

# **BANKRUPTCY AND A FRESH START: STIGMA ON FAILURE AND LEGAL CONSEQUENCES OF BANKRUPTCY**

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# **BANKRUPTCY AND A FRESH START: STIGMA ON FAILURE AND LEGAL CONSEQUENCES OF BANKRUPTCY**

## **TITLE 1. INTRODUCTION**

In Belgium distinction is made between insolvency procedures for traders (company or individual) and non-traders (individuals/consumers).

Traders who ceased their payments and lost their creditworthiness may be declared bankrupt by the court. A formal bankruptcy procedure will apply, that is aimed at the liquidation of the bankrupt trader. The law relating to bankruptcy is to be found in the Belgian Bankruptcy Law of August 8, 1997.

Traders who are temporarily unable to pay their debts but for whom economical recovery is possible may benefit from a formal rescue mechanism, which is to be found in the Law on Judicial Composition as amended on July 17, 1997.

For insolvent non-traders (individuals) a new ‘procedure of collective settlement of debts’ was introduced in the Belgian law on July 5, 1998. By this procedure a debtor (only non-trader individuals) can make a proposal to his creditors for a rescheduling or arrangement of his debts which, if approved by all the creditors or the court, binds all creditors. The court appoints an insolvency practitioner (known as ‘*Mediateur de dettes/schuldebemiddelaar*’) for the purpose of supervising and implementing the arrangement. This is however not a formal bankruptcy procedure. The application can only be made by the debtor, and it focuses essentially on a plan of rescheduling debt.

The two main insolvency procedures for traders: bankruptcy and judicial composition are set out in Title 4 and 5. The procedure of collective settlement of debts is only applicable to non-trader debtors, and will therefore not be further considered in this report.

## **TITLE 2. DEFINITIONS AND TERMINOLOGY**

For the purposes of the report, the following terms shall have the meaning set forth below:

### **Chapter 2.1. General**

**“Trader”:** means individuals or companies performing trade activities as their main or subsidiary occupation (Article 1-3 Code of Commerce);

**“Provisional Administrator”:** means a person appointed by the court to accomplish a specific mission for a company or

to replace its management (*administrateur provisoire/ voorlopig bewindvoerder*);

**“Ad Hoc Representative ”:** means a person appointed by the court to accomplish a specific mission for a company (*mandataire ad hoc/lasthebber ad hoc*);

## Chapter 2.2. Judicial composition

**“Law on Judicial Composition”:** means the Belgian Law on Judicial Composition (*“Loi relative au concordat judiciaire du 17 juillet 1997/Wet van 17 juli 1997 betreffende het gerechtelijk akkoord”*);

**“Judicial Composition ”:** means a moratorium from making payments to creditors granted by the court, during which a recovery plan must be drawn-up that must be submitted to the creditors and ultimately the court and must lead to the recovery of the financial situation (*“concordat judiciaire /gerechtelijk akkoord”*);

**“Administrator ”:** means a person appointed by the court to assist and supervise the Judicial Composition procedure (*“commissaire au sursis/commissaris inzake opschorting”*);

## Chapter 2.3. Bankruptcy

**“Bankruptcy Law ”:** means the Belgian Bankruptcy Law (*“Loi sur les faillites du 8 août 1999/Faillissementswet van 8 augustus 1997”*);

**“Bankruptcy ”:** means formal insolvency procedure whereby a receiver is appointed for the purpose of collecting in and realising the assets of a trader and distributing the realisations to satisfy, in so far as possible, its liabilities. (*“faillite/faillissement”*);

**“Receiver ”:** means a person appointed and controlled by the court to manage the bankruptcy. The receiver’s duty is to collect in and realise the assets of the bankrupt trader and distribute the realisations to

satisfy, in so far as possible, its liabilities (“*curateur/curator*”).

### **TITLE 3. WARNING LIGHTS AND PREVENTION OF INSOLVENCY**

The amended law on Judicial Composition of 1997 introduced a procedure aimed at detecting traders with financial difficulties at an early stage. The commercial court systematically gathers data concerning traders facing financial difficulties: e.g. tax arrears, court orders, seizures, etc<sup>1</sup>. A file containing these data is kept at the clerk of the commercial court, which can be consulted by the concerned trader and the public prosecutor (not by creditors or other third parties). On the basis of the gathered information, special divisions within the commercial court may start an inquiry. The trader will be heard by the court on his financial difficulties and will be able to defend himself, eventually assisted by his consultant (e.g. accountant or lawyer). Finally such inquiry can lead to Bankruptcy or Judicial Composition in so far the conditions for these insolvency proceedings are fulfilled.

The objective of this system of “data-collection” and subsequent “trade inquiry” (“*Enquêtes Commerciales/Handelszonderzoeken*”) by the court is to try to monitor the financial situation of traders in order to detect businesses in difficulties as early as possible and to guide them towards the right type of insolvency procedure. The court’s duty is however not to act as a consultant for the trader. Its only mission is to detect traders with financial difficulties and to investigate the seriousness of these difficulties. The decision to petition for Bankruptcy or Judicial Composition remains a responsibility of the traders or ultimately the Public Prosecutor.

The benefit from these trade inquiries by the commercial court is that traders are urged to take precautionary measures in time, so that they do not have to be heard by the court. Moreover when a trader has to answer to a competent neutral third party (i.e. judge) for his financial difficulties, this can have positive effects.

### **TITLE 4. LEGAL POSSIBILITIES TO CONTINUE ECONOMIC ACTIVITIES**

Traders facing temporary financial difficulties but for whom economical recovery is possible may benefit from a formal rescue mechanism, which is to be found in the Law on Judicial Composition as amended on July 17, 1997.

#### **Chapter 4.1. Judicial Composition**

##### ***§ 1. Description of the regime and its underlying philosophy***

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<sup>1</sup> Some courts subscribed to online financial information service provides such as Graydon: “De Bloedkamer gaat on line” Trends, 6 September 2001.

## 1.1. Description

Judicial Composition is a formal insolvency procedure governed by the law of July 17, 1997 on Judicial Composition (“*Loi relative au concordat judiciaire du 17 juillet 1997/Wet van 17 juli 1997 betreffende het gerechtelijk akkoord*”) whereby a moratorium from making payments to creditors is granted by the court, during which a recovery plan must be drawn-up that must be submitted to the creditors and ultimately the court and must lead to the recovery of the financial situation.

The court will only grant a Judicial Composition if it is satisfied that the Judicial Composition is likely to achieve the survival of the company<sup>2</sup> or any part of its undertakings as going concern.

On the presentation of a petition for a Judicial Composition, a statutory moratorium on enforcement and proceedings comes into effect under article 13 of the Law on Judicial Composition. Once the court grants a Judicial Composition, the statutory moratorium is continued, for six months (extendible with another three months) in nearly identical terms under article 21 of the Law on Judicial Composition. During this period, the company must draw up a recovery plan to be submitted to the creditors and ultimately the court.

If the creditors approve the recovery plan by a simple majority in number and in value of creditors, the recovery plan takes effect and binds all the creditors, when sanctioned by the court.

## 1.2. Critical analysis

Judicial Composition is a procedure meant to prevent Bankruptcy. The procedure was thoroughly reviewed in 1997. Before the reformation of 1997, the procedure of Judicial Composition was governed by a law of 1946<sup>3</sup> and was almost never used<sup>4</sup>. The most important reasons therefore were: a compromise or arrangement between the company and its creditors required the agreement of a qualified majority of creditors; preferential creditors were not bound by the arrangement; there was no supervision over the company or change in the control over the company during the procedure; the company had to petition itself for the procedure<sup>5</sup>.

The reformation of 1997 aimed at creating a clear distinction between Judicial Composition and Bankruptcy: Judicial Composition intended for companies with continuation perspectives, and Bankruptcy, aimed at irrevocable liquidation of companies without chance of survival.

Four years after the reformation, it appears that – in practice – the legislator did not reach its aim.

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<sup>2</sup> Also traders individuals (not companies) can petition for a judicial composition.

<sup>3</sup> Regentbesluit 25 september 1946.

<sup>4</sup> Decrease of 132 in 1970 to 47 in 1985 (W. Van Gerven, *Handels- en Economisch recht*, Story-Scientia, p. 240).

<sup>5</sup> W. Van Gerven, *Handels- en Economisch recht*, Story-Scientia, p. 240.

Table 1<sup>6</sup> shows that there has been no significant decrease of Bankruptcies, whereas the procedure of Judicial Composition was seldom used.

**Table 1**  
**Judicial Composition versus Bankruptcies**

	Judicial Composition granted by the court	Ordered Bankruptcies
1998	177	6952
1999	167	5422
2000	140	6281
2001	126	7062

Table 2<sup>7</sup> shows that it is not always an efficient measure since most of the companies that worked under Judicial Composition were after all declared Bankrupt.

**Table 2**  
**Bankruptcy or liquidation of companies under Judicial Composition.**

	Judicial composition granted by the court	Judicial composition successful	Judicial composition followed by bankruptcy	Judicial composition followed by liquidation
1998	177	28 (14%)	134 (76%)	15 (8,5%)
1999	167	6 (3,6%)	124 (74%)	9 (5,4%)
2000	140	-	76 (54%)	4 (2,8%)
2001	126	-	37 (29%)	-

The reasons for this failure are, amongst others:

- ❑ Ignorance: companies are not aware of the possibilities offered by Judicial Composition proceedings;
- ❑ Negative publicity: the court order granting the Judicial Composition must be published in the Official Belgian Gazette and in two newspapers under article 17 of the Law on Judicial Composition. This publicity is harmful for the company: third parties (suppliers, customers, banks) become reluctant to do business with companies in Judicial Composition;
- ❑ Hesitation: Companies wait too long before applying for the procedure;
- ❑ Recognition: Companies (especially family owned companies) have difficulties to recognise, that their business is in difficulties;
- ❑ Expensive: Judicial Composition is rather complicated and often too expensive for small and medium sized companies. The company has to bear the fees of the Administrator(s) appointed by the court.

## § 2. Procedure

<sup>6</sup> E. DIRIX and H. COUSY, *Insolventierecht*, Themis, 2000-2001, p. 58-62; "Concordat et faillite. Bilan de la réforme et nouvelles modifications en 2001", GRAYDON, Studie 2 november 2001

<sup>7</sup> GRAYDON, *Studie 2 november 2001*

## 2.1. Description

Reference is made to paragraph 1, 1.1.

## 2.2. Critical analysis

Reference is made to paragraph 1, 1.2.

### **§ 3. *Criteria to benefit from the regime***

#### 3.1. Description

Under article 9 of the Law on Judicial Composition, a company may be allowed to Judicial Composition proceedings:

- (a) if the company is temporarily unable to pay its debts (i.e. it is facing a lack of cash), or
- (b) if the continuity of the company is threatened by problems, which may lead to a cessation of payments in the near future. With respect to the latter, it is presumed that a company's continuity is put at risk if, as a consequence of losses, the company's assets have fallen below half of the company's share capital.

The court will only grant a Judicial Composition if it is satisfied that the procedure is likely to achieve the survival of the company as going concern.

#### 3.2. Critical analysis

The criteria to benefit from Judicial Composition proceeding are intentionally flexible and wide. Such criteria tend to give the court large appreciation powers.

### **§ 4. *Initiators of the procedure***

#### 4.1. Description

Judicial Composition proceedings can in the first place be petitioned by the trader under article 11, §1 of the Law on Judicial Composition.

Under article 11, §2 the Public Prosecutor has the possibility to “launch” the procedure. The decision to enter into Judicial Composition proceedings remains however with the trader.

The law does not provide a statutory obligation to petition for Judicial Composition proceedings (even not when the procedure is ‘launched’ by the Public Prosecutor).

The Law on Judicial Composition does not provide the possibility for other parties (e.g. creditors, employees etc.) to initiate the procedure.

## 4.2. Critical analysis

Judicial Composition proceedings are seldom launched by the Public Prosecutor. It therefore depends on the voluntary cooperation of the debtor who, as explained above, often waits too long before initiating the procedure.

Certain Belgian authors are of the opinion that other parties (creditors, employees, etc.) should be granted the right to initiate Judicial Composition proceedings<sup>8</sup>. Such extension of the right of initiative would however go against the philosophy of the Judicial Composition procedure, which is not based on pressurizing the trader, but on his goodwill to petition for the procedure.

## § 5. *Restructuring plan*

### 5.1. Description

Once the court grants a Judicial Composition procedure, a temporary statutory moratorium on enforcement and proceedings comes into effect, for maximum six months (extendible with another three months) during which, the company must – assisted by the Administrator – draw up a recovery plan to be submitted to the creditors and ultimately the court.

The plan can specify various restructuring measures such as rescheduling of debts, social restructuring measures, transfer of branches of activities, changes in management structure, etc.

An important innovation in the Law of 1997 on Judicial Composition, is the extended binding effect of the regime. While under the old regime secured and preferential creditors were not bound by the recovery plan, this possibility exists under the reviewed law<sup>9</sup>. The recovery plan may affect the situation of the secured and/or preferential creditors, but depending on the proposed measures their individual approval may be required (e.g. suspension of payment of debts for more than 18 months, measures of debt relief etc.).

At the end of the temporary moratorium, the recovery plan is submitted to the creditors' vote and to the court's approval.

If the recovery plan is approved by a simple majority in number and in value of creditors, it takes effect and binds all the creditors, when approved by the court.

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<sup>8</sup> H. Braeckmans, E. Dirix en E. Wymeersch, *Faillissement en gerechtelijk akkoord: het nieuwe recht*, Kluwer, Antwerpen, 1998, p. 29.

<sup>9</sup> In Belgium we distinguish between (a) secured creditors whose claims against the debtor is secured by reference to some property owned by the debtor and which the secured creditor may arrange to have sold and to be repaid out of the proceeds; (b) preferential creditors who are entitled to be paid first (before the ordinary creditors); (c) ordinary creditors who are paid after the preferential creditors have been paid.

If the creditors or the court reject the plan, the court can under article 15, § 2 of the Law on Judicial Composition, assuming the company is insolvent, order the Bankruptcy of the trader.

An important innovation in the Law on Judicial Composition is the possibility to put the company into liquidation under article 33 of the Law. When the court rejects the plan, it can order the Administrator to convene a shareholders' meeting to decide upon the dissolution or putting into liquidation of the company. If the shareholders' meeting decides to dissolve and wind up the company, the procedure under article 181-195 of the Belgian Companies Code of May 7, 1999 will apply; the company's shareholders, in a meeting held before notary, will first place the company into liquidation and appoint a liquidator. The liquidator will sell the company's assets, pay its liabilities and distribute, in so far as possible, any surplus to the shareholders. When this is done, the liquidator convenes a shareholders meeting and submit his liquidation report (normally including a distribution plan) and financial statements. The shareholders consider the report of the auditor (if any), approve the documents submitted by the liquidator, and declare that the liquidation is completed.

The Law on Judicial Composition provides two other moments to opt for voluntary liquidation as an alternative for Bankruptcy (article 24 and 37): (a) the court orders the ending of the temporarily moratorium because the company does no longer meet the criteria to benefit from the regime; (b) the court orders the ending of the Judicial Composition procedure while the recovery plan is not being executed.

## 5.2. Critical analysis

The Belgian legislator introduced the above mentioned possibility for the court to opt for 'voluntary' liquidation instead of (or as alternative to) Bankruptcy – when Judicial Composition proceedings fail –, arguing that such procedure avoids the “unnecessary and social stigmatising publicity often given to bankruptcy proceedings.”<sup>10</sup>

The extended binding effect of the regime towards secured and preferential creditors was an important innovation meant at increasing the chances of success of Judicial Composition proceedings.

## § 6. Administration of the procedure

### 6.1. Description

The court will appoint an Administrator whose primary duty is to assist and supervise the company during the Judicial Composition proceedings. It is very important to emphasize that the powers of the directors do not cease and that the Administrator does not take over the control of the company. However under article 15, §1, 2 of the Law on Judicial Composition, the court can prescribe that the trader has no power to carry on its business to a certain extent, without the sanction of the Administrator. The

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<sup>10</sup> *Memorie van Toelichting (G.A.)*, p. 35-36; uiteenzetting van de Minister in *Verslag Vandeurzen I*, p. 17-18.

court could for example decide that the trader has no power to sell its real estate or branches of its activities, without the sanction of the Administrator.

The administrator has various specific duties: to report to the court on the process, to verify claims, to assist the trader with the drafting of the recovery plan.

The administrator is an agent of the court (*'gerechtelijk mandataris'*). Usually one or more lawyers and/or auditors are appointed to act as Administrator.

## 6.2. Critical analysis

Administrators charge on the basis of an hourly rate. The fees of the Administrator – to be paid by the company – are sometimes a stumbling block for small and medium sized companies<sup>11</sup>. Usually the companies in difficulties (have to) appoint advisors to project manage the process. The fee of the Administrator is then an additional cost.

## ***§ 7. The degree of protection of the actors implied in the procedure***

### 7.1. Description

During the Judicial Composition a statutory moratorium on enforcement and proceedings comes into effect.

Contracts entered into before the Judicial Composition will be continued under article 28 of the Law on Judicial Composition. Contractual clauses stipulating that the agreement will end if one of the contractors petition for Judicial Composition proceedings are null and void.

A separate position is given to 'new' debts, i.e. debts made during the Judicial Composition proceedings. These 'new' creditors do not fall under the moratorium. The purpose of this rule is encouraging contractors to carry on their business with the debtor in order to safeguard continuity of the company.

### 7.2. Critical analysis

N/A

## ***§ 8. Termination of the procedure***

### 8.1. Description

The procedure ends when the recovery plan has correctly been executed. Under article 35, 3 of the Law on Judicial Composition the debtor is [fully] and [definitely] [discharged] from all debts included in the plan. Under the old regime, the debtor was

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<sup>11</sup> H. Braeckmans, E. Dirix en E. Wymeersch, *Faillissement en gerechtelijk akkoord: het nieuwe recht*, Kluwer, Antwerpen, 1998, p. 228.

not [discharged] from all these debts, which was obstructing a permanent recovery of the company.

Other ways that lead to the end of the procedure is when the conditions to benefit from the regime are no longer or met or when it appears that the recovery plan is not being complied with.

## 8.2. Critical analysis

N/A

## ***§ 9. Information on the procedure towards creditors***

### 9.1. Description

The information towards creditors and other third parties is guaranteed by the following measures:

- ❑ the court order granting Judicial Composition proceedings is published in the Belgian Official Gazette and in two newspapers (article 17, §1);
- ❑ all creditors are informed of the procedure by the Administrator via registered mail (article 17, §2);
- ❑ a file with all elements of the procedure is kept at the court which can be consulted by all creditors or other interested parties (article 18).
- ❑ the hearings at the court (e.g. the vote on the recovery plan, etc) are public.

### 9.2. Critical analysis

As already mentioned the mandatory publicity requirements can have adverse effects. Current and potential contractors lose their trust in the company and become reluctant to carry on their business with the debtor, which of course puts the continuity of the company at stake.

## ***§ 10. Costs related to the procedure***

### 10.1. Description

The main cost of Judicial Composition proceedings is the fee of the Administrator.

### 10.2. Critical analysis

The cost of the procedure is often a stumbling block of small and medium sized companies.

## ***§ 11. Competence, knowledge and functioning of commercial courts***

### 11.1. Description

Judicial Composition proceedings are overseen by the commercial court. There are no specialized bankruptcy courts nor are Judicial Composition proceedings assigned to judges with specialized bankruptcy expertise.

Belgian commercial courts are, however, composed of three judges, one professional and two non-professionals with management expertise (“*Rechters in handelszaken*”).

### 11.2. Critical analysis

N/A

## § 12. *Publicity*

### 12.1. Description

See paragraph 9.1

### 12.2. Critical analysis

See paragraph 9.2

## **Chapter 4.2. Provisional Administrator**

In the years 1990 a tendency with the commercial courts grew to appoint Provisional Administrators in companies in difficulties, with the intention to, with the assistance of external professionals, avoid a Bankruptcy. Such Provisional Administrators – mostly lawyers and/or auditors – replace or assist the directors of the company.

This practice developed by the courts to replace an incompetent management in order to avoid bankruptcy, was heavily criticized by certain Belgian authors<sup>12</sup> stating that the existence of financial difficulties is, as such, not enough to appoint a Provisional Administrator<sup>13</sup>. It is feared that the formal regimes of Bankruptcy or Judicial Composition might unlawfully be set aside by appointing a Provisional Administrator.

It seems however that this trend inspired the legislator in 1997. Article 8 of the Law of August 8, 1997 on Bankruptcy namely provides the possibility to appoint a Temporary Administrator at the request of any interested party when it is feared that the company is virtually bankrupt (cfr. Chapter 5.2., § 2)

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<sup>12</sup> E. POTTIER and M. DE ROECK, “L’administration provisoire: bilan et perspectives”, *T.B.H.*, 1997, p. 216, nr. 71-83 en p. 219, nr. 91-98; K. GEENS, M. DENEFF, F. HELLEMANS, R. TAS and J. VANANROYE, “Overzicht van rechtspraak (1992-98) Vennootschappen”, *T.P.R.*, 2000, p. 289, nr. 243 e.v.

<sup>13</sup> B. TILLEMANN, “De voorlopige bewindvoerder als precurator?” in *T.R.V.* 1992, p. 42.

This measure results from the fear that a virtually bankrupt trader, summoned for bankruptcy, may quickly take steps that would be harmful for the creditors.

### **Chapter 4.3. Administrator Ad Hoc**

A similar mechanism is the appointment by the court of an Ad Hoc Representative, which is in fact a Provisional Administrator with a very limited and specific assignment (in which case the board of directors will continue to manage the company).

The advantage is that the appointment of an Ad Hoc Representative, contrary to appointment of a Provisional Administrator, must not be published in the Belgian Official Gazette. The publication of the appointment of a Provisional Administrator may disturb third parties (creditors, bank etc.) and put the continuity of the company at stake.

## **TITLE 5. LEGAL CONSEQUENCES OF BANKRUPTCY AND POSSIBILITIES FOR A FRESH START**

### **Chapter 5.1. Bankruptcy procedure**

Bankruptcy is a formal insolvency procedure governed by the Law of August 8, 1997 on Bankruptcy (“*Loi relative au faillites du 8 août 1997/Faillissementswet van 8 augustus 1997*”) whereby a Receiver in bankruptcy is appointed for the purpose of getting in and realising the assets of the bankrupt for the purpose of distributing the net proceeds to creditors who have proved their debts.

A Bankruptcy order is made by the commercial court on the petition of a creditor, the debtor or the Public Prosecutor on the grounds that the debtor ceased its payments and lost its creditworthiness (article 2 Bankruptcy Law).

The *Bankruptcy de officio* (i.e. bankruptcy ordered by the judge without presentation of a petition) has been [abrogated] with the reformation of 1997.

Under article 8 of the Bankruptcy Law, traders are obliged to petition for Bankruptcy within one month of the cessation of payments<sup>14</sup>.

### **Chapter 5.2. Legal effects of the initiation of *Bankruptcy* procedures**

#### ***§ 1. The suspension of the pronouncement of the Bankruptcy***

On the petitioning for Bankruptcy the court may, under article 7 of the Bankruptcy Law, delay its decision with 15 days<sup>15</sup> during which the debtor or the Public

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<sup>14</sup> Article 9 of the Law on Bankruptcy

<sup>15</sup> Article 7 of the Law on Bankruptcy

Prosecutor is given the possibility to petition for Judicial Composition proceedings. The court indicates in its judgement the deadline to present a petition for Judicial Composition.

### **§ 2. *Deprivation of the management powers: Provisional Administrator***

To avoid the risk that the debtor would take steps to the detriment of his creditors (e.g. misappropriate assets of the company etc.), article 8 of the Bankruptcy Law provides the possibility for the court to appoint a Provisional Administrator (cfr. Chapter 4.2.).

In case of absolute necessity and if there are serious, precise and concordant indications that the Bankruptcy-conditions might be fulfilled, the President of the commercial court may deprive the manager of his management powers and appoint a Provisional Administrator. The procedure is introduced in compliance with the summary procedure.

The appointment is made by the court on the petition of any interested party. The court may also appoint a Provisional Administrator *de officio* (i.e. automatically).

Within 8 days from the appointment of the Provisional Administrator, a petition for Bankruptcy should be presented to the court. Subsequently the Provisional Administrator will be discharged.

## **Chapter 5.3. Legal effects of Bankruptcy as such**

### **§ 1. *Personal consequences***

One of the most important personal consequences for the bankrupt individual or for the managers from the bankrupt company concerns certain disabilities. (cfr. Chapter 5.4.).

Under article 53 of the Bankruptcy Law the bankrupt is somewhat limited in his freedom of action (possible examination by the Receiver; obligation to give information to the Receiver; obligation to inform the Receiver of changes of address).

Article 50 of the Bankruptcy Law stipulates that the correspondence for the Bankrupt is handed over to and opened by the Receiver.

A (positive) consequence for the bankrupt is the possibility to benefit from a special social allowance (Royal Decree 18 November 1996).

### **§ 2. *The divestment of control of property***

Chapter II of the Bankruptcy Law describes the effects of Bankruptcy. The main effect of the judgement of Bankruptcy is that the bankrupt is automatically divested of control and title to (nearly) all of his assets, which vests in the Receiver<sup>16</sup>. If the

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<sup>16</sup> To the exception of the assets exhaustively enumerated by article 16: assets considered as a vital minimum, minimum amounts that can never be seized, damages for personal injury. The bankrupt keeps all his management powers over these assets, which do not fall into the “*Mass*”.

bankrupt is a company the company bodies (board of directors/shareholders meeting) are paralysed. This particularity distinguishes fundamentally the Judicial composition and the Bankruptcy; indeed, the Judicial composition does not involve a divestment of the management powers: the management retains its powers.

The objective of this provision is to prevent the bankrupt to dispose of his assets and by acting so, breaching the equality between the creditors. However, the bankrupt is divested neither of his legal capacity nor of his right of property over these assets. For example, the bankrupt may start another professional activity (as an employee or as an independent), without need of any authorization. The corollary of this divestment is the establishment of a statutory moratorium on enforcement and proceedings by the creditors.

The bankrupt cannot dispose of his assets; any payment, operation or act by the bankrupt or to the bankrupt cannot be opposed to the creditors. The bankrupt is not entitled to commence court proceedings (except with relation to personal and family issues, as divorce for example). The bankrupt is represented by the Receiver, who for the carrying out of his functions, has a wide range of powers.

Moreover, the divestment of the management powers applies to all assets of the bankrupt, present as future. Consequently, the bankrupt would also be divested of the control of the incomes of his new activity. However only the profits from that activity will be affected by the principle of divestment.

Even though the legislator did not necessarily intend to prevent the bankrupt to start a new activity, it is obvious that these rules will affect, if not the possibility itself, at least the success of the new activity.

### *§ 3. Claims and interests*

As from the moment of bankruptcy all claims against the bankrupt become due under article 22 Bankruptcy Law. Another consequence is that interests on (ordinary) claims stop accruing from the moment of the bankruptcy (article 23 Bankruptcy Law).

### *§ 4. Stay of executions or enforcements*

Generally, once a trader is declared bankrupt there is a stay of all legal proceedings and executions or enforcement against the bankrupt or his property. This rule is only applicable towards ordinary and preferential creditors and not towards secured creditors.

The creditors regain their powers to execute on the bankrupt's property, except if the bankrupt were discharged ('excused' – cfr. chapter 5.5.).

## **Chapter 5.3. Criminal offences in connection with Bankruptcy**

Articles 489 and following of the Belgian Criminal Code provide for all criminal offences in connection with Bankruptcy. The sanctions vary according to the seriousness of the offence; offenders may be sentenced to imprisonment and/or fines.

Criminal convictions of individual traders or managers of a company may have very serious financial consequences; indeed, if the offences have caused a prejudice, the civil liability of the convicted person may be engaged.

In addition to the penal conviction, the authors of certain offences may be convicted to interdictions, which are considered in Chapter 5.4.

### ***§ 1. Article 489 of the Criminal Law***

The offences consist of:

- conclusion of engagements without sufficient counterpart and which are too important compared to the financial situation of the company;
- breach by the bankrupt of his obligation to co-operate with the Receiver.

### ***§ 2. Article 489 bis of the Criminal Law***

The offences consist of:

- with the specific intent to postpone Bankruptcy, the buying of goods to sell under the market price, or the fact of borrowing money under ruinously expensive conditions, in order to generate cash;
- the fact of having expenses or losses or not having justified the existence or the utilization of the assets as they appear from the accountancy of the company;
- with the specific intent to delay Bankruptcy, the fact of favouring one of the creditors, to the prejudice of the others;
- not filing for Bankruptcy although the conditions were met;

### ***§ 3. Article 489 ter of the Criminal Law***

The offences consist of:

- misappropriation or concealment of assets;
- concealment of all or parts of the accountancy documents;

### ***§ 4. Article 490 bis of the Criminal Law***

Article 490 bis of the Criminal Law relate to the fraudulent organization of insolvency. The Bankruptcy Law of 1997 reviewed the provision. However, the application of this provision is not limited to Bankruptcy, and applies to any debtor – whether trader or not – who fraudulently organized his insolvency may be convicted of this offence.

The offence consists of fraudulently organizing one's insolvency and refusing to execute one's obligations.

## **Chapter 5.4. Royal Decree n° 22 of 24 October 1934**

Royal Decree n° 22 of 24 October 1934 provides for the possibility to ban certain convicted or bankrupts from certain professions.

The interdictions stipulated in the Royal Decree n° 22 constitute an essential element of the balance between the will of the legislator to allow the bankrupt to start again and its will to purify the market by putting aside these who disturb it. The Royal Decree was recently reviewed<sup>17</sup>.

If the court sentences a person for one of the bankruptcy offences (cfr. articles 489, 489 bis, 489 ter, and 492 bis of the Criminal Law) it may in addition ban this person from certain professions for a term from three to then years (Article 1 and 1bis Royal Decree n° 22). Under this regulation the court can prohibit someone to practice any trade activity, personally or through other persons.

### a) Other legal interdictions

- Article 2, §3, of the Royal Decree of 5 September 1978

The person convicted of one of the offences of Book II, Title IX, Chapters I and II of the Penal Law (among which figure article 489 and following) is divested from the right to exercise the profession of national or international carrier, except his rehabilitation.

- Article 90 of the Law of 9 July 1975 relating to the control of the insurance Companies

The persons who fall under the scope of the Royal Decree n° 22 (see above) are deprived from the right to exercise a function of administrator, director or manager of an insurance company. The persons convicted for an offence stipulated in the Royal Decree n° 22 to a sentence of less than three months are similarly deprived from the right to exercise these functions.

The Control of Insurance Companies Office may grant exceptions to these interdictions, to the exception of the persons in charge of the effective direction of the company.

- Article 4 of the Law of 22 July 1953 relating to the creation of the Institute of auditors

Under article 7, only members of the Institute of Auditors may have the title “auditor”. Undischarged bankrupts and persons convicted to a sentence (even suspended) of more than three months for one of the offences stipulated in the Royal Decree n° 22 are divested from the right to be a member of the Institute.

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<sup>17</sup> Laws of June 2, 1998, January 10 and February 10, 1999.

- Article 78 of the Law of 12 June 1991 relating to the consumers credits

The approval or the inscription to the Ministry of Economic Affairs cannot be given or maintained to undischarged bankrupts or to persons who have been convicted to a sentence (even suspended) of one month for an offence stipulated in the Royal Decree n° 22.

## **Chapter 5.5. Publicity**

### **§ 1. Publicity of the judgement of Bankruptcy**

The court Bankruptcy order must be published, under the responsibility of the Receiver, in the Official Belgian Gazette, and in at least two periodicals or newspaper of a regional diffusion<sup>18</sup>.

### **§ 2. The Bankruptcy file**

A file relating to each Bankruptcy is kept at the clerk of the commercial court<sup>19</sup>. This provision is in harmony with one of the objectives of the legislator, namely to guarantee a more transparency and a better information towards third parties with respect the Bankruptcy process. Any interested person may consult the file for free.

### **§ 3. Publicity of the penal convictions and interdictions**

Jurisdictions that pronounce an imprisonment sentence by virtue of articles 489, 489 bis or 489 ter, order at the same time the publication of an extract of the decision in the Belgian Official Gazette<sup>20</sup>.

According to case law<sup>21</sup>, the will of the legislator was to ensure publicity of fraudulent bankrupts to advise third parties that the convicted person failed in the context of a commercial activity.

However, some authors<sup>22</sup> refuse to follow this point of view. They consider that it is contrary to the objective of the Law of 29 June 1964 relating to stay of proceedings, suspension and probation, which establishes that suspension is justified when the pronouncement of the sentence risks to compromise the future or current reclassifying of the accused in the society.

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<sup>18</sup> Article 38 of the Bankruptcy Act

<sup>19</sup> Article 39 of the Bankruptcy act

<sup>20</sup> Article 490 of the Criminal Law

<sup>21</sup> Brussels, 14 December 1994, *J.L.M.B.*, 1995, p 210; P. COPPENS and F. T'KINT, "Chronique de jurisprudence, Faillite, concordat et privilèges (1991-1996)", *R.C.J.B.*, 1995, p 214

<sup>22</sup> I. Veroeegstraete, *Manuel de la faillite et du concordat*, Brussels, Kluwer, 1998, p 589

## **Chapter 5.5. Possibility of a “fresh start”**

Following the American “fresh start” doctrine, the Belgian Bankruptcy Law of 1997 introduced the possibility for bankrupts to be “excused” (i.e. “discharged”) from their debts (article 82 Bankruptcy Law).

### ***§1. Concept***

The underlying principle of the “excusability” is to discharge the bankrupt from the remaining debts, or more precisely, to prevent his creditors to proceed against him<sup>23</sup>.

The bankrupt can start again with a clean state without having to fear that after the closure of the bankruptcy the creditors would regain their rights and would start enforcing their claims.

The discharge however is not automatic and can only be obtained by the bankrupt producing evidence as to good behaviour.

Discharged bankrupts are automatically rehabilitated under article 110 of the Bankruptcy Law. Article 109 stipulates that undischarged bankrupts who paid all their debts may obtain their rehabilitation. The request for rehabilitation must be filed with the Court of Appeals.

### ***§2. Conditions for discharge***

In principle individuals as well as companies can be discharged. In the case of an individual, the advantage of being excused is obvious. It is not so obvious in the case of a company. Indeed, the bankrupt company is an “empty shell”<sup>24</sup>.

The Bankruptcy Law does not prescribe specific conditions that should be fulfilled to be discharged. Article 81 Bankruptcy Law only provides for a list of circumstances under which a bankrupt can not be discharged. It concerns criminal convictions for theft, fraud etc.

The court decides whether or not a bankrupt is discharged. Since there are no specific conditions the court has a wide interpretation margin, which gave rise to some interesting case law and which could be summarized in the following general guidelines:

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<sup>23</sup> The term “discharge” will used, referring to “Excusabilité/verschoonbaarheid”.

<sup>24</sup> The Bill 1132 abrogates totally the possibility for a legal person to be excused; However, the refusal of discharge has a specific consequence, under article 83 Bankruptcy Law undischarged will automatically be wound up. On the opposite, a discharged company will be able to start again while keeping its name and its shareholders. The survival of the legal person may in some cases allow the rescue of some licenses or other advantages that are not transferable and that were preserved during the liquidation.

- A majority of the case law decided that discharge must be seen as a favour that can only be granted if the bankrupts can prove some circumstances that justifies discharge. The court usually takes into account circumstances of any nature – familial, personal, professional, recession, disease – that led the debtor to Bankruptcy. The fact that the bankrupt can prove external reasons for his bankruptcy often leads to discharge. For example:
  - the fact that the bankrupt was previously an employee, who lost his job, and, instead of staying unemployed, tried to launch his own business; he had no experience and failed, but filed for Bankruptcy on time and co-operated during the Bankruptcy process; moreover, right after the Bankruptcy, he had a heart attack<sup>25</sup>.
  - the fact that the bookkeeping was regular; that a theft contributed to the failure; that the bankrupt's wife died so that he had to take care of the education of his four children<sup>26</sup>;
  - the fact that the bankrupt had lost the majority of his clients notably because of works ordered by the State<sup>27</sup>;
- The attitude of the bankrupt during and before the bankruptcy is often taken into account by the court (e.g. did the bankrupt co-operate with the Receiver; did he filed for bankruptcy in time, etc)<sup>28</sup>.
- However, the objective of the legislator was clearly to favour re-integration and fresh starts, it is not always construed as such by certain courts considering that discharge must remain the exception because of the interests of the creditors.
- The non-payment of tax debts is not as such a sufficient reason to refuse discharge<sup>29</sup>.

From these decisions, it appears that commercial courts are usually ready to grant a possibility for a fresh start to those who “deserve” it, those who failed because of misfortune or because of certain circumstances of life.

### **§3. Effects of discharge**

Discharge has three consequences:

- (a) No proceedings

In case the bankrupt is discharged, his creditors can no longer institute proceedings against him, except for his future debts. This provision was one of the most innovative introduced by the Bankruptcy Law in 1997. Prior to this legislative modification, the individual bankrupt could be sued by his creditors his all life, on his personal assets.

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<sup>25</sup> Comm. Liège, 13 July 1998, *J.L.M.B.*, 1998, 1256

<sup>26</sup> Comm. Namur, 2 April 1998, *J.L.M.B.*, 1998, 1254

<sup>27</sup> Comm. Tongres, 23 February 1999, *R.W.*, 1998-1999, 1425; Bruxelles, 14 April 1999, *R.W.*, 1998-1999, 1457

<sup>28</sup> Ch. MATRAY, “L’excusabilité du failli”, *Rev. Rég. de Droit*, 1998, 265

<sup>29</sup> Comm. Namur, 2 April 1998, *J.L.M.B.*, 1998, 1254

(b) Automatic rehabilitation

According to article 110 of the Bankruptcy Law, the discharged bankrupt is considered rehabilitated.

(c) Discharged company

The discharged bankrupt company can in principle continue. The undischarged bankrupt company will under article 83 Bankruptcy Law be wound up.

#### ***§ 4. Procedure***

Whether or not a bankrupt is discharged is a court decision taken at the closure of the Bankruptcy process (article 80 Bankruptcy Law). The bankrupt will be heard and can defend himself eventually assisted by a lawyer.

#### ***§ 5. The Bill 1132<sup>30</sup>***

The Bill 1132 (cfr. Title 6) thoroughly modifies article 80, part 2. It results from this modification that except under serious circumstances, the judge should discharge the bankrupt who is “unfortunate and of good faith”. Discharge should accordingly become the principle, whereas the refusal of discharge would be the exception.

However, the bill provides, in its reviewed article 82, that the judge may exclude all or part of the debts of the bankrupt from discharge, when it appears that discharge would cause a prejudice to a certain creditor that is manifestly unreasonable compared to the advantage for the bankrupt.

### **Chapter 5.6. Responsibility of the founders and managers**

#### ***§ 1. Responsibility of the founders***

The responsibility of the founders of the company may be engaged in case the registered capital was manifestly insufficient to ensure the normal activities of the company during at least two years. This rule applies to companies that are declared Bankrupt within three years of the incorporation<sup>31</sup>. In such a case, the founders may be held responsible for part or all the liabilities of the company.

#### ***§ 2. Responsibility of the managers of the company***

##### **2.1. Liability for serious fault that contributed to the bankruptcy**

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<sup>30</sup> Doc. Parl., Ch., doc 50, 1132/015

<sup>31</sup> Article 229, 405 and 456 of the Belgian Companies Code

If the assets of the bankrupt company are insufficient, any director, or other person that effectively held the power to manage the company, who has committed a serious fault that has contributed to the bankruptcy, can be declared liable for all or part of the company's debt (article 530 Companies Code).

Legal action can be taken upon the basis of this section of the Companies Act by the bankruptcy Receiver alone.

## 2.2. Substantial loss

If as result of a loss sustained, the net assets of a company have fallen down below half of the company's share capital, the general meeting of shareholders must, within no more than a two-month period after the loss has or should have been established, meet in order to, as the case may be, deliberate and resolve, upon a liquidation of the company and any other measures announced in the agenda. By not convening a meeting of shareholders directors can engage their liability (article 633 Companies Code).

## 2.3. Liability for tort

The general principles of tort also apply to directors who may be liable towards any third parties for damage they have suffered as a result of faults committed by the director (article 1382 of the Civil Code).

As far as the company itself is concerned, article 1382 of the Civil Code may, in principle, only be invoked if the damage it suffers is different from that results from the poor performance of the mandate.

The type of fault to be taken into consideration for a director to be considered liable upon the basis of article 1382 is more serious than that taken into account for the director's liability for performance of his mandate.

Failing to file for bankruptcy when the conditions are reunited constitutes a fault giving rise to a directors liability upon the basis of article 1382, as well as failure to convene the General Meeting when the net assets drop to below 50 % of the company's fixed capital and even, in certain case case-law, having used excessively low prices and agreeing to undertakings that the company clearly cannot respect.

## 2.4. Extension of the bankruptcy to the "real master" of the business

This is a theory that has been created by the courts whereby the bankruptcy can be extended to the person or entity that is really master of the business behind the scenes, the bankrupt company only being a screen.

The idea is that as the person behind the scenes has not respected the rules that govern companies (i.e. that a company is a separate legal entity that has its own corporate person and company bodies that run and control it), the limited liability that a

company provides also falls away and the receiver is authorised to go after the “real master’s” assets to settle the creditors claims against the bankrupt company.

Court decisions have extended the bankruptcy to the person or entity behind the scenes in the following circumstances :

- total control of the company :

The “real master” of the business own all or almost all of the shares and takes all decisions that are binding to the company alone. The official company bodies (General Meeting of Shareholders, Board of Directors, auditors) play no effective role in the running of the company.

- confusion of assets, activities and accounts :

The company’s assets, activities and accounts are mixed up with those of the person or entity behind the scenes, for example, the company’s cash is used to acquire items for the use of the person or entity, payments are made to or invoices are addressed indifferently to the person or entity instead of the company.

## **TITLE 6. PROSPECTS AND RECOMMENDATIONS**

A bill<sup>32</sup> (hereinafter: the Bill 1132) was submitted on March 2001 to the House of Representatives (“Chambre des Représentants”). After various amendments, the project was adopted and thereafter transmitted to the Senate. The current draft is called the “ Bill 1132”<sup>33</sup>.

This bill includes a number of modifications; a lot of them are related to the form and delays of the procedure, whereas some others are more substantial.

For example:

- receivers must take the oath before being inscribed to the list (once and for all), instead of taking the oath at the time they are appointed to a specific procedure;
- obligation of the manager of the company to join the registry of the personnel to the admission of Bankruptcy;
- the abrogation of the first financial statement of the Bankruptcy after 6 months; the first one must occur after one year;
- the receiver may declare that the assets will be insufficient as soon as the inventory is completed and the closure of Bankruptcy may automatically follow;

A more substantial change relates the discharge or “excusability” of the bankrupts. Under the new law bankrupt companies can no longer be discharged.

A clear distinction between honest and dishonest bankrupts is essential to avoid that honest bankrupts are stigmatised through association with the dishonest.

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<sup>32</sup> See G.-A. DAL, “L’excusabilité”, *J.T.*, 26 January 2002, p 57 and followings.

<sup>33</sup> Doc. Parl. , Ch., ord. Sess. 2000-2001, 1132/015

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