ISRAEL

I. Introductory questions on the insolvency procedures available in the relevant jurisdiction

1. What insolvency procedures – either liquidation or reorganization procedures – are available for distressed or insolvent companies

1.1 Overview of the Israeli Insolvency Law

Insolvency proceedings in Israel are regulated by the Israeli law via three major laws and ordinances and by regulations enacted by virtue of these laws and ordinances (hereinafter: "Insolvency laws")

(1) The Bankruptcy Ordinance – regulates insolvency proceedings regarding individuals.

The other two laws regulate insolvency regarding corporations:

(2) The Companies Ordinance – addresses corporate liquidation as well as receivership.

(3) The Companies Act – addresses corporate reorganization (under Part IX, Chapter III of this act).

Pursuant to the Insolvency laws, the Minister of Justice may promulgate rules as necessary to facilitate carrying out the purposes and provisions of the Insolvency legislation.

1.2 Overview of the Israeli Insolvency System

The office of the Official Receiver is a department of the Ministry of Justice. The Official Receiver, currently Prof. David Hahn, supervises the administration of all insolvency
The Official Receiver’s organizational structure consists of a national headquarters and 4 division offices across the country.

The Official Receiver has a general supervisory function over all bankruptcy and insolvency estates administered under the Insolvency laws. Under the insolvency legislation, the Official Receiver serves as the default trustee or liquidator until the court appoints another trustee or liquidator from the private practice, based on a nomination by either a party (the debtor or a creditor) or the Official Receiver. Currently, the Official Receiver maintains a pool of 130 practitioners from which it nominates a trustee for individual bankruptcy cases. To date, there is yet to be established a pool for nominees to serve as liquidators. Thus, liquidators are nominated to the court by the parties or the Official Receiver. In cases of a public interest or other wide interest, the Official Receiver may be appointed as the trustee or liquidator, in order to reflect those interests.

The Office of the Official Receiver is summoned to appear in front of the court in all insolvency cases and express its professional opinion on the matters at hand.

1.3 The Act of Promotion of Competition and Reduction of Concentration, 2013

Israel's economy for many years was highly concentrated, compared to different markets around the world. In other words, quite a small group of businessmen and firms controlled a significant amount of assets- real and financial- in the market. The control was achieved mostly through business groups arranged in a pyramid structure.

Recognizing the difficulties raised by a centralized controlled economy, a committee was established in order to examine ways of dealing with the different structural problems existing in the Israeli economy. The committee found that this structure raises concerns about the strength of the financial system, to the business competition, to bondholders and to minority shareholders in public companies. Based on the conclusions of the committee a new law was enacted in December 2013: The Act of Promotion of Competition and Reduction of Concentration, 2013.
The law regulates the limitation of the control in the pyramidal structure, by limiting such structures to the holding of businesses through publicly traded holding companies to a maximum of two layers of corporations.

1.4 The New Insolvency Draft Bill

Israeli Insolvency law is based on archaic British Mandate ordinances. Similar law was in force in England at the time (1920s and 1930s), but has long ago been repealed by the Insolvency Act. 1986, as amended since. Corporate reorganization proceedings are regulated in the Companies Act. Basing a modern legal regime on ordinances issued by principles that were suitable for the beginning of the previous century is outdated.

Thus, the Ministry of Justice has published recently a new Insolvency Draft Bill. The draft bill offers comprehensive modern insolvency legislation for Israel.

The draft bill has three main goals:

1. To advance the debtor’s financial rehabilitation;
2. To maximize the return to the creditors;
3. To increase the certainty and stability of the law, shorten procedures, and reduce the bureaucratic burden.

Among the key-innovations of the draft bill are the following:

- Providing for a corporate insolvency proceeding, that will later be channeled to either reorganization or liquidation;
- Providing for a corporate arrangement of debt mechanism without the issuing of a formal insolvency order;
- Cancelling the priority claims of the tax authorities;
- A carve-out from secured creditor’s collateral in favor of unsecured claims;
2. Are there special insolvency procedures available for financial institutions or for other special classes of companies?

In General, Israeli law does not contain special insolvency procedures for financial institutions or for other special classes of companies, and their liquidation or reorganization is administered under the general insolvency law.

Banking - Notwithstanding, the Banking Ordinance, 1941, provides the frame for the administration and management of a banking corporation in case of financial difficulties. Section 8d provides that in the event the Governor of the Bank of Israel believes, after consultation with the Supervisor of the Banks thereunder, that a particular banking corporation cannot meet its obligations or that it was mismanaged, the Governor is entitled to appoint an authorized manager to manage the bank or a special supervisor to oversee the management of the bank.

Section 8f regulates the powers of the authorized manager regarding the ongoing operation of the bank, and provides that she will possess all the powers and functions of the board of directors and its committees.

Section 8L(b) provides that if an authorized manager has been appointed for the bank, the court will not issue a liquidation order for the bank or an order to obtain assets of the bank, according to a petition filed by its shareholders. Also, the bank or its shareholders general assembly (or any other assembly of right-holders) will not pass a resolution to initiate insolvency proceedings for the bank.

An authorized manager, as described in the Banking Ordinance, was indeed appointed to the Bank of North America Inc., which had been seized by the Bank of Israel, seven years after its founding, following acts of embezzlement by one of its owners. After the appointment of the authorized manager, the bank continued to function for two more years. Eventually, the bank became insolvent and entered liquidation in court (1987).
3. Are there any specific legal provisions that apply to debt restructurings achieved without a full formal insolvency process?

The Israeli law, at the moment, does not contain any specific legal provisions that apply to debt restructurings achieved without a full formal insolvency process.

Yet, it is important to note that the Part 10 of the new Insolvency draft bill deals with debt arrangement without an insolvency order. Chapter 4 thereof, provides for a voluntary initiation of negotiations by the company of a debt arrangement while the corporation is still solvent under the cash-flow test. This mechanism will be named "protected negotiations". To qualify for such a mechanism under the draft bill, the board of directors will have to certify that the company's debts have been paid to date and that the corporation has the ability to pay its debts as they become due during the next 12 months.

Opening the protected-negotiations period will be by notifying the creditors that the corporation seeks protection from them and by informing the Official Receiver.

During the protected negotiations period the corporation will enjoy the following protections:

- Exclusivity – In the course of the negotiations the corporation will have the exclusive prerogative to propose an arrangement, therefore creditors cannot force a settlement on the corporation.

- Stay of any debt collecting actions – Creditors will not be allowed to accelerate debt payments or to foreclose on collateral.

The protected-negotiations period shall be determined by the corporation, but may not exceed a period of six months.

When a corporation is making payments during the protected-negotiation period, then its ability to repay its debts to creditors that have not yet reached their maturity date may be
undermined, while under the draft bill, launching insolvency proceedings by a future creditor during this time period is prohibited, and the creditor banned from using his contractual remedies to help himself improve his position.

For this period the financial creditors will appoint an observer to the board of directors, that will report to the creditors on board meetings and resolutions and advise the creditors on their rights.

To the extent the financial creditors will not agree on the identity of the observer, the Official Receiver will appoint one.

The draft bill provides that the decision of functionaries to initiate a protected negotiation mechanism is presumptively a decision in favor of the corporation.

4. What are the commencement criteria for insolvency procedures?

Section 259 of the Companies Ordinance provides who is entitled to apply for the liquidation of a corporation: the corporation, a creditor, including a conditional creditor or a future creditor, a shareholder, and the Attorney General. The main cause for applying for liquidation is the insolvency of the debtor.

Section 350 of the Companies Act regulates a compromise or arrangement between a corporation and its creditors. It provides that the corporation, a creditor, a shareholder or a liquidator of the corporation may file a motion requesting the court to convene a creditors or shareholders meeting to consider a proposal for a compromise or arrangement. In order to initiate a compromise or arrangement proceedings, in accordance with section 350 of the Companies Act, a decision of the board of directors is required, unless the corporation's bylaws provide that a decision of the general assembly is required.

Under the Draft Bill, a shareholder cannot file a motion for the commencement of an insolvency proceeding of the corporation.
Section 350(b) of the Companies Act provides that the court may order a stay of proceedings and recovery procedures if the court is satisfied that it would aid the corporation's recovery.

The Draft Bill proposes to add an insolvency test as a prerequisite for a voluntary commencement of an insolvency proceeding. The debtor must be insolvent (cash-flow test) or that "the order is necessary to prevent its insolvency".

5. Who can propose a restructuring plan? (e.g. corporate bodies, insolvency representatives, creditors)

Section 350 of the Companies Act deals with debt arrangements, and states that at the request of a corporation, a creditor, a shareholder or a liquidator the court may order the convening of meetings of creditors or shareholders in order to vote on a proposed reorganization plan.

A reorganization plan may be proposed by the shareholders, the creditors, the company or by new outside investors. For an example, in PR"K 11478-06-13 I.D.B Holdings Company Ltd. V. The Official Receiver (17.12.13) (hereinafter: "the IDB proceedings"), the court was asked to approve a debt arrangement for a holdings company, the assets of which were the shares of a subsidiary company, I.D.B. Development Company Ltd., which in turn controlled several significant companies in the Israeli economy. Eventually, two proposed arrangements were presented to the creditors - one by new outside investors and the other by the existing controlling shareholder who joined a group of investors. The creditors voted in favor of the new investors, and the court confirmed the vote, while holding that it's the creditors right to choose the course of action (liquidation, reorganization, investors etc.) that will maximize their return.

In a later case, PR"K 26826-07-14 Hermetik Trust (1975) Ltd. V. The Official Receiver (4.9.14) (hereinafter: "the Israel Postal Company proceedings"), the court dealt with a request to initiate a reorganization process, the indenture trustee of bonds issued by the Israel Postal Company filed a motion for the appointment of an observer to the board of
directors on behalf of the bondholders. The indenture trustee acknowledged that the company was not yet insolvent but that it was concerned that it will not meet its payment obligations to the bondholders, due half a year later. The company did not dispute that without an urgent reorganization plan it will become insolvent in the near future.

The Court examined the qualifications of the parties to initiate an arrangement with the creditors, noting that the wording of section 350 of the Companies Act indicates that there is no requirement that an arrangement shall necessarily be proposed by the company itself, and that it is not necessary that the company would agree to the proposed compromise or arrangement.

In its decision, the court stressed that the purpose of section 350 of the Companies Act is to reorganize corporations and save their going-concern value. The Court also stated that there is a close connection between the state of the company and its proximity to insolvency and the court's willingness to grant the protection requested by the company or by its creditors. The court added that the more serious the company's position on the "axis of insolvency" and more significant its insolvency, the court will be more willing to allow creditors to propose a debt arrangement.

The Draft Bill proposes to allow the corporation or a shareholder thereof to propose a debt arrangement. A creditor will be allowed to propose an arrangement or a reorganization plan only upon the insolvency of the corporation. A corporation will be deemed insolvent upon a payment default that was not rectified within 30 days.

6. Please describe whether and to what extent shareholders’ rights can be affected by a situation of distress/insolvency of a company before and/or irrespective of the opening of a formal insolvency proceeding (e.g., are there any fiduciary duties of the shareholders to approve corrective measures/plans proposed by the board?)
As long as formal insolvency proceedings against the company were not initiated, the shareholders have the right to conduct themselves as they see fit, within the framework of the general assembly.

However, the directors may be obliged to take action in order to prevent the financial downfall of the company or to minimize the expected damage to its creditors. Section 267 of the new Insolvency Draft Bill explicitly states such a duty of the directors.

1. Shareholders’ Rights in Companies Subject to Insolvency Proceedings

7. Are shareholders notified of the initiation of an insolvency process? If notification is individualized, what are the mechanisms used to identify shareholders?

There is no specific regulation for notifying shareholders about the initiation of an insolvency proceeding. Presumably, they become aware of it by the public notification provided by Rule 18(b) of the Companies Rules (Liquidation) - a notice of the bankruptcy order and the date of the creditors and members meetings shall be published in the Official Gazette and in a daily newspaper. The Official Receiver may decide to not publish the notice at all if it finds it just under the circumstances.

Rule 3(b) of the Companies Rules (Motion for Compromise or Arrangement) provides that a motion for the commencement of a compromise or arrangement proceeding shall be served to the company, its significant creditors, its shareholders, and if it is a public company – to its significant shareholders, the employees committee (if it has more than fifty employees), and if there is no employees committee, the notification for hearing will be posted at the company offices in a visible place.
8. Are shareholders required to file claims in the insolvency proceeding? What are the consequences of not filing a claim?

A shareholder is required to file a proof of claim only to the extent that it is also a creditor of the company, within the time prescribed by the law. According to the Bankruptcy Rules, which apply also to the liquidation of companies, a creditor has to file its proof of claim within six months from the publication of the commencement order in the Official Gazette.

In the case of PR"K 1218/98 Israel National Bank v. Credit Lines of Israel- Financial Services and others (3.6.15), the court was asked whether the petitioner, a shareholder and a debtor of the liquidated company, is allowed to appeal against the decisions of the liquidator on the claims of other creditors of the company.

The court referred to section 310(c) of the Companies Ordinance which states that a person injured by an act or decision of the liquidator may apply to the court and the court may confirm, annul or modify the decision and issue any order on the matter as it deems just.

The court decided that the shareholder, as a subordinated creditor, has demonstrated that it may be injured by the liquidator's decision and if the appeal will be accepted, then the dividend to be distributed to the shareholders will be higher. The court also stated that the applicant should be required to post a guarantee to ensure the expenses of the liquidator.

Another opinion was expressed by a different court in PS"R 59344-01-12 Nidar Building and Development Company Ltd. v. The Official Receiver (7.7.13). This case involved a motion for instructions filed by the controlling shareholders of a company undergoing insolvency proceedings, regarding the decision of the administrator in a proof of claim of a creditor.

The court ruled that the controlling shareholder had no legal right to appeal against the decisions of the administrator on the proof of claim. This right is given only to the creditors (Rule 96 of the Bankruptcy Rules 1985). The court added that the controlling shareholder, who sees itself injured by the administrator's decisions on debt claims, may file with the court a motion for instructions.
9. Can shareholders continue to trade and transfer shares after the initiation of an insolvency proceeding affecting the company?

Section 268 of the Companies Ordinance provides for the avoidance of any transaction pertaining to the debtor company's assets or any transfer of its shares that occurs after the commencement of the liquidation proceedings.

Part IV of the Stock Exchange Regulations sets forth the rules concerning temporary cessation of trading in securities and rules regarding trading suspension thereof.

Article 6.a determines as follows: The Director General of the Securities Exchange or a person authorized by him, may suspend trading of shares, when... (b) A liquidator or a temporary liquidator or temporary receiver or an administrator was appointed to the company or to most of its assets or its subsidiary company which is holding the majority of the company's assets, and in a limited partnership – a receiver or an administrator or a business manager was appointed or if it was resolved to liquidate the limited partnership or if the court ordered its liquidation.

When a compromise or arrangement proceedings were opened under section 350 of the Companies Act, then the trading of the company's shares is not suspended, and there is no barrier to continue to trade the company's shares, as long as the company is public.

10. Do shareholders have the right to request that a shareholders' meeting is held, even if the company is insolvent? (If there are separate reorganization and liquidation procedures, does this affect the response?)

During the insolvency proceedings the powers granted to the controlling shareholders, by virtue of the ownership thereof, are expropriated. This is due to the residual character of the shareholder's rights and to change in the essence of the company from maximizing the shareholders' profits to maximizing debt repayment to the creditors. Therefore, even if
ownership of shares has remained with the original owners, the control of the company passes to a court appointed administrator, who is the trustee representing the creditors, and the shareholders are postponed creditors (PR”K 2118/02 Rubanenko Samuel Holdings Ltd. v Capital Builders Construction and Investments Ltd. 30.06.03, hereinafter: "the Rubanenko proceedings").

For the most part, an official appointed by the court, expropriates the executive powers. In the circumstances described above, when the shareholders rights are expropriated, then the right to require the gathering of a general meeting is not granted or given to the shareholders.

However, to the extent the court shall determine that the company is not balance-sheet insolvent, the shareholders will maintain the right to convene a shareholders meeting for the purpose of voting on a proposed reorganization plan.

11. Do shareholders have the right to request information in an insolvent company? Do they have information rights as to the progress of a reorganization procedure? Can they exercise that right vis-à-vis the directors of the company -if they remain in charge of the company- or vis-à-vis the insolvency representative?

Similarly, the shareholders have no right to demand information about the insolvent corporation as well as information regarding the progress of organizing repayment of the company’s debts, unless the corporation is balance-sheet solvent.

12. Can shareholders make proposals for nomination of directors, if the directors continue managing the company?
As mentioned above, the Company's entry into insolvency proceedings and the appointment of an official by the court results in transferring all management powers and capacity to act on behalf of the company to the administrator. Therefore the right to appoint directors to manage the company becomes unnecessary and irrelevant. If the court shall elect to administer the reorganization proceedings by a debtor-in-possession, any identity of the board members shall be subject to the approval of the court.

13. If special categories of shares exist whose holders are granted additional governance rights, are these additional rights affected by the opening of an insolvency procedure? (If there are separate reorganization and liquidation procedures, does this affect the response?)

As stated above, simultaneously to the company's entry into insolvency proceedings, all powers conferred to shareholders by virtue of the ownership thereof, including the management powers, are effectively transferred to the liquidator or administrator appointed by the court.

14. Can shareholders challenge the decisions of the shareholder meeting, if it is still active? Do they retain the possibility of taking action against the acts of the directors? And against the acts of an insolvency representative? Is any authorization by a judicial or administrative body required to do so or, more generally, to exercise corporate rights? (If there are separate reorganization and liquidation procedures, does this affect the response?)
As detailed above, the answer is again negative. The shareholders may apply to court by way of a request for instruction, like any other person injured by an act or decision of the liquidator who may apply to the court and the court may confirm, annul or modify the decision and issue any order on the matter as it deems just (section 310(c) of the Companies Ordinance).

15. Do shareholders have the right to call a special investigation of the affairs of the insolvent company?

Even though theoretically the shareholders have the right to call a special investigation of the affairs of the insolvent company, practically this is not done because in most cases there is no one who will bear the costs involved in conducting such an investigation. Such possible investigations are invariably controlled by the appointed liquidator or administrator and by the creditors.

16. Does the law provide for the establishment of a shareholders’ committee (or several committees, in case of different share classes)? What are their powers? Who bears the related costs?

The answer is negative.

17. Can shareholders voluntarily transfer shares of the company undergoing insolvency proceedings against any provisions in the articles/bylaws restricting transfers of shares?
Regarding liquidation, as noted in answer to question 9 above, Section 268 of the Companies Ordinance provides for the avoidance of any transaction pertaining to the debtor company’s assets or any transfer of its shares that occurs after the commencement of the liquidation proceedings. In other words, shareholders are not permitted to transfer voluntarily any shares, regardless of any provisions in the articles/bylaws of the corporation restricting transfers of shares.

In the Rubanenko proceedings, the court dealt with the issue of a shareholder’s right of first refusal to purchase shares of the company. In that case, the contract which created the refusal right held that it is not transferable. The court ruled that the right of first refusal is not avoided per se in insolvency proceedings. The trustee is subject to the refusal right just as the shareholders are subject to it, unless she can find legal grounds for its avoidance. In this case, however, the court concluded that the holder of the right of first refusal acted in bad faith and thus disregarded its objection to the sale of the shares to an external purchaser (the court did not need to state its opinion regarding the limits to transfer of share in the Article of Association).

18. Can outstanding shares of the company undergoing insolvency proceedings be assigned to third parties without the consent of the relevant shareholders? If yes, under what conditions? Are existing shareholders entitled to compensation? What other safeguards are provided? (e.g., does the law include a principle according to which the affected shareholders should not receive less than in a liquidation procedure?)

The Israeli law contains a "cramdown" clause, i.e. confirming an arrangement over the dissent of a class – creditors and shareholders (section 350M of the Companies Act, amended in Amendment 19). Amendment 19 addresses the holdout problem by authorizing the court to "cram-down" the arrangement by its confirmation over the dissent of a class. The court may confirm an arrangement over the dissent of a class only when it is satisfied that certain statutory requisites have been met. Those requisites are:
(a) More than half of the represented claims value of all classes had voted in favor of the proposed arrangement; and

(b) The proposed arrangement is fair and equitable to any dissenting class.

In this respect, a plan is fair and equitable to a dissenting class if it meets two cumulative requirements:

(a) The court is convinced that without an arrangement the corporate will be liquidated; and

(b) To the extent the dissenting class is a class of secured claims - the value of their secured claim will be paid in cash or installments, or that they will receive an asset of the same value; To the extent the dissenting class is a class of unsecured claims - that either they receive the full value of their approved claims, in cash, installments, securities, or any other form, or that the shareholders will not receive any value. This imposes the absolute priority rule as between the creditors and the shareholders.

An implicit outcome is that to the extent the company is insolvent and thus does not pay all classes of creditors 100% of their claims, the shareholders are entitled to no value and thus their vote on the plan is unnecessary.

In the case of PR"K 37456-06-14 Shiri et al. v. Orckit Communications (22.07.15) (hereinafter: "the Orckit proceedings"), the court accepted the motion of the temporary liquidator of the company, and approved an arrangement with the creditors for the sale of the company's stock market shell. This arrangement was approved by the requisite majority of the unsecured creditors meeting but not by the priority creditors and the shareholders.

The court cited Section 350(2A) of the Companies Act: a creditor or a shareholder shall make use of the right to vote at class meetings in good faith and shall refrain from exploiting her voting power.
The Court came to the conclusion that the controlling-shareholders' voted in bad faith both at the priority-creditors meeting and the shareholders meeting, and therefore will not be taken into account.

The court concluded: "a basic rational is that the status of the shareholders meetings in approval of an arrangement with creditors is 'postponed' because their interest is inferior to that of the creditors. Therefore, even if there was no majority at the shareholders' meeting for approval of the proposed arrangement it is not enough to undermine the confirmation of the arrangement."

It should be noted that an appeal against this ruling was filed this year (CA 7113/15) by a former co-founder and controlling-shareholder in the company, which is yet to be heard.

In an earlier case, PR"K 49085-11-11 Credit Lines Complementary Financial Services to Israel Ltd (in liquidation) v. the Official Receiver (4.10.12), (hereinafter: "the Credit Lines proceedings"), which was decided before Amendment 19 of the Companies Act entered into force, the court examined two requests to approve an arrangement for the Credit Line group which was in liquidation proceedings - on behalf of the indenture trustee and on behalf of the liquidators.

At the time of the petition, a civil lawsuit was filed by the liquidators against various defendants, including the controlling-shareholders and functionaries in the company, in respect of looting the assets of the companies and the takeover of their assets (oil companies, real estate) (hereinafter: "the civil lawsuit").

The Court concluded that the liquidators' arrangement proposal was superior to the indenture trustee's proposal, despite the requisite majority of claims' votes enjoyed by the latter.

The court concluded that the purpose of the proposed arrangement by the indenture trustee was to override the civil claim.

Also, the court found that a shareholders' meeting was not convened. The court held that, given the existence of public shareholders, one cannot rule out the possibility that if the civil
lawsuit filed by the liquidators is accepted, there will remain residual value even for the shareholders.

Therefore, one cannot rule out the possibility that if a shareholders meeting was convened they would have voted against the indenture trustee's proposal and in favor of the liquidators' proposal. Thus, it was necessary to convene the shareholders' meeting.

19. Can outstanding shares of the company undergoing insolvency proceedings be cancelled without the consent of the relevant shareholders? If yes, under what conditions? Are existing shareholders entitled to compensation? What other safeguards are provided? (e.g. does the law include a principle according to which the affected shareholders should not receive less than in a liquidation procedure?)

See answer to question 18, above.

20. Do shareholders of the company undergoing insolvency proceedings have pre-emption rights over new issues of shares? (1) Are there special conditions for the suppression of pre-emption rights if the company is insolvent (if there are separate

(1) Please, note that the power to decide new issues or conversions of shares, as well as the power to decide operations that affect the structure of the corporate entity (e.g., by merger, spin-off, or change of the legal form) are dealt with in Questions 33 and 34 below.
reorganization and liquidation procedures, does this affect the response?).

Generally, the answer is negative. Israeli law does not grant pre-emption rights in issuance of new shares to the existing shareholders of the company undergoing insolvency proceedings.

But see the Rubanenko proceedings described in answer to question 17.

21. Can shareholders retain a participation in the company that has emerged from an insolvency process (or in the company to which the insolvent company’s assets have been transferred) even if the company was insolvent according to a balance-sheet test? (i.e., where the value of its liabilities exceeds the value of its assets) If yes, under what conditions? (If there are separate reorganization and liquidation procedures, does this affect the response?)

For the most part, when a debt arrangement is approved for a balance-sheet insolvent company and the arrangement includes the conversion of debt to equity, then the company’s ownership passes to the creditors and the shareholders lose their holdings or at the very least they are substantially diluted. Things are different when the old shareholders inject new capital to the company and thus "buy" their right to remain shareholders of the company.

In the Nidar case, the court was asked to approve a debt arrangement between the unsecured creditors and the controlling shareholders. The argument against the proposed arrangement was that there was no contribution of value from the controlling shareholders to the company, while the arrangement proposed that the controlling shareholders will
retain equity of approximately 17.5 million NIS in value, as well an exemption from potential lawsuits against them.

The court held that although the controlling shareholders did not contribute significant fresh capital to the proposed arrangement, they nonetheless injected cash for the operation of the reorganizing company prior to the approval of the arrangement and gave up their claims as creditors within the arrangement. Under these circumstances the court confirmed the arrangement including the retaining of equity by the old controlling shareholders.

In the Elbit Proceedings, it was argued that the proposed arrangement provided for the allocation of options to the controlling-shareholder that were not disclosed. The Court concluded that there was no sufficient evidentiary for a secret agreement between any of the bondholders to the controlling-shareholder which provides the latter with various benefits. The Court noted in this context that the process of allocation of options to the controlling shareholder, among other ways in which the former controlling shareholder preserves control of the company after the arrangement, is not comprehensively wrong under the laws of the arrangements. At the same time, it added, such a move requires full transparency in accordance with the comprehensive disclosure requirements of the Companies Regulations.

22. Are the ranking of classes of shares and the preferential rights of classes of shares affected (and if yes, to what extent) by the fact that the company is undergoing an insolvency process? (If there are separate reorganization and liquidation procedures, does this affect the response?)

Answered above, but basically the answer is negative.
23. Can shareholders, in the course of an insolvency procedure, supply goods, services or financial resources to the company? If yes, under what conditions (e.g., judicial authorization)? What would their ranking position be towards other creditors?

Basically there is no reason to prevent the shareholders from providing supplies such as goods, services or financial resources to the insolvent company. The expenses will have the priority status of process expenses. For more details, see answer to question 24 below.

24. Can shareholders, in their capacity as counterparties, be under a duty to continue a contractual relationship with the insolvent company during an insolvency procedure? (If there are separate reorganization and liquidation procedures, does this affect the response?)

The duty and the necessity of shareholders to continue their contractual relations with the company subject to insolvency proceedings, is not derived from their capacity or identity as the shareholders, but is derived from the question of whether they can be seen as "essential supplier" or "essential service or commodity" as regulated by the Companies Act, Under Amendment 19, 2012.

The Companies Act, as amended by Amendment 19, now regulates the matter of executory contracts comprehensively and addresses both the rejection and the assumption of such contracts. The new amendment vests the trustee with the power to decide whether to reject or assume an executory contract.

The provisions of the Companies Act, as amended, are designed to facilitate the effective reorganization of financially distressed corporations by giving the trustee the flexibility to continue beneficial contracts that can enhance the prospects of the debtor's economic
recovery, whereas in liquidation the law is designed mainly to prevent one debtor from gaining unjust priority over another debtor, through her onerous contract/asset.

Until the trustee elects whether to assume or reject an executory contract, that contract may not be terminated by the counter-party based on its prior breach by the debtor corporation, without the consent of the trustee or the approval of the court (The Companies Act § 350H(e)). In order to balance, however, the rights of the counter-party, that party may request the trustee to either inform him as to her decision whether to assume or reject a contract, or to file a motion with the court to assume or reject a contract (§ 350J(a)). The trustee must inform the counter-party of her decision and file an applicable motion with the court within 45 days of the counter-party's request. The court may extend this period. It may also shorten this period for special reasons (§ 350J(b)). If, upon a request of the counter-party, the trustee fails to elect whether to assume or reject an executory contract within the specified period, that contract is deemed assumed (350J(d)).

Assumption or rejection of an executory contract previously breached by the debtor company requires the court's approval after notice and a hearing (§350H(c), 350J(b), (c)). The court may approve the assumption of an executory contract only if it is convinced that the debtor company will perform its current obligations under that contract from the date of assumption forward (§350H(d)). The trustee need not, however, cure pre-assumption breaches of that contract as a condition for its assumption. Once the contract has been assumed, with the court's approval, it may not be terminated by the counter-party for pre-assumption breaches thereof (§ 350H(f)).

All post-assumption contractual obligations of the debtor company constitute reorganization expenses (§ 350K(a)).

Generally, the counter-party's right to damages for a pre-assumption breach of an assumed executory contract constitutes an allowed unsecured claim against the corporate estate. However, the court may allow those damages to rank as reorganization expenses to the extent that:

(a) Separation between the breached pre-assumption obligation and post-assumption obligation is unreasonable and unjustifiable, and
(b) The counter-party is performing its own contractual obligations during the reorganization proceedings (§ 350K(b)(2)).

Exceptions to the trustee's right to assume a contract: Specifically, the statute excludes certain contracts from unilateral assumption by the trustee (§ 350H(g)). The excluded contracts are:

(a) Labor contracts;
(b) Personal service contracts; and
(c) Credit contracts.

Both labor contracts and personal service contracts were excluded due to their personal nature. Such contracts cannot be expected to be enforced unilaterally, by way of assumption, on the counter-party without her consent to continuing to provide her personal performance under the contract. Credit contracts were excluded because their assumption would have been perceived as forcing the counter-party to provide fresh financing to the debtor.²

Treatment of Specific Types of Contracts: The amendment also accords specific treatment to contracts that provide a product or service essential for the continuing operation of the debtor company. It also refers to supply of infrastructure services, such as electricity, water or any other infrastructure service, as the minister of justice shall determine (§ 350F).

The focal point of the statutes concerning these types of contracts, in this respect is to bar an infrastructure / essential service provider from terminating its continued provision of the infrastructure / essential service to the debtor company and the requirement to continue the service during the reorganization proceedings (§ 350F(b)).

The debtor company must pay consideration for the post-commencement service by the provider as agreed upon by the parties or based upon payment terms determined by the law, or a consideration as the court may order after taking into consideration the customary conditions in the market and the applicable law on that matter (§ 350F(b)). Nonetheless, the

² Explanatory notes to the Companies Act Bill (Amendment No. 17)(Corporate Reorganization), 2011.
court may allow an infrastructure/essential service provider to discontinue its service if the court is convinced that providing that service is not essential for the corporate reorganization (§ 350F(c)).

The consideration paid by the debtor company in exchange for post-commencement services may not include consideration for services that were supplied pre-commencement (§ 350F(b)). Post-commencement consideration shall constitute reorganization expenses (§ 350F(e)).

To the extent the company debtor fails to pay consideration for post-commencement service, or if the court is convinced that there is a reasonable concern that consideration will not be paid accordingly the court may condition the continuance of service on such payment or on providing assurances for payment by the debtor company. Otherwise, the court may allow the infrastructure provider to discontinue its service to the company (§ 350F(d)).

Assignment of assumed contract: Another statutory innovation of Amendment 19 with respect to executory contracts is the authority to assign an assumed executory contract. A trustee may assign, upon the court’s approval, an assumed executory contract notwithstanding any contractual restriction on its assignment and the Assignment of Rights and Obligations Act’s limitation on assignment of contractual obligations without the consent of the counter-party (§ 350I(a)). The court may approve such assignment only if such assignment is essential for the corporation’s reorganization and it does not impair the counter-party. The court may also condition the assignment as it finds appropriate, including requiring the providing of means or guarantors for the fulfillment of the assigned obligations by the assignee (§ 350I(b)).

Rejection of Executory Contracts: Prior to the enactment of Amendment 19, statutory law on corporate reorganization contained no specific provision pertaining to executory contracts. Nonetheless, the Supreme Court drew on corporate liquidation law and derived a trustee’s authority to reject an executory contract from that law by way of analogy.3 The

3 C.A. 2717/10 The Reorganization Trustee v. Interlink Mischar Benleumi Ltd. (28.2.12).
Court has held that the counter-party is merely entitled to an unsecured claim for its damages.

In this respect, Amendment 19 now reflects pre-Amendment law on rejection. The Amendment explicitly authorizes a trustee to reject an executory contract upon the court’s approval (§ 350H(c)). Upon rejection the debtor company is divested of all its rights and obligations under that contract from that point on (§ 350H(h)). The counter-party’s right for damages constitutes merely an unsecured claim (§ 350K(c)). Nonetheless, the statute allow for treatment of a counter-party's claim as a reorganization expense, if that claim arose as a result of performance by the counter-party of an obligation, the performance of which was due under the contract within the interim period of post-commencement and pre-rejection of the executory contract, and either the trustee consented to that performance by the counter-party or the court finds the according of reorganization expenses priority to such claim justified under the circumstances (§350K(d)).

25. Can shareholders (or companies of the same group) holding credit claims against the company under insolvency procedure participate in the creditors’ meeting and vote on the insolvency plan without restrictions? (If there are separate reorganization and liquidation procedures, does this affect the response?)

As stated above, Section 350(a) of the Companies Act governs the convening of creditors or shareholders in order to approve a compromise or arrangement between a corporation and its creditors or shareholders or between certain classes of them.

Section 350(a1) establishes that the classification will be made according to the interests test, i.e. a group of creditors or shareholders holding a common interest regarding the proposed arrangement that is distinctive from other creditors or shareholders and which justifies holding a separate meeting.
It should be noted that a shareholder can submit a claim in her capacity as a creditor (i.e., for credit, loans, goods or services provided to the company). In this capacity, and absent any subordination of its claim, the (shareholder) creditor may participate in the corresponding creditors' meeting.

Notwithstanding the aforementioned, there are two main grounds for the subordination of shareholder's claim in her capacity as a creditor:

The first ground is section 52n(1) of the Securities Act 1968. This section provides for the subordination of a controlling shareholder's claim that is based on the possession of the company's bonds to the extent the company is in financial distress, unless provided otherwise in the company's debt arrangement. In light of this, it is clear that a controlling shareholder holding corporate bonds will be classified as a distinct class.

The second ground is section 6(c) of the Companies Act. Section 6 deals with lifting the corporate veil. provides for treating the debt of the company to its shareholders as inferior to the Section 6(a) provides for lifting the veil if:

(1) The legal entity was used to deceive a person or to deprive a creditor; or

(2) The legal entity was used while taking unreasonable risks that imperil the company's ability to pay its debts, and in a way which contradicts the purpose of the company.

Section 6(c) authorizes the court to subordinate a shareholder's claim as a creditor in lieu of a complete lift of the veil on the same grounds as in section 6(a).

26. If shareholders (or companies of the same group) do not hold credit claims against the company under insolvency procedure, must/can they participate in the creditors’ meeting? If that is the case, what rights or duties do they have in that meeting? (If
there are separate reorganization and liquidation procedures, does this affect the response?)

As long as shareholders or cluster of companies do not hold debt claims against the company, there is no legal basis entitling or obliging them to take part in a meeting of creditors.

27. Do shareholders in an individual company have information rights as to the filing of insolvency proceedings by the parent or other related companies?

See answer to question 7 above, regarding the right of the shareholders to be notified of the initiation of an insolvency process.

II.

III. The Role of the Shareholders’ Meeting in Companies Subject to Insolvency Proceedings

28. Does the shareholders’ meeting continue to exist in insolvency proceedings? (If there are separate reorganization and liquidation procedures, does this affect the response?)

29. Does the shareholders’ meeting preserve all of its competences, generally? (If there are separate reorganization and liquidation procedures, does this affect the response?)

The general shareholders meeting in the format of its operations and roles while the company is solvent, or at least not yet facing insolvency proceedings, does not continue to
maintain its status as such, with the company's entry into insolvency proceedings, where there is no shareholders' meeting.

As mentioned, when a reorganization plan is proposed pursuant to Section 350(a), the administrator may convene the shareholders' meeting, for the purpose of approving the plan and in the format prescribed in Section 350(a1) of the Companies Act (i.e. classification of meetings). However, this depends on the balance-sheet state of the debtor company. In the vast majority of such arrangements, there is no real meaning to the convening of the shareholders' meeting, for when the creditors do not get full return of their claims, there is no residual value left for the shareholders, and thus their voting becomes irrelevant to the case. Only when the existing shareholders retain any interest in the company in a proposed arrangement, then the shareholders' meeting is convened in order to approve an arrangement or compromise by the class meeting.

30. Does the shareholders’ meeting need to approve the accounts of the distressed/insolvent company?

The answer is negative.

31. Does the shareholders’ meeting have the power to dismiss directors – if directors are still in charge of the insolvent company? Can the shareholders’ meeting request the removal of the insolvency representative? (If there are separate reorganization and liquidation procedures, does this affect the response?)

As discussed above, following the company's entry into insolvency proceedings, all management powers are vested in the administrator or liquidator. Therefore, no convening
of the shareholders' general meeting or the removal of directors (in the case of a debtor-inpossession controlled proceeding) is possible absent a court order.

In principle, the shareholders or creditors cannot remove the insolvency representative. They may however file such a motion with the court. However, the court will attribute a greater weight to the position of the creditors than to the shareholders' on the matter at hand.

32. Is a shareholders’ meeting authorisation required to start an insolvency procedure? (If there are separate reorganization and liquidation procedures, does this affect the response?)

In general, within the current legal situation, a resolution to initiate an insolvency proceeding is a resolution of the board of directors. There is no need for authorisation by the general meeting of shareholders, unless the articles of association or bylaws provides otherwise.

33. Does the shareholders’ meeting need to approve an insolvency or reorganization plan? Can shareholders, even individually, challenge an insolvency or reorganization plan?

If existing shareholders retain any interest in the company under a proposed arrangement, then the shareholders’ meeting is convened in order to approve an arrangement or compromise by the class meeting. To the extent, however, that the company is balance-sheet insolvent and the creditors are not paid in full under the proposed arrangement, a shareholders’ meeting is irrelevant for the confirmation of the plan.

An individual shareholder may file a motion with the court objecting the confirmation of a plan, after the creditors (and, occasionally, the shareholders’) meetings voted in favor of
that plan. Despite her right to being heard in court, the court will invariably reject such an objection, absent circumstances showing bad faith or other grounds of procedural unfairness in the voting, and shall confirm the plan given its approval by the various classes.

In PR"K 42082-05-14 ZIM Integrated Shipping Services Ltd. v. the Official Receiver (07.10.14) a shareholder who held only a fraction of the company's shares filed a motion to object an arrangement that proposed to cancel the holdings of the minority shareholders while leaving the controlling shareholders with equity in the reorganized company.

The court rejected this objection and held that the company was insolvent, and the creditors were given equity in exchange for their claims, and as a result the old equity was excluded. However, the old controlling shareholders were to receive 32% of the equity in the reorganized company in exchange for a significant investment of new capital ($ 200 million), an extension of credit (totaling $ 50 million), and giving up its claims as creditors (in the amount of $ 240 million. The arrangement was brought before the shareholders' meeting, and won the approval of the requisite majority required by law.

In PR"K 5084-03-13 Polar Investments Ltd. v. The Official Receiver (28.10.13) the court was requested to confirm a debt arrangement for a publicly traded investment company that proposed to allocate part of the equity of the reorganized company to part of the old shareholders.

The bondholders' meeting approved the arrangement unanimously. At the shareholders' meeting, however, 50.8% of the shares participating voted in favor of the arrangement, while 49.19% dissented, thus failing as a class to meet the 75% vote threshold.

The court concluded that despite the fact that the arrangement failed to cast the requisite majority of the shareholders' class, it should nonetheless confirm the arrangement given the creditors' unanimous approval, the company's insolvency and that the arrangement is preferable to the alternative of liquidation.

As mentioned above, in the Orckit case a debt arrangement for the sale of the company's stock market shell was approved. The proposed arrangement received the requisite majority of the unsecured creditors meeting, but failed to obtain the requisite majority at the
priority-creditors meeting as well as at the shareholders meeting. The court applied section 350(a2) of the Companies Act which states that the use of the right to vote at the class meetings will be done in good faith and in customary manner, while avoiding the misuse of power.

The court found the controlling shareholders' vote at the priority creditors' meeting and the shareholders' meeting tainted with bad faith, motivated by extraneous interests and thus did not take it into account. The appeal (CA 7113/15) on this decision is still pending at the Supreme Court.

34. Is a shareholders' meeting decision required to issue new shares of the company undergoing insolvency proceeding? Can a new share issue be decided by the board? Can a new share issue be decided by the insolvency representative? If a capital increase has to take place through the conversion of claims into new shares, does this affect the response?

An administrator appointed for a company in insolvent proceedings, may file a motion with the court for permission to issue new shares during the proceedings. Usually, issuing new shares will be relevant within the framework of a proposed reorganization plan. Thus, the voting on such issuing of shares will take place within the general vote of classes on the reorganization plan. Following the issuing of the new shares as part of the implementation of the reorganization plan, the company may convene a general shareholders meeting, under the rules of the general corporate law, for the appointment of directors.

---

4 These questions are aimed at understanding whether the fact that the company is subject to insolvency proceedings allows or causes deviations from the company law rules determining the body competent to take decisions on the issue of new shares of the company, and/or from the company law rules establishing the criteria and purposes with which such decisions must comply.
35. Can an insolvency/reorganization plan affect the structure of the corporate entity (e.g., by merger, spin-off, or change of the legal form)? Is a shareholders’ meeting authorization required for this?

The reorganization plan may affect the corporate structure and may include a merger, spin-off or another type of change of the corporate form. This will be voted on as part of the general vote by the classes of creditors on the reorganization plan. Only if the debtor company is balance-sheet solvent will the shareholders be entitled as well to vote on the plan.

At PR"K 40886-06-13 Hook Medical Technologies Ltd v Official Receiver (31.12.13), the court was asked to approve an arrangement between a solvent company and its shareholders, while there was no arrangement of the corporate debt. The arrangement proposed to dismiss preferential rights accorded to the preferred shares.

The court ordered to convene a meeting of shareholders in order to reconsider the proposed arrangement, as the company failed to convene meetings for approval in advance.

As for the classification of meetings the court held that on the basis of Section 350(a1) of the Companies Act, there is a need to convene a separate meeting for the preferred shares, and for the ordinary shares.

36. On what conditions can the company carry on business during an insolvency procedure? (If there are separate reorganization and liquidation procedures, does this affect the response?) Is a shareholders’ meeting authorization required?
An arrangement with creditors, based on section 350 of the Companies Act, is designed to allow the company's creditors a preferable alternative to taking the course of liquidation of the company.

The court is authorized to issue a moratorium order ex parte. The court should be convinced that this is required, among other things, to maintain the company's property and assets, ensuring its rights, continue its operation as an ongoing business, and to enable the formulation of a reorganization plan. In this regard see PR"K 29930-08-14 Z. Landau Construction and Engineering Ltd v Official Receiver (20.8.14) (hereinafter: "the Landau Proceedings").

For the purpose of granting a moratorium order, before a settlement was negotiated with creditors, the court must be convinced of the reasonable likelihood that an arrangement will be formulated that is preferable to the creditors over the alternative of liquidation. In light of the dismal financial condition of the company, the court must be convinced of the probability of continuing to operate the company, based on the operating plan. The company must attach an outline of the arrangement with the creditors, usually formulated with the assistance of financial advisors. The recovery outline should specify, inter alia, the sources of the company's cash flow from now on, or at least for the near future. The court must be convinced that the operating expenses will not exceed the expected revenues of the company.

Moreover, in order to operate the company during the bankruptcy proceedings, the court also seeks the position of the creditors and takes into account the position of employees.

See also the answer to Question 37 below.

In liquidation proceedings, to the extent the court appointed an interim liquidator, the court order also to continue the operation of the company's business, albeit in a limited scope.

37. In the course of an insolvency procedure, what provisions apply to the sale of specific assets out of the ordinary course of
business and to the sale of the entire business operation of the company? Is a shareholders’ meeting authorisation required? (If there are separate reorganization and liquidation procedures, does this affect the response?)

Section 350E of the Companies Act governs the authority of an administrator in bankruptcy proceedings to use, rent or sell collateralized assets and assets subject to retention of title clauses.

The Companies Act now explicitly provides the staying of the enforcement of retention of title clauses as part of the general moratorium ordered. The moratorium may be lifted and the claimant may repossess the asset if (a) the claimant is not provided adequate protection; or (b) the asset is not required for the reorganization of the company. For this purpose adequate protection means the providing of the value the claimant would have obtained had she sold the asset at the date of filing the motion for adequate protection.

When we are not dealing with collateralized assets and assets subject to retention of title clauses, the administrator may sell the assets in the ordinary course of business. When the selling is not part of the ordinary course of business of the company, the approval of the court is required.

In this case too, the convening of the general assembly of shareholders is not required.

When the administrator is appointed for ongoing management of the company's assets, she doesn’t need to get the courts approval for selling of an assets during the ordinary course of business. This is different when the administrator was not authorized to manage the company's assets, thus the administrator has to obtain the courts approval in advance, for selling an asset during the ordinary course of the business.

38. Does the shareholders’ meeting have any power in relation to a decision of the board or the insolvency representative to continue or reject any favourable, unfavourable or essential
contract during an insolvency procedure? (If there are separate reorganization and liquidation procedures, does this affect the response?).

As noted above (see answer to question 24), section 350h of the Companies Act deals with executory contracts, and governs the authority of the administrator to adopt or reject contracts of a corporation undergoing bankruptcy proceedings. The shareholders have no position regarding the adoption or cancellation of existing contracts in insolvency proceedings.

39. If an insolvency plan can be presented for a whole corporate group, must that plan be approved by the shareholders’ meetings of each company of the group, including of those that are balance-sheet insolvent? How are the different meetings’ decisions coordinated? Are there specific safeguards (e.g., any veto power or other remedy) for the minority shareholders of the companies that are not insolvent?

When separate proceedings are filed with respect to various companies in the group, there is no existing mechanism that may ensure the coordination of those proceedings. If the administrator deems it necessary, or if it is required for the effectiveness of the discussion, then he may appeal to the court for consolidation of the hearings in the various proceedings in the companies of the same group. This way we can ensure, at least to some measure, the coordination between the various insolvency proceedings, at least procedurally.
40. If companies belonging to the same group file separate insolvency proceedings, are there specific requirements/mechanisms to provide for coordination of those proceedings? Are shareholders’ meetings of the relevant companies involved in the coordination mechanisms, if any?

When there is a group of companies and some of the companies are subject to insolvency proceedings, and the proposed arrangement with creditors involves the various companies in the group, then it is necessary to approve the arrangement by each company in accordance with Section 350 of the Companies Act, i.e. convening meetings of creditors (and shareholders, to the extent a debtor company is balance-sheet solvent) and obtaining approval in accordance with the provisions of section 350(i) of the Act. The court may issue procedural orders as to the administration of the insolvency cases of the different companies in the group.

For example, at the IDB proceedings, the proceedings started with IDB Holdings Company Ltd. A few months later its subsidiary company, IDB Development Company Ltd., was also subjected to a creditors arrangement proceeding (more details about this proceedings can be found in answer to question 5). The court appointed the same expert for examining the debt arrangements of both companies and the same observer on behalf of the court. The court effectively consolidated the cases procedurally, yet the arrangement was eventually voted on only at the level of the parent company, while the subsidiary remained afloat due to capital injection from the investors in the parent corporation.

The shareholders however may not hold independently a general shareholders meeting absent the approval of the court.
IV. Other Obstacles for Insolvency Procedures Found in Company Law

41. Please list any other legal provision in company law that, in your opinion or in your experience, may interfere with the insolvency procedure of a company in your jurisdiction.

Dr. David Hahn

Administrator General
And Official Receiver