



# The protection of creditors in Austrian insolvency proceedings

**Hans-Georg Kantner, Head of Insolvency Department of KSV1870, writes on the success of the Austrian bankruptcy system that has seen debtors, creditors and attorneys working together for a common goal. Here he examines the parties involved in debt recovery and the different roles that they play.**

## Where it all began; forming the Kreditschutzverband

The origins of KSV1870 can be traced back to 1869 when the Austrian Empire brought into force the *Concursordnung*. Some 80 companies joined forces and founded an association to protect their special interests and position as creditors in bankruptcy proceedings. This vehicle was baptised by the name of “*Creditorenverein zum Schutz der Forderungen in Concursen*” and it had three main duties:

- To be a taskforce to be used by all members, thereby creating economies of scale and cost sharing
- To provide close scrutiny of debtors and their manoeuvrings
- Close supervision of bankruptcy courts and the appointed receivers

It is a commonly experienced fact that claims falling into bankruptcy are only worth a few cents in the Euro. A basic rule in Austrian insolvencies states that creditors do not receive remuneration for any cost incurred in the course of the proceedings. Therefore, only large

creditors are regularly able to incur such cost. And who are these large creditors? Mostly banks of course and the taxman! Small creditors and unsecured trade creditors, however, are normally unable to properly participate in any insolvency case, let alone cases in remote parts of a country that used to be quite a bit larger than it is today.

It did not take long for this association, which today is called KSV1870 (Kreditschutzverband of 1870) to become a model for other similar associations in Austria.

## Who benefits from Credit Protection Agencies?

“Associations for the protection of creditors” or APCs as I will call them from now on, work with many parties in the case of a business insolvency. (For a better and more complete picture of all the parties involved and affected please see the graph below.)

I will run through the various stakeholders in insolvency of a business and briefly demonstrate their particular relationship with APCs.



### 1. Trade creditors

These are the base of members of APCs like KSV1870. They expect swift and reliable information as soon as a company becomes insolvent and they need to file their claims with the bankruptcy court and have someone represent their interest in a legal environment.

In some 20% of claims filed, the administrators and receivers, (collectively referred to as *IPs*), request more information or contest claims for reasons of legal issues. APCs resolve these differences without the need or risk of a full legal dispute, thereby saving cost not

only for their clients but most notably for the IPs and thereby for all other creditors as well.

Trade creditors typically share similar interests in that they want to be able to continue trading. They are rarely secured creditors and therefore are quite happy to be commonly represented by an APC. They tend to look at the cost effectiveness as much as at the outcome in monetary terms. Trade creditors in Austria have learned to enjoy a high degree of participation in insolvency proceedings by way of autonomous APCs to whom they turn in case of need. They are also used to the benefits of creating a constructive working atmosphere rather than that of a controversial court dispute, as may be the case with attorneys representing them in court.

For the purpose of creditors' assemblies, APCs offer ad-hoc representation for creditors or their registered representatives (attorneys) free of charge. Thus, Austrian attorneys are regular clients of APCs: they receive information before any topic is being voted on and a report after the event, all free of charge.

## 2. Public Sector

This includes tax authorities and social security bodies and they are able to access some services by APCs on a free of charge basis, including regular information letters, occasional feed-back or discussion of facts. Since these creditors are typically unsecured themselves, they find comfort in APCs acting on their behalf. Whenever creditors are entitled to vote on a particular subject, most commonly a restructuring plan proposed by the debtor, these public bodies may use the services of APCs to vote for them in court free of charge. These public creditors furthermore are quite content to rely on the other benefits emanating from APCs as far as the supervision of the insolvency proceedings is concerned.

## 3. Business Competitors

It may appear surprising to see competitors of the bankrupt company listed among the stakeholders in insolvency. However, these competitors are the representatives of the economy that benefits when the weakest competitor leaves the marketplace. That is what competition is all about. If we believe in a competitive system being the most efficient and beneficial to the economy as a whole, we have to accept that bankruptcy or other forms of exit do actually occur. Not every company merits restructuring.

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Thus, decision makers independent and unaffected by the case in question are better able to help keeping certain standards up than those personally affected. In the Austrian context, APCs participate in the Steering Committee and are able to direct the negotiations in certain ways.

## 4. The Public

The public benefits in various ways from the existence of APCs. They provide:

- A source of information on insolvency cases and development
- A source of expert advice on general matters of law and policy
- Reliance on continuous control of insolvency proceedings by autonomous bodies governed by creditors
- A high degree of legitimacy of proceedings due to constant and professional involvement of creditors' representatives

Insolvencies can affect public confidence or the confidence of a particular community or region of the country. The media need to access reliable information which in most cases neither court nor IPs would be in a position to reveal due to their official capacity. Therefore, it is often a huge benefit that good quality information can be disseminated using APCs as the official source.

## 5. Bankruptcy courts

The bankruptcy courts have to assume a

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high degree of responsibility in choosing, appointing and supervising the individual practitioners as IPs. The courts benefit from APCs in numerous ways:

- Creditors are always represented in court so that any decisions to be taken by vote will enjoy a high degree of democratic legitimacy. Representation quotas range between 75% and 90% of all creditors.
- APCs act as experienced and professionally trained members of Steering Committees and are used to heeding common points of interest rather than just one creditor's interest as would be expected from single large creditors or their appointed attorneys
- Even large and complex votings by Creditors' Assemblies can be carried out with just a few representatives present and in very short time
- A high degree of creditor organisation reduces adversarial situations, litigation and appeal
- Professional non-profit organisations take considerable burden from the courts in that every small creditor can easily be referred to them while referrals to particular practicing lawyers would be quite inopportune. Requests by the media and by government can also be referred to APCs
- Deliberations of choice and remuneration of IPs can be shared by the courts with APCs as representatives of creditors
- A number of administrative acts as individual correspondence with creditors, summons of creditors for example, can be cut down quite substantially

## 6. Administrators and Receivers

Good IPs have to take a great number of decisions, some quite controversial. Therefore they need to rely on support by steering committees and creditors assemblies to vote on their proposals and back them up during the process. The less bickering in a particular steering committee, the better and more constructive the environment for the practitioner. In Austria, because of APCs, IPs can always rely on reasonable, equitable and constructive support from a few people from APCs. Every practitioner who has yet had to deal with unruly steering committees, where all parties want something different at the same time, probably knows what I am referring to.

Furthermore, APCs tend to take very predictable positions, never favouring only one creditor's interest but heeding the general interest. Sometimes “prisoners’

dilemmas” can be avoided which maximises value for all parties involved.

APCs step in at the same time the IPs are appointed. Their strength is that they do not have any prejudice as is sometimes unavoidable with the existing creditors, who all share some history of dissatisfaction with the debtor. Therefore, right from the beginning, a constructive work atmosphere is more or less guaranteed.

People who have been working with one another have been able to build up mutual trust. This trust in turn helps reduce red tape. “My word is my bond” is the predominant work atmosphere between practitioners and APCs.

### 7. Banks

In many instances, banks find themselves in a special situation. They hold security interest in the assets of the debtor; they have had privileged information and they are probably the only creditors able to extend new loans during the proceedings. It is therefore necessary to co-operate with banks as creditors and to find workable compromises rather quickly. Experienced practitioners know this well and try to come to meaningful agreements with banks concerning possible legal flaws and voidable contracts as the case may be. In my view, banks receive a certain amount of value from the existence of APCs in that litigation is kept to a minimum. Fast compromises are in everybody’s best interest, and professional members in steering committees help ensure the prevalence of what I call “rule of reason”.

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### 8. Management and its counsel

It is the prime target of management to keep the company trading and possibly restructure debt and continue the business. Although creditors seem to be the “natural adversaries” of management, it turns out that APCs offer management a unique opportunity of “collective bargaining”. Emotions are kept to a minimum. Negotiations will still be tough but constructive and the deals so struck

are normally ratified by all or almost all creditors. This saves time and energy for all parties.

Furthermore, management will experience a certain amount of burden taken from them by APCs shielding them from much of their creditors’ dissatisfaction in the first weeks after proceedings have been opened. **Creditors needing a “wailing wall” to get rid of their frustration, tend to turn to APCs and utilise them as a conduit for any complaints or points of reproach.**

The Legal Counsel of a business in insolvency will find it much easier to deal with regular representatives, whose thinking and reasoning will be well known. The strategy of attaining the common goal of restructuring the business in insolvency can thereby be reached much faster and with a much more predictable result. Unrealistic ideas from either side will not be able to slacken or impede good and constructive work.

### So who pays?

By now it is evident that the existence of professional representatives of (mostly unsecured) creditors in Austria tends to work in everybody’s favour.

The members of the APC pay for the cost of a standing office and a taskforce participating in the various proceedings. Members therefore pay an annual membership fee set in relation to the size of the company. Furthermore, all members or other clients pay individual fees for particular services rendered. As early as 1900 the activity of APCs was widely recognised as constructive and in the best interest of all creditors. Courts and the lawmaker in 1923 acknowledged this fact by awarding the APCs monies from the estate to be paid by the receivers or the management of a company restructured in insolvency. Nowadays, these two different sources (members and clients on the one hand – court awards on the other) are about equal. This system of court awarded contributions was codified in more detail in 1999 by setting aside a certain percentage rate of the IP’s remuneration to be shared by the APCs.

Materially, such contributions create a transfer from large to small creditors as the payout or dividend will be a fraction lower for everybody, thus costing small creditors little money and large creditors proportionally more. Especially since large creditors usually prefer to use in-house or external legal counsel, as is often the case with banks and the public sector. Therefore, the system is fair, as it creates a balance between large and small creditors.

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### Success to be proud of

There are three APCs in Austria. Two are organised by trading companies ([www.akv.at](http://www.akv.at) and [www.ksv.at](http://www.ksv.at)) and one for employees, having been set up by Trade Unions and the Federal Chamber for Employees (*Arbeiterkammer*). The system enables creditors to participate actively in all insolvency cases. It also creates a very good chance for debtors to restructure their business in insolvency. In Austria some 35% of all bankruptcies lead to restructuring. (Best practice examples by EU directorate enterprises of May 2001 can be found by google search using the keywords: noordwijk kantner)

A new chapter of insolvency law for private individuals introduced in 1995, would not have yielded the success it did but for the existence of APCs. They allow creditors to participate in the proceedings and thereby reach majority approvals in 75% of all cases. Average payout in private bankruptcy amounts to 15% over 5-7 years. This puts the Austrian system of private bankruptcy far ahead of the German system introduced at about the same time.

Taken from his presentation given in May 2006 at INSOL Europe’s Accessing Countries Committee Conference in Warsaw, Poland.



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