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Bankruptcy, Insolvency & Rehabilitation Proceedings in Israel

ILN RESTRUCTURING & INSOLVENCY GROUP

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KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER ISRAELI LAW

The Israeli Parliament (Knesset) passed a new statute regarding insolvency law, which is named the Insolvency and Rehabilitation Law-2018 (the "**Law**"). The Law was enacted on March 5, 2018 and came into force on September 15, 2019. The Law offers a comprehensive reform and provides Israel with modern insolvency legislation dealing with both corporate and individual insolvency.

The Law has three primary objectives:

1. to promote the debtor's economic rehabilitation;
2. to maximize the debt repayment to creditors and to divide the debtor's pool of assets in a more equitable manner between the secured and unsecured creditors;
3. to increase the certainty and stability by streamlining processes and reducing the bureaucratic burden.

The key principles of the Law are as follows:

1. *A clear and simple definition of insolvency*

An entity shall be deemed insolvent if it cannot actively pay its debts. According to the Law, a creditor is entitled to file an application for a court order to open insolvency proceedings only when a debt has not been paid to a said creditor on time and therefore, creditors cannot file applications preemptively as was previously the case.

2. *Reducing the bureaucratic burden and streamlining the process*

The jurisdiction to conduct insolvency proceedings in relation to corporations is the district court. However, a significant share of the proceedings being conducted will be decided by administrative authorities and thus will not require court rulings. The Law empowers the Official Receiver or, under its new name, the "Administrator in Charge of Insolvency Proceedings and Economic Rehabilitation" with the administrative powers of insolvency proceedings.

3. *Uniformity in the opening of proceedings*

The Law establishes a uniform and orderly procedure for opening proceedings against a corporation facing insolvency. The Law prescribes that the court shall decide whether a corporation is insolvent and, only subsequently, determine the most appropriate procedure for handling that corporation on the basis of data submitted to the court. The main procedures for corporations are Liquidation processes and Recovery procedures.

4. *Creditors' debt repayment order and distribution of funds*

According to the Law, some of the debt repayments will be carved out from the sums owed to the strong secured creditors (i.e., banks and tax authorities). They will then be distributed among the general unsecured creditors holding no collateral whatsoever. In the majority of cases, these general creditors (usually suppliers, customers, and employees) receive only a tiny portion, if any, of the debtor's pool of assets. To counter this to a degree, the Law prescribes, inter alia, that 25% of the assets pledged under a floating charge (to differentiate from a fixed charge on a specific asset) be carved out in favor of the debtor's general unsecured creditors. It further determines that the volume of assets used to repay the holder of the floating charge be reduced.

The Law also reduces the preferential right given to the tax authorities when dividing up the debtor's assets. Under the former law, the tax authority was entitled to be treated as a

preferred creditor in respect of one tax year of its choice. The new Insolvency Law restricts the preference of the tax authority only to debts pursuant to voluntary debt settlements with the debtor regarding tax arrears. The preference for such debts is restricted to a maximum of three tax years.

5. ***Minimizing damages***

The Law imposes an obligation on the board of directors of the debtor corporation to take all reasonable measures to minimize the extent of the insolvency during the period prior to the opening of insolvency proceedings.

6. ***Raising new debt***

Section 65 of the new Insolvency Law provides the ability to raise new debt secured by existing pledged assets or using such assets in another manner, as required for the corporate operation or imposing obligations on certain essential suppliers and third parties to continue providing services, or to abstain from cancelling contracts due to the insolvency even if they are contractually entitled to do so.

Proceedings for corporations

A creditor or a debtor wishing to initiate insolvency proceedings must file a standard application to obtain a commencement of insolvency proceedings order. The court will determine whether to channel the corporate entity into a course of rehabilitation or winding up. This decision depends on the economic condition of the entity and is independent of the manner in which the application has been drafted.

Upon issue of the order by the court for the initiation of insolvency proceedings, an automatic stay of proceedings will apply. The court may choose to manage the corporate entity with a view to achieving its economic rehabilitation. In such a case, a stay of proceedings will apply against the secured creditors, subject to adequate protection in order to safeguard the value of their security.

Simultaneously with the issue of the order, the court will appoint a trustee to be entrusted with full control of the corporate assets.

The Law creates a new mechanism of “protective negotiations”. This is a temporary provision to be in effect for four years. This mechanism allows a public company to initiate out-of-court protective negotiations with its creditors while allowing it to remain active and without appointment of a trustee. During the period of the protective negotiations, a complete stay of proceedings shall not apply but the creditors may not file an application for a commencement of insolvency proceedings order against the corporation and may not call for the immediate repayment of debt. If the temporary provision will show positive results in practice, there are good chances it will be prolonged.

Prior to the enactment of the Law, Israeli courts generally did not allow a debtor to terminate agreements simply because a receiver believed that it could receive a better return within an alternative commercial framework. While the prior statutory framework permitted courts in insolvency proceedings to terminate "burdensome" or "unprofitable" executory contracts, courts generally did not allow licensors to terminate agreements that were moderately profitable.

Section 70(d) of the new Insolvency Law provides that a court may allow for the cancellation of all or part of an executory contract if the court determines that such cancellation is either "required for the economic rehabilitation" of the debtor or alternatively will "increase the proportion of the debt that will be

repaid to the creditors". The court may approve the cancellation of the contract after giving the other party to the contract the opportunity to voice its position, and may, at the request of the other party, order the cancellation of only part of the contract, if it is found to be sufficient for economic restoration or to reduce such debt rate.

If an existing contract is revoked under this section, all of the corporation's rights and obligations under the contract will cease but will not be revoked to prejudice another person's rights and obligations but to the extent necessary to release the corporation and its assets.

Proceedings for individuals

Under the new Law, a substantial part of the administration of insolvency proceedings related individuals has been moved from the court to administrative authorities.

Insolvency proceedings below NIS150,000 will be administered entirely by the Enforcement and Collection Authority. Insolvency proceedings above NIS150,000 will be conducted before the official receiver (the Insolvency Commissioner) and, if relevant, before the court with respect to further, more specific matters.

At the end of this audit by the Collection Authority/Insolvency Commissioner a payment plan is established, at the end of which the debtor will receive a discharge. The default scenario is a payment period of three years. The court reserves the right to increase or decrease the period depending upon the circumstances of the case.

If the debtor has no proven financial ability to pay the creditors, he may be granted an immediate discharge.

According to the new law a person who is in bankruptcy proceedings, and who owns an apartment registered with the Israel Lands Administration or the Land Registry - may find himself in a particularly problematic situation. This is because the current legislation abolishes the protection afforded by the Tenant Protection Act to the debtor and his family members residing in the property he owns.

Hence in some cases it does not necessarily pay off for debtors to resort to insolvency proceedings, e.g., when the debtor owns a real estate property whose value according to the appraiser's assessment is significantly higher than the debtor's debts. If the value of the apartment allows a person to repay his debts in full by selling it and leaves him with a sufficient amount to purchase another residential property or pay rent, then there is no point in going into insolvency proceedings, which endanger the debtor in losing the property.

In cases where the value of the property is not significantly higher than the amount of its debts listed in the debtor's execution, and he chooses to go into insolvency proceedings, it is important to know that the court is not necessarily in a hurry to put any residential apartment up for sale, preferring to exhaust all other alternatives. There is still the possibility of receiving the protection of the debtor's residential apartment in certain circumstances.

Order of Repayment

Under Israeli law, the order of repayment in insolvency proceedings is as follows:

1. Creditors secured by a fixed charge
2. Expenses of insolvency proceedings
3. Preferred creditors
4. Creditors with a floating charge
5. Ordinary creditors

6. Deferred creditors and shareholders

Directors' and CEO's liabilities

The Law allows the court to impose personal liability on a director or general manager that knew, or ought to have known, that the corporate entity was insolvent and did not take reasonable steps to reduce the potential impact of the insolvency.

However, the Law creates a presumption that a director or general manager took reasonable steps to reduce the extent of the insolvency, if measures were taken to evaluate the economic position of the corporation and acted to ensure that the corporation take one of the following measures:

1. Receipt of assistance from a corporate rehabilitation specialist
2. Negotiations for debt settlement
3. Commencement of insolvency proceedings
4. Additional measures may be derived from existing case law and practice, such as in cases of distressed companies, the officers of the corporate are required to act in favor of the corporate creditors, and to take all precautionary measures for that purpose.