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The International Comparative Legal Guide to:

Corporate Recovery & Insolvency 2007

A practical insight to cross-border Corporate Recovery & Insolvency

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1 Issues Arising When a Company is in Financial Difficulties

1.1 How does a creditor take security over assets in your jurisdiction?

Under Spanish Law, *in rem* security interests are conceived as rights created upon certain assets which allow creditors to enforce their credit rights against those assets with priority over other creditors of the owner of the assets. See questions 3.2 and 5.2 regarding restrictions for enforcement and ranking of secured creditors.

In order to take security over the debtor's assets, a creditor has a wide range of possibilities under Spanish Law:

(i) Pledge (*prenda*) over movable assets with respect of which the Law does not allow the registration of the pledge (see (ii) below). This type of pledge, which is applicable to almost all types of movable assets (shares, credits, etc.), requires mandatory transfer of possession on the relevant asset from the debtor (or owner of the asset) to the secured creditor. The pledge is granted in a public deed in order to have evidence of the date when the pledge was granted and cannot be registered.

(ii) Pledge over certain movable assets (machinery, assets with serial number, stocks, harvest products, livestock, farm machinery) that do not involve the mandatory transfer of possession of the relevant asset (*prenda sin desplazamiento*). This type of pledge is granted in a public deed and registered.

(iii) Mortgage created on real estate assets (*hipoteca*). A mortgage must be granted in a public deed and registered with the Property Registry. No transfer of possession is necessary as the principles underlying the Property Registry allows everyone to be aware that a certain asset is the subject of a security interest.

(iv) Mortgage on certain movable assets (businesses, motor vehicles, railway wagons, airplanes, industrial machinery, industrial and intellectual property) (*hipoteca mobiliaria*). This type of mortgage on certain movable assets must be granted in a public deed and registered. No transfer of possession is necessary.

1.2 In what circumstances might transactions entered into whilst the company is in financial difficulties be vulnerable to attack?

The Spanish Insolvency Act (the "**Insolvency Act**") provides a claw-back period of two years starting from the date when the insolvency is declared by the Judge. All transactions carried out during such period can be declared void if they have caused a damage to the debtor's estate, even if no fraud has been committed. Payment and settlement transactions in securities and financial markets and those entered into by the debtor in the ordinary course of business on an arm's length basis are not subject to claw-back claims.

As a general rule the party who claims the annulment of a particular transaction carried out within the claw-back period (i.e. the receivers or a creditor, which is entitled to do so if the receivers do not claim such annulment) must give evidence of the damage caused to the debtor's estate.

However, in the following cases it is presumed that damage to the debtor's estate has been caused irrespective of the evidence brought: (i) transfer of assets without consideration; and (ii) prepayment of indebtedness maturing after the time the insolvency is declared.

In addition, in the following cases it is presumed that a damage has been caused to the debtor's estate (although the debtor is allowed to bring the necessary evidence to destroy the presumption): (i) transfer of assets to any of the persons which are "specially linked with the debtor" (e.g. inter-group transactions); and (ii) security granted for securing existing non-secured obligations or new obligations replacing non-secured obligations;

If the Judge annuls a transaction under the claw-back provisions, the Judge will order that the party who has received any asset from the debtor returns it back with its interests and proceeds. If this cannot be carried out because the relevant asset was subsequently transferred to a party under any of the circumstances provided by Law according to which such sale cannot be annulled, the first acquirer will be obliged to deliver to the debtor's estate an amount equal to the value of the asset previously given plus interests calculated at the interest rate provided by Law.

The consideration delivered by such first acquirer in the voided transaction would be considered as a credit against the debtor's estate that must be paid simultaneously with the return to the debtor by the first acquirer of the relevant asset.

However, if the Judge considers that the relevant transaction has been carried out in bad faith, the first acquirer will be obliged to indemnify all the creditors. Likewise, it will be considered that the acquirer's right to the return of the consideration delivered is only a subordinated credit to be paid once all the unsecured creditors have been fully paid.

1.3 What are the liabilities of directors (in particular civil, criminal or disqualification) for continuing to trade whilst a company is in financial difficulties in your jurisdiction?

If the directors continue to trade whilst a company is in financial

difficulties, they may face the liabilities referred to below. Directors' liabilities under any of these grounds can be claimed independently.

(i) Capital impair situation

According to article 260.1.4º of the Spanish Public Companies Act, if the company's net worth is reduced by losses to less than 50% of the share capital, the company is in a statutory cause of compulsory dissolution. Directors are obliged to call a general shareholders' meeting within the two months following the date they become aware - or should have become aware - of this situation, in order to pass a resolution to dissolve or to recapitalise the company.

If the general meeting is not held, or if none of these resolutions are passed, the directors are required to lodge a judicial claim requesting the dissolution of the company within the two months following the date of the general meeting or when such meeting should have been held.

If the directors fail to comply with these obligations, they will be held joint and severally liable for those obligations arising after the capital impairment situation. All credits will be presumed that have arisen after the capital impairment situation, unless directors give evidence on the contrary.

Directors' obligation to apply for judicial dissolution may be substituted by an application for insolvency if the company is in insolvency as provided in question 2.2 below.

(ii) Liability in case of guilty insolvency

If the insolvency proceedings leads to the liquidation of the company, or to a creditors' agreement which provides for a reduction higher than 1/3 of the liabilities of the company or for a stay of more than three years, the Insolvency Judge shall analyse if the insolvency should be declared guilty or not.

Pursuant to the Insolvency Act, the insolvency would be qualified as guilty if it has been caused or aggravated due to the debtor's and/or its directors' (including shadow and *de facto* directors) wilful misconduct or gross negligence. Absent evidence to the contrary, wilful misconduct or gross negligence will be presumed in the following cases (among others):

(a) where directors fail to file an application for insolvency within two months from the date when they knew or should have known the insolvency situation of the company; and

(b) where the annual accounts related to the three fiscal years preceding the declaration of insolvency have not been issued, or audited or, once approved, have not been deposited with the Commercial Registry.

Additionally, it must be highlighted that, among other cases, the Insolvency Act provides that the insolvency will be declared in any case as guilty if:

1. the debtor has not complied with its accounting obligations or has double accounting or incurs a relevant irregularity that may affect the understanding of its net worth or financing situation;
2. the assets of the debtor are fraudulently transferred from the debtor's estate during the two years prior to the declaration of insolvency; or
3. the debtor has carried out acts with the intention to simulate a fictitious net worth position.

If the insolvency is qualified as guilty, the Judge may order that the directors (including shadow and *de facto* directors) and all the persons who have fulfilled management functions within the two years prior to the insolvency declaration (i) are disqualified to manage assets or to become a director for a period of 2 to 15 years; (ii) lose any claims that may be held against the debtor; and (iii) indemnify any damages caused and -in the event that the insolvency proceedings end in liquidation- pay the amount of credits that remain unpaid after the liquidation of the debtor.

Likewise, the Insolvency Act foresees that at any stage the Judge may order the seizure of goods owned by directors (including shadow and *de facto* directors during the above referred period of time) when it is foreseeable that the insolvency will be declared as guilty and that there would not be enough assets to pay all debts.

The existence of any of the above referred circumstances or facts that may cause the insolvency to be considered guilty may be alleged by any of the creditors, but will be in any case investigated by the Judge with the assistance of the Trustees.

(iii) Criminal liability

Under Spanish Criminal Law (*Código Penal*), directors guilty of criminal liability may be punished by prison (from two to six years) and with penalties (from eight to twenty-four months), if they have caused or wilfully aggravated the insolvency of the company.

1.4 Is it common to achieve a restructuring outside a formal procedure in your jurisdiction? In what circumstances might this be possible?

The decision to structure a corporate rescue through out-of-court negotiations with creditors or through formal insolvency proceedings depends very much on the applicable circumstances of each case.

It may be possible to achieve a rescue by rescheduling debt or changing its terms, but unless debt is held by a reduced number of lenders, out-of-court restructurings are not usual in Spain as a way to structure a corporate rescue because these agreements do not bind the creditors which are not a party of them, who may accelerate debt or commence legal proceedings to recover overdue debt.

If secured creditors hold the main part of debt, this sometimes makes it more convenient to structure a corporate rescue through out-of-court negotiations.

In this respect, the procedure provided by the Insolvency Act, may help to implement pre-pack arrangements already negotiated out-of-court by the debtor with some key creditors, in order to impose such arrangements to the rest of the creditors (except for secured and privileged creditors) through an Anticipated Creditors' Agreement (see question 6.1 below).

2 Formal Procedures

2.1 What are the main types of formal procedures available for companies in financial difficulties in your jurisdiction?

The Insolvency Act establishes a single procedure ("*concurso*") for any type of insolvencies (both liquidation and restructuring) which is governed by a Judge with participation by a number of Trustees. This procedure has a common phase and two different solutions, namely:

(a) A creditors' composition agreement, whose purpose is to reach an agreement between the debtor and the creditors for the payment of their credits and is designed to permit the debtor to reactivate its business under certain conditions set forth in the agreement.

(b) The liquidation of the assets of the debtor in order to pay its debts. This option shall only proceed in the absence of creditors' composition agreement; in case of non-compliance by the debtor with the composition agreement; or when the debtor requests so.

During the ***common phase***, the Judge will appoint the members of the Trustees panel (the "**Trustees**"), whose main function is to determine the debtor's estate and existing debts, and to control the management of the debtor's business. This stage is concluded with a report drafted by the Trustees on the inventory of the debtor's estate and the list of creditors.

2.2 What are the tests for insolvency in your jurisdiction?

The test for insolvency is the incapability of the debtor to comply with its obligations regularly when they become due and payable.

Additionally, the debtor can apply for insolvency if the debtor foresees that it will not be able to regularly comply with its obligations.

2.3 On what grounds can the company be placed into each procedure?

See question 2.2 above.

2.4 Please describe briefly how the company is placed into each procedure.

Either the debtor or any of its creditors may file for the insolvency of the debtor.

The directors of a company have the obligation to file for insolvency (a "**Voluntary Insolvency**") within two months from the date its directors become aware or should have become aware of the insolvency situation. Once the debtor evidences to the Judge its indebtedness and insolvency situation, the Judge automatically declares the debtor to be insolvent. The failure of a debtor to file for Voluntary Insolvency where it is required to do so subjects the company and its directors to various sanctions (see question 1.3 above).

Where a creditor files an application for the insolvency of a debtor (an "**Involuntary Insolvency**"), the creditor must base its claim on the insufficiency of attachable assets when enforcing its credits against the debtor, or otherwise to provide evidence of any of the following facts:

(a) general default of the debtor's payment obligations;

(b) general seizure of the debtor's assets;

(c) sale of the debtor's assets at a loss or in a negligent manner; and/or

(d) the debtor's failure to pay during the three-month period preceding the filing for Involuntary Insolvency its (i) tax liabilities; (ii) social security obligations; or (iii) salary and other monetary employment obligations.

2.5 What notifications and meetings are required after the company has been placed into each procedure?

Declaration of the insolvency would be made public by placing the corresponding advertisements in the Spanish Official Gazette and in a newspaper of the same province where the debtor is located.

Creditors must communicate their credits to the Trustees one month after the last placed advertisement.

Likewise the declaration of the insolvency should be registered in all Public Registries and published on the website www.publicidadconcursal.es run by the Spanish Ministry of Justice and the Registries Association.

2.6 How does somebody establish whether the company has been placed into one of these procedures?

Only the Judge may declare that a debtor is in insolvency (for publicity of the insolvency see question 2.5 above).

3 Creditors

3.1 Are unsecured creditors free to enforce their rights in each procedure?

No enforcements may be started during the insolvency proceedings.

Enforcement of claims initiated before the declaration of insolvency will be suspended from the date of the declaration of insolvency except those of an administrative and labour nature to the extent that they are enforced on assets which are not necessary to carry out the business of the debtor.

3.2 Can secured creditors enforce their security in each procedure?

Secured creditors (including financial lessors) may not foreclose their collateral upon the declaration of insolvency if the security relates to assets which are assigned to the activity of the debtor. Rather, such creditors will be required to wait until either a creditors' composition agreement is passed or one year has passed since the declaration of insolvency, whichever occurs earlier.

If the secured assets are not assigned to the activity of the debtor, secured creditors can enforce their security. According to the scarce existing case-law, Spanish Courts are considering that assets are not assigned to the activity when the debtor ceases to carry out business or at least the part of it with respect of which the specific asset is required.

3.3 Can creditors set off sums owed by them to the company against amounts owed by the company to them in each procedure?

No set-off can be carried out after the declaration of insolvency. If requirements for set-off are met prior to the declaration of insolvency, set-off will be totally effective.

Notwithstanding any possible claw-back actions, insolvency will not affect the right of the creditor to set-off if the Law that governs the reciprocal credit of the debtor allows set-off in case of insolvency.

4 Continuing the Business

4.1 Who controls the company in each procedure? In particular, please describe briefly the effect of the procedures on directors and shareholders.

The declaration of insolvency does not affect the continuation of the debtor's ability to continue trading. However, upon request by the Trustees the Judge may decide to shut down the debtor's operations totally or partially.

Subject to judicial discretion, during the common phase of the insolvency proceedings the Trustees will replace the debtor's existing management in case of an Involuntary Insolvency; and will have certain supervisory powers over the debtor's management in case of Voluntary Insolvency. Although this is the general rule the

Judge is entitled to modify this regime at the beginning and during the insolvency proceedings. Once the common phase ends and the liquidation starts, to the extent that no creditors' agreement is discussed, directors of the debtor will cease in their functions, which shall be performed during for the liquidation by the Trustees.

Trustees have the right to assist and participate in the board and shareholders meetings of the debtor.

The insolvency does not have any special effect on shareholders.

4.2 How does the company finance these procedures?

If we compare the Spanish Insolvency Proceedings with the insolvency proceedings in other jurisdictions, the cost of the Spanish Insolvency Proceedings is low (it is quite cost-effective) due to the fact that (i) steering committees are not established and consequently no fees arise in this respect; and (ii) the debtor does not pay the creditor's lawyers fees nor the steering committee's lawyer fees.

Almost all fees incurred by the professionals acting in the insolvency proceedings for the benefit of the debtor are considered credits against the debtor's estate, and therefore are paid prior to any other credit.

The fees of the Trustees are determined by law.

Insolvency would be terminated at any time if it is evidenced that there are not any assets to pay creditors.

4.3 What is the effect of each procedure on employees?

Employment contracts may become subject to amendment, suspension or termination, including those relating to severance payments, or golden parachutes of high-ranked employees.

The Insolvency Judge has jurisdiction to rule on labour claims of the debtor's employees. Among the Judge's labour and employment powers is the ability to (i) dismiss, under certain circumstances, senior employees of the debtor; (ii) decide on the compensation of such employees; and (iii) rule on collective employment reorganisation measures.

4.4 What effect does the commencement of any procedure have on contracts with the company and can the company terminate contracts during each procedure?

Early termination clauses triggered by the declaration of insolvency become void and unenforceable.

As regards contracts with reciprocal obligations for both parties that are pending to be performed at the time of the declaration of the insolvency, such declaration will not affect the existence of the relevant contract that will continue in force and effect. Any obligations of the debtor under such contract will be funded with the debtor's estate. However, the competent Judge may declare, if convenient for the insolvency proceedings, the termination of such contracts upon request by the Trustees or by the debtor even if no specific termination provision exists. In the absence of an agreement on the termination terms the Judge will determine such terms including the indemnification to the creditor that must be paid with the debtor's estate.

Additionally, any non-compliance by any of the parties of a contract occurring after the declaration by the Judge of the insolvency may enable the non-defaulting party to apply to the Judge for the termination of the agreement. However, the Judge may decide not to terminate the agreement if it considers that it is convenient for the insolvency proceedings. In this case the Judge will determine that any obligation arising under such agreement will be satisfied by the debtor's estate.

Likewise, the Trustees may request the reinstatement of loans, credits and other financing agreements, if any of those agreements were terminated during the three months prior to the declaration of the insolvency, provided that the creditor prior to the declaration of the insolvency did not initiate the enforcement of its credit. The Trustees shall pay or deposit all the amounts owed until the time the relevant agreement is reinstated and undertake to pay all future amounts on account of the debtor's estate.

Interest on unsecured claims ceases to accrue, while interest on secured claims continues to accrue up to the value of the collateral.

5 Claims

5.1 Broadly, how do creditors claim amounts owed to them in each procedure?

See question 2.5 above regarding communication of credits.

5.2 What is the ranking of claims in each procedure? In particular, do any specific types of claim have preferential status?

Where the insolvency proceedings result in the liquidation of the debtor, its debts are paid in the following order:

1st. Claims against the debtor's estate: Certain debts incurred by the debtor following the declaration of insolvency, including inter alia: (i) salary claims corresponding to the immediately preceding 30-day period, subject to a limit of twice the minimum salary; (ii) legal costs, expenses of the insolvency or for filing the insolvency proceedings (with certain limits); (iii) Trustees' fees; (iv) debts incurred during the insolvency proceedings in the ordinary course of the business or any other obligations with the approval of the Trustees; (v) credits due as a consequence of reinstatement of credits; and (vi) credits for claw-back actions due to third parties who acted in good faith (see question 1.2).

2nd. Special privileged claims: Credits secured with assets of the debtor and which are paid on account of said assets with preference over any other creditor. Such special privileged credits include (i) mortgage and pledge claims; (ii) salary claims arising from assets manufactured, restored or repaired by employees while such assets are owned by or are in the possession of the debtor; (iii) lease and retention of title; (iv) credits secured with securities; and (v) pledge over credits and claims.

3rd. Generally privileged claims: Credits that are paid with preference over any creditor other than those referred above, including inter alia: (i) other salary claims and redundancy payments up to a certain threshold; (ii) tax and social security liabilities (for certain credits up to 50% of the amount owed); (iii) non-contractual civil liabilities; and (iv) in the case of Involuntary Insolvency, 25% of the amount of the claim of the creditor that filed for insolvency.

4th. Ordinary claims: Credits that are not classified by the Insolvency Law as privileged (either specially or generally) or subordinated.

5th. Subordinated claims: Credits that will only be paid out once all other credits (privileged and ordinary) have been satisfied in full, including: (i) claims for which timely notice has not been given to the Trustees; (ii) contractual subordination claims; (iii) claims of individuals and companies related to the debtor (e.g. group companies, certain shareholders, directors, liquidators, relatives);

(iv) claims for interest and penalty payments; and (v) credits for claw-back actions due to third parties who acted in bad faith (see question 1.2).

Please note that this ranking would not be applicable if the insolvency proceeding is ended by a creditors' agreement.

5.3 Are tax liabilities incurred during each procedure?

There are no particularities on tax liabilities or tax regime for trading whilst the company is in insolvency.

6 Ending the Formal Procedure

6.1 Is there a process for "cramming down" creditors who do not approve proposals put forward in these procedures?

All unsecured creditors and subordinated creditors and those secured and privileged creditors that may voluntarily vote, shall be bound by the Creditors' Agreement approved with the applicable majority (see below).

A proposal of the composition agreement may be filed by the debtor with the support of creditors representing at least 20% of the total debt for its early approval before the end of the common phase (the "**Anticipated Creditors' Agreement**"). In such case, if creditors representing more than 50% of the ordinary credits adhere to the Anticipated Creditors' Agreement before the end of the common phase, the composition agreement is deemed to be approved without further action and without the need for holding a general creditors' meeting (however such composition agreement will be subject to the formalisation of the final inventory and the list of creditors by the Trustees).

Anticipated Creditors' Agreement could be a workable way to implement pre-pack arrangements agreed out-of-court by the debtor with key creditors as once approved with the majorities disclosed above, all creditors (other than, in principle, privileged creditors - see below) will be bound by such composition agreement. Additionally, if the proposal of Anticipated Creditors' Agreement is filed by the debtor with its application for insolvency with the support of creditors that at least hold 20% of the total debt, the Anticipated Creditors' Agreement will substantially shorten the length of the proceedings as will be approved during the common phase.

Where the debtor does not propose an Anticipated Creditors' Agreement (or where support for such proposed composition agreement falls below the 50% threshold discussed above), the Court will call a creditors' meeting to negotiate a composition agreement (the "**Ordinary Creditors' Agreement**"). Either the debtor or creditors holding 20% of the company's outstanding claims can propose an Ordinary Creditors' Agreement, which will be submitted for the approval of creditors within the general creditors' meeting to be called by the Judge once the common phase is closed.

In this regard, a simple majority vote of the creditors who actually vote on the Ordinary Creditors' Agreement (i.e., votes in favour exceeding votes in opposition), rather than the support of creditors holding 50% or more of the debtor's ordinary claims, will be required where the Ordinary Creditors' Agreement contemplates the full payment of outstanding claims in less than three years or the immediate payment of outstanding claims with a discount of not more than 20%.

Only ordinary, secured and privileged creditors have the right to vote on composition agreement proposals. Subordinated creditors and assignees of credits who have acquired the credit after the declaration of insolvency have no right to vote. This rule makes it difficult to create a distressed debt market.

The approved composition agreement binds ordinary and subordinated creditors. Secured and privileged creditors will only be bound to the extent they vote the composition agreement. Subordinated Creditors will be paid under a composition agreement once all ordinary creditors (and if applicable privileged creditors) are paid. In the event the composition agreement provides for a stay, subordinated creditors stay shall be counted from the day the stay for ordinary creditors terminated.

A composition agreement may not provide for:

(a) a change in the creditor's ranking (e.g. subordinated creditors could never be paid *pari passu* with ordinary creditors);

(b) a moratorium for more than 5 years;

(c) a debt reduction for more than 50% of the debts; or

(d) a "hidden" liquidation by assigning any asset of the debtor to the creditors in discharge of any debt

6.2 What happens at the end of each procedure?

An insolvency proceeding may be terminated by the approval of a composition agreement between the debtor and its creditors (see question 6.1 above) or by the liquidation of the debtor's estate.

The debtor may request its liquidation with the application for insolvency and at any time during the insolvency proceedings, provided that such request is made within five days after the filing of a composition agreement by the creditors (or where a composition agreement has been submitted by the debtor, at any time prior to its approval).

Further, in case that a composition agreement is proposed by the creditors and is passed without the approval of the debtor, the debtor is also entitled to oppose to such agreement and simultaneously request its liquidation within the 10 days following the approval of said agreement.

In addition, the debtor must file for liquidation if the debtor defaults its payment obligations during the performance of the composition agreement. Finally, the Judge itself may seek the liquidation of the debtor if:

(a) a proposed composition agreement submitted by the debtor is not approved by the creditors;

(b) no composition agreement is filed;

(c) a composition agreement is declared null and void by a court; or

(d) the debtor's default in the performance of the composition agreement is declared by a Court.

7 International

7.1 What would be the approach in your jurisdiction to recognising a procedure started in another jurisdiction?

The EU Insolvency Regulation provides a set of rules for determining the competent jurisdiction and how assets and creditors of insolvent EU companies are to be treated in each case. It goes without saying that the EU Insolvency Regulation is applicable in Spain.

With regard to those international insolvency proceedings which are not governed by the EU Insolvency Regulation, it should be highlighted that the Insolvency Act has a private international law

system very similar to the EU Insolvency Regulation, which enables the recognition of international insolvency rulings through *exequatur* proceedings provided that a series of conditions are satisfied.

The Insolvency Act follows a "cooperative-reciprocity" approach in relation to non-EU insolvencies according to which such insolvencies shall be recognised through the *exequatur* proceeding assuming in principle that the same resolution if issued by a Spanish Court would be recognised in the State in which the resolution has been issued. Only if lack of reciprocity from such State is evidenced, then Spanish Courts would not recognise such resolution.

Consequently, no evidence of reciprocity needs to be rendered when requesting the exequatur before the Spanish Court. This cooperation principle is more friendly to the recognition of foreign resolutions than the more strict pure "reciprocity" approach where the party requesting the recognition of the foreign resolution needs to give evidence of such reciprocity *ex ante*.

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His practice has an international scope as most of the transactions and insolvencies in which he has advised have cross-border elements. Ángel has worked with clients in a wide range of economic sectors including, among others: real property, financial services, hotel business and technology and industrial sectors.
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URÍA MENÉNDEZ

Uría Menéndez ("**UM**") is an independent law firm founded in the 1940's by Professor D. Rodrigo Uría González. The firm currently has fourteen offices in Spain, Portugal, Europe and The Americas. UM specialises in providing legal advice to Spanish, Portuguese and European Community based businesses. The firm also provides support to its clients through its network of offices and through its relationships with equally prestigious international law firms.

The comprehensive legal advice provided by UM covers all areas of Commercial Law.

With regard to insolvency matters, UM provides advice to all the parties that may be involved in a company crisis, covering all kinds of situations. These include, amongst others, company or group restructuring procedures, refinancing of debts, acquisition of distressed assets and debt, protection of creditors' rights, directors' duties and liabilities, protection of assets, claw-back actions, design of security structures, corporate recovery as well as general advice on insolvency proceedings and related litigation. UM's high level of expertise in insolvency matters covers a broad range of economic sectors including, amongst others, industrial companies, banks, financial and insurance institutions, technology, construction and real estate. This expertise enables UM to deal with insolvency situations with an intricate knowledge of the practical business issues and cross-border consequences in foreign insolvency cases.

Sweden

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1 Issues Arising When a Company is in Financial Difficulties

1.1 How does a creditor take security over assets in your jurisdiction?

There are various ways of creating security under Swedish law, but the vastly predominantly used forms of security are floating charges and pledges.

A creditor whose claims are secured by a floating charge is entitled to payment out of the assets covered by the charge in connection with a bankruptcy of the company or through seizure. If the company is not in bankruptcy, the creditor has to obtain an enforceable judgement or decision in order to demand seizure and receive payment. Generally speaking, a floating charge covers all assets of the company from time to time that are not subject to another specific security arrangement.

A pledge can be taken over basically all different types of assets of a company (property, shares, securities, receivables, insurances, bank accounts, contracts, etc.), although the formalities for creating and perfecting the pledge differs depending on the asset.

1.2 In what circumstances might transactions entered into whilst the company is in financial difficulties be vulnerable to attack?

Under the Swedish Bankruptcy Act a transaction may be recovered to the bankruptcy estate if it has the effect that a certain creditor is inappropriately favoured. It is a requirement that the debtor is or becomes insolvent at the time of the transaction or by the transaction. Furthermore, the creditor must have been aware of the insolvency for the recovery to take place. If the creditor is closely related to the debtor, for example through ownership or by being an executive in the debtor, the creditor is presumed to be aware of the insolvency of the debtor. Recovery may only take place with respect to transactions that have been carried out within a certain time span prior to the filing of the bankruptcy at the bankruptcy court. The times vary depending on the type of transaction. However, under the general recovery rule described above, the recovery period is indefinite as regards transactions with closely related persons or companies.

Besides the above stated general recovery rule, there are also special recovery rules which apply in certain situations (security, irregular payments, etc.) and for which specific time periods apply.

1.3 What are the liabilities of directors (in particular civil, criminal or disqualification) for continuing to trade whilst a company is in financial difficulties in your jurisdiction?

Under the Swedish Companies Act, the directors are liable in relation to the company for any damage caused intentionally or by negligence. The directors are also liable in relation to shareholders or other third parties (including creditors) if the damage is a result of an action taken which is in breach of the Companies Act, applicable accounting legislation or the Articles of Association of the company. This liability is applicable irrespective of whether a bankruptcy is at hand, but may become applicable in a bankruptcy or reorganisation scenario.

Under the Swedish Penal Code, the directors may be subject to criminal liability if they continue trading when the company is insolvent or when there is an apparent risk for insolvency. However, this only applies if the continued trading, somewhat simplified, can be seen as negligent and if the directors, by such actions, have intentionally or grossly negligent significantly worsened the financial position of the company.

1.4 Is it common to achieve a restructuring outside a formal procedure in your jurisdiction? In what circumstances might this be possible?

Private insolvency proceedings/workouts are rare in Sweden, although they are possible. It has been the aim of the Swedish government to improve the Swedish rescue culture (however, without extending the Swedish legal system to embrace the rescue friendly US system). These efforts have however been rather fruitless and rescues are still rather uncommon in Sweden. Private rescues are primarily achieved through private compositions. In private compositions, all creditors whose claims will be affected must consent to the composition. In practice, this makes private rescues rather difficult to achieve.

2 Formal Procedures

2.1 What are the main types of formal procedures available for companies in financial difficulties in your jurisdiction?

In Sweden there are two different proceedings with respect to a company which has difficulties meeting its payment obligations. These are bankruptcy proceedings (Sw: *konkurs*) pursuant to the Bankruptcy Act Sw: *Konkurslagen (SFS 1987:672))* and company reorganisation (Sw: *företagsrekonstruktion*) pursuant to the Company Reorganisation Act (Sw: *lagen (1996:764) om*