CONFERENCE ON EUROPEAN RESTRUCTURING AND INSOLVENCY LAW

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Re: CERIL REPORT 2019-2 on Reversal of Value Extraction Schemes

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CERIL highlights that in many jurisdictions in Europe value extraction schemes can be challenged through transactions avoidance laws and other remedies in company law and/or civil law. Generally, national laws provide for sufficient protection against value extraction schemes, however acquiring the necessary information to initiate a claim needs improvement.

[1] The group of conferees was chaired by Reinhard Bork (Germany) and Catarina Serra (Portugal). Members of the group are Reinhard Dammann (France), Miodrag Dordevic (Slovenia), Artur Galea Salomone (Malta), Jasnica Garašić (Croatia), Tuomas Hupli (Finland), Ivan Ikrényi (Slovakia), Renato Mangano (Italy), Grégory Minne (Luxembourg), Anders Ørgaard (Denmark), Annina H. Persson and Göran Millqvist (Sweden), Tomás Richter (the Czech Republic), Ignacio Sancho (Spain), Jean Luc Vallens (France), Melissa Vanmeenen (Belgium), Rolef de Weijs (the Netherlands), Oleg Zaitsev (Russia), Kristin van Zwieten (United Kingdom). Contributions came from 13 group members, namely Reinhard Bork (Germany, also reporting on the law of England and Wales), Miodrag Dordevic (Slovenia), Jasnica Garašić (Croatia), Tuomas Hupli (Finland), Ivan Ikrényi (Slovakia), Renato Mangano (Italy), Anders Ørgaard (Denmark), Annina H. Persson and Göran Millqvist (Sweden), Tomás Richter (the Czech Republic), Ignacio Sancho (Spain), Catarina Serra (Portugal), Jean Luc Vallens (France) and Rolef de Weijs (the Netherlands). The author of this text is *Reinhard Bork*, based on input and discussions with all conferees mentioned.

Contents

1 INTRODUCTION

1 The present research project has been undertaken by a working group of CERIL (the Conference on European Restructuring and Insolvency Law). It sought to collect information on the rules in insolvency[2], company and general civil laws from various jurisdictions in the EU regarding the reversal of value extraction schemes, whereas criminal law has not been subject of the present research.

2 Insolvencies are sometimes caused by shareholders sucking the last valuable assets from their company, only based of the sheer ownership of the shares in the company. It can frequently be observed that investors buy a company in financial distress via share deal and, while feigning a rescue attempt, strip it of its assets and eventually send it into insolvency proceedings. The company is then no longer salvageable, is subject to liquidation proceedings, and creditors will then receive only a small (if any) return of the proceeds.

3 Such value extraction schemes appear in various shapes: shareholders (or other closely related persons) are granted a contract as directors and receive an unusually high salary; the company pays a "management fee" to the shareholders without them being official directors; shareholders grant a short term loan with unusually high interest rates which is paid back in the vicinity of the application for, or opening of, insolvency proceedings; shareholders receive charges over company property for securing such loans; shareholders buy assets for an unusually low price or lease them back for excessive remuneration; etc. After the opening of insolvency proceedings, Insolvency Practitioners (if necessary by approaching a court) will try to reverse the value extraction scheme by recollecting unfair advantages from the shareholders, be it by means of transactions avoidance, be it by means of company or general civil law.

4 In the UK, the government launched a consultation on Insolvency and Corporate Governance on 20 March 2018[3] which, among other things, has explicitly addressed value extraction schemes. The consultation (p. 15) describes the following example:

> *A company in financial trouble is bought by a new investor. The new investor injects £20m as a loan into the company, to support its working capital. The company pays interest on the loan at considerably more than a commercial rate and the loan is secured over the company's property. In addition, the company pays a 'management fee' to the investor. The company subsequently enters formal insolvency.*

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[2] Regarding terminology, this study adopts the English distinction between corporate insolvency and personal bankruptcy. In other countries, the word "bankruptcy" refers to corporate as well as personal financial difficulties. These differences in approach can be left to one side for the purposes of this research.

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/691857/Condoc_-_Insolvency_and_Corporate_Governance_FINAL_.pdf (last accessed 3 May 2019), p. 13 et seq.

The investor has benefited from interest payments and management fees prior to the insolvency and, at insolvency, benefits from its charge over the assets (...).

5 On 26 August 2018, the UK government published a response to this consultation[4] and has announced that it intends to tackle the problem of unfair transactions in the lead up to insolvency (p. 36 et seq.), albeit without making concrete proposals. According to this response, many participants in the consultation have expressed their concern that the current powers of Insolvency Practitioners (or courts) under English law are not sufficient to undo such transactions. It is most likely that this is also a problem in many other jurisdictions. Against this background, the CERIL Working Party on Transactions Avoidance started a survey on the reversal of value extraction schemes, collecting information on the available rules in the Member States and evaluating the results. This was achieved by distributing a questionnaire which was designed to cover the available remedies under insolvency law (with the focus on liquidation proceedings[5]), company law, and general civil law (e.g. contract law or tort law). The present report submits the results of this survey.

2 GENERAL OBSERVATIONS

6 Value extraction schemes are a well-known phenomenon in many jurisdictions covered by this survey, albeit with diverging emphasis. They have been discussed primarily – but not exclusively – in the context of insolvency proceedings where the estate was insufficient and did not even cover the costs of the proceedings. However, while in some countries value extraction schemes, although challengeable under insolvency or company law, were not a major topic for a long time (Croatia, Czech Republic, England and Wales, Finland, Italy, the Netherlands, Portugal, Slovakia, Slovenia), they were judged as a severe problem which has led to comprising case law or even legislative activities in others (Denmark, France, Germany, Spain, Sweden). Nevertheless, there is general agreement that such schemes need to be fought on, although one must bear in mind that serious investments could be deterred by rules that are too strict. However, remedies can be found in insolvency law, particularly transactions avoidance law (3.), company law (4.) and general civil law (5.).

3 TRANSACTION AVOIDANCE LAW

7 Starting with transactions avoidance law, value extraction schemes can be voidable as preferences (1.) as well as transactions at an undervalue (2.) and intentionally fraudulent

[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC.pdf (last accessed 3 May 2019).

[5] Value extraction schemes leave the company frequently with few valuable assets. Hence, restructuring proceedings – including debtor-in-possession proceedings – are not very likely and therefore left out in this study. The same holds true for the sometimes eroding effects of failed restructuring proceedings which may leave the company with less assets than were available before the commencement of restructuring efforts.

transactions (3.). Most of these rules have not only objective requirements (e.g. detriment to the general body of creditors or performance within a certain suspect period) but also subjective requirements (mental elements, such as intent, knowledge or negligence); both will be described below. Special attention is required regarding rules on shareholder loans (4.). Many laws have special rules where closely connected parties are involved. These rules will not be evaluated when discussing the laws on preferences, transactions at an undervalue and intentionally fraudulent transactions, but in a separate chapter of this study (5.).

3.1 Preferences

8 Under certain conditions, in nearly all jurisdictions – except for the Netherlands[6] – payments (whether excessive or not) can be clawed back on the basis of rules on preferences,[7] roughly defined as "performances to the benefit of a creditor who would be worse off without this performance". Some national laws restrict claw-back of preferences to improper or unusual transactions (Denmark, Finland). Others, namely Croatia, Germany, Italy and – albeit without mentioning these terms – France, Portugal[8] and Sweden,[9] distinguish between "congruent coverage" (where the payments meet the terms of the (loan etc.) agreement between creditor and debtor company) and "incongruent coverage" (where the shareholder receives payments which are not due or for other reasons not covered by the agreement between creditor and debtor company), permitting the avoidance of incongruent coverages at all or under alleviated preconditions. Most other jurisdictions are not familiar with this distinction, but all agree that performances in the vicinity of insolvency should be voidable in principle. However, significant differences can be observed regarding the details.

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[6] Dutch law has no special rules on preferences or transactions at an undervalue but instead two rules on voluntary and obligatory legal acts which are manifestations of the *actio pauliana*. The transaction avoidance law of the Netherlands is therefore discussed below at para. 19 et seq.

[7] For details of the law of avoiding preferences, reference can be made to the CERIL report "Clash of Principles: Equal Treatment of Creditors vs. Protection of Trust in European Transactions avoidance Laws" of 26 September 2017, available at http://www.ceril.eu/publications/statement-2017-1/ (last accessed 3 May 2019).

[8] In Portugal, only the granting of charges no longer than six month prior to the application for insolvency proceedings is challengeable (without any further condition) as preference (so-called unconditional avoidance rule). This refers to the granting of charges related to *pre-existing* obligations. But not only this granting is challengeable but also the granting of preferences simultaneously with the rise of the corresponding debt which occurs within sixty days prior to the application for the insolvency proceedings. All other legal acts, particularly payments, are only voidable as transactions at an undervalue or as intentionally fraudulent transactions. Exceptions are premature payment of debts which fall due after the commencement of insolvency proceedings, unusual payments and performances which the creditor could not claim. Insofar, they are "incongruent" in the sense defined in the text above and can be clawed back as preferences.

[9] For Spain, see Art. 1292 Civil Code: "Payments made in the state of insolvency on account of obligations which the debtor could not be compelled to fulfil at the time of making them shall also be capable of rescission."

9 First, while all transactions avoidance laws require the transaction to disadvantage the general body of creditors as a general prerequisite for any avoidance, some have an additional prerequisite that the debtor was (or became[10]) *substantively insolvent* at the time at which the transaction to be challenged was carried out, substantive insolvency mostly being defined as inability to pay debts when they fall due (Croatia, Czech Republic, Denmark, England and Wales, Finland, France, Germany, Italy, Slovakia, Slovenia, Sweden). Under the law of Spain, substantive insolvency of the debtor is irrelevant; instead, a fixed suspect period prior to the dissolution of the company or the commencement of insolvency proceedings is implemented,[11] which may serve as an implicit irrebuttable presumption of the debtor's insolvency.

10 Second, almost all countries involved in the study have established a *suspect period* in their insolvency laws.[12] However, the finer details here are also hugely varied. First, the laws choose different starting points for the calculation of the relevant time period, which always runs backwards: in most countries, this is not the opening of insolvency proceedings (differently: Italy[13] and Spain[14]) but the application for such proceedings[15] (Croatia, Czech Republic, Denmark, England and Wales, Germany, Poland, Portugal,[16] Slovenia and Sweden), regularly including the time span between the application for and the opening of insolvency proceedings. Second, in all countries except Spain (here, the suspect period has a uniform length of one or two years) the length of the suspect period depends on the avoidance grounds. For preferences, the length varies from three months (Croatia, Denmark, Finland, Germany and Sweden) to six months (England and Wales,[17] Italy and Portugal[18]), and even to one year (the Czech Republic, Slovakia and Slovenia). Some laws use a longer time period if the defendant is a shareholder[19] or a closely related party

[10] This refers to cases where the transaction in question triggers the insolvency.

[11] Cf. below at para. 10.

[12] General remarks on relevant time periods can be found in *Gerard McCormack/Andrew Keay/Sarah Brown*, European Insolvency Law – Reform and Harmonization, Edward Elgar Publishing, Cheltenham (UK)/Northampton (MA, USA), 2017, p. 135 et seq., p. 141 et seq.

[13] This will change when the Decree of 12 January 2019, No. 14, containing the 'Code on Business Crisis and Insolvency (Codice della crisi d'impresa e dell'insolvenza)' enters into force according to which the point in time for calculation of the suspect period will be the date of the application for opening of insolvency proceedings. The Code will enter into force on 15 August 2020, with the exception of a few regulations which are already applicable since 16 March 2019.

[14] The law of Malta refers to the "dissolution of the company", which is a result of the court decision to open insolvency proceedings.

[15] Equivalents can be found in other methods of commencing insolvency proceedings, for example the out-of-court appointment of an administrator in England and Wales. The difficulty here is that some rules which mention the "opening" of proceedings are referring to the application for or the commencement of the proceedings rather than the opening decision of the court; cf. also *McCormack/Keay/Brown* (fn. 12), p. 161 et seq.

[16] Cf. above fn. 8.

[17] But two years where the opponent is a closely related party, cf. below at para. 26.

[18] For the latter, see above fn. 8.

[19] Cf. below at para. 24.

(insider)[20]. A special case is France, where the suspect period depends on the cessation of payments and is determined by the court accordingly but is no longer than eighteen months prior to the opening decision.

11 Third, many laws attach *mental elements* to avoidance actions, i.e. subjective prerequisites such as intent, knowledge of certain circumstances or – as a defence – good faith, be it on the part of the debtor or the defendant.[21] Again, national laws proceed quite differently. Some countries (e.g. the Czech Republic, Denmark, Portugal,[22] Slovakia and Spain) refrain from using subjective requirements entirely. Others take a different approach: they frequently demand knowledge of the defendant of the debtor's (imminent) insolvency (partly in Croatia, France, Germany and Slovenia, and completely in Finland, Italy and Sweden) or of an application for insolvency proceedings (Croatia and Germany).[23] In contrast, "good faith" of the defendant is irrelevant in England and Wales[24] and instead the debtor's desire to put the other party in a better position is necessary.

12 However, transactions avoidance is not possible if the shareholder is sufficiently *secured*, because in this case the payment is not detrimental to the general body of creditors which is required in all jurisdictions. The grant of the charge is the detrimental aspect, and it is for this reason that challenging the charge is predominant to challenging the payment. In other words, payments on secured credit are only voidable if the security is voidable itself which is possible in Croatia, Czech Republic, Denmark, England and Wales, Finland, Germany, Italy, Portugal and Sweden, where charges can be challenged under similar prerequisites as payments, at least if the security right is granted subsequently for an already existing debt.[25]

13 Another question is whether the underlying disadvantageous contracts rather than the payments on such contracts can be challenged. For example, the answer is affirmative in Croatia, England and Wales, France and Germany were contracts can be challenged under similar prerequisites as transactions, provided that the contract caused an immediate disadvantage to the general body of creditors which is the case in most value extraction schemes if the counter-performance of the shareholder is unusually low. In Spain, contracts are subject to transactions avoidance law and also to the general rule on intentionally fraudulent transactions in the Civil Code.[26]

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[20] Cf. below at para. 26.

[21] General observations by *McCormack/Keay/Brown* (fn. 12), p. 163 et seq.

[22] Cf. above fn. 8.

[23] For the burden of proof, see below at para. 26.

[24] *Rebecca Parry* and *Sharif Shivji* in: Rebecca Parry/James Ayliffe/Sharif Shivji (eds.), Transaction Avoidance in Insolvencies, Oxford University Press, 3rd edn., Oxford 2018, para. 5.108. This is different where the defendant is a third party, cf. sec. 241(2) IA 1986.

[25] Special rules are available if the collateral secures a shareholder loan, cf. below at para. 24.

[26] See below at para. 40.

3.2 Transactions at an undervalue

14 In all jurisdictions included in this study – except for the Netherlands[27] –, payments covered by a value extraction scheme can be challenged on the basis of special rules for transactions at an undervalue,[28] roughly described as "performances to the benefit of the opponent which result in a reduction of assets without (or with no compensating) counter-performance". The decisive substantive prerequisite is that the performance of the debtor was *gratuitous*, which is mostly defined as being without adequate and balancing counter-performance of the recipient. Regarding value extraction schemes, this covers (for example) unusually high salaries, interest rates[29], or remunerations or sales for unusually low prices. Most laws provide for exceptions, e.g. for occasional gifts of reasonable or low value, but these exceptions are of no importance in the context of value extraction schemes.

15 Most jurisdictions are content with the objective requirement of the transaction being at an undervalue and refrain from demanding additional prerequisites. It is, in particular, not necessary that the debtor was *substantively insolvent* at the point in time when the transaction was performed, the Czech Republic, England and Wales, France[30] and Slovakia being important exceptions. In Denmark, there is a longer suspect period (one year instead of six months) unless it is proven that the debtor was not insolvent or became insolvent as a result of the transaction.

16 There is, however, in all jurisdictions a *suspect period*, the length of which varies from country to country. This suspect period is six months to one year in Denmark and Sweden, one year in the Czech Republic, Finland, Portugal and Slovakia, up to two years in France and Italy,[31] two years in England and Wales, and Spain, three years in Slovenia and four years in Croatia and Germany, in most jurisdictions calculated backwards from the application for – not the opening of – insolvency proceedings.[32]

17 Nearly all jurisdictions refrain from requiring *mental elements* such as intent of the debtor or knowledge of the opponent[33] of the debtor's insolvency. This holds true for the laws of

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[27] Cf. above at fn. 6.

[28] In England and Wales, not only sec. 238 Insolvency Act 1986 (which will be explored here) deals with transactions at an undervalue but also sec. 423 Insolvency Act 1986 (which will be discussed later; cf. below fn. 39).

[29] One important aspect might be whether the company would have been able to get credit for lower interest rates from other lenders.

[30] According to Art. 632-1(1)No.1 and 2 Code de Commerce, gratuitous transactions which have occurred since the date of the cessation of payments shall be considered null and void. However, Art. 632-1(2) permits the court to set aside gratuitous acts described in Art. 632-1(1)No.1 Code de Commerce if they were made within six months prior to the date of the cessation of payments.

[31] See above at the end of para. 10 and fn. 30.

[32] Cf. above at para. 10.

[33] "Opponent" is the person who benefited from the challengeable transaction. This is not necessarily a creditor and will henceforth be labelled "counterparty", "opponent" or "defendant".

Croatia, the Czech Republic, Denmark, Finland, France, Germany, Italy, Portugal, Slovenia and Spain. However, under some of these laws, a subjective perspective is taken for establishing the gratuitousness of the performance. According to judgments of the German Bundesgerichtshof, for example, it is necessary that both parties (company and shareholder) are aware of the inequality of the performances,[34] and in Denmark a transaction is deemed to be gratuitous if it appears to be the result of generosity.[35] England and Wales accept the "good faith" defence regarding the debtor's intent if at the time there were reasonable grounds for believing the transaction would benefit the company.

18 In sum, avoiding transactions at an undervalue seems to be a very efficient remedy against value extraction schemes in almost all jurisdictions. However, it should be emphasised that the effect of tackling value extraction schemes as a transaction at an undervalue can be limited to the excessive part of the performance.[36] If, as a simple example, a fee of 100 is usual and the parties have agreed to pay 140, only 40 can be clawed back under rules on transactions at an undervalue.

3.3 Intentionally fraudulent transactions

19 A third group of voidable performances relevant in the context of value extraction schemes are intentionally fraudulent transactions, roughly defined as "any act performed with the (as the case may be: implied) intent to disadvantage the general body of creditors or similar mental elements (such as knowledge)". This type is the modern form of the *actio pauliana* the appearance of which can be established in nearly all jurisdictions covered by this survey. Only France has no specific rules on intentionally fraudulent transactions but provides a general long suspect period.[37] In Portugal, there are two avoidance regimes. One enables the Insolvency Practitioner to tackle transactions which have been performed to the detriment of the general body of creditors in bad faith of the defendant no longer than two years prior to the application for insolvency proceedings. The other is part of the Civil Code, to which the Insolvency Act refers, and will be dealt with later on in this paper.[38] *Actio pauliana*-type rules are typically marked by intensive mental elements, long suspect periods and little objective criteria.[39] However, wording and location of the relevant rules vary from country to country. In the Netherlands, for example, transactions avoidance law consists of two rules on avoidance grounds only and both are appearances of the *actio*

[34] BGH, 15.9.2016 – IX ZR 250/15 = NZI 2017, 68. Critical remarks by Reinhard Bork, *Die Anfechtung unentgeltlicher Leistungen nach § 134 InsO*, NZI 2018, 1-9.

[35] § 64(1) Danish Bankruptcy Act.

[36] See for Germany BGH, 25.6.1992 – IX ZR 4/91 = NJW 1992, 2421.

[37] See above at the end of para. 10.

[38] Cf. below at para. 39. At this stage, only the insolvency law rules are analysed.

[39] An important exception is England and Wales where sec. 423 Insolvency Act 1986 requires that the fraudulent transaction is a transaction at an undervalue.

pauliana.[40] In other jurisdictions, such rules are not (Spain) or not exclusively (Portugal) part of insolvency law but rather of general civil law.[41] In many countries, rules on intentionally fraudulent transactions can also be used to contest onerous contracts (e.g. Croatia, Germany).

20 At the forefront of *actio pauliana*-type rules are mental elements, mostly for both sides. Nearly all national transactions avoidance laws require the debtor's intent or purpose to defraud or disadvantage their creditors (Croatia, Czech Republic, Denmark, England and Wales, Finland, Germany, Italy, Slovakia, Spain and Sweden), whereas knowledge suffices in the Netherlands for the avoidance of voluntary legal acts[42] and in Portugal where knowledge of the (imminent) insolvency is required.[43] This is frequently, but not always, accompanied by the counterparty's knowledge of the debtor's intent (Croatia, Czech Republic, Germany, Slovakia), of the detriment to the general body of creditors (Italy[44] and the Netherlands[45]) or of the debtor's insolvency (Portugal, Slovenia) as an additional prerequisite. More strictly, collusion between debtor and counterparty is required in the Netherlands for the avoidance of obligatory legal acts unless the counterparty knew of a pending application to open insolvency proceedings.[46] A different approach is taken in Denmark and Sweden, where avoidance is only possible if the debtor was (or became as a result of the transaction) substantively insolvent and the counterparty knew or should have known of the insolvency and the circumstances causing the transaction to be fraudulent.

21 In nearly all jurisdictions the debtor is not required to be substantively insolvent at the point in time when the transaction was performed; exceptions are Denmark[47] and Sweden. However, given that mental elements are difficult to prove, in Germany it is taken as substantial evidence for mental elements such as the debtor's intent to disadvantage creditors or the counterparty's knowledge of this intent, if the parties knew that the debtor

[40] Cf. sec. 42, 47 Faillissementswet (Fw). Sec. 42 Fw covers voluntary legal acts, i.e. acts which the debtor was not obliged to perform; they can be challenged if the debtor knew or should have known that the act would prejudice the creditors and – in case the legal act was received against consideration – the counterparty had or should have had the same knowledge. Sec. 47 Fw covers obligatory legal acts, i.e. acts the performance of which the debtor was obliged; they can be challenged only where either both parties colluded or the counterparty knew of a pending application for opening insolvency proceedings.

[41] More below at para. 39 et seq. and for Portugal above at fn. 38.

[42] Cf. above at fn. 40.

[43] Cf. above para. 19.

[44] Special prerequisites apply under Italian law if the debtor received a consideration. In this case, either collusion of the parties or the counterparty's knowledge of the debtor's intent is required.

[45] Cf. above fn. 40.

[46] Cf. above fn. 40.

[47] See above at para. 20.

company was (at least imminently) insolvent.[48] Similarly, Dutch law contains no express reference to the insolvency of the debtor; however, according to the Supreme Court of the Netherlands, the mental elements (i.e. knowledge/collusion) require that the opening of insolvency proceedings and a lack of assets for use in such proceedings were reasonably foreseeable at the time of performance,[49] which indirectly makes the insolvency of the debtor an important factor. The same holds true for Portugal, where the mental element of "bad faith" is defined as awareness of the debtor's existing or imminent insolvency.[50] In England and Wales, there must be a "victim" of the transaction under sec. 423 IA 1986, and creditors won't be victims if the company can nevertheless pay in full.

22 Suspect periods for intentionally fraudulent transactions are usually longer compared to preferences and transactions at an undervalue. Time frames range from one year in Slovenia, two years in Portugal, four to ten years in Germany, five years in the Czech Republic, Slovakia and Sweden and ten years in Croatia. In most jurisdictions these are calculated backwards from the application for – not the opening of – insolvency proceedings.[51] The laws of Denmark, England and Wales and Finland have no suspect period at all.

3.4 Shareholder loans

23 Special rules on the avoidance of transactions in favour of shareholders are rare. They can be found in the laws of Croatia, Germany, Italy, Portugal and Slovakia. The laws of the Czech Republic, England and Wales, France, the Netherlands, Spain and Sweden do not address shareholders with a special avoidance ground but legislators tend to include them in rules for closely related parties, as described below.[52] Only a handful of laws contain no special rules at all (i.e. the insolvency laws of France and Slovenia).

24 In Croatia and Germany, transactions of the debtor company made with regard to shareholder loans can be challenged without further requirements if (1) the debtor is a company which does not have a natural person as a general partner, nor a general partner which is a company that has a natural person as its own general partner, and (2) performance was rendered no more than a year (for the granting of collateral five years in Croatia and ten years in Germany) prior to the insolvency application. Neither substantive insolvency of the debtor nor mental elements of the parties are required. Similar rules can be found in the laws of Italy (albeit in Company Law) and Portugal. In Slovakia, all payments

[48] BGH, 14.6.2018 – IX ZR 22/15 = ZIP 2018, 1794; 18.1.2018 – IX ZR 144/16 = NZI 2018, 264; 14.9.2017 – IX ZR 3/16 = NZI 2018, 114; 6.7.2017 – IX ZR 178/16 = NZI 2017, 850; 5.3.2009 – IX ZR 85/07 = BGHZ 180, 98 = NJW 2009, 1601; 29.11.2007 – IX ZR 121/06 = BGHZ 174, 314 = NJW 2008, 1067; 13.4.2006 – IX ZR 158/05 = BGHZ 167, 190 = NJW 2006, 2701.

[49] Hoge Raad, 22.12.2009 – 08/02255, ECLI:NL:HR:2009:BI8493 (*ABN AMRO BANK N.V. v. van Dooren q. q. III*), para. 3.7.

[50] See above at para. 20.

[51] Cf. above at para. 10.

[52] At para. 25 et seq.

of dividends to shareholders can be contested unless the company has fully satisfied all registered unsecured claims.

3.5 Closely connected parties

25 In nearly all jurisdictions – with the exception of France and Slovenia[53] – there are rules which amend the general norms of transactions avoidance laws for closely related parties, i.e. insiders.[54] Amendments concern presumptions for objective (e.g. detriment to the general body of creditors) or subjective prerequisites (e.g. knowledge of the counterparty of the debtor's insolvency). Such presumptions shift the burden of proof from the claimant (typically the Insolvency Practitioner or a disadvantaged creditor) to the defendant (the closely connected party).

26 In more detail, the amendments regarding closely related parties are as follows: In some countries, the suspect period is longer for closely related parties than for normal unsecured creditors or it even ceases to apply (the Czech Republic, Denmark, England and Wales, Finland, Italy, Slovakia and Sweden). In others, there is a rebuttable presumption that the requirements of detriment to the general body of creditors (the Netherlands and Spain), of substantive insolvency (the Czech Republic, Denmark, England and Wales, Finland, the Netherlands, Slovakia and Sweden) or of mental elements (Croatia, the Czech Republic, England and Wales, France, Germany, the Netherlands, Portugal and Sweden) have been fulfilled.[55] As opposed to that, the shift of burden of proof for closely related parties is in some jurisdictions itself generally (the Netherlands: one year for the avoidance of voluntary legal acts) or for certain grounds of avoidance (Croatia and Germany: two years for detrimental contracts concluded in fraudulent intent) limited to certain time periods.

27 Against this background, a decisive question in the context of value extraction schemes is whether shareholders and directors are considered closely related to the debtor company. As regards shareholders, in few jurisdictions every shareholder is deemed closely connected (unclear for the Czech Republic). In others, this effect is restricted to shareholders with significant influence, e.g. personal liability (Germany, Portugal) or more than 5% resp. 10% (Spain) or 25% (Croatia and Germany) of the company's share capital; holder of a substantial part of the company's capital (Denmark); more than 50% of the issued capital (the Netherlands) or special knowledge (Croatia and Germany) or control (England and Wales). Directors and board members are included in Croatia, the Czech Republic, England and Wales, Germany, the Netherlands, Portugal and Spain. In Italy, only members of a group of companies and accordingly only intra-group transactions are covered.

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[53] In Slovenia, special rules for closely related parties are only available for personal bankruptcies which will be left out here.

[54] Cf. *McCormack/Keay/Brown* (fn. 12), p. 137 et seq., p. 139.

[55] General remarks on the relevance of such presumptions in *McCormack/Keay/Brown* (fn. 12), p. 135.

3.6 Varia

28 In some jurisdictions rules can be found which do not follow a general approach but are shaped for tackling certain situations which are of importance in the present context. For example, under Danish law the payment of wages or other work remunerations to closely related parties within the six months prior to the application for insolvency proceedings can be challenged without further prerequisites if they evidently exceed what would be considered reasonable; excessive wages can be clawed back if they were paid earlier than six months but no longer than two years prior to the insolvency application, unless it is proven that the debtor was (and became) not insolvent at the relevant time. A similar rule is available in Finland where excessive wage payments can be challenged if they were paid no longer than three years prior to the insolvency application, unless it is proven that the debtor was (and became) not insolvent at the relevant time.

29 The Finish Bankruptcy Act contains a provision on *artificial transactions* which can be disregarded without further prerequisites if the transaction's legal form does not correspond to its actual content or intent and if this form is used in order to avoid enforcement or to keep assets out of reach of creditors.

30 In England and Wales, sec. 244 Insolvency Act 1986 permits the avoidance of *extortionate credit transactions*, provided the credit transaction was entered into in the period of three years ending with the day on which administration or liquidation proceedings were commenced. This rule covers contracts which require the company to make grossly exorbitant payments. However, the test is whether the credit agreement is "so unfair as to be oppressive"[56] which is difficult to establish. In addition, sec. 245 Insolvency Act directly voids floating charges granted by an insolvent company within twelve months ending with the commencement of insolvency proceedings unless the floating charge was established against new and fair value. For connected parties the suspect period is two years and substantive insolvency of the debtor at the relevant time is not necessary.

4 COMPANY LAW

31 Alongside transactions avoidance law, additional remedies can be found in the company laws of many jurisdictions. Although none of the company laws implemented in this study deals with value extraction schemes directly, some address agreements with shareholders concerning financial assistance for the shareholder (Denmark) or for the company by the shareholder (Germany) or the consideration for the shareholder's occupation (Denmark), trying to ensure the market conformity of such transactions. Besides such specific regulations, rules on directors' liability (1.) and on share capital protection (2.) can be enforced. In this chapter, norms on these topics are in the focus, including those which are

[56] *Paragon Finance Plc v Nash* [2001] EWCA Civ. 1466; *White v Davenham Trust Ltd* [2010] EWHC 2748 (Ch) and on appeal [2011] EWCA Civ. 747.

part of insolvency law rather than company law, albeit under restriction to limited liability companies which prevail in practice.[57]

4.1 Directors' liability

32 Starting with directors' liability, rules on this subject can be found in nearly all jurisdictions covered by this survey. First, there are *general liability rules* according to which the directors shall conduct the company's affairs with the due care of a prudent businessman and directors who breach these duties shall be liable to the company for any damage arising (Croatia, Denmark, England and Wales, Germany, Italy, the Netherlands, Portugal, Slovenia, Spain). In the context of value extraction schemes, this means that directors who (e.g.) conclude detrimental contracts and pay excessive remunerations to shareholders and thereby cause damage to the company can be held liable in person. However, those norms are frequently not applicable where a shareholders' meeting has approved of or even directed the conclusion of such contracts or the making of payments and directors are bound to directions of the shareholders' meeting (Croatia, Germany).[58]

33 Second, directors are, in many jurisdictions, obligated to compensate the company for causing the company's insolvency in a reproachable manner (Portugal) or at least for payments made to creditors after the company has become *substantively insolvent*. For example, this is true for Croatia, Czech Republic, Germany and Slovenia, although in these jurisdictions the relevant rules shall not apply to payments which are compatible with the due care of a prudent businessman. In some jurisdictions, directors can be held liable if they knew that the company was facing an imminent threat of insolvency and failed to take all necessary and reasonably foreseeable steps to avoid insolvency or at least disadvantaging creditors. However, the consequences diverge: in England and Wales and Slovakia (and to some extent in Sweden) a breach of this duty leads to a claim for damages, in the Czech Republic and Denmark the directors have to pay back their wages or comparable consideration.

34 Third, the directors can be held liable for certain *payments to shareholders*. This is sometimes restricted to payments which have led to the company becoming illiquid (Germany) or to payments for which causation of insolvency was recognisable whilst observing the due care of a prudent businessman. Applying such rules to value extraction schemes means that directors have to reimburse to the company all payments which have been made to the shareholder after the point in time where the company was either unable to pay its debts or was overindebted. This is not a remedy against contracts with a

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[57] It is for this reason, the norms on related party transactions, implemented in national laws following the Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017, amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (OJ of 20 May 2017 – L 132/1), are not considered here.

[58] As opposed to that, shareholders lose the ability to authorize or ratify a breach under English law where directors' duties have become affected by the need to have regard to creditors' interests, because the company is (nearly) insolvent.

hollowing effect (as contracts are not payments) yet a precaution against further diminishing the estate to the detriment of the general body of creditors.

35 Fourth, directors can be held liable for damages in some jurisdictions if they *omit to file for insolvency proceedings* once the company has become substantively insolvent. Such duties to apply for the opening of insolvency proceedings in due time after the occurrence of substantive insolvency can be found in the (insolvency) laws of Croatia, the Czech Republic, Germany, Portugal, Slovakia and Spain. In England and Wales directors can be held liable for fraudulent trading where the business has been carried on with the intent to defraud creditors, or for fraudulent trading where the directors must have known that the company had liabilities in excess of its assets and that liquidation was inevitable.

36 *Directors* in the sense of the aforementioned norms are generally not only the current regular office holders but also former directors (provided they were office holders at the relevant time), shadow directors and *de facto* directors. In some jurisdictions, the same liability as to directors applies to persons (or at least to shareholders) who intentionally misuse their influence in the company to their own benefit (Croatia, Czech Republic, Denmark, Italy, Portugal, Slovenia). In others, this is restricted to the influence a parent company in a group of companies (Germany).

4.2 Share capital protection

37 Some company laws provide also for rules on protecting the capital of the company which are relevant for fighting value extraction schemes. While some laws are completely silent on this matter (Czech Republic, France), in Germany the statute on companies with limited liability interdicts the repayment of the assets necessary to maintain the company's share capital to the shareholders. Although the rule does not cover payments which are compensated by a full claim to counter-performance against the shareholder, in the context of value extraction schemes this exception is mostly not met, since the shareholder, by definition, receives excessive or unusually high salaries, management fees, interest rates etc. If the rule on share capital protection is violated, the shareholder has to pay the money back and the directors who have made the payments are personally liable if the money cannot be clawed back from the shareholder. Similar rules can be found in the company law of Croatia and Sweden (where payments not only to shareholders but also to other recipients are covered). Other jurisdictions restrict themselves to narrowly shaped rules on the conditions for distributing dividends (Denmark, the Netherlands, Portugal, Slovakia) or protect share capital indirectly with norms on financial assistance for shareholders (Denmark).

5 GENERAL CIVIL LAW

38 The tools of transactions avoidance law and company law are sometimes complemented by those of civil law. Special appearances of the *actio pauliana* (1.) and instruments of tort law (2.) are central.

5.1 Actio pauliana

39 In some jurisdictions the *actio pauliana* is part of general civil law, not – or not exclusively – of insolvency law.[59] They are dealt with here provided they are applicable in insolvency proceedings.[60] A first example is Portugal where Art. 127 Insolvency Act refers to Art. 610 et seq. Civil Code. This rule requires (1) a performance either after the incurrence of the debt or with the debtor's intent to disadvantage their creditors, (2) that the transaction was detrimental to the creditors and (3) when the transaction is onerous, bad faith of both parties. However, the avoidance of intentionally fraudulent transactions under this rule is the task of the disadvantaged creditor, not of the Insolvency Practitioner, and the proceeds, which return to the insolvency estate, do not benefit the general body of creditors but only the creditor who took the avoidance initiative.

40 The same holds true for Spain where Art. 71.6 Insolvency Act refers to Art. 1291.3 Civil Code. Under this rule, contracts entered into in fraud of creditors are capable of rescission, when the creditors cannot otherwise recover what is owed to them. The rescission leads to the return of the received and its fruits (Art. 1295 Civil Code). The counterparty is also liable for damages if they acted in bad faith (Art. 1298 Civil Code). However, this appearance of the *actio pauliana* is subsidiary and may not be exercised unless the aggrieved party lacks any other remedies of recovery (Art. 1294 Civil Code). Since it is for the Insolvency Practitioner to take this action once insolvency proceedings have been opened, the regular insolvency law on transaction avoidance precedes.

41 A similar rule can be found in Art. 67 Civil Obligation Act of Croatia, where onerous disposal can be contested if at the time of disposal the debtor knew or could have known that such an action would cause damage to their creditors and if this was known or could have been known to the person with whom or to whose benefit the legal transaction was undertaken.

42 Further, Art. 1167 of the French Code de Civil enables a creditor to challenge fraudulent actions entailing personal damage for this creditor. Special knowledge of the counterparty is not required. In insolvency proceedings, this claim can be enforced by the Insolvency Practitioner.

43 In Italy, Art. 2901 et seq. Civil Code permit the avoidance of transactions detrimental to a creditor by this creditor if the debtor intended (or was aware of) the damage to the

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[59] See for insolvency law above at para. 19 et seq.

[60] It is for this reason that transactions avoidance provisions in national civil codes or special statutes outside insolvency acts are not mentioned here, unless they can be enforced in insolvency proceedings. Such rules can be found in the laws of the Czech Republic, Germany, the Netherlands, Slovakia and Slovenia.

creditor and – where the transaction was performed against consideration – the counterparty shared the debtor's intent or awareness. In insolvency proceedings, this claim can be enforced by the Insolvency Practitioner to the benefit of the general body of creditors.

5.2 Tort law

44 Some jurisdictions provide for special tort law instruments which can be enforced against value extraction schemes. A first example is Germany. Here, the *Bundesgerichtshof* applies § 826 BGB,[61] a tort law provision according to which a person who, in a manner which infringes *boni mores* (i.e. is contrary to public policy), intentionally inflicts damage on another person is liable to the other person to make compensation for the damage. Applying this norm, the BGH established the legal figure of "existence-crushing intrusion" (*existenzvernichtender Eingriff*, destruction of the company) of the shareholder into the company, which is now generally accepted. However, in order to establish "infringement of *boni mores*", the court requires intentional existence-crushing by „plundering" the company's assets which appears as self-service instead of creditor-service.

45 In other countries general tort law can be applied (e.g. Czech Republic, Denmark, Italy, the Netherlands, Portugal) if the transaction has caused damages and intent or negligence can be established.

5.3 Contract law

46 Moreover, under national contract laws, fraudulent contracts can be invalid as they infringe *boni mores*. i.e. are contrary to public policy. For example, this can be established for Denmark, Finland, Germany, the Netherlands, Portugal, Spain and Sweden and may be helpful for tackling value extraction schemes.

6 GENERAL ASPECTS

47 At the end, some general remarks are due.

48 The first one concerns the *person entitled to enforce* the claims or rights against the shareholder. Here, the legal situation is the same in nearly all jurisdictions covered by this survey. Before the opening of insolvency proceedings, claims against the shareholder are either claims of the company (which can be seized by creditors) or – in the case of a Civil

[61] BGH, 8.2.2018 – IX ZR 103/17 = NJW 2018, 2404; 15.9.2014 – II ZR 442/13 = GmbHR 2015, 644; 18.6.2013 – II ZR 217/12 = GmbHR 2013, 1321; 21.2.2013 – IX ZR 52/10 = NJW-RR 2013, 1321; 23.4.2012 – II ZR 252/10 = BGHZ 193, 96 = NZI 2012, 517; 9.2.2009 – II ZR 292/07 = BGHZ 179, 344 = NJW 2009, 2127; 28.4.2008 – II ZR 264/06 = BGHZ 176, 204 = NJW 2008, 2437; 16.7.2007 – II ZR 3/04 = BGHZ 173, 246 = NJW 2007, 2689;. – See for details Tan Cheng Han/Wang Jiangyu/Christian Hofmann, *Piercing the Corporate Veil; Historical, Theoretical and Comparative Perspectives*, NUS Law Working Paper 2018/25, p. 30-44; Sebastian Mock, *Groups of companies*, in: Martin Schmidt-Kessel (ed.), German National Reports on the 20th International Congress of Comparative Law, Mohr Siebeck, Tübingen 2018, 307-396 at p. 378-380.

Code based *actio pauliana* or other claims for damages[62] – such of the disadvantaged creditors. After the opening of insolvency proceedings, all claims are collected by the Insolvency Practitioner[63] who is particularly entitled to enforce insolvency law based transactions avoidance, albeit in some countries only with the consent of the court (Croatia). The result of such an action will be for the benefit of the insolvent estate (i.e. indirectly for the creditors). Creditors are not (or only subsidiarily in case the Insolvency Practitioner fails or refuses to file for avoidance in due time[64] or only to the benefit of the estate[65]) entitled to enforce avoidance claims.

49 The second observation is on the *burden of proof*. Generally, in all jurisdictions the *onus* is with the Insolvency Practitioner who has to establish the prerequisites of the relevant (transactions avoidance) norms. However, there are many facilitations. In some national insolvency laws, the statute helps in certain cases – depending on the relevant avoidance ground – with presumptions for required disadvantage to creditors (France, Portugal), insolvency of the debtor (Denmark) or mental elements (Croatia, Germany, the Netherlands). More importantly in the present context, the burden of proof is shifted to the defendant where this is a closely connected person.[66]

50 The third remark regards the *limitation period* for the insolvency law based[67] rights or claims in question. In this regard, national laws diverge quite significantly. In some countries the limitation period is one year (Czech Republic, Finland, Slovakia and Slovenia), in others 18 months (Croatia), three years (Germany and Italy[68]), five years (Portugal), ten years (Sweden) or twelve years (England and Wales). In France and Spain[69] recovery actions are permissible as long as insolvency proceedings are pending. Regarding the starting point of the limitation period, national laws also tie on different points in time. It is rarely the moment where the transaction was performed.[70] In most countries it is the opening of the insolvency proceedings (Croatia, Czech Republic, England and Wales,

[62] Cf. above at para. 38 et seq.

[63] This may be different in debtor-in-possession proceedings. See for these above fn. 5.

[64] This holds true for Croatia, Denmark, Slovakia and Sweden.

[65] This is the law in England and Wales, Finland and Slovenia. However, the requirement that "victims" represent the class of victims means there is little incentive to pursue this.

[66] For details, see above at para. 26.

[67] Company law or general civil law based claims may have diverging limitation periods; this is neglected here.

[68] In Italy, this period is three years beginning with the opening of insolvency proceedings with a maximum of five years beginning with the performance of the transaction. Because of an express choice of policy (see Art. 69-*bis* of the Italian Insolvency Statute, which is titled "decadenza dall'azione"), this temporal restriction is mainly procedural in nature and consists of an unusually long time-limit for the bringing of the action. This implies that this period of time is not subject to any form of interruption.

[69] For actions based on the Civil Code, the limitation period is four years.

[70] But see for Italy above fn. 68. Portuguese, Spanish and Swedish laws also seem to tie on the performance of the transaction.

Finland, Italy[71], Slovakia and Slovenia[72]). Others refer to the point in time where the Insolvency Practitioner knew (or should have known) of the relevant facts and the person of the debtor. This holds true for Denmark (six months after this point in time) and Germany (three years after the end of the year during which the relevant facts became apparent).

7 GENERAL ASSESSMENT

51 In summarising whether and how precisely the various performances (contracts as well as payments) connected to a value extraction scheme can be challenged by the Insolvency Practitioner, the following can be said:

52 Except for avoidance of preferences, an *unusual high salary* for the shareholder acting as a director can be clawed-back as transactions at an undervalue and intentionally fraudulent transactions, at least as far as the excessive part of the salary is concerned. In many jurisdictions, also the contract can be challenged under the respective national version of the *actio pauliana*, in some circumstances with the effect that the complete salary has to be paid back. Directors can frequently be held liable for damages under company law and collaborating shareholders can be held liable for damages under the requirements of general tort law.

53 The same rules apply to other transactions which are not market-compliant, particularly to a *management fee* for a shareholder not acting as a director, to a *sale and lease back for excessive remuneration* and to an *unusually high interest rate for a loan* granted by the shareholder. The same is true for charges for such a loan. In addition, all payments on shareholder loans are challengeable in some jurisdictions and the same holds true for charges for such a loan.

54 Where assets were bought from the company by a shareholder for an *unusually low purchase price*, such transactions are voidable as transactions at an undervalue and as intentionally fraudulent transactions, too. Directors can frequently be held liable for damages under company law and shareholders can be held liable for damages under the requirements of general tort law.

[71] Cf. fn. 68 above.

[72] More precisely, Slovenian law ties on the finality of the opening decision (Art. 277.1 Slovenian Insolvency Act).

8 CONCLUSION

55 This analysis supports the thesis that, in all jurisdictions covered by this survey, value extraction schemes can be challenged through transactions avoidance law, particularly through rules on transactions at an undervalue and on intentionally fraudulent transactions, providing for aggravation to the disadvantage of closely connected parties by extension of suspect periods or by rebuttable presumptions for certain prerequisites such as mental elements or detriment to the general body of creditors. Additional remedies can be found in company law and/or certain rules of general civil law (including tort law), particularly in the rules on directors' liability. Interestingly, nearly all national reporters (with some reluctance from Finland and the Netherlands) feel that their national laws provide for sufficient protection against value extraction schemes already, with some members of the working group seeing the decisive problem more in acquiring the necessary information about the relevant facts than in pursuing the claims resulting from these facts.