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Impact of new insolvency law on the insurance industry

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Following the recent economic crisis, the need arose to make it easier for insolvent companies to continue their business through restructuring. This objective was achieved through a reform to the Insolvency Law 2010.

Restructuring proceedings

The reform introduced a uniform Insolvency Act, which now provides for restructuring proceedings. Provided that the debtor offers its creditors a minimum quota that is 30% payable within two years, restructuring proceedings with self-administration may be initiated. The debtor may run the self-administration and be supervised only by a restructuring administrator appointed by the court. If the debtor cannot provide the minimum quota of 30% payable within two years, but instead provides only 20%, it is still allowed to file a restructuring plan together with the opening application. In such case the court will appoint an insolvency administrator and the restructuring proceedings will be processed without self-administration of the debtor.

Limited right to termination of contracts

A further important alteration introduced by the law is the restriction of creditors' rights to terminate contracts with the debtor when insolvency proceedings are opened. Until now, many creditors exercised this right. However, in particular, the termination of lease contracts, energy supply and telephone contracts may hinder the restructuring of the company. The law thus facilitates the continuation of insolvent companies and their restructuring. If the termination of a contract may harm the continuation of the company, the creditor may terminate the contract within six months after opening of insolvency proceedings only upon good cause being shown. The deterioration of the debtor's financial situation and the non-fulfilment of a claim that became due before the opening of insolvency proceedings are not to be considered as such good cause. These restrictions do not apply:

- to the termination of employment contracts;
- to entitlement to the disbursement of a credit; and
- when the termination of the contract is essential for the avoidance of severe personal or economic detriment to the contractual partner - such a severe personal or economic detriment will exist where the creditor is also threatened with insolvency.

This leaves scope for interpretation that undermines legal certainty.

Impact on insurance industry

It has been market standard to include 'insolvency clauses' in financial lines insurance policies in particular. These clauses provide for an automatic end to the policy term if insolvency proceedings are initiated involving the policyholder or (in some policies) if the policyholder files a petition for insolvency. From the point of view of the act, such insolvency clauses are now ineffective (at least in usual circumstances, as there will be no good cause).

However, under Section 14(1) of the Insurance Act, the insurer may stipulate the possibility of terminating the insurance relationship with one month's prior notice in the event of insolvency proceedings being opened involving the policyholder. This provision clearly is in stark conflict with the Insolvency Act provisions described above.

It is disputed which of these two provisions prevails and, unfortunately, no precedent is available. There are arguments to the effect that the Insurance Act provision prevails, as it is specific to insurance policies. However, the majority opinion appears to be that the Insolvency Act provision prevails, as it is the newest provision and sets out an exhaustive list of exceptions, which does not include insurance policies.

Practical consequences for D&O policies

The parties to directors' and officers' policies usually agree on insolvency clauses, which refer to the opening of insolvency proceedings. As discussed, there is a high risk that such clauses are now invalid.

It is therefore recommended that insurers explicitly exclude claims arising out of or in connection with factual insolvency, although the policy itself remains in place. Thereby, coverage for claims against directors and officers for damages on the basis of culpably delaying insolvency proceedings - which is one of the main threats to directors and officers under Austrian law - will be excluded.

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