

# Bankruptcy quarantine in Denmark

Jesper Trommer Volf and Thomas Heering sum up the legislation and some of the case law based on it



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**O**n 1 January 2014, Denmark introduced a new law on bankruptcy quarantine. The legislation has now been in force for more than two years and the number of cases is surprisingly high. The article sums up the legislation and some of the case law based on it.

The new law was implemented due to political pressure from a number of Danish political organisations and authorities with a view to protecting both consumers and creditors from losses and to promoting fair competition between enterprises and the overall consumer trust in the system.

The legislation disqualifies an individual from doing business without personal liability “...if it must be assumed that the person in question is unfit to participate in the management of commercial activities due to grossly irresponsible business conduct...” (Section 157 of the Danish Bankruptcy Act).

As the disqualification is decided by the Bankruptcy Court based on a recommendation from the trustee of the bankruptcy estate (of the company in which the relevant person has been involved in the management) the ban is called bankruptcy quarantine (in Danish: Konkurskarantæne).

## Grossly irresponsible business conduct

Grossly irresponsible business conduct is not defined in the legislation itself, but a number of examples of general, as well as



specific, actions and failures to comply with certain rules are mentioned in a report from the Danish bankruptcy council which prepared the legislation. *Here are some examples:*

- Criminal offences;
- Failure to comply with tax law, including failure to file returns and pay VAT, tax and duties;
- Failure to comply with the book-keeping law;
- Shareholders loans;
- Lack of financial management; and
- Disposal of business assets at prices significantly below market value.

However, the legislation is not meant to disqualify individuals who are not able to run a business (cases of incompetence) or who have lost significant contracts or customers (and consequently go into bankruptcy).

In the assessment of (grossly irresponsible) business conduct, it must be taken into account whether the conduct has resulted in losses to the creditors. For instance, the Danish courts acquitted an individual in a case where the sum of the liabilities was of approximately €10,000 (including group liabilities of

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approximately €6,000).

It is not a requirement that a causal relation between the grossly irresponsible business conduct and the bankruptcy should exist.

The grossly irresponsible business conduct must have taken place within one year of the reference date (the date when the bankruptcy petition was filed with the bankruptcy court) or the date of the authorities' decision to compulsory wind up a company. The Supreme Court has, however, decided that negligence to correct past failures (more than one year before the reference date) may also be regarded as grossly irresponsible business conduct.

### Who may be forced into bankruptcy quarantine

Individuals who have participated in the management of a business may be forced into bankruptcy quarantine (disqualified as managers). This means that not only individuals registered (by the authorities), but also individuals who *de facto* have been running a business (e.g. via a frontman) may be forced into bankruptcy quarantine. However, the latter is much more difficult to prove.

### The bankruptcy quarantine (director disqualification)

The Bankruptcy Court can initiate a bankruptcy quarantine case based on a recommendation from the trustee of the bankrupt company (the bankruptcy estate), in which the individual was a former manager. Creditors in the bankruptcy estate may not initiate the procedure. It is, however, not uncommon that creditors are active in contributing relevant information and documentation to the trustee.

If the Bankruptcy Court initiates the procedure, the trustee of the bankruptcy estate must file a pleading with the Bankruptcy Court and the defendant may provide a defense.

Based on the parties' pleadings, the Bankruptcy Court will make a decision, sometimes hearing submissions by the parties.

The quarantine (disqualification) is set at three years but may be for a shorter period if specific reasons support a reduction of the period.

### Consequences of a bankruptcy quarantine

A bankruptcy quarantine is registered in a non-public register. Only the Bankruptcy Court and the Danish authorities have access to the register and the individual subject to it cannot take part in the management of a business without being liable (unlimited) for all liabilities of the business.

If the disqualified individual is imposed a new bankruptcy quarantine during the course of an existing bankruptcy quarantine, the new bankruptcy quarantine will ban the individual from being allowed to participate in the management of any business (irrespective of unlimited personal liability).

### Bankruptcy quarantines in Denmark and the future

The Danish bankruptcy council expected approximately 150-250 bankruptcy quarantine cases per year in 2011, when the council released its report/recommendation regarding the bankruptcy quarantine legislation. According to the annual office report from the Maritime and Commercial Court of Copenhagen, the Insolvency Division handled 460 cases in 2015. The Insolvency Division of the Maritime and Commercial Court of Copenhagen handles approximately one third of all the insolvency cases in Denmark.

Criticism has been levied at the time limit in the law, as a bankruptcy quarantine may only be imposed if the grossly irresponsible business behavior has been conducted one year before the reference date in the bankruptcy estate. This means

that grossly irresponsible business conduct immediately prior to the time limit cannot lead to bankruptcy quarantine. A number of examples show that this relatively short timeframe may not be enough to meet the objectives of the law.

There have been examples of companies in which members of the management have deregistered themselves, presumably anticipating it taking more than a year for the authorities to initiate a compulsory winding-up of the company or for a creditor to file for bankruptcy. In those cases, the former actual management of the company cannot be subject to bankruptcy quarantine if the reference date is set more than a year after the deregistration. Sometimes an (unaware) front man or a person with an address in a foreign country is registered when the actual management is deregistered. By the next revision of the law we expect the politicians to consider an extension of the time limit.

Another point of criticism has been the fact that a bankruptcy quarantine bears close resemblance to a criminal penalty, on the one hand, and that the court procedure of the bankruptcy quarantine case follows the rules of civil law suits, on the other hand. Consequently, there have been concerns related to the defendant's legal rights.

The present case-law indicates that the Danish Bankruptcy Courts have led a hard line against former members of managements of bankrupt companies. Some of the appealed cases have, however, led to acquittals and, in our opinion, we might see a softening in the level of what is regarded as "grossly irresponsible business conduct". In our opinion, this falls in line with the objective of the legislation which was (only) to disqualify individuals guilty of gross negligence and intentional bad behavior. ■



**A POINT OF CRITICISM HAS BEEN THE FACT THAT A BANKRUPTCY QUARANTINE BEARS CLOSE RESEMBLANCE TO A CRIMINAL PENALTY**

