HARNEYS

Overview of the Cyprus examinership regime

The near collapse of the Cyprus economy back in 2013 was the instigator for the introduction of a new generation of amendments into the Cyprus companies' legislation (Cap. 113) providing for a new array of tools which could be utilised with the intention of protecting businesses and buttressing the economy from the then expected adverse consequences a potential depletion of liquidity brought about by the 2013 banking crisis could have on them. Those same tools stand now at the ready to be used by businesses to tackle the difficulties presented to them by the COVID-19 and the new ensuing global recession following in the pandemic's wake.

The aforementioned amendments introduced the examinership procedure which is essentially a rescue process and tool (the Examinership Procedure). This process is designed to save potentially viable companies by facilitating their survival in a manner that is not unfair to the parties involved including importantly, the creditors as a whole. At the same time, it attempts to avoid or defeat, where possible, receivership and winding up, both of which work more in favour of the secured creditors. In short it purports to strike a balance among the creditors based on the idea that the fate of a company and those who depend on it (including employees) should not rest solely in the hands of secured creditors to the disadvantage of those less protected. The examinership procedure is not however designed to save or help shareholders whose investment has been unsuccessful.

Overview

The Examinership Procedure gives a company facing insolvency a period of protection from its creditors in order to facilitate its survival as a going concern. They provide for a statutory period in which some form of compromise with creditors can be reached. The company is placed under the court's protection for a limited period while its affairs are assessed by the examiner, during which the examiner ascertains whether or not the company is capable of being rescued. If a rescue is possible, the examiner must bring forward a rescue plan.

Protection

The company is placed under the court's protection for an initial period of four (calendar) months from the date of the presentation of a petition. The protection period ends if the petition is withdrawn or dismissed. If protection is granted, the examiner is required to put together proposals for a scheme of arrangement. The examiner may apply for an extension of a further 60 days to finish the report. Therefore, the maximum protection period is six (calendar) months. After the presentation of the report, the court may extend the protection period further in order to decide on the report (ie whether to approve a scheme of arrangement or not).

The court petition may be presented by:

- The company;
- A creditor or a contingent or prospective creditor (including an employee) of the company;
- A member or members of the company (holding at least 10 per cent in its paid up voting share capital); and
- A guarantor under a guarantee made pursuant to Cyprus contracts legislation (Cap149).

The petitioner has a duty to exercise utmost good faith in the preparation and presentation of the petition.

Preconditions to the examiner's appointment

There are a number of preconditions for an examiner to be appointed.

- The company must be unable to pay its debts or must be likely to be unable to do so;
- No resolution has been passed and published in the Cyprus Gazette for the voluntary winding-up of the company;
- No order must have been made for the winding-up of the company by the court; and
- No receiver must have been appointed to the company for more than 30 days.

The first precondition to the examiner's appointment (Precondition 1) is met if:

- The company is unable to pay its debts as they fall due;
- The value of the company's assets is less than its actual, contingent and prospective liabilities;
- A creditor having made a demand in writing that a sum exceeding €5.000 be paid and the company has neglected to pay the sum or satisfy the creditor; or
- A judgment or other court order has been made in favour of a creditor and it remained unsatisfied in whole or in part.

Obtaining significant extensions on the payment of debts will imply that Precondition 1 has been met.

The examiner (as in the case of a receiver and liquidator) must be an individual qualified as an "insolvency practitioner."

Examiner's appointment

The court has the power to appoint an examiner where there is a reasonable prospect of survival of (both):

- The company
- The whole or any part of the company's undertaking as a going concern

A proposal to sell off the company's business and assets does not meet the above test as there is no prospect of survival of the whole or part of the company's undertaking as going concern; the whole or part of the undertaking of the company must remain with the company.

The power of the court to appoint an examiner may be exercised once the court becomes satisfied that there are reasonable prospects of such survival. This power is discretionary thus the petitioner is not entitled to have an examiner appointed. As a part of this discretion, the court may also consider whether one or more creditors will be prejudiced as a result of an examiner being appointed. The interests of the employees may also be relevant to the court's decision. In making its decision, the court will consider the effects of the alternatives (a) of an examinership and (b) of a winding up. The independent expert is required to express an opinion as to whether saving the whole or any part of the undertaking will be more advantageous to the members as a whole and the creditors as a whole, than the alternative of winding-up.

The court will not consider having a receiver appointed instead of the aforesaid two alternatives. This is because the prime responsibility of a receiver is to protect the interests of the secured creditors and to realise the charged assets for their benefit. Instead, an examiner's role is wider and takes broader considerations into account, such as the interests of employees (who are also less protected as contingent or future creditors).

The examiner may resign, or be removed by the court and the court may fill the examiner's vacancy.

Independent expert's report

The petition must be accompanied by an independent expert's report. Such an expert may be the auditor of the company or an "insolvency practitioner." The expert also has a duty of utmost good faith in the preparation of the report.

The main object of the report is to inform the court whether or not the company has a viable future and if so, the necessary steps (including possible arrangements) to achieve this. The expert is expected to express opinions and give recommendations on a number of matters including the statutory matters listed in the Examinership Procedure.

Any opinions expressed should be based on evidence. Optimistic yet unjustified or unsupported projections for success do not amount to a demonstration of an identifiable possibility of survival. Practically the auditor of the company should generally be in the best position to prepare the report.

The report does not bind the court albeit it will influence the court. The level of influence depends on the degree and extent to which the expert supports his/her opinions with his/her own objective reasoning or justification and his/her appraisal of the material factors relied upon for reaching his/her conclusions.

Related companies

The court may also appoint an examiner to any related company of the company named in the petition being a subsidiary or holding or associated company (related company). This complements the protection afforded to the company named in the petition as it prevents attack against any related company. The court must be separately satisfied that there are reasonable prospects of survival of the related company. It seems that save in the case of Precondition 1, the rest of the preconditions to the examiner's appointment need to be satisfied in relation to related companies.

The examiner appointed for at least two related companies will have the same powers in relation to each such company, but the examiner must exercise these powers separately in relation to each such company unless the court orders otherwise. The examiner may not formulate proposals which would have the effect of impairing the interests of creditors of the original company in a manner which favours the interests of the creditors or members of a related company. If an examiner is appointed to a company and at least one related company:

- Separate proposals for schemes of arrangements would be required to be prepared for each company in the group under examination;

  Each set of proposals for each company would be interdependent on others, in that the ultimate approval of each proposal would be conditional on the approval of all the other proposals; and

- Each creditor would be furnished copies of all the proposals in respect of all the companies in the examinership but the creditor will only vote (cf. to heading on "Acceptance of proposals at meetings" below) on the proposals relating to the company (or companies) which is (or are) in debt, or liable, to the creditor.

Unless a particular treaty is in place between Cyprus and another country or state which is not a Member State of the EU or a member of the Commonwealth, the statutory protection is unlikely to extend to assets or subsidiaries situated in that country or state; if such a related company is not a Cyprus company and has no assets in Cyprus, then there is no connection to Cyprus.

Effect of protection

During the protection period the creditors may not pursue the remedies which they, until now, have normally pursued against a debtor company. No petition to wind-up the company can be brought. If there is an outstanding winding-up petition at the time of the presentation of the petition to appoint an examiner, both petitions should be heard together, and if the court decides not to appoint an examiner, it may make a winding-up order. The court will not appoint a receiver once a petition to appoint an examiner has been presented. If a receiver has been appointed for 30 days or less, the court may direct the receiver to cease to act or to act only in relation to particular assets. Furthermore no action can be taken to realise any security, or enforcement be made in relation to company assets, without the examiner's consent.

Similarly, proceedings may not be initiated against any guarantor (or other third person) to pay any company debt during the protection period. Although it would seem that generally, the creditor could serve a demand on the guarantor to pay pursuant to the guarantee, the guarantee cannot during the protection period, be enforced. If the guarantor does pay up pursuant to the guarantee, the guarantor ceases to be a contingent creditor and becomes an actual one.

Creditors with retention of title rights over property (usually stock in trade) in the company's possession are prohibited from recovering their goods without the consent of the examiner.

No legal proceedings can be brought on grounds of oppression under Cap113, and any other proceedings in relation to the company cannot be commenced without leave of the court. The company may not pay any of its pre-emption debts during the examinership process unless this is recommended in the independent expert's report, or if the court sanctions such a payment on the application of the examiner, creditor or member. The court must be satisfied that failure to make the payment will considerably reduce the prospects of the survival of the company or the whole or any part of its undertaking as a going concern. Pre-petition liabilities may be paid to employees (their salaries in arrears) or to essential suppliers (such as electricity, water, and telephone).

Examiner's powers

Once appointed, the examiner is vested with the rights and powers of the auditor of the company. These enable the examiner to formulate proposals for saving the company.

The court may give the examiner additional powers including all or any of the directors' powers (management and borrowing) and/or the liquidator's powers. The examiner is not (unless vested with the powers of directors) an agent of the company. The examiner will nevertheless be personally liable on any contract entered into by him/her (in the name of the company or as an examiner) in the performance of his/her functions. He/she is also entitled to an indemnity out of the assets of the company. The examiner (as in the case of any company officer) may be sued for breach of duty.

The examiner's primary duty is to the court and to comply with the statutory obligation to examine the company and, if appropriate, formulate and bring forward proposals for a scheme of arrangement. The examiner may have to balance a range of interests imposed by the Examinership Procedure or which are required by the court. However, the examiner may apply to the court to determine any question arising in the course of his/her office, or in the exercise of any powers afforded to him/her. This right gives adequate protection to the examiner as it is hardly possible (if at all) to hold him/her liable for implementing the directions of the court.

Expenses of examinership

Certain liabilities incurred by the company during the examinership may be certified as "expenses properly incurred" by the examiner and as such enjoy preferential status once the remuneration, costs and expenses of the examiner are sanctioned by the court. Simply put, post-petition liabilities may be paid in preference to certain creditors. Nevertheless, such expenses and costs are subject to the discretion of the court.

In certifying post-petition liabilities, the examiner should exercise care and professional expertise. If the directors continue to manage the company during examinership and

propose to incur liabilities the examiner should require the directors to submit their proposals and justify themselves to the satisfaction of the examiner that such liabilities will contribute to the survival of the company during the protection period. The court will potentially sanction liabilities certified by the examiner such as employees' salaries/wages, supply of raw materials and the payment of utilities (eg telephone/water/electricity bills). These liabilities may well be contested at a costs hearing and therefore the examiner should certify these in writing referring also to the relevant statutory conditions of the Examinership Procedure.

Fixed and Floating Charges

The examiner may apply to the court for permission to dispose of charged property or any other security such as retention of title over goods where that would facilitate the survival of the company. The holder of the security must be given notice of the application. If a receiver has been appointed by the holder of a floating charge before the appointment of the examiner, the floating charge will "de-crystallise" upon the examiner's appointment.

Where such charged property is disposed of, a charge-holder's priority is preserved. This is achieved by making any disposal of secured property conditional upon the net proceeds from the disposal being applied towards discharging the creditors secured by the property so disposed.

Power to repudiate contracts

The examiner has power to take any steps to halt, prevent or rectify the effects of any actual or proposed act, omission, course of conduct, decision or contract taken by or on behalf of the company or any person in relation to the income, assets or liabilities of the company which were created before the appointment of the examiner, if the examiner is of the opinion that any of these is or is likely to be detrimental to the company or any interested party. The examiner cannot however repudiate a contract entered into by the company before the appointment of the examiner except in relation to any contractual term prohibiting the company to borrow or obtain credit or create security over company assets (negative pledge). The dis-satisfied creditor may apply to the court as an interested party to consider whether the examiner's proposed action to override the contract or term was necessary in the circumstances.

The company may also repudiate contracts, with the sanction of the court, for the purpose of formulating proposals for a scheme of arrangement.

Formulating proposals for scheme of arrangement

The examiner is required to formulate proposals for a compromise or a scheme of arrangement as soon as practicable after appointment and report to the court within 60 days or such longer period as the court may allow.

The examiner is unrestricted in formulating a suitable scheme of arrangement. The company officers have duty to provide reasonable assistance to the examiner in the performance of his/her functions.

If at any stage in the course of the examinership it becomes apparent to the examiner that it is not possible to rescue the company, the examiner should immediately bring this to the attention of the court. Failing to do so may have a negative impact on the examiner when applying to have his/her remuneration, costs and expenses sanctioned by the court.

Members' and creditors' meetings

The examiner may convene meetings of members and creditors and may appoint a committee of creditors. The purpose of these meetings is to approve, reject or modify the examiner's proposals. The proposals presented at the meetings must specify the classes of members and creditors and indicate the classes whose interests will be impaired and the classes whose interests will not be impaired.

Classification of members & creditors

Members will generally be divided in accordance with the class of shares they hold (eg ordinary shares and preference shares).Creditors will generally be divided into preferential, secured and unsecured creditors, and further (depending on the circumstances) divided into other categories such as contingent creditors.

The principles applicable for distinguishing classes may give rise to litigation. It is submitted that the court may potentially adopt either of the following principles in the context of examinership:

- The classes must be constituted in a manner to avoid confrontation and injustice and that individuals can only be classed together where their rights are not dissimilar as to make it impossible for them to consult together with a view to their common interest.

- Inclusion of certain creditors or shareholders in a class had to result in others in that class suffering actual rather than potential prejudice before the constitution of the classes would be set aside.

The individual position of the creditors and members within their relevant classes must also be considered. A particular creditor or member may object on the ground that the scheme affecting such creditor's or member's designated class would unfairly prejudice the objector's interests. If the objection is sustained, the court will not give its sanction to the scheme. While the objector's class in general may be getting a fair and equitable treatment, the particular circumstances of the objector may render that treatment unacceptably harsh.

The responsibility for designating and constituting the classes lies in the first instance with the examiner.

Acceptance of proposals

With regard to creditors, the examiner's proposals are deemed to be accepted if a majority in number and in value of the claims/creditors represented at the meeting, are in

favour of the proposals. If the proposals are rejected, the court will order the winding up of the company. With regard to members however, their lack of acceptance of the proposals will not determine whether the proposals will be approved by the court.

Guarantors' rights to vote

A creditor cannot enforce a guarantee or indemnity unless the creditor serves a notice to the guarantor offering to transfer to the guarantor any rights to vote at the creditors' meeting on the examiner's proposals. The notice must be given within 48 hours of the creditor receiving the notice calling the meeting. The guarantor may vote on the proposals according to the guarantor's own interests.

If the creditor fails to serve this notice, the creditor may not enforce by legal proceedings or otherwise the guarantor's obligation in the event (a) the examinership is successful and (b) the scheme is sanctioned by the court.

Examiner's report

The content of the report is statutory. The proposals for a scheme of arrangement to be sanctioned by the court should be appended to the report. The report should also include an account of the examinership costs to date in order to provide a full picture of the company's position post-examinership. Importantly the examiner should ensure to include in the report facts which either support or justify the opinions expressed. The court will give additional weight to any appraisal of facts or factors relied upon or reasons for the opinions expressed and recommendations made.

Court's confirmation

The court's confirmation of the proposals operates to bind the various parties affected by the proposals. Where the proposals cannot be adopted by the affected parties or where the proposed scheme is rejected by the court, the court will decide that the company be wound-up.

Conclusion

The Examinership Procedure gives some hope to businesses in financial difficulties under the current volatile environment of the Cyprus economy. It is not however an escape route by which companies can evade their creditors or liabilities. The Examinership Procedure attempts to give relief to promising yet financially cornered businesses for a certain period of time. This provides an otherwise unavailable chance to re-direct the fate of the company, kick off a new start and ultimately prevent its failure and associated effects on the wider economy. This is a tool that used correctly and in a timely manner has great potential in assisting businesses navigate safely through the treacherous, dark waters of the COVID-19 pandemic and mitigate the impact a new global financial crisis could have on them.

For more information and key contacts please visit **harneys.com**