Country Reports
Winter 2012

Czech Republic, European Commission, Russia, USA, Germany, The Netherlands

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Czech Republic: Czech Highest Court Defines "Known Creditor"

The highest Czech Court decision defining "known creditor" within Council Regulation (EC) No. 1346/2000 has European-wide impact. In order to understand the influence of the decision, it is necessary to briefly describe the Czech law provisions for lodging claims.

Submission of claims in insolvency proceedings

The insolvency proceeding in Czech Republic is regulated by the Insolvency Act No. 182/2006 as amended. With a minor simplification it may be noted that the Act distinguishes between the legal position of the so-called Czech creditors (creditors with residences or registered offices in Czech Republic) and foreign creditors (creditors with residence, domiciles or registered offices in one of the member states of the European Union except Denmark).

Submission of claims by Czech creditors

Pursuant to Section 110 Subsection 2 of the Insolvency Act, the insolvency court requires that creditors who want to file their claim in the insolvency proceeding must submit their claim. Creditors shall submit their claims to the insolvency court within the time period between the moment of opening of the insolvency proceeding until the lapse of the term stipulated in the ruling on insolvency. According to Section 173 of the Act, claims filed at a later date shall not be taken into consideration by the insolvency court, and shall not be satisfied in the insolvency proceeding. In short, the right to submit the claim exists only until the date stipulated in the ruling on insolvency.

Submission of claims by foreign creditors

The legal regulation of the foreign creditors' status in the Insolvency Act follows the respective provisions of the Council Regulation (EC) No. 1346/2000, which is applicable to all EU member states except Denmark. Article 40 of this Regulation states that *as soon as insolvency proceedings are opened in a Member State, the court of that State having jurisdiction or the liquidator appointed by it shall immediately inform known creditors who have their habitual residences, domiciles or registered offices in the other Member States. That information, provided by an individual notice, shall in particular include time limits, the penalties laid down in regard to those time limits, the body or authority empowered to accept the lodgment of claims and the other measures laid down. Such notice shall also indicate whether creditors whose claims are preferential or secured in rem need lodge their claims.*

The above mentioned provision was reflected in the Czech Insolvency Act in Section 430, where it states that the known creditors who have their habitual residences, domiciles or registered offices in the other member states except Denmark shall be informed forthwith about the opening of the insolvency proceeding and about the issue of a ruling on insolvency by the court. Moreover, the known creditors shall be called upon to submit their claims in separate procedure.

Who is a known creditor?

In practice, it was unclear how the term "known creditors" should be construed. On July 26, 2012, the Supreme Court of the Czech Republic answered this problem directly. The case before the court involved a foreign creditor located in Germany who was not properly identified in the debtors' accounting and who learned about the running

insolvency proceeding more than a year after it was opened (i.e. after the given period for submitting the creditors' claims).

The court of first instance stated that such a creditor was not known to the court as a known creditor at the time of initiation of the insolvency proceeding. The creditor's claim was rejected as belated on the grounds that the creditor did not have to be informed about the initiation of the insolvency proceeding and about the decision on bankruptcy. That decision was confirmed by the Court of Appeals. Moreover, it was added that the notification can only be issued by the insolvency court if the existence of a known creditor becomes apparent during the proceeding no later than the lapse of the period for lodging of claims for Czech creditors. According to the Court of Appeals, another approach would constitute an unacceptable preference for foreign creditors over others (Czech creditors and from another parts of the world).

The Supreme Court rejected and annulled both the above mentioned decisions. The negative consequences for foreign creditors were acknowledged. The EU regulation aims not only to overcome an existing language barrier, but also to overcome prejudice to foreign creditors who are usually not as familiar with the procedural rules applicable to local insolvency proceedings. Improper keeping of the debtor's records about the state of its assets and liabilities or the debtor's failure to fulfill its obligation to submit to the court a complete list of its liabilities on time and in a proper way creates no right to presume that the creditor should not be able to lodge claims in insolvency proceedings. On the other hand, a creditor will not be considered 'known' if, until the end of lapse period for admission of claims, nothing has become apparent about such creditor in the insolvency proceeding or from properly kept accounting by the debtor, or from any other lists of the debtor's assets and liabilities which the insolvency administrator had time to become familiar with.

With reference to the above-stated arguments, the Supreme Court defined the term "known creditor" as a creditor who the insolvency court or the insolvency administrator would normally have learned about from documents on the status of the debtor's assets and liabilities that the debtor is obliged to submit to the insolvency court. In addition, the court may take into consideration the accounting and correspondence with creditors.

It is necessary to stress that the duty of the insolvency court as stated in section 430 of the Insolvency Act (to inform the known creditors about the opening of the proceeding, to inform them about the issue of the ruling on insolvency and to call upon the creditors to submit their claims) does not apply to the known creditors from the Czech Republic or unknown creditors from the other EU member states except for Denmark.

Conclusion

The Supreme Court of the Czech Republic has defined the term "known creditor" in a very wide scope. According to the Court, the term refers to everyone who is mentioned in documents on the status of the debtors' assets and liabilities that the debtor is obliged to submit to the insolvency court as well as in the accounting (properly kept) and correspondence with creditors. Such definition includes *de facto* any entity who had business contact with the debtor.

> "THE SUPREME COURT OF THE CZECH REPUBLIC HAS DEFINED THE TERM "KNOWN CREDITOR" IN A VERY WIDE SCOPE"

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Single Market Act II: Modernising Insolvency Laws

On 3 October 2012, the European Commission expressed its wish for a strong, deep and integrated Single Market which creates growth, generates jobs and offers opportunities for its European citizens, which were not there 20 years ago.

The Commission, in its wish to address the current economic crisis, has adopted the "Single Market Act II", putting forward twelve key actions for rapid adoption by the EU institutions. These actions are concentrated on what is called "*four main drivers for growth, employment and confidence*", being, I am quoting again: "a) integrated networks, b) cross border mobility of citizens and businesses, c) the digital economy, and d) actions that reinforce cohesion and consumer benefits.".

Interestingly, section b) has as a third action point: (iii) "*modernise insolvency proceedings, starting with cross-border cases, and contribute to an environment that offers second chances to failing entrepreneurs.*"

For ease of reference I quote the specific abstract dealing with modernisation of EU insolvency rules to facilitate the survival of businesses and present a second chance for entrepreneurs:

"*Businesses operating in Europe benefit from an overall positive business environment, which the EU is further improving through its better regulation agenda. But more can be done. Europe needs modern insolvency laws that help basically sound companies to survive, encourage entrepreneurs to take reasonable risks and permit creditors to lend on more favourable terms. A modern insolvency law allows entrepreneurs to get a second chance and ensures speedy procedures of high quality in the interest of both debtors and creditors. We thus need to establish conditions for the EU wide recognition of national insolvency and debt-discharge schemes, which enable financially distressed enterprises to become again competitive participants in the economy. We need to ensure simple and efficient insolvency proceedings, whenever there are assets or debts in several Member States. Rules are needed for the insolvency of groups of companies that maximise their chances of survival. To this end, the Commission will table a legislative proposal modernising the European Insolvency Regulation. However, we need to go further. At present, there is in many Member States little tolerance for failure and current rules do not allow honest innovators to fail 'quickly and cheaply'. We need to set up the route towards measures and incentives for Member States to take away the stigma of failure associated with insolvency and to reduce overly long debt discharge periods. We also need to consider how the efficiency of national insolvency laws can be further improved with a view to creating a level playing field for companies, entrepreneurs and private persons within the internal market. To this end, the Commission will table a Communication together with the revision of the European Insolvency Regulation.*"

See http://ec.europa.eu/internal_market/smact/docs/single-market-act2_en.pdf.

Observations

The Communication mentioned is set for the 4th Quarter 2012. INSOL Europe members should take to opportunity to express their wishes! One observation is that the new agenda seems to reflect the EU legislatures' belief in the power of the full manufacturability of this Single (internal) market?

The Commission should consider to adopt in addition to the "top-down" legislation-ladder a "bottom-up" approach too, by inviting private actors such as INSOL Europe to express their views. The Commission's announcement of new steps aligns well with the European parliament's desire, expressed end 2011, to create "*an EU corporate insolvency framework*", including the introduction of "*corporate rescue as an alternative to liquidation*", whereas "*insolvency law should be a tool for the rescue of companies at Union level*". Undoubtedly, to be continued.

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THE UNCITRAL MODEL LAW HAS BEEN USED AS A BASIS FOR THIS DRAFT LAW

Russia: Regulating cross-border insolvency

Today there is an objective need for regulation in the area of cross-border insolvency. This need is brought about by the emergence of transnational corporations as well as Russia's further economic integration and expansion of the country's foreign economic relations. Under these conditions, due to the inherent risk of entrepreneurial activity, there is always a possibility of threat of bankruptcy on a cross-border level. Therefore, it is essential to have appropriate legal mechanisms regulating cross-border insolvency issues.

The bankruptcy legislation now in force does not regulate situations complicated by the presence of a "foreign element" (e.g. foreign creditors, debtor having assets abroad). The provisions of the Civil Code of the Russian Federation state that creation, reorganisation and liquidation of a legal entity are regulated by the laws of the country where that legal entity has been formed. However these conflict-of-law provisions cannot resolve the numerous difficulties arising in the cases of insolvency of a debtor involved in economic relations with some "foreign element".

To fill this gap, the Ministry of Economic Development of Russia prepared a draft federal law "On Cross-border Insolvency (Bankruptcy)", which is currently being considered by the State Duma of the Russian Federation.

In order to make the new mechanism for regulating cross-border insolvency procedures as highly effective and universal as possible and to minimize the probability of conflict with the provisions of foreign legislation, foreign (European) experience in this area and the UNCITRAL Model Law have been used as a basis for this draft law.

Proposed law will help protect the rights and legitimate interests of creditors from the so-called international fraud, where unscrupulous entities conceal their assets and transfer them to other countries, and will therefore improve the overall stability of property circulation.

The draft law provides clear rules for determining cases where arbitration courts of the Russian Federation have exclusive jurisdiction. For example, Russian arbitration courts will have exclusive jurisdiction where the centre of the entity's main interests is in Russia; or where its permanent representative office and/or its assets are located within the territory of the Russian Federation, although the centre of the entity's main interests is elsewhere.

In addition, the draft law introduces legal concepts of primary and secondary proceedings, previously unknown in Russia. This suggests that interested parties will be able to initiate parallel (secondary) proceedings against the same debtor but in respect of his property and other assets located abroad only. This draft law seems advantageous to creditors as it will allow them to satisfy their claims through initiating secondary proceedings in addition to primary proceedings.

Currently in Russia the cross-border insolvency practice is limited to cases involving foreign creditors. Adoption of the new law will allow for a more effective use of rehabilitation procedures in bankruptcy cases, as well as for extension of national insolvency regime to foreign assets of Russian companies.

However, there still are significant gaps in the legal

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framework. The institution of recognition and enforcement of interim decisions of foreign courts (e.g. freezing the assets of the debtor as an interim measure) is still underdeveloped. The main issue is the impossibility of enforcement of such decisions on the territory of the Russian Federation because they are not final judgements on the merits of the case, and the Arbitration Procedure Code of the Russian Federation only provides for recognition and enforceability of such final judgements. The draft law on cross-border bankruptcy touches on this issue, but unfortunately only in relation to the court's obligation to enforce an interim decision and the possibility of appealing against it. This gap cannot be ignored as all the efforts of the legislator shall be in vein if we fail to offer a satisfactory legal framework to foreign creditors.

Further, the draft law doesn't impose a time-limit on possible duration of a bankruptcy procedure. Experts suggest that a compulsory assessment of the cost effectiveness of bankruptcy procedures should be introduced to prevent the creditors from suffering financial losses in the future due to high complexity and length of such insolvency procedures.

It should be stressed that presence or absence of clear and transparent regulation of all cross-border insolvency issues within the legal framework of a particular country significantly influences the degree of attractiveness of its local businesses to foreign investors.

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USA: The Mexican Hat Dance: the Story of Vitro

On 28 November 2012, the United States Fifth Circuit Court of Appeals ruled that the Plan of Reorganization (a "Concurso" Plan) of Vitro, S.A.B. de C.V., confirmed in Vitro's Mexican bankruptcy case, was not enforceable in the United States, under Chapter 15 of the US Bankruptcy Code.

Vitro, founded in 1909, is Mexico's largest manufacturer of flat glass and beverage bottles, with 2010 turnover of approximately $1.8 billion. Vitro operated through subsidiaries in 11 countries, including the United States. Vitro defaulted on bond debt of approximately $1.2 billion. After a failed workout with the bondholders, Vitro filed an insolvency proceeding in Mexico under Mexico's Business Reorganization Act. Immediately upon filing, Vitro filed a "Concurso" Plan which a Mexican commercial court approved. The Concurso Plan was approved in part based upon the affirmative vote by Vitro subsidiaries holding intercompany claims totalling $1.8 billion.

Among other terms, Vitro's Concurso Plan provided for a 40% haircut for the bondholders, and unilaterally released the guaranties of Vitro's subsidiaries in favour of the bondholders. The Mexican court approved Vitro's Plan, overruling the bondholder's objections that the Plan improperly discounted the bondholders' debt while allowing Vitro's shareholders to retain their equity interests; improperly extinguished guaranties held by the bondholders from non-debtor parties; and improperly allowed affiliated entities to vote their intercompany claims in support of the Plan.

Despite Vitro's Mexican insolvency proceeding, the bondholders continued to pursue Vitro and its subsidiaries in courts in the United States. In response, Vitro filed for Chapter 15 to invoke the automatic stay to enjoin the lawsuits. In addition, Vitro petitioned the United States Bankruptcy Court in the Chapter 15 to in essence adopt and enforce Vitro's Mexican "Concurso" Plan in the United States. If enforced, the bondholders' guaranties from Vitro's subsidiaries would be released, leaving the bondholders unable to assert claims against Vitro's subsidiaries.

In Vitro's United States Chapter 15 proceeding, the bondholders opposed enforcement of Vitro's Concurso Plan. The United States Bankruptcy Court for Vitro's Chapter 15 case agreed with the bondholders, because a plan releasing guaranties of non-debtor parties violated United States public policy, since United States insolvency laws rarely allow for releases of liability in favour of non-debtor parties. Hence, the United States court refused to grant comity to the Mexican Court's approval of Vitro's "Concurso" Plan.

Chapter 15 is the United States' version of the United Nations Model Law on cross-border insolvency. It is designed to allow United States Courts to assist foreign courts and insolvency administrators that are supervising foreign insolvency cases. Chapter 15 is at its essence a statute of comity and will be applied to assist foreign courts provided there is no violation of United States public policy.

On appeal, the United States 5th Circuit Court of Appeals upheld the Bankruptcy Court's ruling, but not based on the public policy exception. Rather, the 5th Circuit simply found that discharging obligations of non-debtor parties is not relief available to Chapter 15 debtors. Even though the Court of Appeals avoided basing its decision on the public policy exception, we predict future Chapter 15 cases will address the public policy exception to United States Courts granting comity to foreign courts in insolvency cases.

Germany:
News on the infamous German Balance Sheet Test – The final curtain?

On 8 November 2012 German parliament met again to fine tune the often heard of but rarely understood German balance sheet test. The German insolvency Code does, as one may recall, feature two insolvency triggers – one being illiquidity and the other being over-indebtedness based on a balance sheet test, where the balance sheet is a non-statutory special purpose balance sheet reflecting marketable assets at time values and all obligations, unless subordinated.

It was in October 2008, the early days of the financial crisis, when German parliament decided to ease the insolvency test introduced with the new Insolvency Code in 1999. Until 2008 corporations had the mandatory insolvency filing requirement if over-indebted. Filing has to be instant, with the 21 day grace period, where there is hope. In going concern situations the valuation was allowed to be a going concern, else it was liquidation values.

The change introduced in October 2008 was that a test had only to be done if there was no going concern. This reintroduced the rule that applied pre 1999. Therefore, the balance sheet test was again only applicable in situations where a going concern was less than likely. As the measure was intended to mitigate the effects of the financial crisis the eased rules were for a limited time only and due to expire on 31 December 2013. Building on arguments of report commissioned by the Federal Government in early 2012 that was based on a survey of experts in the insolvency and the restructuring profession, the legislator has now decided to keep the eased rules until further notice.

Finally, please find the author's ultimate attempt to provide assistance to those that always wanted to try the German balance sheet test themselves. The DIY chart provided does even include the viability test that has gained wider publicity in German professional literature recently.

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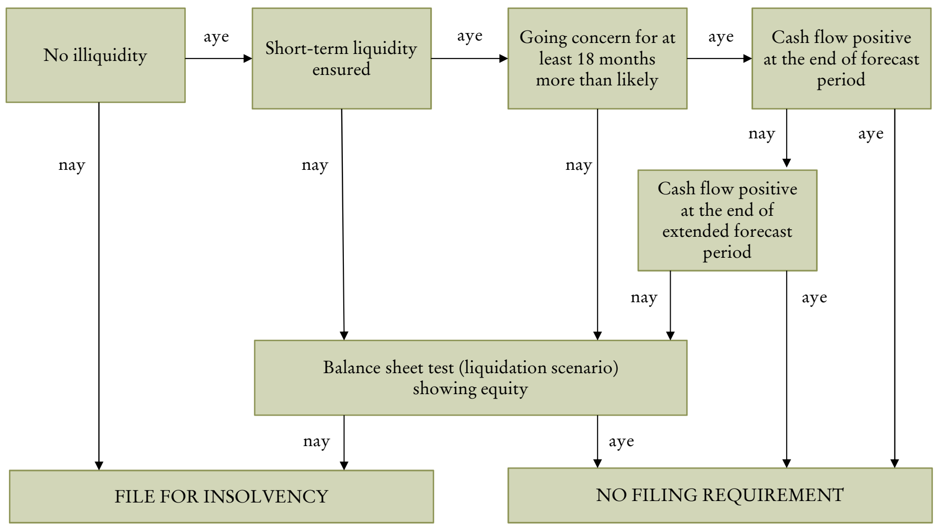
The German balance sheet test



Netherlands:
New legislation shall force a "secured" lender to warn the tax-authorities before foreclosing

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A lender having a right of a pledge on inventory in the Netherlands (the term "inventory" comprises also heavy machinery on the premises of the debtor) needs to warn the tax-authorities four weeks in advance, prior to making use of its rights. That is, if the Dutch parliament finalizes the legislative process to that extent in December 2012. The warning aims to provide the tax-authorities with sufficient time to make an attachment on the inventory in favour of its claims. The same obligation shall apply to financial lessors of inventory and creditors claiming retention of title.

Although the legislation is likely to come in to force on 1 January 2013 and will be applicable for tax-debts that arise as of then, it provides a short 'term the grace' of three months for rights existing on 1 January 2013.

In the event the legislation acquires force of law, the author will write a more extensive article on the background of this legislation and the consequences for the several parties involved.