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Avoiding liquidation

Insolvency law reform in Austria is based on the idea of avoiding stigma. But, ask Andreas Zahradnik and Alexander Schopper, is the change nothing more than a matter of semantics?

The forthcoming reform of Austrian insolvency law is based on the motto 'reorganisation instead of liquidation' and is considered an important and necessary response to the current difficult economic environment. The new rules are under discussion and are expected to enter into force this spring.

The core amendments of the draft legal framework focus on developing mechanisms to reduce rejection of applications to initiate bankruptcy proceedings for lack of assets, offering tools for procedural simplicity, flexibility and cost efficiency, and to encourage early recourse to the proceedings by debtors facing financial difficulties, thus enhancing the chances of successful reorganisation.

With a view to protection of creditors, under the planned new rules the debtor has to establish a financial restructuring plan. The debtor is obliged to offer its creditors a minimum quota of (as planned) 30 per cent of its unsecured claims, to provide information on the enterprise as well as on how the funds required to pay the quota will be raised. Finally, the financing of the continued business operations must be ensured. Therefore an additional finance plan is required.

Essential amendment

An essential amendment is envisaged regarding the possibility of self-administration in financial restructuring proceedings. Currently, it is only possible for the management to remain in charge – but closely supervised by a court-appointed administrator – by filing for composition (instead of bankruptcy) proceedings. However, owing to the high level of required debt-payback (40 per cent), composition proceedings in practice rarely occur.

Forced competition

Therefore, in 2008, one third of Austrian bankruptcy proceedings closed with financial restructuring via 'forced composition'. To reduce its debts, the debtor under the existing rules has to pay the creditors a minimum quota of 20 per cent over two years, with the requirement that a qualified majority of creditors approve the forced composition proposal. However, bankruptcy proceedings generally come along with the appointment of a receiver, who completely takes over the management.

The planned reform offers the possibility of self-administration under the mere supervision of a receiver by offering a quota of 30 per cent. After their appointment the receiver immediately has to start reviewing the debtor's economic situation and to verify that the debtor is able to meet the requirements of the financial restructuring plan, as well as to carry out their finance plan. Moreover, the self-administration is limited to 90 days. If the financial restructuring plan is not accepted within this time limit, the self-administration is cancelled.

Another substantial amendment affects creditor approval requirements. The reduction of the requirement to get the approval of creditors holding three-quarters of the debt to a simple majority is a big step towards procedural simplification. To be accepted, a financial restructuring plan needs a simple majority of creditors and capital. Major creditors get deprived of their power, which so far results from their position as a blocking minority. This ensures that more weight is given to the interests of the debtor and the smaller creditors.

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To diminish the accompanying negative connotation of the term 'forced composition', the process is now being called a 'financial restructuring plan' and in future bankruptcy proceedings will be called 'financial restructuring proceedings'.

An issue subject to heated discussions is the preference of those banks giving loans for financial restructuring concepts outside of an insolvency proceeding. It is intended that the repayment and securing of such loans can be challenged by the receiver in a bankruptcy after an unsuccessful restructuring only under very restricted circumstances.

Challenging dealings

The rationale of challenging dealings within certain hardening periods prior to the opening of insolvency proceedings is to ensure equal treatment of creditors. Dealings after the point when the entrepreneur is unable to pay or considered over-indebted, can be challenged even when they are considered only indirectly disadvantageous to the creditors.

The crucial point is that under these circumstances, loans for financial restructuring currently can also be challenged by the receiver if the bank knew or should have known about the inability to pay, which of course reduces the appetite of banks to grant such loans. To minimise the risk of false judgment in this context, but not to jeopardise the positive effects of the possibility to challenge, in future this should only be possible if the bank knows for sure or when it is obvious that the restructuring concept of the debtor is ineffective. Critics claim that this would

privilege banks as compared with other creditors (for example, social insurance carriers who strive to get the same benefit).

Further draft provisions subject to public discussion, concern the limitation of rights of the contractual partners of an insolvent enterprise in financial restructuring proceedings to terminate agreements (for example, lease agreements) owing to insolvency. While this is of importance to facilitate the continuing of operations of an enterprise in restructuring, it creates additional risks for its contractual partners – in particular when the restructuring fails.

Although there is a broad consensus that a reform of the Austrian insolvency law is needed, it remains to be seen if its effectiveness is weakened by compromises that result from the ongoing discussions.

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