

**Bankruptcy and a fresh start: stigma on failure and
legal consequences of bankruptcy**

Austria

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TABLE OF ABBREVIATIONS

<i>AO</i>	<i>Ausgleichsordnung</i> (Settlement and Recomposition of Debts Act)
<i>KO</i>	<i>Konkursordnung</i> (Bankruptcy Act)
<i>BWG</i>	<i>Bankwesengesetz</i> (Financial Institutions Act)
<i>StGB</i>	<i>Strafgesetzbuch</i> (Criminal Code)
<i>IESG</i>	<i>Insolvenzentsicherungsgesetz</i> (Act on the Protection of Wages in Insolvencies)
<i>VAG</i>	<i>Versicherungsaufsichtsgesetz</i> (Supervision of Insurance Companies Act)
<i>URG</i>	<i>Unternehmensreorganisationsgesetz</i> (Business Reorganization Act)
<i>GewO</i>	<i>Gewerbeordnung</i> (Industrial Code)

TITLE 1. INTRODUCTION

Chapter 1.1. Overview of the Current Insolvency Legislation

Austrian insolvency law is codified primarily in two statutes: (i) the Bankruptcy Act of 1914 (*Konkursordnung* or *KO*), and (ii) the Settlement and Recomposition of Debts Act, also of 1914 (*Ausgleichsordnung* or *AO*).¹

Additionally, insolvency related provisions are contained in numerous other statutes. The reorganization of banks is regulated in the Financial Institutions Act of 1993 (*Bankwesengesetz* or *BWG*),² of insurance companies in the Supervision of Insurance Companies Act (*Versicherungsaufsichtsgesetz* or *VAG*).³

The Business Reorganization Act of 1997 (*Unternehmensreorganisationsgesetz* or *URG*)⁴ contains provisions for the restructuring of a non-insolvent debtor's business. It does not affect creditors' rights and, in spite of its title, is not an insolvency statute in the strict sense.

Insolvency related provisions are also found in the Criminal Code (*Strafgesetzbuch* or *StGB*)⁵, and in the Act on the Protection of Wages in Insolvencies (*Insolvenzentgeltsicherungsgesetz* or *IESG*),⁶.

Cross-border insolvencies are regulated in the *KO*,⁷ and in bilateral treaties.⁸ As of May 31, 2002, the European Regulation on Insolvency Proceedings⁹ will enter into force in Austria, providing, in particular, for uniform conflict-of-law rules, rules of jurisdiction, and recognition of foreign judgments in the field of insolvency throughout the whole EU.¹⁰

¹ The original versions of both statutes date back to the times of the Habsburg monarchy. They were enacted by Imperial Regulation (*Kaiserliche Verordnung*) of 10 December 1914, RGBI 337. Both statutes have been amended many times since. Apparently, there is no published English translation of the present Austrian insolvency laws.

² Federal Law Gazette (*Bundesgesetzblatt – BGBl*) 1993/532 (Secs. 82 *et seq.*).

³ *BGBl* 1978/569.

⁴ *BGBl* I 1997/114.

⁵ *BGBl* 1974/60.

⁶ *BGBl* 1977/324.

⁷ Sec. 1 and 180 *KO*.

⁸ Austria has concluded bilateral treaties covering insolvency proceedings only with the following countries: Belgium, Germany, France, Italy, the United Kingdom and Turkey.

⁹ Council Regulation (EC) No 1346/2000 of May 29, 2000, on Insolvency Proceedings, Official Journal of the European Communities (OJ) L 160/1 of June 30, 2000.

¹⁰ Except Denmark.

Chapter 1.2. Summary of the Historical and Political Lines of Force of the Insolvency Legislation

Generally speaking, Austrian insolvency law is still primarily creditor oriented. The proceeding regulated in the *KO* - the bankruptcy proceeding (*Konkurs*) – is, mainly, a liquidation or winding-up proceeding, i.e. a proceeding involving the realization of the debtor's assets and the subsequent distribution of the proceeds among the creditors. However, also the bankruptcy proceeding contains elements of debtor protection and rescue of the debtor's business.¹¹

The proceeding regulated in the *AO*, on the other hand, provides for a court controlled reorganization (*Ausgleich*) of the debtor from the outset of the proceeding. Its goal is to rescue the insolvent debtor's business by enabling the debtor to continue its business activities and, eventually, to be discharged from a part of its debts. The conditions for a discharge of residual debts are quite strict. The main requirements are (1) that the debtor undertakes to pay to its creditors, over a maximum period of two years, a minimum of 40 percent of its debts, and (2) that the creditors accept the debtor's plan by a majority vote.

A similar reorganization proceeding is available under the *KO*. A proceeding that has originally begun as a bankruptcy proceeding may be converted into a reorganization proceeding (1) if the debtor undertakes to pay to its creditors, again, over a maximum period of two years, a minimum of 20 percent of its debts and, (2) if the creditors accept this, again, by a majority vote. This special type of reorganization proceeding is – if translated literally - called “compulsory reorganization” (*Zwangsausgleich*).

The *KO* also provides for a specific consumer bankruptcy proceeding, called “regulation of debts proceeding” (*Schuldenregulierungsverfahren*), or, in practice, rather “private bankruptcy” (*Privatkonkurs*). It enables natural persons to achieve, under certain circumstances, an eventual discharge of debts.

¹¹ E.g., the bankruptcy administrator (*Masseverwalter*) has to continue the insolvent debtor's business, unless such continuation were detrimental to the creditors' chances of satisfaction of their claims. A bankruptcy proceeding may, under certain circumstances, be converted into a reorganization proceeding (so-called “compulsory reorganization” or “*Zwangsausgleich*”), with eventual discharge of residual debts.

Out-of-court reorganizations of insolvent businesses (informal work-outs, in German: *außergerichtlicher Ausgleich* or *stiller Ausgleich*) are, in principle, possible but, in practice, difficult to achieve. The main obstacles are the tight statutory deadlines to file for court insolvency proceedings¹² which leave little time for successful out-of-court negotiations, and the necessity to achieve unanimous acceptance by the creditors of the debtor's reorganization plan. Additional obstacles are the risks of civil, and even criminal, sanctions if the principle of equal treatment of creditors is not strictly observed.

A proposal for an amendment to certain provisions of, among others, the *KO* and the *AO* was submitted by the Austrian Government to the Austrian Parliament in early February 2002. The key issues of the Insolvency Law Reform Act 2002 ("*Insolvenzrechts-Novelle 2002*") are the following:

- When appointing the insolvency administrator (i.e. the bankruptcy or reorganization administrator, in German: *Masseverwalter* or *Ausgleichsverwalter*), the court has to give special attention to the requirements the administrator must fulfill with regard to the specific insolvency situation;
- The insolvency administrator has to inform the court of legal or material obstacles to its appointment;
- The courts will be provided a list of insolvency administrators for their information;
- In order to avoid that the debtor company is sold at an disproportionately low price, the creditors' committee has to consent to the sale.

¹² Sixty days from the time when the debtor recognizes, or could have recognized, that it is in a state of insolvency.

TITLE 2. DEFINITIONS AND TERMINOLOGY

Chapter 2.1. *Konkurs* (Bankruptcy)

The term ‘Konkurs’ (*bankruptcy*) is used to describe the proceeding under the Bankruptcy Act (*Konkursordnung* or *KO*). This proceeding is, primarily, a liquidation type proceeding, although it contains also elements of continuation and, if possible, rescue of the debtor’s business.

§ 1. *Konkursgericht* (Bankruptcy Court)

In a bankruptcy proceeding (*Konkurs*), the court is named ‘bankruptcy court’ (*Konkursgericht*). As regards its tasks, see Title 5, Chapter 1, § 2.

§ 2. *Gemeinschuldner* (Debtor)

In order for bankruptcy proceedings to be commenced with respect to the assets of an entity, this entity must be a natural or legal person. Legal persons include:

- Stock corporations (*Aktiengesellschaften* or *AGs*);
- Limited liability companies (*Gesellschaften mit beschränkter Haftung* or *GmbHs*);
- Co-operative societies (*Vereine*);
- Public trusts or foundations (*Stiftungen*);
- Partnerships (*Personengesellschaften*), which under Austrian law are technically not regarded as legal persons, are also subject to bankruptcy proceedings.

In principle, all legal forms in which a business may be conducted are subject to bankruptcy proceedings, with the exception of "civil law partnerships" (*Gesellschaften bürgerlichen Rechts*) and so-called “silent partnerships” (*stille Gesellschaften*).¹³

Entities subject to bankruptcy proceedings are called *Gemeinschuldner*.

¹³ Undisclosed participation in the business of another with share in profits and losses but no voice in the management.

§ 3. *Masseverwalter* (Bankruptcy Administrator)

In the decision opening the bankruptcy proceeding, the bankruptcy court appoints a "bankruptcy administrator" (*Masseverwalter*).¹⁴ The bankruptcy administrator is a "key player" in the course of a bankruptcy proceeding. Both natural and legal persons can be appointed as administrator.¹⁵ Usually a natural person – most frequently an attorney - is appointed. The person chosen must be reliable and experienced in business matters.

As regards the competences and responsibilities of the bankruptcy administrator, see Title 5, Chapter 1, § 3.1..

§ 4. *Gläubigerausschuss* (Creditors' Committee)

The creditors' committee (*Gläubigerausschuss*) is a representative body appointed by the bankruptcy court.

As regards the competences and responsibilities of the creditors' committee, see Title 5, Chapter 1, § 3.2..

§ 5. *Gläubigerschutzverbände* (Associations for the Protection of Creditors' Rights)

Creditors often do not participate themselves in the course of the proceedings, e.g. in court hearings, in the creditors' assembly or in the creditors' committee. Rather they are represented by one of the so-called "*bevorrechtete Gläubigerschutzverbände*" (privileged associations for the protection of creditors' rights).

For more details, see Title 5, Chapter 1, § 3.4..

¹⁴ Sec. 80 *KO*. In this article, "bankruptcy administrator" is used as a translation for the German term "*Masseverwalter*", in particular, to distinguish the administrator in a bankruptcy proceeding from the respective administrator in a reorganization proceeding ("reorganization administrator", in German: *Ausgleichsverwalter*). Other translations use "receiver" or "trustee" for both functions. A literal translation of "*Masseverwalter*" would be "estate administrator".

¹⁵ Sec. 80 para. 5 *KO*.

§ 6. *Gläubigerversammlung* (Creditors' Assembly)

Together, all creditors form the creditors' assembly (*Gläubigerversammlung*).¹⁶ This is the body that exercises the rights of participation of the creditors in an insolvency proceeding.

The tasks of the creditors' assembly are described in Title 5, Chapter 1, § 3.3..

§ 7. *Zwangsvergleich* (Compulsory Reorganisation)

“Compulsory reorganization” is the term used for a special type of reorganization proceeding, regulated under the Bankruptcy Act (*Konkursordnung* or *KO*). Because of its nature (as a reorganization proceeding in contrast to a liquidation proceeding), and because of its similarity with the “ordinary” reorganization proceedings under the Settlement and Recomposition of Debts Act (*Ausgleichsordnung* or *AO*), the provisions on compulsory reorganization are treated together with the provisions on “ordinary reorganization” (see Title 4, Chapter 1).

Chapter 2.2. *Ausgleich* (Reorganization)

Reorganization (*Ausgleich*) is the term used for the proceeding under the Settlement and Recomposition of Debts Act (*Ausgleichsordnung* or *AO*), which aims, from the outset of the proceedings, at the rescue of the debtor’s business through a partial discharge of debts.

§ 1. *Ausgleichsgericht* (Reorganization Court)

In a reorganization proceeding (*Ausgleich*), the court is named reorganization court (*Ausgleichsgericht*).

§ 2. *Ausgleichsschuldner* (Debtor)

Entities subject to reorganization proceedings are called *Ausgleichsschuldner*.

¹⁶ Sec. 91 to 95 *KO*

§ 3. *Ausgleichsverwalter* (Reorganization Administrator)

In an ordinary reorganization proceeding, the reorganization court appoints a reorganization administrator (*Ausgleichsverwalter*).¹⁷ Mostly attorneys are appointed.

The competences and responsibilities of the reorganization administrator are enumerated in Title 4., Chapter 1, § 6.1..

§ 4. *Gläubigerbeirat* (Creditors' Committee)

The creditors' committee (*Gläubigerbeirat*) is a representative body appointed by the reorganization court. As in a bankruptcy proceeding, it consists of three to seven members. Its purpose is to supervise and assist the reorganization administrator. A creditors' committee is only appointed if the nature or amount of the business so requires.¹⁸

§ 5. *Gläubigerversammlung* (Creditors' Assembly)

In contrast to the responsibilities of the creditors' assembly (*Gläubigerversammlung*) in a bankruptcy proceeding, the creditors' assembly in a reorganization proceeding only has one task, namely, to vote, in the reorganization hearing,¹⁹ on the reorganization proposal made by the debtor.²⁰

§ 6. *Gläubigerschutzverbände* (Associations for the Protection of Creditors' Rights)

Many creditors let themselves be represented by one of the so-called “associations for the protection of creditors' rights” (*bevorrechtigte Gläubigerschutzverbände*) also in a reorganization proceeding.²¹ In a reorganization proceeding, these associations examine whether the reorganization proposal and, in particular, the quota offered by the debtor to the creditors, is fair and reasonable.

¹⁷ Sec. 29 AO.

¹⁸ Sec. 36 AO.

¹⁹ See Title 4, Chapter 1, § 5.1.

²⁰ Secs. 37 to 45 AO.

²¹ See Title 4, Chapter 1, § 6.1.

§ 7. *Sachwalter der Gläubiger* (Creditors' Trustee)

After the reorganization proposal has been accepted by the creditors,²² and confirmed by the court,²³ the judicial reorganization proceeding is, mostly, terminated.²⁴ The debtor still has to fulfill its proposal, i.e. it must render to its creditors the payments stipulated in the proposal. For the fulfillment of these obligations, usually the maximum time period of up to two years is provided. Unless a creditors' trustee (*Sachwalter der Gläubiger*) is appointed, the debtor is, during this time period, under no restrictions or supervision whatsoever (so-called "autonomous fulfillment of the reorganization").²⁵

As an alternative to such autonomous fulfillment of the reorganization, the debtor may propose to remain, during the fulfillment period, under supervision of a so-called creditors' trustee (*Sachwalter der Gläubiger*).²⁶ Usually the reorganization administrator is entrusted with that function.

As regards the competences of the creditors' trustee, see Title 4., Chapter 1, § 6.1..

²² See Title 4, Chapter 1, § 5.1.

²³ See Title 4, Chapter 1, § 5.1.

²⁴ See Title 4, Chapter 1, § 8.1.

²⁵ See Title 4, Chapter 1, § 8.1.

²⁶ The practical reason why a debtor would voluntarily submit to supervision by a creditors' trustee is to increase the willingness of the creditors to accept the debtor's reorganization proposal.

TITLE 3. WARNING LIGHTS AND PREVENTION OF INSOLVENCY

Chapter 3.1. General

The Insolvency Law Reform Act of 1997 (*Insolvenzrechtsänderungsgesetz 1997*) introduced a new statute, the so called Business Reorganization Act (*Unternehmensreorganisationsgesetz - URG*) which replaced that part of the Settlement and Recomposition of Debts Act (*AO*) regulating a moratorium (*Vorverfahren*). The *URG* is – in spite of its name - not an insolvency statute in the strict sense, as it does not apply to insolvent undertakings.

The purpose of a proceeding under the *URG* is to enable businesses that are only in temporary financial difficulties, but are basically healthy and fit to stay in business, to continue to carry out their activities after having undergone a reorganization procedure. The *URG* applies to all kinds of businesses except banks, pension funds, insurance companies and investment firms.

Whether the company's rescue is likely must be determined by a so-called "continuation forecast" (*Fortführungsprognose*). This forecast includes an evaluation of the capitalized value of the anticipated yield of the company. In practice, it must be determined whether the economic strength of the company is sufficient to overcome the current crisis. If that is the case, then no bankruptcy proceedings will be opened, even if the company is, technically speaking, over-indebted.

Chapter 3.2. Opening of Proceedings

Only the debtor itself may apply for the opening of a business reorganization procedure under the *URG*, provided, however, it is still solvent at the time. Upon application to the insolvency court, which must include sufficient proof of the need for the business's reorganization and may include a reorganization plan for the debtor's business, the court initiates the business reorganization proceedings by appointing a temporary reorganization auditor. This court resolution will not be publicly announced. This is a significant difference to insolvency proceedings under the *KO* or the *AO*.

Chapter 3.3. Reorganization Plan

If the debtor did not submit a reorganization plan with its application, the court will order it to do so within 60 days (or, in exceptional circumstances, within 90 days). The reorganization plan must state how new financial resources shall be found, the effect the reorganization will have on employees and the period of time necessary for the reorganization (which should not exceed two years).

A temporary reorganization auditor examines the reorganization plan and inquires as to whether the debtor is still solvent, and, in the affirmative, files within 30 days upon receipt of the reorganization plan an expert opinion as to the appropriateness of the measures and steps suggested in the plan to remedy the temporary incapacity of the debtor to meet its financial obligations. If the temporary reorganization auditor approves the plan, the court will suspend the business reorganization proceedings. Furthermore, the reorganization plan requires the consent of all involved creditors.

Chapter 3.4. Consequences of the Proceedings

With the opening of business reorganization proceedings, contractual provisions (particularly in leasing agreements) giving a party the right to terminate in the event that business reorganization proceedings are opened are ineffective. In the case of subsequent bankruptcy the receiver's right to void a contract concluded between the debtor and a creditor in the course of the business reorganization is subject to stringent limitations; creditors cannot challenge the validity of a loan made by a shareholder of a company based on certain principles of corporate law that require that such loan be assimilated into the equity and therefore be subordinated to the claims of other creditors.

While the reorganization plan is in force, the business owner must report to the involved creditors of the status of its business and the measures and steps taken under the reorganization plan. This report is due every six months and immediately after circumstances pertinent to the implementation of the plan have changed. In case the temporary reorganization auditor has been put in charge of supervising the fulfilment of the reorganization plan, it must report to the court.

Chapter 3.5. Termination of the Proceedings

The court will terminate the business reorganization proceedings when

- the debtor becomes insolvent;
- the debtor is late in submitting the reorganization plan;
- the debtor fails to deposit an advance for the temporary reorganization auditor's fees;
- the debtor violates its duty to co-operate under the plan; or
- the temporary reorganization auditor reaches the opinion that the suggested reorganization plan fails to serve its purpose and lacks a prospect of success.²⁷

Chapter 3.6. Practical Use of the Proceedings

The *URG* has shown no practical use. In fact, only 2 proceedings under the *URG* have been initiated so far.

²⁷ Werner Huber in Heller, Löber, Bahn, Huber, Horvath, Austrian Business Law (Manz 1992, Suppl. 8 April 2000), Chapter XXIII 1-3.

TITLE 4. LEGAL POSSIBILITIES TO CONTINUE ECONOMIC ACTIVITIES

Chapter 4.1. Reorganization Proceedings under the AO (*Ausgleich*) and Compulsory Reorganization Proceedings under the KO (*Zwangsausgleich*)

§ 1. Comprehensive Description of the Regime as well as the Underlying Philosophy

§ 1.1. Description

“Reorganization” (*Ausgleich*) is the term used to describe primarily the judicial insolvency proceeding under the Settlement and Recomposition of Debts Act (*Ausgleichsordnung* or *AO*). This proceeding aims, from the outset of the proceedings, at the rescue of the debtor’s business through a partial discharge of debts.

Under the Bankruptcy Act (*Konkursordnung* or *KO*) there exists a very similar, also judicial, proceeding, the so-called “compulsory reorganization” (which is a literal translation of the German word “*Zwangsausgleich*”). The compulsory reorganization proceeding is, therefore, also treated in this context, together with the provisions on “ordinary” reorganization proceedings. Whenever the word “reorganization” is used, it is meant to cover both “ordinary” and compulsory reorganization proceedings, unless otherwise stated.²⁸

In contrast to bankruptcy proceedings (*Konkurs*) which aim, primarily, at the liquidation of the debtor’s business through the sale of the debtors' assets and distribution of the proceeds,²⁹ reorganization proceedings aim, primarily, at the continuation and rescue of the debtor’s business.

Reorganization, including the two types of judicial reorganization proceedings, (i.e. ordinary reorganization (*Ausgleich*) and compulsory reorganization (*Zwangsausgleich*) is basically structured as an agreement between the debtor on the one side and its creditors on the other side. In its essence, the agreement stipulates that the debtor will pay to its creditors a certain

²⁸ Care must be taken not to confuse the reorganization (*Ausgleich*) and compulsory reorganization (*Zwangsausgleich*) proceedings, which are both true insolvency proceedings in the strict sense of the word, on the one side, with the provisions and proceedings under the Business Reorganization Act (*Unternehmensreorganisationsgesetz* or *URG*), on the other side. The *URG* is, in spite of its name, not an insolvency statute.

²⁹ See Title 5, Chapter 1, § 4.

percentage of its debts within a specified time period. If the debtor meets this obligation, it will be discharged of the residual debt.

The minimum quotas which a debtor must offer to its creditors to be granted a discharge, are:

- 40 percent of the unsecured debts in an ordinary reorganization proceeding; and
- 20 percent of the unsecured debts in a compulsory reorganization.

The payment of the quota is due within a maximum time period of two years, calculated from the acceptance of the reorganization proposal by the creditors. Usually, payment is rendered in two or more installments.³⁰

§ 1.2. Critical Analysis

Because of the high minimum quota (40 %) that must be offered and paid for achieving a discharge in a reorganization proceeding under the *AO*, the *Ausgleich* is, in many cases, either not feasible or not very attractive to insolvent businesses. Many insolvent businesses, therefore, rather opt for a bankruptcy proceeding under the *KO* (*Konkurs*) and try to subsequently convert it into a compulsory reorganization proceeding (*Zwangsausgleich*).

The significant advantage, on the other hand, of the “ordinary” reorganization proceeding under the *AO* is the fact, that the debtor retains a much higher degree of control over its undertaking (comparable to the “debtor in possession” under US law), whereas, in any proceedings under the *KO*, practically all powers are transferred to the bankruptcy administrator.

§ 2. Classification of the Procedure among Branches of Law, Competent Jurisdictions, Overview of the Procedure Followed before these Jurisdictions, Implications of International Private Law

§ 2.1. Description

Insolvency law forms a part of the body of private law (as opposed to public or administrative law). It contains substantive and procedural rules. On the other hand, there exist also provisions in the body of criminal law which relate to insolvency situations.

Since Austria is a federal state (divided into nine provinces, the *Bundesländer*), Austrian law distinguishes between federal law, and the law of the provinces. Insolvency law is federal law.

The courts competent for the conduct of insolvency proceedings are civil law courts. For details on the courts, see § 11.1.. For an overview on the procedure, see § 5.1, § 6.1. and § 8.1..

§ 2.2. Critical Analysis

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§ 3. Criteria to Benefit from the Regime

§ 3.1. Description

In principle, the requirements for the opening of (ordinary) judicial reorganization proceedings (i.e. proceedings under the *AO*) are the same as for the opening of bankruptcy proceedings.³¹ Additionally, the following differences apply:

In addition to illiquidity and/or over-indebtedness, depending on whether the debtor is a legal entity or a natural person,³² also **impending illiquidity** is a reason for the commencement of ordinary reorganization proceedings.³³ A compulsory reorganization, on the other hand, can be started only in the process of a bankruptcy proceeding.³⁴

The application for the opening of an ordinary reorganization proceeding must contain the following **elements**:³⁵

- a reorganization proposal, i.e. in particular, the offer made by the debtor to pay to its (unsecured) creditors, within a certain period of time, a certain percentage of its debt;³⁶
- a declaration that there is reason that would make a reorganization proceeding unlawful;³⁷

³⁰ For details on the reorganization proposal, see § 5.1.

³¹ See Title 5, Chapter 1, § 1.

³² See Title 2, Chapter 1, § 2 and Chapter 2, § 2.

³³ Sec. 1 para. 1 *AO*.

³⁴ Sec. 140 para. 1 *KO*. For the requirements for opening a bankruptcy proceeding, see Title 5, Chapter 1, § 1.

³⁵ Sec. 2 *AO*.

- a reorganization plan, i.e. information on how the reorganization shall be achieved and, in particular, how the funds necessary to pay the quotas offered to the creditors shall be raised;
- an exact inventory;
- a status of assets and liabilities; and
- a list of creditors.

The application to convert a bankruptcy proceeding into a compulsory reorganization proceeding must contain the so-called **compulsory reorganization proposal**, i.e. in particular, the offer made by the debtor to pay to its (unsecured) creditors within a certain period of time a certain percentage of its debt.

The opening of an ordinary reorganization proceeding will be rejected by the insolvency court under the following conditions.³⁸

- if the debtor is fugitive;
- if the debtor, after the debtor has become illiquid, has been convicted by the criminal court because of fraudulent bankruptcy;
- if, during the last five years prior to the filing of an application to open reorganization proceedings, a bankruptcy or reorganization proceeding has been opened or rejected due to lack of assets;
- if the reorganization proposal violates mandatory legal provisions;
- if the debtor does not offer to pay to its creditors a minimum amount of 40 percent of the unsecured debts within a maximum time period of two years.

The **reasons for rejecting** an application by the debtor for converting a bankruptcy proceeding into a compulsory reorganization proceeding, are basically the same as in the case of an ordinary reorganization proceeding.³⁹ Additionally, an application for compulsory reorganization can be rejected,

³⁶ For minimum quotas, *see* § 1.1.. For details on the reorganization proposal, *see* § 5.1.

³⁷ For such reasons, *see* § 5.1..

³⁸ Sec. 3 *AO*.

³⁹ Secs. 141, 142 *KO*.

- if the application was filed with the intention of prolonging the bankruptcy proceeding;⁴⁰
- if the fulfillment of the compulsory reorganization is unlikely;⁴¹
- if, in the case of the debtor being a natural person, during the last ten years prior to the application, a private bankruptcy proceeding has been opened;⁴²
- if the debtor does not or, is not capable to, render sufficient information on its economic situation;⁴³
- if, in the course of the bankruptcy proceeding, the debtor has already applied for compulsory reorganization, and such reorganization had already once been rejected by the creditors.⁴⁴

§ 3.2. *Critical Analysis*

The criteria to benefit from ordinary reorganization proceedings (i.e. proceedings under the *AO*) are very strict and very formalistic. Even to submit a proposal for a “compulsory reorganization” in the course of a bankruptcy proceeding under the *KO*, a debtor must demonstrate that it is likely to be able to fulfill a minimum quota of 20 percent. This situation limits the possibility for rescue. One might consider to allow reorganization of insolvent businesses also under more flexible conditions.

§ 4. *Specification of the Possible Initiators of the Procedure*

§ 4.1. *Description*

The application for the opening of ordinary reorganization proceedings or for the converting of a bankruptcy proceeding into a compulsory reorganization proceeding may only be filed by the **debtor** itself, not by a creditor.⁴⁵ Austrian law does not provide for a reorganization contrary to the debtor’s wishes. If a creditor applies for involuntary bankruptcy proceedings, the debtor may still file for reorganization, as long as the court has not opened the bankruptcy proceedings.⁴⁶

⁴⁰ Sec. 141 no. 4 *KO*.

⁴¹ Sec. 141 no. 5 *KO*.

⁴² Sec. 141 no. 6 *KO*.

⁴³ Sec. 142 no. 3 *KO*.

⁴⁴ Sec. 142 no. 4 *KO*.

⁴⁵ Sec. 1 para. 1 *AO*; Sec. 140 para. 1 *KO*.

⁴⁶ Sec. 1 para. 2 *AO*.

As in bankruptcy, the **application** by the debtor to open ordinary reorganization proceedings must be filed within 60 days after the debtor has recognized that it is over-indebted or illiquid.⁴⁷

§ 4.2. *Critical Analysis*

In many cases, reorganization proceedings are more beneficial to the creditors than the liquidation oriented bankruptcy proceedings. However, if the debtor refuses to apply for (ordinary or compulsory) reorganization proceedings, the creditors cannot impose reorganization upon the debtor. One might consider to introduce the possibility that also creditors can initiate reorganization proceedings.

§ 5. *Restructuring Plan (Reorganization Proposal, in German: Ausgleichsvorschlag)*

§ 5.1. *Description*

The **reorganization proposal** must contain certain minimum requirements:⁴⁸

- The rights of creditors with the right to segregation of assets and of creditors with the right of separate satisfaction must not be affected by the reorganization plan. Their claims must be satisfied in full or at least sufficient security must be provided;
- Creditors with privileged claims (in the case of a compulsory reorganization proceedings: the creditors of the estate) must be satisfied in full;
- Ordinary reorganization creditors must be treated equally, except if they have consented to a subordinate treatment of their claims;
- The quota offered to unsecured creditors, i.e. ordinary reorganization creditors (in an ordinary reorganization proceeding) or ordinary bankruptcy creditors (in a compulsory reorganization) must be a minimum of:

(1) 40 percent in an ordinary reorganization proceeding⁴⁹ and

(2) 20 percent in a compulsory reorganization proceeding.⁵⁰

⁴⁷ Sec. 1 para 1 AO in connection with Sec. 69 para. 2 KO.

⁴⁸ Secs. 46 para. 1 to 4 AO and Sec. 47 AO; Secs. 149 para. 1, 150 para. 1 KO.

The above-mentioned minimum quotas must be paid in a maximum time period of two years, calculated from the day of the creditors' acceptance of the reorganization plan.

Different rules regarding quotas and/or time periods apply:

- To compulsory reorganization proceedings of natural persons;⁵¹
- To ordinary and compulsory reorganization proceedings, if (1) the fulfillment of the reorganization plan is supervised by a creditors' trustee and (2) the debtor has handed over its assets to the trustee;⁵² and
- To consumer bankruptcies.

In practice, creditors seldom agree that the amount can be paid up to the maximum time period permitted by law. Usually the creditors demand, as a prerequisite to their consent to the debtor's proposal, that the debtor offers to pay the amount in installments, beginning immediately after the acceptance of the reorganization proposal and being made periodically over the statutory maximum period of two years. A typical payment plan would be, e.g. that the 40 percent quota be paid as follows:

- 10 percent within 14 days after acceptance of the reorganization proposal;
- 10 percent within 12 months;
- 10 percent within 18 months; and
- 10 percent within the maximum period of 24 months.

In compulsory reorganization where the minimum amount is only 20 percent, the above installments are reduced accordingly.

In practice, the creditors will evaluate the reorganization proposal based on the economic situation of the debtor and the probability of the fulfillment of the plan. In principle, creditors will only accept such a proposal if it is appropriate and fulfillable. In this decision-making process, the associations for the protection of creditors' rights play a major role. They will

⁴⁹ Sec. 3 para. 1 no. 3 *AO*.

⁵⁰ Sec. 141 no. 3 *KO*.

⁵¹ In this case, the minimum quota is 30 percent, and the maximum time period is five years (Sec. 141 no. 3 *KO*).

⁵² In this case, the maximum time period can be extended up to four and a half years (Sec. 64 para. 3 *AO*; Sec. 157g para. 3 *KO*).

carefully examine whether the debtor is in such a position that it could offer a better, i.e. higher, amount to the creditors and make corresponding recommendations to the creditors that they represent. If the situation of the debtor is such that it is highly unlikely that the reorganization proposal, i.e. the payment of the proposed amounts, can be fulfilled, then the association for the protection of creditors will recommend that their clients not accept the reorganization proposal.

Consequently, in the phase prior to the reorganization hearing in which the vote is taken on the debtor's proposal negotiations are conducted between the debtor and its representative, on one side, and the creditors (or the association for the protection of creditors), on the other side, on whether the plan is appropriate and fulfillable and whether the creditors will accept it. The debtor is always free to submit a more favorable proposal, even as late as in the reorganization hearing.⁵³ The debtor may also withdraw its reorganization plan, even as late as during the reorganization hearing.⁵⁴

The rules on **voting** are practically identical in an ordinary reorganization proceeding and in a compulsory reorganization proceeding.

- Ordinary reorganization creditors, or ordinary bankruptcy creditors, respectively, have a right to vote on the reorganization plan, to the extent that their claim has not been contested;
- Creditors whose rights are not affected by the reorganization are not entitled to vote;
- Creditors with the right to segregation of assets have no right to vote;⁵⁵
- Creditors with a right to separate satisfaction have a right to vote only to the extent that their claim has not been contested and to the extent that their claim is not satisfied.⁵⁶

For the debtor's **reorganization proposal to be accepted**, it is necessary that two majorities vote for it:

- The absolute majority of individual creditors who are actually present (or represented) at the reorganization hearing; and

⁵³ Sec. 37 para. 2 *AO*, Sec. 145 para. 4 *KO*.

⁵⁴ Sec. 37 para. 2 *AO*, Sec. 145 para. 4 *KO*.

⁵⁵ Sec. 39 para. 1 *AO*, Sec. 143 para. 1 *KO*.

- The total amount of the claims of those individual creditors who vote in favor of the reorganization plan must amount to at least 75 percent of the total amount of claims of the individual creditors who are actually present or represented at the reorganization hearing.⁵⁷

If only one of the two majorities is achieved, then the debtor may demand that a second vote be taken at another reorganization hearing.⁵⁸

For the **reorganization to become effective** it is necessary that the court confirms it in a formal decision.⁵⁹ In particular, under the following circumstances, **confirmation** *must* be rejected by the court:⁶⁰

- If the opening of the reorganization proceedings was unlawful;⁶¹
- If severe procedural mistakes have occurred;⁶²
- If one creditor has received preferential treatment contrary to law.⁶³

Confirmation by the reorganization court *may* be refused, if e.g. the reorganization plan is contrary to the common interest of the reorganization creditors or if it was not possible to receive full information about the economic situation of the debtor.⁶⁴ The reorganization court may also deny confirmation of the reorganization plan, if the discharge granted to the debtor is not in accordance with its economic situation.⁶⁵ This would be the case if the debtor, according to its economic situation, was in a position to offer to the creditors a higher quota than the statutory minimum quota but refused to do so.

If the reorganization court confirms the reorganization, creditors who did not consent to the reorganization plan may **appeal** against it. If the reorganization court refuses to confirm the

⁵⁶ Sec. 39 para. 3 *AO*, Sec. 93 para. 3 *KO*.

⁵⁷ Sec. 42 para. 1 *AO*, Sec. 147 para. 1 *KO*.

⁵⁸ Sec. 42 para. 2 *AO*, Sec. 147 para. 2 *KO*.

⁵⁹ Sec. 49 para. 1 *AO*, Sec. 152 para. 1 *KO*.

⁶⁰ Sec. 50 *AO*, Sec. 152 *KO*.

⁶¹ Sec. 50 no. 1 *AO*, Sec. 153 no.1 *KO*.

⁶² Sec. 50 no. 2 *AO*, Sec. 153 no. 2 *KO*.

⁶³ Sec. 50 no. 3 *AO* in connection with Sec. 47 *AO*, Sec. 153 no. 3 *KO* in connection with Sec. 150 para. 5 *KO*.

⁶⁴ Sec. 51 *AO*, Sec. 154 no. 1 *KO*.

⁶⁵ Sec. 51 no. 1 *AO*. Sec. 154 no. 1 *KO*.

reorganization, the debtor and those creditors who have voted in favor of the reorganization plan may appeal against this decision.⁶⁶

If the **reorganization** has been accepted by the creditors (with the necessary majorities) and if the reorganization has been **confirmed** by the court, then the debtor must pay to the creditors only the amount stipulated in the reorganization proposal. Creditors who voted against the proposal are also bound by it. They receive only the amount specified in the reorganization proposal. Likewise, creditors who did not vote are bound by it.⁶⁷

In an ordinary reorganization proceeding, if **the debtor's proposal has not been accepted** by the creditors with the necessary majorities, the reorganization court must decide upon its own motion whether it will initiate bankruptcy proceedings.⁶⁸ In practice, this is almost always the course taken. Such bankruptcy proceedings are called **“follow-up bankruptcy”** (*Anschlusskonkurs*).⁶⁹

If the debtor's proposal for a compulsory reorganization has not been accepted by the creditors or was rejected by the court then the “normal”, i.e. liquidation oriented, bankruptcy proceeding is continued.

§ 5.2. Critical Analysis

See critical analysis to § 3. The possibilities for successful reorganization should be more flexible.

§ 6. Administration of Procedure

§ 6.1. Description

The reorganization court

Both the ordinary reorganization proceeding and the compulsory reorganization proceeding are court-controlled proceedings.

⁶⁶ Sec. 52 para. 1 *AO*, Sec. 155 *KO*.

⁶⁷ Sec. 53 para. 1 *AO*, Sec. 156 para. 1 *KO*.

⁶⁸ Sec. 69 para. 1 *AO*.

In an **ordinary reorganization proceeding**, the same court that would have had jurisdiction if the debtor or a creditor had filed for bankruptcy, i.e. the Superior Court (*Landesgericht*), also has jurisdiction. While in a bankruptcy proceeding that court is named “bankruptcy court” (*Konkursgericht*), in an ordinary reorganization proceeding the same court is named “reorganization court” (*Ausgleichsgericht*).

The reorganization court is responsible for:

- The opening of the reorganization proceedings and publishing the decision to do so;
- Conducting the entire reorganization proceeding;
- Appointing of a reorganization administrator and, if appropriate, of a creditors’ committee;
- Supervision of the reorganization administrator, the creditors’ committee, and other persons entrusted with particular responsibilities (e.g., expert witnesses);
- Conducting the reorganization hearing, i.e. the hearing in which the creditors take a vote on the debtor’s reorganization proposal;
- Confirmation or non-confirmation of the reorganization;
- Terminating of the reorganization proceeding and publication of the decision to do so; and
- Deciding over the eventual opening of a bankruptcy proceeding upon the court’s own motion.

Certain transactions need to be approved by the reorganization court before they become effective, in particular:

- The closing of the debtors' business; and
- The re-opening of the debtors' business.⁷⁰

In a **compulsory reorganization proceeding** which evolves out of a bankruptcy proceeding, the bankruptcy court keeps its name, i.e. “bankruptcy court” (*Konkursgericht*), even after the filing of the application for compulsory reorganization.

⁶⁹ Sec. 2 para. 2 *KO*.

⁷⁰ Sec. 8 para. 2 *AO* in connection with Sec. 115 *KO*.

In a compulsory reorganization proceeding the bankruptcy court is in particular responsible for:

- Conduction the compulsory reorganization hearing, i.e. the hearing in which the creditors take a vote on the debtor's compulsory reorganization proposal;
- Confirmation or non-confirmation of the compulsory reorganization; and
- Terminating of the compulsory reorganization proceeding, i.e. the bankruptcy proceeding, and publication of the decision to do so.

In both types of reorganization proceedings, the court may be called upon to supervise the fulfillment of the reorganization plan.

The reorganization administrator

In an **ordinary reorganization proceeding**, the debtor retains – with certain exceptions and in contrast to a bankruptcy proceeding, its legal capacity. Consequently, in a reorganization proceeding it is not necessary that the administrator acts on behalf of the debtor, i.e. as its legal representative. A reorganization administrator has, in contrast to a bankruptcy administrator, therefore primarily supervisory functions with respect to the debtor.

In a **compulsory reorganization proceeding**, there is no “reorganization administrator”. Since a compulsory reorganization evolves out of a bankruptcy proceeding, the bankruptcy administrator keeps his/her function, powers and responsibilities,⁷¹ and, additionally, performs all the tasks that, otherwise, in an ordinary reorganization proceeding, the reorganization administrator would perform.

Like a bankruptcy administrator, the reorganization administrator is entitled to a fee and to compensation for his/her expenses.⁷²

As in bankruptcy proceedings, a primary objective of the reorganization administrator is to secure the estate. Furthermore, the reorganization administrator must see to it that the business of the debtor is being continued unless the continuation of the business were contrary

⁷¹ See Title 5, Chapter 1, § 3.

⁷² Sec. 33 para. 1 AO.

to the interests of the creditors. The **obligations of the reorganization administrator** include:⁷³

- To establish the true economic status of the debtor's business and the reasons of the insolvency, and to render a preliminary report to the reorganization court within three weeks;
- To determine the exact amount of the assets and liabilities of the estate, in particular to examine all claims filed by the creditors in the reorganization proceeding;
- To assess, and to report to the creditors, whether the reorganization proposal made by the debtor is (1) sufficient and (2) realistic;
- To supervise the debtor; and to approve, or disapprove, of transactions concluded by the debtor which need approval, in particular of transactions which are not in the ordinary course of the debtor's business;
- If the reorganization court so decides, to serve as a supervisor, or even as a trustee, until the fulfillment of the reorganization plan.

Creditors' committee

See Title 2., Chapter 2., § 4.

Creditors' assembly

See Title 2., Chapter 2., § 5..

Associations for the protection of creditors' rights

See Title 2., Chapter 2., § 6.

Creditors' trustee

After the reorganization proposal has been accepted by the creditors,⁷⁴ and confirmed by the court,⁷⁵ the judicial reorganization proceeding is, mostly, terminated.⁷⁶ The debtor still has to

⁷³ Secs. 30 *AO et seq.*

⁷⁴ *See* § 5.1..

fulfill its proposal, i.e. it must render to its creditors the payments stipulated in the proposal. For the fulfillment of these obligations, usually the maximum time period of up to two years is provided. Unless a creditors' trustee (*Sachwalter der Gläubiger*) is appointed, the debtor is, during this time period, under no restrictions or supervision whatsoever (so-called "autonomous fulfillment of the reorganization").⁷⁷

As an alternative to such autonomous fulfillment of the reorganization, the debtor may propose to remain, during the fulfillment period, under supervision of a so-called creditors' trustee (*Sachwalter der Gläubiger*).⁷⁸ Usually the reorganization administrator is entrusted with that function.

The creditors' trustee may serve as a mere supervisor of the debtor.⁷⁹ In this case, the debtor retains its full legal capacity, only restricted by the limitations imposed by an ordinary reorganization proceeding.

Otherwise, the creditor's trustee may – in addition to its supervisory functions – also serve as a trustee in the strict sense of the word.⁸⁰ In the latter case, the debtor's assets are handed over to and administered by the trustee. The debtor then lacks the legal capacity to conclude valid transactions with respect to these assets. One effect of such trusteeship is a change in the maximum time period to fulfill the reorganization proposal. Instead of the standard maximum period of two years to fulfill the minimum quota, up to four and a half years may be provided as time for payment.

Like in the case of a bankruptcy or reorganization administrator, the standard of liability for the creditors' trustee is the strict liability of an expert.⁸¹ The creditors' trustee is entitled to a fee and to compensation for its expenses.⁸²

⁷⁵ See § 5.1..

⁷⁶ See § 8.1..

⁷⁷ See § 8.1..

⁷⁸ The practical reason why a debtor would voluntarily submit to supervision by a creditors' trustee is to increase the willingness of the creditors to accept the debtor's reorganization proposal.

⁷⁹ Sec. 59 to 64 *AO*.

⁸⁰ Sec. 62 *AO*.

⁸¹ Sec. 59 para. 5 *AO* in connection with Sec. 1299 *ABGB*.

⁸² Sec. 59 para. 6 *AO*.

A creditors' trustee (be it as a mere supervisor, or, as a trustee in the strict sense of the word) may also be installed in a compulsory reorganization proceeding.⁸³ The above rules apply *mutatis mutandis*.

If a creditors' trustee is appointed, basically, all rights and responsibilities of the reorganization administrator are transferred to the creditors' trustee. In particular, the creditors' trustee

- Has access to the debtor's premises;
- May inspect the debtor's books;
- May demand information from the debtors' employees; and
- May apply to the reorganization court, to lift or impose restrictions on the debtor that are deemed necessary to safeguard the fulfillment of the reorganization plan.

§ 6.2. *Critical Analysis*

It might be useful to have specific insolvency courts, at least in Vienna, to achieve an even greater degree of efficiency. Creditors should have to possibility to influence the proceedings in more ways than just saying yes or no to the reorganization proposal.

§ 7. *The Degree of Protection of the Actors Implied in the Procedure*

§ 7.1. *Description*

Creditors with a right to segregation of assets (*Aussonderungsgläubiger*) are, in a reorganization proceeding, in the same position as they would have been in a bankruptcy proceeding.⁸⁴ In principle, since the debtor still retains its full legal capacity, it is left to the debtor itself to fulfill these creditors' claims. However, in practice, the debtor must seek approval of the reorganization administrator because the fulfillment of the claim will regularly be beyond the debtor's ordinary course of business. To the extent that the claims of these creditors are fully satisfied, they do not have a voting right in the reorganization hearing, i.e., on the reorganization proposal. On the other hand, to the extent their claims are not satisfied

⁸³ Secs. 157a to 157g KO.

⁸⁴ Sec. 21 AO.

(for instance because the object belonging to them is no longer available), such creditors have damage claims against the debtor. Insofar, these creditors are treated as ordinary reorganization creditors, and also have the right to vote on the reorganization proposal.

Creditors with a right to separate satisfaction (*Absonderungsgläubiger*) are also in the same position as they would have been in a bankruptcy proceeding. To the extent that their claim is satisfied, such creditors have no voting rights on the reorganization proposal. To the extent that the claim of such creditors is not satisfied, such creditors have the status as ordinary reorganization creditors and, therefore, do have a voting right.⁸⁵

Certain claims must be satisfied in full. These claims are not affected by the reorganization proceeding, i.e. instead of receiving only a part of what they are owed, these creditors are entitled to receive full payment. Consequently, such privileged creditors do not have the right to vote on the reorganization plan.⁸⁶

The **privileged creditors** are exhaustively enumerated in the Settlement and Recomposition of Debts Act:⁸⁷ Their claims include:

- The costs of the reorganization proceeding;
- All expenses incurred in connection with the supervision of the continuing management of the business by the debtor and in the course of the examination of the status of the debtors' assets and liabilities and of the chances of continuing its business;
- Certain claims resulting from the termination of employment contracts;
- Taxes and contributions to social security institutions, if they were incurred after the opening of the reorganization proceedings;
- Wages for the time after the opening of the reorganization proceedings.

Generally, claims resulting from transactions performed or entered into by the debtor itself or by the reorganization administrator that are incurred in the course of continuation of the debtors' business have to be satisfied in full.⁸⁸

⁸⁵ Sec. 39 para. 3 *AO*.

⁸⁶ Sec. 46 para. 2 *AO*, Sec. 10 para. 4 *AO* in connection with Sec. 39 para. 1 *AO*.

⁸⁷ Sec. 23 *AO*.

Claims resulting from bilateral contracts which have not been fulfilled by both parties to the contract, also must be satisfied in full unless the debtor decides to rescind the contract within the statutory period of time (one month or, if extended, two months).⁸⁹

All other creditors - with the exception of subordinate reorganization creditors and excluded creditors - form the group of **ordinary reorganization creditors** (*Ausgleichsgläubiger*). If the reorganization plan is accepted by the necessary majorities, these creditors will receive only a certain percentage of their claims. Claims that do not consist of a claim for the payment of money must be converted to an equivalent money claim.⁹⁰

These ordinary reorganization creditors are the ones who have a voting right on the reorganization proposal submitted by the debtor. Among these creditors, there are no different categories or privileges.

Basically, two types of creditors will be satisfied only if all other creditors, in particular after the ordinary bankruptcy creditors, have been satisfied. These creditors are called **subordinate creditors** (*nachrangige Gläubiger*). Subordinate creditors are:

- Shareholders who have granted a loan to the bankrupt company that is deemed to be "equity replacing" (*eigenkapitalersetzendes Darlehen*);
- Creditors who have, by agreement between the creditor and the debtor or by agreement between that creditor and other creditors, agreed to subordinate treatment of their claim.

An "equity-replacing" loan is made when a shareholder of a company grants the company a loan instead of raising its equity share. Such loans are treated as if they were equity as long as the bankruptcy persists.

In practice, the fulfillment of a reorganization plan is often only possible if one or the other major creditor agrees that their claims (even the reduced claims, according to the reorganization plan) are fulfilled only after other reorganization creditors are satisfied.

Banks sometimes allow such a subordinate treatment of their claims, because otherwise the debtor would not be able to pay the minimum quotas that must be offered to the creditors by

⁸⁸ Sec. 10 para. *AO* in connection with Sec. 39 para. 1 *AO*.

⁸⁹ Sec. 20a and Sec. 20b *AO*.

law, i.e. 40 percent in an ordinary reorganization proceeding, and 20 percent in a compulsory reorganization proceeding. Consequently, the reorganization would not be possible and would lead to bankruptcy, and the bank would receive even less.

The following claims are totally excluded from participation in the bankruptcy proceedings (**excluded creditors** - *ausgeschlossene Gläubiger*):⁹¹

- Interest on bankruptcy claims since the opening of bankruptcy proceedings;
- Costs, in particular legal fees, incurred by the creditors in the course of their participation in the bankruptcy proceedings (applies to compulsory reorganization proceedings);
- Fines imposed on the debtor;
- Claims arising out of gifts and donations made by the debtor.

In compulsory reorganization proceedings, if a creditor of the bankrupt debtor is at the same time its debtor, then such creditor may set-off its claims and liabilities.⁹² By setting off its claim against its debt, the creditor, at the same time, fulfills its obligation and receives payment. To the extent that its claim has thus been satisfied, the creditor need not file its claim in the bankruptcy proceedings. These creditors are called **creditors with a right of set-off**.

For set-off it is necessary that the claim and the debt were offsettable at the time of opening of the bankruptcy proceeding. Furthermore, set-off is not possible, if the creditor has acquired its claim during the last six months prior to the opening of bankruptcy proceedings, if at that time the creditor knew or should have known about the illiquidity of the other party (the eventual bankruptcy debtor).⁹³

Normally, i.e. outside a bankruptcy situation, the **owners** or shareholders of a company can - depending upon the type of the company and their voting rights - influence the course of business of their company to a greater or lesser extent. The shareholders can, e.g. give instructions to the management of the company. During a judicial bankruptcy proceeding, the situation is totally different. The powers of management of the bankrupt company are

⁹⁰ Secs. 14 to 20 *AO* and Secs. 24 to 27 *AO*.

⁹¹ Sec. 28 no. 1-3 *AO*, Sec. 58 *KO*

⁹² Sec. 19 para. 1 and 2 *KO*.

⁹³ Sec. 20 para. 1 *KO*.

completely transferred upon the court-appointed bankruptcy administrator who is not bound by any instructions from the owners, or management, of the debtor company.

In practice however, the bankruptcy administrator will, if the business operation of the debtor is being continued, conduct the business in close cooperation and coordination with the existing management, and/or owners, of the company. The role of the owners is particularly important if the owners attempt to convert the bankruptcy proceeding into a compulsory reorganization proceeding. Quite often, the minimum quota that is necessary for a “compulsory reorganization”, i.e. 20 percent of the unsecured debts, cannot be fully earned from the continued operation of the debtor’s business. It will then be left to the owners of the company to raise the necessary funds.

§ 7.2. Critical Analysis

It is important to note that, in Austria, tax claims and social security claims do not receive preferential treatment as such. On the other hand, the social security institutions rarely ever consent to a reorganization plan which makes it often difficult to achieve the necessary votes.

§ 8. Termination of the Procedure

§ 8.1. Description

Depending on the individual situation and in view of the benefit to the creditors the court proceedings may be terminated immediately after acceptance of the debtor’s plan by the creditors and confirmation by the court. In this case, the fulfillment of the debtor’s plan will be conducted outside of the court proceedings. All restrictions that were imposed upon the debtor in the course of the proceedings are immediately removed.

On the other hand, if the creditors’ interest demands that the court proceedings be continued until the obligations entered into by the debtor in its reorganization proposal are completely fulfilled, then the proceedings will be continued.

The **discharge** granted to the debtor by the reorganization is final and irreversible only if the debtor fulfills its obligations under the reorganization plan. If on the other hand the debtor

does not fulfill the reorganization plan, particularly if the debtor does not render the payments when they fall due, the original, i.e. full claims of the creditors can be revived, to a certain extent and under certain conditions. In order for a claim to be revived, the creditor must have granted the debtor a fourteen day grace period in writing; and the debtor still did not render payment.⁹⁴ In this case, the claims of the creditors are revived on a *pro rata* basis. This means that the claims are deemed fulfilled to the extent to which the amount promised in the debtor's plan has been paid.⁹⁵

The **fulfillment of the reorganization plan**, in particular the payment of the quota stipulated by the debtor, can be carried out in four different ways:

- Autonomous fulfillment, i.e. without the appointment of a creditors' trustee, with termination of the reorganization proceedings immediately after confirmation of the reorganization;
- Autonomous fulfillment with termination of the reorganization proceedings only after fulfillment of the reorganization, so-called prolonged reorganization proceeding (*fortgesetztes Verfahren*);
- Fulfillment under supervision of a creditors' trustee;⁹⁶
- Fulfillment with handing over the debtor's assets to the creditor's trustee.⁹⁷

The **reorganization may be declared null and void**:

- If, within two years after confirmation of the reorganization, the debtor is sentenced by a criminal court for fraudulent bankruptcy (*betrügerische Krida*), then the discharge of residual debts granted by the reorganization is automatically extinguished;⁹⁸
- If it turns out that fraudulent actions or the unlawful granting of preferred treatment to individual creditors had led to for the acceptance of the debtor's reorganization plan, then any reorganization creditor may claim the rest of the original amount owed to it within three years after the confirmation of the reorganization.⁹⁹

⁹⁴ Sec. 53 para. 4 AO, Sec. 156 para. 4 KO.

⁹⁵ Sec. 54 para. 1 AO, Sec. 156 para. 5 KO.

⁹⁶ See § 6.1..

⁹⁷ See § 6.1..

⁹⁸ Sec. 70 AO, Sec. 158 para.1 KO.

§ 8.2. *Critical Analysis*

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§ 9. *Degree of Information on the Development of the Procedure towards Creditors*

§ 9.1. *Description*

In reorganization proceedings, each creditor and the associations for the protection of creditors' rights have access to the court files. Only the minutes of the hearing of the creditors' committee as well as the documents that are of no interest to the creditor, but the maintenance of secrecy of which is crucial to the continuation of the business, are exempted thereof.¹⁰⁰

§ 9.2. *Critical Analysis*

Creditors often do not have a clear picture of the true financial and economical situation of the debtor. This makes it difficult to vote on the reorganization proposal. The ability of the reorganization administrator to inform him/herself and, in turn, to inform the creditors is therefore crucial. One might consider proceedings which allow creditors to gain more relevant information on the status of the debtor's undertaking.

§ 10. *Costs Related to the Procedure, if Applicable*

§ 10.1. *Description*

In order to open bankruptcy proceedings, there must be sufficient assets to cover the costs of the proceedings.¹⁰¹ This requirement is fulfilled if the assets are sufficient to at least cover the initial costs of the proceedings, including the bankruptcy administrator's fee.¹⁰² In practice, the amount is presently set at approximately €4,000,--.

⁹⁹ Sec. 71 para. 1 *AO*, Sec. 161 para. 1 *KO*.

¹⁰⁰ Secs. 171 and 172 para. 3 *KO*, Secs. 76 *AO*.

¹⁰¹ Sec. 71 para. 1 *KO*.

¹⁰² Sec. 71 para. 2 *KO*.

Both in ordinary and in compulsory reorganization proceedings, the administrator is entitled to a fee and to compensation for expenses. The amount of the remuneration is regulated by statute, and determined by the bankruptcy / reorganization court. The administrator's claim is a so-called "estate claim" (*Masseforderung*), i.e. a claim with preference over other claims.

The regular remuneration of the administrator amounts to at least €2.000,-- in both types of reorganization proceedings. The exceeding amount is calculated on a percentage basis and depends on the amount of the quota on the one side and the gross proceeds the administrator could bring in on the other side.

The associations for the protection of creditors' rights involved in the proceeding are also entitled to a fee. In ordinary reorganization proceedings, this fee amounts to 20 % of the fee granted to the administrator altogether and must be divided among the associations. In compulsory reorganization proceedings, the fee amounts to 10 % - 15 % of the fee granted to the administrator altogether.

§ 10.2. Critical Analysis

Costs of proceedings are also often crucial and, as practice shows, prohibitive. In out-of-court workouts the costs can be significantly lower. But, due to statutory requirements and deadlines, out-of-court workouts are rather seldom in Austria.

§ 11. Competence, Knowledge and Functioning of Insolvency Courts

§ 11.1. Description

There are no special courts for insolvency matters. Insolvency proceedings are conducted before the ordinary courts. The Superior Courts (*Landesgerichte*) and, in Vienna, the Commercial Court (*Handelsgericht*), serve as courts of first instance. These courts have specialized departments entrusted exclusively with the conduct of insolvency proceedings.

In terms of territorial jurisdiction, the court is competent

- In whose district the debtor's business is located; or

- If the debtor does not have its main place of business in Austria but only a branch office in Austria, in that district; or
- In the district where assets of the debtor are situated.¹⁰³

If more than one court has jurisdiction, then the court which acts first, has priority.¹⁰⁴ In consumer bankruptcies, the competence lies with the District Courts (*Bezirksgerichte*).

In principle, the institutions involved in reorganization proceedings are the same as the institutions involved in a bankruptcy proceeding.¹⁰⁵

Both the ordinary reorganization proceeding and the compulsory reorganization proceeding are court-controlled proceedings.

In an **ordinary reorganization proceeding**, the same court that would have had jurisdiction if the debtor or a creditor had filed for bankruptcy, i.e. the Superior Court (*Landesgericht*), also has jurisdiction. While in a bankruptcy proceeding that court is named “bankruptcy court” (*Konkursgericht*), in an ordinary reorganization proceeding the same court is named “reorganization court” (*Ausgleichsgericht*).

The reorganization court is responsible for:

- The opening of the reorganization proceedings and publishing the decision to do so;
- Conducting the entire reorganization proceeding;
- Appointing of a reorganization administrator and, if appropriate, of a creditors’ committee;
- Supervision of the reorganization administrator, the creditors’ committee, and other persons entrusted with particular responsibilities (e.g., expert witnesses);
- Conducting the reorganization hearing, i.e. the hearing in which the creditors take a vote on the debtor’s reorganization proposal;
- Confirmation or non-confirmation of the reorganization;
- Terminating of the reorganization proceeding and publication of the decision to do so; and

¹⁰³ Sec. 63 para. 1 and 2 *KO*.

¹⁰⁴ Sec. 63 para. 3 *KO*.

- Deciding over the eventual opening of a bankruptcy proceeding upon the court's own motion.

Certain transactions need to be approved by the reorganization court before they become effective, in particular:

- The closing of the debtors' business; and
- The re-opening of the debtors' business.¹⁰⁶

In a **compulsory reorganization proceeding** which evolves out of a bankruptcy proceeding, the bankruptcy court keeps its name, i.e. "bankruptcy court" (*Konkursgericht*), even after the filing of the application for compulsory reorganization.

In a compulsory reorganization proceeding the bankruptcy court is in particular responsible for:

- Conducting the compulsory reorganization hearing, i.e. the hearing in which the creditors take a vote on the debtor's compulsory reorganization proposal;
- Confirmation or non-confirmation of the compulsory reorganization; and
- Terminating of the compulsory reorganization proceeding, i.e. the bankruptcy proceeding, and publication of the decision to do so.

In both types of reorganization proceedings, the court may be called upon to supervise the fulfillment of the reorganization plan.

§ 11.2. Critical Analysis

Specific insolvency courts (at least in Vienna) might contribute to an even higher degree of efficiency of the courts.

¹⁰⁵ See Title 5, Chapter 1, § 3.

¹⁰⁶ Sec. 8 para. 2 *AO* in connection with Sec. 115 *KO*.

§ 12. *Publicity Conditions, if Applicable*

§ 12.1. *Description*

The opening of ordinary reorganization proceedings as well as the conversion of bankruptcy proceedings into compulsory reorganization proceedings are made public via the internet. The internet address is: <http://www.edikte.justiz.gv.at>.

The announcement contains the essential data on the proceeding, including:

- name and address of the debtor;
- name and address of the administrator
- the time limit within which creditors must file their claims with the court.

§ 12.2. *Critical Analysis*

The publicity of reorganization proceedings has the obviously detrimental effect of harming distressed businesses that might be saved even more. Out of court workouts can avoid this detriment.

Chapter 4.2. Informal Workouts

§ 1. *Comprehensive Description of the Regime as well as the Underlying Philosophy*

§ 1.1. *Description*

Both the ordinary reorganization (*Ausgleich*) and the compulsory reorganization (*Zwangsausgleich*) are court-controlled, i.e. judicial insolvency proceedings. Prior to a judicial insolvency proceeding, a debtor often will try to arrange an out-of-court restructuring of its debt (informal workout). In the Austrian terminology, informal work-outs are called “out-of-court reorganization” (*außergerichtlicher Ausgleich*) or “silent reorganization” (*stiller Ausgleich*).

For informal workouts, no minimum quotas are prescribed by law. Another key distinction between court-controlled reorganization proceedings on the one side and informal workouts

on the other side is the consent of the creditors. In court-controlled reorganization proceedings, it is sufficient that certain majorities of the creditors consent to the reorganization plan offered by the debtor. If these majorities are achieved, the vote of the dissenting minority is overruled (“cram down”). That means even those (minority) creditors who have rejected the debtors reorganization plan will be bound by the vote of the majority and, consequently, by the discharge granted to the debtor. In an out of court reorganization (informal workout), on the other hand, a debtor must get all creditors to agree to its reorganization plan. In practice, this is quite difficult.

§ 1.2. Critical Analysis

Informal workouts have a growing importance in Austria. The detrimental effect of the publicity of a court reorganization proceeding is evident. In many cases a business that might be rescued will definitely be destroyed due to the detrimental effects of a court reorganization proceeding. Therefore a growing number of businesses attempt to restructure their finances through out-of-court procedures. It is estimated that approximately 20 to 30 percent of all business reorganizations are conducted through out-of-court proceedings. On the other hand, informal workouts contain many risks of civil, and even criminal liability, of mandatory statutory provisions – in particular on the equal treatment of creditors - are neglected. Another obstacle to successful informal workouts is the necessity of hundred percent consent from the creditors’ side.

§ 2. Classification of the Procedure among Branches of Law, Competent Jurisdictions, Overview of the Procedure Followed before these Jurisdictions, Implications of International Private Law

§ 2.1. Description

Informal workouts are based on private law agreements between the debtor on the one side and all creditors on the other side. No courts are involved in informal workouts. The typical procedure is described in § 5.1. and in § 8.1.. In terms of private international law, each agreement has to be evaluated by itself, as regards questions of jurisdiction and applicable law.

§ 2.2. Critical Analysis

A more standardized procedure, including a possibility to „cram-down” on a minority of dissenting creditors, perhaps combined with some form of court approval, might be helpful.

§ 3. Criteria to Benefit from the Regime

§ 3.1. Description

In an informal workout, a debtor must get all the creditors to agree to its reorganization plan. This is the only requirement.

§ 3.2. Critical Analysis

In practice, the fulfillment of this requirement is quite difficult. Social security institutions, e.g., in practice never agree to a discharge of debts. This makes an informal workout impossible when contributions are owed to social security institutions.

§ 4. Specification of the Possible Initiators of the Procedure

§ 4.1. Description

The only possible initiator of the informal workout is the debtor itself, submitting and negotiating its reorganization proposal to and with its creditors.

§ 4.2. Critical Analysis

The debtor must observe the statutory time limit to file for bankruptcy, which amounts to 60 days from recognizing that it is over-indebted (balance sheet test) or illiquid. This gives very little time for the negotiations between the debtor and its creditors. A prolongation of this time limit is therefore being discussed.

§ 5. *Restructuring Plan*

§ 5.1. *Description*

Informal workouts are carried out on a private basis. It is left exclusively to the debtor and to its advisors to organize and carry out the process.

In an informal workout, debtor and creditors are to a large extent free to agree on most anything they wish, provided that certain fundamental rules, such as the "equal treatment of equally situated creditors" principle, are observed. Despite the absence of any statute governing the mechanisms in an informal workout, in practice the process follows a standard pattern:

- internal assessment of the insolvency status and the rescue possibilities;
- letter to all (unsecured) creditors, containing the restructuring proposal;
- individual negotiations with the secured creditors;
- individual negotiations with the unsecured creditors who do not consent readily;
- in case of success (theoretically within the 60 days period) fulfillment of the plan, usually including a discharge of the remaining debt if the plan is duly fulfilled;
- in case of no success: initiation of judicial bankruptcy or reorganization proceedings.

§ 5.2. *Critical Analysis*

This requirement of unanimity constitutes, in practice, the biggest difficulty in achieving a successful out-of-court workout. In particular, social security institutions practically always refuse to consent.

Besides, the lack of judicial control may be an obstacle to achieving or fulfilling of the restructuring proposal.

§ 6. *Administration of the Procedure*

§ 6.1. *Description*

As informal workouts are not controlled in any institutional way, there are no administrators of the procedure but the debtor on the one side and 100 percent of the creditors on the other

side. A public element comes into the picture through the associations for the protection of creditor 'rights. Many creditors prefer to entrust one of these institutions with assessing the situation and representing them, thus safeguarding that the proposal offered by the debtor is reasonable and plausible.

§ 6.2. Critical Analysis

If only one creditor refuses to consent to a partial discharge of its claim, no agreement is possible. This situation can sometimes be avoided by paying this creditor a higher quota this creditor accepts or in full, provided all the other creditors agree. Unless all the other creditors agree to such a preferential treatment, the only lawful way to satisfy such a dissenting creditor, is to pay it from a third party.

§ 7. The Degree of Protection of the Actors Implied in the Procedure

§ 7.1. Description

As in reorganization proceedings, creditors can be divided into those who get full compensation (so called "secured" creditors) and those who get only the quota as laid down in the restructuring proposal ("unsecured" creditors).

§ 7.2. Critical Analysis

The risk to commit a criminal offense in the course of a corporate workout is considerable. This might especially be the case if some creditors (in particular those who did not consent to the informal workout) are paid fully, whereas others (in particular those who have consented to the informal workout) receive only a quota of their claim. Under certain circumstances laid down by law this behaviour constitutes a criminal offense. Furthermore, such payments are voidable, and may, additionally, trigger personal liability of the managers.

§ 8. Termination of the Procedure

§ 8.1. Description

As informal workouts are not controlled in any institutional way, there are no statutory rules on the termination of the proceedings. Successful informal workouts are terminated upon the fulfillment of the reorganization plan.

In case of no success, the debtor must initiate judicial bankruptcy or reorganization proceedings.

§ 8.2. Critical Analysis

Often, creditors prevent an out of court workout by filing for involuntary bankruptcy proceedings. It might therefore be considered to allow a stay of all enforcement proceedings while an informal workout is being undertaken.

§ 9. Degree of Information on the Development of the Procedure towards Creditors

§ 9.1. Description

While in bankruptcy and reorganization proceedings, creditors and associations for the protection of creditors' rights have access to the files by law, no such rules exist for informal workouts. In practice, however, creditors might ask for access to the files as a prerequisite for agreeing to the reorganization proposal.

§ 9.2. Critical Analysis

Information is crucial also in an informal workout. More transparency (e.g. through a somewhat more formalized out of court procedure) would be desirable.

§ 10. Costs Related to the Procedure, if Applicable

§ 10.1. Description

Informal workouts are, if completed swiftly and expertedly, usually cheaper than judicial proceedings. As opposed to judicial proceedings, the debtor in an informal workout will usually only have to pay its own advisors (i.e. attorneys, accountants, and/or business consultants), instead of having to pay also court fees and an insolvency administrator's fees.

§ 10.2. Critical Analysis

§ 11. Competence, Knowledge and Functioning of Insolvency Courts

§ 11.1. Description

In informal workouts, no courts are involved.

§ 11.2. Critical Analysis

Some sort of (subsequent) control or approval of informal workouts by courts (or other authorities) might be discussed. In particular, if it is regarded desirable to have fewer full-fledged court proceedings and more informal workouts.

§ 12. Publicity Conditions, if Applicable

§ 12.1. Description

Informal workouts will become known only to those involved (if the confidentiality is observed), as they are not made public.

§ 12.2. Critical Analysis

The obvious detrimental effect of harming distressed businesses that might be saved even more, is therefore avoided.

TITLE 5. LEGAL CONSEQUENCES OF BANKRUPTCY AND POSSIBILITIES FOR A FRESH START

Chapter 5.1. Bankruptcy procedure

§ 1. Requirements for Opening of Proceedings

The primary requirement for the opening of bankruptcy proceedings is the illiquidity of the debtor.¹⁰⁷ There is no statutory definition of the term “illiquidity.” According to case law, a debtor is illiquid when, due to a lack of liquid funds, it is no longer able to pay its debts within a reasonable time as they fall due. In other words, a debtor is illiquid in the meaning of the *KO*, if the debtor can no longer meet its financial obligations. Illiquidity is determined according to objective criteria. It is irrelevant, whether the debtor is *willing* to pay. Illiquidity is assumed if the debtor ceases payment.¹⁰⁸ Illiquidity does not require that the creditors be pursuing their claims.¹⁰⁹ To serve as a ground for a bankruptcy proceeding, the illiquidity must exist for a foreseeable amount of time. A mere temporary delay of payments (*Zahlungsstockung*) does not qualify as illiquidity.

Legal entities, such as corporations or co-operative societies, are deemed bankrupt not only when they are illiquid but, also, in the case of over-indebtedness. There is no statutory definition of “over-indebtedness.” Technically, a debtor is overly indebted when its liabilities exceed its assets. However, the commercial balance sheet test does not necessarily reflect the true value of a company. To determine whether a company is overly indebted in the sense of the Bankruptcy Act, a pre-bankruptcy balance sheet test must be performed. For the purpose of this test, the assets of the company must be valued at their present market value assuming a bankruptcy sale, i.e. based upon liquidation values. This includes possible hidden reserves that are not shown on the commercial balance sheet. Also, eventual discounts on the book value of assets which can, in practice, be quite substantial if the assets were to be sold in the course of a bankruptcy sale must be taken into account.

¹⁰⁷ Sec. 66 *et seq.* *KO*.

¹⁰⁸ Sec. 66 para. 2 *KO*.

¹⁰⁹ Sec. 66 para. 3 *KO*.

In order to open bankruptcy proceedings, there must also be sufficient assets to cover the costs of the proceedings.¹¹⁰ This requirement is fulfilled if the assets are sufficient to at least cover the initial costs of the proceedings, including the bankruptcy administrator's fee.¹¹¹ In practice, the amount is presently set at approximately €4,000.--.

In order to open bankruptcy proceedings, a petition must be filed either by the debtor itself (voluntary opening of proceedings) or by a creditor (involuntary opening of proceedings). Usually, there is no automatic opening of proceedings. The insolvency court will initiate bankruptcy proceedings upon its own motion only under a few circumstances, in particular, when an application by the debtor for the opening of reorganization proceedings (*Ausgleich*) was rejected by the court,¹¹² or when the reorganization proceedings did not lead to a successful settlement.¹¹³

§ 2. *Competent Courts*

In Austria, there are no special insolvency, or bankruptcy, courts. Rather, insolvency proceedings, i.e. bankruptcy proceedings, as well as reorganization proceedings, are conducted in ordinary courts. Original jurisdiction rests with the Superior Courts (*Landesgerichte*).¹¹⁴ In Vienna, where a special "Commercial Court" (*Handelsgericht Wien*) for matters of commercial law exists, this court has jurisdiction in insolvency matters.¹¹⁵ Within each Superior Court, there are specialized departments entrusted exclusively with the conduct of insolvency proceedings. Each department is composed of a single judge (*Einzelrichter*).

In terms of territorial jurisdiction, the court is competent

- In whose district the debtor's business is located; or
- If the debtor does not have its main place of business in Austria but only a branch office in Austria, in that district; or
- In the district where assets of the debtor are situated.¹¹⁶

¹¹⁰ Sec. 71 para. 1 *KO*.

¹¹¹ Sec. 71 para. 2 *KO*.

¹¹² Sec. 3 para. 3 *AO*.

¹¹³ Sec. 69 *AO*.

¹¹⁴ Sec. 63 para. 1 *KO*.

¹¹⁵ Sec. 64 *KO*.

¹¹⁶ Sec. 63 para. 1 and 2 *KO*.

If more than one court has jurisdiction, then the court which acts first, has priority.¹¹⁷ In consumer bankruptcies, the competence lies with the District Courts (*Bezirksgerichte*).

The bankruptcy court is, in particular, responsible for

- The opening of the bankruptcy proceedings and publishing the decision to do so;
- Conducting the entire bankruptcy proceeding;
- Appointing of a bankruptcy administrator and, if appropriate, of a creditors' committee;
- Supervision of the bankruptcy administrator, the creditor's committee, the creditor's assembly and other persons entrusted with particular responsibilities (e.g., expert witnesses);
- Deciding about the continuation or termination of the debtor's business;
- Ordering interim measures to secure the estate;
- Confirming or dismissing decisions taken by the creditors' committee or the creditors' assembly;
- Approving of the sale of the debtor's business, a part of it, of the stock or of individual goods;
- Deciding over the plan to distribute the proceeds of the bankruptcy proceedings;
- Terminating of the bankruptcy proceeding and publication of the decision to do so.

If the bankruptcy proceeding has been converted into a reorganization proceeding¹¹⁸ the bankruptcy court is responsible:

- For the judicial confirmation of the reorganization plan; and
- For the supervision of the fulfillment of the plan.

The bankruptcy court has exclusive competence to hear and decide

- All actions for proving, or contesting, a creditor's claim, brought either by creditors or by the bankruptcy administrator.¹¹⁹

¹¹⁷ Sec. 63 para. 3 *KO*.

¹¹⁸ So-called compulsory reorganization" (*Zwangsausgleich*); see Title 4, Chapter 1, § 5.1..

¹¹⁹ Sec. 111 para. 1 *KO*; see § 4.

Furthermore, the bankruptcy court is competent for a number of ancillary disputes, claims and proceedings, including:

- Disputes over the right to a segregation of assets, and the right to a separate satisfaction (*Ansprüche auf Aus- und Absonderung*);
- Dispute over claims against the estate (*Masseforderungen*);
- Claims for damages arising out of actions by the bankruptcy administrator, by the creditor's committee, or by an expert witness.¹²⁰

§ 3. *Actors of the Bankruptcy Procedures*

The actors of the bankruptcy procedures are the bankruptcy court, the bankruptcy administrator, the creditor's committee, the associations for the protection of creditors' rights and the creditors' assembly.

§ 3.1. *The Bankruptcy Administrator*

In the decision opening the bankruptcy proceeding, the bankruptcy court appoints a bankruptcy administrator (*Masseverwalter*). The bankruptcy administrator is a "key player" in the course of a bankruptcy proceeding. He/she is primarily responsible

- For securing and – if possible – continuing the debtor's business;
- For inventorying the estate; and
- For liquidating the estate in order to achieve the maximum satisfaction of the creditors' claims.¹²¹

Generally speaking, the bankruptcy administrator must safeguard the common interests against the interests of individual creditors.¹²²

Both natural and legal persons can be appointed as administrator.¹²³ Usually a natural person most frequently an attorney is appointed. The person chosen must be reliable and experienced in business matters.

¹²⁰ Sec. 178 *KO*.

¹²¹ There will be no liquidation of the estate if the bankruptcy, upon application of the debtor, is successfully converted into a reorganization (so-called "compulsory reorganization"). See Title 4, Chapter 1, § 5.1..

¹²² Sec. 81 para. 2 *KO*.

¹²³ Sec. 80 para. 5 *KO*.

The bankruptcy administrator

- Must not be a relative of the debtor;
- Must not be economically dependent on the debtor or on any creditor;
- Shall not be a competitor of the debtor; and
- Must not have been an auditor in a pre-bankruptcy reorganization proceeding (in the meaning of the Business Reorganization Act - *URG*).¹²⁴

The bankruptcy administrator, acting on behalf of the estate, is entitled to enter into any transactions and to take any legal actions against third persons that the bankruptcy administrator regards necessary to carry out his or her responsibilities. Only a few types of transactions require the consent of the creditor's committee and the bankruptcy court. In particular circumstances, the bankruptcy court can restrict the powers of the bankruptcy administrator.

The bankruptcy administrator is entitled to a fee and to compensation for expenses. The amount of the remuneration is regulated by statute,¹²⁵ and determined by the bankruptcy court. The administrator's claim for remuneration is a so-called estate claim (*Masseforderung*), i.e. a claim with preference over other claims.¹²⁶

Under the supervision of the bankruptcy court and – if established – of the creditors' committee, the bankruptcy administrator is fully in charge of the bankrupt's estate. In particular, the administrator is responsible for the following tasks:¹²⁷

- To establish the true economic status of the debtor's business;
- To determine, whether there are any possibilities to continue the debtor's business, and, if there are, to carry on the debtor's business;
- To determine the exact amount of the assets and liabilities of the estate;
- To examine all claims filed by the creditors in the bankruptcy proceeding;
- To pursue any eventual claims of the estate.

¹²⁴ For general information on the *URG*, see Title 3.

¹²⁵ Sec. 82 *KO et seq.*

¹²⁶ Sec. 46 para. 1 no. 1 *KO*.

¹²⁷ Sec. 81a *KO*.

The standard of liability of the bankruptcy administrator for his or her actions and omissions is the strict liability of an expert.¹²⁸

§ 3.2. *The Creditors' Committee*

The creditors' committee consists of three to seven members. Its purpose is to supervise and assist the bankruptcy administrator.¹²⁹ The bankruptcy court appoints a creditors' committee either on its own motion or upon a motion from the creditors' assembly.¹³⁰ The duties of the creditors' committee include:

- Checking the cash management;¹³¹
- Assisting the bankruptcy administrator, in particular with the selling and distribution of the estate in a liquidation situation; and
- Approving certain transactions concluded by the bankruptcy administrator.¹³²

The consent of the creditors' committee is necessary whenever the bankruptcy administrator concludes certain transactions, in particular the sale of real property, with a value exceeding € 35.000,--.¹³³ Regardless of the value of the transaction, the consent of the creditor's committee is required if the bankruptcy administrator wishes to sell the debtors' business as a whole or a substantial part of it.¹³⁴ For such transactions, the approval of the bankruptcy court is also required.

§ 3.3. *The Creditors' Assembly*

The primary responsibility of the creditors' assembly is to supervise the creditors' committee (if established) and the bankruptcy administrator. However, its powers are limited.

In a bankruptcy proceeding, i.e. a proceeding which is originally directed towards liquidation of the estate, the most important task of the creditors' assembly is to vote on an eventual

¹²⁸ Sec. 81 para. 1 *KO*, Sec. 1299 ABGB.

¹²⁹ Sec. 89 para. 1 *KO*.

¹³⁰ Sec. 88 para. 1 *KO*.

¹³¹ Sec. 89 para. 1 *KO*.

¹³² Sec. 116, 117 *KO*.

¹³³ Sec. 116 *KO*.

¹³⁴ Sec. 117 *KO*.

application by the debtor to convert the liquidation into a so-called "compulsory reorganization" (*Zwangsausgleich*).¹³⁵

Furthermore, the creditors' assembly has the following rights:

- To supervise, with limited influence though, the creditors' committee and the bankruptcy administrator;
- To be heard in all important matters in the course of the bankruptcy proceeding;
- To make decisions in such matters for which the approval of the creditors' committee is required, in the event that no creditors' committee has been established;
- To apply for the dismissal of the bankruptcy administrator or of a member of the creditors' committee;
- To apply for the establishment of a creditors' committee;
- To approve or reject an application by the debtor for "compulsory reorganization."

§ 3.4. Associations for the Protection of Creditors' Rights

The so-called "privileged associations for the protection of creditors's rights" (literal translation of the German term: '*bevorrechtete Gläubigerschutzverbände*') play an important role in the Austrian insolvency practice. They are institutions whose main purpose is the representation of creditors in the course of insolvency proceedings.¹³⁶

The setting-up of such an association requires the approval of the Federal Ministry of Justice.¹³⁷ Presently, three associations exist in Austria:

- *Kreditschutzverband von 1870 (KSV)*;
- *Alpenländische Kreditorenverband (AKV)*;
- *Insolvenzschutzverband für Arbeitnehmer (ISA)*.

¹³⁵ For details see Title 4, Chapter 1.

¹³⁶ Sec. 172 para. 3 KO.

¹³⁷ Sec. 11 of the Imperial Regulation Introducing the Austrian Insolvency Laws (*Insolvenzrechts-Einführungsgesetz - IEG*), Imperial Law Gazette (*Reichsgesetzblatt - RGBl.* 1914/337).

In addition to their primary responsibility of representing creditors in the course of bankruptcy proceedings, the Associations for the Protection of Creditor's Rights are involved in the following tasks:¹³⁸

- Establishing of an eventual Creditors' Committee;¹³⁹
- Establishing and securing the estate for the benefit of the creditors;
- Assisting the bankruptcy court;
- Preparing an eventual "compulsory reorganization";
- Consumer bankruptcies.

The Associations for the Protection of Creditor's Rights are entitled to a fee.¹⁴⁰ Like the administrator's fee, the fee has the status of a preferred claim.¹⁴¹

§ 4. *Formal Procedure*

As soon as the bankruptcy court finds that the conditions for the opening of bankruptcy proceedings are fulfilled, the court must render a formal decision declaring the proceeding opened.¹⁴² The court publicly announces the decision.¹⁴³ Since the year 2000, the announcement is made via the internet.¹⁴⁴ The announcement contains the essential data on the proceeding, including:

- Name and address of the debtor;
- Name and address of the bankruptcy administrator; and
- The time limit within which creditors must file their claims with the court.¹⁴⁵

Bankruptcy creditors have to **file their claims** at the bankruptcy court within the deadline set by the court decision opening the bankruptcy proceeding.¹⁴⁶ The publication of this decision also has the effect of a service of process. The time limit within which the bankruptcy

¹³⁸ Sec. 87a para. 1 *KO*.

¹³⁹ They have a right of nomination of members of the creditor's committee (Sec. 88 para. 1 *KO*).

¹⁴⁰ Sec. 87a *KO*.

¹⁴¹ Sec. 46 para. 1 no. 8 *KO*.

¹⁴² Sec. 69 para. 1, Sec. 70 para. 1 *KO*.

¹⁴³ Sec. 74 para. 1 *KO*.

¹⁴⁴ Sec. 173a *KO*. The internet address is: <http://www.edikte.justiz.gv.at>

¹⁴⁵ Sec. 74 para. 2 *KO*.

¹⁴⁶ This decision is published on the internet by the Federal Ministry of Justice <http://www.edikte.justiz.gv.at>.

creditors must file their claims is usually set at approximately two months after the opening of the bankruptcy proceeding.

The **examination and recognition of claims** is one of the primary responsibilities of the bankruptcy administrator. The bankruptcy administrator enters each claim into a table ("*Anmeldungsverzeichnis*").¹⁴⁷ The table is handed over to the bankruptcy court.¹⁴⁸ The bankruptcy administrator must declare whether he or she recognizes the filed claims.

This declaration is made at the court hearing for the examination of claims (**examination hearing** – "*Prüfungstagsatzung*"). The date of the hearing is set and published by the bankruptcy court in the decision to open bankruptcy proceedings.

The bankruptcy administrator and the debtor (the debtors' representatives) must attend the hearing for the examination of claims. The bankruptcy administrator must declare for each and every filed claim (i) whether he or she recognizes or disputes the claim, and (ii) whether he or she regards the claim as an ordinary bankruptcy claim or as a different type of claim.

The absolute deadline for filing a claim is the date of distribution of the proceeds of the bankruptcy proceedings. Claims that are filed after that date cannot participate in the bankruptcy proceedings.

To the extent that a claim has been recognized by the bankruptcy administrator, and furthermore, has not been disputed by any other ordinary bankruptcy creditor with a determined claim, the claim is deemed to have been determined. Objection by the debtor shall not prevent the determination of a claim.¹⁴⁹

The recognition of a claim has the same effect as an nonappealable and enforceable judgment. Above all, the claim participates in the bankruptcy proceeding, and in particular, after liquidation of the estate, in the distribution of the proceeds.

After termination of the bankruptcy proceedings, if the debtor still exists, the creditor whose claim has been determined and entered in the table, may conduct enforcement proceedings

¹⁴⁷ Sec. 104 para. 4 *KO*.

¹⁴⁸ Sec. 104 para. 6 *KO*.

¹⁴⁹ Sec. 109 *KO*.

against the debtor to enforce the claim to the extent the claim has not been satisfied in the course of the bankruptcy proceeding, provided that the debtor did not contest the claim during the examination hearing.¹⁵⁰

If the bankruptcy administrator or another ordinary bankruptcy creditor have disputed the claim, then it is not deemed as determined.

If the creditor whose claim has been disputed by the bankruptcy administrator or by another ordinary bankruptcy creditor still wants its claim to participate in bankruptcy proceedings, then it must file a complaint, i.e. a suit for determination (*Prüfungsprozess*), against the disputing party.¹⁵¹ If, on the other hand, the creditor had already obtained an enforceable judgment against the debtor prior to the opening of the bankruptcy proceeding, the disputing party must file the complaint.¹⁵²

In the course of a “regular” business bankruptcy (*Konkurs*), i.e. one that is not being converted into a “compulsory reorganization” (*Zwangsausgleich*),¹⁵³ there is no formal discharge. A formal discharge with the effect that the debtor is relieved from its debts to a certain extent, can be obtained only in the course of a reorganization proceeding (*Ausgleich*), including a “compulsory reorganization”.

Apart from such conversion, a bankruptcy proceeding is terminated, after the following steps have been performed:

- Realization of assets;¹⁵⁴
- Distribution of assets.¹⁵⁵

If reorganization is not attempted by the debtor or is not feasible, the bankruptcy administrator will continue to conduct the bankruptcy proceeding until a full and formal winding-up. Primarily, the bankruptcy administrator will try to liquidate the debtor company by selling its business as a whole. Then, of course, it is essential that the business of the

¹⁵⁰ Sec. 61 *KO*.

¹⁵¹ Sec. 110 *KO*.

¹⁵² Sec. 110 para. 2 *KO*.

¹⁵³ For details, see Title 4, Chapter 1.

¹⁵⁴ Sec. 114 to 120 *KO*.

¹⁵⁵ Sec. 124 *et seq. KO*.

debtor company be kept running. The other alternative is to liquidate the bankrupt company through the piecemeal sale of its assets.

If the bankrupt company is still running a business, the bankruptcy administrator must examine whether the continuing operation of that business is likely to produce a profit or a loss. During this examination stage, the bankruptcy administrator is under a statutory obligation to carry the business on, unless it is evident that the continuation will increase the loss.¹⁵⁶ If the bankruptcy administrator determines that the continuing operation of the business would create a loss and thus reduce the value of the estate, then the bankruptcy administrator will propose closing the business to the bankruptcy court.¹⁵⁷ On this issue, the creditors' committee (if established), as well as the debtor itself, must be heard.¹⁵⁸

If the business of the bankrupt company cannot be continued without the danger of a reduction of assets, then the bankruptcy administrator must realize the assets. The bankruptcy administrator proposes the method of realization that in his or her opinion would be best. The creditors' committee votes on this proposal. To become effective this decision must be confirmed by the bankruptcy court.¹⁵⁹

While estate creditors are entitled to their claims irrespective of the stage of the bankruptcy proceeding,¹⁶⁰ ordinary bankruptcy creditors will receive payment only in the course of the distribution of the estate.¹⁶¹ Of course, a distribution of the estate is only possible if there are sufficient assets or proceeds from the sale of assets.¹⁶²

The **distribution of the estate** can be performed either in a formal or an informal manner. An informal distribution is possible in small bankruptcies, if the creditors' committee and the bankruptcy court approve.¹⁶³ By contrast, in more difficult or complex bankruptcies, or if the creditors' committee or the bankruptcy court have doubts regarding an informal distribution of the estate, a formal distribution of the estate must be carried out. The bankruptcy administrator must propose a draft distribution plan. This draft distribution plan must be

¹⁵⁶ Sec. 114a para. 1 *KO*.

¹⁵⁷ Sec. 115 *KO*.

¹⁵⁸ Sec. 114 *KO*.

¹⁵⁹ Sec. 114a para. 4, Sec. 117 *KO*.

¹⁶⁰ Sec. 124 para. 1 *KO*.

¹⁶¹ Sec. 128 *et seq.* *KO*.

¹⁶² Sec. 128 para. 2 *KO*.

¹⁶³ Sec. 129 para. 1 *KO*.

submitted to the creditors' committee for approval. It must be published.¹⁶⁴ The creditors and the debtor may raise objections within 14 days. Eventually, the bankruptcy court must approve the distribution plan.¹⁶⁵

Bankruptcy proceedings are **terminated** by a decision of the bankruptcy court. The court may terminate the bankruptcy proceedings for one of the following reasons:¹⁶⁶

- The distribution of the estate has been completed;¹⁶⁷
- In the course of the bankruptcy proceedings it becomes evident that the estate is not sufficient to cover the costs of the proceedings (lack of assets, subsequent lack of assets);¹⁶⁸
- With the consent of all estate creditors and all bankruptcy creditors;¹⁶⁹
- Conversion of the bankruptcy proceedings into a “compulsory reorganization” proceeding (*Zwangsausgleich*), after the reorganization plan has been accepted by the creditors (by a majority vote) and has been confirmed by the court.¹⁷⁰

§ 5. *Length of Procedure*

Bankruptcy procedures may last up to several years until they are eventually completed. The length of the respective procedure depends to a large extent on the reason of termination.

Chapter 5.2 Legal Effects of the Initiation of Bankruptcy Procedures

The sole application for bankruptcy does not create any legal effects but the obligation for the bankruptcy courts to examine whether the conditions for the opening of bankruptcy proceedings are fulfilled. In this case, the court has to render a formal decision declaring the proceedings opened.

¹⁶⁴ Sec. 130 para. 1 *KO*.

¹⁶⁵ Sec. 130 *KO*.

¹⁶⁶ Sec. 139, 157, 166 *et seq.* and Sec. 79 *KO*.

¹⁶⁷ Sec. 139 and Sec. 79 *KO*.

¹⁶⁸ Sec. 166 and Sec. 79 *KO*.

¹⁶⁹ Sec. 167 and Sec. 79 *KO*.

¹⁷⁰ Sec. 157 and Sec. 79 *KO*.

The filing of an application to open insolvency proceedings as such does not affect the rights and obligations of the debtor or the creditors. In particular, the application does not trigger any automatic stay of proceedings, neither of litigation nor of enforcement proceedings being conducted against the debtor. Only the court decision opening the proceedings has such effects.¹⁷¹

However, if the bankruptcy proceeding cannot be opened immediately, the bankruptcy court may, in order to secure the debtors' assets, order interim measures even before it opens the proceedings.¹⁷² In practice this is rarely done.

Interim measures may include:

- Prohibition of legal transactions that are not in the usual course of business;
- Prohibition of the sale or encumbering of real property of the debtor;
- Prohibition of entering into suretyships;
- Prohibition of making gifts or donations or of concluding other legal transactions without consideration.¹⁷³

Chapter 5.3. Legal Effects of Bankruptcy as Such

§ 1. The Bankruptcy Estate; Transfer of Legal Capacity to the Bankruptcy Administrator

From the day following the publication (via internet) of the opening of bankruptcy proceedings,¹⁷⁴ the debtor is deprived of all rights to make any dispositions with respect to the bankruptcy estate (*Konkursmasse*). The administration of the estate is exclusively transferred to the bankruptcy administrator (*Masseverwalter*). The estate consists of all goods and rights belonging to the debtor as of the commencement of the bankruptcy proceedings which can be valued in money and all of which form the debtors' property. Assets that are acquired by the debtor in the course of the bankruptcy proceedings also become part of the bankruptcy estate.

¹⁷¹ For details, see Chapter 3.

¹⁷² Sec. 73 para. 1 *KO*.

¹⁷³ Sec. 73 para. 2 *KO*.

¹⁷⁴ Sec. 2 para. 1 *KO*.

Only very limited assets, e.g. certain assets that cannot be seized in the course of enforcement proceedings, do not fall into the bankruptcy estate.¹⁷⁵ This exception only applies to natural persons. If the debtor is a natural person, a portion of the debtor's income that is necessary to cover the basic, moderate living expenses of the debtor is exempt.

Transactions concluded by the debtor with respect to assets pertaining to the estate, after the opening of bankruptcy proceedings, are void vis-à-vis its creditors.¹⁷⁶

§ 2. *Effects upon Litigation and Enforcement Proceedings*

After the opening of bankruptcy proceedings, the debtor can no longer conduct legal proceedings, be it as plaintiff or as defendant, which concern the bankruptcy estate.¹⁷⁷ All pending litigation is automatically temporarily suspended.¹⁷⁸ If creditors bring new complaints against the debtor, such complaints will be dismissed. Only claims for segregation of assets and for separation of assets can be instituted. Such litigation must be conducted against the bankruptcy administrator.¹⁷⁹

In proceedings where the debtor was the plaintiff, the bankruptcy administrator has the right to decide whether the bankruptcy administrator wants to continue the proceedings on behalf of the debtor.¹⁸⁰ Whether the bankruptcy administrator resumes litigation will largely depend on how the bankruptcy administrator evaluates the potential outcome of a pending litigation.

After the opening of bankruptcy proceedings, enforcement proceedings against the debtor's assets pertaining to the estate can be neither instituted nor continued.¹⁸¹ The opening of proceedings even has retroactive effect: security interests that were created by creditors through judicial enforcement proceedings within 60 days prior to the opening of bankruptcy proceedings are automatically voided.¹⁸²

¹⁷⁵ Sec. 1 para. 1 *KO*.

¹⁷⁶ Sec. 3 para. 1 *KO*.

¹⁷⁷ Sec. 6 para. 1 *KO*.

¹⁷⁸ Sec. 7 para. 1 *KO*.

¹⁷⁹ Sec. 6 para. 2 *KO*.

¹⁸⁰ Sec. 8 *KO*.

¹⁸¹ Sec. 10 para. 1 *KO*.

¹⁸² Sec. 12 para. 1 *KO*. Security interests that were created for the enforcement of tax debts are exempted from this effect.

Creditors with existing rights to segregation of assets (*Aussonderungsgläubiger*)¹⁸³ and creditors with existing rights to separate satisfaction (*absonderungsberechtigte Gläubiger*)¹⁸⁴ are, in principle, not affected by the opening of bankruptcy proceedings. The bankruptcy court may, however, order that such rights cannot be enforced for a period of 90 days, if such enforcement would endanger the continuation of the debtor's business.¹⁸⁵

§ 3. *Effects upon Executory Contracts*

The *KO* regulates in great detail the effect of the opening of bankruptcy proceedings upon contracts that have been entered into by the debtor but that have not been fully performed either by the debtor or by the other party to the contract, i.e. executory contracts. In particular, the *KO* contains provisions on:

- Bilateral contracts in general;¹⁸⁶
- Lease contracts;¹⁸⁷
- Employment contracts;¹⁸⁸ and
- Contracts of mandate.¹⁸⁹

The general rule concerning **bilateral contracts** is: Creditors will receive payment from the liquidation of the bankruptcy estate only on a *pro rata* basis. On the other hand, any person who is a debtor of the bankruptcy estate must fully fulfill its obligation (for instance, paying the full amount).

If upon the opening of bankruptcy proceedings a bilateral contract is fully executory, i.e. the contract has been fulfilled neither by the debtor nor by the other party to the contract, then the bankruptcy administrator has a right of choice. The administrator can, e.g., demand fulfillment of the other party's obligation. In this case, the administrator (being the legal representative of the estate) also must fulfill the obligation of the estate (i.e. the obligation incurred by the debtor prior to the opening of the bankruptcy proceeding). Alternatively, the

¹⁸³ For details, see Title 4, Chapter 1, § 7.1..

¹⁸⁴ For details, see Title 4, Chapter 1, § 7.1..

¹⁸⁵ Sec. 11 para. 2 *KO*.

¹⁸⁶ Sec. 21 *et seq. KO*.

¹⁸⁷ Sec. 23 *et seq. KO*.

¹⁸⁸ Sec. 25 *KO*.

administrator can rescind the contract. In this case neither part to the contract must fulfill its obligation.¹⁹⁰

§ 4. *Effects upon Interest*

Upon the opening of bankruptcy proceedings, interest on the debtors' claims stop accruing.

Chapter 5.4. "Excusability" Following Bankruptcy

§ 1. *Conversion of Bankruptcy Proceeding into Compulsory Reorganization Proceeding*

Bankruptcy proceedings are terminated by a decision of the bankruptcy court. The court may terminate the bankruptcy proceedings for one of the reasons enumerated in Chapter 1, § 4..

If the bankruptcy proceedings were terminated because of conversion into a compulsory reorganization proceeding, then the debtor may continue its business without the restrictions imposed on it by the opening of bankruptcy proceedings. In particular the debtor again has its full legal capacity.

§ 2. *Termination after Complete Liquidation*

On the other hand, if a bankruptcy proceeding is terminated after the complete liquidation and distribution of the estate, then one must distinguish among several situations. In the case of legal persons, the legal person will, after its bankruptcy, be deleted from the commercial register and thus cease to exist. The termination of the existence of a legal person, therefore, leads to a *de facto* discharge.

However, the deletion of a partnership (where the full partners bear unlimited and personal liability for the debts of the partnership) has no impact upon the personal liability of a partner.

¹⁸⁹ Sec. 26 *KO*. A contract of mandate (*Auftrag*) is a contract whereby one party (the contractor) undertakes to conduct a business, e.g. to conclude a transaction, for another party (the mandator) on the other party's account.

¹⁹⁰ Sec. 21 *et seq. KO*.

§ 3. *Regulation of Debts Proceeding (Consumer Bankruptcies)*

In the case of natural persons, a formal discharge is possible in the course of the so-called “regulation of debts proceeding” (*Schuldenregulierungsverfahren*).¹⁹¹ In practice, such proceedings are called “private bankruptcies” (*Privatkonkurs*).

§ 4. *Termination by Other Methods*

Technically, if the bankruptcy proceeding terminates by any other method (for any other reason) than reorganization, creditors who have not been paid in full, continue individually to have an action against the debtor. The debts are not formally discharged. Thus the debtor - if it still exists - continues to be obligated to pay the full amount of its debts. The entry of the debt into the table¹⁹² serves as an enforceable instrument.

§ 5. *Withdrawal of Business Licence*

In case that a bankruptcy proceeding has not lead to a successful compulsory reorganization, the debtor is prohibited from engaging in a trade or business according to the Industrial Code ("*Gewerbeordnung*" – *GewO*)¹⁹³. The same applies to natural persons having decisive influence over the debtor’s business.

However, the authority may grant an exemption to the prohibition if the debtor or the natural person are likely to fulfill their financial obligations both in connection with engaging in the intended business activities and in connection with settling “old” debts that have already become due.¹⁹⁴

Chapter 5.5. Responsibility of the Company’s Management in Case of Bankruptcy of a Limited Liability Company

§ 1. *Withdrawal of Business Licence*

The statements made in Chapter 4., § 5., apply. Therefore, the debtor’s managing directors (*Geschäftsführer*) might – unless they are not exempted from the prohibition of engaging in a trade – be deprived from starting a fresh start as independent owners of a business.

¹⁹¹ Secs. 181 to 216 *KO*. Consumer bankruptcies are not discussed in this article.

¹⁹² See Chapter 1.

¹⁹³ Sec. 13 *GewO*.

§ 2. *Criminal Sanctions*

In case of bankruptcy, there is – under certain conditions - the risk of criminal sanctions against the debtor or the debtor’s managing directors. A fundamental principle to be observed in all insolvency proceedings is the principle of equal treatment of (equal type) creditors.

After the debtor has become illiquid or over-indebted, the preferential treatment of even only one creditor to the other creditors may trigger criminal sanctions against the managing directors according to the Criminal Code.¹⁹⁵

Managers might be held liable not only for intentional or fraudulent conduct, but also for grossly negligent prejudicing of creditor’s interests.¹⁹⁶

§ 3. *Civil Liability*

One of the greatest risks to the managing directors of an insolvent company is the civil liability for the company’s debts (or for certain parts of such debts). Such civil liability may arise under certain conditions, in particular, if the managing director did not file for judicial insolvency proceedings in due time and has thus contributed to a situation where a creditor eventually receives less than this creditor would have received if the debtor had applied for judicial bankruptcy or reorganization proceedings in due time.

§ 4. *Being the Managing Director of another Company*

Under Austrian law, managers of a bankrupt company are not excluded from being managers of another company.

TITLE 6. PROSPECTS AND RECOMMENDATIONS

As recommended in the “Uniform guidelines for national reports”, the following observations are structured along the “Questionnaire”. Only such aspects are mentioned, where the

¹⁹⁴ Sec. 26 *GewO*, Verwaltungsgerichtshof 24.10.2001, 2001/04/0178.

¹⁹⁵ Sec. 158 *StGB*.

¹⁹⁶ Sec. 159 *StGB*.

“Principles and Guidelines” of the World Bank are, in the author’s view, not fully observed in Austria. The numbers refer to the numbering of the “Principles”.

Chapter 6.1 Legal Framework for Creditor Rights

1. Austrian law does not provide for security interest on a global basis (like e.g. a “floating charge” under UK law).
2. More detrimental is the lack of a recording and registration system of secured interests in movable assets (in particular in accounts receivable).
3. The realization of security interests can be very difficult and time consuming. Non-judicial enforcement methods are practically non-existent.

Chapter 6.2 Legal Framework for Corporate Insolvency

4. In terms of reorganization proceedings, Austrian law contains very rigid rules which often make reorganization difficult. In terms of cross-border insolvencies, Austria is extremely reluctant to recognize foreign proceedings (with the exception, of course, of EU countries, due to the EU Insolvency Regulation).
5. Director and officer liability sometimes goes too far in Austria. Less liability would enhance more reasonable risk taking.
6. Conversion of proceedings is easy in the sense of shifting to liquidation, but difficult the other way.
7. Creditors cannot initiate reorganization proceedings, but only bankruptcy proceedings.
8. Creditors cannot influence the appointment of the administrator, neither in bankruptcy nor in reorganization proceedings.
9. The rules on treatment of contract are very rigid and formalistic. They do not allow for a balanced assessment of “compelling commercial, public or social interest in upholding the contractual rights of the counter-party”. More flexibility would be helpful.

Chapter 6.3 Features Pertaining to Corporate Rehabilitation

10. The statutory requirements for reorganization plans are very rigid. Access to reorganization proceedings is therefore not always quick and easy. Again, more flexibility would be helpful to enable viable businesses to survive.

11. Priority funding for businesses in reorganization is practically not regulated, and therefore extremely difficult to obtain.
12. To obtain the necessary information is often difficult for administrators and creditors. More expedient means of disclosure would be helpful.
13. Contrary to Principle 20, Austrian law prescribes the nature of a reorganization plan very rigidly.
14. Creditors cannot amend a plan.
15. Austria does not recognize foreign insolvency judgments, except where there is a bilateral or multilateral agreement with the other country. The situation is different, of course, within the EU, where the EU Insolvency Regulation will govern from 31 May, 2002.

Chapter 6.4 Informal Corporate Workouts and Restructurings

16. There is no legislative framework to support informal workouts, on the contrary, the tight statutory time limit to file for judicial insolvency proceedings make informal workouts often impossible. Social security institutions claim that, by law, they are not allowed to consent to an informal workout.
17. There is no code of conduct on informal processes, in the financial sector. It is therefore very difficult to predict how a bank will act upon a restructuring proposal.

Chapter 6.5 Implementation of the Insolvency System

18. Austria has specialized departments within the general civil courts, but no specialized bankruptcy courts.
19. Performance standards of courts as well as qualification criteria for judges are unheard in Austria.
20. The standard or court organization and the predictability of court decisions differs from court to court.
21. Transparency is not always given.
22. See 20.
23. There is no specific body regulating or supervising insolvency administrators. In most cases, attorneys are appointed as administrators. Therefore the local bar plays a significant role in watching over the administrators. The Insolvency Reform Act which is presently in preparation will set more precise standards for insolvency administrators.

7. STATE OF KNOWLEDGE

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Werner Huber in *Heller*, *Löber*, *Bahn*, *Huber*, *Horvath*, “Austrian Business Law”, Suppl 8 April 2000 (Manz 1992), Chapter XXIII 1-3.

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