been initiated in another Member State]

140 Regional Court of Salzburg 05.08.2004 [COMI in Austria]

141 Higher Regional Court of Linz 07.09.2004 [Territorial Proceedings in Austria]

142 Higher Court of Justice Austria 13.11.2002 [Transaction Avoidance Claims]

143 High Court of Justice Chancery Division 15.11.2005 [Distribution of assets in cross-border proceedings (DAEWOO)]

144 Court of Appeal 11.04.2006 [Worldwide freezing order (Dadourian Group Int. v. Simms]

145 Tallinn District Court 14.06.2006 [Secondary Proceedings Estonia]

146 District Court of Hamburg 09.05.2006 [COMI of a UK incorporated Ltd. in Liquidation]

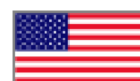
147 Privy Council 16.05.2006 [Judicial Assistance in US Chapter 11 [Cambridge Gas]

148 Grand Court of the Cayman Islands 12.05.2006 [Parmalat Cayman Islands]

149 Paris Court of Appeal 09.09.2005 [Banque Le Crédit du Nord}

150 Supreme Court Commercial Section France 21.03.2006 [Khalifa Airways]

151 Regional Court of Szeged 20.04.2006 [Presentation to the ECJ: transfer of legal seat]



17. U.S. Bankruptcy Court for the Eastern District of Michigan 24.05.2006—Recognition of Proceedings opened in Germany [Alpha-200 GmbH & Co. KG aka Erwin Behr GmbH & Co. KG]
18. U.S. Bankruptcy Court for the District of Hawaii (Honolulu) 13.06.2006—Recognition of Proceedings opened in Japan [Katsumi Iida]
19. U.S. Bankruptcy Court for the Southern District of New York 08.06.2006-Recognition of Proceedings opened in Bermuda [Hatteras Reinsurance Ltd.]
20. U.S. Bankruptcy Court District of Arizona (Phoenix Division) 09.06.2006—Recognition of Proceedings opened in Canada [Mackenzie E. Bowell]
21. U.S. Bankruptcy Court District of Minnesota (Minneapolis) 30.05.2006—Recognition of Proceedings opened in Canada [Norshield Asset Management (Canada) Ltd., et.al.]
22. U.S. Bankruptcy Court Nothern District of Illinois (Chicago) 05.07.2006—Recognition of Proceedings opened in Canada [Quebec, Inc.]
23. U.S. Bankruptcy Court for the Southern District of New York 07.06.2006—Recognition of Proceedings opened in the Cayman Islands [Sphinx Strategy Fund Ltd.]

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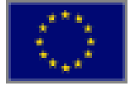


MANAGEMENT CHANGE—THE LAST RESTRUCTURING TABOO

NICK HOOD

Bringing effective restructuring techniques to the developing parts of the Asia Pacific region means having to face many challenges. Some of the legislative regimes are still sadly lacking despite encouraging efforts at modernisation, with no provision for a moratorium and a dependence on the endgame procedure of liquidation. Where there are more flexible laws, the lack of judicial capacity, experience and independence can be a severe obstacle.

There is rapidly growing interest by specialist rescue funders and other investment sources in the greater opportunities and better returns on offer by comparison with the West's over-fished and fiercely competitive market. But government restrictions and overt nationalism can put off even the most aggressive hedge fund, no matter how desperate they are to find a productive home for their excess liquidity.

Professional capacity is another issue, not least delivering it at a price considered affordable in the lower cost base parts of the region. Selling in the value added concept can be difficult. We have all learnt to steer discussions away from headline hourly or daily rates and we try instead to stress the net benefit that can be achieved for stakeholders. Success-related fees are now popular, but can be dangerous in such an uncertain environment, especially if they are based on some complex set of measures of what has been achieved.

But probably the greatest battle to be fought is to create widespread acceptance of the principle that without management change, few restructurings will succeed. The extent of resistance to what the West holds as a self-evident truth is quite staggering. Efforts to get this problem onto the agenda at conferences and seminars in the Asia Pacific region are treated with a polite but firm disinterest, which is really a cover for a fundamental fear of opening this Pandora's Box of business cultural change.

Even the biggest enterprises tend to be family-owned in most jurisdictions, notably and most importantly in India. Those that are not will be either government controlled, or else considered to be of such strategic economic importance, that the real management influence lies outside the boardroom.

Nick Hood

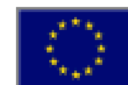
Begbies Traynor

London, UK

But this is a fight, which must be won if the region is to see its dead weight of non-performing assets put to more productive use. Research in Europe shows clearly that management change is one of the most effective tools in the restructuring professional's kit-bag, coming second only behind asset reduction as a successful strategy in turning round under-performing businesses.

Without management change, it is next to impossible to make the operational improvements that are vital to bringing the struggling business safely through its difficulties. It is not just that the existing management team may have glaring gaps in its skill sets, or be riddled with under-performers. Much worse is the obstruction and delay that their continued involvement will inevitably bring to the process of creating a new and more effective management style and ethos. And they are highly unlikely to be good at managing change within the business.

Cynics might suggest that cost concerns should rarely be a sustainable argument against change, simply because a common characteristic of the management of failing businesses is their determination to pay themselves way above prevailing market rates for even the most experienced and effective replacements. Sadly, such simple economics do not apply in family companies, because remuneration packages tend to reflect lifestyle considerations which owners prefer not to restrict. But with careful negotiation, packages can be trimmed in return for the expectation of preserving shareholder value, or more likely restoring some of what has been lost.



In owner-managed family enterprises, there is also a potent psychological blurring of proprietorial and management behaviour patterns. Giving up day to day operational control is seen as abandoning a family's heritage, wealth, and future prospects, not to mention a betrayal of family honour. Fear of loss of face within tight-knit communities gets in the way of taking pragmatic commercial decisions in times of financial stress.

But a fundamental skill in the restructuring game is practising the art of the possible, so we need to be realistic about how we tackle the management change conundrum in the region.

It will inevitably be a long time before the sort of slash and burn policies now so common in restructuring assignments in the US and Europe will be acceptable in Asia Pacific, with the wholesale replacement of senior staff and the ousting of even quite promising managers in favour of the outsiders who are grizzled veterans of turnarounds. Many would say that they might never become so.

Instead we should consider using more subtle techniques to bring about management change, whilst also recognising one other key factor.

The breakdown in the ties of loyalty between owner-managers and their workforce is now common in the affluent, envy-driven societies we have developed in the West. Such mistrust and loss of respect is unusual in Asia Pacific, where the family business is so often a community business as well, providing all sorts of peripheral benefits to workers and their families. The results of a badly-handled and enforced management change programme can be devastating on productivity just when this is least welcome. Unlike in the West, throwing reassurances, money and incentives at the confused workforce is unlikely to work, simply because their worries are so much more fundamental.

So restructuring professionals must polish up their "soft skills" and achieve management revitalization by consensus and careful negotiation. A little careful use of "smoke and mirrors" techniques can be very effective, making real change seem like no more than a re-alignment of responsibilities.

One possibility is selling in the new management as additions to the team, rather than direct replacements, and as experts who bring specialist skills, which can be demonstrated to be important to profit improvement. Articulate explanations of the cost/benefit equation must be given, to show that they will not be a net cost to the business.

This still leaves the problem of still having the old management around. Sadly, we cannot always be as lucky as on one recent assignment in the region where an unexpected new romance for an intransigent owner manager so utterly distracted the individual that they lost all interest in their business, allowing a complete overhaul of the management team to be carried out without any protest.

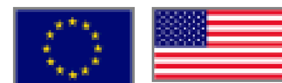
The trick is to re-define management roles to take the old guard away either from direct involvement in decision-making or into areas more suited to their abilities. For example, assigning them the responsibility for ongoing communication with the workforce might be beneficial, provided that clear parameters are set and the inter-actions are carefully monitored.

Very often, their general responsibilities have side-tracked family managers from the tasks at which they excel. With careful prompting, they may be extremely glad to be allowed to shed those other responsibilities to be able to concentrate once more on their strengths. These are usually focussed in building, maintaining and developing relationships with key partners in the business, whether they are customers, suppliers or other stakeholders. Their continued involvement in this aspect will reassure these partners, always provided that their deal-making authority is subject to appropriate limits.

What is often forgotten is that the management of a struggling business have come to hate the role into which the crisis has pushed them. Their decision-making has been paralysed by the fear of making matters worse, or simply because they have no experience of dealing with cash flow pressures and angry creditors. The relief when they are persuaded to step aside and let others who revel in change and dynamic situations take control is astonishing, but not so surprising.

There will be much practical psychology in getting managers to realise all of this. The best possible outcomes happen when they can be persuaded to think that the change was really their idea in the first place. We should not imagine that this will be easy, but for professionals who believe we are so good at manipulation and mediation, it should not be impossible.

It also pays to start by promising the previous family management some element of consultation about the actions of the new team. Unlike with professional managers in the Western model, they will still be around even if they no longer have any significant day-to-day responsibilities.



Good restructuring plans usually depend on a great deal of ongoing communication in every conceivable direction, so why would you exclude the previous owner managers?

So we should not be frightened of confronting the great management change taboo. Instead we must be pragmatic about it, deal with any opposition firmly but constructively and find innovative ways to leave the side-lined owner managers of the region with some dignity.

Otherwise we will all be guilty of accepting a severe limitation on our ability to deliver successful restructuring. We will simply be practising financial engineering and those painfully re-organised balance sheets will be eaten away by the fundamental business issues we failed to tackle because the management got in our way. However difficult management change may be, the developing parts of Asia Pacific deserve much better from us.

JUDICIAL ASSISTANCE UNDER THE COMMON LAW -

CAMBRIDGE GAS TRANSPORT CORPORATION V THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF NAVIGATOR HOLDINGS PLC (PRIVY COUNCIL, 16TH MAY 2006)

PROF.ADRIAN WALTERS

Facts

A group of companies registered in the Isle of Man operated a shipping business. The group was financed by loans raised on the New York bond market. The group filed for Chapter 11 protection in the United States (Southern District of New York). The bond holders did not support the plan of reorganization put forward by the debtor in possession. They proposed a rival plan under which the creditors' committee would acquire the shares in the Isle of Man parent company ("Navigator") thus extinguishing the claims of Navigator's shareholders. The New York court confirmed the bond holders' plan. The bond holders asked the High Court of the Isle of Man to recognize the confirmed Chapter 11 plan and assist them in giving effect to its terms. Navigator's principal shareholder, a Cayman registered company ("Cambridge"), resisted the application in the Isle of Man courts and the matter came on appeal to the Privy Council.

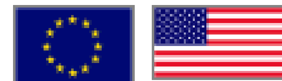
Cambridge's grounds of opposition to recognition

Cambridge argued that the order confirming the Chapter 11 plan could not affect its property rights in the Isle of Man as it had never submitted to the jurisdiction of the bankruptcy court in New York. This was, at best, a technical argument as Navigator's Chapter 11 filing was voluntary and Cambridge was clearly a party in interest. Nevertheless, the Isle of Man High Court found as a fact that Cambridge as a legal entity had not submitted to the jurisdiction of the New York court.

Adrian Walters

Professor, Nottingham University, UK

Cambridge's objection to recognition was developed further by reference to general principles of English private international law concerning the recognition of judgments *in rem* and judgments *in personam*. A judgment *in rem* only affects property within the court's territorial jurisdiction. Here the order purported to affect property rights derived from Isle of Man law. A judgment *in personam* only binds parties in respect of whom the court has jurisdiction. It had been found as a fact, however, that Cambridge had not submitted to the jurisdiction of the New York court. It was submitted that, on either analysis, there was no basis for recognition under the common law.



Decision of the Privy Council

The Privy Council held that the New York proceedings should be recognized and the assistance requested by the bond holders granted. The reasoning was as follows:

1. The New York proceedings were bankruptcy proceedings and the New York court's order was neither a judgment *in rem* nor a judgment *in personam*. Judgments *in rem* or *in personam* are judicial determinations establishing the existence of rights. Bankruptcy proceedings, by contrast, provide "a mechanism of collective execution against the property of the debtor by creditors whose rights are admitted or established". The issue before the court therefore concerned the principles of private international law applicable to foreign bankruptcy proceedings rather than foreign judgments.

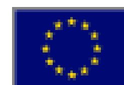
2. The common law has traditionally favoured universality of bankruptcy: a single bankruptcy proceeding in which all creditors may prove rather than a multiplicity of parallel bankruptcy proceedings. This is given effect in the context of corporate insolvency "by recognizing the person who is empowered under the foreign bankruptcy law to act on behalf of the insolvent company as entitled to do so in England". This was sufficient to confer jurisdiction on the Manx court to recognize the Chapter 11 proceedings and assist the bond holders in giving effect to the plan. There were no creditors who would be treated any more favourably under Manx law and no other grounds for the court to withhold assistance as a matter of its discretion.

3. The Privy Council expressed doubts whether, at common law, the English (or here, Manx) court could provide assistance in a form that involved applying foreign insolvency law. In this respect, the assistance available to foreign office holders at common law is therefore narrower than that which can be provided by the English court under section 426 of the Insolvency Act 1986. However, at common law, "the domestic court must at least be able to provide assistance by doing whatever it could have done in the case of a domestic insolvency" so as to avoid the need for parallel proceedings.

   The bond holders could have achieved the same outcome as that contemplated in the confirmed plan by bringing winding up proceedings against Navigator in the Isle of Man and then proposing a statutory scheme of arrangement (equivalent to a scheme under section 425 of the English Companies Act). A scheme of arrangement in respect of an insolvent company which extinguished the rights of shareholders who had no remaining economic interest in the company would certainly be sanctioned by the court as a matter of domestic law. Accordingly, the court should give the assistance requested rather than put the bond holders to the trouble and expense of separate proceedings in the Isle of Man.

Comment

This case clearly fell outside the scope of both the European Insolvency Regulation and section 426 of the Insolvency Act 1986. It also predated the coming into force of the Cross-Border Insolvency Regulations 2006 (which implement the UNCITRAL Model Law in Great Britain). It illustrates the point that there may still be cases which fall to be decided on general principles of private international law. The decision is important because it modifies the approach traditionally taken to questions of recognition and assistance at common law. It is clear that recognition and assistance are no longer conditional on the foreign bankruptcy proceedings taking place in the corporate debtor's place of incorporation. It is interesting to consider how the English courts might approach a Chapter 11 case involving a company registered in England and Wales under the Model Law. Clearly, in those circumstances, the court would have to resolve the threshold question of whether the Chapter 11 proceedings were "foreign main" or "foreign non-main". Nevertheless, it is suggested that if the facts were otherwise identical to the facts of the *Cambridge Gas* case, the English court could reach the same outcome as that engineered by the Privy Council using its powers to grant relief under Article 21.



TALLIN DISTRICT COURT'S JUDGEMENT OF 14 JUNE 2006 IN THE MATTER OF COMPANY S'S PETITION TO OPEN SECONDARY PROCEEDINGS REGARDING COMPANY R AB (CASE NO.145)

ANNEMARI ÕUNPUU

Company R AB is registered in commercial registry of Sweden. R AB's branch office is located in Tallinn, Estonia and registered in commercial registry kept by Tallinn City Court. Company R AB's economic activity concerned transport of oil through Estonia. R AB owns land (registered immovable) in Estonia and has one employee. R AB's sole shareholder and only board member Mr Niit lives in Tallinn. R AB has neither assets, employees nor economic activities in Sweden.

On 8 October 2004 debtor company R AB filed a petition at the Rapla County Court in Estonia to open main insolvency proceedings. On 9 December 2004 Rapla County Court initiated bankruptcy proceedings, appointed a provisional liquidator [Estonian Bankruptcy Act uses the term „ajutine pankrotihaldur", which is translated in the English version of the Bankruptcy Act as „interim trustee in bankruptcy". Duties of the interim trustee in bankruptcy include 1) determining the assets of the debtor; 2) assessing the financial situation and solvency of the debtor; 3)ensuring preservation of the debtor's assets and 4) giving or refusing to give a consent to the disposal of the debtor's assets if the court has prohibited the debtor from disposing the assets without the consent of the interim trustee (see Estonian Bankruptcy Act § 22 http://www.legaltext.ee/et/andmebaas/ava.asp?m=022). According to the Article 2(b) of the EIR "liquidator" shall mean any person or body whose function is to administer or liquidate assets of which the debtor has been divested or to supervise the administration of his affairs. Those persons and bodies are listed in Annex C. "Ajutine pankrotihaldur" is appointed temporarily prior to the declaration of bankruptcy and he is listed in Annex C. In the present summary I will refer to „ajutine pankrotihaldur" as the "provisional liquidator" as I believe this is the best umbrella term to describe liquidators in Annex C who are appointed temporarily prior to the opening of insolvency proceedings.] and set the time of the court hearing for the hearing of the bankruptcy petition. (Bankruptcy proceedings are "opened" in two stages in Estonia. First the court initiates bankruptcy proceedings and appoints a provisional liquidator. In the second stage the court will decide whether to declare the debtor bankrupt or not. Estonian Bankruptcy Act is available in English at http://www.legaltext.ee/et/andmebaas/ava.asp?m=022)

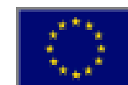
Annemari Õunpuu

Legal Consultant, Harju County Court, Estonia

Meanwhile creditor company TNK had filed a petition at Stockholm City Court to open main insolvency proceedings in Sweden. On 17 December 2004 Stockholm City Court denied the petition, finding that Rapla County Court had already opened main insolvency proceedings which prevented Swedish court to take any steps with regard to opening main proceedings.

On 13 January 2005 Rapla County Court dismissed the petition and terminated main proceedings in Estonia, finding that Estonian courts do not have jurisdiction because COMI of the debtor is not in Estonia. As main proceedings in Estonia were terminated, Swedish courts were now able to open main proceedings in Sweden. Based on the petition of creditor company TNK Stockholm City Court opened main insolvency proceedings of R AB on 21 March 2005 and appointed Mr Abjörnsson as the liquidator.

However, before main proceedings were opened in Sweden, another creditor of R AB, creditor company S, had filed a petition on 22 February 2005 at the Tallinn City Court for opening main insolvency proceedings regarding company R AB. On 28 March 2005 Tallinn City Court initiated bankruptcy proceedings and on the next day appointed the provisional liquidator and set the date of the court hearing. The court arrested debtor's bank accounts and prohibited the debtor from disposing the assets without the consent of provisional liquidator Mr Rattus.



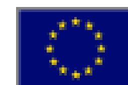
On 27 April 2005 Mr Abjörnsson informed Tallinn City Court of the opening of main proceedings in Sweden, noting that Estonian courts should take "no further actions/.../ in order to have R AB declared bankrupt in Estonia/...as it would be in direct violation with the Council regulation (EIR) if Estonian courts were to initiate further insolvency proceedings in this matter". As opening main proceedings in Estonia was no longer possible, creditor S changed its initial petition and asked to open secondary proceedings of debtor company R AB.

On 26 May 2005 Tallinn City Court denied the petition of creditor S. The court found that R AB's COMI is in Sweden. According to the report by the provisional liquidator R AB's economic activity concerning transport of oil has ended in 2002. Buying land in Estonia does not constitute as economic activity and therefore there is no establishment as meant in Article 2(h).

The creditor company S appealed the Tallinn City Court's decision claiming that R AB has an establishment in Estonia. On 14 June 2006 Tallinn Court of Appeal opened secondary insolvency proceedings and appointed Mr Rattus as the liquidator and sent the case to Harju County Court [After a reform in the court system in 2006 Estonia has four first instance courts: Harju, Pärnu, Tartu and Viru County Court. Tallinn City Court was united with Harju County Court. Information about the Estonian court system can be found at the Estonian Ministry of Justice`s website: http://www.just.ee. The site also contains useful links to the Estonian Bar Association`s, Notaries` etc websites.] for surveillance over bankruptcy proceedings.

The Tallinn Court of Appeal found that Article 2(h) of the regulation should be interpreted autonomously, meaning that the concept of the „establishment“ used in the regulation cannot be equalized with similar concepts used in legislation of the Member States or EU. Establishment in the sense of the regulation means a place where the debtor conducts his economic activity by using employees and assets and such activity is not temporary. The court stated that the concept of the establishment in the regulation is wider than the concept of establishment in the Estonian General Part of the Civil Code Act § 29 (2) (available in English at http://www.legaltext.ee/et/andmebaas/ava.asp?m=022) which requires permanent and continuous economic activity (compare Aricle 2(h) wording in other EU official languages: 'non-transitory economic activity', wirtschaftliche Aktivität von nicht vorübergehender Art etc). The need to interpret Article 2(h) widely is emphasised also in literature (e.g Heiderhoff, art 27 commentary in: Hass/Huber/Gruber/Heiderhoff, EU-Insolvenzordnung, Verlag C.H Beck Munich 2005; Fritz/Bähr, Die Europäische Verordnung über Insolvenzverfahren-Herausforderung an Gerichte und Inolvenzverwalter, Deutsche Zeitschrift für Wirtschafts- und Insolvenzrecht 2001, pp 221, 230-231; Paulus, Die Europäische Insolvenzordnung und der Deutsche Insolvenzverwalter, Neue Zeitschrift für Insolvenz und Sanierung 2001 no 10, pp 505, 510) in which the view is taken that only the assets being located in the Member State do not constitute as an establishment. Any economic activity which is based on using workforce, assets and is recognisable by third persons as economic activity, should be considered sufficient to constitute an establishment. Minimal requirements should be set for the organisational structure and temporal continuation of the economic activity. If the debtor has had an establishment that corresponds to the above requirements in the Member State in the past and there are assets left from that activity, it should be considered sufficient for the opening of secondary proceedings.

In the view of the court R AB's activity in Estonia corresponds to the concept of establishment in Article 2(h). The land was bought to develop economic activity in Estonia. According to the report of 13 May 2005 by the provisional liquidator the debtor planned to build a hunting cabin on the land and to develop hunting tourism. R AB had a contract to start construction works on the land. R AB also had an employment contract with Mr Podnek for the latter to start working as a project manager. Debtor's activity had economic purposes and involved persons and assets. The court found that R AB's activity can be considered as non-transitory and real as the debtor had contracts with third persons. The fact that R AB's economic activity regarding transport of oil ended in 2002, does not preclude the debtor to have an establishment in Estonia.



According to the Supreme Court's decision from 6 March 2006 no 3-2-1-7-06, the debtor's board (member) has the right to represent the debtor in the opening of secondary insolvency proceedings (Article 4 of the regulation and § 54 (1) of the Estonian Bankruptcy Act). The liquidator in the main proceedings is aware of the court proceedings in Estonia concerning the opening of secondary proceedings (the letter from the liquidator to Tallinn City Court dated 27 April 2005) The court pointed out that according to Article 32(3) the main liquidator has the right to participate in secondary proceedings, especially in the creditors' meetings and to Article 40 (1), which states that the liquidator has to inform the creditors in other EU Member States about the opening of secondary proceedings.

NEW BOOKS AND UPDATES

Nikolaus Arnold

Privatstiftungsrecht

This excellent oeuvre on the Austrian private foundation has been awarded with the “Walther Kastner”-Award 2003 by the Austrian Bankers Association.

ISBN 3-7007-2232-X

2002 / German

You can access up-to-date information on the Austrian Law of Private Foundations (Privatstiftungsgesetz, PSG) at www.privatstiftung.info

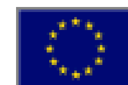
J.Israel

European Cross-Border Insolvency Regulation

This book presents a comprehensive analysis of the regulation of cross-border insolvencies in Europe. Council Regulation 1346/2000 on Insolvency Proceedings forms the natural focal point of such a study. However, while this book explores in detail the background, legal basis as well as the substance of the Regulation, it also contains an examination of the Regulation from two wider perspectives: that of international cross-border insolvency regulation and Community law.

ISBN 90-5095-498-7

2005 / English



ACCESS TO THE ASSETS OF A FOUNDATION (AUSTRIAN SUPREME COURT 26 JUNE 2006, 3 OB 217/05S)

DR. NIKOLAUS ARNOLD

Foundations, including the Austrian "*Privatstiftung*" according to the Act on Private Foundations (hereinafter referred to as private foundations), are legal entities. As they have neither proprietors nor shareholders/partners the question arises whether, and under what conditions, creditors of a founder ("*Stifter*") are entitled to access to the foundation's assets. The Austrian Supreme Court (OGH) has recently handed down a landmark decision regarding creditors' access to assets. This decision referred to an Austrian private foundation but may also be of relevance for foundations set up on different legal bases.

Dr. Nikolaus Arnold

ARNOLD Rechtsanwalts-Partnerschaft, Vienna, Austria

1. The board of trustees ("*Stiftungsvorstand*") of a private foundation is obliged to comply with the provisions of the declaration of establishment ("*Stiftungserklärung*") and to ensure that the purpose of the foundation is met. As a rule, the board of trustees is not bound by instructions when performing its activities.

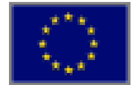
Nevertheless the founder/s may reserve certain rights to exercise influence. These include, without limitation, the right to revoke the private foundation ("*Widerrufsrecht*"), to change the declaration of establishment ("*Änderungsrecht*"), to appoint the members of the board of trustees (but not the foundation's auditor) and to name (or identify) the beneficiaries. However, the founders will only be entitled to these rights if they reserve them explicitly.

The members of the board of trustees must not include any beneficiaries or any of their close relatives (pursuant to the definition laid down in sec. 15 para. 2 of the Austrian Act on Private Foundations, "*Privatstiftungsgesetz*" – "*PSG*"). This limitation also applies to the founder/s.

As the activities of the board of trustees are separated from the beneficiaries and the board of trustees is not bound by instructions the private foundation is recognised under both national and international tax law.

2. The public has often criticised foundations using the argument that a founder could evade his/her creditors' justified claims against his/her assets by setting up a foundation. As the OGH found in a recent landmark decision (3 Ob 217/05 s) this is not true in the case of private foundations, at least not if the founder has reserved the right to access the foundation's assets.

First of all it has to be stated that the transfer of assets to a private foundation is also subject to the general provisions governing the rescission of legal transactions (especially under the Austrian "*Anfechtungsordnung*"). That means that, if a founder moves his/her assets to a private foundation (for instance with the purpose of harming his/her creditors), the creditors may be entitled to contest this transfer of assets (provided that the statutory requirements are met).

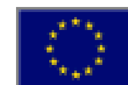


If the founder has reserved a right of revocation (and if he/she is entitled to the assets as the ultimate beneficiary in the case of a revocation of the private foundation) legal literature also recognises that the creditors of the founder may attach the liquidation proceeds of the founder. If necessary, the creditor will then by authorized by the court to exercise the right of revocation in lieu of the founder. However, the founder may easily prevent such access by the creditors by not reserving the right of revocation or by not being the ultimate beneficiary.

Up to now it was unclear whether creditors could also attach the founder's right to change the declaration of establishment (provided that the founder had reserved such right). By obtaining the right to change the declaration of establishment the founder does not finally lose his/her right of access to the assets. For instance the founder could change the declaration and make him/herself one of the beneficiaries. The OGH now found that creditors of a founder are entitled to attach the founder's right of change. They will then be authorised by the court to exercise such right of change in lieu of the founder. The change could, for instance, be made in such way that the private foundation is obliged to make obligatory endowments to the founder (as the beneficiary). Following an attachment, the value of the assets will then flow to the creditors.

3. For creditors of founders this new decision by the OGH means an extension of their possibilities of access. The decision at hand also made clear that the purpose of a private foundation is not to hide the assets from the founder's creditors. It is hoped that this will lead to a wider public acceptance of the establishment of foundations. If, however, the founder refrains from reserving any rights to obtain the assets there is no reason (after expiry of the time limits for rescission) to institute attachment proceedings to grant the founder's creditors access to the foundation's assets.

Dr. Nikolaus Arnold has been involved in these proceedings (3 Ob 217/05 s) on the side of the creditor



COMMENTS ON RECENT CASELAW FROM FRANCE [CASES NO.149, 150, 135]

PROF. JEAN-LUC VALLENS

Prof Jean-Luc Vallens

Magistrate, Strasbourg, France

1. Legislation

As regards the regulations governing insolvency law, the French government has notified to Brussels the consequences of the statutory reform dated July 26, 2005, modifying the annexes to the EU regulation on insolvency proceedings.

Since January 1, 2006, the French Courts apply the new rescue procedure, which supplements the existing procedures of reorganization and judicial liquidation.

In that procedure, for which the debtor alone may apply, the debtor is granted a stay of proceedings even before having suspended payments, as soon as he encounters financial difficulties that may lead to such an insolvency situation. During this period, the debtor retains full management powers over his assets and management of the business. An administrator may be appointed, but in a supervisory capacity only. The procedure is intended to result in a reorganization plan. Despite the absence of suspension of payments and the debtor remaining in possession, this procedure has been added to Annex A to the EU Regulation, which already contains similar procedures, such as the Belgian "*concordat judiciaire*".

In addition, the judicial reorganization procedure is now covered by the Regulation, whether or not an administrator has been appointed: thus, the scope of these procedures has been extended, facilitating the recognition and enforcement of proceedings in other member States.

Finally, Annex C has been modified because of a change in terminology; the "creditors' representative" (*représentant des créanciers*) who checks the liabilities and brings proceedings in the creditors' collective interest is now referred to as a "liquidator" (*mandataire judiciaire*).

2. Case-law

Three decisions are worthy of mention.

Paris Court of Appeal, September 9, 2005 (*Banque Le Crédit du Nord c. Me. Fréchou et Société de droit suédois Boxman AB*) [Case No.149]

A Swedish commercial company was subjected to insolvency proceedings under Swedish law (Stockholm District Court). That company had a branch office in France. The liquidator asked the two French banks with which the branch office had accounts to transfer the available funds to the liquidation's account. The Paris Court of Appeal approved this action, despite the fact that the judgment opening insolvency proceedings had not been recognized in France: apparently, no proceedings had been brought for exequatur. Such a decision secures the full effectiveness of the proceedings opened in Sweden, and is consistent with the principle of universality of bankruptcy. It should be pointed out that the EU Regulation was not yet applicable to these proceedings. Outside the Regulation's scope, the decision seems to differ, however, from the case-law in force in France to date. Traditionally, only protective measures could be granted to a foreign liquidator before the exequatur ruling. Transfer of the funds from the branch office's account to the liquidation's account cannot be considered as being a protective measure.

In addition, it impedes the management of the branch office's affairs and may be inconsistent with the interests of local creditors of the branch office having obtained security relating to its bank accounts. The Paris Court of Appeal has clearly taken a position supporting the effectiveness of insolvency proceedings. Would a different solution have been adopted in relation to a State not party to the EU Regulation ?

Supreme Court (Commercial Section), March 21, 2006, No 411, *Khalifa Airways* [Case No.150]

The Supreme Court approved a judgment having opened judicial liquidation proceedings against an air-transport company organized under Algerian law and having an establishment in France. The Court had already ruled in the same way in proceedings for judicial reorganization opened against debtors, part of whose assets were located in Belgium (Supreme Court, 1st Civil Section, Nov. 19, 2002, Bull civ. 2002, I, N 275).

As in its earlier ruling, the Supreme Court pointed out that the French Court has jurisdiction in relation to the company organized under foreign law itself on the grounds only of the presence of an establishment in France. That jurisdiction extends not only to that French establishment but to the parent itself, on the basis of the principle of comprehensiveness of the estate. But it specified that the proceedings produce effects wherever the debtor has assets, subject however to international treaties or EU instruments, and to the extent of the ruling's acceptance by the foreign legal system.

It would therefore be up to the French liquidator to obtain exequatur of the judgment abroad, if he intended to exercise his powers there: this is a *de facto* territorial limitation of the proceedings.

Supreme Court (Commercial Section) June 27, 2006, *Daisytek* [Case No.135]

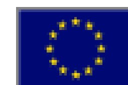
The Supreme Court upheld the judgment of the Versailles Court of Appeal recognizing an English judgment opening insolvency proceedings against the French subsidiary of a British company (CA Versailles, September 4, 2003). The Supreme Court held this ruling in abeyance pending the judgment of the Court of Justice of the European Communities in the *Eurofood* case, delivered on May 2 last.

In fact it expressly based its ruling on the principles affirmed by the Luxembourg judges. It upheld recognition of the foreign judgment on the following grounds.

First, the foreign proceedings opened by the Court, basing its jurisdiction on the debtor's centre of main interests, is to be recognized and enforced, without the foreign Court within the circuit of which the insolvent company has its registered office (the French Court in this case) being able to review the jurisdiction of the British Court. The principle of mutual trust in this instance overrides the possible grounds for such a review.

It shall be noted, however, that in the judgment dated May 2, 2006, the Court of Justice had stressed that there was compensation for this mutual trust: the Court which considers that it has jurisdiction must actually ascertain its jurisdiction.

Second, only public policy could be cause for a Court to refuse recognition or enforcement of the foreign judgment (under Article 26 of the Regulation). In the *Daisytek* case the British Court had applied its own law, without hearing testimony from the representatives of the French company's staff as required by French insolvency law. But this fact alone was not "manifestly contrary" to French public policy.



In the *Eurofood* case, the Luxembourg Court of Justice had also had to answer a question from the Irish Supreme Court regarding public policy and the hearing of the parties involved by the Italian Court, the judgment of which was asserted in Ireland.

But it based its decision on EU public policy, and not Irish public policy.

While the former is included in the latter, the reverse is not necessarily true.

THE CHANGING NATURE OF STAKEHOLDERS IN RESTRUCTURINGS

SWATI PATEL AND MARK FENNESSY

The European loan market has undergone significant changes in recent years. All-time low default rates in the past couple of years have pushed non-bank financial institutions into new areas in order to extract value during a period of excess cash and low returns. This in turn has enabled arranging banks to structure ever bigger and more complicated debt packages comprising tranches of senior debt, second lien, mezzanine and sometimes junior mezzanine. The composition of creditors participating in these debt packages is rapidly changing as the traditional line among banks, hedge funds, and other asset managers blur, a trend which is set to continue. Hedge funds and CLO/CDO vehicles traditionally investing in second lien and mezzanine tranches are now investing in senior tranches of leveraged deals and are actively looking to participate in investment grade loans, an arena which has in the past been dominated by the commercial banks. This is illustrated by the £1.32 billion financing for Wendel to fund its leveraged buy-out of a French chemicals company in May 2006. The lead arranger, BNP Paribas, estimated that three-quarters of the money that Wendel needed to fund its acquisition would come from "institutional investors" such as hedge funds.

Swati Patel and

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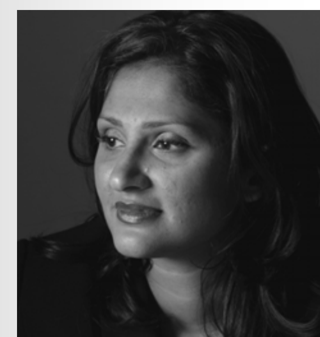
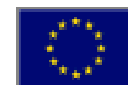




Whilst non-bank financial institutions continue to make inroads into the primary markets, the European secondary markets have continued to grow significantly, year on year for the past five years. The majority of this growth has come from the "buy side," US hedge funds attracted by the relatively higher returns in the Euromarkets. This increased liquidity in both the primary and secondary markets has been a contributing factor to the low default rates, as corporations that may have been ripe for a work-out are able to find new money to refinance existing indebtedness.

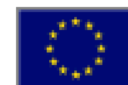
Most commentators believe, however, that a combination of higher interest rates, higher commodity prices, weakening consumer demand and wage inflation in emerging markets such as the PRC may lead to a credit crunch in the next 12 to 18 months with the automotive, transportation and utility industries most at risk. If this were to occur, a number of highly leveraged corporations may find themselves facing a work-out or even worse, an insolvency process.

The increased number and differing composition of creditors participating in debt packages are set to change the face of future work-outs. Many wonder whether non-bank financial institutions will have the appetite for a work-out. Second lien creditors are an unknown quantity when it comes to restructurings. Will their interests be aligned or opposed to that of the senior creditors, who have traditionally been the dominant force in restructurings, or will their interests be very different? There is a consensus among restructuring and insolvency professionals that the multiplicity of stakeholder positions, and the diverse agendas pursued by the broad range of institutional and private investor classes, will unquestionably complicate turnarounds and restructurings in the coming months and years.

Given the possible complexity and time-consuming nature of future work-outs and the uncertainty of the return, certain stakeholders may choose to sell their positions to specialist distressed investors. The strength and depth of the secondary markets has given stakeholders a variety of exit options. Through the use of sub-participations and credit default swaps, stakeholders can effectively transfer the economic ownership/interest in any particular position while still remaining a lender of record. This will, in turn, present turnaround professionals with new classes of stakeholders, whose interests may be very different to that of traditional senior lenders.

In the current market, cautious sponsors are trying to exert some control over the composition of syndicates by restricting sub-participations or altering the "unanimous decisions clauses" so that minority senior lenders cannot exert a disproportionate amount of control over any potential restructuring plans agreed to by the majority. Borrower-drafted term sheets are starting to emerge with so-called "yank the bank" clauses (allowing the borrower to replace a minority non-consenting bank) and "snooze and lose" clauses (to stop banks effectively rejecting a proposal by not responding). These provisions may give comfort to sponsors and may also be helpful to turnaround professionals in some scenarios.

The above notwithstanding, many experts believe that it will be increasingly difficult to achieve a harmonized approach to a restructuring, reflecting the logistical hurdles in coordinating and communicating diverse strategies among a myriad of stakeholder positions. Many have also predicted that there will be an increase in the number of "hold-out" lawyers who try to improve their clients' short-term position by threatening to pull down the entire restructuring. In the process, the entity may survive but the underlying businesses will lose a great deal of value.



Furthermore, most experts believe that the process of achieving consensus among a multitude of stakeholders, each having diverse interests, will invariably lead to weakened capital structures for corporates exiting a restructuring.

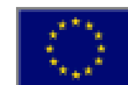
It is also likely that the level of work-out failures will increase leading to formal insolvencies and a "race to the courts" by various interested parties to maximize their position. Cross-border securities and insolvency laws have struggled to keep pace with the development and increased internationalization of business and trade. On new assignments, restructuring teams will have to negotiate legislative discrepancies and anomalies in various jurisdictions, some of which are debtor-friendly and some of which are creditor-friendly.

The United Nations, through its Commission on International Trade Law ("UNCITRAL"), has attempted to increase the level of cooperation between different national courts exercising insolvency jurisdiction by reference to a Model Law. Last year, the US incorporated the UNCITRAL Model Law through a new chapter in its Bankruptcy Code (Chapter 15). In Europe (with the exception of Denmark), Regulations on Insolvency Proceedings (Council Regulation No. 1346/2000) have been in place for four years now, which have attempted to improve the efficiency and effectiveness of cross-border insolvency proceedings.

There has been, however, some evidence of judicial friction between courts of member states. For example, in the case of Parmalat and its Irish subsidiary Eurofoods, a battleground for jurisdictional prominence as opposed to a forum for co-operation between courts and relevant national officeholders has emerged.

Notwithstanding the attempts to increase cooperation between different national courts, the lack of a uniform insolvency regime throughout the EU will entail a greater degree of forum-shopping to reflect an acute jurisdictional awareness among the myriad of creditor groups. The practicalities of cooperation and communication between restructuring professionals in a number of jurisdictions needed to undertake cross-border deals will come under the microscope as a greater number of complicated work-outs come on stream.

Future work-outs will be more complex, time consuming, costly and, ultimately, may be more susceptible to legal challenge. Break-ups of corporate groups into their respective component parts mainly along national lines may well be the resulting trend. Another expected trend will be the increase in stakeholders trading their debt on the secondary market to ensure timely returns to traditional investors. This will bring a new breed of stakeholders into the capital structure. While European corporations may benefit from increased liquidity in the market currently, a change in the economic cycle may ultimately result in loss of value for some.



RESTRUCTURING OF LISTED COMPANIES AND CONGLOMERATES BY INSOLVENCY PLANS– THE CASE OF SENATOR ENTERTAINMENT AG BERLIN/GERMANY

MARC FRITZE

On 07 July 2006 Senator Entertainment AG held its first shareholders meeting since emerging from insolvency proceedings on March 31st, 2006. The Senator Group was restructured through an insolvency plan proceeding. This took the form of a capital increase with an issue of new shares and a conversion of debt into equity (debt-equity swap); probably the first time this has happened in the case of a listed company in Germany during insolvency.

Marc Fritze

Leonhardt & Partner

Berlin, Germany

I. Introduction

Insolvency proceedings have always served to satisfy the creditors by realisation of the assets of the debtor in the context of collective bankruptcy proceedings (cf. - for Germany - Section I sentence 1 1st Alternative Insolvency Code). However, as a rule this inflicts considerable damage: In nearly all cases, the break-up value is below the going-concern value, goodwill is destroyed irretrievably, jobs are lost forever. Hence, the creditors, the debtor and the economy all suffer alike.

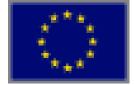
Therefore, when introducing the Insolvency Code (Insolvenzordnung, abbreviated InsO) in 1999, the explicit goal of German parliament was to promote restructurings and continued operations of businesses [Amtl. Begr. zum RegEInsO, Allg. 4 a aa, BT Drucks. 12/2443, p. 77; Smid, InsO, 2nd edition, 2001, Section 1, marginal No. 38 ff] .

With the insolvency plan proceedings parliament introduced a flexible alternative to restructuring by asset sale. Admittedly this has not been the major success hoped for.

The number of restructurings by means of an insolvency plan is still relatively small. On the one hand this is due to the complex legal rules applicable to plan proceedings; on the other hand it is due to the debtors´ attitude of only filing for insolvency when it is already far too late and the business has already collapsed financially, mentally and strategically. Often restructuring is then no longer possible.

However, insolvency plans are increasingly being used in a number of special cases: If in this way

- a simplified and quick reduction of indebtedness can be achieved or



- the creditors can receive a quota through an one-off outside investment or
- a quota can be paid through continued operations that would not be achieved in the case of liquidation or in the case of a protracted operation of the business by the administrator.

Special features of the company in debt can make the standard alternative to the insolvency plan – i.e. the restructuring by transfer in the form of an asset deal – more difficult or even impossible. This is particularly the case if there are assets that cannot be transferred to a new entity or if the operations of a larger company with a multitude of customers and supply contracts would have to be transferred within a reasonable period of time. This applies to the case in question. Senator Entertainment AG was an international group of companies primarily operating in the fields of film licensing and film production. Therefore special features of copyright law and film financing had to be taken into consideration, making a restructuring by way of an asset sale impossible.

In the case of Senator there were further developments complicating the case. The claims of major creditors, a consortium of banks, were sold to an investment bank so that the principal creditor changed during the insolvency proceedings. Furthermore, the restructuring was carried out in the form of a severe cut in equity rights followed by two capital increases in the context of which debt was converted into equity.

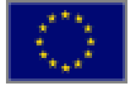
This process was completed in eight months; the fact that the restructuring ultimately took almost 24 months was due to an appeal – which was eventually withdrawn – against the insolvency plan.

II. Senator Entertainment AG

1. The Group

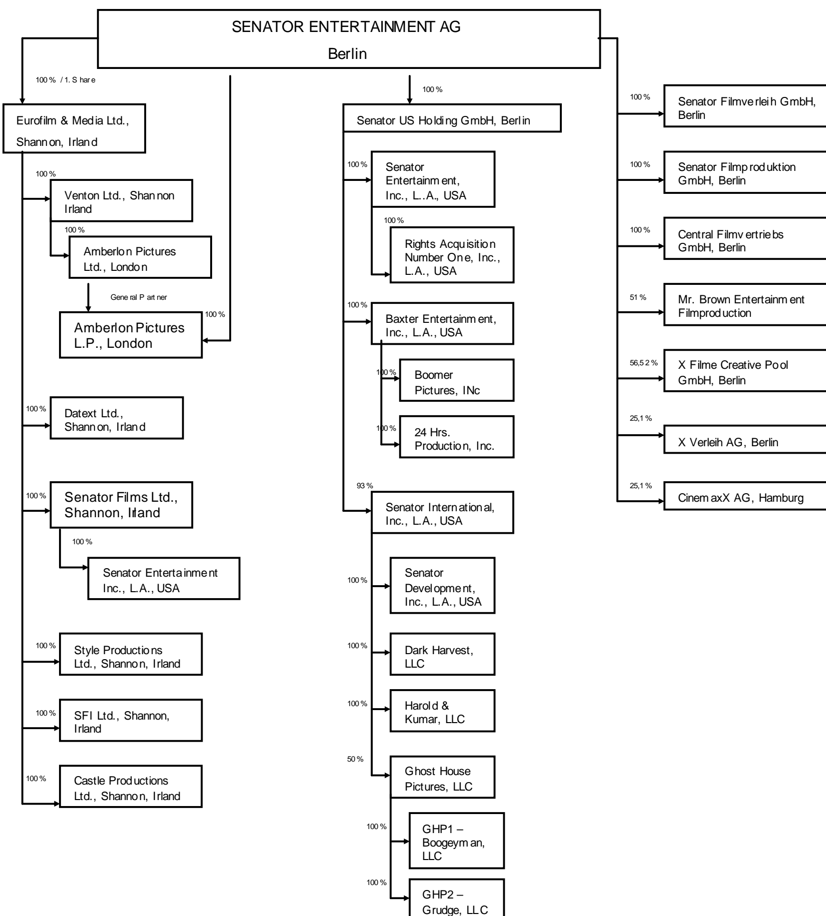
Having been founded in 1979, Senator had developed into a group of companies for international and German film productions, film distribution and trading in licences. It had acquired a large film library, i.e. various licenses to show or sublicense films worldwide, in Europe or in Germany. It operated worldwide and was a leading company in its area in Germany. The company went public in 1999 at the height of the dot-com stockmarket boom. The combination of a familiar product and the dynamic of the media industry made it a star on the tech sector of the German stock exchange, the so-called “Neuer Markt”. At its peak, the Senator Group was valued at over 800 million euros.

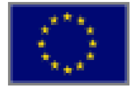
The main holding company, Senator AG, held shares in a total of 30 group companies in Germany and abroad. These included such well-known names as the cinema operator CinemaxX AG and the film production company X-Filme Creative Pool GmbH, whose successes such as LOLA RENNT and GOOD BYE LENIN and its own co-production DAS WUNDER VON BERN are familiar names to cinema audiences.



The structure of the group as regards its main holdings is depicted below.

The bursting of the dot-com bubble also affected Senator Entertainment AG. While the volume of bank credit had previously been low, it quickly increased to a total of 170 million euros. At the same time, sales of the associated companies fell and investments (films) did not produce the returns calculated. After negotiations with the lenders´ consortium broke down the loans were frozen. Management changed, and when the new CEO had the value of the film library re-assessed and the results of revaluation were presented, the companies liabilities were found to clearly exceed its asset value ("Überschuldung", overindebtedness).





Therefore, the board of directors of Senator Entertainment AG and the managing directors of a number of subsidiaries filed for insolvency with the relevant insolvency court.

2. Legal Questions

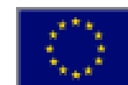
The film business is interesting to many for its connections with art and glamour. In addition, interesting legal questions abound. For example, the group acquired film exploitation rights via its subsidiaries, Senator Film Verleih GmbH, Senator Film Produktion GmbH, Eurofilm & Media Ltd. (Ireland) and Senator US-Holding GmbH. Copyright is with the author of the work, section 7 of the German Copyright Act. Copyright can be licensed for exploitation purposes. This licence is to be treated as a lease in German insolvency proceedings [Uhlenbruck, InsO, 12th edition, 2003, Berscheid, Section 103, marginal No. 26; MüKo InsO, vol. 2, 2002, Section 103, marginal No. 76] and the relevant statutory rules for leases (Section 581 para. 2 German Civil Code - BGB, Sections 111 sequ., 119 Insolvency Code) apply [Hess, InsO, 1999, Section 103, marginal No. 16]. Hence the film licence is not under insolvency law an item that can be transferred but is to be seen as a reciprocal contract of a continuous nature that has not been performed in full by either side, Sections 103 sequ. Insolvency Code. Termination clauses owing to an insolvency are invalid (Section 119 Insolvency Code), but special rights of termination can exist or be excluded (Sections 103, 109 sequ., 112 Insolvency Code). These legal issues have not so far been decided on by the German Federal Court of Justice.

The international nature of the matter further complicates these issues, as it is typical in the industry that contracts are governed by English or Californian law by agreement or that conflict of law rules call for the applicability of foreign law.

The production and distribution of films in Germany receives public funding to a considerable extent. As a rule, funding is given for a specific project, i.e. for a specific film. Producers and distributors of successful films are entitled to further funding. The subsidies have to be repaid if the original conditions for paying them no longer exist, for example if new films cannot be properly financed. The insolvency and winding up of the funded company therefore as a general rule results in termination of the funding granted and cuts off future subsidies. This de facto stops continued operations of the company on account of the substantial amounts of subsidies involved in German film productions.

III. The Insolvency Plan Proceedings

On the day the application was filed, *Rolf Rattunde* of Leonhardt & Partner was appointed to act as temporary insolvency administrator of the parent company, Senator Entertainment AG, and the subsidiaries, Senator Film Verleih GmbH, Senator Film Produktion GmbH and Central Film Vertriebs GmbH. The reasons already stated, in particular the complexity of the group, the legal structure of the business transactions and the possibility of raising capital from shareholders ultimately led to the idea of restructuring by means of insolvency plan proceedings.



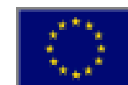
The insolvency plan of Senator Entertainment AG covers 20 pages. It explains the restructuring concept. The core is to reorganize the capital structure of the AG in the form of providing fresh capital as equity as well as a conversion of dept into equity, accompanied by the possibility of bringing in a strategic investor.

Under the rules of German insolvency law an insolvency plan has to contain a descriptive section which describes the business and gives the reasons for the crisis as well as a restructuring section which outlines the specific measures that will come into effect through acceptance of the plan.

Here the descriptive section describes the corporate, legal and financial status of the indebted company with special attention to the matter of (film) rights and the international structure of the group. In addition, the plan contained a special category for shareholders who had incurred losses, as accusations had emerged ahead of the plan that an earlier crisis of the company had been covered up in the accounts by invented sales, figures leading to imaginary profits. These had been publicly reported causing investors to buy shares and eventually to suffer losses. Hence, potential claims arising from these acts of an unforeseeable size needed to be provided for. The plan allocated potential payments from damage claims against the alleged perpetrators to the creditors in this group. However, in actual practice this provision later turned out to be of no relevance.

In the restructuring section, the bank claims were substantially reduced by the insolvency plan in order to balance the accounts. Out of the claims of over 170 million euros bank dept an amount of 11 million euros and a subordinated claim for a further 10 million remained. In addition to these claims the bank was permitted to change those parts of their debt into equity that were found by an independent audit to be covered by the current value of the company´s assets. All debt exceeding these amounts was forgiven. Otherwise, the plan did not affect the collateral securities of creditors. This concerned shares in CinemaxX AG, shares in US subsidiaries, bank deposits and some individual claims all of which had been pledged as collateral but were not necessary for the continued operation of the core business. Unsecured non-preferential creditors including tax claims received a quota of 10 %, a quota that was – as shown by a comparative calculation – markedly higher than the possible quota calculated for the case of break-up which – in addition – would have been payable only years later. Claims between member companies of the group and claims of subordinated creditors – the latter pursuant to Section 226 Insolvency Code – were forgiven in full.

As mentioned above pursuant to Section 219 Insolvency Code the plan consists of a descriptive section and a restructuring section; the annexes named in Sections 229, 230 Insolvency Code form annexes to the plan.



Plan Structure (Senator Insolvency Plan)

I. Declaratory Section

1. Overview

1.1 Plan Concept

1.2 Film Production and film law

1.3 The Senator Group

1.4 Facts & figures / addresses

1.5 Tax position

2. The restructuring concept

2.1 The company in brief

2.2 Measures to date

2.3 Measures planned

2.4 The plan

2.5 Risks

3. The creditors

3.1 Creditors' groups

3.1.1 Banks

3.1.2 Shareholders who have suffered losses

3.1.3 Employees

3.1.4 Other creditors

3.1.5 Institutional fiscal creditors

3.1.6 Subsidiaries

3.1.7 Junior creditors

3.2 Changes to creditors' rights

3.3 Quota in the case of break-up

3.4 Plan fulfilment

II. Restructuring section

1. Modification of the rights according to creditor group (Sections 223-225 Insolvency Code)

2. Condition

3. Monitoring of the plan

III. Plan annexes

Annex 1 Pro-forma balance sheet per 31.12.2004

Annex 2 Standard license agreement, valuation of rights, moveable property

Annex 3 List of the group companies (excerpts from the Commercial Register)

Annex 4 Administrator's initial report and report to the creditor's meeting

Annex 5 Loan agreement of Senator Group

Annex 6 List of creditors

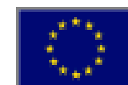
Annex 7 Annual financial statements of the Senator Group for 2001, 2002 and 2003

Annex 8 Consent of Eurofilm to the assignment

Annex 9 Declarations re the capital increase

Annex 10 Valuation of BDO (auditors)

IV. Summary of the main points (Section 235 of the Insolvency Code)

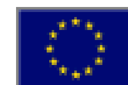


The consortium banks initially planned to use their collateral to partially satisfy their claims, by winding up the group. However, it became evident that national players from the film industry as well as some international players and financial investors were interested in the company. Therefore, the decision was taken to find an investor that would either acquire the majority of shares in the holding compared or buy the operating companies. Parallel to this, an extraordinary general meeting had to be convened at the beginning of insolvency proceedings in order to comply with the statutory requirements regarding listed companies. This meeting was held on 17.06.2004. Resolutions were adopted to initially decrease the nominal capital to 10 percent of its value (a 10 to 1 writedown of capital) and then to carry out a capital increase by 10.364 million euros. Although this move was opposed by a small number of individual shareholders, the measure was implemented. The existing shareholders could subscribe to the new shares, which were otherwise then available for issue to an investor at the discretion of Senator´s management which worked in close cooperation with the insolvency administrator.

The injection of new money in the form of a capital increase and the reduction of the group's debt were intended to resolve the crisis. At the same time, it was necessary to avoid the opening of formal insolvency proceedings for the operative subsidiaries that held the various film rights in order to prevent loss of these rights.

The nature of the film business which primarily required long-term financing for film projects rather than short-term cost-cutting measures made it possible to continue the business without dramatic changes to the extent that circumstances permitted. At the same time, the long preparation period for projects which is typical for the industry – normally the initial production agreement comes at least two years before final exploitation and repayment of the investment - necessitates medium and long-term planning security with a relatively large volume of financing of the individual transactions. Hence, it was necessary to discharge the subsidiaries from the provisional insolvency as quickly as possible. Otherwise, it would not have been possible to continue the production of films with public film funding.

The sale by the consortium banks of all claims as a bundle to a London-based investment bank in May 2004 **a** had come as a complete surprise. This had led to delays and a shift in creditor interests to swap dept into equity and to regard the engagement as medium-term instead of winding it up. But apart from the need to agree all actions with the bank in London as of this time, this did not in retrospect lead to disadvantages in carrying out the restructuring plan. On the contrary: The investment bank wanted, in accordance with Anglo-American practice, to convert its claims into shares by way of a debt-equity swap. However, under German law a direct swap is not possible. Hence, the investment bank made use of the capital increase initiated by the insolvency administrator and as an investor subscribed to shares in an amount of approx. 9.9 million euros.



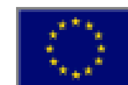
This proceeding made sense only because of the previous capital decrease and the waiver of the bulk of claims during the insolvency plan proceeding, making the bank in consequence both the principal creditor and also the principal shareholder of a company with sound balance sheet.

The creditors unanimously accepted the insolvency plan put forward by the administrator at a special meeting of creditors held on 15.09.2004. As a consequence, the subsidiaries were released from their co-liability as envisaged in the plan and their insolvency applications could be withdrawn. Business operations per se could be continued outside the insolvency. Specifically, production of the French-English-Romanian-German co-production MERRY CHRISTMAS (later nominated for an Academy Award) could be completed. The film had its world premiere during the insolvency proceedings. Individual assets that were not part of the core business of the company – i.e. <the US investments of Senator and its CinemaxX shares> - were transferred to the investment bank for a liquidation outside the insolvency proceedings.

A resolution to increase equity by contributions in kind was adopted at a further general meeting held on 23.11.2004. Among other things, this enabled the bank to contribute a part of the balance of its claims under the insolvency plan and receive further shares for the corresponding amount.

By cutting back on personal costs and rent in the company's operations, further restructuring measures were carried out and the cost structure reorganised.

This would have meant that the insolvency proceedings could have been concluded at the end of 2004, i.e. within a period of well under a year. However, one single creditor filed a special appeal against the order of the insolvency court confirming the insolvency plan (cf. Section 231 III Insolvency Code). The appeal was denied by the court of next instance, the Berlin regional court (Landgericht). The creditor then filed an appeal on points of law with the Federal Court of Justice, the highest level of appeal in insolvency cases. He, however, ultimately withdrew the appeal, enabling the plan to come into force. The admissibility of the appeal was highly problematic. The Insolvency Code provides for legal remedies for the parties concerned in specific circumstances. In the opinion of the administrator this should be seen as final. The creditor in question did not take part in the proceedings, although he was informed about them in detail. He did not raise objections at the meetings of creditors or at the claims review hearing and did not make use of the special appeals provided for, e.g. in the case of an individual creditor being outvoted. The regional court thus held that failing to use the specific appeals provided by the insolvency code precluded the creditor from filing a general appeal. However, as a final judgement at the federal level would not be obtained, the legal question of the admissibility of the appeal must remain unanswered here [Smid/Rattunde, Der Insolvenzplan, 2. ed., marginal No. 16.23]. In effect the appeal delayed the conclusion of the insolvency proceedings by over one year.



After the unsecured creditors had been paid the plan-specified quota of 10 per cent and a new credit agreement had been negotiated to secure the further financing of the company, the insolvency proceedings were concluded per 31.03.2006. Since then the investment bank has the majority of its shares to a strategic investor, from the industry. Now that the insolvency proceedings have been concluded, the future of the group again lies in the hands of the executive bodies of the AG.

IV. Conclusion and outlook

The Senator insolvency shows that a group of companies with international operations can be successfully restructured through German insolvency proceedings. It also illustrates that de facto a debt-equity-swap can be achieved if both shareholder measures and insolvency plan proceedings are combined. Changing the name of a company and shifting its seat outside the German jurisdiction – as was done in the case of Deutsche Nickel AG / DENIC – is at any rate not necessary too achieve equivalent results.

In the case of Senator AG the insolvency plan proceedings saved the company and a large part of its jobs while paying an above average quota to unsecured creditors. While the existing shareholders had to accept a 90% writedown of their positions they could at least keep some of their equity interest in the company. Therefore, the plan proceedings meant an improvement in their position as well.

At the peak of the New Market, Senator AG had a market value of just under 800 million euros at a price of 30 euros per share. After the dot-com bubble burst and the company had to file for insolvency the price bottomed out at 0.30 euros per share. At the end of June 2004 there was the 90% capital writedown leading to a sharp price increase for the remaining shares. The price rallied towards the end of the insolvency proceedings and now stands at just above 2.50 euros. Thus the restructuring of Senator was a success for the existing shareholder as well because they did not lose the full amount of their investment as is otherwise the norm in bankruptcy situations. Admittedly they now have fewer shares, but these shares still have a market value and some growth potential. Had the company been wound up the existing shareholders would have received nothing at all. Those who also subscribed to new shares at the time of share issue at the end of June 2004 have seen the price of these shares rise by just under 150 per cent.

Substantial problems, however, arose due to a lack of co-ordination of the different statutes applying to this case. For example, to some extent the Insolvency Code contradicted provisions in the German Stock Corporation Law on holding general meetings, on the function of the board of management, on the function of the supervisory board and on procedural rules for capital increases [Rattunde, Sanierung durch InsO, ZIP 2003, 2103; Rattunde, Die Aktiengesellschaft in der Insolvenz, expected date of publication: end of 2006] . The most serious problem resulted from open questions of the admissibility of legal remedies. Whereas the insolvency court and the administrator only have days or a few weeks to make decisions on complex matters, the final appeal was still not ruled on by the Federal Court of Justice six months after its filling. Whereas the restructuring itself had been put into place within a few months, the appeal proceedings took almost a whole year. It was only the solid long-term business of the company that prevented the worst from happening. This could have spelt disaster for a trading company doing business on a day-to-day business or a manufacturing company. In other words, a number of amendments synchronizing companies law and insolvency law as well as removing opportunities for destructive appeals would be very helpful in extending the opportunities for restructuring contained in the Insolvency Code.

COMMENTS ON COLLINS & AIKMAN EUROPE SA AND OTHER COMPANIES [2006] EWHC 1343 (CH); [2006] AA ER (D) 80 (JUN) APPROVED JUDGEMENT [CASE NO.134]

NATASHA WATSON

I. Introduction

The judgment of Mr Justice Lindsay on 9 June 2006 saw a UK Court ruling for the first time that overseas creditors of an administration can be paid dividends in priority according to their local insolvency laws. This ground breaking judgment has afforded great flexibility to UK insolvency practitioners in exercising their powers in European group-wide administrations under the EC Regulation on Insolvency Proceedings 2000 (the “EC Regulation”).

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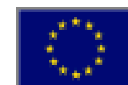


II. Background

On 15 July 2005 the English High Court (the "Court") made administration orders for 24 of the European Collins and Aikman companies (the "Companies") on the basis that the proceedings in the UK were main proceedings for the purposes of Articles 3 and 4 of the EC Regulation. The administration orders for the Companies were made as a result of severe financial pressure after the US Collins and Aikman Group companies filed voluntary petitions for reorganisation under Chapter 11 of the US Bankruptcy Code.

After a successful business sale of a number of the Companies, the administrators sought directions from the Court to distribute the sale proceeds to creditors in accordance with the local laws of their jurisdiction.

III. Issue facing the administrators

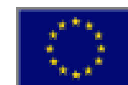
On implementation of the administrations, the administrators recognised that the Companies functioned as a closely linked group, whose functions were organised on a Europe-wide rather than national basis. The administrators' strategy was to adopt a coordinated approach to the continuation of the businesses, to the funding of the administration and to the sale of the businesses and assets of the Companies, in the firm belief that such approach would lead to the best possible returns to creditors.

An inherent risk to the success of the administrations was the possibility of creditors opening secondary proceedings in jurisdictions where an "establishment" existed, which by prejudicing the group running of the administration and causing additional complication and cost would have been detrimental in obtaining optimum value for creditors in any sale. In order to alleviate such risk, the administrators gave non-UK creditors assurances that their respective final positions in local law would be respected and undoubtedly on reliance of that the creditors agreed to the administrators' proposals. In light of their assurances to creditors, the administrators sought directions from the Court in relation to ten of the Companies to approve the distributions they proposed to make to creditors under local law provisions.

IV. The application

After the realisations of the administration were mainly complete in April 2006, the administrators made their first application to the Court for directions to implement their assurances to creditors. At this point, the giving of the assurances by the administrators had not been questioned and neither had doubts been raised that the assurances given were given other than with the view to achieve the statutory objectives of paragraph 3 (1) (b) of Schedule B1 of the Insolvency Act 1986 (the "Act") [Paragraph 3 (1) sets out the purpose of the administration:

> "The administrator of a company must perform his functions with the objective of-
>
> (a) rescuing the company as a going concern, or
>
> (b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or



(c) realising property in order to make a distribution to one or more secured or preferential creditors".]

The Court provisionally agreed that the English legislation provided sufficient support to implement the administrators' assurances. It was decided that before a final ruling could be made, the creditors should be consulted and provided an opportunity to express any concerns. The administrators returned to the Court on 6 June 2006 with full creditor approval for the directions they sought.

The administrators argued before Lindsay J that the Court had both jurisdiction to order the distribution in accordance with their assurances, and that the Court should exercise its discretion under its jurisdiction.

VI. Jurisdiction

As to jurisdiction, the administrators argued that the Court and the administrators were enabled to honour the assurances given and to thereby indirectly respect local law under:

> (i) the express powers of the English legislation;
>
> (ii) the inherent jurisdiction of the Court over the administrators as officers of the Court; and
>
> (iii) under the rule in *Re Condon, ex parte James (1874) LR 9 Ch App 609.*

Legislation

The provisions of paragraph 65 and 66 of Schedule B1 to the Act were considered. Paragraph 65 (1) states:

> "The administrator of a company may make a distribution to a creditor of the company".

Such distribution is limited by paragraph 65 (3):

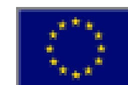
> "A payment may not be made by way of distribution under this paragraph to a creditor of the company who is neither secured or preferential unless the Court gives permission."

Lindsay J was not clear whether paragraph 65 applied in these circumstances since there was an implication that there was a requirement to pay preferential creditors, as defined under English law, before any paragraph 65 payment could be made. The different jurisdictions within which creditors of the Companies were found have preference provisions (and treatment of intercompany indebtedness) which differ not only from English law, but to one another.

Paragraph 66 on the other hand allows that:

> "The administrator of a company may make a payment otherwise in accordance with paragraph 65…if he thinks it likely to assist the achievement of the purpose of the administration."

Lindsay J's view was that, in the absence of certainty over the application of paragraph 65, the administrators could be given directions pursuant to this provision. Paragraph 66 relates to "payments", a term wide enough to include distributions.



In considering whether making a payment was likely to assist the achievement of the purpose of the administration, Lindsay J distinguished between the *giving* of assurances, which at the time the administrators thought would assist them in achieving their statutory objectives, and the *performance* of the assurances, in assisting to achieve the purpose of the administration. He considered that such a distinction caused problems on three grounds. Firstly, the legislature would expect the administrators to behave honorably. Secondly, such a distinction gave rise to a possible tortious claim against the administrators in misrepresentation. Thirdly, the administration process depends greatly on confidence between a company's creditors and its administrators for its success. He considered that exceptional circumstances may arise where assurances given are not performed if they are no longer thought to assist the purpose of the administration, but no such circumstances arose in this case.

The rule in *Ex parte James*

In considering the rule in *Ex Parte James*, Lindsay J noted that the administrators were not relying upon it alone to support their application, but that it did make a strong contribution to the propriety of the directions being given to allow the administrators to distribute in accordance with their assurances.

Lindsay J found that the rule as considered was one based on morality: that the Court expects its officers (administrators are officers of the Court) to act in an honourable and high minded way.

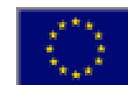
A high ethical standard is expected and required of an officer of the Court, which can outweigh other considerations, even the prospect of a better realisaton for the estate. However, he thought it was doubtful that such a rule would carry weight where to exercise it would to fly in the face of express statutory provision.

The Court's inherent jurisdiction

As the Court had found that the statutory provisions in place alone were sufficient to enable it to make the direction that the administrators sought, Lindsay J found it unnecessary to discuss in depth the relationship between the Court's inherent jurisdiction and the extent to which it has been fettered by recent and current statutory provision. It was noted however, that the changes to the insolvency legislation brought in by the Enterprise Act 2002 had resulted in a more prescriptive statutory framework, directing what administrators can and cannot do, which naturally had an impact on the necessity for the Court to exercise its inherent jurisdiction to control its officers.

Discretion

Having satisfied himself that the Court had jurisdiction to give the directions requested by the administrators, Lindsay J considered whether he should exercise the Court's discretion in exercising its jurisdiction.



The alternatives open to the administrators and the Court were not considered an attractive option. Outside the administrations, distributions could be made by way of the Companies entering a Creditors Voluntary Liquidation, a Company Voluntary Arrangement, or through the implementation of secondary winding up proceedings in the relevant local jurisdictions. It was decided that each had their own disadvantages:

a. A Creditors Voluntary Liquidation may not have given sufficient flexibility to enable a liquidator to depart from the statutory scheme of distribution. A voluntary liquidator is not an officer of the Court and therefore would not be subject to the strictures of *Ex parte James*.

b. Creditor Voluntary Arrangements involve time and expense in preparing the proposals and seeking creditors' approval.

c. Secondary proceedings could lead to delay, expense and undesirable complication and uncertainty.

Lindsay J also took into consideration the important fact that the administrators had consulted with the creditors committees regarding the directions they sought from the Court and the proposals for distribution. Importantly, the administrators received unanimous approval in their approach, even from the US creditors who sought to gain less from a distribution using local rather than English law priorities.

In light of the degree of approval and the disadvantageous alternatives, Lindsay J felt well able on the point of discretion to exercise the jurisdiction which he had.

VI. Comment

Lindsay J's judgment is a significant and important decision for UK based restructurings, which, together with the Eurofood decision, has wide ranging practical impact on the conduct of European-wide insolvencies. The judgment was necessary to implement the US side of the Collins and Aikman administration and essential for a successful implementation of the administrators' proposals and outcome to the administrations. It gives non-UK debtors with their centre of main interests in the UK under the EC Regulation further opportunity to implement a successful, cohesive group-wide administration, and their creditors an increased opportunity to optimise returns. The UK statutory provisions' flexibility has proved a useful, if not essential, tool in group-wide administrations.

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SURVEY ON „ALIEN" COMPANIES

Entities having been incorporated under the laws of another country than the country of their registration have become a major practical issue. In Germany, a great number of UK-Limited companies and some companies incorporated in other Member States or non-member States (e.g. Serbia) have become active. A number of court cases deal with the practical issues and the conflict between company and insolvency statutes. In one of the next issues of the Alert, we will feature several articles on how such „Alien" companies are handled in several Member States (e.g. Germany or the presentation to the ECJ by a Hungarian Court).

We would be grateful if our readers could supply us with information on how „Alien" companies are handled in particular with regard to registration issues and if cases of conflict between company and insolvency law have already been decided. Of course, we would be happy to print summaries of the situation in your country in one of the next issues of the Alert!

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