INSOL International

Module 7A

Guidance Text

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CERTIFICATE
in INTERNATIONAL INSOLVENCY LAW

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CONTENTS

1. INTRODUCTION TO INTERNATIONAL INSOLVENCY LAW IN ISRAEL

Welcome to **Module 7A**, dealing with the insolvency system of **Israel**. This Module is one of the elective module choices for the Foundation Certificate. The purpose of this guidance text is to provide:

- a general overview, including the background and history, of Israel's insolvency laws;
- a relatively detailed overview of Israel's insolvency system, dealing with both corporate and consumer insolvency; and
- a relatively detailed overview of the rules relating to international insolvency and how they are dealt with in the context of Israel.

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please note that the formal assessment for this module must be submitted by **11 pm (23:00) BST on 31 July 2021**. Please consult the web pages for the Foundation Certificate in International Insolvency Law for both the assessment and the instructions for submitting the assessment. Please note that no extensions for the submission of assessments beyond 31 July 2021 will be considered.

For general guidance on what is expected of you on the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law on the INSOL International website.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of insolvency law in Israel:

- the background and historical development of Israeli insolvency law;
- the various pieces of primary and secondary legislation governing Israeli insolvency law;
- the operation of the primary legislation in regard to liquidation and corporate rescue;
- the operation of the primary and other legislation in regard to corporate debtors;
- the rules of international insolvency law as they apply in Israel;
- the rules relating to the recognition of foreign judgments in Israel.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of Israeli insolvency law; and
- be able to answer questions based on a set of facts relating to Israeli insolvency law.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in **Appendix A**.

3. AN INTRODUCTION TO ISRAEL

The State of Israel declared its independence, on Friday, May 14, 1948. The capital of Israel is Jerusalem. As of 2017, the population of Israel is approximately 8,500,000 persons, the majority of which (74.4%) are Jewish.

Israel is a thriving democracy, respecting the separation between the 3 branches of the State:

(a) the Knesset, its legislature;

(b) the Government, its executive branch; and

(c) the Judiciary.

The formal head of the State of Israel is the President of the State.[1] However, the President has merely a representative and ceremonial role. The executive authority lies with the Government, led by the Prime Minister.[2] The legislature, the Knesset, is comprised of 120 members,[3] who are elected (through parties) in the state-wide general elections[4] that take place every 4 years.[5] The President conveys the power to form a Government to the Member of the Knesset (MK) who has the strongest chance to form a coalition and a Government that will gain the support and confidence of the Knesset. The Government serves as long as it is supported by a majority of the Knesset.

The Judiciary is comprised of appointed judges to all courts, the Magistrate's, the District and the Supreme Court. Judges are appointed by a public committee chaired by the Minister of Justice and who is comprised as follows: two ministers of the Government (the Minister of Justice and another minister designated by the Government); two MKs (designated by the Knesset); the Chief Justice and two additional Supreme Court justices; and two members of the Israeli Bar.[6] A judge is appointed and serves on the bench until the mandatory retirement age of 70.[7]

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1 Basic Law, s 1, The President of State.
2 *Idem*, The Government.
3 *Idem*, s 3, The Knesset.
4 *Idem*, s 4, The Knesset.
5 *Idem*, s 8, The Knesset.
6 *Idem*, s 4(b), The Judiciary.
7 The Courts Act 1984, s 13(a).

There is no written constitution in Israel. As an alternative, the legislature has enacted over the years certain Basic Laws, that are interpreted and considered as the highest normative authority, on top of regular Acts of the Knesset. The Basic Laws cover the main government institutions, including the Knesset, the Government, the President, the Military, as well as Human Rights.[8]

Israel is a Jewish and democratic state. As a modern democracy, Israel respects the human rights of all its residents and aliens, and defends with the utmost importance the freedom of speech, the freedom of press and the freedom of religion of all.

The origins of Israel's legal system relate back to British law. Following World War I and up until Israel's independent statehood in 1948, the land of Palestine was under the governance of the British Mandate. The British Mandate enacted ordinances for the domestic population, based on the British laws in the UK at the time. Upon Israel's establishment and independence, the interim government and interim legislature immediately enacted the Government and Law Ordinance, 1948, which provided that the law that was in force in the land that day shall remain in force until subsequently repealed and replaced by specific Acts of Israel's legislature. Thus, the British Mandate Ordinances remained in force, some for years and decades to come, until new and modern acts of the eventual Israeli legislature, the Knesset, replaced them.

Given the British origin of its legislative infrastructure, the judicial system of the State of Israel followed British case law for many years and based much of its holdings on British precedents. Israel has always deemed itself more of a common law jurisdiction, where courts interpret laws and the judges utilise judicial discretion to set precedents and fill statutory gaps.

Over the decades, two significant legal developments took place in Israel: First, some of the new Israeli legislation, specifically in private law (such as contracts law) looked also to continental law as a comparative source for its legislation. Nonetheless, the comparative kin of most Israeli law is still primarily the Anglo-American common law. Secondly, since the 1980s there has been a gradual shift from the strong influence of British law over the legislation and case law to the increasing influence of US law. The modern laws of Israel, primarily its corporate laws, rely nowadays more than ever before on comparative American law.

Economically-wise, Israel has emerged over the years from being a developing country and evolved as a developed and market-based economy. One of its primary industries is the high-tech industry. Known as "Start-Up Nation", Israel is globally recognised as leading in innovative and cutting-edge information and technologies in various fields, including medicine and pharmaceuticals, agriculture, clean-tech, fin-tech, transportation-tech, security and cyber. Israel joined the OECD as a full member in Sep. 2010.[9] Israel's currency is the New Israeli Shekel (NIS).[10] As of 2017, Israel's GDP is approximately USD 350 billion (per capita GDP of approximately USD 36,000).[11]

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8 The Knesset, The Government, The President, The Army, The Judiciary , Freedom of Occupation , Human Dignity and Liberty, Israel - The Nation State of the Jewish People, The National Economy.

9 See also http://www.oecd.org/israel/.

10 NIS 1 approximates USD 0.26.

11 This ranks as 55th in the global GDP ranking, based on the https://www.cia.gov/library/publications/the-world-factbook/.

4. LEGAL SYSTEM AND INSTITUTIONAL FRAMEWORK

4.1 Legal system

As stated above, Israel's statutory law relied for many years on the legislation enacted during the British Mandate, pre-statehood. This holds true also in the specific context of insolvency laws. The British Mandate enacted two pieces of legislation pertaining to insolvency law. In chronological order, the first piece was the Companies Ordinance, 1929. This legislation covered all corporate law at the time, including the incorporation of companies, their governance structure, their by-laws, the role of the general meeting of shareholders and the authorities and powers of the board of directors, etcetera. Similar to the UK Companies Act at the time, this Ordinance included also all the provisions dealing with a company's liquidation (or winding-up), both out-of-court winding-up and court driven liquidations. This Ordinance also provided for the process of appointing a receiver for the enforcement of the rights of a creditor secured by a floating charge (see below).

The second piece of British Mandate insolvency legislation was the Bankruptcy Ordinance, 1936. This legislation covered insolvency proceedings of individual debtors and was based on the UK Bankruptcy Act of 1914.

It should be noted that in a similar fashion to the UK's insolvency legislation of the first half of the 20th century, this British-based legislation in Israel did not address corporate reorganisation. It was only receivership and liquidation that were covered. This want of legislation presented a challenge to the courts dealing with corporate financial distress. It limited the judicial options to provide adequate remedies and legal relief to the corporate debtors and their creditors. The courts have urged the legislature to address corporate reorganisation. As a result, in 1995 the legislature amended the Companies legislation and inserted a provision authorising the court to issue a comprehensive moratorium in order to facilitate corporate reorganisation.[12] For the following years, this served as the legislative basis for corporate reorganisations. It was bolstered and complemented in a subsequent amendment in 2012, which added additional provisions dealing with case administration in reorganisation and a cramdown provision.[13] The Ministry of Justice, which initiated this corporate reorganisation legislation, looked primarily to US bankruptcy law, and specifically to its worldwide known Chapter 11, as a comparative source for reorganisation legislation.

Although the two British Mandate insolvency ordinances were occasionally amended over the years by the Knesset, this general two-pillar infrastructure of insolvency law in Israel remained in force over the decades. It has only recently been replaced by comprehensive new insolvency legislation – The Insolvency and Economic Rehabilitation Act, 2018.[14] This Act was enacted by the Knesset in March 2018 and became effective on 15 September 2019 and has repealed the British Mandate insolvency ordinances as well as the provisions of the Companies Act, 1999 on corporate reorganisation.

The subsequent paragraphs on insolvency law (particularly Paragraphs 6 and 8) therefore focus on the New Insolvency Act.

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12 In 1999, this provision was subsequently moved to s 350 of the Companies Act, 1999. In 2012 it was once again moved to ss 350B-350C of the Companies Act.

13 Companies Act (Amendment No 19), 2012.

14 Hereinafter referred to as the New Insolvency Act.

4.2 Institutional framework

4.2.1 The judiciary

The judiciary in Israel is comprised as follows: The lowest courts in the system are the magistrate's courts. Above the magistrate's courts are the district courts. The district courts serve both as courts that hold exclusive jurisdiction over certain matters and issues designated in legislation, and as courts of appeal over the magistrate's courts. There are six district courts in Israel, located in different geographical venues across the country.[15] The highest court in the country is the Supreme Court. The Supreme Court hears appeals on decisions of the district courts.[16] In addition, the Supreme Court hears petitions against governmental actions and constitutional petitions in its capacity as the High Court of Justice.[17]

4.2.2 Collection of debts outside insolvency

Outside insolvency, creditor rights are enforced primarily through the Enforcement and Collection Agency (ECA). This is an administrative agency under the Minister of Justice. It is in charge of the execution of all civil judgments and the collection of monetary and compensatory awards. Self-help and private collection agencies are prohibited and unlawful. All collections are channelled through the ECA. In addition, the ECA enforces perfected security interests (except floating charges) by foreclosing on the collateral without the need of the secured creditor to obtain a judicial order beforehand.

4.2.3 Insolvency proceedings and jurisdiction

Collection in insolvency proceedings is a collective process. Individual creditors are gathered together in the proceeding. Insolvency proceedings are administered through the judicial system. Under the old insolvency legislation (that is, the Bankruptcy Ordinance, the Companies Ordinance and the Companies Act) the district courts had sole and exclusive jurisdiction over all insolvency proceedings, regardless of the type or size of the case. In recent years, as a result of a pro-debtor reform of bankruptcy proceedings spearheaded by the Official Receiver, the number of bankruptcy petitions filed by debtors has sky-rocketed. This has caused a flood of cases swamping the district court dockets and crippling the system. Over the years it was realised that a unitary jurisdictional approach for all insolvency cases, big and small alike, is inefficient and does not serve the debtors or the creditors well in an insolvency proceeding. The New Insolvency Act has reformed the jurisdiction of insolvency cases; for the first time the legislature has split insolvency cases between three judicial and administrative jurisdictions:

- Corporate insolvency cases, both liquidation and reorganisation cases, remain the exclusive jurisdiction of the district courts.

- Individual insolvency cases with stated debts exceeding NIS 150,000 must be initiated by administrative orders of the Superintendent in Insolvency[18] and are subsequently adjudicated by the magistrate's courts.

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15 The locations, from north to south, are in Nazareth, Haifa, Tel-Aviv, Lod, Jerusalem and Beer-Sheba.
16 Basic Law, s 15(a), The Judiciary.
17 *Idem*, s 15(c), The Judiciary.
18 Under the New Insolvency Act, this is the new name of the Official Receiver.

- Individual insolvency cases with stated debts of NIS 150,000 or less fall under the exclusive jurisdiction of the administrative Enforcement and Collection Authority and must be adjudicated by the execution registrars of the ECA.

4.2.4 The Superintendent in Insolvency

In Israel, the insolvency regulator is the Official Receiver, or under its new name the Superintendent in Insolvency.[19] The Superintendent is an administrative agency within the Ministry of Justice. It serves as the governmental agency overseeing the transparency and integrity of insolvency proceedings. It is in charge of protecting the rights of debtors on one hand and the creditors on the other hand. The Superintendent monitors the actions of all trustees and liquidators and they are accountable to the Superintendent and to the presiding court. Under the New Insolvency Act, the Superintendent maintains a pool of trustees for individual insolvency cases and another pool for corporate insolvency cases. In Individual insolvency cases the Superintendent will appoint trustees from the pool. In corporate insolvency cases the Superintendent will present nominees for trustees to the district court for appointment. The Superintendent in Insolvency advises the courts in all insolvency proceedings and appears before the court to introduce its impartial and professional opinion on all matters requiring a judicial decision. This agency is considered the expert authority on insolvency and is consulted upon by various governmental units and the legislature on all matters relating to insolvency. While the agency is an administrative agency within the Ministry of Justice, in any specific insolvency case the Superintendent is accountable and reports to the presiding court.

The Superintendent in Insolvency comprises a central management, chaired by its director, and holds four regional branches: Haifa in the north, Tel-Aviv in the centre, Beer-Sheba in the south, and Jerusalem. The staff of the regional branches include both insolvency investigators and inspectors (who oversee the investigative and financial activities of insolvency trustees) and lawyers who appear on behalf of the Superintendent in court in all insolvency hearings. In addition, there are certain central units in the organisation, including a trustees' division that is in charge of the maintenance of the pools of trustees and the corporate division that is in charge of all major corporate insolvency proceedings (liquidations and reorganisations) and who appear in these proceedings before court and advise the courts on any legal, accounting and economic aspects of the case at hand.

Self-Assessment Exercise 1

Question 1

What are the original pieces of legislation that governed Israel's insolvency law, and what legislation governs insolvency law today?

Question 2

Under the current law, which court or administrative agency has jurisdiction over individual insolvency cases and which has jurisdiction over corporate insolvency cases?

[19] New Insolvency Act, s 268.

For commentary and feedback on self-assessment exercise 1, please see APPENDIX A

5. SECURITY

Security interests in Israel are the result and aggregation of several pieces of legislation. Some of this legislation is original Israeli legislation, such as the Pledge Act (or, more accurately translated as the Security Interest Act) and the Real Property Act. Another piece of legislation pertaining to security interests is the British Mandate Companies Ordinance, which introduced into domestic law the British concept of a floating charge to secure corporate debt.

The general legislation on security interests is The Security Interest Act, 1967. This Act provides for the creation and perfection of security interests, sets the priorities between competing security interests and the procedure for foreclosure. An important general rule established by the Act is that any transaction that is intended to secure an obligation or debt through property of the obligor, must be construed as a transaction creating a security interest and is subject to the laws of this Act, regardless of its form.[20] As a result, certain retention of title in personal property sales transactions, sales with a termination and sale-back clause and certain financial leases or factoring transactions have been interpreted in case law as constituting a security interest under the Security Interest Act.[21] This interpretation subjects these transactions to the perfection through registration provision and the foreclosure procedures provided for by the Security Interest Act.

A security interest is created through an agreement between the parties, namely the debtor and the creditor.[22] However, in order to be effective against third parties, the security interest must be perfected. Under the Security Interest Act there are two alternative ways to perfect a security interest in collateral and thereby entrench the creditor's rights and priority *vis-à-vis* third parties. The first manner of perfection is by delivering possession of the collateral to the creditor. Perfection by possession is applicable only in respect of tangible personal property.[23] The second method of perfection is through filing (or registering) the security interest in a public registry that is open and available for public inspection. The default registry for perfecting security interests is the Security Interests Registrar, maintained under this Act. Any security interest in personal property that is not possessed by the creditor must be perfected by filing with this registrar.[24] However, there are two notable exceptions that require a different filing and registry. First, a security interest in real property (defined statutorily as a "mortgage") must be perfected by filing the mortgage with the Real Property Registrar in lieu of the regular filing with the Security Interests Registrar.[25] Secondly, under the Companies Ordinance, a security interest on the property of a corporate debtor (also termed as a "fixed charge") must be filed with the Companies Registrar and not the Security Interest Registrar.[26]

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20 Security Interest Act, s 2(b).
21 See, eg, CA 46/11 *In re Vita Pri Galil* ; 7281/15 *In re Agrexco (in liquidation)*.
22 Security Interest Act, s 3(a).
23 *Idem*, s 4(2).
24 *Idem*, s 4(3).
25 *Idem*, s 4(1); The Real Property Act, ss 4, 6.
26 Companies Ordinance, s 178(a). This section further provides that when a security interest (or charge) is created over corporate real property, the perfection requires a double filing (or registration) – first with the Real Property Registrar and subsequently with the Companies Registrar.

Following the British law in this regard, the Companies Ordinance facilitates the creation of a floating charge over the corporate assets as they may consist of from time to time. The floating charge is a security interest that hovers over all or part of the company's assets, while the debtor company may continue to enter into transactions and conduct business with that property in the ordinary course of business. The floating charge rests over and seizes all the company assets on the date of its crystallisation. A crystallisation event is usually the appointment of a receiver to foreclose on the corporate assets subject to the floating charge or the appointment of a liquidator. The floating charge needs to be filed with the Companies Registrar.[27] Unlike a fixed charge on real property, to the extent the floating charge encompasses also real property of the debtor corporation, it need not also be filed with the Real Property Registrar.[28]

Any perfected security interest or mortgage can be foreclosed on through enforcement and sale by the Enforcement and Collection Agency.[29] The execution registrar appoints a receiver to take control of the security interest and to auction it on the market. The rights of a creditor secured by a floating charge, however, are enforced by the appointment of a receiver by the district court.[30] The receiver takes control of the property subject to the charge (being all the corporations assets and business) and attempts to auction it either as a going-concern or on a piecemeal basis.

The position of secured creditors and the enforcement of their rights by foreclosure in insolvency proceedings varies according to the nature of the proceedings. In liquidation proceedings, the collateral is excluded from the insolvency estate and, with minimal limitations, the secured creditors are at liberty to continue with foreclosure on the collateral and are not prevented from doing so by the moratorium. By contrast, in reorganisation proceedings a comprehensive moratorium applies also to secured claims. As a result, secured creditors are prevented from foreclosing on the collateral without express and specific exemption from the moratorium sanctioned by the insolvency court.[31]

Self-Assessment Exercise 2

Question 1

A company obtains a loan from a bank and is requested to create a fixed charge over a vehicle that it owns and the corporate headquarters building, also owned by the company. What is the appropriate method of perfecting the fixed charge over both pieces of property?

Question 2

Assuming that the bank perfected its fixed charge appropriately, would the bank need a court order in order to enforce its security interest?

27 *Ibid*.
28 *Idem*, s 169(a).
29 Security Interest Act, s 17.
30 Companies Ordinance, s 194.
31 For a further discussion of the moratorium in the various insolvency proceedings and its effect on the enforcement rights of secured creditors, see below.

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

6. INSOLVENCY SYSTEM

6.1 General

The general framework of the insolvency system in Israel has experienced recent transformation by virtue of the New Insolvency Act. As elaborated on in the paragraphs below, this Act:

- unifies the laws of insolvency in Israel;
- redirects insolvency law towards providing relief to debtors; and
- fragments the jurisdiction of the courts over insolvency proceedings.

As explained earlier, from the time of the creation of the State of Israel up to the time of the New Insolvency Act, insolvency legislation in Israel followed British legislation as it existed at the time. As a result, the insolvency legislation was fragmented based on whether the debtor was a consumer or a separate legal entity. Individual debtors were subject to insolvency proceedings named "bankruptcy" under the Bankruptcy Ordinance. On the other hand, corporate debtors would undergo liquidation proceedings under the Companies Ordinance. As has been the case in many other jurisdictions around the world, there was a debate in Israel surrounding the desirable composition of its insolvency legislation – whether it should remain fragmented or become a unitary statute. In the end the legislature chose to enact a unitary insolvency statute - the New Insolvency Act. This act encompasses all insolvency proceedings pertaining to all debtors – individuals and corporate. Reminiscent of the UK Insolvency Act 1986, the New Insolvency Act separates the proceedings into two parts – Part II of the Act regulates corporate insolvency proceedings while Part III of the Act addresses individual insolvency proceedings. However, all the other parts of the Act (including priorities, avoidable transactions, proof of claims, creditor committees, cross-border insolvency, etcetera) apply to both individual and corporate debtors alike.

6.2 Debtor- or creditor-oriented?

It is somewhat difficult to characterise Israel's insolvency law as either creditor- or debtor-friendly. The nature of the law and its orientation has changed over the years. Traditionally, Israel may have been considered a creditor-friendly jurisdiction in respect of insolvency. The British Mandate insolvency legislation in the country was rather rigid, with individual debtors obtaining a discharge but only after a lengthy and thorny bankruptcy proceeding. During this proceeding the debtor was exposed to intrusive investigations and was subject to many limitations. On the corporate side, the law provided first and foremost for corporate liquidation or receivership. It did not assist financially distressed corporations with a statutory path to reorganisation and rescue.

This orientation gradually changed during the 1990s. In 1995, for the first time ever, the legislature enacted a comprehensive moratorium to allow corporate debtors to

reorganise instead of going into liquidation. Subsequently, in 1996, the legislature amended the Bankruptcy Ordinance in a manner that facilitated the obtaining of a discharge for debtors even where the proceeding yielded no return to creditors. In 2012, the turnaround in approach was completed once the Official Receiver launched the reform of its bankruptcy policy. Under the reform, individual bankruptcy proceedings were channelled towards the release of debtors through a discharge sanctioned by the courts within a maximum period of four years. The system has tilted more and more towards the rehabilitation of debtors and facilitating their economic recovery.

The New Insolvency Act now complements the gradual revision of Israel's approach to insolvency. The full name of the Act (The Insolvency and Economic Rehabilitation Act, 2018) and its stated purpose make it clear that a primary goal of the statute is to provide financially distressed debtors with a fresh start.[32] The statute facilitates the obtaining of a discharge by individual debtors within four years and encourages corporate rescue proceedings as the desirable proceeding as long there is an economic prospect of "righting the ship" and being able to restructure the corporate business.

6.3 Jurisdiction – from unified to fragmented

While the New Insolvency Act unified insolvency legislation into a single unitary statute, it nonetheless fragmented judicial jurisdiction over insolvency proceedings. As explained above, this fragmentation is intended to increase the efficiency of the judicial system. Thus, under the Act all corporate insolvency proceedings remain the exclusive jurisdiction of the district courts. On the other hand, individual insolvency proceedings have been shifted to the jurisdiction of the Superintendent in Insolvency and the magistrate's courts (for cases exceeding NIS 150,000 of stated claims) or the execution registrars at the Enforcement and Collection Authority for cases with aggregate claims of up to NIS 150,000.

6.4 Case administration – key players

Insolvency proceedings entail the involvement of various players. The proceedings take place within the courtroom. The judicial hearings cover all aspects of the case, including the issuing of a moratorium, interim relief, motions by the parties, the appointment of a trustee, ongoing instructions to the trustee, the convening of creditors meetings, confirmation of arrangements and so forth. Indeed, upon the onset of an insolvency case the court appoints a trustee.

In all cases a trustee is appointed. In corporate cases the trustee is appointed by the court.[33] In individual cases, voluntary and involuntary, the trustee is appointed by the Superintendent.[34] The trustee is the pivot player in the case. The trustee is authorised to administer the insolvency estate, make business decisions, negotiate an arrangement with the creditors, investigate the past conduct of the debtor or its directors and officers and approve or reject proofs of claims. Except for ordinary business decisions, in all other matters the trustee needs to obtain the advance authorisation of the court for its actions.

In all matters and hearings before the court, the debtor and creditors are entitled to appear and be heard on the matter at hand. Also, the debtor and creditors may hold

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32 New Insolvency Act, s 1(1) and (3).
33 *Idem*, s 33.
34 *Idem*, s 121(5).

ongoing communication with the trustee during the case and receive updates from the trustee about the progression of the case.

In certain cases, the trustee or the Superintendent in Insolvency may ask the court to authorise the constitution of a creditors' committee to more effectively represent the creditors' interest in the case. The appointment of a creditors' committee is subject to the discretion of the court.[35]

The standing of shareholders in insolvency proceedings is controversial. The general approach is that shareholders deserve to be heard only if the corporate debtor is solvent under the balance sheet test (that is, where the debtor has a positive Net Asset Value (NAV)). However, since in many cases the exact NAV is not determined in the early stages of the case, it is unclear whether the shareholders should be addressed and heard. In practice, this matter remains largely in the discretion of the presiding judge until the value of the debtor corporation is determined.

Self-Assessment Exercise 3

Over the span of the past 25 years, how would you describe Israel's insolvency law – as more creditor-oriented or debtor-oriented? Motivate your answer.

For commentary and feedback on self-assessment exercise 3, please see APPENDIX A

6.5 Personal / consumer bankruptcy

6.5.1 Introduction

An individual:

- whose domicile is Israel at the date of the filing or at some date within the 6 months preceding the date of filing, and
- who has assets in Israel or conducts business in Israel,

may be subject to insolvency proceedings under the New Insolvency Act.[36]

There is no mandatory obligation to file for individual insolvency proceedings. An individual debtor may enter insolvency proceedings through a voluntary or an involuntary petition.[37] A voluntary case is commenced by the debtor itself. By contrast, a creditor or creditors may commence an insolvency proceeding involuntarily (from the perspective of the debtor). There are differences between these two gateways to individual insolvency proceedings. Also, the voluntary proceedings are fragmented between two different jurisdictions. The following paragraphs elaborate on the various paths into individual insolvency proceedings.

35 *Idem*, s 263(a).
36 *Idem*, s 101(b).
37 *Idem*, s 102.

6.5.2 Voluntary proceedings under the Superintendent and the magistrate's courts

To qualify as a debtor and be eligible to file for insolvency proceedings with the Superintendent in Insolvency a debtor must file with the petition an affidavit in which he states that:

(a) his debts exceed NIS 150,000, and

(b) he is insolvent or that the proceedings will assist him to prevent insolvency.[38]

Insolvency is defined in the statute as either balance-sheet insolvency or as a cash-flow insolvency (*i.e.* the debtor cannot pay its debts as they become due).[39] The petition is filed with the Superintendent[40] and must contain information specified in the Act. That information includes statements disclosing the debtor's, his spouse and their dependent children's assets and bank accounts, income, debts, the identity of the creditors, any person owing money to the debtor, any pending legal proceedings to which the debtor is a party, the debtor's education and occupation.[41] The debtor is also required to sign a waiver of his privacy and secrecy and his consent to the obtaining of information from official public records regarding his assets, income, debts and his travelling abroad.[42]

To the extent that the Superintendent finds that the two aforementioned eligibility conditions are met the Superintendent shall issue an order of commencement within 30 days of the filing.[43]

6.5.3 Involuntary proceedings

A creditor may file with the magistrate's court an involuntary petition for the commencement of his debtor's insolvency proceedings.[44] A petition may be filed by a creditor only if the debtor is insolvent.[45] In order to overcome the information gap, which places the creditor at an information disadvantage concerning the debtor's economic state and his aggregate debts, a creditor may establish a "presumption of insolvency" in its petition. A presumption of insolvency may be established in one of the following ways:[46]

- If the creditor presented to the debtor a payment demand exceeding NIS 75,000, including a notice that if the payment will not be made the creditor intends to file an involuntary petition against the debtor, and the debt was not paid within 45 days of the demand;

- The creditor served the debtor with a warning under section 7 of the Execution Act, 1967, for a payment judgment exceeding NIS 75,000, and the payment was not paid within the period specified in the warning;

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38 *Idem*, s 104(a) and (b)(1).
39 *Idem*, s 2.
40 *Idem*, s 104(a). The petition may be filed in the district where the debtor resides, where his assets are located or where he conducts his main business, or filed online - s 104(d).
41 *Idem*, s 104(b)(2).
42 *Idem*, s 104(b)(3).
43 *Idem*, s 105(a).
44 *Idem*, s 109(a).
45 *Ibid*.
46 *Idem*, s 110(a).

- A court issued a payment judgement of an amount exceeding NIS 75,000 and the debtor did not pay that judgment to the creditor within 30 days;

- The Labour Tribunal issued a payment judgement of an amount exceeding NIS 10,000 and the debtor did not pay that judgment to the creditor within 30 days.

The court is required to hold a hearing on the creditor's petition and issue its decision as early as possible. To the extent the court finds that the creditor established the debtor's insolvency it issues an insolvency proceedings commencement order.[47]

6.5.4 Voluntary proceedings for small cases

Debtors with aggregate debts exceeding NIS 50,000 but less than NIS 150,000 may file a voluntary petition for insolvency proceedings with the execution registrar at the Execution and Collection Authority. To qualify as a debtor and be eligible to file for insolvency proceedings with the execution registrar a debtor must state that:

(a) his debts exceed NIS 50,000 but are less than NIS 150,000, and

(b) he is insolvent or that the proceedings will assist his to prevent insolvency.[48]

After examining the petition and finding that it meets the statutory eligibility requirements, the registrar must first try to advance a payment arrangement between the petitioning debtor and his creditors. The registrar shall convene the parties within 30 days after the filing of the petition in order to advance a payment arrangement.[49] To the extent there is a unanimous consent, a comprehensive payment arrangement will be approved by the registrar and all pending execution proceedings against the debtor will be stayed.[50] If there are dissenting creditors then an arrangement may be approved by a majority of unsecured creditors who hold together 75% or more of the value of the aggregate claims voting on the proposed arrangement.[51] The arrangement will then be confirmed by the registrar and shall become binding on all unsecured creditors.[52] If no payment arrangement is approved and confirmed the registrar shall issue an insolvency proceedings commencement order.[53]

6.5.5 The consequences of a commencement order

Upon the issuing of an insolvency proceedings commencement order under any of the three abovementioned gateways to individual insolvency proceedings, the following legal results take place:

6.5.5.1 Moratorium

The legal effect of a commencement order is to stay all pending proceedings against the debtor.[54] No creditor may initiate or continue any collection or other legal proceedings against the debtor or his property without the specific authorisation of the presiding court or the Superintendent, as the case may be. Exemptions to the moratorium will rarely be authorised. Secured creditors are also stayed by the

47 *Idem*, s 186-187.
48 *Idem*, s 104(a), (b)(1).
49 *Idem*, s 190.
50 *Idem*, s 192.
51 *Idem*, s 195.
52 *Idem*, s 196.
53 *Idem*, s 199.
54 *Idem,* s 121(2), (3).

moratorium, but only if the judge or the Superintendent finds that the individual debtor is operating an ongoing business and there are efforts within the insolvency proceedings to continue the operation of that business and rescue it.[55] Otherwise, secured creditors are exempt from the stay and may continue their actions to foreclose on the collateral and collect their secured claims.

6.5.5.2 Insolvency estate, exempt property

As a result of the commencement order the debtor's pre-commencement property become an insolvency estate, out of which the creditors' pre-commencement claims as well as the proceedings expenses will get paid.[56] Certain property, however, is exempt from the insolvency estate, as follows:[57]

(a) Food necessary for the debtor's family living;

(b) Clothing, linen, medical equipment, kitchenware and other personal tools for the debtor and his family;

(c) Religious articles;

(d) Tools and machines, including vehicles and livestock, necessary for the debtor's occupation and earning;

(e) Personal property, equipment, tools or vehicle required for the disabled debtor or his family member;

(f) Domestic pet;

(g) Personal computer and printer, TV set, radio, domestic or portable phone, washing and drying machines;

(h) Articles, up to NIS 4,000 to which the debtor is personally and emotionally attached.

Also, in Stage 2 of the insolvency proceeding the debtor pays the trustee monthly payments set in the magistrate's court's order.[58] These payments, as well as property acquired by the debtor in Stage 1 of the proceeding (the "interim period"), add to the resources available to the trustee for paying the creditors' approved claims.

6.5.5.3 Limitations imposed on the debtor

The commencement of the insolvency proceeding imposes certain limitations on the debtor's day-to-day affairs. First, the debtor may not enter into any credit transaction unless approved by the Superintendent.[59] Secondly, certain limitations apply until the judicial approval of a payment plan.[60] These include:[61]

(a) a limitation on obtaining a passport;

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55 *Idem*, s 245(a).
56 *Idem*, ss 121(1), 216(2).
57 *Idem*, s 217 and Sch 2.
58 For a discussion of the two stages of the individual insolvency proceeding, see below.
59 New Insolvency Act, s 123.
60 This approval takes place after approximately one year from the commencement of the case.
61 New Insolvency Act, s 142(1)-(4).

(b) limiting the debtor's ability to leave the country;

(c) limiting the debtor's ability to hold and use a credit card.[62]

In addition, the trustee may move for limiting a debtor from forming a new corporate entity if the trustee can show that there is a risk that this will harm the creditors or a third party.[63] These limitations are imposed during Stage 1 of the insolvency proceeding (that is, from the commencement order until the court's issuing of an economic rehabilitation order), but may be extended by the court, in whole or in part, during Stage 2 of the proceeding.[64]

6.5.6 Appointment of a trustee

Immediately subsequent to the issuing of a commencement order, the Superintendent must appoint a trustee to administer the insolvency proceeding of the debtor. The Superintendent is required to appoint a trustee both in voluntary cases (in which the Superintendent issued the commencement order) and in involuntary cases in which the magistrate's court issued the commencement order.[65] In an involuntary case, the magistrate's court may, however, appoint an interim trustee until the appointment of a permanent trustee by the Superintendent.[66] In a small case insolvency proceeding the execution registrar appoints a trustee,[67] but the execution registrar is also authorised to not appoint a trustee and administer the case itself.[68]

A trustee must be appointed from a designated pool of trustees maintained by the Superintendent.[69] The pool must be formed by a public committee appointed by the Minister of Justice and chaired by a former district judge.[70] Eligible candidates to the pool are licensed lawyers or accountants with five years of practical experience, or with a provable experience in the administration of insolvency proceedings.[71] Every three months the Superintendent must publish on its website the number of insolvency cases that each trustee received during the preceding three month period.[72]

The trustee has several roles and various powers. The trustee must take control of the insolvency estate and collect any receivables or debts owed to the debtor. The trustee is required to study the economic state of the debtor and his earning capacity and to examine the proofs of claims filed by the creditors and approve or reject each one. After the court approves a debtor's monthly payment plan for the duration of the proceedings, the trustee must ensure the debtor's compliance with the payments under the plan. The trustee has also the task of selling the assets in the insolvency estate for the purpose of paying the creditors. Finally, the trustee is in charge of paying the creditors, under the priority order of payment, out of the proceeds of the assets sold and the accumulation of the monthly payments by the debtor.[73]

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62 The debtor may nonetheless use a debit card.
63 New Insolvency Act, s 142(5).
64 For a discussion of the two stages of an individual insolvency proceeding, see below.
65 New Insolvency Act, ss 121(5) and 125(a).
66 *Idem*, s 119(2)(a).
67 *Idem*, s 202.
68 *Idem*, s 205.
69 *Idem*, s 125(a), (b).
70 *Idem*, s 126(a).
71 *Idem*, s 126(b).
72 *Idem*, s 125(e).
73 *Idem*, s 130.

6.5.7 *Proof of claims*

Any creditor holding a pre-commencement claim against the debtor is required to file a proof of claim with the trustee within six months after the publication of the commencement order.[74] The trustee is required to examine each proof of claim and may decide to approve that claim, entirely or partially, or to reject it.[75] To the extent the claim is for unliquidated amounts, the trustee must evaluate the claim.[76] After the decision to approve or reject the claim, the trustee must notify the creditor and the debtor of its decision concerning that creditor's proof of claim.[77] Any person interested in the proceedings is entitled to view the proofs of claims filed and the trustee's decisions in respect of those claims.[78] A person who is affected by the trustee's decision concerning a proof of claim may appeal that decision to the court presiding over the insolvency proceeding.[79]

6.5.8 *Executory contracts, providers of essential services*

The New Insolvency Act addresses executory contracts and providers of essential services in the context of corporate insolvency proceedings. Those provisions have been incorporated in their entirety into the individual insolvency proceedings as well.[80] For a discussion of this subject please see the discussion on corporate insolvency proceedings below.

6.5.9 *Voidable transactions, clawback provisions*

The New Insolvency Act addresses voidable transactions and contains clawback provisions in a uniform manner. Part V of the Act deals with these matters and applies its provisions to all insolvency proceedings under the Act, for both individual and corporate insolvencies alike. This matter is discussed and elaborated upon below under the discussion of corporate insolvency proceedings.

6.5.10 *The administration of the insolvency proceeding*

The administration of an individual insolvency proceeding is now determined by the New Insolvency Act. It is based on the procedure introduced into practice by the Official Receiver in its reform of bankruptcy proceedings in 2012 under the former Bankruptcy Ordinance. The structure of contemporary individual insolvency proceedings under the New Insolvency Act is as follows. The proceedings are split into two stages:

a) Stage 1 (statutorily termed "the interim period") covers the period between the commencement order and the economic rehabilitation order;

b) Stage 2 – covers the period from the economic rehabilitation order to the debtor's discharge.

These stages are discussed in more detail below. It should be noted at the outset that all the trustee's powers, including powers to avoid past transactions or to

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74 *Idem*, s 210(a). The trustee may extend the period for filing a proof of claim if it is convinced that there were justifiable circumstances that prevented the creditor from filing on time - s 210(b).
75 *Idem*, s 211(a).
76 *Idem*, s 213.
77 *Idem*, s 211(c).
78 *Idem*, s 214.
79 *Idem*, s 215.
80 *Idem*, s 157(c).

assume or reject executory contracts, are fully applicable in both stages of the insolvency proceeding.

6.5.10.1 Stage 1

This stage lasts approximately one year from the date of the commencement order. During this stage the trustee starts to function and takes control over the insolvency estate. The trustee's primary objective during this interim period is to closely examine the economic state of the debtor and his earning capacity on the one hand and to map the claims of the creditors (through the process of approving or rejecting the proofs of claims) on the other hand. After completing these objectives (and within nine months from the date of the commencement order) the trustee is required to submit to the Superintendent a report summarising its findings concerning the debtor's financial situation, affairs and the circumstances that led to the debtor's insolvency.[81] Based on the trustee's report, the Superintendent must propose a monthly payment plan for the debtor for Stage 2 of the proceeding (this proposal is called "an economic rehabilitation plan" in the statute). The Superintendent is required to file this proposal with the magistrate's court within 60 days after receiving the trustee's report. Once the proposal has been filed with the magistrate's court, the court will schedule a hearing on the proposal.

6.5.10.2 Stage 2

This stage follows Stage 1 and is launched by the magistrate's court. After a hearing on the proposal presented by the Superintendent, the court must issue an "order of economic rehabilitation".[82] This order determines the nature of the remainder of the insolvency proceeding, being Stage 2. An economic rehabilitation order includes:

(a) a monthly payment plan for the debtor;

(b) provisions pertaining to the liquidation of the assets of the insolvency estate;

(c) extension of those limitations imposed on the debtor in Stage 1 that are necessary for the protection of the creditors.[83]

The order may also include a requirement for the debtor to undergo a training workshop for managing a diligent economic household if the court believes that such a workshop will enhance the debtor's economic rehabilitation.[84] It therefore follows that the main active duty of the debtor during Stage 2 of the proceeding is to pay the trustee the monthly payments set out in the court's order. The monthly payments are calculated based on the debtor's earning capacity, after deducting the necessary monthly expenses to allow for the debtor's family to enjoy a decent living.[85] The monthly payments are paid to the trustee who adds them to the insolvency estate and uses the accumulated amounts, alongside the rest of the assets of the estate, to pay the creditors' approved claims.

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81 The report must contain the following information: the debtor's education and occupation; an inventory of the assets comprising the insolvency estate; the actions taken by the trustee during the interim period; the proofs of claims filed and the trustee's decisions; the circumstances that led to the creation of the debts; the behavior of the debtor during the interim period; recommendations concerning the debtor's business and that business' future prospect; and any actions that may constitute an avoidable preference or a fraudulent conveyance – New Insolvency Act, s 153(c).

82 *Idem*, s 161(a).

83 *Idem*, s 161(b)(1)-(4).

84 *Idem*, s 161(b)(5).

85 *Idem*, s 162(a)(1).

The statutory period for the payment plan is three years.[86] The court is authorised to shorten this period if it is justifiable to do so and expedite the debtor's path to a discharge.[87] The court is also authorised to extend the period beyond three years if the debtor acts in bad faith during the proceeding and abuses the process, or if the debtor fails to co-operate with the trustee.[88] Upon completion of the debtor's payments under the payment plan, the debtor will enjoy a discharge from all his remaining unpaid debts and the insolvency proceeding will terminate.[89]

6.5.11 Discharge

The ultimate point in an individual insolvency proceeding is obtaining a discharge. The discharge relieves the debtor from all his remaining and outstanding unpaid debts that have not been paid by the trustee out of the assets of insolvency estate and the monthly payments.[90] However, there are certain claims that are not dischargeable. These are:

(a) penal fines;

(b) a debt created by fraud;

(c) a debt to victims of theft, severe violence or sex offences;

(d) a judgement for alimony payments.[91]

The discharge reflects the fresh-start policy of the statute, providing the debtor with a new economic and financial start ("fresh-start"). For the debtor, the discharge is the light at the end of the insolvency tunnel. As stated above, the average period for obtaining a discharge is four years (one year for Stage 1 plus three years for Stage 2) and the court may shorten or extend the period, depending on the circumstances. In cases where the debtor's monthly family expenses in order to enjoy a decent living exceed the debtor's monthly earning capacity, the court may issue an immediate discharge at the beginning of Stage 2 of the insolvency proceeding.[92] No monthly payments may be imposed in such circumstances and there is therefore no point in keeping the debtor in the proceedings.

To the extent new information is revealed after obtaining a discharge and that information casts a cloud over the debtor's eligibility for a discharge, the court may void the discharge already granted.[93]

6.5.12 Distribution to creditors

After completing the collection of assets belonging to the insolvency estate and collecting the debtor's monthly payments under the court's economic rehabilitation order, the trustee needs to liquidate the assets of the estate by selling them. The proceeds and the accumulated payments of the debtor are used by the trustee for

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86 *Idem*, s 163(a).
87 *Idem*, s 163(b).
88 *Idem*, s 163(c).
89 *Idem*, s 174(a). However, the trustee's powers to administer the insolvency estate and liquidate its assets survive the discharge - s 174(b).
90 *Idem*, s 174(a).
91 *Idem*, s 175(a).
92 *Idem*, s 167.
93 *Idem*, s 176.

distributing payments to the creditors based on their approved claims. The order of priority among the creditors is set in unified provisions in Part V of the New Insolvency Act. These provisions apply to all insolvency proceedings under the Act, individual and corporate alike. The order of priority is thus discussed and elaborated upon below.

Self-Assessment Exercise 4

Question 1

What are the two stages of individual insolvency proceedings? What are the main elements, actions or substance taking place in each stage? What is the duration of each stage?

Question 2

May a debtor clear himself of all debts that he owes by obtaining a discharge in the insolvency proceeding?

For commentary and feedback on self-assessment exercise 4, please see APPENDIX A

6.6 Corporate liquidation

6.6.1 Introduction

The New Insolvency Act provides that a corporate insolvency proceeding may be commenced with respect to a corporation that:

(a) is incorporated in Israel;

(b) is doing business in Israel; or

(c) has assets in Israel.[94]

6.6.2 Unitary gateway to insolvency proceedings

Part II of the New Insolvency Act provides for a unitary gateway to corporate insolvency proceedings, either liquidation or reorganisation. It is available for all corporations, private and public alike. The initiation of an insolvency proceeding under Part II is by the filing of a voluntary or an involuntary petition for a commencement order. A voluntary proceeding is petitioned by the debtor. An involuntary proceeding is petitioned by creditors. Only after a hearing on the petition will the court decide whether to channel the proceedings towards reorganisation or liquidation. It follows then that the conditions for the filing of a voluntary petition or an

[94] *Idem*, s 5.

involuntary petition are identical for (the eventual) liquidation and reorganisation cases.[95]

6.6.3 Voluntary petition for a commencement order

A debtor corporation may file with the court an application for a commencement order, if:

a) the corporation is insolvent, or the order is required to prevent its insolvency; and

b) its total debts exceed NIS 25,000.[96]

Insolvency is defined in the statute as either balance-sheet insolvency or cash-flow insolvency (that is, the debtor cannot pay its debts as thay fall due).[97] It should be noted that a corporation may request the court to order its economic reorganisation within the commencement order, but the court has discretion whether to issue an order for reorganisation or liquidation.[98]

6.6.4 Involuntary petition for a commencement order

A creditor may file an application for a commencement order with the court if the corporation is insolvent. In order to overcome the information gap, which places the creditor at an information disadvantage concerning the debtor's economic state and its aggregate debts, a creditor may establish a "presumption of insolvency" in its petition. A presumption of insolvency may be established in one of the following ways:[99]

- if a creditor presented to the debtor a payment demand exceeding NIS 75,000, including a notice that if payment is not made the creditor intends to file an involuntary petition against the debtor and the debt was not paid within 30 days of the demand;

- a creditor served the debtor with a warning under section 7 of the Execution Act 1967 for a payment judgment exceeding NIS 75,000 and the payment was not paid within the period specified in the warning;

- a court issued a payment judgement of an amount exceeding NIS 75,000 and the debtor did not pay the judgment amount to the creditor within 30 days;

- The Labour Tribunal issued a payment judgement of an amount exceeding NIS 10,000 and the debtor did not pay the judgment amount to the creditor within 30 days.

In order to establish standing for filing an involuntary petition by a future creditor (that is, a creditor whose payment date has not arrived yet), that creditor must establish that either:

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95 A corporation may also self-liquidate which is a process of dissolution without the involvement of the court and therefore by its very nature it is a more flexible process. According to this procedure, a company may self-liquidate only if it has the capability of paying its debts in full within one year from the commencement of the liquidation. A resolution to self-liquidate the corporation is passed by the general meeting of the shareholders.

96 New Insolvency Act, s 7.

97 *Idem*, s 2.

98 Idem, s 8.

99 *Idem*, s 110(a).

(a) its claim is payable within the next six months; or

(b) that the corporation is acting in such a way as to defraud its creditors or to hide or remove assets from its creditors.[100]

6.6.5 No duty to file for liquidation; directors' liability for failure to reduce insolvency

The New Insolvency Act does not impose a duty on the debtor corporation (or the creditor) to file for liquidation or reorganisation proceedings. Nonetheless, the statute imposes a duty on the directors to reduce the extent of insolvency of the company.

The statute provides that a director or Chief Executive Officer (CEO) who knew, or should have known, that the corporation is insolvent and has not taken reasonable steps to reduce the extent of its insolvency, may be personally liable to the corporation for damages caused to its creditors due to the director or CEO's negligence. The section further specifies three safe-harbour measures that create a presumption. One of these measures is to file for an insolvency proceeding with the court.[101] Therefore, while the law does not impose an official obligation to file for an insolvency proceeding, there is certainly an incentive for directors to consider doing so.

6.6.6 Conversion from reorganisation to liquidation, and vice versa

The New Insolvency Act allows the court to convert a reorganisation proceeding into a liquidation proceeding. This will occur when the court concludes that despite the initial attempt to reorganise the company, there seems to be no reasonable prospect for the successful recovery of the corporate business. Alternatively, the court may order a liquidation proceeding in cases where it is of the opinion that the continued recovery procedure of the corporation will harm the creditors.[102]

The statute also allows for a conversion from liquidation to a reorganisation, although such a conversion is much less practical.[103]

6.6.7 Moratorium

The legal effect of a commencement order is to stay all pending or new legal proceedings against the debtor.[104] No creditor may initiate or continue any collection or other legal proceedings against the debtor or its property without the specific authorisation of the court. Exemptions to the moratorium will rarely be authorised in practice. In insolvency (liquidation) cases, secured creditors are exempt from the stay and may continue their actions to foreclose on the collateral in order to pay their secured claims.[105] Secured creditors are entitled to a priority over unsecured creditors and as a result any stay of actions against them would not serve any practical purpose in liquidation. Whenever the collateral is sold, the secured creditors who hold the property as security will be paid first from the proceeds. However, if the court ordered for the reorganisation of the corporate debtor, the secured creditors are also subject to the moratorium and may not foreclose on their collateral.

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[100] *Idem*, s 9(c).
[101] *Idem*, s 288.
[102] *Idem*, s 94.
[103] *Idem*, s 98.
[104] *Idem,* s 121.
[105] *Idem*, s 245.

However, statutory law and case law impose certain limitations on secured creditors' rights to foreclose on the collateral they hold as security. Firstly, the New Insolvency Act provides that where the estimated value of the collateral of a secured creditor significantly exceeds the value of the secured creditor's claim (that is, an over-secured creditor), the foreclosure on the collateral must be conducted by the trustee.[106] The trustee has an incentive to maximise the value extracted from the collateral through the foreclosure for the potential benefit of other creditors as well. It is worth mentioning that even before the enactment of the New Insolvency Act, the Supreme Court held in *Sasson Levy v Housing and Construction Real Estate Investments*[107] that the insolvency court may apply its discretion whether or not to supervise the process of foreclosure by a secured creditor when the circumstances give rise to the concern that the secured creditor is failing to maximise the value extracted from the collateral.

6.6.8 Debt arrangements not in the framework of formal liquidation

The law enables debt arrangements to be concluded outside the framework of an order of proceedings. The various debt arrangements are set out by Part X of the New Insolvency Act and are discussed in more detail below (see the section on corporate reorganisation).

6.6.9 Appointment of trustee (liquidator)

The New Insolvency Act uses the unitary term "trustee" for all officeholders in the various types of court-driven insolvency proceedings. Consequently, a corporate liquidator is also called a trustee. Under the Act, the court appoints a trustee upon the issuance of the commencement order.[108] The trustee is appointed from a list (or pool) of trustees formed by a public committee appointed by the Minister of Justice and maintained by the Superintendent. This committee is comprised of five members:[109]

(a) A retired judge of the District Court (chair);

(b) two representatives of the Superintendent;

(c) one representative of the Institute of Certified Public Accountants in Israel;

(d) one representative of the Israel Bar Association.

The following persons are eligible for inclusion on the list of trustees:[110]

(a) a person who is a member of the Israel Bar Association and has experience of five years of employment in the profession;

(b) a person who holds a license under the Auditors Law and has experience of five years of employment in the profession; or

(c) a person who has special expertise or proven experience in managing corporations in insolvency proceedings.

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[106] *Idem*, s 248.
[107] CA 8044/13 *Sasson Levy v Housing and Construction Real Estate Investments* (13.2.2014).
[108] New Insolvency Act, s 33.
[109] *Idem*, s 37(a).
[110] *Idem*, s 37(b).

In any specific insolvency case, the Superintendent recommends to the court several candidates from the pool (between three to five candidates) for the position of trustee. In addition, the corporation and any creditor may propose to the court additional candidates (from the pool) for the position of trustee. However, if the court appoints a trustee who was not recommended by the Superintendent, it must address this matter in its decision. The court may appoint several trustees if it finds that it is necessary due to the complexity of the proceeding.

A trustee may not be appointed if there is a conflict of interest between his role as trustee and a personal matter or other position relating to herself (or of a relative or of another person with whom he has personal or financial relations), including a conflict of interest deriving from an undertaking made by the trustee to an interested party, or to a representative of an interested party, in insolvency proceedings.

6.6.10 Debtor-in-possession approach

The court may appoint one or more of the corporate officers or directors as the trustee of the corporation if it is convinced, after providing creditors with an opportunity to present their arguments, that this will benefit the insolvency proceedings and will not harm the creditors' interests. If the court does appoint officers or directors of the corporation as trustees, it must nonetheless appoint an additional trustee from the list of trustees alongside those officers or directors.[111]

If a trustee cannot be appointed upon the issuance of the commencement order, the court will appoint a temporary trustee in accordance with the above procedures.[112]

6.6.11 Powers and duties of the trustee

The trustee's powers and duties are set out in the New Insolvency Act. Upon the appointment of a trustee the powers of the corporate and other officers of the corporation vest in him and he must use them to the extent required for fulfilling his duties.[113] The trustee's role is to act for the liquidation of the corporation or to operate the corporation as going concern for the purpose of its economic rehabilitation. The role of the trustee to reorganise or liquidate the debtor corporation, is derived from the court's instructions in the commencement order.

As part of these duties the trustee must:

(a) approve or reject proofs of claim;

(b) administer the assets of the insolvency estate and liquidate them through their sale;

(c) distribute the proceeds of the corporation's assets to the creditors.[114]

In addition, there are some powers of the trustee that require the approval of the court. These powers are:

(a) filing or defending a law suit on behalf of the corporation;

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[111] *Idem*, s 36.
[112] *Idem*, s 34.
[113] *Idem*, s 43.
[114] *Idem*, s 42.

(b) employment of a person who will assist the trustee in managing the insolvency proceedings;

(c) settling with a creditor or debtor of the corporation in respect of an amount that is significant and substantial for the insolvency estate.

The trustee's duties are not explicitly defined in the Act. An important case dealing with the duties of a trustee is the Tel Aviv-Jaffa District Court decision in the matter of *Miyab Contracting Company*.[115] In this case, the court forbade the trustee to increase the company's financial deficit. The trustee presented to the court that the company was operating with a positive cashflow. However, a few months later, it became clear that the reorganisation was not progressing well and the procedure had been converted into receivership. At this stage, several suppliers turned to the court and demanded payment for goods and services supplied to the company during its attempted reorganisation. It was brought to the attention of the appointed receiver that there was not enough money in the company to pay these new liabilities. The receiver filed a claim against the previous officeholder (the trustee), alleging that he had breached his duty towards the company and that he was personally liable for the liabilities that had been incurred. In his defence, the officeholder argued for the application of the business judgment rule as he believed at the time that the company's continued operations would yield sufficient cashflow to meet these obligations. The District Court rejected this argument and ruled that the duty of the trustee in insolvency proceedings is different to that of the officers and directors of a company and that a trustee in insolvency proceedings does not enjoy the protection of the business judgment rule. The court held that a trustee is subject to a higher duty of care and skill towards the creditors, the court and third parties who come into contact with him in the performance of his duties. Since the Company is in a sensitive and problematic financial situation, the holder must refrain from taking business risks without the specific prior approval of the insolvency court.

Consequently, the incurring of new liabilities during reorganisation without seeking the prior approval of the court constitutes a breach of the trustee’s duties for which he may be held personally liable.

6.6.12 Proofs of claim

A pre-commencement creditor may submit to the trustee a proof of claim within six months from the date of publication of the commencement order. The trustee is entitled to extend the period for the filing of proofs of claim if it is justifiable.[116] The trustee must examine every proof of claim and decide whether to approve or reject it. The trustee will notify the creditor of his decision.[117] Any person who considers himself injured by the trustee's decision may appeal the decision to the insolvency court.

6.6.13 Executory contracts, providers of essential services

These aspects are dealt with in the paragraphs below.

[115] Liq (Tel-Aviv) 1357/03 *Miyab Contracting Company* (24.12.03).
[116] New Insolvency Act, s 210.
[117] *Idem*, s 211.

6.6.14 Avoiding a preference to creditors

The New Insolvency Act authorises the court to avoid a pre-commencement action that led to the repayment of a debt due to a creditor (or elevated it in the payment order) and which took place prior to the commencement order, under the following circumstances:

(a) the action took place within the three months prior to the date of filing the petition for a commencement order (if the creditor is a relative[118] of the debtor, the period is one year);

(b) at the time of the action, the debtor was insolvent; and

(c) as a result of the action, the creditor will receive payment of a larger share of the owed debt than it would have been paid under the insolvency proceeding.

The court will not avoid an action which confers priority on the creditors if one of the following conditions are met:

(a) on the date of execution (or on a date in close proximity to the date of execution) of the transaction the debtor received new and adequate value for the action that was performed; or

(b) the performance of the transaction was in the normal course of business of the debtor and the debt repaid in the action was created during the debtor's normal course of business.

6.6.15 Avoidance of transactions at an undervalue

According to the New Insolvency Act, the court is authorised to avoid a pre-commencement action that removed an asset from the corporation, under the following circumstances:

(a) the action was performed without value or at an undervalue;

(b) the action took place within two years prior to the date of filing the petition for a commencement order (if the transferee is a relative[119] of the debtor, the period is four years); and

(c) at the time of the action the debtor was insolvent, or the transfer of the asset resulted in the debtor becoming insolvent.

If the transfer of an asset for no equivalent value was made with the **intent** of reducing the property available to the debtor's creditors, it may be avoided if it took place within seven years prior to the date of filing the petition for a commencement order, even if the debtor was not insolvent at the time of the transfer.

6.6.16 Liability of directors for fraudulent trading

The New Insolvency Act imposes personal liability on an officer or director of a company in insolvency proceedings who managed the business fraudulently prior to

[118] In the case of a corporate debtor, "relative" is defined as a controlling shareholder, another entity controlled by the debtor or by its controlling shareholder, an officer or director or his relative. *Idem*, s 4 (definition of "relative").
[119] *Ibid*.

the insolvency proceedings.[120] The Act focuses on the civil liability of the officer and provides that the court may, at the request of the trustee, determine that the officer must bear liability for damages caused to the corporation as a result of his fraudulent management of the corporation. In addition, the Act allows the court to disqualify that person from serving as an officer in any corporation for a fixed period of time (but for no longer than a period of five years).

6.6.17 Liability of a director or CEO for failure to reduce the extent of insolvency

The New Insolvency Act adds a new ground of liability for directors and officers, inspired by the United Kingdom's wrongful trading provision.[121] A director or CEO who has not taken reasonable steps to reduce the extent of insolvency of a corporation from the time he knew or should have known about its insolvency, is exposed to personal liability towards the corporation for damages caused to the corporation's creditors due to his negligence.[122]

The statute contains several safe-harbour provisions for the directors and CEO in the form of presumptions of taking reasonable actions to reduce the extent of insolvency of the corporation. These actions are:

(a) receiving professional assistance from experts in corporate rehabilitation;

(b) negotiating with the corporation's creditors in order to reach a debt arrangement with them; or

(c) filing a petition for the commencement of an insolvency proceeding.[123]

However, the law makes provision for some exceptions and states that a director or Chief Executive Officer will not be liable under this section if he can prove that he relied, in good faith and on reasonable grounds, on information that showed that the corporation was not insolvent at the time.

Furthermore, the law determines that a corporation may not exempt a director from his liability under this section by including an exculpation provision in the articles of association. However, the law does not rule out the possibility of purchasing professional insurance for directors for coverage of their liability under this section.

6.6.18 Order of payment of claims

The New Insolvency Act establishes a clear order or priority for the payment of claims, which is as follows:[124]

(1) security interests (fixed charges);

(2) expenses incurred in the insolvency proceeding;

(3) priority claims (these claims are listed below);

(4) floating charges;

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[120] *Idem*, s 290.
[121] Insolvency Act (UK) 1986, s 214.
[122] New Insolvency Act, s 288.
[123] *Idem*, s 288(b).
[124] *Idem*, s 231.

(5) unsecured claims (distribution amongst them is on a *pari passu* basis);[125]

(6) interest payments (which are not recognised as part of the proof of claim);

(7) subordinated claims (either contractual subordination, or judicial subordination of shareholders' loans due to under-capitalisation of the debtor corporation).

The New Insolvency Act introduces a carve-out from the floating charge (for the level 4 claims above) in favour of the unsecured creditors. Under the Act, 25% of the proceeds of the floating charge assets must be ring-fenced and be made available for the payment of the claims of unsecured creditors. The unsatisfied part of the claim of the creditor secured by the floating charge will also constitute an unsecured claim and that creditor will participate in the distribution to unsecured creditors on a *pro rata* basis.

Secured claims include accrued contractual interest (both pre- and –post-commencement) and the pre-commencement default accrued interest. Unsecured claims include only accrued pre-commencement contractual interest. Post-commencement interest on unsecured claims rank as level 6 claims listed above.

The priority payments included under level 3 of the above list are as follows (in their order of preference):

(1) employees' wages (up to a maximum of NIS 25,630) and severance payments (up to a combined maximum of NIS 39,945);[126]

(2) deductions at source (but not paid over) for income tax and social security payments by employees;[127]

(3) value-added tax (VAT) claims, for the period of one year preceding the commencement of the case;[128]

(4) pre-commencement arrear alimony payments (in individual insolvency proceedings);[129]

(5) tax claims assessed by the Tax Authority prior to the commencement of the insolvency proceeding and settled with the debtor for payment in instalments (limited to a of maximum period of three years).[130]

6.6.19 Treatment of a group of companies under the same procedure

In Israel there are no statutory provisions relating to the process of dealing with the insolvency of a group of companies. However, the courts in Israel tend to procedurally consolidate the administration of insolvency proceedings of groups of companies in order to enhance the efficiency of the case administration.[131]

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[125] *Idem*, s 232.
[126] *Idem*, s 234(a)(1).
[127] *Idem*, s 234(a)(2).
[128] *Idem*, s 234(a)(4).
[129] *Idem*, s 234(a)(3).
[130] *Idem*, s 234(a)(5).
[131] See, eg, 47302-05-16 *Better Place Israel 2009 v Shai Agassi* (Sep 12, 2018), Nevo Legal Database (by subscription, in Hebrew) (Isr).

6.6.20 Liquidation of a corporation

After completion of the corporate liquidation process, the court will order the corporation to be dissolved and it will then cease to exist as a legal entity. The court will issue an order relating to the preservation of documents and records belonging to the dissolved corporation. These must be retained and stored for a period of at least seven years after the dissolution of the corporation.

6.6.21 Provisions relating to small corporations / corporations without assets

In Israel, there are no special rules regarding small companies or companies without assets.

6.7 Receivership

Receivership has already been dealt with under the section dealing with "Security" above.

Self-Assessment Exercise 5

Question 1

A bank lent a company NIS 20 million and secured the loan by way of a fixed charge over real property with an estimated value of NIS 30 million. Assume the company has entered into a liquidation insolvency proceeding. The Bank wishes to appoint a receiver to foreclose on its charge. Would the court grant this motion? Explain.

Question 2

Assume the same facts as Question 1, except that the Bank took a floating charge over all the company's assets (the same values apply). The company also owes NIS 50,000 to 10 of its employees for combined wages and severance payments, NIS 4 million for VAT not paid over the course of the last year and also owes NIS 8 million to some unsecured creditors. How would the proceeds be distributed among the various creditors?

For commentary and feedback on self-assessment exercise 5, please see APPENDIX A

6.8 Corporate rescue

6.8.1 General

The New Insolvency Act emphasises corporate reorganisation as a preferred method for dealing with financially distressed corporations. If there is a viable business prospect for rescuing the corporate business, reorganisation should be sought rather than liquidation. Indeed, the Act states the economic rehabilitation of debtors as one of its goals.[132]

[132] New Insolvency Act, s 1(1).

To that end, the Act provides for two separate paths or procedures aimed at achieving corporate rescue. The first procedure is the "regular" or "full-scale" reorganisation proceeding, which is administered under the jurisdiction of the court. The second procedure is the "out-of-court workout" or the "light-scale reorganisation". There are notable differences between the two procedures and consequently they are discussed in detail below.

6.8.2 Full-scale reorganisation

This insolvency proceeding is governed by Part II of the New Insolvency Act. Part II of the Act deals with the insolvency proceedings of corporate debtors, both liquidations and reorganisations. Various aspects of the reorganisation proceeding runs in parallel (and is identical to) the liquidation proceeding and the statutory provisions apply equally to both types of proceedings. Other provisions are applicable specifically in reorganisations and have less application to liquidations. The various aspect and provisions relating to reorganisation proceedings are discussed below. Those aspects that are identical to liquidation will not be repeated.

Part II of the New Insolvency Act provides for a unitary gateway to corporate insolvency proceedings (which can either be liquidation or reorganisation) and applies to both private and public corporations. The initiation of an insolvency proceeding under Part II is by the filing of a voluntary or an involuntary petition for a commencement order. A voluntary proceeding is petitioned by the debtor. An involuntary proceeding is petitioned by creditors. Only after a hearing on the petition will the court decide whether to steer the proceeding towards reorganisation or liquidation. From this it follows that the conditions for filing a voluntary or an involuntary petition are identical for (the eventual) liquidation and reorganisation cases.

The specific conditions for filing both types of petitions have already been discussed under the heading "Corporate liquidation" above.

6.8.2.1 Moratorium

The legal effect of a commencement order in which the court orders the reorganisation of the corporate debtor and the carrying on of its business operations, is to stay all pending legal proceedings against the debtor.[133] No creditor may initiate or continue with any collection or other legal proceeding against the debtor or its property without the specific authorisation of the insolvency court. Secured creditors are also stayed by the moratorium under reorganisation proceedings.[134] However, a secured creditor may file a motion with the court asking for exemption from the moratorium. The court will only grant an exemption to that creditor if it finds that either the corporate debtor failed to provide adequate protection for the secured claim of the creditor, or that the collateral securing the creditor's claim is not necessary for a successful corporate reorganisation.[135] To the extent that the secured creditor is granted permission to foreclose on the collateral, the foreclosure procedure depends on whether the estimated value of the collateral significantly exceeds the creditor's claim (or *vice versa*). If the value of the collateral does not significantly exceed the value of the creditor's claim, the secured creditor may pursue foreclosure through the regular enforcement procedures by appointing a receiver on

[133] *Idem,* ss 25(2) and (3), 29.
[134] *Idem*, s 245(a).
[135] *Idem,* s 245.

its behalf by the execution registrar at the Enforcement and Collection Authority. However, where the estimated value of the collateral significantly exceeds the creditor's claim, the statute requires that foreclosure must be carried out by the corporate trustee.[136] The rationale for this provision is that the secured creditor, who is in these circumstances over-secured, lacks the incentive to maximise the proceeds of the collateral beyond the extent of its secured claim, which would be to the detriment of the other creditors of the debtor.

6.8.2.2 Appointment of a trustee

The New Insolvency Act requires the appointment of a trustee for any corporate insolvency proceeding under Part II of the Act, whether it be liquidation or reorganisation. In this regard, the Act follows the UK law on administration rather than the US Chapter 11 procedure, the latter of which is a debtor-in-possession proceeding without the requirement of appointing a trustee. While Israel's law empowers the insolvency court to maintain the management of the corporate debtor as a debtor-in-possession procedure, this power is an exception to the general rule of replacing management with an independent trustee. In any event, even where the court retains the existing management in a debtor-in-possession styled procedure, it is nonetheless required to appoint an external trustee alongside the existing management.

The procedures and rules for appointing a trustee for a corporate debtor under Part II of the New Insolvency Act, as well as the powers and duties of trustees, have already been discussed above.

6.8.2.3 Proofs of claim

The rules for filing proofs of claim by creditors and their approval or rejection by the trustee, have already been discussed above.

6.8.2.4 Sale of assets during the proceeding

The trustee may sell assets of the corporate debtor during the reorganisation proceeding. Assets that are not subject to a security interest in the form of a fixed charge may be sold by the trustee in the ordinary course of business without the need to obtain the prior approval of the insolvency court. The holder of a floating charge over the corporation's assets may nonetheless object to a sale where the court's authorisation has been sought. To the extent that a motion objecting to a sale has been filed with the court, the court will approve the sale if it finds that the assets are not necessary for the corporate reorganisation and that the secured creditor has been provided with adequate protection for its secured claim.[137] If the trustee wishes to sell assets subject to a fixed charge, whether in or outside the ordinary course of business, he must obtain prior approval for the sale from the insolvency court.[138] The court will approve such a sale if it finds that the sale is necessary for the corporate reorganisation and the proceeds will provide the secured creditor with adequate protection. The trustee is also required to obtain the prior approval of the court for the sale of assets subject to a floating charge and which sale is not in the normal course of business.[139]

[136] *Idem,* s 248.
[137] *Idem,* s 61(a)(2).
[138] *Idem,* ss 61(a)(3), 62(a).
[139] *Idem,* s 62(a).

6.8.2.5 Post-commencement financing

During the insolvency proceeding a trustee may seek to obtain fresh or new funding for continuing the business operations of the reorganising corporate debtor. In a similar fashion to other jurisdictions, the New Insolvency Act facilitates such post-commencement financing by offering certain priority rights to post-commencement lenders. The trustee must obtain the prior approval of the court for post-commencement financing.[140] The statute provides an ascending scale of priorities that the court can ascribe to the post-commencement financing, based on the circumstances and the terms under which the lender is willing to finance the debtor. The default is that the post-commencement loan will enjoy priority over the expenses of the proceeding (which are payable ahead of the statutory priorities in insolvency).[141] However, if the trustee cannot obtain a loan under such priority terms, the court may approve a post-commencement loan with a junior (lower ranking) security interest on assets of the corporate debtor.[142] If this also prevents the trustee from obtaining a loan, the court may approve a loan secured by a security interest that will rank *pari passu* with a pre-existing security interest over the same collateral.[143] However, this type of loan is only permissible if the court is satisfied that the pre-existing secured claim is provided with adequate protection.[144]

6.8.2.6 Executory contracts

Subject to the approval of the court, a trustee in a corporate reorganisation is authorised to assume or reject executory contracts to which the debtor corporation is a party.[145] A contract that is onerous to the corporate debtor is detrimental to the reorganisation proceeding and the creditors. For this reason, the New Insolvency Act allows the trustee to file a motion with the insolvency court for the purposes of rejecting an executory contract.[146] The trustee is required to file such a motion with the court within 90 days from the date of the commencement order,[147] although the court may extend the period for filing such a motion by the trustee. The court must approve the trustee's rejection of an executory contract if it finds that the rejection will enhance the corporate reorganisation or will maximise the return to creditors.[148] Upon rejection of an executory contract, all obligations and rights under the contract cease to exist. Any damages that the counter-party suffers as a result of the rejection of the contract constitute an unsecured claim against the insolvent estate.[149]

A trustee may also assume an executory contract and thus continue its performance within the reorganisation proceeding. The trustee may assume an executory contract despite any previous breaches by the corporate debtor.[150] To the extent that the contract has been breached prior to its assumption, the trustee should file a motion with the court requesting judicial approval of its assumption. This motion must be filed within 45 days of the trustee having received a notice from the counter-party of its intention to rescind the contract due to a breach of its provisions.[151] The trustee is

[140] *Idem,* s 65(a).
[141] *Idem,* s 65(b).
[142] *Idem,* s 65(c).
[143] *Idem,* s 65(d).
[144] *Idem,* s 65(e).
[145] An executory contract is defined as a pre-commencement contract to which the debtor corporation is a party and the performance of which has not yet been completed by either of the parties - s 66.
[146] *Idem,* s 67.
[147] *Idem,* s 70(b).
[148] *Idem,* s 70(d).
[149] *Idem,* s 74(a).
[150] *Idem,* ss 68(a) and 71.
[151] *Idem,* s 71(b).

not required to remedy any pre-assumption breaches of the contract as a condition for assumption. Any such breaches constitute a pre-commencement unsecured claim against the insolvent estate.[152] The court may not authorise the assumption of an executory contract where there have been previous breaches unless the trustee convinces the court that it is able to provide the counter-party with adequate assurances of its intended performance of the contract.[153]

To further enhance the feasibility and practicality of the assumption of executory contracts for the benefit of the reorganising corporation and its creditors, the New Insolvency Act disallows any insolvency *ipso facto* termination clauses that may exist in an executory contract.[154] The contract remains operative and ripe for assumption, notwithstanding the presence of any such insolvency-related termination clause.

6.8.2.7 Providers of essential services

The New Insolvency Act provides for the continuity of infrastructure and essential services to a corporate debtor undergoing reorganisation. Infrastructure services are defined as being: electricity, water or any other service that the Minister of Justice and the corresponding applicable minister define as such.[155] The provider of an infrastructure service must continue providing that service to the corporate debtor despite any previous payment defaults by the debtor.[156] The terms of payment for that service during the insolvency proceedings may be determined by the insolvency court.[157]

Other services that may be continued under the statute are services or products that are essential for the operation of that corporate debtor. To the extent such essential services or products are provided to the debtor, other than within the framework of an executory contract, the court may order the continuation of the provision of those services or products to the corporate debtor during the reorganisation proceeding for periods of 60-days at a time.[158] The court will only issue such an order if it is satisfied that the following conditions are met:

(a) the continued provision of the service or product is essential to the successful reorganisation of the corporation;

(b) in the circumstances there is no practical alternative for providing this service or product in similar terms;

(c) the provider's refusal to continue the service or the products is unreasonable; and

(d) the court determines the payment terms for the service or product during the proceedings and may demand a security bond from the trustee.[159]

The payments by the trustee for the services provided to the corporate debtor by such suppliers during reorganisation proceedings constitute reorganisation

[152] *Idem,* s 74(b).
[153] *Idem,* s 72(a).
[154] *Idem,* s 68(b).
[155] *Idem,* s 77(a).
[156] *Idem,* s 77(b).
[157] *Idem,* s 77(c).
[158] *Idem,* s 78(a), (b), (c).
[159] *Ibid*.

expenses.[160] Unpaid pre-commencement payments constitute unsecured claims by the supplier.

6.8.2.8 Voidable transactions, clawback provisions

The New Insolvency Act addresses voidable transactions and contains clawback provisions in a unitary fashion. Part V of the Act deals with these matters and the provisions apply to all insolvency proceedings under the Act. These aspects have already been discussed above under the heading "Corporate liquidation" and apply equally here.

6.8.2.9 Approving a reorganisation plan

In a corporate reorganisation proceeding the trustee presents one or more proposed plans for the approval of the creditors and subsequent confirmation by the court.[161] To the extent that the proposed plan values the corporate net asset value (NAV) – being the value of the corporate assets after deducting the corporate liabilities – positively and the plan proposes to pay off all creditors' claims in full, then such proposed plan must also be submitted to a vote of the corporation's shareholders.[162] Creditors' votes are held in separate classes based on the common rights and interests of all the members of that class.[163] The classification of claims for the purpose of voting on the proposal is made by the trustee[164] and may later be challenged in court. As a result, it is common to hold separate meetings and votes for the secured claims class and the unsecured claims class. The required statutory majority within each class of creditors for approving a proposed plan, is:

(a) a simple majority of the persons attending and voting; and

(b) a 75% majority of the aggregate claims represented and voted at the meeting.[165]

Upon approval of the plan by the classes of creditors at the various meetings, the plan requires judicial confirmation.[166] The plan then becomes effective and binding on the corporation and all its creditors (and, where applicable, its shareholders).[167] If a proposed plan was approved by some of the creditors' class meetings but did not receive the requisite majority in other classes, it may nonetheless be confirmed by the court despite the dissent of certain classes (this is referred to as a cross-class cramdown).[168] Before it confirms a reorganisation plan over the dissent of a class of creditors, the court must satisfy itself that the terms of the plan are fair and equitable in relation to that class. To that end, the court should request a valuation of the debtor corporation and examine the following elements:[169]

(a) whether the corporation will spiral into liquidation without the approval of the reorganisation plan and whether the value that each creditor in the dissenting class will receive is more than it would receive in a liquidation;

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[160] *Idem,* s 79.
[161] *Idem,* ss 83(a), 84-86. The trustee may solicit proposals from the creditors or from any other person - s 81(a).
[162] *Idem,* s 83(b).
[163] *Idem,* s 84(a).
[164] *Idem,* s 84(b).
[165] *Idem,* s 85.
[166] *Idem,* s 86.
[167] *Idem,* s 89(a).
[168] *Idem,* s 87.
[169] *Ibid*.

(b) to ensure that the plan does not provide for any consideration to be paid to the equity holders (in their capacity as such) while failing to provide full payment to each creditor in the dissenting class;[170] and

(c) to the extent the dissenting class is the class relating to secured creditors, that the plan provides each creditor of that class with a value equal to or greater than the market value of its secured claim (that is, the lesser of the creditor's claim or the value of its collateral).

6.8.3 The light-scale, out-of-court workout – the Protected Negotiations scheme

The New Insolvency Act provides an alternative channel for restructuring corporate debts. This channel is an out-of-court workout under a new procedure called "Protected Negotiations". It can be found in Chapter 4 of Part X of the Act. By and large, the new workout framework is somewhat reminiscent of the 2019 European Commission Directive for the adoption of a preventive workout mechanism.[171] Certain similarities may be also drawn between the new Protected Negotiations scheme and the UK Scheme of Arrangement, and even to certain components of the US Chapter 11 procedure.

Generally speaking, the Protected Negotiations scheme is intended to serve as an amicable workout framework under which the corporate debtor and its creditors negotiate in the boardroom rather than negotiate (and fight) in the courtroom. The most notable aspect of this framework is that the board runs the negotiations without the appointment or intervention of a trustee. In essence this a debtor-in-possession procedure, albeit that it takes place out of court.[172]

Unlike a full-scale reorganisation proceeding under Part II of the New Insolvency Act, the Protected Negotiations scheme is only available to listed corporations.[173] Moreover, it is only likely to be practical for holding corporations whose sole debt is financial (bank loans and publicly issued bonds) and less attainable for listed industrial corporations. Another limiting condition of this new framework is that it requires corporations who wish to use this mechanism to meet an eligibility test. In order to qualify for the Protected Negotiations scheme, a corporation may not already be insolvent. Moreover, the board must state that:

(a) the corporation has not defaulted on any of its payment obligations to date; and

(b) there is no substantial risk that the corporation is likely to default on any of its payment obligations within the subsequent nine months.[174]

The framework of the Protected Negotiations scheme is as follows: after the board has issued a solvency statement as described above, it must send a notice of commencement of Protected Negotiations to every creditor with whom it chooses to negotiate and to the Superintendent in Insolvency. The board must attach to the

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170 This reflects the absolute priority of creditors over the equity holders of the debtor corporation.

171 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

172 The commencement and process of this scheme does not require any court involvement or order. Only confirmation the final outcome by the court is required – ie, the plan / arrangement requires court confirmation after the creditors have voted, in order to bind all dissenting creditors.

173 New Insolvency Act, s 338(a).

174 *Ibid*.

notice a copy of its solvency statement.[175] This commences the scheme.[176] The operative results of the Protected Negotiations scheme is as follows:

(a) The creditors elect a representative on their behalf to negotiate with the corporation and who also serves as their observer at board meetings for the duration of the scheme.[177]

(b) All participating creditors are enjoined from enforcing their individual rights against the corporation for the duration of the scheme, including the acceleration of payments based on any default of loan or bond covenants and filing a petition for formal insolvency proceeding.[178]

(c) During the protected period, the debtor corporation enjoys the exclusive right to propose a reorganisation plan and to present it to the creditors for a vote.[179]

The maximum duration for the Protected Negotiations scheme is six months, and it cannot be extended beyond that period of time.[180] On the other hand, to the extent that within this period a covenant in one of the corporation's debt instrument has been breached, or an acceleration event is triggered under an instrument and the creditor informed the corporation of this violation or default, then although at that date no enforcement measure can be taken by the creditor due to the statutory protection that the corporation enjoys, the protected period shrinks to 45 days immediately thereafter.[181]

6.8.4 Combining the Protected Negotiations scheme with a voluntary arrangement vote

Besides the specific chapter on Protected Negotiations, Part X of the New Insolvency Act also contains provisions that allow a debtor to enter into a voluntary arrangement with its creditors (although without any protective moratorium *per se*). These provisions apply to all debtors, individuals and corporate alike.[182] Nonetheless, it is expected that they will mostly be used by corporate debtors and only rarely by individual debtors.

The voluntary arrangement provisions allow the debtor to file a motion with the insolvency court for the mere convening of creditors' meetings to vote on a proposed arrangement between the corporation and its creditors.[183] All the voting rules discussed above in regard to a full-scale reorganisation vote (being the classification of creditors into classes, the double requisite majority within each class, the cross-class cramdown, the participation and voting by shareholders if the net asset value is positive) also apply to voluntary arrangements.[184] After the creditors have voted in favour of the arrangement, it requires the court's confirmation before becoming binding on all parties.[185]

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[175] *Idem*, s 338(b).
[176] *Idem*, s 338(c).
[177] *Idem*, s 341(a).
[178] *Idem*, s 339(a)(2), (3). This prevention of the enforcement of creditors' rights is a *de jur*e moratorium, even if it is phrased with different terminology. It requires the creditors to negotiate collectively with the debtor corporation.
[179] *Idem*, s 339(a)(1).
[180] *Idem*, s 339(b)(2).
[181] *Idem*, s 339(b)(3).
[182] *Idem*, s 319.
[183] *Idem*, s 321.
[184] *Idem*, s 322(a), (b), 323(a), 324(a).
[185] *Idem*, s 322(a), (c), 324(a).

A practical outcome of the Protected Negotiations scheme is therefore to present the proposed plan (that the corporation negotiated with its creditors during the protected period) for a vote of approval by the creditors and then to submit the plan for confirmation by the court. The method used to conduct this vote is through the voluntary arrangement mechanism.

Self-Assessment Exercise 6

Question 1

May proponents of a reorganisation plan overcome the dissent of a class of creditors and, to the extent they may be able to, are there any conditions for this to take place?

Question 2

Explain the prerequisites and the mechanics of the Protected Negotiations scheme. Could the parties to this scheme avoid the involvement of the court completely?

For commentary and feedback on self-assessment exercise 6, please see APPENDIX A

7. CROSS-BORDER INSOLVENCY LAW

Similar to other countries in the world, insolvency proceedings may involve Israeli companies who conduct business or own assets in foreign jurisdictions (and *vice versa*). This presents a contemporary challenge for debtor companies, their domestic and foreign creditors, domestic and foreign courts as well as insolvency regulators.

Prior to the enactment of the New Insolvency Act, cross-border insolvency proceedings were not anchored by Israeli legislation. The only applicable provision was section 380 of Companies Ordinance, which set the jurisdiction of Israeli courts to order the liquidation of a foreign company who has assets in Israel. In addition, the courts in Israel used the Israeli Recognition and Enforcement of Foreign Judgments Act 1958, which sets conditions for direct or indirect recognition and the enforcement of foreign judgments.

Two significant cases dealing with the cross-border insolvencies were decided in the early 2000s by the Tel Aviv District Court. The cases dealt with two US airline insolvency cases adjudicated in the US bankruptcy courts under the US Bankruptcy Code. Both airlines, *Tower Air*[186] and *TWA*,[187] operated flight routes to Israel and employed local Israeli workers. In both cases, after insolvency proceedings had been initiated in the US court, a motion on behalf of Israeli creditors and employees was filed with the Israeli courts to appoint a local interim liquidator to control the assets in Israel and protect the employees' payment rights under Israeli law.

The Israeli court recognised the legal proceedings but also held that it nonetheless has ancillary jurisdiction given that the airlines have some assets in Israel. However,

[186] LiqC (D Tel-Aviv) 1383/00 *In re* Tower Air.
[187] LiqC (D Tel-Aviv) 1225/01 *In re* TWA.

the operative bottom line of the court in these two cases was different. In the case of *Tower Air* a trustee was appointed in the US (under Chapter 11) and that trustee tried to continue the flight route to Israel and the Israeli operation of the airline. As a result, the court was satisfied with the trustee's actions v*is-a'-vis* the Israeli creditors and employees and thus did not appoint a domestic liquidator. In the *TWA* case, which was a debtor-in-possession Chapter 11 case in the US, the airline was to be sold to a new purchaser (American Airlines) and was about to cancel its flights to Israel and cease all its local branch operations. In this case, the court appointed an interim local liquidator to administer the assets located in Israel for the benefit of the Israeli employees and creditors.

In the more recent *Sybil*[188] case, the district court in Tel-Aviv ruled that the Cyprus-incorporated company complied with the "assets in Israel"-test required by section 380 of the Companies Ordinance, based on the following factors:

- its centre of main interests (COMI) was in Israel;
- its management and board resided in Israel;
- it issued bonds to the public in Israel and had no business or establishment whatsoever in Cyprus.

In a creative ruling, this satisfied the court as meeting the requirement of having "assets in Israel". On appeal, the Supreme Court held that the public issuing of the bonds constituted "assets in Israel".[189]

Part IX of The New Insolvency Act addresses cross-border insolvency based entirely on the UNCITRAL Model Law on Cross-Border Insolvency and basically translates the Model Law's provisions to Hebrew. Just like the Model Law's general approach, the application of the cross-border provisions of the New Insolvency Act does not require reciprocity by the foreign jurisdiction.

The main issues addressed by Part IX of the Act are:[190]

- assistance to a foreign court / trustee in Israel in respect of a foreign proceeding;
- assistance to an Israeli court / trustee abroad in respect of the Israeli proceeding;
- concurrent proceedings in Israel and abroad;
- the rights of foreign creditors in proceedings in Israel.

For the purpose of the recognition of foreign proceedings by an Israeli court, Part IX of the Act defines a "main proceeding" (and, by contrast, a "non-main proceeding"). A main proceeding is defined as the location of the centre of main interests (COMI) of the debtor. Unless proven otherwise, the default COMI of a corporate debtor is its place of incorporation and, in the case of an individual debtor, his place of residence.[191] Once a foreign proceeding is recognised in Israel as a main proceeding, it entails an automatic moratorium in Israel, prohibiting the disposition of assets in Israel and obtaining any relief necessary for the foreign trustee (including

[188] LiqC (D Tel-Aviv) 13800-10-10 *In re Sybil Europe*.
[189] CA 2706/11 *Sybil Germany v Hermetic*.
[190] New Insolvency Act, s 294.
[191] *Idem*, s 293.

the management of assets situated in Israel, investigations and disclosure).[192] On the other hand, if a foreign proceeding is recognised in Israel as a non-main proceeding, the Israeli court has a wide discretion to provide any of the above-mentioned relief and legal remedies if it is convinced that they are required for managing the assets located in Israel.[193] Also, upon recognition of a foreign proceeding a foreign trustee enjoys free and direct access to the Israeli insolvency court at any time.[194] After recognition of a foreign proceeding, the foreign trustee may also participate as a party in the local proceedings.[195]

The New Insolvency Act treats Israeli and foreign creditors equally in respect of their rights to commence insolvency proceedings in Israel and to receive information about the proceedings.[196] It also establishes a duty to notify the creditors about any relevant information.[197]

The Act encourages co-operation between Israeli jurisdictions and their foreign counterparts by authorising the Israeli courts to directly contact the foreign insolvency administrative and judicial authorities for the transfer of information or assistance regarding cross-border insolvency proceedings.[198] In addition, Israeli courts may commence and administer insolvency proceedings concurrently with foreign proceedings.[199]

A notable limitation of the automatic application and recognition of foreign proceedings in Israel is the court's discretion to not recognise a foreign proceeding, or to not grant relief available to foreign trustees or authorities under Part IX of the Act, if:

- the Israeli court is convinced that such recognition or relief is contrary to public policy;
- the Israeli court finds that the foreign proceeding was conducted fraudulently; or
- the Israeli court finds that the debtor was not granted a reasonable opportunity to present its arguments and produce evidence in the foreign proceeding.[200]

Self-Assessment Exercise 7

Question 1

What is the main contribution of the New Insolvency Act with respect to cross-border insolvency (in comparison to the old Israeli law)?

[192] *Idem*, s 302.
[193] *Idem*, s 303.
[194] *Idem*, s 295.
[195] *Idem*, s 306.
[196] *Idem*, s 298.
[197] *Idem*, s 299.
[198] *Idem*, ss 308-310.
[199] *Idem*, ss 311-315.
[200] *Idem*, s 316.

Question 2

A corporation has incorporated in the British Virgin Islands, offered bonds in Israel (that are traded on the Tel-Aviv Stock Exchange), its board and management and employees reside in Israel and its main assets are in Israel. An insolvency proceeding is commenced against the company in the BVI. The BVI-appointed trustee files a motion for recognition as a foreign proceeding in Israel. Would the Israeli court be mandated to recognise the foreign proceeding and, if so, would the foreign proceeding be recognised as a "main" or "non-main" proceeding?

For commentary and feedback on self-assessment exercise 7, please see APPENDIX A

8. RECOGNITION OF FOREIGN JUDGMENTS

The Foreign Judgments Enforcement Act 1958 establishes conditions for the recognition or enforcement of foreign judgments. The conditions for the enforcement of foreign judgments are cumulative, as follows:

(a) the foreign court that delivered the foreign judgment was authorised to grant it under the laws of that country;

(b) the judgment is enforceable in the country where it was granted;

(c) the judgment is final and conclusive;

(d) it is possible to enforce that judgment in Israel;[201] and

(e) mutuality / reciprocity (the foreign country enforces the judgments of Israeli courts).[202]

A foreign judgment that has been ruled enforceable by an Israeli court may be enforced and executed in Israel through the Enforcement and Collection Authority, in the same way as a domestic judgment.[203]

A foreign judgment will not be enforced if five years have elapsed since the date of the judgment, unless there is an agreement between Israel and the foreign jurisdiction stating a different time limit, or if the court finds the delay justifiable.[204]

An Israeli court will not enforce a foreign judgment even where the above listed conditions are met, if it finds that:

(a) the judgment was obtained fraudulently;

(b) the defendant was not granted a reasonable opportunity to present argument and produce evidence in the foreign proceeding;

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[201] Foreign Judgments Enforcement Act 1958, ss 3 and 4.
[202] *Idem*, section 4.
[203] *Idem*, section 10(a).
[204] *Idem*, section 5.

(c) the judgment was delivered by a court which, under the prevailing choice of law rules in Israel, was not authorised to deliver the judgment;

(d) the judgment contradicts another existing judgment between the same parties;

(e) at the time of filing the lawsuit with the foreign court, a pre-existing lawsuit was pending between the same parties in an Israeli court.[205]

In addition, the court will not enforce a foreign judgment that may harm or interfere with Israel's sovereignty or security.[206]

An Israeli court will recognise a foreign judgment in direct recognition (following a motion to recognise the foreign judgment) if the following conditions are met:

(a) there is an international agreement or treaty in regard to the foreign judgment;

(b) the agreement or treaty provides that Israel undertakes to recognise foreign judgments;

(c) the undertaking applies only to judgments that are enforceable in Israel; and

(d) the terms of that agreement or treaty have been met.[207]

The court may also recognise a foreign judgment indirectly (that is, as an ancillary matter within the litigation of another main matter), even if the conditions for a main recognition are not satisfied, if the court finds it just and equitable to so recognise the foreign judgment.[208]

9. INSOLVENCY LAW REFORM

As explained above, the insolvency law of Israel has undergone comprehensive reform through the enactment of the New Insolvency Act. This reform has just become the new law of the land and consequently this guidance text has focused and elaborated specifically on the provisions of the New Insolvency Act and the insolvency law that it has now designed for Israel.

10. USEFUL INFORMATION

The applicable sources of information and websites are in Hebrew, and thus less accessible for international students.

[205] *Idem*, section 6(a).
[206] *Idem*, section 7.
[207] *Idem*, section 11(a).
[208] *Idem*, section 11(b).

APPENDIX A: COMMENTARY AND FEEDBACK ON SELF-ASSESSMENT EXERCISES

Self-Assessment Exercise 1

Question 1

What are the original pieces of legislation that governed Israel's insolvency law, and what legislation governs insolvency law today?

Question 2

Under the current law, which court or administrative agency has jurisdiction over individual insolvency cases and which has jurisdiction over corporate insolvency cases?

Commentary and Feedback on Self-Assessment Exercise 1

Question 1

Before current legislation was introduced, the Companies Ordinance 1929 regulated the winding-up of companies and the Bankruptcy Ordinance 1936 regulated personal insolvency. Currently, Israeli insolvency law is regulated by the Insolvency and Economic Rehabilitation Act, 2018.

Question 2

- Corporate insolvency cases, both liquidation and reorganisation cases, remain the exclusive jurisdiction of the district courts.
- Individual insolvency cases with stated debts exceeding NIS 150,000 must be initiated by administrative orders of the Superintendent in Insolvency and are subsequently adjudicated by the magistrate's courts.
- Individual insolvency cases with stated debts of NIS 150,000 or less fall under the exclusive jurisdiction of the administrative Enforcement and Collection Authority and must be adjudicated by the execution registrars of the ECA.

Self-Assessment Exercise 2

Question 1

A company obtains a loan from a bank and is requested to create a fixed charge over a vehicle that it owns and the corporate headquarters building, also owned by the company. What is the appropriate method of perfecting the fixed charge over both pieces of property?

Question 2

Assuming that the bank perfected its fixed charge appropriately, would the bank need a court order in order to enforce its security interest?

Commentary and Feedback on Self-Assessment 2

Question 1

The fixed charge over the vehicle is to be registered at the Registrar of Companies. The charge over the real property must be perfected by registering it in both the Real Property Registrar and at the Registrar of Companies.

Question 2

No, in order to enforce a fixed charge no court decision is required. The enforcement of fixed charges is undertaken through the Enforcement and Collection Agency.

Self-Assessment Exercise 3

Over the span of the past 25 years, how would you describe Israel's insolvency law – as more creditor-oriented or debtor-oriented? Motivate your answer.

Commentary and Feedback on Self-Assessment Exercise 3

Over the past 25 years Israel has shifted from a traditionally creditor-oriented jurisdiction to a more debtor-oriented jurisdiction. This is reflected in (a) the 1995 amendment of the Companies Ordinance that facilitated for the first time corporate reorganisation in Israel (through the imposition of a comprehensive moratorium); (b) the 1996 amendment of the Bankruptcy Ordinance that allowed the ordering of discharge for individual debtors, even when they have no economic means and thus there is no recovery for creditors; (c) the adoption in 2012 of the Official Receiver's policy to enhance discharge for individual debtors; and (d) the enactment of the new Insolvency and Economic Rehabilitation Act, 2018.

Self-Assessment Exercise 4

Question 1

What are the two stages of individual insolvency proceedings? What are the main elements, actions or substance taking place in each stage? What is the duration of each stage?

Question 2

May a debtor clear himself of all debts that he owes by obtaining a discharge in the insolvency proceeding?

Commentary and Feedback on Self-Assessment 4

Question 1

Stage 1 of the proceeding is the "interim period". In this period the Superintendent in Insolvency appoints a trustee to the proceeding, the trustee needs to map the debts and obligations of the debtor (through the proof of claims process) and inquire about the debtor's economic means and family needs, to draft a "rehabilitation plan / proposal" and submit it to the Superintendent. During this stage certain limitations are imposed on the debtor, such as the limitation of leaving the country or obtaining a credit card. The duration of this stage is one year. Stage 2 is the stage of the implementation of the adopted "rehabilitation plan", under which the debtor pays monthly payments to the estate, out of which – together with proceeds of property of the debtor – the creditors will get paid. This stage lasts three years, at the end of which the debtor obtains a discharge.

Question 2

Not of all his debts. Under the statute, certain debts cannot be discharged, including:
- penal fines;
- a debt created by fraud;
- a debt to victims of theft, severe violence or sex offences;
- a judgement for alimony payments

Self-Assessment Exercise 5

Question 1

A bank lent a company NIS 20 million and secured the loan by way of a fixed charge over real property with an estimated value of NIS 30 million. Assume the company has entered into a liquidation insolvency proceeding. The Bank wishes to appoint a receiver to foreclose on its charge. Would the court grant this motion? Explain.

Question 2

Assume the same facts as Question 1, except that the Bank took a floating charge over all the company's assets (the same values apply). The company also owes NIS 50,000 to 10 of its employees for combined wages and severance payments, NIS 4 million for VAT not paid over the course of the last year and also owes NIS 8 million to some unsecured creditors. How would the proceeds be distributed among the various creditors?

Commentary and Feedback on Self-Assessment Exercise 5

Question 1

No, the court will not grant the motion and will not appoint a receiver. The Bank is an over-secured creditor, with the value of its security interest exceeding its claim by 50%. When the creditor is over-secured the insolvency judge appoints the liquidation trustee, not a receiver, to foreclose, in order to maximise the value in the foreclosure for the benefit of other creditors of the company as well.

Question 2

Due to the 25% carve out from a floating charge in favour of the unsecured creditors, only NIS 22.5 million (75% of NIS 30 million) from the proceeds of the charged property is available for paying off the claim of the floating charge. However, out of the proceeds available to pay off a floating charge claim the trustee must first pay, in priority to the floating charge, the statutory priority claims. In this case, these claims are NIS 400,000 of the employees claims (10 x a cap of NIS 40,000 per employee) and the NIS 4 million for the last year's VAT. So, from the NIS 22.5 million available to the floating charge claim, one must first pay off NIS 4.4 million to the statutory priority claims. This will leave the Bank with NIS 18.1 million paid at the level of a floating charge holder. The Bank still holds a claim for the remaining NIS 1.9 million (NIS 20 million total claim less NIS 18.1 million paid); the employees have a remaining claim of NIS 100,000 (the total employees claims of NIS 500,000 – the NIS 400,00 already paid as a statutory priority); and the NIS 8 million to other unsecured creditors. That aggregates to a total of NIS 10 million unsecured claim, for which there is only NIS 7.5 million available of the proceeds from the 25% carve out from the floating charge. All such unsecured claims will be paid 75% of their claims (a *pro rata* payment).

Self-Assessment Exercise 6

Question 1

May proponents of a reorganisation plan overcome the dissent of a class of creditors and, to the extent they may be able to, are there any conditions for this to take place?

Question 2

Explain the prerequisites and the mechanics of the Protected Negotiations scheme. Could the parties to this scheme avoid the involvement of the court completely?

Commentary and Feedback on Self-Assessment Exercise 6

Question 1

Yes, the Insolvency Act contains an inter-class cramdown provision (section 87 of the Act). This allows the court to confirm a reorganisation plan over the dissent of a class of creditors. However, in order to cramdown a plan, the court must first be satisfied that the plan is fair and equitable to the dissenting class. That means that the plan does not provide those creditors less than they would have received in a liquidation distribution, and - (a) to the extent the dissenting creditors is a class of unsecured creditors, that the shareholders do not receive any value under the plan prior to a full payment to the dissenting class; or (b) to the extent the dissenting class is a class of secured creditors – the plan provides that class the value of its secured claim (that is the lesser of the amount of its claim or the value of its collateral).

Question 2

The Protected Negotiations scheme is an amicable out-of-court scheme to advance the reorganisation of listed companies in Israel. It is commenced by a notice sent from the company's board of directors to its creditors with whom the company wishes to negotiate and reach an arrangement. The scheme may last for a maximum period of six months. During this period the company enjoys the following protections: (a) no creditor may enforce its rights against the company, including a bar on acceleration of payments based on contractual covenants; (b) the company enjoys exclusivity in proposing a reorganisation plan for the negotiations; and (c) no creditor may file an involuntary insolvency petition against the company with the court. However, in order to launch this scheme, the board of directors must meet the following prerequisite: The board must declare that the company has not defaulted to date on any payment obligation and that there is no substantial risk that it will not be able to meet a payment obligation as it becomes due within the next nine months. Although the negotiations in this scheme are conducted outside the boundaries of the court, nonetheless once an arrangement is reached by the company and its creditors through these negotiations they will turn to the court to convene creditors meetings for voting, followed by a court confirmation of the arrangement in order to bind dissenting creditors to the arrangement.

Self-Assessment Exercise 7

Question 1

What is the main contribution of the New Insolvency Act with respect to cross-border insolvency (in comparison to the old Israeli law)?

Question 2

A corporation has incorporated in the British Virgin Islands, offered bonds in Israel (that are traded on the Tel-Aviv Stock Exchange), its board and management and employees reside in Israel and its main assets are in Israel. An insolvency proceeding is commenced against the company in the BVI. The BVI-appointed trustee files a motion for recognition as a foreign proceeding in Israel. Would the Israeli court be mandated to recognise the foreign proceeding and, if so, would the foreign proceeding be recognised as a "main" or "non-main" proceeding?

Commentary and Feedback on Self-Assessment 7

Question 1

The main contribution of the New Insolvency Act is the adoption of UNCITRAL's Model Law on Cross-Border Insolvency, which now facilitates the recognition of foreign proceedings in Israel and the co-operation between Israel and foreign jurisdictions. The old law did not have such provisions and the only way to enforce foreign court decisions was through the old and general Foreign Judgments Enforcement Act 1958.

Question 2

Under Part IX of the New Insolvency Act, an Israeli court is required to recognise a foreign proceeding. However, the court has discretion to not recognise a foreign proceeding if –

- the Israeli court is convinced that such recognition or relief is contrary to public policy,
- the Israeli court finds that the foreign proceeding was conducted fraudulently; or
- the Israeli court finds that the debtor was not granted a reasonable opportunity to present its arguments and produce evidence in the foreign proceeding.

The foreign proceeding will be recognised as a main proceeding if the COMI of the company is in the BVI. The default for determining a corporate COMI is its place of incorporation – that is, the BVI. However, given that all the elements and ties of the company are in Israel (management, employees, assets, offering of public debt), but for its incorporation, it is likely that the Israeli court may recognise the BVI proceeding as a non-main proceeding.

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