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Unsecured Creditors' Rights and Options in Restructuring and Bankruptcy Proceedings in Denmark

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1.1 Introduction

For insolvency law purposes the most important Danish Act is the Danish Insolvency Act (Konkursloven), Act No 217 of 2011. The Danish Insolvency Act stipulates that restructuring and bankruptcy are the two main types of insolvency proceedings in Denmark.

The main principle of the Danish Insolvency Act is the equal allocation of the debtor's assets to the debtor's creditors. However, this main principle is deviated from as mortgages/pledges are preferential claims and a ranking of creditors has been introduced that determines the order of priority of the payment of the creditors' claims.

At the top of the ranking of creditors are the administration expenses which include any claims raised during the actual bankruptcy proceedings. The next claims are the preferential claims that include the costs incurred in an attempt to restructure the business, the claims proved by the employees and the claims for excise duties on goods proved by the suppliers for goods supplied up to the bankruptcy. Then follows the claims proved by the unsecured creditors (the ordinary claims) and then comes the deferred claims which include the promises of gifts, any claims for interest accrued since the date of the bankruptcy as well as any claims relating to an incorrect tax return or failure to file a tax return with the Danish tax authorities.

The Danish court system is a three-tier system consisting of trial courts, the courts of appeal and the Supreme Court. The trial courts are important in insolvency law as a petition for restructuring or bankruptcy must be filed with the bankruptcy court division of the particular trial court. However, if a bankruptcy petition is filed

against a debtor domiciled in the Copenhagen area, the petition must be filed with the insolvency division of the Maritime and Commercial Court in Copenhagen.

1.2 Restructuring

The restructuring rules were only implemented in the Danish Insolvency Act in April 2011.

The option to file for a suspension of payments and a compulsory arrangement with creditors was abolished when the rules on restructuring were introduced.

The purpose of the change was to make it easier for viable businesses that are temporarily insolvent to survive. The previous rules rarely resulted in the actual restructuring of the debtor or a voluntary arrangement with creditors and the rules were often used as a framework for an informal liquidation of the debtor's business and the winding up of the debtor's activities without all the creditors' consent.

The regard for the survival of the business has resulted in the new restructuring rules giving creditors better options to handle ailing businesses.

Under the previous suspension of payment rules and the compulsory arrangement with creditors the debtor was in charge of the process as only the debtor could file for a suspension of payments or file a petition for a compulsory arrangement with creditors and the debtor was also still in charge of the management of the business during the process.

Under the new rules a petition for restructuring proceedings can be filed by either the debtor or by a creditor. If the petition is filed by the debtor, the bankruptcy court will commence the restructuring proceedings immediately when the bankruptcy court has received the petition. The same rule applies if the debtor has given its consent to a petition filed by a creditor. If, however, a petition has been filed by a creditor without the debtor's consent, the bankruptcy court will arrange for a court meeting where the petition will be processed.

When the restructuring proceedings start, the bankruptcy court will appoint one or more trustees (in practice always lawyers). The bankruptcy court is not bound by the proposal in the petition as to the choice of trustee(s). It is also a statutory re-

quirement that a representative with accounting skills, who will often be a certified public accountant, is appointed at the beginning of the restructuring proceedings.

If the debtor rejects a petition for restructuring filed by a creditor, the debtor will become subject to bankruptcy proceedings immediately and if a company with limited liability rejects a petition, the restructuring administrator can take over the management of the company. It means that the creditors have a decisive influence on whether restructuring proceedings are to be opened.

The structure of the rules is that the creditors must be active during the restructuring proceedings in order to actually influence the proceedings. For example, a restructuring proposal does not require a qualified majority but only that a qualified minority does not vote against the proposal.

All creditors have the right to vote (except creditors that are 'related' to the debtor as defined in the Danish Insolvency Act). The main rule is that the creditors can only vote if their claims are expected to get dividends. If the creditor will get fully compensated, the creditor has no right to vote. A creditor having a claim can only vote for the part of the claim that is expected not to be covered by the security. The bankruptcy court will - based on the information at hand - determine to which degree a claim can be considered covered under a security and as a consequence what part of a claim that gives voting rights. The bankruptcy court's decision may be made based on a recommendation from the appointed accountant. The Danish Bankruptcy Act stipulates that the determination of voting rights only depends on the expected dividends and security and that any (other) specific rights provided in any financing documents do not have any influence on the voting rights.

As to the voting process, the creditors vote first on the proposed restructuring plan as presented by the company, the trustees and the accountant. The vote has to take place within 4 weeks of the start of the restructuring proceedings. The proposed restructuring plan (choice of model) is considered to having been approved unless a majority of the creditors vote against the plan and that majority represents 25% of the debt.

No later than 6 months after the meeting (can be extended by up to 4 months) during which the proposed restructuring plan was adopted a meeting must be held at the bankruptcy court with the participation of the creditors. During this meeting

the creditors must vote on the (final) restructuring proposal (assumingly including the offer). The restructuring proposal is considered to having been adopted unless creditors representing the majority of the debt (entitled to vote) vote against the proposal.

It means that the creditors only vote on the adoption of the proposed plan (within 4 weeks) and subsequently on the adoption of the entire proposal (assumingly including the offer) within 6 or maximum 10 months. The creditors only vote on the adoption of the complete plan and subsequently on the adoption of the entire proposal. As mentioned earlier the restructuring rules are quite new, but it seems very likely that the creditors' approval cannot be subject to any changes of the offer.

The typical course of events of restructuring proceedings is:

The petition is filed by the debtor or a creditor.

No later than one week after his/her appointment the restructuring administrator must distribute a circular letter containing various information to all creditors. A meeting is then held with the creditors and the meeting is followed up by the restructuring administrator distributing the proposed restructuring plan, which can be changed at the meeting. The plan must contain either a takeover and/or a provision about a compulsory arrangement with creditors.

The final restructuring plan must be adopted by the creditors no later than 6 months (which can be extended by the bankruptcy court to 10 months) after the restructuring proceedings have commenced.

Restructuring proceedings can be terminated for a lot of reasons. Irrespective of the cause, bankruptcy proceedings will be commenced against the debtor when the restructuring proceedings have terminated. However, that is not the case if the debtor is solvent or the restructuring plan contains a proposal for a compulsory arrangement with creditors, which would result in the debtor becoming solvent.

1.2.1 *Summary*

Unsecured creditors are consequently to have an influential and controlling role during the restructuring proceedings. However, the requirement is that the creditors participate actively in the proceedings, including that they participate in the meetings held at the bankruptcy court. If not, the creditors will lose the possibility of having any influence as the restructuring plan prepared by the restructuring administrator will be adopted.

1.3 Bankruptcy

A bankruptcy petition can be filed by both the debtor and a creditor. The joint principal condition applying to all bankruptcy proceedings is that the debtor must be insolvent. The Danish Bankruptcy Act stipulates that the term "insolvency" means that the debtor is unable to pay its debts as they fall due (provided that any such inability cannot be assumed to be of a purely temporary nature). The mere fact that the company's liabilities exceed its assets does not, in other words, mean that the company is "insolvent" within the meaning of the Danish Bankruptcy Act.

In connection with the issue of the bankruptcy order the bankruptcy court must appoint one or several trustees. The trustee's principal task is to safeguard the interests of the estate, including secure the assets, represent the estate in all respects, expedite the estate administration and so on.

First and foremost, it is the bankruptcy court that makes sure that the trustee fulfils his/her statutory obligations and the bankruptcy court is able to intervene if any inexpedient actions are taken.

The creditors' committee, more of which later, may criticise the trustee but is only able to force through a change with the assistance of the bankruptcy court or a meeting of creditors.

The trustee is under an obligation to inform the creditors about the estate administration. During the first 4 months after the issue of the bankruptcy order the trustee must regularly inform all creditors about the estate administration, including the estate's assets, liabilities, the trustee's work and so on. After such period the

trustee is only under an obligation to inform the creditors that are expected to receive dividend.

In practice, however, the trustee will present decisions of significant importance to the estate administration, such as the sale of any unencumbered assets, to the estate's largest creditors.

Any unsecured creditors are able to affect the estate administration in several ways. Firstly, the creditors can influence the choice of trustee. Secondly, the creditors can set up the creditors' committee. Thirdly, the creditors can participate in the meeting of creditors. And finally, the creditors are able to bring a legal action on behalf of the estate if the trustee does not want to being any legal action.

1.3.1 *The choice of trustee*

Immediately after the issue of the bankruptcy order the bankruptcy court must appoint one or several trustees after having consulted the creditors present at the issue. However, the creditors' advice is not binding on the bankruptcy court.

The Danish Insolvency Act stipulates that after such appointment the creditors are able to request that a meeting of creditors is convened to appoint a new trustee (choice of trustee). The request must be sent in writing to the bankruptcy court within 3 weeks after the bankruptcy has been made public in the Danish Official Gazette.

All creditors, also the creditors that are not expected to receive any dividend, have the right to request such choice of trustee.

Whether a trustee is to be chosen depends on the creditors' votes as minimum one third of the known creditors entitled to vote must be represented and more than half of the votes must be cast on the same person. The amounts of the claims decide the weighting of the creditors' votes.

Deferred claims, administration expenses and claims that will be repaid in full cannot vote. It means that only unsecured creditors may vote.

The creditors often decide to influence the choice of trustee.

1.3.2 *Creditors' committee*

The Danish Insolvency Act stipulates that the creditors are able to request that a meeting of creditors is convened to elect a creditors' committee. The request must be forwarded to the bankruptcy court no later than 3 weeks after the bankruptcy has been made public in the Danish Official Gazette.

During the meeting of creditors a third of the represented creditors entitled to vote may demand, either according to their number or the amount of their claims, that a creditors' committee is set up. The maximum number of members is 3. The members are elected by the creditors.

The purpose of the rules is to enable the creditors to set up a committee that can assist the trustee with for example knowledge of the line of business in question. The committee can also supervise the trustee to some extent. However, the trustee does not need the creditors' committee's consent in order to carry out a decision and the creditors' committee cannot prohibit the trustee from taking specific action or order the trustee to take specific action.

The trustee is under an obligation to inform the creditors' committee about all important decisions and to inform them about any contemplated and particularly important decisions. The notification should be given before the action is taken unless immediate action could have a detrimental effect on the estate.

After the trustee has been notified, the creditors' committee should be given the opportunity to discuss the action with each other or with the trustee before the committee presents its opinion. It must be emphasised that the opinion is not binding on the trustee as I mentioned earlier.

If the trustee does not inform the committee about any important decisions, the result could be a complaint to the bankruptcy court or to the meeting of creditors, which I will come back to. However, the trustee is still authorised to make decisions on its own on behalf of the estate.

The only possible sanction available to the committee in respect of the trustee is to convene a meeting of creditors where the committee can request the bankruptcy

court to dismiss the trustee. The creditors' committee may consequently criticise all elements of the estate administration and only if the trustee ignores the criticism may the committee force through a change by involving the bankruptcy court or a meeting of creditors.

During the estate administration the committee is able to ask the trustee questions about the estate's affairs and the trustee must answer such questions.

The previous Danish Insolvency Act stipulated that a creditors' committee was to be set up and that the trustee was under an obligation to present all important decisions to such committee and the committee could demand that the trustee was to dismissed. However, it turned out that it was difficult to get enough members to the committee. The consequence was that the Act was changed in 1996 so that in future a certain number of creditors were to demand a creditors' committee.

A creditors' committee is rarely used in practice.

1.3.3 *Meeting of creditors*

A meeting of creditors is a meeting held at the bankruptcy court to discuss/clarify issues concerning the estate administration. It is the bankruptcy court that convenes the meetings of creditors, which will take place when the bankruptcy court finds that it is required and if the trustee or a member of the creditors' committee requests such meeting.

The decisions by a meeting of creditors are binding on the trustee if minimum a third of the known creditors entitled to vote are represented at the meeting of creditors and more than half of the votes have been cast on the same. The amounts of the claims decide the weighting of the creditors' votes.

On request, the meeting of creditors must make a decision about the choice of trustee and may decide too choose a trustee. The final statement and the distribution of dividend must be presented to the meeting of creditors for its approval or rejection. However, the meeting of creditors cannot prevent that a bankrupt estate which is not able to cover the estate administration costs is closed and dissolved, just as any disputes involving the accounts and the distribution of dividend cannot be settled by voting but by the ruling of the bankruptcy court.

Any issue relating to the estate administration may be presented in addition to the issues that I have just mentioned.

The majority of the meetings of creditors held in practice only focus on the choice of trustee, the final statement and the distribution of dividend. It does therefore not happen very often that a meeting of creditors is used to clarify other issues important to the estate administration.

1.3.4 *To bring a legal action on behalf of the estate*

If the trustee decides not to pursue a possible claim without any settlement having been made, any creditor may bring a legal action or become a party to a legal action brought by the debtor before the bankruptcy order has been issued.

It means that a creditor is able to bring a legal action that the trustee does not think will be successful. If a creditor is successful in continuing a legal action that has been given up by the trustee, the subject-matter goes to the estate and the estate must compensate the creditor in question for such creditor's reasonable costs relating to the legal action.

1.3.5 *Summary*

As I have just mentioned, the Danish Insolvency Act stipulates that any unsecured creditors are able to influence the estate administration by the choice of trustee, the creditors' committee, participating in the meetings of creditors and the option to bring any legal action on behalf of the estate.

The choice of trustee where the creditors decide on the trustee is most important in practice. Creditors often exercise this option.

The other options are of limited importance in practice. The reason is that first and foremost the creditors are not actually able to participate actively in the estate administration but only to receive information about the estate administration and make their opinions known to the trustee and the bankruptcy court and such opinions are not always followed.

The reason for the current rules is that it has turned out to be very difficult to involve the creditors in the estate administration. The consequence has been that the legislature has decided to reduce the creditors' options to become an active part of the decision-making process so that the estate administration will not be restrained by such involvement.