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A quick guide to corporate insolvency in Austria

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After a number of crises (COVID-19, Russian invasion of Ukraine, Israel's war against Hamas), the current economic situation and development is pointing in a positive direction. Nevertheless, the full impact of these crises – rising energy prices, inflation and interest rates - is only just hitting companies to the full extent. The real estate and construction sectors, as well as the industry sector in general, continue to be massively affected by these effects. Therefore, this article provides an overview of the key aspects of corporate restructuring and insolvency in Austria, which are especially relevant for the highly impacted sectors outlined above.

Out-of-court restructuring

The first dividing point for corporate restructuring and bankruptcy is out-of-court restructuring on the one hand and court-based restructuring and insolvency on the other. An out-of-court restructuring can take place on the basis of a restructuring agreement. With such a restructuring agreement, either a shareholder-led solution or a lender-led solution can be implemented. Whereas in the first variant, restructuring is essentially achieved through financial contributions from the shareholders, the second variant aims primarily at achieving a haircut (discharge of debt), including deferrals and the sale (of parts) of the company. These measures, which provide for the relief of the debtor on the one hand and the reduction of debts through repayment on the other, are accompanied by ongoing reporting obligations.

Since the restructuring agreement is governed by contract law the restructuring, including each restructuring measure, requires the consent of all creditors involved. The advantage of an out-of-court restructuring is that it takes place behind closed doors and thus negative effects such as damage to the company's reputation and changed customer and supplier behaviour can be prevented. However, special measures provided for in the Austrian Insolvency Act, such as preferential dismissals of employees or withdrawal from contracts, cannot be used.

Types of insolvency proceedings

The legal framework for court-based restructuring and insolvency in Austria is codified in the Austrian Insolvency Act. In principle, the Insolvency Act provides for two types of proceedings: reorganisation proceedings and bankruptcy (liquidation) proceedings.

A reorganisation proceeding enables the debtor to discharge debt while continuing its business. As part of these proceedings, debt is discharged on the basis of a reorganisation plan in which the creditors are offered a quota of 20% (in reorganisation proceedings without debtor in possession) and 30% (in reorganisation proceedings with debtor in possession) payable within two years. At the same time, the debtor is able to continue its business or parts thereof.

The difference between these two types of proceedings is whether or not the debtor retains control over the company's assets and a court-appointed insolvency administrator takes over control or is only involved in important matters.

Insolvency proceedings in the form of bankruptcy (liquidation) proceedings are opened if the company is no longer viable. No longer viable means that the company cannot meet its liquidity needs and is not generating sufficient income. In these proceedings, the court appoints an insolvency administrator who takes on the task of liquidating the company and distributing the proceeds of the liquidation proportionately to the creditors without any minimum quota.

With the Recovery and Resolution Act (BaSAG), a special regime in accordance with Directive 2014/59/EU for the reorganisation and insolvency of financial institutions (banks) is available in Austria. If deemed necessary, the competent authority (Financial Market Authority) may put in place early intervention measures, such as the removal of senior management or the appointment of a temporary administrator. If an institution is failing or likely to fail, the bank will be dissolved (wound up).

For the dissolution four different kinds of tools are provided to the competent authority: sale of business; bridge institution; asset separation and bail-in. While a sale of business is the sale of shares or part of the operations of a bank to a third party, the bridge institution and asset separation tools are used to set up a new institution controlled by the competent authority, which takes over part of the operations of the bank.

The difference between the two lies in the objective of the measure, being either continuation (bridge institution) or liquidation (asset separation) of the separated part. The bail-in tool may be used by the competent authority to decrease in part or fully outstanding liabilities of the bank, if there is a justified reason to expect that the measure - together with all other measures - will restore the financial situation of the bank.

Besides the insolvency proceedings under the Insolvency Act and the Recovery and Resolution Act, since mid-2021 the new Restructuring Act provides for pre-insolvency restructuring proceedings, which is in principle a self-administration procedure in accordance with Directive (EU) 2019/1023 on Restructuring and Insolvency. In these proceedings the debt is discharged on the basis of a restructuring plan, whereby a haircut is possible by means of a majority decision. The restructuring plan defines classes of "affected creditors". The majority of the creditors in each class and the court must confirm the restructuring plan in order for the restructuring plan to come into effect (be binding upon the affected parties). In addition, the court has to decide on the confirmation of the restructuring plan.

Reasons for opening insolvency proceedings under the Insolvency Act

Under Austrian insolvency law, there are two reasons for opening insolvency proceedings: illiquidity and over-indebtedness.

Illiquidity means that the debtor is unable to pay more than 5% of its debt due and is unlikely to be able to obtain the necessary liquid funds within a short period of time. Inability to obtain the funds within a short period of time means that there is a high probability that the necessary liquid funds cannot be obtained within three months, although this period also can be extended to five months in exceptional cases. In these cases, however, the liquid funds must be made available with a higher degree of probability.

Over-indebtedness under insolvency law occurs when the debtor's status based on liquidation values and a going concern prognosis is negative. According to Section 225 of the Austrian Commercial Code (UGB), if there is negative equity, it must be checked whether there is over-indebtedness within the meaning of insolvency law.

When examining whether there is over-indebtedness under insolvency law (calculatory over-indebtedness and a negative going-concern prognosis), there is no order to be followed.

The criteria 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. A positive going-concern prognosis is feasible if it can be proven that the company has the necessary liquid funds and that its earning power will be restored within a period of two to three years.

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.

Obligation to file for insolvency proceedings

Pursuant to Section 69 of the Insolvency Act, if there is reason for the opening of insolvency (illiquidity or over-indebtedness; material insolvency), the debtor must apply for the opening of insolvency proceedings without undue delay, but no later than sixty days after the occurrence of material insolvency. The debtor may only use the period of 60 days if it makes serious efforts to restructure. To do this, the debtor must either attempt an out-of-court restructuring, including measures such as downsizing operations, selling assets, reducing staff, raising new capital and undertaking measures to boost sales, or prepare to open reorganisation proceedings. In exceptional cases, such as a natural disaster, this period can be extended to 120 days.

In the event of material insolvency, the legal representatives are obliged to apply for the opening of insolvency proceedings in accordance with Section 69 of the Insolvency Code. 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 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.

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 paying its debts as they fall due (illiquidity).

Procedural aspects

The application for the opening of insolvency proceedings must be filed with the competent insolvency court. 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.

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.

The insolvency administrator must immediately obtain an overview of the current economic situation of the company and the necessary decisions to be made (Section 81a of the Insolvency Act). A debtor who wants to continue its business in the insolvency proceedings should already state the key data in the application for the opening of the insolvency proceedings in order to reach a quick decision in favour of the continuation of the business. 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.

As a rule, the creditors' committee consists of representatives of the creditor protection associations; in individual cases, representatives of the tax office or the deposit guarantee scheme (in the event of a bank's insolvency) are also part of the creditors' committee.

Effects of insolvency proceedings

The opening of insolvency proceedings is relevant both in the period before and after the opening of these 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 it acknowledges or rejects a claim.

In principle, the opening of insolvency proceedings has no effect on the debtor's contracts. However, a significant exception is that the insolvency administrator has a special right to terminate the debtor's contracts (Section 21 of the Insolvency Act). On the other hand, the contractual partner of the debtor can only terminate contracts that are necessary for the continuation of the company to a very limited extent. The agreement of a right of termination, which is linked to the opening of insolvency proceedings, is void.

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

(i) the challenge results in an increase of the insolvency estate; and
(ii) the challenged legal act or transaction caused a 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. 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

Regardless of the form of the 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:

(i) 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 therefore 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.

(ii) 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.

(iii) 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.

(iv) 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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