A quick guide to corporate insolvency in Austria

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Although the COVID-19 pandemic has hit the global market as a whole, mainly national laws within the European Union still govern restructuring and insolvency proceedings. As a result, the measures to mitigate the effects of the coronavirus pandemic vary significantly from jurisdiction to jurisdiction. This article summarises the applicable law relating to corporate insolvency and restructuring in Austria and answers some of the questions most likely to be asked by distressed companies or their creditors.

Legal framework

The legal framework for insolvencies of business entities (as well as individuals) in Austria is codified in the Insolvency Act. The primary objective of the Insolvency Act is to ensure uniform and proportionate satisfaction of unsecured creditors. In addition, insolvency proceedings are also intended to restructure companies and relieve individuals of debt.

Ahead of insolvency proceedings, solvent debtors may apply for reorganisation under the Business Reorganisation Act. The Austrian Business Reorganisation Act sets out rules for corporate reorganisation proceedings (which are not to be confused with insolvency proceedings) in relation to a solvent debtor's business, which affect creditors' rights to a lesser degree.

The purpose of the Business Reorganisation Act is to encourage businesses to attempt a restructuring under the supervision of a court-appointed restructuring auditor where the business is not yet insolvent, but where the financial position of debtor has deteriorated beyond a certain point (showing a debt-equity ratio of less than 8% and a pro-forma debt amortisation period of 15 years or more).

Restructuring proceedings are intended to be completed within a two-year period and are not available to insolvent companies. In practice, due to the high costs of the restructuring auditor, the fear of reputational damage and outcome uncertainty means that these types of proceedings are rarely applied.

On February 22, 2021, the eagerly awaited ministerial draft regarding the Federal Law on the Implementation of the Directive on Restructuring and Insolvency (EU) 2019/1023 (DRI) was published. The main objective of the DRI is to establish a uniform pan-European restructuring framework that enables debtors to restructure their business in order to limit the unnecessary liquidation of economically viable companies. For this purpose, viable companies that have run into financial difficulties are to have access to court-based "pre-insolvency restructuring proceedings". The draft includes a new federal law on the restructuring of companies. The review period ends on April 6, 2021. Austria is obliged to implement the directive by July 17, 2021.

Types of insolvency proceedings

There are three different kinds of insolvency proceedings under the Insolvency Act:

(i) bankruptcy proceedings;
(ii) restructuring proceedings with self-administration; and
(iii) restructuring proceedings without self-administration.

While bankruptcy proceedings lead to the liquidation or the sale of the debtor's business, the aim of both restructuring proceedings with self-administration (the debtor generally retains

control over the estate's assets subject to certain restrictions) and restructuring proceedings without self-administration (a court-appointed insolvency administrator takes control) is the restructuring of an insolvent entity as a going concern.

Insolvency proceeding triggers

Under Austrian law, a debtor is obliged to file for the opening of insolvency proceedings if the debtor is insolvent, which means that the debtor is either illiquid or over-indebted. The Insolvency Act does not provide a legal definition for illiquidity and over-indebtedness.

According to case law, illiquidity is to be assumed if the debtor is unable to pay more than 5% of its due monetary liabilities and cannot obtain the necessary means of payment in the foreseeable future.

The determination of over-indebtedness involves a two-pronged test. According to case law, the necessity to apply this test is triggered by negative equity. The subsequent testing steps are as follows:

(i) the company needs to assess whether the liabilities on the debtor's balance sheet exceed the debtor's assets (calculatory indebtedness); and
(ii) the company needs to assess whether it qualifies for a positive going-concern prognosis.

If the company is in a state of calculatory over-indebtness and a positive going-concern prognosis is not feasible, the company is insolvent by reason of over-indebtedness.

The Insolvency Act requires the debtor to file for the opening of insolvency proceedings without culpable delay no later than 60 days after the debtor has become insolvent. If the debtor's insolvency is caused by a "natural disaster" such as an epidemic or a pandemic (including the COVID-19 pandemic), the 60-day period is doubled to 120 days. This time period can be used for restructuring efforts, such as downsizing operations, selling assets, reducing staff, raising new capital and undertaking measures to boost sales. Any restructuring measures deployed by the management need to focus on the restoration of liquidity and removal of over-indebtedness, as long as the particular action does not harm the debtor's creditors.

If an entity is illiquid or over-indebted, the legal representatives are obliged to file for the opening of insolvency proceedings. If the legal representatives fail to file for insolvency without undue delay – or in any event, no later than within the 60 or 120-day time period, whichever is applicable – the legal representatives expose themselves to possible civil and criminal charges (including fraud and undue preference for a creditor) for impairment of the creditors' interests.

Disregarding the 60 or 120-day time limit is one of the few cases where a legal representative of a limited liability company may be held personally liable for damage inflicted on the company's creditors (a possible reduction of the insolvency quota). Furthermore, the legal representatives may be liable to the entity for any payments implemented while already in a state of insolvency.

Due to the COVID-19 crisis, the duty to file for insolvency due to over-indebtedness is suspended until June 30, 2021 for the time being, whereby this deadline has been extended several times thus far mirroring the continuation of the COVID-19 pandemic: A debtor is not required to file an insolvency petition for over-indebtedness occurring between March 1, 2020 and June 30, 2021. If the debtor is over-indebted at the end of June 30, 2021, it must file for the opening of insolvency proceedings without undue delay, but at the latest within 60 days after the end of June 30, 2021 or 120 days after the date of determination of over-indebtedness, whichever period ends later.

Apart from the company's legal representatives, any creditor is entitled to file for insolvency in the form of liquidation bankruptcy proceedings. In case a creditor attempts to put the debtor into involuntary bankruptcy, the creditor must provide evidence that the following statutory requirements are met:

(i) the existence of a claim against the debtor; and

(ii) insolvency of the debtor, which is to be presumed if the debtor has stopped to pay its debts as they fall due (illiquidity).

Procedural aspects

Insolvency proceedings of companies are conducted by the insolvency court, a separate part of the court of general jurisdiction, in which the debtor has its legal seat or residence. Insolvency proceedings of private individuals are an exception, as they are conducted before district courts, which are courts of limited general jurisdiction. The court, among other things, decides on the opening of proceedings, appointment of the insolvency administrator and a possible creditors' committee, the sale of the business or relevant assets, and the end of the proceedings.

The insolvency administrator is appointed by the court from a list of potential candidates (typically the insolvency administrator is a lawyer). The insolvency administrator has a central oversight and management function in any type of insolvency proceedings. Regularly, the insolvency court's order for the commencement of the proceedings cuts off the debtor's (management's) authority to represent the insolvent entity and to make any dispositions in respect of its assets and liabilities, which powers are transferred to the administrator under such order.

In case restructuring proceedings with self-administration are opened, the debtor is generally entitled to keep on running the company and take steps and measures in the ordinary course of business, but the consent of the insolvency administrator and/or insolvency court is required for a number of other extraordinary measures.

The court must promptly assign a creditors' committee consisting of three to seven members if the nature or particular scope of the debtor's business necessitates such a measure. The court must always assign a creditors' committee to the insolvency receiver where a sale or lease of the debtor's business, or a portion thereof, is intended. The creditors' committee has the duty to supervise and assist the insolvency administrator.

Effects of insolvency proceedings

Once insolvency proceedings or reorganisation proceedings without a debtor-in-possession regime are opened, the debtor (in most instances, the debtor's management) loses its right to represent the insolvent entity and to make any dispositions with respect to its assets. Any attempted disposition by the debtor or its officers is void and without effect.

Creditors may not initiate or continue legal actions – specifically enforcement actions – against the debtor. After the opening of insolvency proceedings, the enforcement of a claim requires the filing of the claim as an insolvency claim with the insolvency court. The period in which the claim must be filed is published in the official notice. The insolvency administrator summarises all claims in a special registration list, which is then submitted to the court. In practice, all claims are first examined by the debtor and the insolvency administrator, and then again formally in the examination hearing in court. The insolvency administrator needs to declare whether he acknowledges or rejects a claim.

Furthermore, legal actions and transactions that have taken place within certain periods may be challenged if the following general prerequisites are fulfilled:

(i) the avoidance results in an increase of the insolvency estate; and
(ii) the challenged legal act or transaction caused the direct or indirect discrimination of creditors.

A transaction can be contested for intent to discriminate, squandering of assets, free-of-charge disposal, preferential treatment of creditors and knowledge of illiquidity. A successful challenge forces the other party to return received payments or transferred assets to the debtor's estate. The look-back period varies, ranging from a maximum of 10 years for intent to discriminate, to 60 days prior to the commencement of insolvency proceedings for preferential treatment of creditors, whereas certain periods are shortened where the third party knew or should have known (i.e. negligently did not know) the respective facts.

Rights of creditors

In all types of insolvency proceedings (reorganisation proceedings with debtor in possession, reorganisation proceedings without debtor in possession and liquidation proceedings), claims are classified and ranked in the following order of priority:

Secured creditors

Secured creditors either have claims of separation to receive assets (*Aussonderungsanspruch*) and/or claims of separation to receive the proceeds of enforcement after sale (*Absonderungsanspruch*). These claims generally are not affected by the opening of the insolvency proceedings but may be challenged if the prerequisites therefor are met.

In order to assert its claim, the secured creditor merely has to inform the insolvency administrator. If the insolvency administrator does not acknowledge the claim, the secured creditor has to file a lawsuit against the insolvency administrator in order to enforce the senior security. However, under Austrian insolvency law no secured claim can be paid within six months from the commencement of insolvency proceedings in case such claims might jeopardise the business continuity of the debtor. Only if the enforcement is vital to prevent severe economic disadvantage to the secured creditor may this be disregarded.

Estate claims

Ranked behind secured claims are estate claims (*Masseforderungen*), which are to be satisfied prior to other insolvency claims. Estate claims comprise, *inter alia*, the costs of the insolvency proceedings, the expenses of management and administration of the estate, claims for labour, services and goods furnished to the estate post-filing, and the costs of the insolvency administrator. Preferential creditors of estate claims share in such claims on a pro rata basis.

Estate claims are to be paid by the insolvency administrator without any filing procedure.

Insolvency claims

The next rank is taken by insolvency claims (*Insolvenzforderungen*), which are claims of unsecured creditors. Insolvency claims must be filed with the insolvency court within a certain time period after the opening of insolvency proceedings as fixed by the court. The insolvency creditors who file a claim acknowledged by the insolvency administrator also share in such claims on a pro rata basis.

Subordinate claims

Subordinate creditors only participate in the insolvency proceedings if a surplus for distribution is generated. Subordinate claims may result from contractual provisions or from statutory provisions. For example, claims for repayment of equity substituting shareholder loans, which are loans granted to a company during its crisis, are subordinate claims.

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