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Business Restructuring & Insolvency Report

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Restructuring and Insolvency in Austria

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In 2016, more than five-thousand companies filed for the opening of insolvency proceedings before Austrian courts, resulting again in an increase by approximately 2% compared to 2015. The general goods production, building industry, retail business and the hotel and general accommodation businesses were those areas which were again the most affected, with an above-the-average increase of insolvencies in the building industry and the retail business. Some of the most prominent insolvency cases having started in 2016 were the insolvencies of the plant construction and engineering company KRESTA, the industry and stake holding SLAV Group, the yarn producer Borckenstein and the agricultural machine producer VOGEL & NOOT.

The above proves that the commercial relevance of insolvency law, which is codified in Austria in the Federal Austrian Insolvency Act (*Insolvenzordnung*) and which has undergone a substantial amendment in 2010, is unbowed. A codified pre-insolvency out of court restructuring framework (such as provided by the English law scheme of arrangement) is still missing in Austria and the positive going concern prognosis (see in more detail below) became even more key for stakeholders, creditors and management when considering the implementation of restructuring measures versus the petitioning for the opening of in-court insolvency proceedings. That there is a quite limited playfield for the existing management of the debtor (or a replaced management) in an in-court insolvency proceeding, might also be evidenced by the fact that one of the cornerstones of the 2010 amendment introduced to the Federal Austrian Insolvency Act, i.e. a debtor-in-possession regime within the scope of reorganisation proceedings which basically allows the debtor to retain under certain circumstances control over the estate's assets, was far less applied in 2016 than in previous years.

Pursuant to Sec 69 para 2 of the Federal Austrian Insolvency Act debtors shall file for commencement of insolvency proceedings without culpable delay but in no event later than within a period of sixty days once the statutory insolvency criteria are met. A delay shall not be deemed culpable according to the law, if the debtor pursued with due care the opening of in-court insolvency proceedings in the form of self-administration. In case the debtor is a legal entity, such legal entity's legal representatives are under the non-conferrable duty to file for insolvency on behalf of such entity. Creditors may claim from legal representative losses they have suffered from delay of the opening of insolvency proceedings. In addition, legal representatives may also face charges under criminal law, e.g. for non-equal treatment of creditors. In other words: attempts of the management to stabilise the business of an insolvent company have to be established within the sixty days' grace period. An exemption for management on-boarded in a pre-insolvency scenario does not exist.

Under Austrian law, entities are deemed insolvent, if they are either over-indebted or illiquid. Illiquidity is to be assumed, if

the entity is unable to pay its debts when they fall due. While mere temporarily delays with due payment obligations do not constitute illiquidity, delays beyond a reasonable period customary for the type of business of the debtor and the type of claim will trigger the illiquidity criteria of the Federal Austrian Insolvency Act. The Austrian Supreme Court holds that the maximum permissible default period with due payment obligations shall not exceed three months as a general guideline, but the definite permissible maximum period shall be determined on a case by case basis. The Supreme Court has also ruled that a shortfall of liquidity up to 5% of all due payment-obligations of the debtor could be acceptable. In any event, any stagnancy in payments must be cured within the sixty days' period. For purposes of the assessment whether the debtor is illiquid, assets, which do not constitute liquid assets, must only be counted towards due payment obligations if such assets can be realistically realized within the maximum three-months period. New loans are in principle acceptable means to cure illiquidity, provided that a fair management prognosis proves that the entity will be able to pay interest and repay the loans.

The more complicated, but at the same time more relevant assessment in insolvency scenarios concerns the question whether the entity is over-indebted. According to the Austrian legal doctrine for this purpose a two-step-test has to be applied.

Firstly, it shall be assessed whether the liabilities of the debtor (including hidden liabilities) exceed the assets (such assets must be calculated on the basis of their liquidation value taking into account hidden reserves); if the liabilities exceed the assets, the debtor is considered materially insolvent. When calculating the assets, the liquidation scenario which shall be applied, shall be an out-of-court scenario, thus e.g. severance payments for laid off employees shall be fully accounted.

Secondly, a materially insolvent entity is only considered over-indebted in the meaning of the Federal Austrian Insolvency Act, if it fails establishing a positive going-concern prognosis. In such going-concern prognosis, it shall be evidenced with preponderant probability that within a term of twelve months the entity will be able to regain (cash flow) solvency (primary prognosis) and within a period of two to three years (the period shall depend on the type of business and the restructuring measures) the entity will be able to achieve a sustainable turn-around (including the maintenance of liquidity and the improvement of the profitability).

In March 2016 the guidelines for going-concern prognoses, which have been published for the first time in 2006, were republished, providing in essence cornerstones for the minimum requirements for acceptable going-concern prognoses in respect to their form, content, but also in respect to the minimum requirements for the basis (financials, assumptions, etc) on which going-concern prognoses have to be established.

Reorganisation measures forming part of going-concern prognoses often include or relate to third-party funding, third-party debt relieve or other asset or liability relevant third-party measures. Equity contributions which form part of the prognosis to be provided by direct or indirect shareholders or other reorganisation measures (e.g. moratorium, debt relieve) shall in principle only be considered if specifically intended, feasible and agreed in a manner forming an enforceable obligation against the direct or indirect shareholders or other third parties.

When courts scrutinise going-concern prognoses, in particular in respect to the question when the criteria of insolvency have been triggered, they question, if at the time of drawing up the respective going-concern prognosis all relevant data at that time (*ex ante*) has been diligently reflected and if the calculations have been made in a diligent and precautionary manner.

Arising from the fact that pursuant to section 69 para 3 of the Federal Austrian Insolvency Act the legal representatives are liable to petition within the sixty days' period (at the latest) for insolvency proceedings, the primary responsible persons for the drawing up of the going-concern prognosis are the entity's legal representatives (management). Irrespectively of this primary responsibility of the management, the management may – and in certain instances the due care of the management may force them – to involve external experts, in particular auditing firms, to draw up the going-concern prognosis (which in further consequence may also under certain circumstances provide relief or arguments for relief to the management from liability). Furthermore, going-concern prognoses regularly include assumptions and conditions, and it is common practice, especially when credit institutions are involved as lenders, that external experts are involved to monitor whether such assumptions and conditions of such going-concern prognoses are met during the term of the respective prognosis.

Liquidation proceedings are carried out under the supervision of a court-appointed insolvency administrator focused on the sale of the estate's assets with the aim to maximise the value of the assets to be distributed to the estate's creditors.

Reorganisation proceedings are focused on continuing the debtor's business, or parts of it. Such reorganisation proceedings are only available to debtors, who provide a

restructuring plan to be submitted to the court, together with financial records for the past three years, within ninety days from opening of the insolvency proceedings, evidencing that the debtor is able to pay 20% of the claims of its creditors, over a period of two years, in which instance a court-appointed insolvency administrator will control the business of the debtor. If the debtor is able to evidence in a restructuring plan, that he is able to pay 30% of the claims of its creditors over a period of two years, he can also apply for self-administration, i.e. in first instance and without prejudice to restricted measures which still need the approval of the court-appointed insolvency administrator, not such court-appointed insolvency administrator but the legal representative of the debtor will continue to control the debtor's business. In addition to the 30% minimum threshold 50% of the admitted insolvency claims represented at a special approval hearing before the insolvency court has to consent to the restructuring plan to allow self-administration of the debtor.

In November 2016 the European Commission published a proposal for a new directive on preventive restructuring frameworks, second chance and measures to increase efficiency of restructuring, insolvency and discharge procedures. Besides general attempts to further harmonise the insolvency laws of the Member States, the impact to Austrian insolvency law of such directive would be most likely that (a) debtors will benefit from a timely limited 'breathing space' from enforcements actions in order to facilitate negotiations and successful restructuring ('stay off individual enforcement actions'; compared to the current situation, where creditors may hinder early restructuring by seizing debtor's assets, leading also to lower recovery for other creditors and lowering the chances of successful restructuring), (b) dissenting classes of creditors can be outvoted under certain conditions in order to avoid jeopardising restructuring, while safeguarding their interests (compared to the current situation, where dissenting minorities can unreasonably hinder the restructuring process), and (c) over-indebted entrepreneurs may apply for full debt relief already after a period of three years and, at the same time, repayment obligations shall be adapted more to individual circumstances. The Commission's proposal includes also a framework for protection of new and interim financing and other restructuring related transactions, protecting such measures in particular from being declared void, voidable or unenforceable as an act detrimental to the general class of creditors in subsequent insolvency proceedings.

While such pre-insolvency restructuring framework is apparently still in fledgling stages, end of March 2017 the Austrian Ministers' Council has passed an amendment to the insolvency law for private individuals, such law being currently under review by a special committee of the Austrian Parliament. Against severe protests of creditor protection associations, the new law would considerably facilitate debt relief for private individuals. The current law provides that in a first step a payment schedule shall be negotiated with the creditors, to be approved by the majority of the creditors, providing for monthly payments over a period of maximum 7 years in an amount not less than the amount seizable from the individual's income to the subsistence level within 5 years. If the creditors reject the payment plan, the current law provides that debt relieve is granted to the individual debtor if within 7 years the debts are repaid to the maximum amount seizable from the individual's income within such 7 years, but in any event not less than 10% of the debts owed. The new law would further provide that debt relieve is granted already after a period of 3 years' payment in the maximum amount seizable from the individual's income within such 3 years (no minimum percentage of debts anymore). In addition, the new law would provide that insolvent individuals having no income may even skip negotiating a payment plan. The new law will become most likely effective by 1 July 2017.

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