Austria

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1. Introduction

1.1. The New Insolvency Act of 2010

On July 1, 2010 the new Insolvency Act *(Insolvenzordnung)*[1] became effective. It is the legislative response to concerns that the rigors and lack of business perspective of Austrian insolvency law had been thwarting efforts to restructure salvageable businesses in distress. In an effort to stream-line the proceedings, one of the types of the insolvency proceedings historically used in Austrian law, the Composition Proceedings *(Ausgleichsverfahren)*, has been eliminated along with the Composition Act *(Ausgleichsordnung)*[2] as a stand-alone proceeding with its surviving elements rebranded as Reorganization Proceeding *(Sanierungsverfahren)* fused on the new *Insolvenzordnung*.

An important policy goal of the reform was to encourage entrepreneurial risk taking. To further this objective, a Debtor-in-Possession Regime *(Eigenverwaltung)* is now available under certain circumstances in Reorganization Proceedings. The minimum repayment obligation in a Reorganization Proceedings is now lower than the one required under prior law. Among other things, the new statute aims at encouraging companies in financial distress to use the various procedures for restructuring and insolvency protection offered by Austrian law as early as possible.

1.2. Focus on Business Insolvency

As the most popular business entity in Austria is the limited liability company (*Gesellschaft mit beschränkter Haftung*, „GmbH") followed by the stock corporation (*Aktiengesellschaft*, „AG"), special rules dealing with insolvencies of partnerships *(Personengesellschaften)* or individuals are not covered in this outline. GmbHs are managed by one or more managing directors *(Geschäftsführer)*, while an AG is managed by one or more management board members *(Vorstand/ Vorstände)* as chief executive officers, both of which are referred to as „Officers" in this outline. They act under the oversight of a supervisory board (non-executive directors) which must be in place for all AGs and for certain types of large GmbHs. Members of supervisory boards are referred to as „Directors" for the purposes of this outline.

2. Types of Insolvency Proceedings and Statistics

2.1. Proceedings under the 2010 Insolvency Act

There are 2 kinds of insolvency proceedings for business insolvencies under the Insolvency Act:

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1 *Insolvenzrechtsänderungsgesetz* (IRÄG) 2010, BGBl. I Nr. 29/2010, as amended (BGBl. I Nr. 109/2013), which added numerous provisions to, and amended a significant portion of the provisions of, the original 1914 Bankruptcy Code *(Konkursordnung)*, RGBl. Nr. 337/1914, as amended.

2 For reasons of comparison, some references to the old law have been retained.

- Reorganization Proceedings *(Sanierungsverfahren)*, which as an incentive for early filing and pro-active planning of a reorganization allow the debtor to retain control of the estate's assets under certain circumstances (Debtor-in-Possession Regime *(Eigenverwaltung)*) and to start over with its debts extinguished if the debtor is able to pay at least 30% of the allowed claims of its creditors over a 2-year-period, or at least 20% over the same time period without retaining control over its business; and,
- Bankruptcy-type Proceedings *(Konkursverfahren or Konkurs)*, which aim at maximizing the value of the estate for the purposes of an eventual prorated distribution of the debtor's assets to its creditors. In practice, also this type of proceeding oftentimes leads to a sale of the debtor's business as a going concern and not to a liquidation of the debtor's business and distribution of the liquidation proceeds, as, typically, a much higher value can be realized by preserving the debtor's business as a going concern.

2.2. Recent Statistics

The „market for insolvency" and insolvency-related services is sizeable. According to data released by the KSV[3], in the time period between 2011 (year in which the new Insolvency Act became effective) and 2013, on average about 5,800 businesses, ranging from the proverbial mom-and-pop store to storied publicly traded stock companies, sought the protection of the insolvency courts each year. The use of annual averages is appropriate as the number of annual filings is fairly stable, the fluctuation amounts to merely 8%. About 42% of those petitioners were turned away on the steps of the courthouse because applicants did not even have the funds to finance the initial costs of the insolvency proceedings (the underlying rules are outlined in Section 3.2.). Also for this parameter the relative consistency of the numbers is significant as it shows that one of the aims of the Insolvency Act, namely to reduce the number of cases where owners simply walk away from a failing business without any accounting, is only taking effect very slowly, if at all.

Ultimately, 3,260, 3,505 and 3,266 proceedings were commenced in those 3 years. It may help to understand these numbers if one considers that typically less than 2% of the insolvency proceedings opened each year involve creditors with claims exceeding EUR 10 million, but that those 2% of proceedings involve roughly 2/3 of all claims filed in a given year.

As the table set out below shows, the vast majority of those cases were Bankruptcy-type Proceedings *(Konkurse)* and the share of the newly introduced Reorganization Proceedings *(Sanierungsverfahren)* slightly fell after reaching an all-

3 https://www.ksv.at/insolvenzstatistik-unternehmen-und-private-2013.

time high of almost 29% in 2011 to about 25% in 2013. While these numbers are certainly a marked improvement compared to the pre-2010 Composition Proceedings *(Ausgleich)*, these numbers should be a matter of concern to the Austrian legislator if this trend persists. Similarly, it is obvious that also the acceptance of the much-acclaimed Debtor-in-Possession-Regime *(Eigenverwaltung)* is lagging behind expectations. And even in 20% of the cases of initial *Eigenverwaltung*, the debtor was/is unable to maintain this privileged position. Also here, the relatively constant numbers are surprising, as one would expect an improvement as debtors and their advisers become more familiar with this tool.

	2011	**2012**	**2013**
Cases opened	3,260	3,505	3,266
Bankruptcy-type Proceedings	2,532	2,756	2,598
Reorganization Proceedings (total)	728	749	668
Reorganization Proceedings without Debtor-in-Possession Regime	520	587	525
Proceedings with (initial) Debtor-in-Possession Regime	208	162	143
Loss of Debtor-in-Possession Status	84	63	50

2.3. Pre-2010 Law

For cases under the old law, the so-called Forced Composition *(Zwangsausgleich)*, was the restructuring tool of choice. A major factor in the success of the Forced Composition had been that it allowed the debtor, subject to approval by the requisite majority of creditors, to obtain a general discharge for a payment of a minimum quota of 20% over a 2-year-period compared to the regular Composition Proceedings *(Ausgleich)* which required the debtor to pay a minimum quota of at least 40% of all unsecured debts within the same period. If the terms of the plan of reorganization adopted under a *Zwangsausgleich* were fulfilled, the debtor company emerged from the insolvency with the balance of its obligations owed to participating creditors being discharged, as this was also the case in an *Ausgleich*.

Building on the success of the Forced Composition, the new law aims to strike a compromise between the interests of creditors and debtors by increasing the target quota to 30% for Reorganization Proceedings *(Sanierungsverfahren)* on the one hand, while offering to the debtors on the other hand a Debtor-in-Possession Regime *(Eigenverwaltung)* as an incentive. The success of this reform will be obvious if the total amount of distributions to creditors measured against the aggregate value of assets subject to insolvency proceedings is higher under the Insolvency Act than under its predecessor.

3. Are there Triggers Making the Commencement of Insolvency Proceedings Compulsory? Is Insolvency Relief Available to all Companies?

3.1. Over-Indebtedness vs. Illiquidity

Under Austrian law, the commencement of insolvency proceedings is compulsory for the debtor if certain factual predicates exist. If the debtor or its Officers fail to comply with this precept, they face exposure to claims by creditors and the insolvent entity, represented by the Administrator, and potentially also criminal prosecution. A debtor is under obligation to commence insolvency proceedings without culpable delay once its financial condition meets the statutory criteria for insolvency. There are 2 scenarios where corporate entities[4] are deemed insolvent, Over-Indebtedness *(Überschuldung)* and Illiquidity *(Zahlungsunfähigkeit)*:

3.1.1. Over-Indebtedness *(Überschuldung)*

The determination of whether a company is insolvent by reason of Over-Indebtedness *(Überschuldung)* involves a two-factor test. According to case law, the necessity to apply this test is triggered by a finding of negative equity, looking at balance sheet or status prepared on the basis of regular accounting principles. On the first level of the test, a company needs to assess whether it is in a state of „calculatory over-indebtedness" *(rechnerische Überschuldung)*, i.e., whether the „value" of its assets is less than the amount of its liabilities (including provisions)[5]. After a considerable amount of debate, it is now the prevailing view that, for the purposes of this analysis, the assets of the prospective debtor have to be taken at their liquidation values[6]. If the company is in a state of calculatory over-indebtedness it needs to perform the second step of the test and show that it qualifies for a positive Going Concern Prognosis *(Fortbestehensprognose)*. This prognosis is in essence a standardized business plan prepared on the basis of generally accepted conservative business planning practices, showing with a preponderance of probability that the company will (i) return to, and retain, a state of solvency (cash flow) within the

4 For individuals or limited partnerships where the general partner is a natural person, illiquidity is the only insolvency criterion.

5 Practice manuals list a variety of additional fact patterns (beyond the obvious case mentioned above) which trigger the duty to conduct such a test, including cases where, even in the absence of calculatory over-indebtedness, the signs of a manifest crisis are so obvious and threatening that it is clear also to the naked eye that the existence of the company is in jeopardy. On the other hand, according to some commentators, not all scenarios involving a calculatory over-indebtedness (taken at liquidation values) necessarily require the preparation of a Going Concern Prognosis. This would be the case only if there are additional manifest signs of crisis, such as the applicability of the criteria laid out Sections 23 and 24 of the Austrian Business Restructuring Act of 1997 (*Unternehmensreorganisationsgesetz* – „URG", BGBl. I Nr. 114/1997 as amended BGBl. I Nr. 58/2010).

6 Otherwise, the amount of negative equity in the first place would be equal to the amount of calculatory overindebtedness.

first 6 to 12 months following the date of the prognosis, and (ii) be able to achieve in the long term, a sustainable turn-around, i.e., find a way to restore its earning power *(Ertragskraft)*. The time frame for achieving the second objective depends on the circumstances, but is in any event longer than a year, and typically spans over a 2 to 3 year period. If the prospective debtor company is able to qualify for a positive Going Concern Prognosis, there is no obligation to file for insolvency, its negative equity and the calculatory over-indebtedness notwithstanding.

A tool commonly used by Austrian practitioners in connection with these kinds of forecasts is a standardized template detailing the key elements to be set forth in, and methods to be used for the preparation of, a Going Concern Prognosis promoted by leading Austrian CPA firms together with the Austrian Federal Chamber of Commerce[7]. According to these guidelines, the analysis has to be bifurcated: for the first 6 months, the company must be able to show with a high degree of certainty, how it is going to meet its financial obligations; for the balance of the time the certainty requirements are somewhat reduced.

3.1.2. Illiquidity *(Zahlungsunfähigkeit)*

A prospective debtor is considered illiquid if it is unable to pay its debts as they fall due. A temporary delay of payments *(Zahlungsstockung)* does not amount to insolvency. The delineation is difficult. Case law speaks of a „reasonable period" within which due debts must be paid so as to avoid illiquidity. The customs of the particular industry or trade may play a role. At any event, the debtor has a better chance of convincing the court that it is merely delaying some payments but not in a technical condition of illiquidity if only a small percentage of its accounts payable are affected.

The specter of an up-coming illiquidity (threat of illiquidity) does not amount to illiquidity.

3.2. Limitations and Prerequisites for Seeking Relief under the Insolvency Act

However, not all entities and individuals that meet either of the two aforementioned criteria are entitled to relief under the insolvency laws[8]. Austrian courts will refuse to commence voluntary or involuntary insolvency proceedings if it is likely that the debtor's assets are not even sufficient to cover the initial costs of the proceedings (in case of a corporate debtor, the company's Officers and shareholders with a stake in excess of 50% have a joint obligation to advance out of their

7 *Leitfaden für die Fortbestandsprognose* by *Wirtschaftskammer Österreich.*

8 For the sake of completeness, it should be mentioned that certain types of financial institutions are subject to a special form of insolvency proceedings *(Geschäftsaufsicht)* under the Banking Act (*Bankwesengesetz – BWG,* BGBl. I No. 532/1993, as amended, BGBl. I No. 13/2014).

personal funds up to EUR 4,000 as a deposit to cover the initial court costs[9]). Alternatively, also a creditor may advance the prospective initial costs of the proceedings.

In case the opening of proceedings is refused due to lack of funds, corporate entities (in particular, GmbHs and AGs) are automatically dissolved and the dismissal of the insolvency proceedings due to a lack of sufficient assets is published. Nevertheless, any extant liabilities continue to be undischarged obligations of the debtor, even though their collectability is unlikely in most cases. However, there are situations in which assets that were concealed or unknown surface[10]. In practice, that means for creditors that if they become aware of any assets belonging to a corporate debtor, they may continue to bring actions and levy execution against the seemingly defunct entity. Indeed, the Insolvency Act specifically authorizes the (re)opening of insolvency proceedings with respect to dissolved legal entities, even if they have been struck from the Company Register *(Firmenbuch)*.

A Reorganization Proceeding *(Sanierungsverfahren)* may also be commenced by the debtor (creditors are never permitted to initiate a Reorganization Proceeding) if the debtor is not yet insolvent in the technical sense of the term. Already if a „threat of illiquidity" (not Over-Indebtedness) puts the debtor's business in jeopardy, the law permits the debtor to be proactive and initiate a Reorganization Proceeding.

4. Who is Authorized and/or Required to Initiate Insolvency Proceedings on Behalf of a Company?

4.1. Legal Representatives of the Debtor

The Officers (or certain other legal representatives[11]) of the debtor have the obligation to file a petition with the competent court (see Section 7.1.1.) for the commencement of an insolvency proceeding. The debtor's obligation to file is triggered by the company becoming insolvent (see Section 3.1.). The Officers must file a petition to commence insolvency (bankruptcy-type or reorganization) proceedings without culpable delay, but no later than 60 days after having detected

9 The financial liability of shareholders and Officers aims at cutting back on the large number of proceedings that have in the past been dismissed because of (alleged) lack of assets. This troublesome phenomenon has allowed unscrupulous business operators to simply „go out of business" without at least an initial assessment of the affairs of such debtors or scrutiny of their business practices.

10 Please note that the striking of a company from the Company Register *(Firmenbuch)* has merely declaratory effect; as long as there are assets the company is only „quasi-dead".

11 E.g., the liquidators of a company. There is also case law suggesting that any de-facto managing directors of a GmbH fall in this group. In a recent departure from what had been deemed a principle written in stone, namely that shareholders never have an obligation to file an insolvency petition in respect of their company, Austrian law now requires also shareholders who own more than a 50 % share in a company to file an insolvency petition if the entity has (temporarily) no Officers.

that the debtor is insolvent (see Section 6.1.). Importantly, in case of an AG or GmbH it is generally accepted that its Directors *(Aufsichtsräte)* are never required or authorized to file an insolvency petition.

4.2. Creditors

Likewise, any creditor[12] of the debtor has the right to petition the competent court to commence an insolvency proceeding. As a matter of statutory law, a petition to place a debtor into involuntary bankruptcy must be supported merely by *prima facie* evidence that the debtor is insolvent and that the creditor has a claim against the debtor, even though such claim does not necessarily need to be due and payable at that time.[13] The practice of the courts is more restrictive, however (see Section 8.2.).

5. "Zone of Insolvency"

This chapter serves as a synoptic preview to show that many areas of Austrian law have to be taken into account simultaneously when assessing insolvency-related risks. It also highlights that the phenomenon of insolvency should be viewed as a continuum marked by varying stages of growing financial distress and not merely as an isolated event. While „Zone of Insolvency" is not a legal term under Austrian law, it is used here as an organizing concept to highlight the challenges arising from the fact that insolvency, as defined in Sections 3.1.1. and 3.1.2., is potentially reaching back and imposes duties on the management of the debtor and also third parties dealing with the eventual debtor, long before the debtor is technically insolvent. Most important is here to be aware of certain solvency-related indicators and time-periods measured from the point of actual insolvency. Ignoring those goal posts may result in liability both on the debtor and creditor side.

5.1. "Zone of Insolvency" from the Debtor's Perspective

5.1.1. Accounting-based Warning Signs

The accounting-based warning signs described below do not trigger *per se* dramatic consequences or the duty to start insolvency proceedings. For the most part they build on accounting-related disclosure obligations. However, if and when the question arises at what point in time the Officers should have realized that a debtor entity had become technically insolvent, accounting-based warning signs such as these are among the relevant factors.

12 There is no need to show the existence of more than 1 creditor holding an unsatisfied claim against the debtor.

13 Also, claims arising out of shareholder loans (monetary transfers substituting equity contributions) qualify as obligations of the debtor for insolvency purposes, even though they are subordinate to the claims of ordinary creditors.

5.1.1.1. Loss of more than 50% of Share Capital

The loss of more than 50% of the share capital of a corporate entity triggers the duty of the Officers of the affected company to convene a special shareholders meeting. Clearly, the duty to convene such meeting arises as soon as the Officers are aware of the critical deterioration of the capital position of their company. On the other hand, if the Officers do not have positive knowledge of the adverse development, the question arises whether that ignorance as such amounts to a breach of their duties.

The duty of Officers as to how often or in which intervals they are required to determine the capital status of their company depends on the size and the sophistication of the entity in question. Considering that the basic rule for the laying of statutory accounts provides for an annual accounting period, there may be cases for small privately held companies in which no liability attaches if the bad news is discovered only at the end of the fiscal year. On the other hand, it is obvious that large, publicly held entities are required to have in place sophisticated accounting and reporting systems able to flag such adverse developments at least on a monthly basis. The uncertainty becomes much greater with respect to companies in the middle of the spectrum. A weighty argument is probably that management accounts could have been obtained at a fingertip (most accounting software programs have the respective capacity). In case of the existence of a supervisory board, quarterly reporting is mandatory. Besides, in all cases in which there are indications that the financial position of the company may be materially deteriorating (unexpected lawsuits, insolvency of debtors, strong market swings, significant production accidents, or the like) one must probably vet the impact immediately.

5.1.1.2. Total Loss of Share Capital *(Negatives Eigenkapital)*

While a total loss of the registered share capital, which leads to negative equity *(negatives Eigenkapital)*, does not equal insolvency in the technical sense, it triggers duties on the part of the Officers of a prospective debtor company. They are required to issue a reasoned explanation to the shareholders as to why the company deserves a positive Going Concern Prognosis *(Fortbestehensprognose)* despite the loss of its share capital.[14] There may be new equity waiting to be contributed (think of an independent R&D start-up that has no turnover relying on new financing rounds, typically granted once new milestones have been reached) or a company that generates enough cash flow to steer clear of illiquidity with the expectation to replenish its equity base over time by virtue of those cash flows. The examples are many. The aforementioned explanation must be filed with the annual accounts. In addition, as in the case of loss of more than 50% of share capital, the Officers are required to call an extraordinary shareholders meeting to discuss the affairs of the company.

14 See chapter 3.1.1.

5.1.1.3. URG/EKEG – Derived Indicators of a Financial Crisis

The Austrian Business Restructuring Act of 1997 (*Unternehmensreorganisationsgesetz*, „URG")[15] discussed in detail in Section 14 identifies 2 crucial measurements for the financial health of a company:

- a debt-equity-ratio of less than 8%; and,
- a pro-forma debt amortization period of 15 years or more (payback exclusively from operational cash flow).

If the financial health of a company has deteriorated beyond this point, Austrian law provides for a variety of legal consequences:

- Officers of a GmbH (not applicable in case of an AG) must call a special shareholders meeting and report to the court at which the company is registered the resolutions passed at that meeting;
- if a company is subject to audit, its auditors must alert management in a special note in their report that the above mentioned financial criteria apply to the company;
- upon receipt of such a warning from the company's auditors, the company's Officers are well-advised – if this makes sense under the circumstances – to commence a restructuring proceeding pursuant to the URG[16] in relation to the yet solvent company to avoid (i) a EUR 100,000 per person liability for the creditors' shortfall in an ensuing insolvency proceeding and (ii) liability vis-à-vis the company for breach of their duty of care;
- shareholders making loans to their company after the emergence of the above mentioned criteria will find their loans in most instances deemed „equity-replacing" and, thus, subordinated to the claims of all ordinary creditors. A more detailed discussion of the statute imposing this subordination, the "Act on Substitution of Equity Capital (*Eigenkapitalersatz-Gesetz*, „EKEG")[17]" can be found in Section 14.2.

5.1.2. Anti-Avoidance/Preference Related Considerations

The deepening financial crisis of a business subjects also certain transactions and payments to the danger of being set aside under the anti-avoidance/preference statutes of the Insolvency Code. As this is a more pressing concern for creditor, it will be treated in Section 5.2.2. below. Management of the debtor would typically not risk personal liability in case the respective transaction is set aside, unless, in particular, criminal acts are perpetrated.[18]

15 See FN 5.
16 In case of threat of illiquidity, also a Reorganization Proceeding would be an option.
17 BGBl. I No. 2003/92, as amended, BGBl. I No. 2010/58.
18 See Section 11.1.

5.1.3. 60-Day-Grace-Period for Restructuring Attempts from the Moment of Insolvency

5.1.3.1. General

As discussed in more detail in Section 6.1., the management of the entity in financial crisis faces additional challenges in the moment of actual „insolvency", as such term is defined in Section 3.1. It must decide whether it is possible to restructure the business within 60 days to a state of financial health that it merits again a positive Going Concern Prognosis *(Fortbestehensprognose)* or whether the business cannot be salvaged (if at all) without the additional tools offered by an insolvency proceeding. In the affirmative case, management must closely monitor whether any restructuring measures deployed are in fact yielding the desired result in a timely fashion. It is of critical importance that at the end of the 60-day-window insolvency no longer exists, which means that (i) liquidity must be restored, and (ii) Over-Indebtedness removed, either by the injection of equity (e.g., subordinated capital) or the existence of a positive Going Concern Prognosis.

5.1.3.2. Restructuring Measures

Downsizing operations by selling assets or reducing staff, raising new capital – equity, hybrid, or debt – and measures to boost sales such as redoubling marketing efforts come to mind. In all cases the paramount test is whether or not the particular action is prone to harm creditors. Of course, in case the restructuring succeeds, no creditor is harmed. Therefore, management will only become potentially the target of damage claims if the restructuring fails and creditors or the Administrator can point to measures that were arguably outside of what the so-called „business judgment rule" protects.

Thus, managers should to be wary of, and scrutinize before implementation, transactions and measures which involve the disposition of assets at fire-sale prices or extraordinary operational expenditures which lack with hindsight a reasonable likelihood of positively impacting the fate of the company. It would be hard to argue that, e.g., a marketing drive without having a proper product or engaging an expensive investment bank to raise equity when the chances of success are miniscule are appropriate measures.

Transactions with related entities are especially prone to be attacked if the restructuring fails. Typical examples are the transfer of material assets such as IP, valuable contracts, customers, key personnel and the like to upstream or sidestream affiliates in order to preserve them for the group in case the distressed group company concerned cannot be salvaged.

Particular care needs to be given in case new investors are courted. There must be a reasonable chance that fresh money is not lost immediately and investors are fully aware of the circumstances of their investment, in particular of the current state of affairs of the company and the business plan. For example, if an expert witness testifies after bankruptcy that the investors where misguided in terms of the realistic cash needs of the business to reach break-even, so that their money was burned without earning them a reasonable chance of a profitable investment, management might be found personally liable fairly easily.

5.1.3.3. Trading Operations

The law does not distinguish in principle between regular trading operations and transactions not in the ordinary course of business within the 60-day-window. What is prohibited is favoring one creditor over the other. In other words: there is an equal treatment obligation regarding existing creditors.[19]

To illustrate: settling trade payables vis-à-vis a group company while not doing so vis-à-vis other suppliers (in the same proportion as the case may be) will get a manager into trouble. The same is true if payment of an old debt is made because the creditor refuses to continue shipping needed supplies unless old and current obligations are settled. Thus, as a general rule, being put under pressure does not allow the debtor to ignore the equal treatment principle. Only in extraordinary circumstances, such as if a bigger damage is to be expected for all creditors primarily due to being forced to shut down production as a consequence of lack of crucial supplies, management might be justified to favor a particular creditor.

Note that favoring a new creditor in terms of payment terms over an old one (cash on delivery as opposed to the theretofore usual 30-day payment term) does not run afoul of the equal treatment principle as the position of the new creditor is different from that of the old one. Of course, the same applies if an old creditor is willing to enter into a new transaction with the debtor.

5.2. Impact on Creditors of Dealing with a Business in the "Zone of Insolvency"

5.2.1. Impact of Accounting-based Warning Signs

The warning signs discussed above in Section 5.1. are for the most part a matter of concern for debtors. However, there are 2 scenarios, where also creditors may experience unpleasant surprises if they are ignoring those signs:

- Preference and avoidance scenarios: In those circumstances where the knowledge of the creditor with respect to the insolvent state of the debtor is a prerequisite of liability (see Section 10.), creditors who have special information rights, such as is typically the case with banks, may be charged with (constructive) knowledge of the deteriorating financial situation of the debtor.

19 Of course, also transactions that are not at arm's length will attract scrutiny.

- EKEG (see Section 14.2.): In the event that a third party who is not a shareholder of the later debtor company and unaware of the distressed financial state of such debtor company extends a loan to such debtor/company and a shareholder of that company is putting up a personal guarantee or other security for such a loan, the provisions of the EKEG become applicable. In such a situation there are several issues the creditor needs to be aware of. As offering a credit enhancement to secure financing extended by a third party is in the eyes of the EKEG tantamount to extending direct credit, the law treats the shareholder as if he was the primary debtor. While the creditor is still free to demand repayment from the debtor company, his collection efforts are steered towards the shareholder, as the law allows the creditor to go after the collateral without having to make first a demand for payment on the debtor company. The shareholder, who would otherwise have a subrogation claim to the extent his collateral covered the outstanding loan, is barred from enforcing such a claim until the finances of the company are sound again or after a successful completion of a Reorganization Proceeding *(Sanierungsverfahren)*.
- While the previous paragraph dealt with innocent creditors, a different set of rules applies if a creditor was aware of the ”crisis“ of the company because of the (published) annual accounts of the debtor, or otherwise. In the event that the security posted by the shareholder is insufficient (uncollectible) to cover the entire amount owed, the creditor’s right to demand payment from the company is limited to the deficiency amount, a limitation that would not obtain under the circumstances discussed in the preceding paragraph.

5.2.2. Avoidance and Preference-related Concerns

Austria’s legal framework with respect to avoidance rules and preference actions (for a comprehensive overview, see Section 10.) is a veritable minefield for unwary creditors. In extreme cases, the claw-back period is 10 years! Therefore, also creditors need to use a great deal of care when entering into transactions with parties in financial difficulties. Here, 2 areas of risk shall be highlighted where, unlike in most avoidance scenarios, merely the deepening financial crisis of the debtor and the fact that the creditor received a payment, may create preference exposure for the creditor.

5.2.2.1. 6 Months before the Opening of Insolvency Proceedings

Once the 6-month-mark has passed, actual or constructive knowledge of the debtors’ illiquidity or over-indebtedness or the fact that an insolvency petition was filed puts creditors receiving a “favor” in the form of a payment or credit enhancement in danger of having to disgorge what they have received under the rules of Section 31 of the Insolvency Act.[20]

20 See Section 10.2.2.