

The International Comparative Legal Guide to:

Corporate Recovery & Insolvency 2008

A practical insight to cross-border Corporate Recovery & Insolvency



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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 Cyprus Law a creditor may mortgage or charge any immovable property and pledge, lien or impose a floating charge on any moveable property. The difference between the legal mortgage and the fixed charge is that the property under mortgage is being transferred into the creditor's ownership with a right of redemption in case the loan or any other obligation will be settled, and then the property will be reconveyed. The fixed charge gives certain legal rights as security without any transfer of the ownership. The pledge on a moveable gives the lender the right to sell the item in his possession, but without having the ownership of the goods. The moveable under a contractual or equitable lien gives the right to the debtor to possess the items until the debtor pay its debts, but without the right to sell them. A floating charge is a security over all of the assets of the debtor which "floats" until the event of a default and transforms the floating charge into a fixed charge. In case of a company, the creditor also has the option to appoint a receiver in order for the creditor to satisfy its secured claim.

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

The directors of the company have the duty to act in favour of the interests of the company, its shareholders and to its creditors once the company becomes insolvent. Transactions carried out undervalue or with the purpose to defraud the creditors of the company, making any of its assets unreachable to its creditors are vulnerable to be declared null and void. The same will result in the case of giving away any of the assets or shares of the company after an order of winding-up from the court has been issued.

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?

A personal liability of the directors may occur in the event that a director continues to trade with the intention to defraud the company's creditors. Articles 307-310 of the Companies Law indicate when any officer of a company is liable under certain circumstances. A director may incur a penalty of up to two years imprisonment. Criminal liabilities may also occur.

1.4 Is it common to achieve a restructuring outside a formal procedure in Cyprus? In what circumstances might this be possible?

Formal procedures lack the flexibility that many companies in financial difficulties would like. Nowadays the need of simplicity, effectiveness, and a smooth and quick resolution of any corporate financial difficulties that may arise, is essential for the successful continuance of the company's tasks and ongoing projects. A private agreement following negotiations with all the company's creditors is the way to avoid the complicated and time consuming formal procedures.

2 Formal Procedures

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

The Cyprus Companies Law recognises three formal procedures for companies in financial difficulties:

- a) a reorganisation plan of the company and/or a settlement between the company and its creditors may be effected following the approval of the Court;
- b) voluntary liquidation by the members or the creditors; and
- c) liquidation by the Court/monitored by the Court.

A company in financial difficulties may implement and propose to its shareholders a reorganisation plan. Two companies may be merged or a new company may be incorporated with new desirable tasks and a new financial strategy. The old company will be dissolved and its liabilities will be transferred to the new company. The current shareholders will be given shares in the new company and the new arrangement and reorganisation plan will be sent for approval by the old shareholders in separate general meetings for shareholders of different classes of shares. Provided that the reorganisation scheme receives the shareholders' approval, a petition for approval of the plan to the Court will be followed and an order will be issued to that effect. The above way gives a company in financial difficulties the flexibility and a chance to restructure its sphere of business tasks and objectives and to take advantage of a new chance for a more productive and better designed corporate financial policy.

The members of a company may decide that the best solution to the financial difficulties they face is to voluntarily dissolve the company. That is the case when the company is solvent and the members are of the opinion that the company will be able to repay its creditors in 12 months, from the date specified on the resolution for the

dissolution. On the other hand, if the members believe that the company will be unable to satisfy its creditors, the winding-up of the company must be undertaken by them. Either way an administrator will be appointed in order to liquidate the assets of the company and satisfy its creditors.

The Court may issue a liquidation order of a company followed by a petition filed by a creditor, the company, a contributor, the Official Receiver and/or the General Attorney. In practice, the most common phenomenon is for a creditor to file such a petition if he has already served the company with a formal signed letter, claiming his money. The letter must be given to the company's registered office address 21 days before the filing of the petition. If the company fails to satisfy the creditor, then the right to apply to the Court is being granted by the Law. The Court examines the petition for liquidation and if it is of the opinion that the company is unable to pay its debts, then issues a liquidation order for the satisfaction of the applicant creditor.

2.2 What are the tests for insolvency in Cyprus?

Cyprus law prefers the term "inability to pay its debts" to describe an insolvent company. Article 212 of the Cyprus Companies Law refers to three occasions where a Cypriot company is considered unable to pay its debts:

- a) In the case the company owes more than 855 Euros to a creditor, a creditor may claim the debt by sending a formal signed letter to the registered office address of the company. After 21 days and if the creditor has not still received his money, he may apply to the Court asking the Court to issue a liquidation order against the company.
- b) If a writ against assets of the company returns back to the Court unsatisfied the company is considered unable to pay its debts.
- c) The Court takes into account the company's present and potential future liabilities and, if it believes that it would be difficult for the company to pay its debts, the company is officially considered incapable of paying off its debts.

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

a) Reorganisation plan/scheme

There is no formal requirement for a company to enter into that procedure. The company may decide at any moment that it is in its best interest to reorganise the structure of the company and to apply a new financial policy towards its creditors and its future liabilities.

b) Voluntary liquidation

As mentioned above either the members of the company or its creditors may liquidate the company voluntarily. If the directors of the company are in the position to make a declaration of solvency, then the creditors must be satisfied in a period not exceeding 12 months from the date of the declaration. If such statement is not possible the creditors will take control of the company and the liquidation process. In both procedures an administrator is appointed and given the responsibility of managing the liquidation process.

c) Liquidation by the Court/monitored by the Court

The Court may issue a liquidation order followed by a petition filed by a creditor, the company, a contributor, the Official Receiver and/or the General Attorney or if any of the requirements of the Companies Law Article 211 is met. The most common circumstances under which the Court issues a liquidation order is either in the case of a voluntary liquidation as explained above or if a creditor applies to the Court for a debt above 855 Euros. The

Court will decide if the company is unable to pay its debts and, if it is of the opinion that it is fair to dissolve the Company, will issue a liquidation order appointing an administrator responsible to liquidate the assets and satisfy the creditors.

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

a) Reorganisation plan

Either the members of a company or its creditors will agree to a reorganisation plan compromising their claims. The members of the company, in separate general meetings of different classes of shareholders approve the plan; then it is up to the Court to sanction the plan and to bind the company and its creditors with the new reorganisation structure and policy.

b) Voluntary liquidation by the members or the creditors

In a general meeting the members will vote in favour of the dissolution of the company. The directors will declare that the company is solvent and capable to cover its debts in a period not exceeding 12 months from the date of the meeting. An administrator will be appointed by the members who will be responsible for liquidating the assets of the company and paying the creditors. In case the creditors are of the opinion that the company is unable to pay its debts in 12 months, a general meeting of the members and the creditors of the company is convened and a resolution liquidating the company and appointing an administrator is passed from both the creditors and the members.

c) Liquidation by the court

A creditor, the company, a contributor, the Official Receiver and/or the General Attorney may file a petition of liquidation to the Court. The Court will examine if any of the cases the Article 211 of the Cyprus Companies Law applies and will issue the liquidation order. The Court may proceed with the liquidation of a company in his own right.

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

a) Reorganisation plan

The company must convene a general meeting and the reorganisation plan or the settlement with its creditors must be voted by the members (shareholders) in separate general meetings for shareholders of different classes of shares. Then a petition must be filed to the Court to issue the relevant order in order to bind the company and its creditors. The Court will notify the Registrar of Companies (a public authority responsible of incorporating companies in Cyprus and a filing service) to merge the files of the two restructured companies.

In case the old company will be dissolved and a new one will be incorporated, a general meeting of the members is required and a resolution appointing an administrator and liquidating the company is required. The administrator will liquefy the assets and satisfy the creditors. A last general meeting will be convened to inform the shareholders of the old company and to send the relevant notices to the Registrar of Companies. The administrator in any case must always notify the Registrar of Companies and the Official Receiver about his appointment.

b) Voluntary liquidation

As already mentioned above, a voluntary liquidation may take place either by the members or the creditors of the company. In the case of the voluntary liquidation by the members a declaration by the directors five weeks before the general meeting of the company,

stating that the company is capable of paying its debts in the following 12 months, must be sent to the Registrar of Companies. The director's declaration will follow a general meeting of the members in which the resolutions for liquidating the company and appointing an administrator will be passed. Copies of these resolutions must be sent to the Registrar of Companies.

The liquidation may be undertaken by the company's creditors. If the directors are of the opinion that the company is unable to pay its debts in the following 12 months, the liquidation may be initiated by its creditors. A meeting of the creditors must be convened the same day with the general meeting of the company. A notice of the meeting to the creditors must be sent the same day with the notice of the general meetings by the members. There is a requirement by Law that the notice of the creditors' meeting must be published in the official gazette of the Republic, as well as to two local newspapers of the town the registered office of the company is located. Copies of the resolution appointing a shareholder and liquidating the company must be sent to the Registrar of Companies and the Official Receiver. The administrator must always notify the Registrar of Companies and the Official Receiver about his appointment.

c) Liquidation by the Court

The Court will serve the liquidation order to the Company and inform the Registrar of Companies and the Official Receiver that a liquidation order has been issued against the specific company.

3 Creditors

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

There is a common principle met in all reorganisation or liquidation procedures. There is a hierarchy of priorities in the distribution and satisfaction of the creditors. Unsecured creditors are in the lowest rank in that hierarchy of priorities. An administrator either appointed by the Court, the members or the creditors will satisfy first the secured creditors. If liquefied assets remain available then the unsecured creditors will be satisfied. An unsecured creditor may initiate an action for recovery against the company to the Court and if such judgment is obtained then he may enforce it like any other civil judgment. Unsecured creditors may have a better chance to get satisfied in a case where directors make a declaration of solvency according to which the entire company will satisfy all the creditors.

3.2 Can secured creditors enforce their security in each procedure?

Secured creditors must use their right to enforce their security wisely. They may enforce their security in the case where a company is to be liquidated. Their security has a certain value and if it is liquidated and the value of the security exceeds the amount of the debt then the creditor will be fully satisfied. The remaining balance will be credited to the assets of the company and used by the administrator to satisfy other liabilities of the company. If however the value of his security is less than the value of the debt then the secured creditor will receive the amount of the value of his security and will be ranked as an unsecured creditor for the remaining unpaid debt. It is up to the creditor to estimate the value of his security in order to decide what measure is most suitable for his case.

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

Articles 198-200 of the Cyprus Companies Law regulate the procedure of setting off sums owned by creditors to the company against amounts owed by the company to them in each procedure. Article 198 of the Cyprus Companies Law enables the creditors to achieve a set off with the company disregarding the fact that the 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 the creditors to whom the set off arrangement is being proposed. If three-quarters of the creditors present accept the proposal for set off, then the Court's approval will follow. If such an approval is obtained then the proposal becomes binding for the company and for all the members of the affected class of creditors. Related are the Articles 204(g) and 246 of the Companies Law.

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.

In case the company decides to apply a reorganisation plan the directors remain in control of the company. The services of an administrator or a liquidator are not needed so the management of the company remains in the hands of the already appointed board of directors who are obliged to manage the company according to the approved plan. The shareholders' rights remain unaffected unless the approved scheme provides differently.

The situation is different when an administrator, a receiver or a liquidator has been appointed. The administrator, the receiver and/or the liquidator is in charge of the company; working towards the task he was appointed. The powers of the board of directors are not in force; neither are the shareholders' rights.

4.2 How does the company finance the procedures?

The Board of Directors of a company in financial difficulties will seek further funding, if it's needed, from its current sources of funds and lenders, informing them that they are in the process of reorganisation or under liquidation. The costs of the liquidation process are covered from the liquidated assets of the company.

4.3 What is the effect of each procedure on employees?

There is no direct impact on employees in case a reorganisation plan is applied. It may be a term of the arrangement that their status will remain unaffected or altered according to the terms of the agreed scheme.

The administrator though has the power to terminate the contracts of the employees who in his opinion are inconsistent with his actions and duties as such.

Upon the issue of the liquidation order by the Court the employees of the company are considered to be automatically dismissed.

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?

The company that has entered into a voluntary arrangement or a

reorganisation plan will suffer no impact on the contracts already entered into, unless there is a different arrangement according to the terms of the agreed scheme of arrangement.

The contracts entered into by a company in administration or liquidation will not be terminated by entering into the procedure itself. It is very common, however, for a contract to be terminated by default upon the commencement of administration or liquidation. The liquidator has the right (an administrator does not) to cancel unilaterally an “onerous” contract in order to fulfill his duties and proceed with the liquidation of the company. If from that action losses of the other party occur, then the damaged party may claim its losses during the winding up.

5 Claims

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

There is no preconfigured method whereby a creditor may claim the money owed to them if the company has followed a reorganisation plan or a voluntary arrangement scheme. The money will be returned to the creditors according to the terms of the mutual voluntary arrangement, plan or settlement.

The creditors may claim the money owed to them in an administration process or under liquidation by proving their debts. An administrator may distribute to secured and preferential creditors having the court's approval. An unsecured creditor though, whose services are critical to the continuation of the administrator's duties, may press to get paid and the administrator has the power to effect that payment.

Whereas a liquidator has been appointed the creditors must send to the company a formal claim in order to prove their debts. The liquidator is obliged to send forms of proof to every known creditor and it must be submitted back to him with all their proofs for any kind of claim they have - present or future. Those forms of proof will be examined by the liquidator, who must decide if he accepts, rejects or requires more information and details about certain claims. In case he rejects a claim he must give in writing the reasons he rejected the claim. Only proved claims may be paid by the liquidator. An unsatisfied creditor may apply to the Court if the liquidator did not accept the proof of his debt.

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

As mentioned above, when a company enters into a voluntary arrangement or a reorganisation plan the creditors are paid according to the terms and conditions they have agreed and approved. It must be noted though that the rights of the secured and preferential creditors remain intact.

Article 300 of the Cyprus Companies Law indicates the ranking of claims in a company under an administration or liquidation, which are the following:

- a) the administrator's costs and expenses occurred from his duties as such;
- b) any preferential debts;
- c) secured creditors by a floating charge;
- d) any unsecured creditors; and

- e) amounts owed to members such as declared dividends but not paid.

There are some preferential claims which must be paid before any other claims such as local and governmental taxes imposed 12 months before the date of the liquidation and sums due to employees such as wages, compensations for injuries, accidents and holiday pay.

5.3 Are tax liabilities incurred during each procedure?

There is a general principle applicable on each procedure. The company is not tax liable for entering each procedure. The company is liable to pay tax on profits gained during each of the above mentioned procedure.

6 Ending the Formal Procedure

6.1 Is there a process for “cramming down” creditors who do not approve proposals put forward in these procedures?

We may say that a “cramming down” of creditors is met only in the voluntary arrangements and when a reorganisation plan is implemented. On those procedures the dissenting majority is obliged to accept the arrangement voted by the majority. There are, however, several protections for the minority, which may be applied accordingly.

6.2 What happens at the end of each procedure?

Whereas there is a successful implementation of the voluntary arrangement or the reorganisation plan, the board of directors and shareholders continue to enjoy their rights under the new status of the company. There is a great possibility, however, that the voluntary arrangement or the reorganisation plan may fail and the company will have to enter into other procedures such as liquidation.

An administrator may end the administration if it is of the opinion that his task has been achieved and in such case he will return control to the company directors. He may also wind-up the company in order to distribute the company's assets or to dissolve it if there are no assets for distribution.

A company under liquidation is considered to be dissolved after three months of the final creditors' meeting.

7 International

7.1 What would be the approach in Cyprus to recognizing a procedure started in another jurisdiction?

Any proceedings opened in an EU member state are recognisable in any other member state from the time the judgment becomes effective in the Member State where the proceedings started. Cyprus being a Member State is obliged to follow the directives and legislation of the European Union. Relevant is the European regulation 1346/2000.

If the proceedings opened in a non-Member State any judgment obtained abroad must be validated in a Cyprus Court. It is advisable to initiate such procedures directly in Cyprus Courts to avoid loss of valuable time and money.

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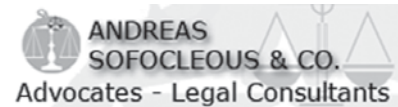
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Andreas Sofocleous & Co. was founded by Mr. Andreas Sofocleous in 1995. The firm nowadays is one of the most successful Corporate and Commercial law firm in Cyprus. Headquartered in Limassol and with offices in Eastern Europe and UK, the firm provides legal services for individuals and companies at national and multinational levels across a wide range of industries, dealing with mergers and acquisitions, cross-border transactions, joint ventures, intellectual property licensing, as well as company formation and management and other business arrangements.

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