Cyprus

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1 Issues Arising When a Company is in Financial Difficulties

1.1 How does a creditor take security over assets in Cyprus?

Under the Companies Law, Cap. 113, a variety of securities over assets is available. A *bona fide* creditor may take one of the following securities:

a) A mortgage. Property is transferred to the creditor's ownership with a right of redemption if the obligation is settled.

b) A fixed charge. The ownership is not transferred, but the charge gives legal rights as security.

c) A floating charge. It is a security that floats over all the assets of the debtor until a default turns the floating charge into a fixed charge.

d) A lien. It gives the creditor the right to possess the asset until the debtor pays the debts but no right to sell.

e) A pledge. It gives the creditor the right to sell the asset, but does not give the ownership of it.

1.2 In what circumstances might transactions entered into whilst the company is in financial difficulties be vulnerable to attack?

The directors of a company have a constant duty to act in the best interests of the company, its shareholders and its creditors once the company becomes insolvent.

Under section 301 of the Companies Law 'any conveyance, mortgage, delivery of goods, payment, execution, or other act relating to property made or done by, or against, a company within six months before the commencement of its winding up will, in the event of the company being wound up, be deemed as a **fraudulent preference** of its creditors and be invalid accordingly'. The court will decide whether or not there was a fraudulent preference, examining the apparent and the real intention and not the result.

In addition section 303 states that when a company is being wound up 'a **floating charge** on the undertaking or property of the company created within twelve months of the commencement of the winding up shall, unless it is proved that immediately after the creation of the charge the company was solvent, be invalid, except to the extent of any cash paid to the company at the time of or subsequent to the creation of and in consideration for the charge'.

1.3 What are the liabilities of directors (in particular civil, criminal or disqualification) for continuing to trade whilst a company is in financial difficulties in Cyprus?

If a director has carried out any business of the company with intent to defraud (under sections 311 or 312 of the Companies Law) the creditors of the company or any other person or for any other fraudulent purpose, the court may declare that any person knowingly involved in such actions shall be personally responsible. Liability is not limited to directors but covers other persons engaged in such activities.

Furthermore every person who knowingly carried out the business with that intent shall be liable, on conviction, to imprisonment not exceeding three years or to a fine not exceeding €2,563 or both. The court may also order the disqualification of a person from being a director for up to five years.

2 Formal Procedures

2.1 What are the main types of formal procedures available for companies in financial difficulties in Cyprus?

Under the Companies Law there is a variety of formal procedures available for companies in financial difficulties:

Reorganisation plan

A reorganisation plan may occur when two companies merge or when a new company with new financial strategies and tasks is incorporated, with the old company being dissolved. The reorganisation plan must first be approved by the old shareholders in separate general meetings for shareholders of different classes of shares, and then a petition to approve the new plan must be filed with the court Registrar. The plan is effective when the Registrar of Companies receives a copy of the new plan; a copy is also annexed to every copy of the memorandum of association or, in the case of a company not having a memorandum, to every copy so issued of the instrument constituting or defining the constitution of the company. This procedure is informal and provides flexibility, giving a chance to restructure the company without totally changing its sphere of business and its objectives. However, it is not a procedure that is always available because it depends on the extent of the financial difficulties and the judgments of the directors.

Voluntary liquidation by members or creditors

When a company is in financial difficulties its members may decide that the best solution is to terminate its existence under section 203 of the Companies Law, leading to a **voluntary winding up process**. This procedure occurs when the members can prove that the

company is solvent and that the creditors will be paid within 12 months from the date specified in the resolution for the dissolution of the company. If the members consider that the company is incapable of paying its creditors, the liquidation is taken over by them. In either case an administrator is appointed to liquidate the assets and pay the creditors.

Compulsory liquidation by the court

A **winding up may be ordered by the court** when a petition is filed, usually by a creditor. The petition for liquidation is examined by the court and, if it concludes that the company is incapable of paying its debts, it issues a liquidation order as the last resort for satisfying the applicant.

2.2 What are the tests for insolvency in Cyprus?

Even if there is no statutory definition of insolvency, the main test to determine insolvency is the **inability of a company to pay its debts**. Section 212 of the Companies Law defines this inability:

a) When a company owes €855 to a creditor. The creditor should first claim the debt by sending a formal letter to the registered office of the company which then has three weeks to pay the creditor. If the company fails to do so, the creditor may apply to the court for a liquidation order against the company.

b) If a writ against the assets of a company is returned to the court unsatisfied, the company is considered incapable of paying its debts.

c) The present and future potential liabilities and/or debts of the company are taken into consideration by the court and if it is proved that the company is unable to pay its debts, the court will issue a liquidation order.

2.3 On what grounds can the company be placed into each procedure?

Reorganisation plan

The reorganisation of the company usually begins with no formal procedures. The members of the company may decide that it is in the best interests of the company to reorganise its business and financial scheme at a general meeting. Afterwards, approval by the shareholders and the court is necessary for the new scheme to take effect.

Voluntary liquidation by members or creditors

This is decided by the members or creditors at a general meeting, in the best interests of the company, depending on whether the members are able to make a declaration that the company is solvent and able to repay the creditors within 12 months. Either way, a general meeting occurs and a special or extraordinary resolution is passed that the company should enter into a winding up procedure (section 261 of the Companies Law).

Compulsory liquidation by the court

The court has the power, under section 211 of the Companies Law, to order the winding up of a company when it has resolved by a special resolution that it is to be wound up, when the company does not commence its business within a year from its incorporation or suspends its business for a whole year, without any notice, and when the court considers it just and equitable to wind up the company. Section 212 provides for a liquidation process to be ordered by the court when the company is unable to pay its debts.

2.4 Please describe briefly how the company is placed into each procedure.

Reorganisation plan

The members of the company agree to a reorganisation plan. The shareholders must then approve the plan in separate general meetings of the different classes of share. Afterwards the new business and financial scheme must be approved and authorised by the court.

Voluntary liquidation by members or creditors

The dissolution of the company is decided by the members at a general meeting and the directors should make a declaration that the company is solvent and able to pay its debts within 12 months. If such a declaration is impossible, a general meeting with creditors and members present occurs, and the winding up of the company is undertaken by the creditors. In both cases an administrator is appointed to liquidate the assets and pay all the debts due.

Compulsory liquidation by the court

The court may order the liquidation of the company after examining a petition filed by a creditor, the company, a contributor, the Official Receiver and/or the Attorney General. The court will make such an order after considering the situations set out in section 211 of the Companies Law and chiefly if the company is unable to pay its debts under section 212.

2.5 What notifications, meetings and publications are required after the company has been placed into each procedure?

Reorganisation plan

At a general meeting the members of the company must vote in favour of the proposed reorganisation plan, which must then be approved by the shareholders in separate general meetings for holders of different classes of share. If the new scheme provides for the merger of two companies, a petition must be filed with the court for an order to bind the members and the creditors. Afterwards a copy of the new plan and the court order should be sent to the Registrar of Companies to merge the files of the two restructured companies.

If the new plan provides for the dissolution of the old company and the incorporation of a new one, it must also be approved by the shareholders at a general meeting. An administrator must also be appointed to liquidate the assets of the company and pay the creditors. Every decision and action taken at the general meeting must be notified to the Registrar of Companies and the Official Receiver.

Voluntary liquidation

When a voluntary liquidation is undertaken by the members of the company, the directors must make a declaration five weeks before the general meeting that the company is solvent and able to satisfy all its creditors within 12 months from the date of the declaration, and it must be sent to the Registrar of Companies. It will follow a general meeting at which a resolution to liquidate the company will pass and a copy of the resolution must be sent to the Registrar of Companies.

If the directors are unable to make such a declaration, the liquidation will be undertaken by the creditors of the company, and the general meeting of the members of the company and the meeting of the creditors must occur. A notice of both meetings must also be sent on the same day. There is an additional requirement, that the meeting of creditors must be published in advance in the Official Gazette of the Republic of Cyprus and in two local newspapers in the town where the registered office of the company

is situated (section 276(2) of the Companies Law). Moreover, copies of the resolution to liquidate the company must be sent to the Registrar of Companies and to appoint an administrator to the Registrar of Companies and the Official Receiver.

Liquidation by the court

After the filing of a petition and an examination by the court, it will issue an order to wind up the company. A copy of this order must be sent to the Registrar of Companies and the Official Receiver.

Section 317 of the Companies Law applies to cases of voluntary liquidation and those ordered by the court. The section makes it clear that where a company is being wound up, whether by, or under, the supervision of the court or voluntarily, every document in which the name of the company appears shall contain a statement that the company is being wound up; failure to comply will render a person who knowingly and willfully authorises or permits a default, liable to a fine of €170.

2.6 Are "pre-packaged" sales possible?

In Cyprus this procedure has not been specifically enacted. However the Cypriot Companies Law reflects the English Companies Act 1948 and has been reinforced by the European Union Regulation on Insolvency Proceedings. In these regimes a pre-packaged sale is possible, and therefore it is also possible in Cyprus.

3 Creditors

3.1 Are unsecured creditors free to enforce their rights in each procedure?

In each procedure, whether reorganisation or liquidation, common principles are applied.

The order of priority in the distribution to, and the satisfaction of, the creditors is set out in section 300 of the Companies Law, which places unsecured creditors in the lowest rank. The administrator will repay the secured creditors first and if any surplus credit or liquidated assets remain then the unsecured creditors will be satisfied.

When a company is in liquidation, unsecured creditors cannot exercise any of their legal rights, but must wait until the distributor has made all the priority distributions under section 300. However an unsecured creditor may initiate a recovery action against the company before any liquidation proceedings begin; by so doing the liquidator will be obliged to follow any judgment obtained, and as a result the unsecured creditor will become a secured creditor.

3.2 Can secured creditors enforce their security in each procedure?

Generally, secured creditors have the right to enforce their security when a company is to be liquidated. This could be a two-edged sword, however, as the extent to which they are able to enforce their security depends on the value of the security.

If the value of the security covers the amount of debt owed by the company to the creditor, the secured creditor will be fully satisfied and the remaining balance (if any) will be credited to the assets of the company and may be used by the administrator to satisfy any other liabilities of the company.

However, if the value of the security does not cover the amount of the debt, the secured creditor will receive the amount of the value of the security and will be ranked as an unsecured creditor for the remainder of the debt.

3.3 Can creditors set off sums owed by them to the company against amounts owed by the company to them in each procedure?

Creditors have the opportunity to set off sums owed by them to the company against amounts owed by the company to them when the company is liquidated. The procedure is set out in sections 198-200 of the Companies Law.

Under section 198, creditors are able to achieve a set-off with the company disregarding the fact that a company may be, or is under, a liquidation process. The company, a creditor, the administrator, or the shareholders may apply to the court to convene a meeting of the class of creditors to whom the set-off arrangement is being proposed. At the meeting three quarters of the creditors present must vote in favour of the proposal for the set-off for the court to be able to approve the set-off. If they do, the proposal becomes binding on the company and all the creditors in that class.

4 Continuing the Business

4.1 Who controls the company in each procedure? In particular, please describe briefly the effect of the procedures on directors and shareholders.

The control of the company depends on which formal procedure has been followed.

If a reorganisation plan has been chosen to confront the financial difficulties that the company faces, it is not necessary to appoint a liquidator or an administrator. As a result neither the directors nor the shareholders lose control of the company.

However, where a liquidator, administrator or receiver has been appointed, they gain control of the company, and the directors and the shareholders lose their rights and controlling powers over the company.

4.2 How does the company finance these procedures?

When a company follows the reorganisation procedure, it may seek further funding from lenders or use current sources of funds or other sources to finance its plans. The sources must have been one of the factors previously taken into consideration by the company when deciding to proceed with a reorganisation plan. However, when a company is wound up, the liquidated assets are the main source to cover the costs.

4.3 What is the effect of each procedure on employees?

Following a reorganisation procedure the position of the employees is difficult to determine. For instance, there may be an agreement in the plan that their status will be unaffected or will be altered.

When a winding up procedure is followed, the employees of the company are automatically dismissed, with a chance for some employees to be re-employed by the liquidator to assist in the process, but only until the winding up process is complete.

4.4 What effect does the commencement of any procedure have on contracts with the company and can the company terminate contracts during each procedure?

Contracts that the company has already entered into are not directly affected if the company enters into reorganisation. However, the appointed liquidator or administrator has the right to cancel an

onerous contract unilaterally in order to fulfill his duties and proceed with the liquidation of the company; if the other party suffers any losses, that party can claim those losses during the winding up.

5 Claims

5.1 Broadly, how do creditors claim amounts owed to them in each procedure?

There is no particular method whereby creditors may claim money owed by the insolvent company, as each liquidation case is different. Usually, however, creditors will submit their claims and include them in a reorganisation plan or agreement. The terms of such an agreement set out the means by which creditors will claim the amounts owed to them.

Any amounts owed may be distributed to secured and preferential creditors with the approval of the court. Unsecured creditors may press to be paid if their services are critical to the administration process, and a liquidator has authority to make such payments.

In a creditors' voluntary winding up or a winding up by the court, creditors will normally have to provide formal proof of any claim they may have, whether present or future. The liquidator will consider all creditors' claims and decide which to accept and which to reject; where a decision cannot be made, he may ask for further evidence from the creditor. Only creditors who succeed in proving their claims will be paid.

If a liquidator rejects a claim, the reasons for his decision must be given to the creditor in writing. Any unsatisfied creditor may appeal to the court for their claim to be reconsidered.

5.2 What is the ranking of claims in each procedure? In particular, do any specific types of claim have preferential status?

Section 300 of the Companies Law ranks the claims in a liquidation process and defines their preferential status.

In a winding up by the court, the following debts should be paid in priority:

a) liquidation costs – these include the liquidator's remuneration and any expenses incurred in his duties;

b) preferential debts – among these are government levies and duties that on the date of liquidation have become due and payable within 12 months before that date. Preferential debts also include any wages due, holiday pay, provident fund contributions and compensation for injuries;

c) creditors secured by a floating charge;

d) unsecured creditors; and

e) deferred debts, such as amounts owed to members in the form of dividends declared but yet to be paid.

Finally any surplus will be distributed among the members of the company, based on their rights.

All the debts mentioned above have equal priority and must be paid in full. If the funds are insufficient to cover the sums owed, the debts abate rateably.

Where the company enters into a voluntary liquidation process or a reorganisation plan, the creditors are paid in line with the agreed terms and conditions. The rights of the secured and preferential creditors, however, remain intact and will not rank lower than those of the unsecured creditors.

5.3 Are tax liabilities incurred during each procedure?

No tax liability is incurred during each of the procedures. The company, however, will be liable to pay taxes on any profit it makes during the procedures.

6 Ending the Formal Procedure

6.1 What happens at the end of each procedure?

On completion of the winding up process the liquidator holds a formal meeting of all creditors and produces a report of the winding up. The liquidator then files his report with the court and applies for an order that the company be dissolved from the date of the order. On receipt of the order the liquidator files it with the Registrar of Companies and Official Receiver within 14 days and the company is deemed to be dissolved (section 260 of the Companies Law).

Voluntary winding up

During the winding up process the liquidator will pay off all the company's debts and distribute all its assets according to the plan agreed by the creditors and/or the members. Once the winding up process is complete, the liquidator will order a meeting of the members and creditors to be held, which he will advertise in the Official Gazette with one month's notice. Following the official meeting the liquidator will file the final account and return with the Registrar and, at the end of a three-month period following the date of the notice, the company will be considered officially liquidated.

Reorganisation or reconstruction plan

The members must hold a meeting and decide on a reorganisation plan; their resolution is filed with the court and, assuming that the court issues an order approving the arrangement agreed by the members, the order is then filed with the Registrar of Companies and Official Receiver. If the reorganisation plan is successfully implemented, both directors and shareholders continue to enjoy their rights under the company's new status. The desired outcome of this procedure is that a plan to solve the financial difficulties of the company is implemented; if the plan fails, the company may be forced to enter into a liquidation procedure.

If an administrator is appointed, he may return the control of the company to its directors once he feels that his task has been achieved. Otherwise he may decide to wind up the company and distribute its assets or dissolve the company if there are no assets to distribute.

7 Restructuring

7.1 Is a formal procedure available to achieve a restructuring of the company's debts in Cyprus?

Today 'workouts' such as debt restructuring are increasingly becoming a global reality, due to the volatile economic conditions, and many businesses are suffering a downturn. This has resulted in the formation of universal restructuring procedures. Cyprus mainly follows the EU Regulation on Insolvency Proceedings (1346/2000), as it has not adopted the United Nations Commission on International Trade Law (UNICITRAL) Model Law on Cross-Border Insolvencies.

Although there is no identified statutory procedure available in Cyprus to achieve the restructuring of a company's debts, section 198 of the Companies Law contains mechanisms for restructuring.

The debtor company will collaborate with its creditor to find the best possible method to restructure its debt, and will usually arrange for lower installments to be paid over a longer period of time. If this approach fails, either party can invite the courts to mediate.

7.2 If such a procedure is available, is a debt for equity swap possible and how are existing shareholders dealt with?

A debt for equity swap is a possible and common remedy in restructuring a company, as there may be potential for future growth of the company, and it also allows creditors to avoid administration costs. A debt for equity swap can be a simple and flexible procedure, as the terms of the debt conversion can be agreed between the company and its creditors. However, such an agreement will not be binding on any dissenting creditors.

Existing shareholders are strongly diluted in such cases and often left without any power in the running of the company.

7.3 Can dissenting creditors be crammed down?

On entering into a voluntary arrangement such as a reconstruction or reorganisation plan, 'cramming down' of minor creditors is a possibility. At least 75 per cent of voting creditors or members must approve voluntary arrangements; the dissenting minority is bound by the vote of the majority and minor creditors may be 'crammed down', simply because their voting power is less.

However, the Companies Law provides protection for the minority's interests, thus limiting the scope of the 'cramming down' procedure. One common way to avoid 'cramming down' the minority is to hold separate meetings for each class of creditors, where a 'cram down' will only affect each class of creditors individually.

7.4 Is consent needed from other stakeholders for a restructuring?

Each type of restructuring requires a different level of support from the stakeholders. A debt for equity swap requires the consent of all participating creditors; a Corporate Voluntary Arrangement needs to be approved by at least 75 per cent of creditors and at least 50 per cent of shareholders who are present and voting. The Arrangement will, however, only affect the rights of those preferential or secured creditors who agreed to the implementation of the proposal.

The main objective of a voluntary arrangement is to place creditors in a more favourable position than they would have been in if the company had been wound up or liquidated. It is, therefore, not difficult for a restructuring expert to prepare a Corporate Voluntary Arrangement acceptable to all secured, unsecured and preferential creditors, using the mechanisms provided by section 198 of the Companies Law.

8 International

8.1 What would be the approach in Cyprus to recognising a procedure started in another jurisdiction?

As a EU Member State, Cyprus follows the legislation of the European Union. Under Regulation 1346/2000 any proceedings started in one Member State must be recognised in another Member State without any formalities. Therefore any proceedings started in a Member State of the European Union are recognisable in Cyprus from the time the judgment becomes effective in the Member State where the proceedings started, provided that the company conducted its main activities or held its main interest in the Member State issuing the judgment.

If the proceedings have been started in a non-Member State, any judgment issued in the non-Member State must be first validated by a Cypriot court before it can be recognised. Cyprus is a party to a number of bilateral agreements for the joint enforcement of judgments.

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