WOLF THEISS

THE WOLF THEISS GUIDE TO:

Restructuring Loans and Enforcement of Security

2017 Edition

THE WOLF THEISS GUIDE TO:

Restructuring Loans and Enforcement of Security

This 2017 Wolf Theiss Guide to Restructuring Loans and Enforcement of Security is intended as a practical guide to the general principles and features of restructuring loans and insolvency proceedings in the countries included in the publication.

While every effort has been made to ensure that the country reports are accurate as at the date stated on the publication, they should be used as a general reference guide only and should not be relied upon as definitive legal advice. In the rapidly changing CEE/SEE jurisdictions, the laws and regulations are frequently revised, either by amended legislation or by administrative interpretation.

Status of information: Current as of November 2016

Conception, design, and editing:
WOLF THEISS Rechtsanwälte GmbH & Co KG, Attorneys-at-Law
Schubertring 6, 1010 Vienna, Austria
www.wolftheiss.com

TABLE OF CONTENT

Foreword

The most important lessons learned since the collapse of Lehman Brothers are that no bank is too big to fail and that national banking systems are ill-equipped to deal with a truly global financial market. In Central and Eastern and Southeastern Europe (CEE/SEE), the financial markets that were dominated by Austrian banks experienced unprecedented growth up until 2008. Since then, we have seen bank nationalisations (Kommunalkredit, HYPO GROUP ALPE ADRIA AG), state rescue packages amounting to hundreds of billions of euros, and cross-border loan lending (i.e. new lending without state or EBRD/EIB support) coming to an abrupt halt only to resume to some extent relatively recently.

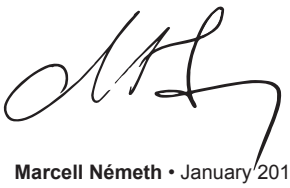
In such times business relationships are stress-tested and lenders in many instances still face defaulted borrowers all over the region. Not surprisingly, the focus of a law firm committed to the CEE/SEE region shifts towards litigation, representation of creditors in insolvency proceedings, consensual restructuring, enforcement of security interests and the sale of non-performing loans. Accordingly, Wolf Theiss has been advising clients coming from all sides of the spectrum in relation to big ticket restructuring and NPL work, including the legal advice provided to a group of Austrian lenders in one of the largest restructurings in the CEE/SEE involving a bankrupt Slovenian state holding company. We also advised a leading Austrian bank in connection with the enforcement proceedings and the auctioning of real estate in Hungary and Bosnia as well as supporting an Austrian bank in respect of an NPL portfolio in the Ukraine, just to name a few from our recent experience.

Some of the lessons learned on a CEE/SEE level were:

- CEE/SEE is far from being a homogenous region where the “one size fits all” approach would work;
- Banks have been reliable partners in the region, working on solutions with borrowers where there is a business case for recovery provided the proper legal advice has been sought to set up the right structure and a proper balance has been found in respect of the interests of all stakeholders.

It is the responsibility of advisors (tax, accounting or legal) to ensure that viable solutions are found in a challenging legal environment such as in the CEE/SEE region: Wolf Theiss is committed and has proven to be such a reliable partner for our clients.

Markus Heidinger • January 2017
Partner, Head of Banking and Finance Practice Group, Wolf Theiss



Marcell Németh • January 2017
Counsel, Banking and Finance Practice Group, Wolf Theiss

WOLF THEISS REGION
EUROPE

1. INTRODUCTION

1.1 Problem Loan – Definition

A Problem Loan requires action on the part of one or more Stakeholders in order to avoid an Event of Default and, consequently, acceleration of the Problem Loan.

In special situations, a Problem Loan may receive (unexpected) third-party support.

1.2 Early warning signs

Cause of distress can result from:

- a flawed business case;
- a general downturn in the economy;
- problems in the company's business sector;
- too much leverage on the balance sheet;
- bad management;
- very often a combination of the above.

Business case for recovery must address above causes and show a way out of the crisis.

1.3 Problem Loan – Stakeholder actions

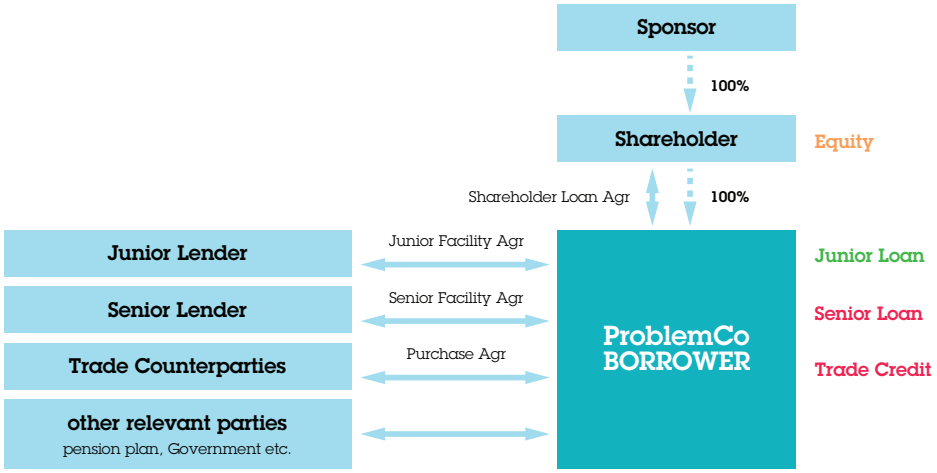
In general, Stakeholder actions may take any of the following forms:

- remedy Default (= potential Event of Default);
- consensual restructuring;
- non-consensual restructuring;
- out-of-court enforcement;
- in-court enforcement.

Special situations include:

- hold-out Lenders;
- loan-to-own Lenders;
- third-party support:
  - public interest in functioning of banking system;
  - private interest in strategic asset.

1.4 Stakeholders



1.5 Events of Default – Back to basics

- Representations and warranties: due to representations and warranties Borrowers have a duty to disclose information.
- Undertakings: due to positive/negative undertakings Borrowers are obliged to act/abstain from acting in a certain way:
  - positive undertakings may give rise to claims for performance and/ or damages;
  - negative undertakings may give right to obtain an injunction.
- Financial covenants (to which equity cures may apply):
  - breach as first indicator of financial stress; however, covenant-lite transactions in the market with few, if any, financial covenants;
  - breach of covenant at the time of delivery of Compliance Certificate;
  - from year end until delivery of Compliance Certificate => Default (include notification undertaking).

1.6 Typical Event of Default

- Payment default:
  - refinancing at end of term may not be available;
  - transactions without realistic exit scenario are in the market.
- Breach of financial covenant
- Misrepresentation
- Breach of undertaking:
  - negative pledge (in some jurisdictions not legally valid);
  - conditions subsequent:
- Cross-default (issue: it may trigger cross-defaults in other facilities or hedging arrangements?)
- Occurrence of Material Adverse Effect:
  - based on the opinion of the Facility Agent?
  - not often used as a standalone default because:
    - reasonability tests are likely to be applied;
    - forward-looking;
    - conservative interpretation by courts (balance sheet tests).
- Criteria of insolvency test met
- Opening of insolvency proceedings
- Attachment by other creditor(s)
- Auditors qualification
- Other Events of Default

1.7 Events of Default – Effects and issues

- Effects of the occurrence of an Event of Default:
  - no further utilizations (already in case of Default);
  - the Loan may be accelerated;
  - usually triggers ability to freely transfer Loan Asset;
  - security interests become enforceable (Enforcement Event).
- Issues:
  - is there a clear-cut Event of Default (e.g. non-payment, breach of financial covenants) or a questionable Event of Default (e.g. Material Adverse Effect)? => risk of damage claims;
  - is there an Event of Default that is allowed to be or otherwise may be cured?
- Do qualifications apply?

1.8 Events of Default – Qualifications

Events of Defaults are mostly subject to qualifications:

- grace/remedy periods;
- monetary thresholds;
- factual representations and warranties: to the best knowledge qualification;
- legal representations and warranties: Legal Reservations qualification;
- materiality qualifications;
- Lenders and Agents may be required to act reasonably.

Such qualifications may make it difficult to declare an Event of Default which does not bear a potential liability risk for the Finance Parties in case of acceleration/enforcement.

1.9 Acceleration

Upon the occurrence of an Event of Default that is continuing, the Facility Agent may, and shall if directed by the Majority Lenders:

- cancel Commitments;
- declare the Loan immediately due and payable;
- declare the Loan payable on demand;
- instruct the Security Agent to enforce the Transaction Security.

In certain countries insolvency laws may prohibit the acceleration of a Loan.

ProblemCo´s liquidity problems may further increase because:

- suppliers may radically shorten payment terms or insist on cash on delivery;
- payment morale of customers may deteriorate.

1.10 Borrower's actions

The Borrower typically knows that the Loan has become a Problem Loan and it should therefore take immediate action:

- if possible, remedy the Default (= potential Event of Default) on its own or, if not advisable / not feasible/ does not make commercial sense;
- initiate a consensual restructuring process with its creditors – TYPICALLY THE PREFERRED OPTION FOR ALL PARTIES;
- file with the competent court for insolvency proceedings and thereby initiate non-consensual restructuring.

ProblemCo must carefully monitor duties of its directors.

1.11 Borrower's actions - Remedy

The Borrower generally wants to remedy an Event of Default on its own:

- to avoid the costs of going through restructuring;
- to a achieve a stronger position for any negotiations with its creditors.

The Borrower's remedy may be achieved through:

- debt buy-back (at a discount);
- equity cure (Mulligan) (short-term fix);
- Permitted Disposals (use proceeds to make prepayments) which may be restricted by:
  - Transaction Security (Release Letter required);
  - negative undertakings.

Lenders concerns with debt buy-backs:

- may lead to unequal treatment of Lenders which contravenes the spirit of syndicated lending:
  - not all Lenders may be offered the chance to sell;
  - not all Lenders may be offered the same selling terms;
- circumvention of prepayment/subordination restrictions;
- effects of purchase; i.e. Borrowers' affiliates may become Lender with blocking minority stake.

Lenders protection:

- transfer restrictions for Loan Assets; however, non-assignment clause may only have relative effect;
- Majority Lenders definition excludes affiliates of Borrower.

2. RESTRUCTURING

2.1 Consensual Restructuring

2.1.1 Initiation of Consensual Restructuring by Borrower

Notification of Problem Loan to Facility Agent may include:

- a request for a Waiver Letter (e.g. postpone testing of covenants);
- a request for time to develop a business plan for recovery (rarely in place at this stage);
- a request for additional liquidity;
- putting something on the table:
  - additional security;
  - Sponsor support (debt buy-back, comfort letter etc.).

Message to Finance Parties should also include:

- convincing arguments that there is a business plan for recovery;
- an invitation to the Lenders to request all information required for them to independently evaluate ProblemCos business.

Note: the Borrower may lose control over the process.

2.1.2 Obstacles to Consensual Restructuring

Potential obstacles to Consensual Restructuring:

- ProblemCo has lost its credibility or its relationships with Lenders have deteriorated;
- out-of-the-money Junior Lenders;
- hold-out Lenders;
- loan-to-own Lenders;
- ProblemCo is on the brink of insolvency and directors have a duty to file for bankruptcy;
- nobody believes that there is a viable business plan for recovery => all creditors want to exit as fast as possible.

2.1.3 Need for New Money

Often New Money is needed by the Borrower:

- may come from Sponsor, in case of a shareholder loan the issue of equity-replacing shareholder loan may be relevant;
- may come from new Lenders; however, security interest may be subject to challenge (“hardening periods”);
- may come from existing Lenders.

New Money should take super-priority but check the relevant insolvency laws for this.

New Money may be restricted by negative undertakings:

- Permitted Indebtedness;
- Permitted Security.

Most likely source for New Money is a mixture of liquidity provided by the Sponsor and the existing Lenders.

2.1.4 Lenders – Be prepared

- Complete set of original documentation:
  - duly signed Finance Documents;
  - legal opinions;
  - complete set of up-to-date excerpts from registers (land register, companies register, etc.).

- Facility Agreement:
  - clear-cut Events of Default;
  - notice details up to date;
  - process agent appointed;
  - jurisdiction/arbitration.
- Security Documents:
  - review whether out-of-court enforcement sale possible;
  - review whether security interests have been duly perfected:
    - up-to-date registrations;
    - third party notifications have been acknowledged.

2.1.5 Suggested Lenders' actions

- DO NOT IGNORE THE PROBLEM: ACT IMMEDIATELY!
- Issue Waiver Letter/Reservation of Rights Letter or Acceleration Notice:
  - comply with notice clause (fax and registered mail);
  - adhere to day counting methods.
- Contact other Stakeholders to enter into Standstill Agreement.
- Banks may consider selling a Problem Loan:
  - if so, comply with confidentiality agreement; in some jurisdictions, banking secrecy rules apply; check loan documentation for transfer restrictions.
- Evaluate your position as a Stakeholder.

2.1.6 Waiver Letter/Reservation of Rights Letter

Typically a Majority Lenders or All Lenders vote is required.

Terms:

- list the Events of Default which are being waived;
- no blank waiver, Lenders should request something in return for acceptance of increased risk;
- term sheet for amendments to Finance Documents may be attached;
- Borrowers confirmation to cover legal costs and other expenses;
- prohibition on dividends, capital expenditures etc.

Effects:

- avoids acceleration => Lenders agree not to accelerate for a specific period of time;
- creates a period during which the situation can be assessed by the Stakeholders.

2.1.7 Acceleration Notice

Typically a Majority Lenders vote is required.

Terms:

- list Events of Default;
- cancel Facility;
- request payment of all outstanding amounts to a specific account until a final date;
- declare an Enforcement Event;
- reserve any further rights.

Effects:

- the Facility is no longer available;
- all outstanding amounts under the Facility Agreement become due and payable;
- Security Interests become enforceable.

2.1.8 Standstill/Override Agreement – Definition and principles

Standstill Agreement is a temporary arrangement entered into between the company and its creditors (typically does not cover trade creditors). It gives Stakeholders time to gather information and evaluate their respective position.

Standstill Agreement is only realistic if each creditor believes that it is better off with a consensual restructuring.

Typically, the following principles apply to the Standstill Agreement:

- it prevents individual creditors from taking enforcement action for a period of time allowing for a consensual restructuring to be completed;
- no improvement of relative creditor position (freezing the exposure) after day-one (so called day-one position);
- parties to Standstill Agreement share all relevant information.

Override Agreements amend terms permanently and create consistency across a number of facility agreements.

The position needs to be checked in respect in respect of ancillary lenders/facilities and hedging – inter-creditor agreements typically contain additional rules regarding voting and priorities and sharing of security.

2.1.9 Standstill Agreement – Content

- Regulates how creditors divide and distribute new cash that may come into the company from:
  - new equity;
  - asset disposals;
  - enforcement proceeds.
- Defines Standstill Period (relatively short, can be extended).

- Decisions requiring Majority Lenders consent:
  - declaring an Event of Default and enforcement action;
  - accepting new or releasing existing security interest;
  - amending agreements;
  - exercising set-off rights;
  - filing for insolvency;
  - charging default interest.
- Borrowers undertakings:
  - prohibited actions;
  - cancel undrawn facilities; close out hedging arrangements;
  - information undertakings.
- Lenders undertakings:
  - do not demand repayment or enforce during Standstill Period;
  - do not seek to better their respective relative position.
- Termination events:
  - filing for insolvency;
  - attachment of material assets;
  - breach of Borrowers undertakings;
  - (Super-)Majority Lenders vote.
- Establishing a Coordination Committee:
  - appointment of members;
  - costs to be born by creditors relative to their exposure;
  - exclusion of liability for Coordination Committee.
- Required liquidity: New Money
  - new facility limited in amount and repayable on demand;
  - by each Lender pro rata or by specific Lender(s) for preferred position (super-priority).
- Confidentiality undertaking by each party.
- (Back-ended) standstill/restructuring fee payable by Borrower.
- Surviving terms after Standstill Period ends.
- Schedules:
  - agreed list of existing Facilities and Lenders exposure;
  - agreed list of existing Security Interests.

2.1.10 Developing a strategy

PLAN A: Consensual Restructuring

- often minimises loss;
- requires that the Borrower cooperates in developing the plan;
- viable business case for recovery necessary;
- most often requires New Money.

PLAN B: Non-consensual Action

- accelerate Loan and trigger Borrowers insolvency;
- enforce security rights;
- file for Borrowers bankruptcy.

Lenders typically seek PLAN A, but should always have PLAN B lined up in order to protect their position should PLAN A fail.

2.1.11 Determinants for strategy

- Stakeholders position:
  - Senior Lenders claim or subordinated Junior Lenders claim;
  - secured or unsecured Lender:
    - secured creditor has a preferential right with regard to the Collateral and participates in distribution of the bankrupt estate with any claim in excess of enforcement costs;
    - unsecured creditor participates solely in the distribution of the bankrupt estate;
  - Standstill Period may apply according to the Standstill/Restructuring Agreement;
  - effectiveness of contractual subordination;
  - violation of financial assistance/ capital maintenance rules;
  - risk of repayments/additional security being challenged in potential insolvency proceedings at a later stage (claw-back).
- Compare benefits of PLAN A and PLAN B:
  - going-concern valuation and business case for recovery:
    - cash-flow business or capital asset business;
    - macroeconomic analysis;
  - liquidation analysis (or break-up value);
  - in-the-money/out-of-the-money Lender.
- Enforcement in Borrowers/Security Providers jurisdiction:
    - ease of enforcement of security interests, in particular timing;
    - functioning of insolvency laws;
    - costs involved.

- Legislative hurdles.
- Political restraints.

2.1.12 Lender's toolkit

- Appointment of Coordination Committee:
  - formed by one or more Lender(s) (largest Lenders);
  - leads the process and addresses intercreditor issues (Standstill Agreement or Intercreditor Agreement);
  - facilitates New Money;
  - sounding board of interests;
  - ensures that each Lender receives same information during Standstill Period;
  - interface between Borrower and Lenders;
  - appoints external advisors.
- Coordination Committee defines agreed action plan, but does not make commercial decisions.
- Lenders will need to decide how much authority to give the Coordination Committee.
- External advisors:
  - Lawyers:
    - structuring and implementing Restructuring Plan;
    - legal due diligence;
    - tax due diligence;
    - assistance in contingency planning (PLAN B);
  - Accountants:
    - check financials;
    - provide information to review Restructuring Plan that proves business case for recovery;
    - make valuations.
- Debt-equity swap/ exchange offers:
  - what type of and how much equity;
  - may be restricted by negative undertakings;
  - typically subject to haircut; extension of term and changing pricing;
  - notes may be easier to trade but allow typically less control for holders.
- Amendments to Finance Documents may include:
  - adjustment of margin (market pricing);
  - payment of restructuring fee;
  - tightening of security structure;
  - further restrictions on disposals, dividend payments etc. ;
  - resetting financial covenants and reviewing the definition of the accounting group;

- a haircut/capitalization of interestas incentive for Borrower to (p)repay;
- tightening of representations and warranties;
- implementation of agreed Restructuring Plan;
- injection of additional equity;
- increased disclosure obligations .

2.1.13 Long-term economic solution

To create a business case as a going concern any of the following may be required:

- injection of additional equity;
- write-off of debt by Lenders;
- restructuring of debt, e.g. extension of repayments, capitalised interest, PIK interest, warrants;
- debt-equity swap, e.g. Mezzanine Lender receives equity for its mezzanine debt;
- Senior Lenders enforce the assets of the Borrower and newly founded SPV owned by Senior Lenders buys all such assets => enforcement proceeds used to pay Senior Lenders; Junior Lenders left with (total) loss.

2.2 Non-Consensual Restructuring

2.2.1 Insolvency test and duty

Typically two separate insolvency tests (each triggers insolvency) for a company apply:

- **Balance-sheet test:** a company's due and payable obligations exceed the value of the company's assets (= over-indebtedness);
- **Cash-flow test:** a company is not able to fulfill one or more monetary obligation (= inability to pay).

Directors duty to file for initiation of insolvency proceedings may apply.

2.2.2 Insolvency Proceedings - Type

Typically, the following types of insolvency proceedings are available:

- **Composition Proceedings** (or Restructuring Proceedings):
  - court-approved scheme to achieve Cram-Down;
  - debtor stays in charge of assets, subject to judicial control;
  - all creditors are bound, but secured creditors are not affected unless they consent.
- **Bankruptcy Proceedings** (or Liquidation Proceedings):
  - court-appointed bankruptcy receiver in charge of assets;
  - aims at winding up the insolvent company;
  - all creditors are bound, but secured creditors have preferential rights to the Collateral;

In an insolvency the directors duties may shift to considering the interests of creditors first.

2.2.3 On an EU level

Insolvency proceedings are regulated on an EU level by:

- Insolvency Regulation (1346/2000/EC and 681/2007/EC), to be replaced by Regulation 848/2015/EU, which is binding and directly applicable to all EU member states with the:
  - exception of Denmark;
  - provides that main proceedings are to be commenced in the EU member state in which the
  - common debtors center of main interest (COMI) lies, and ancillary proceedings may be
  - commenced in any one or more EU member states if the common debtor has assets in those EU member states;
- "Banking Union"; Single Rulebook; Single Resolution Mechanism; Bank Recovery and Resolution Directive (2014/59/EU) which amends Directive on the Reorganization and Winding-Up of Credit Institutions (2001/24/EC);
- Solvency II (2009/138/EC) which replaced Directive on the Reorganization and Winding-Up of Insurance Undertakings (2001/17/EC).

2.2.4 Centre of main interest (COMI)

In case of companies, the COMI is, in the absence of proof to the contrary, presumed to be the place where the common debtors registered office is located.

The law of the EU member state in which proceedings are initiated (i.e. in which state the COMI lies) determines:

- the conditions for the opening of the proceedings;
- their conduct, their closure, and practical rules, such as the definition of debtors and assets;
- the respective powers of the common debtor and the liquidator;
- the effects of proceedings on contracts, individual creditors, and claims;
- rules relating to the voidness, voidability, or unenforceability of legal acts;
- detrimental to all creditors (challenge).

2.2.5 Bankruptcy Proceedings

Bankruptcy Proceedings are liquidation type of proceedings since their purpose is:

- to resolve the debtors insolvency by realizing its assets;
- to collectively satisfy the debtors creditors on a *pro rata* basis.

Either the debtor itself or its creditors may file a petition for bankruptcy.

Petition for the initiation of Bankruptcy Proceedings is not filed in a timely manner => risk of personal (criminal and/or civil) liability of:

- managing directors;
- shadow directors, i.e. persons in accordance with whose directions the managing directors are accustomed to act.

Rescue loans may be qualified as equity-replacing shareholder loans.

Receiver may challenge preferential transactions and repayments made in hardening period prior to insolvency.

Effects of Bankruptcy Proceedings are often:

- stigma (no more trade credit);
- power of attorney may terminate by operation of law;
- counterparties may terminate contracts;
- statutorily preferred claims (e.g. tax) may exist;
- statutory pledges may exist;
- enforcement proceedings may be stayed;
- management loses control of the company.

Note:

- global effect of US proceedings (issue: contempt of court; settlement of USD transactions);
- freezing orders may be issued.

2.2.6 Composition Proceedings

Typically only the debtor may file a petition for Composition Proceedings.

Certain majority of the creditors agrees to a Restructuring Plan which ensures repayment of a specific quota of outstanding debt (issue: the position of public bodies such as tax authorities, social insurance bodies); thus, it can help to deal with hold-out lenders or subordinated lenders who are out of the money.

Purpose of Composition Proceedings is:

- to resolve the debtors (imminent) insolvency as a going concern;
- to (partially) satisfy the debtors creditors.

Effects of Composition Proceedings are often:

- enforcement proceedings are stayed;
- management stays in control of the company (subject to judicial control).

Composition Proceedings are only desirable in case:

- there is a realistic business case for recovery;
- the creditors will not be worse off compared to a bankruptcy solution.

3. ENFORCEMENT

3.1 Security Interest – Types

Personal Security Interests:

- guarantee and suretyship;
- financial soundness and character of Security Provider important;
- bank guarantees and obligations coterminous with the underlying debt.

***In rem* Security Interests:**

- mortgage, share pledge, receivables pledge/assignment;
- value of asset and ease/cost of realisation important.

3.2 Security Interest – Accessoriness

Accessory Security Interests are typically pledges and mortgages.

Being an accessory Security Interest means that:

- such Security Interest depends on the valid existence of the Secured Claims; thus, it is terminated by operation of law upon payment of all Secured Claims;
- unless otherwise agreed the Secured Party must be the holder of the Secured Claims.

Civil law typically does not recognise a trust arrangement whereby security can be granted in favor of the Security Agent as trustee for the Finance Parties => parallel debt/ joint and several obligations issue.

If security is held by third parties or when secured debt is transferred to them lenders are advised to check whether they are secured creditors for any purpose including regulatory requirements and capital relief provisions.

3.3 Security Interest – Perfection

Both a title instrument and an act of perfection (often, a notice or another act of publicity) are required for the valid establishment of a security interest with the required priority.

Title instrument:

- pledge/hypothecation/assignment agreement;
- the title instrument determines the content of the security => important drafting exercise: Secured Claim and Collateral.

Act of perfection:

- registration for mortgages or certain company charges;
- actual delivery of the movables (physical assets) to Secured Party;
- notifications to debtors of assigned claims.

3.4 Court Enforcement

Court Administered Enforcement Proceedings:

- requires enforceable title instrument (i.e. final court judgement or arbitral award);
- sale of Collateral through court leads to public auction;
- purchaser acquires Collateral free of any encumbrances;
- enforcement proceeds are distributed to Secured Creditor to satisfy Secured Claims.

3.5 Private Enforcement

Private sale:

- typically sale of Collateral through public auction;
- requires that the Pledgee/ Assignor is in a position to effect a transfer of the Collateral to a potential purchaser (sales power of attorney may terminate in Bankruptcy Proceedings).

Certain legal limitations may apply:

- pre-agreed right of the Secured Party to swap the Secured Claim against the Collateral (e.g. debt-equity swap in case of share collateral) upon the occurrence of an Event of Default may not be permissible;
- private sale may not be permissible with regard to certain assets (e.g. real estate);
- minimum price as agreed in the security documents may need to be observed.

MARCELL NÉMETH
Counsel

Wolf Theiss, Vienna

T. +43 1 51510 5066
marcell.nemeth@wolftheiss.com

WOLF THEISS

ALBANIA

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

In general, a negative pledge undertaking is legally valid and binding.

1.2 Restrictions on accelerating a loan

In general, Albanian law does not restrict the ability of parties to a facility agreement to agree on any event of default.

1.3 Effectiveness of a non-assignment clause

A prohibition of assignment with regard to monetary claims only has relative effect if concluded between two business entities, i.e. such contractual prohibition is effective only between the parties to the facility agreement. Any assignment by a lender to a third party is valid unless it is proved that the third party was aware of this prohibition.

1.4 Common methods for loan transfers

Rights of an existing lender under a loan agreement, such as the right to receive interest and the right to repayment, can be assigned to a new lender. Notice of the assignment is given to the borrower to make an assignment enforceable.

Where rights under a loan agreement are assigned, it is common for there to be a corresponding assumption of obligations by the assignee. This makes it possible to transfer all of an existing lender's rights and obligations under a loan agreement to a new lender by way of assignment and assumption. It requires the consent of all parties to the loan agreement.

1.5 Effectiveness of a contractual subordination

The effectiveness of contractual subordination is neither explicitly regulated nor addressed in Albanian case law. Contractual subordination is generally permitted and such subordination should be effective between the contracting parties.

There are also good legal arguments that such contractual subordination is also binding upon an insolvency receiver in case the subordination does not put other creditors at a disadvantage.

1.6 Subordination by operation of law

The Albanian insolvency law provides that claims subordinated by operation of law are satisfied only after all other insolvency creditors' claims are satisfied. The following count as subordinated claims:

- claims for the interest accruing on the claims of the insolvency creditors from the time of the opening of the insolvency proceeding;
- claims for costs incurred by insolvency creditors due to their participation in the proceeding;
- civil, administrative or criminal penalties payable by the debtor;
- claims based on a gratuitous promise of the debtor.

1.7 Validity of a forfeiture agreement

An agreement for the forfeiture of the security interest (i.e. the secured creditor may keep the collateral in lieu of the secured liability) is not valid if entered into when the security interest is established. However, the parties may agree afterwards (i.e. when payment is due or after this) that the fulfillment of the obligations of the debtor will be made by handing the collateral to the creditor.

1.8 Super-priority loans in bankruptcy

The insolvency court may decide that the receiver may enter into new loan agreements on behalf of the debtor and the court may decide to grant super-priority to the new lenders.

1.9 Varying interest rate and tenor of the loan – must security be retaken?

There is no need for the security to be retaken if a varying interest rate is provided for in the agreement at the time the security is granted but an increase in the rate may trigger the need to amend the security agreements. In case of change of the tenor of the loan the security must be retaken only if the security is granted for a determined period of time that does not cover the new tenor of the loan.

2. SECURITY INTERESTS

2.1 How to establish a security interest

To establish a valid security interest, a title instrument and an act of perfection (i.e. an act of publicity) are required.

Title instruments include:

- movable securing charge agreement, account securing charge agreement, receivables securing charge agreement, securing charge over shares agreement and mortgage agreement;
- surety agreement.

Pledges under the Civil Code are also possible, but not widely used in practice. In practice the non-possessory form of security, a so-called “securing charge”, is preferred.

In case of a surety the act of perfection is the signing of the surety agreement.

In case of *in rem* rights, a separate act of perfection is required.

2.2 Ranking of charges/mortgages

The ranking of a securing charge depends upon when the filing for the registration was made.

The ranking of a real estate mortgage depends on the exact time when the application for registration of the mortgage was duly submitted to the Land Register (subject to actual registration).

2.3 Can ranking of consensual security be changed by agreement of the creditors?

In general, Albanian law does not restrict the ability of the creditors to agree on any change of the ranking of consensual security.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Pledge/securing charge	Physical delivery of the movables to the pledgee or instruction to possess to a third party holding movables for the pledge/registration with the Securing Charge Register
ACCOUNT	Securing charge	Registration with Securing Charge Register
RECEIVABLES	Securing charge	Registration with Securing Charge Register
SHARES	Securing	Registration with Securing Charge Register
REAL ESTATE	Mortgage	Registered with the Land Register (*Zyra e Regjsitrimit te pasurive te paluajtshme*)

2.5 Availability of floating charge

Albanian law recognises the concept of floating charges over all existing and future assets of a company.

2.6 Trust and parallel debt issues

There is no structure comparable with a common law trust in Albania, and the consensus in the legal community is that a common law trust does not create the ownership with regard to the secured claims that is required to create a valid and enforceable accessory security interest.

The above issue is typically solved through a socalled “parallel debt structure” whereby the parties to the facility agreement agree that the security agent shall be the joint and several creditor of each and every obligation of the borrower towards each finance party (other than the security agent).

The above concept has as yet not been tested in Albanian courts.

2.7 Availability of private sale and its main conditions

Albanian law does not allow private sale (subject to the exceptions below). The sale of the collateral in an enforcement proceeding shall be made by the bailiff in a public sale.

SECURITY INTEREST	ACCESSORY	PRIVATE SALE
GUARANTEE	No	N.a.
SURETY	Yes	N.a.
MOVABLES PLEDGE	Yes	Yes
ACCOUNT PLEDGE	Yes	N.a.
RECEIVABLES PLEDGE	Yes	Yes, if contractually agreed
SHARE PLEDGE	Yes	Yes, if contractually agreed
REAL ESTATE MORTGAGE	Yes	No

2.8 Security and loan transfers

Accessory security is usually made available to a new lender automatically when the secured obligations are assigned, or assigned and transferred by way of assumption of contract.

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

Two kinds of insolvency proceedings exist:

- **Bankruptcy proceedings** (*Procedura e falimentimit me likuidim*) which generally aim to satisfy the creditors' claims by liquidating the assets of the debtor and distributing the proceeds;
- **Judicial reorganisation proceedings** (*Plani i riogranizimit*), the ultimate aim of which is to preserve and continue the debtor's business on the basis of a reorganisation plan.

3.2 Applicable insolvency test and directors' duty to file

Two separate insolvency tests (each triggers insolvency) for a company are typically applied:

- **Balance sheet test:** a company's due and payable obligations exceed the value of the company's assets (= over indebtedness);
- **Cash flow test:** a company is not able to perform more than one monetary obligation (= inability to pay).

Each member of the company's administrative body is obliged to notify the competent court of the company's insolvency within a twenty-one (21) day period after becoming insolvent and to apply for the opening of bankruptcy proceedings. A member of the company's administrative body risks criminal liability in case of non-compliance.

In addition, the members or the shareholders of the debtor are obliged to notify the competent court of their company's insolvency within three (3) months from the day they obtained knowledge of such insolvency. A member or shareholder risks personal liability and administrative fines in case of non-compliance.

3.3 Describe bankruptcy proceedings

Bankruptcy proceedings are initiated by the competent court upon an application either by the debtor or by one or more of its creditors. In addition, the tax authorities may file a petition for the opening of bankruptcy proceedings if a corporate taxpayer's balance sheet shows losses for a period of three (3) consecutive years.

Any application filed by a member of the debtor's administrative body needs to be accompanied by the list of assets and income, and a list of the creditors.

The court must decide within thirty (30) days of filing.

The decision of the court to initiate bankruptcy proceedings is entered into the Registry of Immovable Property and is delivered to the debtor and to all of its known creditors and debtors.

Upon the opening of bankruptcy proceedings, the company's administrative body loses its control over the debtor's assets.

The court appoints a receiver (*administartori i falimentimit*) who assumes control over the debtor's assets.

The decision on the limitation of the administrative body's powers and the appointment of the receiver is published.

The receiver examines the debtor's assets. The list of the debtor's assets and the list of creditors must be filed with the District Court. The Commercial Section of the Court supervises the receiver.

The receiver must obtain the creditors' approval for the implementation of actions of particular importance for the bankruptcy proceedings.

The assets of the insolvent debtor are confiscated and liquidated (i.e. sold in public auction) by a bailiff. The liquidation proceeds are distributed to the company's creditors in accordance with the priority principles set out in the Bankruptcy Act.

The Bankruptcy Act sets out the following priority of payments:

- costs of the bankruptcy proceedings;
- costs for the maintenance and administration of the assets in bankruptcy and related taxes;
- secured creditors;
- unsecured creditors;
- subordinated creditors.

3.4 Timing and costs of insolvency proceedings

The duration of bankruptcy proceedings will depend on several factors (e.g. the extent of the assets and liabilities of the debtor, the number of creditors, whether the receiver challenges any transactions of the debtor in court, etc.). Although there is no general rule, in our experience bankruptcy proceedings may last between twelve (12) months to nine (9) years in more complex cases.

In practice not many bankruptcy proceedings have been carried out by the Albanian courts. However, the statistics show an increase in the number of such proceedings recently.

3.5 Challenge of preferential transactions and suspect periods

The receiver has the right to challenge preferential legal acts or transactions, most importantly, if:

- a debtor has intentionally put certain creditors at a disadvantage compared to its other creditors, and such other creditors knew of this intention (suspect period of ten (10) years);
- a creditor related to the debtor knew of the insolvency of the debtor when entering into the transaction (suspect period of two (2) years).

In addition, certain transactions may be challenged by the receiver (i) if they are carried out during the month preceding the opening of the insolvency proceedings or after the petition for the insolvency proceeding is filed; (ii) if they are carried out three (3) months before the submission of the petition for opening the bankruptcy proceedings provided that the debtor was insolvent and that the creditor was aware of that fact, and/or (iii) if the transaction is carried out after the date of submission of the petition for the opening of the insolvency proceeding provided that the creditor was aware of the opening of the insolvency proceedings or that the petition was filed for the opening of the insolvency proceedings.

3.6 Impact of insolvency proceedings on security and enforcement

In case of insolvency proceedings the enforcement of the security shall be subject to the insolvency law provisions.

The receiver is given control over any immovable property and/or any movable property in the possession of the debtor at the date the insolvency the proceeding is opened.

This control extends to temporary use of the property while the receiver is running the business of the insolvent debtor, and to ultimate disposition of it. However, the receiver shall not exercise the right to dispose of goods subject to particular disposal (i.e. the collateral) if the value of the goods is lower or equal to the value of the amount owed to the creditor and the amount of expenses necessary for its execution.

Thus, in case the insolvency administrator decides not to dispose of these assets, or in case the court upon the request of the secured creditor decides to remove the limitations provided by the insolvency law as mentioned above, the secured creditor may enforce the security pursuant to the applicable legal requirements that are applicable outside of insolvency proceedings.

3.7 Secured creditors in bankruptcy proceedings

A validly established *in rem* security interest gives the secured creditor a preferential claim with regard to the respective collateral.

The secured creditor will have the preferential right to be satisfied from the proceeds of the sale of the collateral before any other creditors in accordance with the preference order set out in the Bankruptcy Act.

3.8 Reorganisation plan

A reorganisation plan (*Plan Riorganizimi*) may be proposed by the debtor or by the receiver at any time before the final creditors' meeting. The creditors' meeting may also assign to the receiver the task of preparing a reorganisation plan.

The reorganisation plan consists of two parts. The first part details the measures that have been taken since the beginning of implementation of the bankruptcy proceedings. The second part describes the procedures to be

carried out and the rights of the parties involved in such procedures. This part should contain the period for the payment of the claims.

3.9 Describe reorganisation plan

If not otherwise provided in the reorganisation plan, the debtor will be released from its debts upon approval of the reorganisation plan. The plan sets forth the costs and the expected incomes during the period of repayment of the creditors. The plan may also provide that the debtor may continue its business activities by regaining control over the company.

The receiver supervises the implementation of the reorganisation plan. The Court resolves on the termination of the period of supervision.

The reorganisation plan requires approval by the creditors. The District Court has the right to approve or reject the reorganisation plan. After the decision of the Court on the plan has become final, the court resolves on the termination of the bankruptcy proceedings.

The reorganisation plan must include a period during which the implementation of the reorganisation plan is to be supervised. During this period of supervision the debtor may obtain new loans subject to prior approval by the receiver and certain other restrictions. Any new lender will take priority over the existing creditors if the reorganisation plan provides for such priority.

4. JUDICIAL ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

A secured creditor may have to pursue judicial enforcement with regard to its collateral in accordance with the provisions of the Civil Procedure Code, which requires completion of the following steps:

- first, the lending bank has to issue a bank statement and file such statement together with the facility agreement with the competent court and request the rendering of an enforcement order (*urdher ekzekutimi*);
- second, the enforcement order is submitted to a bailiff (court employed or private);
- third, the bailiff will take possession of the collateral and submit it to the secured party; and
- finally, the secured party must sell the collateral and is entitled to satisfy its claims out of the enforcement proceeds.

4.2 Timing and costs of enforcement proceedings

In our experience the enforcement procedure takes between three (3) amd thirty-six (36) months (starting with the filing of the enforcement application and ending with the distribution of the monies realised to the secured creditor). This duration also depends on the court's caseload and any defensive pleadings pursued by the debtor.

SOKOL NAKO
Partner

Wolf Theiss, Tirana

T. +355 4 2274 521
sokol.nako@wolftheiss.com

WOLF THEISS

BOSNIA & HERZEGOVINA

Bosnia and Herzegovina ("BiH") is a country consisting of two separate entities, the Federation of Bosnia and Herzegovina ("FBiH") and Republika Srpska ("RS"), and one special autonomous district under direct sovereignty of the state, the Brčko District. In each of these parts essentially different legal regimes are applicable; nevertheless, certain matters are regulated by State laws applicable in all parts of the country. Also, in many cases the relevant laws of the entities and Brčko District are to a large extent harmonised and provide for almost identical legal frameworks. Unless otherwise set out below, our comments apply in both FBiH and RS, while Brčko District is not included.

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

In general, a negative pledge or any other undertaking or agreement not to grant security over immovable property is prohibited in BiH. On the other hand, a negative pledge undertaking is valid between parties to a loan agreement but is not effective towards third parties acting in good faith.

1.2 Restrictions on accelerating a loan

In general, parties are free to agree on any event of default but the loan may not be accelerated due to non-fulfilment of an insignificant part of the obligation.

Enforcement of claims may be temporary restricted during bankruptcy proceedings (including preliminary proceedings) and receiverships.

1.3 Effectiveness of a non-assignment clause

A prohibition of assignment is legally valid and binding between the contracting parties but is not effective towards third parties acting in good faith.

1.4 Common methods for loan transfers

Two methods for transfer of loans are available in BiH: (i) assignment of claims; and (ii) transfer of agreements.

1.4.1 Assignment of claims

An assignment of claims includes transfer of the main receivables together with ancillary rights (such as security interest). Consent of the debtor is not a statutory requirement but notification of the assignment to the debtor is necessary for the assignment to be valid *vis-à-vis* the debtor. Typically NPLs are transferred by way of assignment of claims.

1.4.2 Transfer of agreements

A transfer of agreements includes transfer of the entire contractual position, i.e. all claims, receivables, rights, interests, obligations and undertakings under the agreement. Consent of the debtor is required. Typically, performing loans are transferred by way of transfer of agreements.

1.5 Effectiveness of contractual subordination

Effectiveness of contractual subordination is not explicitly regulated in BiH. Generally, claims which have been contractually subordinated by an agreement between the creditor and the debtor will be settled among the last.

1.6 Subordination by operation of law

In RS, a company may not make payment to its shareholders if such payment would affect its ability to settle debts as they fall due.

In FBiH, profit distributed to shareholders may have to be returned to the company if, after such payment, the company is unable to settle its debts *vis-à-vis* third parties.

Equity replacing shareholder loans are subordinated to other indebtedness in the context of bankruptcy proceedings by operation of law.

Unsecured loans granted by affiliates of a company in RS (excluding affiliates that are financial institutions) are also subordinated in the context of bankruptcy.

The laws regulating bankruptcy proceedings and the laws regulating payment operations provide for a mandatory order of payments if the company is in bankruptcy proceedings or illiquid.

1.7 Validity of a forfeiture agreement

Forfeiture agreements (i.e. agreements permitting the creditor to keep the property subject to the security in lieu of the secured liabilities) are null and void in BiH.

1.8 Super-priority loans in bankruptcy

In general, the concept of super-priority loans is not recognised in bankruptcy proceedings. However, loans granted for the purpose of carrying out the business operations of the debtor during bankruptcy proceedings are considered to be costs of the bankruptcy estate which have priority in settlement.

1.9 Varying interest rate and tenure of the loan – must security be retaken?

If the parties agreed on a floating interest rate, there is no need to retake security from time to time; interest rates only have to be determinable at the moment when the security is taken.

Subsequent changes (in particular increases) of the interest rate or the loan tenure should also be reflected in the relevant security documents and public registries where the security is registered.

2. SECURITY INTERESTS

2.1 How to establish a security interest

To establish a valid *in rem* security by way of a contractual arrangement, a title instrument and appropriate perfection steps (i.e. acts of publicity) are required. Establishment of a valid personal security requires execution of an appropriate title instrument.

Title instruments for *in rem* security include pledge agreements (for movable property, shares, bank accounts, receivables and rights) and mortgage agreements (for immovable property).

Title instruments for personal security include suretyship and guarantee agreements. Certain other instruments are also commonly used as security in practice, in particular bills of exchange (*mjenice*).

Acts of publicity with respect to *in rem* security include:

- registration of pledges in the BiH Pledge Registry (*Registar zaloga Bosne i Hercegovine*) with respect to movable property, shares in limited liability companies, bank accounts, receivables and rights or, if possible and appropriate, transfer of possession over the pledged property;
- registration with the FBiH Securities Register/RS Securities Register with respect to shares in joint stock companies and other securities; and
- registration in the competent land register (*zemljišno-knjižni ured*) with respect to immovable property.

Certain other steps, such as notification to debtors, account holding banks, commercial registries, etc. may also be needed.

2.2 Ranking of pledges/mortgages

The ranking of pledges registered in the BiH Pledge Registry is determined by the time of online registration. The ranking of mortgages and the ranking of pledges over shares in joint stock companies and other securities depends on the order of submission of applications to the competent land register i.e. securities register.

2.3 Can ranking of consensual security be changed by agreement of the creditors?

In general yes, however, such changes would need to be effected in the relevant registries in order to become effective. Furthermore, in certain cases, the consent of the debtor may also be required.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Pledge	Registration with the BiH Pledge Registry or transfer of possession
BANK ACCOUNT	Pledge	Registration with the BiH Pledge Registry and notification to the account holding bank
RECEIVABLES /RIGHTS	Pledge or security assignment	Registration with the BiH Pledge Registry and notification to the underlying debtor
SHARES IN LIMITED LIABILITY COMPANIES	Pledge	Registration with the BiH Pledge Registry, recording of the pledge in the book of shares (*knjiga udjela*) of the company whose shares are being pledged and, if possible, registration with the competent commercial register
SHARES IN JOINT STOCK COMPANIES AND OTHER SECURITIES	Pledge	Registration with the competent securities register
REAL ESTATE	Mortgage	Registration with the competent land register

2.5 Availability of floating charge

In general no floating charge is available; the general rule is that a security has to be specified (or at least definable) at the moment of its creation.

There is one exception in the form of a provision which has effects similar to the floating charge concept but which is only valid with respect to "general movable property" (*opšta pokretna imovina*).

2.6 Trust and parallel debt issues

In BiH there is no comparable structure to the common law trust.

The issue is typically solved through a so-called "parallel debt structure". Under this structure, the creditors agree that a security agent shall be the joint and several creditor (*solidarni povjerilac*) of each and every obligation of the borrower towards each creditor (other than the security agent). However, the respective concept has not yet been tested in court.

2.7 Availability of private sale and its main conditions

SECURITY INTEREST	ACCESSORY	PRIVATE SALE
PLEDGE OVER MOVABLES	Yes	In general no; however, under certain conditions, a pledgee may sell the security independently in a public auction (*javna prodaja*) or through a direct sale (*neposredna pogodba*).
PLEDGE OVER BANK ACCOUNT	Yes	Possible, provided that the relevant preconditions are met (direct payment by the bank).
PLEDGE OVER RECEIVABLES/RIGHTS	Yes	Possible, provided that the relevant preconditions are met (direct payment by the debtor). With respect to non-monetary rights, the same rules as for movables apply *mutatis mutandis*.
PLEDGE OVER SHARES IN LIMITED LIABILITY COMPANIES	Yes	In general no; however, under certain conditions, a pledgee may sell the security independently in a public auction or through a direct sale.
PLEDGE OVER SHARES IN JOINT STOCK COMPANIES AND OTHER SECURITIES	Yes	Possible, provided that the relevant preconditions are met, which inter alia includes that the pledge agreement is executed as a notarial deed and the parties agreed to this (sale on stock exchange).
MORTGAGE OVER REAL ESTATE	Yes	No
BANK GUARANTEES	No	Possible, provided that the relevant preconditions are met (direct payment by the bank).
SURETYSHIPS	Yes	No
BILLS OF EXCHANGE	No	Yes

2.8 Security and loan transfers

When a loan is transferred all accessory security is transferred to the transferee by operation of law. The transfer should also be registered with the relevant registries. In order to effect the transfer, separate security transfer documents and a valid registration clause (*clausula intabulandi*) may be required, in particular with respect to mortgages.

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

There is only one type of insolvency proceedings available in BiH: **bankruptcy proceedings** (*stecajni postupak*).

The aim of bankruptcy proceedings is the collective satisfaction of all creditors through liquidation of the bankruptcy debtor's property and distribution of the sale proceeds. An alternative to liquidation and dissolution is the reorganisation (*reorganizacija*) of the debtor. This can be carried out in the course of bankruptcy proceedings as a separate phase and aims at re-defining the legal and economic position of the bankruptcy debtor and its relationships with creditors in order to maintain the business on a "going concern basis".

Additionally, the RS law provides for **restructuring proceedings** (*postupak restrukturiranja*), which regulate the legal (and financial status) of the debtor and its relationship with creditors and enable the debtor to continue with its business operations. Restructuring proceedings can be initiated due to a threatening illiquidity or if the client is not settling its obligations as they fall due for a period of up to sixty (60) days.

FBiH law does not explicitly provide for restructuring proceedings; however, similar effects can be achieved through the reorganisation of the debtor.

3.2 Applicable insolvency test and directors' duty to file

Illiquidity (*platežna nesposobnost*) is the primary reason for opening bankruptcy proceedings against a debtor in BiH. Illiquidity of a debtor is presumed:

- in FBiH in the event that the debtor fails to fulfil its obligations as they fall due for an uninterrupted period of thirty (30) days; and
- in RS in the event that the debtor fails to fulfil its obligations as they fall due for an uninterrupted period of sixty (60) days or if the debtor's bank accounts have been blocked for an uninterrupted period of sixty (60) days. The ability of the debtor to fulfil some of its obligations but not all of them is *per se* not sufficient evidence against the debtor's inability to pay.

The second reason for opening of bankruptcy proceedings is threatened illiquidity (*prijeteca platežna nesposobnost*) of the debtor. Threatened insolvency exists if it can be anticipated that the debtor will not be able to fulfil its obligations as they fall due, in FBiH for an unspecified period of time and in RS for a period of twelve (12) months. However, only the debtor can initiate bankruptcy proceedings on the grounds of threatened insolvency.

The debtor is generally required to submit a bankruptcy petition without delay, but in any case within thirty (30) days in FBiH and sixty (60) days in RS, from the date of realising that the illiquidity has occurred. Otherwise the management faces monetary fines and potentially also civil and criminal liability.

3.3 Describe the insolvency proceedings

3.3.1 Bankruptcy proceedings

A bankruptcy petition can be filed by:

- the debtor;
- one or more of its creditors; or
- the liquidator (*likvidator*) in the course of (ordinary) liquidation proceedings.

The opening of bankruptcy proceedings becomes effective as of the publication of the decision of the court in the relevant official gazette. As of this date:

- the court appoints a bankruptcy administrator (*stecajni upravnik*), who assumes control over the bankruptcy debtor and its assets;
- any existing court, arbitration and similar proceedings relating to the bankruptcy estate are stayed;
- the opening of bankruptcy proceedings is noted in all relevant public registries (Commercial Registry, Land Registry, etc.).

The creditors have thirty (30) days following the publication of the decision on opening of the bankruptcy proceedings in the relevant official gazette to register their respective claims.

All unsecured creditors who hold a valid and undisputed claim against the bankruptcy debtor and who have duly registered their claims in the course of the bankruptcy proceedings are divided into three payment classes:

(1) Preferential creditors, which include (i) claims incurred in the course of the preliminary bankruptcy proceeding; and (ii) employee claims, but only up to a certain amount.

(2) General creditors, which include all creditors which have a valid claim against the debtor.

(3) Subordinated creditors, which include (i) interest accrued after opening of bankruptcy proceedings; (ii) expenses incurred by a creditor due to its participation in the proceedings; (iii) administrative and criminal fines and related damage claims; (iv) claims related to gratuitous favours of the debtor; (v) equity replacing loans. In RS, claims of affiliates also fall in this category.

The creditors of the lower payment class may have their claims paid only after the creditors of the preceding rank have had their claims paid in full. The creditors of the same payment priority have their claims paid on a *pro rata* basis.

Reorganisation is initiated by submission of a petition for reorganisation by the bankruptcy debtor or bankruptcy administrator at the latest until closure of the final hearing (*rocište za glavnu diobu*). The creditors vote on the reorganisation plan; whereby a majority in each creditor class is required and the sum of the claims of those who voted for the plan is greater than those who voted against.

3.3.2 Restructuring proceedings

In RS restructuring proceedings can be initiated against a debtor due to its threatened illiquidity. A petition for initiation of restructuring proceedings, together with a draft plan of the financial and operational restructuring, can be submitted to the court by the debtor or by a creditor with the consent of the debtor.

By the decision on opening of restructuring proceedings the court will also:

- appoint a trustee (*povjerenik*);
- schedule an examination hearing (*ispitno rocište*);
- invite creditors to notify their claims within thirty (30) days from the publication of the decision in the RS Official Gazette.

If the restructuring plan is subsequently adopted, the claims of the creditors which accepted the plan will be reduced in accordance with the plan, while claims of the creditors who voted against the plan may be reduced by up to ten percent (10%) of their claims.

During the restructuring proceedings, litigation and enforcement proceedings against the debtor are suspended.

3.4 Timing and costs of insolvency proceedings

The duration of bankruptcy proceedings depends on several different factors including the backlog of cases pending in court. Although there is no general rule, in our experience more complex bankruptcy proceedings may take several years.

In relation to restructuring proceedings, under RS law the proceedings should be completed within five (5) months from the date of the decision on opening of the restructuring proceedings; this period can be extended by the court for an additional ninety (90) days.

3.5 Challenge of preferential transactions and suspect periods

As a general rule, a transaction can be contested if:

- it has been carried out within six (6) months before filing of the bankruptcy petition and the bankruptcy debtor was insolvent at the time, provided that the bankruptcy creditor knew or should have known (= gross negligence) about the illiquidity of the debtor.
- it has been carried out after the bankruptcy petition have been filed and the bankruptcy creditor knew or should have known (= gross negligence) about the illiquidity of the debtor and/or the bankruptcy petition.

A transaction providing preference or security for a creditor's claim can also be avoided if:

- it has been carried out within one (1) month prior to the filing of the bankruptcy petition or after the petition has been filed; or
- it has been carried out up to three (3) months prior to the filing of the bankruptcy petition if at that time the debtor was already insolvent.

Furthermore, a transaction entered into by the bankruptcy debtor which provided for no or insufficient compensation for the bankruptcy debtor; can also be avoided if it has been carried out within five (5) years prior to the filing of the bankruptcy petition.

A transaction undertaken by the bankruptcy debtor within five (5) years before or after the filing of a bankruptcy petition or with the intent to harm one or more of its creditors may be avoided if the other contractual party was at the time aware of such intent.

Avoidance proceedings are generally initiated by the bankruptcy administrator on behalf of the bankruptcy debtor, however, a creditor may also do so. The claim for avoidance is filed against the party which benefited from the transaction.

3.6 Impact of insolvency proceedings on security and enforcement

As of the opening of bankruptcy proceedings:

- all enforcement proceedings pending at the time are stopped;
- creditors can no longer initiate enforcement proceedings;
- creditors can no longer request security instruments in relation to the bankruptcy estate.

Enforcement proceedings relating to the debts of the bankruptcy estate (*dugovi stecajne mase*) are prohibited for a period of six (6) months following the opening of the bankruptcy proceedings, except in the following cases:

- bilateral agreements (*dvostranoobavezujući ugovori*) which the bankruptcy administrator elected to perform;
- permanent agreements (*trajni ugovori*) which the bankruptcy administrator did not cancel within appropriate deadlines; and/or
- labour agreements or other long term agreements in relation to which the bankruptcy administrator requested fulfilment of the other party's obligations in favour of the bankruptcy estate.

Secured creditors who have validly established *in rem* security interest can generally demand separate settlement of their respective claims out of the proceeds realised through the sale of the collateral but cannot realise their right to demand sale of the collateral in the course of the preliminary bankruptcy proceedings until the end of the examination hearing.

During the restructuring proceedings, litigation and enforcement proceedings against the debtor are suspended.

3.7 Secured creditors in bankruptcy proceedings

Secured creditors (*razlučni povjerioci*) which have validly established *in rem* security interest (e.g. mortgage or pledge) can demand separate settlement of their respective claims out of the proceeds realised through the sale of the collateral. If the claims of a secured creditor cannot be fully satisfied out of the collateral, the remaining claim will be treated as an unsecured claim in bankruptcy proceedings.

3.8 Survival of powers of attorney

Upon opening of the bankruptcy proceedings any appointment as a procurist (*prokurist*) legal representative (*punomoćnik*) or as an agent (*zastupnik*) granted by the debtor will automatically cease to be valid.

4. JUDICIAL ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

Enforcement proceedings can be initiated based on:

- **enforceable deeds** (*izvršne isprave*), which include: (i) final and binding court decisions and court settlements, (ii) final and binding decisions of administrative bodies; (iii) notarial deeds (in relation to monetary claims); (iv) other deeds defined by law, in particular pledge registrations issued by the BiH Pledge Registry;
- **authentic deeds** (*vjerodostojne isprave*), which include: (i) bills of exchange, (ii) promissory notes, (iii) cheques, and (iv) utility services' invoices or excerpts from bookkeeping records in relation to the utility services.

Enforcement proceedings for monetary claims involve the following main steps:

- seizure of the property;
- appraisal of the property;
- sale of the property through court proceedings or private sale (if allowed); and
- settlement.

4.2 Timing and costs of enforcement proceedings

The duration of judicial enforcement proceedings varies greatly, depending on the court involved, its caseload, defensive tactics pursued by the debtor and similar. In our experience, it generally takes between six (6) months and two (2) years (starting with filing the application for enforcement and ending with the distribution of the funds).

NAIDA ČUSTOVIĆ
Partner

Wolf Theiss, Sarajevo

T. +387 33 953 460
naida.custovic@wolftheiss.com

WOLF THEISS

BULGARIA

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

Even though there is no special regulation regarding negative pledges, they are used in practice. In our opinion, negative pledge undertakings are legal and binding between parties to a loan agreement.

1.2 Restrictions on accelerating a loan

In general, Bulgarian law does not restrict the ability of the parties to a facility agreement to agree on any event of default.

In case of a bank facility, the bank must grant a defaulting borrower a reasonable period of time before the acceleration becomes effective.

1.3 Effectiveness of a non-assignment clause

A prohibition of assignment is legally valid and binding between the contracting parties, and the violation of such clause may give rise to damage claims. However, it is not effective *vis-à-vis* third parties and any assignment by a lender to a third party is valid.

An assignment becomes effective *vis-à-vis* third parties as well as the debtor only upon notification of the debtor.

1.4 Common methods for loan transfers

The most common method used in practice to transfer rights related to a loan agreement in Bulgaria is the assignment of claims. Following the assignment the new lender ("assignee") acquires the receivables including all privileges, securities and other rights of the previous lender ("assignor"). Notice to the borrower is not required in terms of validity of the assignment of claims agreement between the parties. Nevertheless, if the borrower is not notified of the change of creditor, the former may perform its obligation towards the previous lender and the assignment will not be effective *vis-à-vis* third parties.

Novation is another common way for replacing the creditor on a loan agreement. This method requires the express consent of the borrower for the change of creditor. All securities shall be renewed.

1.5 Effectiveness of a contractual subordination

The effectiveness of contractual subordination is neither explicitly regulated nor addressed in Bulgarian case law.

A contractual subordination agreed in a standard inter-creditor agreement is effective between senior lenders and junior lenders. However, such agreement would not be binding upon a bankruptcy receiver.

1.6 Subordination by operation of law

Shareholders' loans are subordinated upon the opening of insolvency proceedings by operation of law.

1.7 Validity of a forfeiture agreement

An agreement for the forfeiture of the security interest (i.e. the secured creditor may keep the collateral in lieu of the secured liability) reached before enforcement commences is not legally valid or binding, except with regard to financial collateral contracts.

Financial collateral contracts include financial contracts between central banks (domestic and European), banks, diverse financial institutions, insurance companies, leasing companies, investment intermediaries and market operators, as well as UCITS, AIFM and other companies.

1.8 Super-priority loans in bankruptcy

Bulgarian law does not provide for prioritised loans within bankruptcy proceedings beyond the ordinary creditors' ranking. Certain types of security interest, however, may be exercised notwithstanding the opening of the insolvency or require severability of the secured assets from the insolvency pool.

Loans or other receivables secured under the Financial Collateral Contracts Act and including netting clause may be qualified as super-priority receivables, as the start of insolvency proceedings or any other proceedings leading to the liquidation of the borrower's assets does not prevent the secured creditor exercising its rights under such netting agreement.

Bulgarian mandatory insolvency rules prevail over contractual netting arrangements, with a few exceptions as set out below. Close out netting arrangements included in a financial collateral contract are not affected by the limitations of Bulgarian mandatory insolvency rules. For banks in insolvency, the netting arrangement is not affected by Bulgarian insolvency rules, if it is valid and enforceable under the foreign law governing the netting arrangement. For insurance companies in insolvency, the creditors may set off if the law governing the debtor's claim allows the set-off.

The enforcement of a pledge given under the Special Pledges Act is also not affected by the beginning of insolvency proceedings. In this regard, the insolvency administrator bears an obligation to provide the secured party with possession over the subjects of the special pledge which are frequently movables and/or other goods or funds. Thus, such security would allow lenders to enforce it despite the opening of insolvency.

1.9 Varying interest rate and tenor of the loan – must security be retaken?

According to Bulgarian law, all security interests are given to cover contractual claims up to a certain amount. Thus, variation of the interest rate may lead to an excess of the amount for which the respective security is established. In this case, the excessive amounts shall not be covered by the security and the existing security shall be amended to cover the excessive amount. Due to the specifics upon perfection for mortgages, an amendment in this regard requires retaking of the security while for financial collaterals and special pledges such variations do not affect security ranking and registration of the changes is sufficient.

Variations of the tenor of the loan do not require retaking of the security interest. Registration of such amendments is not mandatory but may be required if the tenor is reduced and the secured creditor wishes to enforce.

Without prejudice to the above, it shall be noted that all mortgages are valid for a maximum ten (10) year term. On the other hand, special pledges are valid for a maximum of five (5) years. Before expiry of the relevant period, the security shall be renewed with the respective registry if the secured creditor wishes to preserve the priority created by the initial registration.

2. SECURITY INTERESTS

2.1 How to establish a security interest

To establish a valid security interest, a title instrument and an act of perfection (i.e. an act of publicity) are required.

Title instruments include:

- movable pledge agreement, accounts receivable pledge agreement, receivables pledge agreement, shares pledge agreement, securities pledge agreement, going concern pledge agreement, floating pool pledge agreement, financial collateral agreement and mortgage agreement;
- surety (personal guarantee agreement).

Depending on the security interest, the act of perfection may be one or more of: (i) the registration of the security with the respective registry; (ii) notifying the debtor; (iii) the transfer of the respective collateral to the secured party; or (iv) notarisation of the agreement.

In case of surety (personal security interests), the act of perfection falls together with the signing of the respective title instrument.

2.2 Ranking of pledges/mortgages

The rank of a pledge depends upon the time when the respective act of perfection has been made.

The rank of a real estate mortgage depends on the exact time when the application for registration of the mortgage is submitted to the registry agency (subject to actual registration).

2.3 Can ranking of consensual security be changed by agreement of the creditors?

The ranking of creditors within the enforcement procedure is subject to mandatory legal provisions which may not be changed under an inter-creditor agreement. The ranking is defined by the registration date of each security interest. A consensual change of the creditors' ranking will give effect only between the parties to the agreement and will not be opposable to third parties.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Pledge	Physical delivery of the movables to the pledgee or instruction to possess to a third party holding movables for the pledgor or registration with the Central Pledges Registry
ACCOUNT	Title transfer (applicable for financial collateral arrangements) or pledge	Registration with the central pledges registry or compliance with the requirements under the Financial Collateral Contracts Act
RECEIVABLES	Title transfer (applicable for financial collateral arrangements) or pledge	Notification to debtor and/or registration with the Central Pledges Registry

ASSET	SECURITY	PERFECTION
SHARES	Pledge	Endorsement, hand-over and registration with the Shareholder Registry or only the hand-over of share certificates (depending on the type of shares)
BOOK-ENTRY FORM SECURITIES	Title transfer (applicable for financial collateral arrangements) or pledge	Registration with the central depository
REAL ESTATE	Mortgage	Notary deed registered with the registry agency
GOING CONCERN OR FLOATING POOL	Pledge	Registration with the Central Pledges Registry as well as with the respective registries in accordance with the type of the asset class

2.5 Availability of floating charge

Bulgarian law recognises a floating charge in the form of:

- a registered going concern pledge over the going concern of a company (enterprise pledge); that pledge may extend over specific assets if specified in the pledge agreement;
- a registered pledge over a floating pool of (i) receivables, or (ii) movables, or (iii) book entry securities, owned by a company.

2.6 Trust and parallel debt issues

Bulgarian law requires that the secured party must be the holder of secured claims. Bulgarian law, as a general rule, does not recognise a security trustee structure. As an exception, a structure similar to security trusteeship is provided by Bulgarian law in the following two cases:

- bondholders of a bond-issue shall appoint a security trustee; and
- the Financial Collateral Contracts Act (effective as of 25 August 2006) mentions the provision of financial security to a party acting for the account of several secured creditors, so that with regard to financial collateral agreements effectiveness of the security trustee structure seems probable; this has not yet been tested in court.

The above issue is typically solved through a so-called “parallel debt structure” whereby the parties to the facility agreement agree that the security agent shall be the joint and several creditor of each and every obligation of the borrower towards each finance party (other than the security agent).

The above concept has as yet not been tested in Bulgarian courts.

2.7 Availability of private sale and its main conditions

SECURITY INTEREST	ACCESSORY	PRIVATE SALE
GUARANTEE	Yes/No - depending on terms	N.a.
SURETY	Yes	N.a.
MOVABLES PLEDGE	Yes	Yes
ACCOUNT PLEDGE	Yes	Yes
RECEIVABLES PLEDGE	Yes	Yes
SHARE PLEDGE	Yes	Yes / No for quotas in limited liability companies
REAL ESTATE MORTGAGE	Yes	No

2.8 Security and loan transfers

In the event of assignment of claims all securities and privileges of the assignor are acquired by the assignee. The latter shall undertake all necessary steps to register in all applicable registries the change of creditors for the registered securities. It shall be taken into consideration that assignment of receivables that are secured by mortgage need to be performed in writing with notarised signatures. In this case the registration with the Land Registry is a condition precedent for the enforceability of the assignment.

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

Insolvency proceedings may be opened over the assets of an insolvent or over-indebted company.

Insolvency proceedings are initiated through an application for the opening of insolvency proceedings. The single-entry procedure may have two different exits:

- **Composition** (*Оздравяване на предприятието*) formal or informal depending on the existence of a restructuring plan approved by the court or an out-of-court settlement with all creditors;
- **Insolvency** (*Обявяване в несъстоятелност*) of the company which leads to the liquidation of the company's assets.

3.2 Applicable insolvency test and directors' duty to file

Two separate insolvency tests (each triggering insolvency) for a company are typically applied:

- **Balance sheet test:** a company's payment obligations exceed the value of the company's assets (= overindebtedness);
- **Cash flow test:** a company is not able to perform a monetary obligation that has become due (= illiquidity).

The court should not open insolvency proceedings if the debtor's difficulties are of temporary nature.

Directors of a company are obliged to file with the competent court for the opening of insolvency proceedings within a thirty (30) day period after the company becomes insolvent. A director risks criminal and civil liability in case of non-compliance.

3.3 Describe insolvency proceedings

The insolvency proceedings are initiated by the competent court upon application by:

- the debtor;
- one or more of its creditors;
- an assigned liquidator;
- the National Revenue Agency.

The opening of insolvency proceedings becomes effective as of the day of the competent court's ruling on the opening.

In its decision the competent court: (i) appoints an insolvency administrator (*синдик*) (ii) determines the date as of which the debtor has become insolvent or overindebted; (iii) imposes a general injunction over the assets of the debtor; and (iv) determines the date for the first meeting of creditors.

The insolvency administrator supervises and approves the acts of the management of the company, who does not lose control over the business.

The competent court has the power to declare that the insolvency administrator assumes control of the insolvent company's business in case the management of the company endangers the interest of its creditors.

Typically, the debtor's assets are liquidated, i.e. sold to the highest bidder. Liquidation proceeds are distributed to the company's creditors pursuant to the statutory order of priorities.

The Commercial Act lays out the following priority of payments:

(1) claims secured by a pledge or mortgage or by restraint registered under the Special Pledges Act;

(2) claims secured by a lien;

(3) insolvency costs;

(4) claims arising out of employment contracts before the effectiveness of the opening of insolvency proceedings;

(5) obligations (allowance) owed by the debtor to third parties by operation of law;

(6) public claims of the state and the municipalities such as taxes, customs duties, social security contributions, which have arisen before the effectiveness of the opening of insolvency proceedings;

(7) claims which have occurred after the effectiveness of the opening of insolvency proceedings;

(8) all other unsecured claims that have arisen before the effectiveness of the opening of insolvency proceedings;

(9) unsecured claims for interest payment which have become due and payable after the effectiveness of the opening of insolvency proceedings;

(10) claims arising out of a credit extended to the debtor by a partner or a shareholder;

(11) claims arising out of gratuitous transaction;

(12) claims arising from the costs incurred by creditors in connection with their participation in the insolvency proceedings, with the exception of costs for opening of the proceedings.

If liquidation proceeds are not sufficient to satisfy all creditors within a certain class, available proceeds are distributed on a *pro rata* basis.

The commencement of insolvency proceedings against a pledgor does not affect the enforcement of a registered pledge upon the pledged assets if the enforcement started before the opening of insolvency proceedings and if the collateral is identifiable within the debtor's estate.

The commencement of insolvency proceedings against a debtor does not affect the enforcement proceedings of public debts if the enforcement started before the opening of the insolvency proceedings.

3.4 Timing and costs of insolvency proceedings

The duration of insolvency proceedings will depend on several different factors (e.g. the volume of the assets and liabilities of the debtor, the number of creditors, whether a restructuring plan is approved, whether the insolvency administrator challenges any transactions of the debtor in court, etc.). Although there is no general rule, in our experience more complex insolvency proceedings may take up to thirty-six (36) months.

3.5 Challenge of preferential transactions and suspect periods

According to the Amended Commercial Act (2013), the three groups of deals that may be challenged in front of the district court at the place of incorporation of the insolvent company are defined as:

3.5.1 Void actions

The following transactions are completely null with consideration to the creditors admitted in the insolvency proceedings, if performed after the decision for opening of insolvency proceedings: (i) performance of obligation which has occurred prior to the opening of the proceedings; (ii) establishment of pledge or mortgage over an asset which is subject to the insolvency proceedings (iii) any transaction the subject of which is an asset which is part of the insolvency pool.

Compared with the other groups of acts subject to avoidance, void actions do not aim to have a retroactive effect. Rather they are directed at legal acts executed after the opening of the insolvency proceedings, but do not comply with the procedures and exemptions set out in the law.

3.5.2 Preference actions

The court may declare as null with consideration to the creditors admitted in the insolvency proceedings the following deals: (i) payment of an obligation, where maturity has not fallen on the payment date, if paid within one (1) year prior to the filing of the application for opening of insolvency proceedings; (ii) establishment of a pledge or mortgage as security for receivables, which have occurred one (1) year prior to the filing of the application for the opening of the insolvency proceedings; (iii) payment of an obligation which has become due, if paid within six (6) months before the filing of the application for opening of the insolvency proceedings; and (iv) set-off which are subject to avoidance.

If the creditor was aware of the debtor's insolvency at the time of accepting the payment or the security the relevant periods are doubled. These categories of challengeable deals are subject to numerous exceptions. They are defined by legal theory as preference actions because they set forth the beneficial and preferential treatment of certain creditors by the debtor.

3.5.3 Actions subject to avoidance

The difference between void transactions and actions subject to avoidance is that in the case of the latter, for the purposes of setting aside a transaction, the claimant must establish that the negative consequences have occurred, or that the pre-requisites defined by the law are met.

Actions subject to avoidance include gratuitous transactions, transactions where the consideration given by the debtor is considerably more valuable than the consideration received, granting security for the liabilities of a third party and transactions with affiliates which harm the creditors.

There are no presumptions to be applied by the petitioner. Avoidance claims can also be differentiated from preference actions in that preference actions protect the relationships between the creditors and the anti-preference satisfaction, while avoidance claims are directed against acts which endanger the estate and their aim is to ease proving the endangering. These actions are further characterised by the longer periods they cover. Actions subject to avoidance may have been performed within three (3) or two (2) years prior to opening of insolvency proceedings. This is due to their undoubtedly harmful nature contributing to the insolvent state of the company.

3.6 Impact of insolvency proceedings on security and enforcement

Generally in insolvency proceedings claims secured by a first ranking mortgage or a pledge rank first.

The validity of such security is subject to the following restrictions:

- A mortgage or pledge, established by the debtor for a previously unsecured obligation and made in the one (1) year period prior to the filing of a petition for initiation of insolvency proceedings, may be annulled with respect to the other creditors. However such annulment cannot be made if the mortgage and/or the pledge has been established simultaneously with the secured transaction; or the security has been established to substitute other security, which is not subject to annulment; or the security has been established to secure a loan, granted for acquiring the assets, which are subject to the security.
- A security established after the court's decision for the opening of insolvency proceedings, shall be considered void with respect to the rest of the insolvency creditors.
- A security for the obligations of a third party established within one (1) year before filing of the petition for opening the insolvency proceedings and after the date when the debtor has become insolvent or over-indebted may be challenged by the rest of the insolvency creditors.

In certain cases the periods of one (1) year are doubled.

If foreclosure proceedings are initiated:

- In general, once insolvency proceedings are opened the judicial mortgage foreclosure and the judicial pledge foreclosure are suspended.
- The opening of insolvency proceedings does not stop or prevent the commencement of enforcement proceedings with respect to a registered pledge, carried out pursuant to the Special Pledges Act.

3.7 Survival of powers of attorney

Any appointed legal representative powers granted by a company will cease to be valid upon the opening of insolvency proceedings over its assets.

3.8 Describe reorganisation plan

Under the Commercial Act the approval of a restructuring plan is the core of the formal composition proceedings.

A restructuring plan can be proposed not later than one (1) month following the date of publication in the commercial register of the court's ruling approving the list of claims.

A restructuring plan can be proposed by:

- the debtor;
- the administrator;
- creditors holding at least one third (1/3) of the secured claims;
- creditors holding at least one third (1/3) of the unsecured claims;
- shareholders holding at least one third (1/3) of the capital of the debtor;
- twenty percent (20%) of the total number of the debtor's employees.

The restructuring plan may provide for deferment or rescheduling of payments, reduction of debts, debt-to-equity swap, or reorganisation of the enterprise.

The restructuring plan may envisage the sale of the enterprise or a separable part thereof.

The restructuring plan must be accepted by a majority of each of five classes of creditors (secured creditors, unsecured creditors, employees, public creditors, and creditors ranking after the unsecured) and in total by creditors representing more than fifty percent (50%) in value of all accepted claims.

The court must approve the restructuring plan. If the restructuring plan is approved by the court, the insolvency proceedings are terminated.

If the debtor does not perform its obligations under the restructuring plan the insolvency proceedings may be reopened. In the reopened insolvency proceedings, no further composition is permissible.

4. JUDICIAL ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

A secured creditor may have to pursue judicial enforcement with regard to its collateral in accordance with the Civil Procedural Code which requires completion of the following steps:

- first, obtaining a title for enforcement;
- second, filing of a motion for enforcement with the competent Bulgarian regional court or Sofia city court;
- third, obtaining a court ruling of the competent court and an execution order;

- fourth, enforcement through public auction for real estate properties and movables or freezing order of the bank accounts, bonds, shares or movables and subsequent sale or collection;
- finally, the proceeds of the public auction, sale or collection are distributed to the creditor and potentially joint creditors to settle the claims in accordance with the priority of creditors provided by law.

A title for enforcement may be:

- a final, conclusive and binding decision, ruling, settlement or order of a Bulgarian court or other intermediate judgment that is immediately enforceable;
- a final, conclusive and binding judgment by a court of an EU Member State as defined in Council Regulation (EC) 1215/2012 of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters;
- a final, conclusive and binding arbitral award in Bulgaria or a member state to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958;
- a judgment, act or memoranda on court settlement of foreign courts which have been admitted to enforcement in Bulgaria.

4.2 Timing and costs of enforcement proceedings

With regard to judicial enforcement proceedings, in our experience the enforcement procedure takes about six (6) months to two (2) years (starting with the filing of the enforcement application and ending with the distribution of the monies realised to the secured creditor). This duration also depends on the court's caseload and potential objections pursued by the debtor.

4.3 Validity of a foreclosure agreement

The foreclosure agreement (whereas the lender and the borrower agree that the former shall have the right to dispose of the secured asset upon occurrence of event of default) is null according to Bulgarian law, except with respect to collateral under the Financial Collateral Contracts Act. The recognised enforcement methods for security interests (except for the ones under the Financial Collateral Contracts Act) are either auctions (according to the Special Pledges Act) or enforcement proceedings (Civil Procedural Code). Similar to foreclosure, effect may be achieved through agreement for transfer of ownership in exchange for the debt which represents settlement in the event of non-performance of debt. The exchange of different types of securities for the debt has to be performed in the necessary form (notary deed for mortgages, notarised signatures for certain special pledges etc.).

KATERINA KRAEVA
Partner

Wolf Theiss, Sofia

T. +359 2 86 13 700
katerina.kraeva@wolftheiss.com

WOLF THEISS

CROATIA

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

In Croatian law governed agreements, a negative pledge undertaking as a contractual undertaking (as opposed to an *in rem* right) is expected to be upheld in Croatia although the courts' position has not been fully crystallised yet in that respect.

A negative pledge undertaking in a foreign law governed agreement may not be enforceable in Croatia by way of a specific performance, as it might be considered against Croatian public policy (*ordre public*). However, in case of breach of a negative pledge undertaking in a foreign law governed facility, the lender may exercise the available remedies, including declaring a default and accelerating the loan.

1.2 Restrictions on accelerating a loan

In general, Croatian law does not restrict parties to a facility agreement in agreeing on any event of default.

A facility agreement may not be accelerated due to the breach of an insignificant part of the contractual obligations.

1.3 Effectiveness of a non-assignment clause

A prohibition on assignment of monetary claims is effective in respect of third parties and any assignment by a lender to a third party in violation thereto is invalid.

1.4 Common methods for loan transfers

The most common method for transfer of loans is through an assignment of claims and transfer of contractual position.

Assignment of claims provides for assignment of claims, together with ancillary rights. No consent of the debtor is required, but a consent requirement can be contractually agreed. Typically transferred by assignment of claim are:

- NPLs, where the underlying loan has already been accelerated and/or the loan agreement terminated; and
- loan receivables from bilateral retail loans where the loan agreement does not include an advance consent for or does not allow the transfer.

Transfer of contractual position means the transfer of all rights, claims and obligations. The consent of the other contractual party/parties is required, but may also be granted in advance (e.g. in the original loan documentation). Typically transferred by transfer of contractual position are:

- performing loan receivables; and
- loan receivables deriving from syndicated facilities and/or restructured under MRAs.

Under certain circumstances sub-participation arrangements may be chosen as a transfer alternative. These are not unknown in Croatia but the transferring bank remains involved in the NPLs going forward which may not be the desired outcome.

1.5 Effectiveness of a contractual subordination

Contractual subordination is not regulated and may not be binding on insolvency officers.

1.6 Concept of equity-replacing shareholder loans

Shareholder loans are subordinated to other indebtedness in the context of insolvency if:

- the debtor was already in financial distress; and
- a diligent business person would in such a situation infuse equity instead of granting a loan.

This does not apply to:

- shareholders who do not manage the company's business and whose shares represent no more than one tenth (1/10) of the company's share capital;
- lenders who acquire equity positions by way of a capital increase for the purpose of overcoming a situation of distress with respect to (i) loans granted beforehand, and (ii) new loans, up to the amount of the paid in share capital.

1.7 Validity of a forfeiture agreement

An agreement for the forfeiture of the security interest (i.e. a secured creditor may keep the collateral in lieu of the secured liability) is not valid.

1.8 Super-priority loans in bankruptcy

Croatian law does not recognise the concept of super-priority loans in bankruptcy proceedings.

1.9 Varying interest rate and tenor of the loan – must security be retaken?

The varying tenor of the loan does not affect the accompanying security. However, any changes made to the tenor of the loan must be registered with the relevant registries (e.g. Land Registry, Court Registry, and Registry of Notarial Security Instruments over Movables and Rights).

The interest rate of the loan must be determined or at least determinable when executing the original security. If the interest rate subsequently changes, the security will have to be retaken.

2. SECURITY INTERESTS

2.1 How to establish a security interest

To establish a valid security interest, a title instrument and an act of perfection (that is an act of publicity) is required.

Title instruments include:

- mortgage agreement, movables pledge agreement or movables transfer agreement or movables floating charge agreement, share pledge agreement, rights/receivables pledge agreement or rights/receivables transfer/assignment agreement;

- debenture (or prompt collection order) (*zadužnica*); and
- guarantee agreement and surety agreement.

For debentures, guarantees and sureties, the act of perfection is determined by the signing of the respective title instrument.

In case of *in rem* rights, a separate act of perfection is required (i.e. registration with the relevant registry).

2.2 Ranking of pledges/mortgages

The rank of a pledge depends on when the respective title instrument was submitted for registration (= act of perfection) with the relevant registry.

2.3 Can ranking of consensual security be changed by agreement of the creditors?

The ranking can be changed by agreement of the creditors and must be registered with the relevant registry.

Consent has to be given by the owner of the pledged object (e.g. real estate), the lender, and by all lenders in favour of which the security instruments that will be subordinated are established.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Pledge or transfer	Registration with the registry of notarial security instruments over movables and rights maintained by the Financial Agency ("FINA Registry")
ACCOUNT	Transfer or assignment	Registration with the FINA Registry
RIGHTS/RECEIVABLES	Pledge or transfer	Registration with the FINA Registry
SHARES	Pledge or transfer	Registration with the FINA Registry/ Central Depository and Clearing Company, and (best practice) annotation in the book of shares
REAL ESTATE	Mortgage or transfer	Registration with the Land Registry

2.5 Availability of floating charge

Croatian law recognises a floating charge over all (or a certain group) of physical movable assets (e.g. goods on stock) located in a certain individually defined location (e.g. storage).

The goods may be changed during the duration of the floating charge. However, the value of the goods should not fall below the contractually determined value at any time, unless agreed otherwise.

2.6 Trust and parallel debt issues

There is no comparable structure to a common law trust in Croatia. A common law trust does not create the required ownership over secured claims that is necessary to create a valid and enforceable security interest.

This is typically solved through a "parallel debt structure" whereby the parties to an English law facility agreement agree that the security agent shall be the joint and several creditor of each and every obligation of the borrower towards each finance party (other than the security agent).

2.7 Availability of private sale and its main conditions

SECURITY INTEREST	ACCESSORY	PRIVATE SALE
GUARANTEE	Yes (unless bank guarantee)	N.a.
SURETY	Yes	N.a.
MOVABLES PLEDGE/TRANSFER	Yes	Pledge – no Transfer – yes
MOVABLES FLOATING CHARGE	Yes	No
RIGHTS/RECEIVABLES PLEDGE/ ASSIGNMENT (INCLUDING ACCOUNTS)	Yes	Pledge – no Assignment/Transfer – yes
SHARE PLEDGE	Yes	Under
REAL ESTATE	Yes	Mortgage – no Transfer – yes

2.8 Security and loan transfers

When a loan is transferred by way of assignment the security is transferred to the new lender. The transfer of security must be registered with the relevant registry. In the case of a transfer of the contract, security may need to be retaken.

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

The Insolvency Act provides for the following two insolvency proceedings:

- **Bankruptcy proceedings** (*stečajni postupak*), which generally lead to the liquidation of the insolvent entity; and
- **Reorganisation proceedings** which aim to preserve the debtor's business as a going concern.

If the assets of the insolvent entity are less than HRK 2 million (approximately EUR 263,200) less complex bankruptcy procedure applies.

If a company is likely to become unable to perform its monetary obligations as they fall due (*prijeteća nesposobnost za plaćanje*), the company may commence pre-bankruptcy proceedings. Pre-bankruptcy proceedings (*predstečajni postupak*) primarily aim at determining the financial status of a company and its relations towards its lenders, with the purpose of preserving the business of the company.

3.2 Applicable insolvency test and directors' duty to file

Two separate insolvency tests (each of these triggers insolvency) are typically applied:

- **Balance sheet test:** a company's due and payable obligations exceed the value of the company's assets (= overindebtedness, *prezaduženost*) plus a negative business forecast, unless a shareholder of the company who is a natural person has joint and several liability for the obligations of the company and bankruptcy proceedings have not been commenced over the shareholder;
- **Cash flow test:** a company is unable to perform its monetary obligations as they fall due (= inability to pay, *nesposobnost za plaćanje*).

The management board must file a petition for the opening of bankruptcy proceedings no later than twenty-one (21) days after the company becomes insolvent. Directors are personally liable to creditors for damages in case of noncompliance.

3.3 Describe insolvency proceedings

Bankruptcy proceedings are initiated by the competent court upon an application by:

- a debtor;
- one or more creditors; or
- a third party (i.e. financial agency).

Upon receiving the application, the competent court usually initiates preliminary proceedings to determine if the conditions for opening bankruptcy proceedings exist.

The opening of the bankruptcy proceedings becomes effective as of the day the ruling is publicised by the competent court. If the assets of the insolvent entity are insufficient, the court will render a decision on the opening and immediate closing of the bankruptcy proceedings.

The competent court appoints a bankruptcy receiver (*stečajni upravitelj*), who assumes control of the business of the debtor and its assets.

Creditors of the debtor register their claims with the bankruptcy receiver. The competent court examines each claim individually and renders a decision determining the accepted and challenged claims, their value and payment order.

The Insolvency Act lists the following order of payment:

- costs of the bankruptcy proceedings;
- claims of employees and ex-employees of the debtor incurred until the opening of the bankruptcy proceedings;
- all other claims towards the debtor which do not belong to a lower payment rank; and
- other claims of creditors of the bankruptcy estate, i.e. interest rates accrued in relation to the claims of the creditors since the opening of the bankruptcy proceedings, penalties relating to criminal deeds or torts of the debtor, expenses of the creditors in relation to the bankruptcy proceedings, equity-replacing shareholders loans and claims in relation to which a lower order of payment rank has been agreed upon.

3.4 Timing and costs of insolvency proceedings

The duration of the bankruptcy proceedings will depend on several different factors. Although there is no general rule, in our experience more complex bankruptcy proceedings may take up to five (5) years.

3.5 Challenge of transactions and suspect periods

Preferential transactions undertaken prior to the bankruptcy proceedings may be challenged by the bankruptcy receiver and the bankruptcy creditors on the following grounds:

- paying a creditor (or providing security for the payment) in line with previously agreed terms, if the debtor was insolvent at the time of the transaction and the creditor knew (or should have known) of it (suspect period of three (3) months the bankruptcy proceedings);
- paying a creditor (or providing security for the payment) not in line with previously agreed terms (suspect period of one (1) month before the petition for the bankruptcy proceedings), with the suspect period being extended to the second (2nd) and third (3rd) month before the petition for the bankruptcy proceedings if the debtor was insolvent at the time of the transaction and the creditor knew (or should have known) of it or if the creditor knew at the time of the transaction that it would be damaging to the bankruptcy creditors;
- transactions that put the bankruptcy creditors at a disadvantage, if the debtor was insolvent at the time of the transaction and the other party knew of it (suspect period of three (3) months before the petition for the bankruptcy proceedings);
- transactions between the debtor and persons closely connected to the debtor that put the bankruptcy creditors at a disadvantage (suspect period of two (2) years before the petition for the bankruptcy proceedings);
- transactions with the intent of damaging creditors, if the other party knew of it at the time of the transaction (suspect period of ten (10) years before the petition for the bankruptcy proceedings);
- transaction without compensation (suspect period of four (4) years before the petition for the bankruptcy proceedings);
- shareholder loans replacing capital contributions (suspect period of one (1) year, or, if security is provided, five (5) years, before the petition for the bankruptcy proceedings).

3.6 Impact of insolvency proceedings on security and enforcement

All enforcement proceedings for unsecured debt which were pending before the start of the pre-insolvency settlement proceedings will be stayed and new enforcement orders will not be enforced.

3.7 Secured creditors in bankruptcy proceedings

A valid *in rem* security interest gives the secured creditor a preferential claim over the respective collateral.

Creditors with security interests (*razlučni vjerovnici*) are creditors who have a security (mortgage or pledge) or an equivalent right (e.g. the right of retention) over particular assets of a debtor. These creditors have a right of separate satisfaction with respect to the collateral established in their favour.

The right of separate satisfaction is enforced outside of bankruptcy proceedings within a regular enforcement procedure.

A secured creditor may also choose to waive its right of separate satisfaction and participate in the bankruptcy proceedings as an unsecured creditor. The precondition for secured creditors to participate in the bankruptcy proceedings as unsecured creditors is: (i) separate satisfaction is insufficient for the creditor's claim to be fully satisfied; or (ii) the security is given to the creditor for securing a claim the creditor has directly towards the debtor itself (i.e. the security interest was not given for securing a third party claim).

Creditors with exemption rights (*izlučni vjerovnici*) are creditors who can prove, on the basis of their proprietary or personal right, that an asset should not be part of the estate of the debtor (e.g. owners of machinery leased to the debtor or vendors holding title retention rights). The exemption right is enforced outside of the insolvency proceedings.

3.8 Survival of powers of attorney

Any powers of attorney will automatically cease to be valid upon the opening of bankruptcy proceedings.

This may affect a secured creditor's ability to effect a transfer of the collateral to a potential purchaser in a private enforcement.

3.9 Describe reorganisation plan

During the bankruptcy proceedings, the debtor or the receiver may apply for the initiation of reorganisation proceedings by submitting a reorganisation plan to the court, in order to preserve the debtor's business as a going concern.

The reorganisation plan requires acceptance by the majority of creditors within each class of creditors and the value of the claims of the creditors who accept the reorganisation plan must be at least double the value of the claims of the creditors who refused the reorganisation plan.

The opening of reorganisation proceedings becomes effective once the court's decision confirming the reorganisation plan (*rješenje o potvrdi plana*) becomes final and binding.

Once the reorganisation plan has been approved by the competent court and the receiver has paid out the creditors of the bankruptcy estate, the bankruptcy proceedings are terminated and the debtor generally regains control over its assets.

However, if so ruled by the court, the receiver, the creditors' committee and the bankruptcy court supervise the implementation of the reorganisation plan.

Reorganisation proceedings may affect the position of the secured creditors, as the reorganisation plan may envisage a modification of their rights to separate satisfaction. Secured creditors are entitled to vote for or against acceptance of a reorganisation plan and if the majority approves it the rights of the non-consenting secured creditors may be adversely affected by the plan.

4. JUDICIAL ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

Security instruments are generally in the form of a directly enforceable instrument (*ovršna isprava*), i.e. a security agreement in the form of a Croatian notarial deed. Depending on the type of security interest granted these can be enforced either out-of-court or by way of court driven procedures.

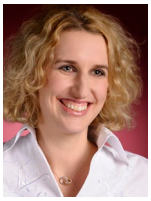
Assignments or transfers (*prijenos*) established by a directly enforceable instrument may be enforced out-of-court. Prior to enforcement, the creditor must obtain an enforcement confirmation (*potvrda o ovršnosti*) from a Croatian notary public, i.e. a ruling on nonpayment by the borrower. The out-of-court enforcement is effected via a Croatian notary public, by means of a public auction (*javna dražba*) or direct sale (*neposredna pogodba*).

Mortgages and pledges established by a directly enforceable instrument are enforced in court. The creditor secured by a security agreement in the form of a Croatian notarial deed will have to:

- obtain an enforcement confirmation from a Croatian notary public;
- file an enforcement request (*prijedlog za ovrhu*) with the competent Croatian court;
- obtain a court decision on the enforcement (*rješenje o ovrsi*);
- effect enforcement by: (i) public auction, in case of real estate; (ii) public auction or court driven direct sale, in case of movables; (iii) auction or court driven direct sale, in case of immaterial stocks and shares; (iv) stock exchange public auction or another legally permitted manner, in case of securities registered with the Central Depository and Clearing Company Inc.; (v) public auction or court driven direct sale, in case of material rights (e.g. IP rights, *usufructus*);
- the proceeds are distributed to the secured creditor(s) to settle secured claims.

4.2 Timing and costs of enforcement proceedings

The duration of judicial enforcement proceedings varies greatly, depending on the court involved, its caseload, defensive tactics pursued by the debtor and similar issues. In our experience, it generally takes between nine (9) months and two (2) years (starting with filing the application for enforcement and ending with the distribution of the monies realised to the secured creditor).



VEDRANA IVEKOVIĆ
Counsel

Wolf Theiss, Zagreb

T. +385 1 4925 400
vedrana.ivekovic@wolftheiss.com

WOLF THEISS

CZECH REPUBLIC

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

A negative pledge undertaking is legally valid and binding. The negative pledge may be established as a right *in rem* and registered as such in the public registers.

1.2 Restrictions on accelerating a loan

In general, Czech law does not restrict the ability of the parties to a facility agreement to agree on any event of default.

1.3 Effectiveness of a non-assignment clause

The prevailing legal opinion is that a non-assignment clause is effective *vis-à-vis* third parties and assignment by an assignor to a third party in violation of such prohibition may be contested by the debtor (relative invalidity).

1.4 Common methods for loan transfers

Loan transfer may be achieved by way of assignment of receivables or assignment of contract (which comprises the transfer of both rights and liabilities).

1.5 Effectiveness of a contractual subordination

A contractual subordination agreed in a standard inter-creditor agreement is effective in an insolvency situation.

1.6 Subordination by operation of law

Within the insolvency proceedings, receivables of shareholders arising from their participation in the insolvent company will be satisfied as subordinated claims.

Otherwise, the concept of subordination by operation of law (including shareholders' loans) does not exist under Czech law.

1.7 Validity of a forfeiture agreement

An agreement on forfeiture of security interests (i.e. a secured creditor may keep collateral in lieu of the secured liability) is legally valid; however it is prohibited to agree that a pledgee may keep the collateral for a predetermined price or to agree on arbitrary terms for price determination.

1.8 Super-priority loans in bankruptcy

During the course of insolvency proceedings, the insolvency administrator can enter into loan agreements, agreements for supply of goods and utilities as well as into agreements ensuring fulfillment of these agreements in order to ensure operation of an insolvent business as a going concern. Existing secured creditors have a priority right to enter into such agreements. Claims of creditors of the super-priority loans will be satisfied as priority claims.

1.9 Varying interest rate and tenor of the loan – must security be retaken?

It is possible to agree on an amendment to the existing title instrument and the security itself does not have to be retaken. Under Czech law, a security agreement must contain (i) the maximum amount of the secured debts and (ii) the time period in which they may arise. The security must be therefore retaken if the maximum amount or the maximum time period would be exceeded by such variation.

2. SECURITY INTERESTS

2.1 How to establish a security interest

To establish a valid *in rem* security interest, a title instrument and an act of perfection (i.e. an act of publicity) are required.

Title instruments include movables pledge agreement, account pledge agreement, agreement on pledge/security assignment of receivables, share pledge agreement, ownership interest pledge agreement, enterprise pledge agreement and mortgage agreement.

In the case of guarantee agreements (personal security interest) no separate act of perfection is required.

2.2 Ranking of pledges/mortgages

The rank of a pledge depends on when the act of perfection is made.

The rank of a mortgage depends on the exact time when the filing for registration of the mortgage is submitted to a competent land register (subject to actual registration).

2.3 Can ranking of consensual security be changed by agreement of the creditors?

It is generally possible to change the ranking of consensual security interests by mutual agreement between the secured creditors. Consent of the security provider is not required.

In cases where a pledge was terminated (e.g. by repayment of the secured amount) but registration in a public register is still in place, it is possible to maintain the registration and use the registered pledge as a security for other obligations. By this way, the newly established security will acquire the ranking of the original pledge.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Pledge	▪ Physical delivery of the movables to a pledgee or third party; ▪ Labelling of the pledged movables; ▪ Registration of the pledge in the Pledge Register (*rejstřík zástav*)
BANK ACCOUNT RECEIVABLES	Pledge	▪ Third-party notification to an account bank; ▪ Registration in the Pledge Register
RECEIVABLES	Pledge or assignment	▪ Third-party notification to debtor; ▪ Registration in the Pledge Register (problematic in respect of registration of a pledge over trade receivables)
SHARES (CERTIFICATES)	Pledge	▪ Endorsement, third-party notification to company and handing over of share certificates
SHARES (REGISTERED SHARES)	Pledge	▪ Registration with the Central Securities Depository (*Centrální depozitář cenných papírů*)
OWNERSHIP INTEREST	Pledge	▪ Third-party notification to company and registration in the Commercial Register (*obchodní rejstřík*)
ENTERPRISE	Pledge	▪ Registration in the Pledge Register
SET OF ASSETS	Pledge	▪ Registration in the Pledge Register
REAL ESTATE	Mortgage	▪ Registration in the Land ▪ Register (*katastr nemovitostí*) or the Pledge Register

2.5 Availability of floating charge

The floating charge concept as used in common law jurisdictions is not recognised under Czech law.

However, effects similar to a floating charge may be achieved under Czech law by establishing a pledge over enterprise or set of assets.

2.6 Trust and parallel debt issues

Even though there is a hybrid Czech law concept of trust (*svěřenský fond*), the common law concept of trusts, especially in connection with distinction between legal and beneficial ownership, is not recognised in the Czech Republic.

The above issue is typically solved through a joint and several creditorship structure together with a parallel debt provision, whereby the parties to a facility agreement agree that the security agent shall be the joint and several creditor of each and every obligation of the borrower towards each finance party (other than the security agent) and accordingly has its own independent right to demand performance of the borrower's obligations. Additionally a parallel debt structure is used whereby discharge of a payment obligation to the security agent reduces the corresponding obligation to the lenders and *vice versa*.

2.7 Availability of private sale and its main conditions

SECURITY INTEREST	PRIVATE SALE
BANK GUARANTEE	N.a.
OTHER GUARANTEES	N.a.
MOVABLES PLEDGE	Yes
ACCOUNT PLEDGE	N.a.
RECEIVABLES PLEDGE	Yes
RECEIVABLES ASSIGNMENT	Yes
SHARE PLEDGE	Yes
OWNERSHIP INTEREST PLEDGE	Yes
ENTERPRISE PLEDGE	Yes
SET OF ASSETS	Yes
REAL ESTATE	Yes

A pledgee must exercise due professional care and act in its own interest as well as in the interest of a pledgor in order to sell security for a price that is "usual" on the particular market. Further conditions of a private sale are subject to any contractual agreement between the parties.

2.8 Security and loan transfers

Securities are transferred by operation of law together with the loan. However, if a pledgee is changed, it is customary to retake the security.

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

The Czech insolvency law regime comprises one main type of insolvency proceedings (*insolvenční řízení*), within which the insolvency of the debtor can be resolved through:

- **Bankruptcy** (*konkurz*) which generally leads to the liquidation of the assets forming the insolvency estate;
- **Reorganisation** (*reorganisace*) which primarily aims at preserving its business as a going concern. The elimination of a certain percentage of the debtor's debts is usually necessary; or
- **Debt relief** (*oddlužení*) which is applicable to individuals only and leads to relief of remaining financial liabilities of the debtor if it fulfils conditions set-out by the insolvency court. The debtor is always obliged to pay at least thirty percent (30%) of its debts (unless the creditors agree otherwise); otherwise the debt relief cannot be granted.

3.2 Applicable insolvency test and directors' duty to file

The following insolvency tests for a company are generally applied:

- **Balance sheet test**: book value of the company's due and payable obligations towards more than one creditor exceed the market value of the company's assets (= overindebtedness);
- **Cash flow test:** a debtor (i) has several creditors, and (ii) has overdue financial liabilities outstanding for more than thirty (30) days, and (iii) is not able to fulfil these liabilities.

A debtor is deemed to be unable to fulfill its financial liabilities if it (i) has defaulted under a substantial portion of its payment obligations; (ii) has defaulted under its payment obligations for more than three (3) months after their due date; (iii) is not able to satisfy its due and payable debts in the course of enforcement proceedings; or (iv) it failed to comply with its obligation to submit a list of assets, employees, etc., imposed upon it by the insolvency court.

A debtor may also file an insolvency petition on the grounds of impending insolvency. This occurs when it may be reasonably assumed that the debtor will not be able to fulfil the substantial part of its financial liabilities.

A statutory body of a company is obliged to file an insolvency petition without undue delay once it finds out that the company is insolvent. Non-compliance with this duty may result in criminal as well as civil liability of the statutory body.

3.3 Describe insolvency proceedings

The insolvency proceedings are initiated upon delivery of an insolvency petition which can be filed either by a debtor itself or by one or more of its creditors.

A commencement of insolvency proceedings and any other document issued in course of the proceedings are published in the Insolvency Register, which is publicly available online on *https://isir.justice.cz/isir/common/index.do/*.

If the debtor's insolvency is proven, the insolvency court will decide on its insolvency, appoint an insolvency administrator and invite the creditors to register their receivables within two (2) months.

The insolvency administrator (*insolvenční správce*) will be appointed by the court from the list maintained by the Ministry of Justice of the Czech Republic.

The insolvency court usually decides within three (3) months following the decision on insolvency about the method of resolution of insolvency (i.e. either bankruptcy or reorganisation or debt relief). When determining the method of resolution, the court is bound by the resolution of the creditors' meeting.

3.4 Distribution of proceeds

When distributing the liquidation proceeds, secured and unsecured creditors are treated separately.

Secured creditors are satisfied by liquidation of their collateral (minus expenses of liquidation and remuneration of an insolvency administrator). Secured creditors may instruct a receiver regarding the method of liquidation of the collateral.

The unsecured creditors are satisfied proportionally only after the full satisfaction of the preferred claims, e.g. costs and remuneration of the insolvency administrator, and certain other costs of the insolvency proceedings,

super-priority loans and employees' claims that have accrued in the last three (3) years preceding the opening of insolvency proceedings.

3.5 Timing and costs of insolvency proceedings

The duration of insolvency proceedings will depend on several different factors (e.g. amount of the debtor's estate, number of creditors). Although there is no general rule, in our experience more complex insolvency proceedings may take up to sixty (60) months.

3.6 Challenge of preferential transactions and suspect periods

An insolvency receiver has the right to challenge preferential transactions by filing a law suit (*odpůrčí žaloba*), e.g. if the debtor:

- has prepaid any of its debt before maturity; or
- has provided a security interest for a benefit of any of its creditors to the detriment of its other creditors.

The preferential transaction can be challenged only if it was entered into within one (1) year prior to the opening of insolvency proceedings (three (3) years in case of persons related to the debtor).

The insolvency administrator can file a lawsuit within one (1) year of the opening of insolvency proceedings.

A disadvantageous transaction can be challenged only if it was entered into within five (5) years prior to the opening of insolvency proceedings.

3.7 Impact of insolvency proceedings on security and enforcement

A validly established *in rem* security interest gives a secured creditor a preferential claim with regard to the respective collateral.

The collateral will form a part of the insolvency estate, but the secured creditor will have the preferential right to be satisfied from proceeds of sale (minus expenses of liquidation and remuneration of the insolvency administrator) of the collateral before any other creditors in accordance with the order of priority in the insolvency proceedings.

3.8 Survival of powers of attorney

Any appointment of a legal representative (*zmocněnec*) or a proxy (*prokurista*) granted by an insolvent company will automatically cease to be effective upon the decision on bankruptcy.

3.9 Describe reorganisation plan/ composition proceedings

During the course of insolvency proceedings, a debtor or any creditor who registered its claim in the insolvency proceedings may apply for reorganisation in order to preserve the debtor's business as a going concern.

Reorganisation is generally available only to debtors exceeding either (i) annual sales of CZK 50 million (approximately EUR 1.8 million) or (ii) a minimum staff of fifty (50) full time employees. The debtor can avoid these requirements if it submits a reorganisation plan accepted by at least half of secured creditors and at least half of non-secured creditors (in both cases calculated on the basis of the amount of receivables).

Reorganisation is carried out by way of a reorganisation plan – this is approved by the creditors with the possible intervention of the insolvency court.

The entry into force of the decision approving reorganisation cancels all pending restrictions on the disposal of the estate applicable to the debtor. However, a debtor with disposal rights may undertake legal acts of material significance with regard to the disposal of the estate and its management solely with the consent of the creditors' committee.

The restructuring proceedings can be concluded either by a decision of the insolvency court acknowledging the fulfilment of the plan of reorganisation or by transformation into straight bankruptcy proceedings (if the plan of reorganisation was not submitted, approved or fulfilled).

When the reorganisation plan is fulfilled, the debts are transformed according to the plan (e.g. into shares of the company or into new debts, etc.). In the absence of a successful reorganisation, the competent court will declare bankruptcy, and an insolvency administrator will liquidate the debtor's assets.

4. JUDICIAL ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

Under Czech law, any creditor may choose between the following types of enforcement:

- Court enforcement (*výkon rozhodnutí*), which is governed by the Civil Procedure Code (*občanský soudní řád*);
- Enforcement by a private bailiff (*exekuce*), which is mainly governed by the Enforcement Act (*exekuční řád*).

In practice, most creditors prefer the (generally more efficient) enforcement by a private bailiff.

The creditor can initiate enforcement proceedings only if it has an enforcement title (*exekuční titul*), which could be a:

- final ruling on the claim;
- final, conclusive and binding judgment by a Czech court;
- settlement agreement approved by a court;
- final, conclusive and binding judgment by a court of a Member State as defined in the European Parliament and Council Regulation (EC) 1215/2012 of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters;
- final, conclusive and binding arbitral award in the Czech Republic or a member state of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958; or
- agreement between a debtor and a creditor on direct enforcement which must be concluded in the form of a notarial deed (*zápis se svolením k vykonatelnosti*) (direct enforcement agreement).

4.2 Timing and costs of enforcement proceedings

In our experience, enforcement by a private bailiff takes about six (6) months to one (1) year; court enforcement generally takes longer. The costs of both private and court enforcement proceedings are borne by the debtor.

4.3 Validity of a foreclosure agreement

It is possible to agree that the obligations will be directly enforceable (i.e. without the need to engage in judicial proceedings first). This agreement must be concluded in the form of a notarial deed.

4.4 Enforcement by a secured creditor

Upon occurrence of an enforcement event, there are several options for the secured creditors:

- sale of a collateral to a third party and using the proceeds for repayment of the secured obligations;
- acceptance of a collateral into its ownership and deduction of the "acceptance price" which must be determined on the basis of objective criteria (e.g. expert valuation) from an amount of the secured obligations;
- sale of a collateral in a public auction by a licensed private auctioneer under the Public Auction Act (*zákon o veřejných dražbách*). The auction is initiated on the basis of an enforcement title; if a direct enforcement agreement exists, no court proceedings of any kind are necessary.

Alternatively, a secured creditor may apply for the sale of a collateral in special proceedings under the Civil Procedural Act (*občanský soudní řád*); the court may elect not to hold a hearing if the creditor submits a direct enforcement agreement.

MILLS KIRIN
Counsel

Wolf Theiss, Prague

T. +420 234 765 111
mills.kirin@wolftheiss.com

WOLF THEISS

HUNGARY

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

In general, a negative pledge undertaking is valid, but may be ineffective in respect of disposals to third parties acting in good faith.

In case of real estate, the negative pledge undertaking may be registered in the Land Registry as a restriction of sale or encumbrance which constitutes notice to third parties and therefore no one even if acting in good faith may acquire good title to the property.

1.2 Restrictions on accelerating a loan

In general, the law does not restrict parties to a facility agreement in agreeing on any event of default but the loan cannot be accelerated upon the commencement of bankruptcy proceedings based on a payment default.

1.3 Effectiveness of a non-assignment clause

A prohibition on assignment of monetary claims is not effective in respect of third parties.

This does not affect the assignor's liability for a breach of the non-assignment clause.

1.4 Common methods for loan transfers

METHOD FOR LOAN TRANSFERS	ASSIGNMENT	TRANSFER OF CONTRACT
SCOPE OF TRANSFER (RIGHTS AND OBLIGATIONS)	Rights and claims only	Rights, claims and also obligations
SET-OFF (AVAILABILITY FOR ORIGINAL CONTRACT DEBTOR)	No	No
SECURITY (AUTOMATIC TRANSFER AVAILABLE)	No	Yes
CONSENT (BY THE ORIGINAL CONTRACT DEBTOR)	No (notification is recommended)	Yes (may be given in advance in the loan agreement)

1.5 Effectiveness of contractual subordination

Contractual subordination is not regulated and may not be binding on insolvency officers.

1.6 Subordination by operation of law

Shareholder loans are subordinated to other indebtedness in the context of insolvency by operation of law.

1.7 Validity of a forfeiture agreement

As a general rule, an agreement for the forfeiture of the security interest (i.e. the secured creditor may keep the collateral in lieu of the secured liability) is not legally valid and therefore not binding.

Nevertheless, a secured creditor may, after its rights for satisfaction have become available, make a written offer to the security provider that it wishes to keep the security asset in lieu of the secured claim.

In addition to the security provider, the secured creditor shall also notify the following persons of its intention to acquire the security asset:

- the direct debtor (*személyes kötelezett*) (if the debtor of the secured creditor is not the same person as the security provider) and the persons which guaranteed the direct debtor's performance;
- the beneficiaries of other security interests over the same security asset;
- all persons having any right registered with respect to the security asset; and
- any other persons who sent a written notice to the secured creditor, claiming that they also have security over the security asset (together with proper evidence of the existence of such security interest).

1.8 Super-priority loans in bankruptcy

If the super-priority nature of a loan is only contractually agreed between the parties, it will not be acknowledged by the liquidator. By virtue of law, in a liquidation procedure secured loans have priority over unsecured loans. With respect to secured loans (if those are secured by the same security asset) the ranking of the security interest is relevant for the priority of such secured loans.

If the super-priority loan is secured by the same security asset and at the same rank as another secured loan, the claims of the creditor of such super-priority loan and the creditor of the other secured loan will be satisfied *pro rata* from the proceeds of the liquidation procedure.

1.9 Varying interest rate and tenor of the loan – must security be retaken?

Varying interest rate and tenor of the loan do not require the security interest to be retaken.

However, if the security provider is different from the borrower and the tenor of the loan is extended by the parties, it is market practice in Hungary that the security provider acknowledges and confirms in writing that the security provided by it will keep securing the loan with such an extended tenor.

2. SECURITY INTERESTS

2.1 How to establish a security interest

To establish a valid security interest, a title instrument and an act of perfection (that is an act of publicity) are required.

Title instruments include:

- movable pledge agreement, account pledge agreement, receivables pledge agreement, quota/share pledge agreement, pledge on assets identified by detailed description ("floating charge") and mortgage agreement;
- guarantee agreement and surety agreement.

Depending on the security interest, the act of perfection may be one or more of: (i) the registration of the security with the respective registry; (ii) notifying the debtor; (iii) the transfer of the respective collateral to the secured party; or (iv) notarisation of the agreement.

In case of a guarantee or surety (personal security interests), the act of perfection is the signing of the security agreement.

2.2 Ranking of pledges/mortgages

The rank of a real estate mortgage, pledge on movables, account pledge, receivables pledge, pledge on assets identified by detailed description and a quota/share pledge is determined by the time of registration. The applications are considered in the order of their submission.

2.3 Can ranking of consensual security be changed by agreement of the creditors?

The ranking can only be modified with the consent of all interested parties.

The new ranking must be registered with the relevant registry.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Pledge/securing charge	Registration with the Collateral Registry (*Hitelbiztosítéki nyilvántartás*) or, in case of certain movable assets such as aircraft and ships, with the separate specialist registry
ACCOUNT	Securing charge	Registration with the Collateral Registry
RECEIVABLES	Securing charge	Registration with the Collateral Registry
QUOTA/SHARE	Securing	Registration with the Companies Registry (*Cégbíróság*)
ASSETS IDENTIFIED BY DETAILED DESCRIPTION	Mortgage	Registration with the Collateral Registry
REAL ESTATE	Mortgage	Registration with the Land Registry (*Földhivatal*)

2.5 Availability of floating charge

Hungarian law recognises a floating charge in the form of a pledge over assets identified by detailed description; the pledge extends also to future assets, without any amendment of the underlying security document.

2.6 Trust and parallel debt issues

The creditors may appoint one of themselves or a third party to be their collateral agent (*zálogjogosulti bizományos*). It is not necessary for the creditors to be a party to the security agreements.

The collateral agent must be registered in the relevant registries as security holder. Following registration it is only the collateral agent who is entitled to enforce the security on behalf of the other creditors.

2.7 Availability of private sale and its main conditions

SECURITY INTEREST	ACCESSORY	PRIVATE SALE
SURETY	Yes	N.a.
MOVABLES PLEDGE	Yes	Yes
ACCOUNT PLEDGE	Yes	No
RECEIVABLES PLEDGE	Yes	Yes (not used in practice)
QUOTA/SHARE PLEDGE	Yes	Yes
PLEDGE ON ASSETS IDENTIFIED BY DETAILED DESCRIPTION	Yes	Yes
REAL ESTATE MORTGAGE	Yes	Yes

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

There are two types of insolvency proceedings applicable for business entities:

- **Bankruptcy proceedings** (*Csődeljárás*) which aim at achieving a composition between the financially troubled business entity and its creditors by granting a temporary relief (payment moratorium) for its financial obligations and enable a reorganisation;
- **Liquidation proceedings** (*Felszámolási eljárás*) which aim at the dissolution of the insolvent business entity and the distribution of its assets among its creditors.

If the debtor and its creditors fail to agree on composition or if the composition agreement fails to comply with the law, the bankruptcy proceedings are terminated and the court will commence liquidation proceedings.

3.2 Applicable insolvency test and directors' duty to file

In case a company is threatened by insolvency, upon the director's proposal, the shareholder is obliged to adopt a resolution which must be implemented within three (3) months with a view to rectifying the company's solvency by providing new capital.

There is no obligation for the directors of a company to file for bankruptcy proceedings or liquidation proceedings. However, in case a company becomes insolvent, the directors, if this is in the best interest of the creditors, must file an application for bankruptcy proceedings or liquidation proceedings in order to avoid personal liability afterwards.

In Hungary none of the concerned parties is obliged to initiate bankruptcy proceedings or liquidation proceedings. Nevertheless, the court commences liquidation proceedings *ex officio*: (i) following unsuccessful bankruptcy proceedings; or (ii) upon request of the commercial or criminal courts.

Liquidation proceedings may only be initiated if the court determines that the debtor is insolvent. The debtor may only be qualified as insolvent, if:

- the debtor fails to settle or contest its previously uncontested and acknowledged contractual debts within twenty (20) days of the due date, and failed to satisfy such debt upon receipt of the creditor's written payment notice;
- the debtor fails to settle its debt within the deadline specified in a final court decision or order for payment;
- the enforcement procedure against the debtor was unsuccessful;
- the debtor failed to fulfil its payment obligation as stipulated in the composition agreement concluded in bankruptcy or liquidation proceedings;
- the court has declared the previous bankruptcy proceedings terminated; or
- the debtor's liabilities in proceedings initiated by the debtor or by the receiver exceed the debtor's assets, or the debtor was unable and presumably will not be able to settle its debts on the date when they are due, and in proceedings opened by the receiver the members (shareholders) of the debtor fail to provide a statement of commitment in relation to providing funds necessary to cover such debts when due.

3.3 Describe liquidation proceedings

Liquidation proceedings are initiated:

- by the competent court upon application by:
  - the debtor; or
  - one or more of its creditors;
- by the court:
  - following unsuccessful bankruptcy proceedings; or
  - upon request of the commercial or criminal courts.

If the liquidation proceedings are requested by a creditor, the creditor must prove that the debtor is insolvent and specify the reasons for the debtor's alleged insolvency.

The opening of liquidation proceedings becomes effective as of the date they are published in the Company Gazette (*Cégközlöny*), a publicly available online platform. As of this date:

- companies subject to liquidation proceedings are identified by the use of the affix "under liquidation" (*Felszámolás alatt* or *f.a.*) after the company name;
- the court appoints a liquidator (*Felszámoló biztos*) who becomes the sole representative of the debtor company and is responsible for conducting the entire liquidation proceedings;
- the directors cease to have management power over the debtor company;
- all assets of the debtor fall within the scope of liquidation assets; and
- any claim against the debtor may only be satisfied in the framework of the liquidation proceedings.

Typically, the debtor's assets are sold to the highest bidder, via auction sales or public tenders. Both forms of sale process take place electronically. Case law has developed the position that liquidators cannot be held liable if assets are sold below their market price.

Creditors' claims are ranked in the following order of priority:

- cost of liquidation (e.g. salaries of employees, costs of sales etc.);
- claims secured by pledges identified by detailed descriptions and established before the commencement date of liquidation proceedings;
- alimony claims, life annuity payment claims and compensation benefits to private individuals;
- other claims of private individuals not originating from economic activities (e.g. damages, warranty claims, etc.);
- taxes and other public dues as well as public utility charges;
- other claims (e.g. any unsecured claims);
- default interest and late charges, as well as surcharges, penalties and similar debts;
- claims held by the shareholder or any member of the management.

However, claims which are secured will enjoy priority in satisfaction irrespective of the order above.

3.4 Timing and costs of insolvency proceedings

In bankruptcy the debtor is granted a temporary relief (payment moratorium) of one hundred and twenty (120) days from the commencement date. With the creditors' consent this can be extended up to two hundred and forty (240) days, but in no event can bankruptcy last longer than three hundred and sixty-five (365) days.

Liquidation proceedings must be completed within two (2) years but in certain cases they may take longer due to any failure to sell the debtor's assets. The duration of liquidation procedures varies significantly depending on the complexity of the case.

3.4.1 Liquidation proceedings

Creditors must file their claims within forty (40) days from the commencement date and at the same time pay a registration fee which is one percent (1%) of the claim, but a minimum of HUF 5,000 (approximately EUR 20) and a maximum of HUF 200,000 (approximately EUR 600) per claim registration in the liquidation proceedings.

The sale must be commenced by the liquidator within one hundred (100) days from the commencement date.

In general, the stamp duty payable on the commencement of liquidation proceedings is HUF 80,000 (approximately EUR 300).

3.4.2 Bankruptcy proceedings

The creditors must register their claims and pay the registration fee within thirty (30) days from the commencement date.

In general, the stamp duty on the commencement of bankruptcy proceedings shall be HUF 50,000 (approximately EUR 200).

3.5 Challenge of transactions and suspect periods

The liquidator or a creditor may challenge transactions by the debtor:

- that took place within five (5) years before the submission of the insolvency petition in the case of fraudulent transfers;
- that took place within two (2) years before the submission of the insolvency petition in the case of transactions at undervalue;
- that took place within ninety (90) days before the submission of the insolvency petition in the case of unlawful creditor preference (the transaction results in an unlawful preference of certain creditors over other creditors, including an amendment of a contract to the benefit of a creditor or provision of a collateral to a previously unsecured creditor;
- that took place within sixty (60) days before the submission of the insolvency petition in the case of other types of unlawful creditor preference (the performance of a contract results in an unlawful preference or the provision of those services is outside the ordinary business of the debtor).

The claim must be filed with the competent court within ninety (90) days from the relevant person taking notice of such transaction but in no event later than one (1) year after the commencement of liquidation proceedings.

3.6 Impact of insolvency proceedings on security and enforcement

As soon as liquidation proceedings are commenced:

- all claims against the debtor become due irrespective of the terms of the underlying agreements;
- all pending procedures for the enforcement of security interests are stayed and the creditors can only satisfy their claims within the liquidation proceedings (and amounts held by the court bailiff in the stayed enforcement proceedings will become part of the bankrupt estate).

Unsuccessful enforcement proceedings provide a basis to initiate liquidation proceedings.

A secured creditor must file its claim and pay the registration fee within forty (40) days from the commencement date. Once the assets of the debtor are sold by the liquidator, the proceeds generated by the sale must be distributed without undue delay to the secured creditors (costs of sale may be deducted by the liquidator).

Unsecured creditors only receive satisfaction at the end of the liquidation proceedings subject to the availability of funds.

In the case of a “floating charge” (assets registered in the Collateral Register have been identified by detailed description so as to cover all assets of the debtor as shown in the Collateral Register), the liquidator must apply fifty percent (50%) of the proceeds from the sale of the relevant assets identified (minus costs of sale) to satisfy the secured claim.

A creditor having a security deposit (*óvadék*) may enforce its claims from the deposited security within three (3) months from the commencement of liquidation proceedings. Upon expiry of such a period the claim can be satisfied from the security deposit by way of distribution by the liquidator only.

3.7 Survival of powers of attorney

The liquidator has the right to terminate any agreements of the debtor with immediate effect (concluded prior to the commencement of the liquidation) including powers of attorney given to security agents.

3.8 Describe bankruptcy proceedings

The representatives of the financially troubled business entity, upon approval of its main statutory body, may request the commencement of bankruptcy proceedings from the competent court.

As of the commencement of bankruptcy proceedings:

- the debtor is granted a temporary relief (payment moratorium) for one hundred and twenty (120) days or two hundred and forty (240) days (if agreed by the creditors). Companies must be identified by the use of the affix "cs.a." after the company name;
- the debtor must inform its creditors of the bankruptcy proceedings and ask them to register their claims. Creditors must register their claims and pay the registration fee within thirty (30) days;
- an administrator (*Vagyonfelügyelő*) is appointed by the court to supervise and control the business and the management of the debtor during the payment moratorium.

The payment moratorium may enable the debtor to prepare a reorganisation proposal (a so-called "rescue plan") for its creditors. Bankruptcy proceedings are successful if the required majority of creditors support the reorganisation proposal and the court approves this. In this case the debtor can regain its ordinary course of business. In all other cases, the court orders liquidation proceedings.

4. JUDICIAL ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

The court bailiff will start enforcement based on:

- a court decision, issued in the course of litigation proceedings, on the maturity and enforceability of the debt;
- an enforcement order issued by a notary based on notarised loan agreements or security documents (if these meet the requirements of the law).

Enforcement proceedings involve the following steps:

(1) a secured creditor files an application for an enforceable document either to the competent court or to the notary;

(2) the competent court or the notary issues the enforcement order and sends it to the court bailiff competent at the registered seat of the security provider;

(3) the secured creditor, who requested the enforcement proceedings, pays the costs of the enforcement in advance to the court bailiff;

(4) the court bailiff seizes the security asset by registering the enforcement right in the relevant register or requests the relevant financial institution for the seizure of the bank accounts of the debtor;

(5) the court bailiff distributes the enforcement proceeds between the secured creditors to satisfy their claim.

4.2 Timing and costs of enforcement proceedings

In general, the timing and costs depend on the subject of the enforcement proceedings. The secured creditor who requested the enforcement proceedings is entitled to decide whether all types of assets (movables, real estate, bank accounts, receivables, etc.) or only specified assets of the debtor are enforced.

With regard to court enforcement proceedings, in our experience the enforcement procedure takes between several months and one (1) year (starting with the filing of the enforcement application and ending with the distribution of the enforcement proceeds to the secured creditor).

MELINDA PELIKÁN
Senior Associate

Wolf Theiss, Budapest

T. +36 1 4848 800
melinda.pelikan@wolftheiss.com

WOLF THEISS

POLAND

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

In general, a negative pledge undertaking is legally valid and binding.

1.2 Restrictions on accelerating a loan

In general, Polish law does not restrict the ability of parties to a facility agreement in agreeing on any event of default.

1.3 Effectiveness of a non-assignment clause

A prohibition of assignment of monetary claims is effective in respect of third parties and any assignment by a lender to a third party in violation thereof is invalid.

1.4 Common methods for loan transfers

In general, the most common methods for transfer of loans are by an assignment of claims and a transfer of contractual position.

An assignment of claims means an assignment of claims, together with ancillary rights. No consent of the debtor is required, but a consent requirement can be contractually agreed. The debtor should be notified of the assignment.

A transfer of contractual position means the transfer of all rights, claims and obligations. The consent of the other contractual party/parties is required, but may also be granted in advance (e.g. in the original loan documentation).

Under certain circumstances sub-participation arrangements may be chosen as a transfer alternative.

1.5 Effectiveness of a contractual subordination

Contractual subordination is not regulated under Polish law and is not binding on insolvency officers.

1.6 Subordination by operation of law

Shareholders' loans are subordinated upon the opening of insolvency proceedings.

1.7 Validity of a forfeiture agreement

An agreement for the forfeiture of a security interest (i.e. a secured creditor may keep the collateral in lieu of the secured liability) is not valid.

1.8 Super-priority loans in bankruptcy

Polish law does not recognize the concept of super-priority loans in bankruptcy proceedings.

1.9 Varying interest rate and tenor of the loan – must security be retaken?

The varying of the tenor of the loan does not affect the accompanying security. However, any changes made to the tenor of the loan must be registered with the relevant registries (e.g. Land and Mortgage Register or registered Pledges Register).

2. SECURITY INTERESTS

2.1 How to establish and perfect a security interest

To establish a valid security interest, a title instrument and an act of perfection (that is an act of publicity) is required.

Title instruments include:

- registered pledge, financial pledge, ordinary pledge, mortgage, security assignment;
- submission to enforcement.

Depending on the security interest, the act of perfection is one or more of: (i) signing a written agreement, (ii) the registration of the security with the respective registry, or (iii) notarization of the agreement.

A voluntary submission to enforcement does not establish a regular security interest but is a procedural document which substitutes a court judgement or an arbitral award and allows enforcement to begin relatively quickly. The agreement must be notarized.

2.2 Ranking of charges/mortgages

The rank of a registered pledge or mortgage depends on when the respective title instrument was submitted for registration (act of perfection) with the relevant registry.

A financial pledge created later has priority over a financial pledge created earlier, unless the pledgee was aware of the existence of another security when the new pledge was created.

There are no rules of priority of submissions to enforcement.

2.3 Can ranking of consensual security be changed by agreement of the creditors?

The priority of mortgages may be changed by agreement and must be registered with the applicable land and mortgage register.

A creditor whose claims are secured with a financial pledge may alter their priority.

A change of ranking of a registered or ordinary pledge is not allowed.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Pledge	Registration with the Pledge Register
RIGHTS/RECEIVABLES	Pledge or Assignment	Registration with the Pledge Register or third-party notification
SHARES	Pledge	Registration with the Pledge Register. If any shares are issued, hand-over of the share certificates. Also, annotation in the issuer's book of shares
REAL ESTATE	Mortgage	Registration with the Land and Mortgage Register

2.5 Availability of floating charge

Polish law recognizes floating charges over all assets of a company and which include all accounts receivable, existing now or in the future.

2.6 Trust and parallel debt issues

There is no structure comparable with a common law trust in Poland. A common law trust does not create the required ownership to create a valid and enforceable security interest.

This is typically solved through a "parallel debt structure" whereby the parties to an English law facility agreement agree that the security agent shall be the joint and several creditor of each and every obligation of the borrower towards each finance party (other than the security agent).

2.7 Availability of private sale and its main conditions

SECURITY INTEREST	ACCESSORY	PRIVATE SALE
GUARANTEE	Yes (unless bank guarantee)	N.a.
SURETY	Yes	N.a.
MOVABLES/RIGHTS PLEDGE	Yes	Yes
RECEIVABLES ASSIGNMENT	No	No
SHARE PLEDGE	Yes	Yes
REAL ESTATE MORTGAGE	Yes	No

2.8 Security and loan transfers

As described above, a loan under Polish law may be transferred by:

- an assignment of rights; or
- a transfer of contractual position, i.e. assignment of rights and claims.

Under an assignment of rights, the security interest will follow a transfer of the loan agreement, except for the guarantee and submission to enforcement where, a new guarantee/submission to enforcement should be issued in favour of the new finance party.

In the case of a transfer of contractual position, the security interest will cease to exist as of the date of transfer unless, there is a trilateral agreement concluded by the withdrawing party, the remaining party, and the party entering into the agreement. If there is such a trilateral agreement the security interest will follow the transfer.

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

There are two types of insolvency proceedings:

- **Bankruptcy proceedings** (*Postępowanie upadłościowe*), which usually lead to the liquidation of the assets of the insolvent debtor,
- **Restructuring proceedings** (*Postępowania restrukturyzacyjne*) which primarily aim at avoiding a declaration of bankruptcy and enabling the debtor to undergo restructuring.

3.2 Applicable insolvency test and directors´ duty to file

Two separate insolvency tests (each of which triggers insolvency) for a corporate debtor are typically applied:

- **Balance sheet test:** payable obligations exceed the value of the debtor's assets (= over-indebtedness) and such situation exceeds twenty-four (24) months;
- **Cash flow test:** a debtor has lost the ability to perform its due monetary obligations (presumed if delay in payment exceeds three (3) months) (= inability to pay).

Directors of a corporate debtor are obliged to file an application for bankruptcy with the competent court within a thirty (30) day period after the debtor becomes insolvent. A director risks criminal and civil liability in case of non-compliance.

3.2.1 Bankruptcy proceedings

Bankruptcy proceedings are initiated by the competent court upon an application by a debtor, one or more creditors, or a third party.

The competent court appoints a bankruptcy receiver (*syndyk masy upadłości*), who assumes control of the business of the debtor and its assets. Typically, the debtor's assets will be liquidated, i.e. sold by the bankruptcy receiver by way of auction sales, public tenders or unrestricted sales. The unsecured creditors will be satisfied from the liquidation proceeds only after the full satisfaction of the preferred claims, such as costs (expenses connected with the securing, administration and liquidation of the bankruptcy estate) as well as claims arisen from or in connection with the bankruptcy and the restructuring proceedings.

3.2.2 Restructuring proceedings

Restructuring proceedings are initiated by the competent court upon application by an insolvent debtor, a debtor threatened with insolvency or by creditor(s).

Generally, a restructuring motion will take precedence over a bankruptcy petition.

The following restructuring proceedings are available:

TYPE OF RESTRUCTURING PROCEEDINGS	CHARACTERISTICS
ARRANGEMENT APPROVAL PROCEEDINGS ***(POSTĘPOWANIE O ZATWIERDZENIE UKŁADU)***	▪ Available for debtors whose disputed claims do not exceed fifteen percent (15%) of the total claims; ▪ The debtors that are capable of obtaining on their own (i.e. without court participation) approvals for the arrangement terms from creditors holding at least two thirds (2/3) of the total sum of claims; ▪ Debtor continues to manage its business subject to the involvement of a licensed supervisor (*nadzorca układu*).
ACCELERATED ARRANGEMENT PROCEEDINGS ***(PRZYSPIESZONE POSTĘPOWANIE UKŁADOWE)***	▪ Court organises a creditors meeting for the purpose of voting; ▪ Debtor continues to manage its business under the control of a court supervisor (*nadzorca sądowy*).
ARRANGEMENT PROCEEDINGS ***(POSTĘPOWANIE UKŁADOWE)***	▪ Disputed claims exceed fifteen percent (15%) of the total claims; ▪ More formal proceedings; ▪ Similar in terms of the impact on the debtor's management rights and the protection from creditors as the accelerated arrangement proceedings.
REORGANISATION PROCEEDINGS ***(POSTĘPOWANIE SANACYJNE)***	▪ Intended to enable deep economic restructuring of the debtor's assets and obligations; ▪ Debtor's business is typically managed by an administrator (*zarządca*).

As a general rule, the broader the restructuring option and protection against creditors, the more limited is the debtor's eligibility for management of its estate.

3.3 Timing and costs of insolvency proceedings

The duration of bankruptcy proceedings will depend on several different factors. Although there is no general rule, in our experience more complex bankruptcy proceedings may take several years.

As restructuring proceedings are only available since 1 January 2016, their duration in practice is not yet known. According to the restructuring law they should take from two (2) weeks to twelve (12) months.

The costs of insolvency proceedings depend on the size and complexity of the proceedings.

3.4 Challenge of preferential transactions and suspect periods in insolvency proceedings

3.4.1 Bankruptcy proceedings

An agreement concluded by the debtor made within one (1) year prior to filing a petition for bankruptcy will be ineffective if the value of the debtor's performance substantially exceeds the consideration paid (if any) by the third party.

The establishment of a security interest in respect of a debt which is not yet due or a payment which is not yet due, and which was made by the debtor within six (6) months prior to filing of the bankruptcy petition, will be deemed ineffective unless a third party to which the debt is owed, or in favour of which security has been established, can prove that, at the time the security was granted, it was not aware of the existence of any grounds for bankruptcy.

Transactions performed for due consideration by the debtor within six (6) months preceding the date of filing a bankruptcy petition will be ineffective if they were entered into with:

- family members (if the debtor is an individual); or
- (if the debtor is a legal entity) (i) shareholders, authorized representatives, or their spouses; (ii) affiliated companies or their shareholders; (iii) authorized representatives of such affiliated companies or their spouses; (iv) and the debtor's parent company or subsidiary.

In the case of third party security (i.e. when the bankrupt is not a personal debtor of the secured creditor), the bankruptcy receiver may claim ineffective security established by a debtor within one (1) year prior to filing a petition for bankruptcy if a debtor has received no consideration or consideration of a very low value.

3.4.2 Restructuring proceedings

Asset disposals made by the debtor during the one (1) year period prior to the filing of a petition for opening reorganisation proceedings will be deemed ineffective if the value of the debtor's performance significantly exceeds any consideration paid to the debtor.

A security established by a debtor within one (1) year prior to filing a petition for opening reorganisation proceedings will be ineffective if the value of the secured asset, compared to the obtained consideration, exceeds certain limits or if security has not been directly established in connection with receipt of consideration by the debtor.

3.5 Impact of insolvency proceedings on security and enforcement

3.5.1 Bankruptcy proceedings

Secured creditors have a preferential position in bankruptcy proceedings.

From the date of the commencement of bankruptcy proceedings, no new security rights may be established with respect to assets that form part of the bankruptcy estate.

3.5.2 Restructuring proceedings

After the commencement of restructuring proceedings it is not possible to create a new security interest in order to secure a pre-petition debt. However, if a motion to register a mortgage or registered pledge is filed more than six (6) months before the filing of a motion to open restructuring proceedings, the security will be registered.

The pre-petition security interests persist in the restructuring proceedings and claims secured by them are, in principle, not affected by the arrangement.

4. JUDICIAL ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

The court bailiff (*komornik sądowy*) will start enforcement based on an enforcement title (*tytuł wykonawczy*) which may be:

- a final, conclusive and binding judgment of a Polish court or another court of an EU Member State;
- a settlement effected before a Polish court, arbitrator or mediator; or
- a notary deed on acknowledgement of a debt and consent to direct enforceability.

Typical court enforcement methods are: public auction, payroll deduction or sale of moveable or immovable assets.

Registered pledges and financial pledges may also be enforced out-of-court as set out in the relevant security agreement. This offers more flexibility and is less time consuming than ordinary court enforcement proceedings.

4.2 Timing and costs of enforcement proceedings

Time and costs of the enforcement proceedings depend on the type of security interest and method of enforcement. In general, out-of-court enforcement proceedings are more effective. In our experience, court enforcement proceedings usually take up to twelve (12) months but may take up to a few years. Creditors must pay court and bailiff fees in advance. These are subsequently returned following successful enforcement, provided that the debtor's assets are sufficient.

Execution through a submission to enforcement may take less than six (6) months. Other enforcement methods take longer and are less cost effective.

PETER DASZKOWSKI
Co-Managing Partner

Wolf Theiss, Warsaw

T. +48 22 37 88 900
peter.daszkowski@wolftheiss.com

WOLF THEISS

ROMANIA

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

A negative pledge clause is invalid and thus not binding on the parties to the agreement or on third parties.

Non-disposal clauses are invalid against third parties, but may however have effects between the parties to the agreement with respect to the right to claim damages.

By way of exemption, non-disposal clauses included in immovable mortgage agreements securing a mortgage loan are valid and may be registered with the relevant land register in order to ensure enforceability against any third party.

1.2 Restrictions on accelerating a loan

In general, the law does not restrict the ability of parties to a facility agreement in agreeing on any event of default, but this may not be triggered solely by the opening of insolvency proceedings.

A creditor is permitted to enforce a mortgage granted in its favour provided that the creditor has reasons to believe that the sale of the mortgaged asset would impede the enforcement of the mortgage.

1.3 Effectiveness of a non-assignment clause

In general, non-assignment clauses are valid. However, monetary claims can always be assigned irrespective of the provisions of the underlying agreement.

1.4 Common methods for loan transfers

The most common methods for loan transfers entail an assignment of contract (*cesiune de contract*) or an assignment of receivable (*cesiune de creanță*). The preferred method is by way of assignment of contract as both rights and obligations are transferred.

Novation or sub-participation or silent assignment is also possible. However, different rules apply in such cases to the transfer of the security interests securing the transferred loan.

Lastly, certain licensing restrictions may apply with respect to the ability to transfer performing loans.

1.5 Effectiveness of a contractual subordination

Contractual subordination is not regulated and may not be binding in insolvency scenarios.

However, this aspect is generally not a hindrance as Romanian law provides for the subordination of shareholder loans or loans granted by affiliates.

1.6 Subordination of shareholder loans by operation of law

Shareholder loans granted by shareholders holding at least ten percent (10%) of a company's share capital or of voting rights, or loans granted by a member of the same economic interest group are treated as subordinated debt in case of insolvency.

1.7 Validity of a forfeiture agreement

In general, an agreement for the forfeiture of the security interest (i.e. the secured creditor may keep the collateral in lieu of the secured liability) is not legally valid and therefore not binding.

However, with respect to movable assets, taking the asset in settlement of the claim is allowed, provided that the debtor and its thirty party creditors agree to it and such consent is granted after an event of default has occurred.

1.8 Super-priority loans in bankruptcy

Creditors granting loans to a debtor during the observation period (*perioada de observaţie*) or in the course of insolvency proceedings enjoy a super-priority right, which may lead to an automatic reduction of the recovery rate of a secured creditor.

1.9 Varying interest rate and tenor of the loan – must security be retaken?

Amending the interest rate or maturity date of a loan does not automatically trigger the necessity to amend or retake the security. If, however, the maximum secured amount is affected by such changes (e.g. to take into account a larger additional secured amount as a result of an increase in the interest rate), then the security documents must be amended to reflect this.

2. SECURITY INTERESTS

2.1 How to establish a security interest

To establish a valid security interest, a title instrument and an act of perfection (i.e. an act of publicity) are required.

Title instruments include:

- agreement creating a movable mortgage over assets, agreement creating a movable mortgage over bank accounts, agreement creating a movable mortgage over receivables, agreement creating a movable mortgage over shares and agreement creating an immovable mortgage;
- surety (*fideiusiune*) agreement and corporate guarantee agreement.

Registration formalities must be observed for the perfection of mortgages.

No formalities are necessary for sureties and corporate guarantees where perfection occurs upon signing of the respective security agreement.

2.2 Ranking of securing charge/mortgage

The rank of a movable mortgage depends upon the date when the movable mortgage is recorded in the public register.

The rank of a real estate mortgage depends on the exact time when the application for registration of the mortgage is submitted to the Land Register (subject to actual registration).

2.3 Can ranking of consensual security be changed by agreement of the creditors?

Creditors can agree to modify the ranking. The new ranking must be registered with the relevant registry.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Movable mortgage	Registration with the Electronic Archive
BANK ACCOUNT	Movable mortgage	Registration with the Electronic Archive, notification of account bank with bank account control granted by account bank to creditor
RECEIVABLES	Movable mortgage or assignment	Registration with the Electronic Archive and third party notification of the debtor; movable mortgages over rent receivables should also be registered with the Land Register
SHARES	Movable mortgage	Registration with the Electronic Archive and registration with the Shareholders' Register and notification of company (if not party to the agreement)
REAL ESTATE	Immovable mortgage	Registration with the Land Register (*Cartea Funciară*)

2.5 Availability of floating charge

A mortgage over a universality of assets may be taken. However, as the nature and content of the universality must be described as accurately as possible, and any asset exiting the universality must be transferred free of any encumbrances, it is usual that a pledge is granted based on certain categories of assets (e.g. inventory, machinery, equipment, etc.).

2.6 Trust and parallel debt issues

The concept of "*fiducia*" is rather similar to the concept of a common law trust. It also allows for movable mortgages to be held by an agent on behalf of creditors but does not apply to immovable mortgages.

Therefore, it is still questionable whether this creates the required ownership necessary to create a valid and enforceable security interest.

This is typically resolved by a "parallel debt structure" whereby the parties to the facility agreement agree that the security agent shall be the joint and several creditor of each and every obligation of the borrower towards each finance party (other than the security agent).

In addition to joint and several creditorship, active solidarity between lenders is also possible as long as the security agent is also a lender (irrespective of the amount of its commitment) as well as agency agreements (*contract de mandat*) concluded among the lenders whereby the lenders appoint the security agent to act on their behalf.

2.7 Availability of private sale and its main conditions

SECURITY INTEREST	ACCESSORY	PRIVATE SALE
CORPORATE GUARANTEE	Yes	N.a.
SURETY	Yes	N.a.
MOVABLES PLEDGE	Yes	Yes, if contractually agreed
ACCOUNT PLEDGE	Yes	Yes, if contractually agreed
RECEIVABLES PLEDGE	Yes	Yes, if contractually agreed
SHARE PLEDGE	Yes	Yes, if contractually agreed
REAL ESTATE MORTGAGE	Yes	No

2.8 Security and loan transfers

In case of the transfer of a loan, accessory security generally follows the loan and is automatically available to the new lender (except for real estate mortgages where certain formalities must be observed).

In case of novation, the novation documentation must state expressly that the security is maintained in favour of the new creditor. The transfer of immovable mortgages must be notarised (*formă autentică*).

Non-accessory security, such as personal or autonomous guarantees, is not automatically transferred to the new lender and would typically need to be re-issued or confirmed.

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

Two types of insolvency proceedings may be initiated:

- **Bankruptcy proceedings** (*Faliment*) which generally lead to the liquidation of the assets forming the bankruptcy estate; and
- **Judicial reorganisation** (*Reorganisare judiciară*) which aims primarily at avoiding bankruptcy and rescuing the debtor by restructuring the company.

The insolvency procedure may take the form of a general procedure (where the debtor may enter into judicial reorganisation or bankruptcy following the observation period) or a simplified procedure (where the debtor enters into bankruptcy directly or following a maximum twenty (20) day observation period).

Insolvency proceedings may be initiated by the competent court upon the application by the debtor facing illiquidity (voluntary insolvency) or by one or more of the creditors (involuntary insolvency).

3.2 Applicable insolvency test and directors' duty to file

One single insolvency test applies, i.e. the cash flow test: a company does not have sufficient financial resources to pay its due and payable debts (= illiquidity).

Insolvency may be either: (i) actual (*prezumată*), in which case the debtor is obliged to apply for the opening of

insolvency proceedings; or (ii) imminent (*iminentă*), in which case the application by the debtor is optional.

The director of a company is obliged to convene a general shareholders' meeting and notify the competent court within thirty (30) days of the date of actual insolvency. In case of non-compliance, the director risks criminal liability.

3.3 Describe insolvency proceedings

The opening of insolvency proceedings becomes effective on the date on which the Syndic Judge has ruled upon it. The decision is published in the online Insolvency Gazette.

As of this date:

- all judiciary and extrajudiciary claims and procedures for the recovery of debts are stayed and the statute of limitation applicable to these actions is suspended;
- the debtor enters into the "observation period" (*perioada de observație*);
- the debtor may be divested of the power to administrate its business;
- no interest, penalty or increase of any kind which occurred before the opening of the insolvency proceedings may be added to the existing debts (except with regard to the claims of the secured creditors);
- all documents issued by the debtor, the receiver or the liquidator must bear the information that the company is "in insolvency" or, as case may be, "in bankruptcy" in Romanian, French and English.

Upon the opening of bankruptcy proceedings, any obligation of the debtor that is not then due is automatically accelerated and assumed to be due. Judicial reorganisation prevents such acceleration in the interest of preserving the debtor's business.

Liquidation proceeds obtained from the realisation of encumbered assets are distributed in the following order of priority:

- taxes, stamp duties and any other costs related to the realisation of those assets, including administration costs in relation thereto;
- the receivables of those creditors whose claims arose after the opening of the insolvency proceedings and in relation to which the law recognises a priority rank (if any), for debts which arose after the commencement of the insolvency proceedings; and
- the receivables of the secured creditors having a security interest over the relevant asset which were duly established prior to the commencement of the insolvency proceedings.

Liquidation proceeds obtained from the realisation of assets which are free of encumbrances are distributed in the following order of priority:

- taxes, stamp duties and any other costs related to the bankruptcy proceedings;
- creditors enjoying a super-priority for financing granted to ensure the funds necessary for the continuation of the debtor's ordinary activities;
- receivables arising out of employment relationships;
- receivables arising out of the activity carried out by the debtor after the opening of insolvency proceedings;
- budgetary claims;

- third party receivables representing alimony obligations or other similar periodical payments;
- receivables arising out of loan agreements granted by credit institutions, as well as any receivables arising out of services agreements, supply agreements, or other agreements and leases concluded prior to the opening of bankruptcy proceedings, including bonds;
- other unsecured claims;
- subordinated debt.

If, at any stage of the bankruptcy proceeding, it is discovered that the assets are insufficient to cover all administrative expenses, the Syndic Judge will issue a decision of termination of the bankruptcy proceedings and order the deletion of the debtor from the trade registry.

3.4 Timing and costs of insolvency proceedings

The length of time of the insolvency proceedings will depend on several different factors (e.g. the extent of the assets and liabilities of the obligor, the number of creditors, whether the receiver/liquidator challenges any transactions of the obligor in court, etc.).

3.5 Challenge of preferential transactions and suspect periods

The receiver/liquidator may challenge certain types of acts or transactions, as follows:

- gratuitous transfers (save for sponsorships with humanitarian purposes) performed within a period of two (2) years prior to the opening of the insolvency proceedings;
- any commercial transaction not completed at arm's length concluded within a period of six (6) months prior to the opening of the insolvency proceedings;
- deeds concluded by the insolvent company with the intent of concealing assets from its creditors or otherwise diminishing their rights and involving collusion with the counterparty (hardening period of two (2) years);
- transfers of asset ownership to a creditor for the payment of a debt or for the benefit of such creditor, if the amount which the relevant creditor could have obtained in a potential bankruptcy scenario is less than the value of the transfer (hardening period of six (6) months);
- establishment of security for an unsecured debt (hardening period of six (6) months);
- certain prepayments of debts which would have otherwise become due after the date on which the insolvency proceedings were opened (hardening period of six (6) months);
- transfers of assets or assumptions of debt for the purpose of concealing or delaying the state of insolvency or prejudicing the interests of creditors (hardening period of two (2) years); and
- transactions concluded with certain persons who had a legal relationship with the debtor if such transactions result in defrauding other creditors (hardening period of two (2) years).

The right to challenge the above transactions is subject to a statute of limitation which cannot exceed sixteen (16) months from the date on which the insolvency proceedings are opened.

3.6 Impact of insolvency proceedings on security and enforcement

The opening of insolvency proceedings stays (i) all judiciary and extrajudiciary claims and procedures for the recovery of debts; and (ii) the statute of limitation applicable to these actions. The actions taken by a secured creditor against the co-debtors or third party security providers shall not be affected by the insolvency of the debtor.

The security held by a creditor entitles it to register its claim as a secured creditor. Further, a secured creditor may ask the Syndic Judge to approve enforcement of certain assets outside of the insolvency proceedings if certain requirements are met.

Any proceeds arising from a forced sale in an enforcement procedure started prior to the commencement of the insolvency proceedings, which have not yet been collected by the creditor will be credited to the insolvency account (less the enforcement costs and the fees of the enforcement officer). These amounts are either transferred to the secured creditor within thirty (30) days or are retained and used in the insolvency proceedings. In the latter case, the respective creditor receives protection of its rights in the insolvency proceedings or, if such protection is not possible, priority of ranking.

A security interest created over the debtor's bank accounts entitles the secured creditor to request the receiver to transfer the credit balance of such account to its bank account within five (5) days from the date of the request.

3.7 Secured creditors in bankruptcy proceedings

The law recognises a super-priority right to creditor(s) granting loans to the debtor during the observation period or in the course of insolvency proceedings ("preferred lender(s)"). This may lead to an automatic reduction of the recovery rate of other secured creditors. Such loans are to be secured by assets which, unless agreed otherwise with the existing secured creditors, are not subject to any encumbrance. If the existing secured creditors do not agree to the assets being encumbered in favour of the preferred lender(s), the proceeds to be distributed in the course of the insolvency proceedings to the existing secured creditors shall be diminished pro rata.

Secured creditors, i.e. those with an established mortgage, lien, pledge or any other security interest over certain assets of the debtor, have priority in the settlement of claims with respect to their respective collateral, after deducting the costs related to the sale of those assets and satisfaction of the claims of any preferred creditor(s) (if any).

3.8 Survival of powers of attorney

A power of attorney is automatically cancelled upon commencement of bankruptcy proceedings.

This may affect the secured creditor's ability to effect a transfer of the collateral to a potential purchaser in a private enforcement.

3.9 Describe judicial reorganisation

Within forty (40) days of being appointed, the receiver must propose either the implementation of a reorganisation plan or, if reorganisation is not possible, the opening of bankruptcy proceedings. The proposal is subject to the approval of the creditors' meeting. If creditors holding at least twenty percent (20%) of the claims propose a reorganisation plan, then it will be construed as a veto against a proposal of the receiver for the opening of bankruptcy proceedings.

A reorganisation plan shall pass if approved by: (i) creditors holding at least thirty percent (30%) of the total claims registered with the table of claims; and (ii) creditors holding the majority claims in value in each class of creditors (secured, unsecured, employees, budgetary and essential suppliers).

The court may confirm a reorganisation plan which has not been approved by all creditor classes, provided that (i) the majority of the classes of creditors voted in favour or, in the event there are only two classes, the class with a higher value of claims has voted in favour, (ii) at least one of the classes that are adversely affected by the plan accepts the plan; and (iii) dissenting creditors will be subject to fair and just treatment.

The confirmed reorganisation plan creates binding obligations on the debtor. It can be amended at any time during the reorganisation period. However, its duration may not exceed a maximum period of four (4) years as of the initial confirmation date.

In case of the failure of the reorganisation plan, any agreed haircut will be reversed (i.e. each creditor will be entitled to claim and receive the value of its claim as registered with the table of claims prior to the confirmation of the reorganisation plan).

4. ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

If a debtor is not willing to, or is no longer in a position to, perform its obligations the creditor may enforce its claim.

In order to enforce against a debtor, the claim of the creditor must be due and payable, certain and liquid. Further, the creditor will have to produce a legally valid enforcement title in relation to the right sought to be enforced as well as a court order approving the initiation of enforcement proceedings.

In case of **real estate assets**, no out-of-court proceedings are available. Enforcement proceedings involve the following steps:

- the court approves the commencement of enforcement proceedings (*încuviinţarea executării silite*);
- the bailiff issues a summons which is registered with the Land Registry;
- if the debtor does not pay the debt within fifteen (15) days of the receipt of the summons, the bailiff proceeds with the sale of the mortgaged property via: (i) an amiable sale; (ii) a direct sale; or (iii) an auction sale.

In relation to the enforcement of **movable assets**, the creditor may choose to:

- sell the mortgaged asset;
- appropriate the mortgaged asset in settlement of the claim; or
- take possession of the mortgaged asset for administration purposes.

Alternatively, an enforcement officer appointed by the creditor will take an inventory of the assets subject to enforcement and seize them (*a sechestra*). The seizure of the assets is published in the Electronic Archive and the Trade Registry.

If within fifteen (15) days from the date of the seizure the debtor does not repay the due amounts, the secured creditor is entitled to (i) proceed with an amiable sale of the mortgaged assets; or (ii) to sell the mortgaged assets directly to a third party or via public auction.

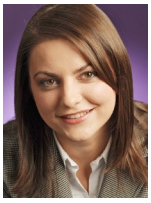
In relation to enforcement proceedings over shares issued by a Romanian company, the enforcement officer prepares a tender book (*caiet de sarcini*) which shall include all documents necessary for potential bidders to evaluate the value of the shares. Further legal provisions may apply if the shares are listed.

4.2 Timing and costs of enforcement proceedings

There is no fixed deadline within which the entire enforcement procedure must be finalised. Based on experience, the process normally takes between six (6) to eighteen (18) months.

The fees of the enforcement officer differ and various arrangements may be reached, i.e. either fixed fees or a percentage of the claim. However, for claims of an amount higher than RON 400,000 (approximately EUR 90,000) the minimum fee set by law is RON 5,500 (approximately EUR 1,223) plus a percentage up to zero point five percent (0.5%) of the amount exceeding RON 400,000 of the claim which is subject to enforcement.

The creditor will have to pay the costs of enforcement proceedings in advance.



CLAUDIA CHIPER
Counsel

Wolf Theiss, Bukarest

T. +40 21 308 81 00
claudia.chiper@wolftheiss.com

WOLF THEISS

SERBIA

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

In general, a negative pledge undertaking is legally valid and binding except with regard to real estate.

1.2 Restrictions on accelerating a loan

There are no explicit restrictions on a lender's ability to accelerate a loan upon the occurrence of any event of default agreed in the credit documentation.

1.3 Effectiveness of a non-assignment clause

A non-assignment clause under Serbian law is effective.

1.4 Common methods for loan transfers

There are several methods that can be used for transfer of loans under Serbian law. In practice, a loan is usually transferred to a third party by way of an assignment agreement.

In general, all claims (regardless of nature or maturity) may be transferred to a third party without limitation and the borrower only has to be notified about such transfer.

However, bank loans cannot be assigned before their maturity save to another bank (note that this prohibition does not apply to cross-border loans by non-resident banks).

1.5 Effectiveness of a contractual subordination

The concept of contractual subordination is not recognized under Serbian law.

1.6 Subordination by operation of law

Serbian law recognizes only subordination of shareholders' claims towards the company. Pursuant to the commercial entities law, a company may not make payments to its shareholders if, after such payments, the company would be unable to settle its obligations towards third party creditors as they fall due.

1.7 Validity of a forfeiture agreement

An agreement for the forfeiture of the security interest (i.e. the secured creditor may keep the collateral in lieu of the secured liability) is not valid in case of real estate collateral.

As for movables pledges this is generally possible except when the pledgor is a natural person who has entered into the pledge agreement outside of the scope of commercial activities.

1.8 Super-priority loans in bankruptcy

In accordance with the Serbian insolvency law, lenders and other creditors that provide financing to a debtor in the course of insolvency are entitled to priority payments in insolvency proceeding. However, claims arising from super-priority loans will not affect existing security and therefore secured loans will continue to rank ahead of any new funding unless otherwise agreed by the creditors.

1.9 Varying interest rate and tenor of the loan – must security be retaken?

Under Serbian law, change of interest rate and tenor of secured loans does not trigger an obligation for the creditor to retake the security. However, when the security is real estate, such change of interest rate and tenor of the loan should be registered in the Serbian cadastre. The only exception to this rule is prescribed by the Serbian mortgage law which states that a change of loan interest rate results in an obligation to retake the security established on real estate when the increase of interest rate results in an overall increase of the secured amount, provided that there is more than one mortgage on the mortgaged real estate.

2. SECURITY INTERESTS

2.1 How to establish a security interest

In order for a valid security interest to be established, a title instrument and an act of perfection (i.e. an act of publicity) are required.

Title instruments include:

- movable pledge agreement, accounts pledge agreement, receivables pledge agreement, shares pledge agreement, mortgage agreement, insurance pledge agreement, guarantee agreement;
- surety agreement.

In case of a guarantee or surety (both personal security interests), the act of perfection is the signing of the respective title instrument.

In case of *in rem* rights, a separate act of perfection is required.

2.2 Ranking of pledges/mortgages

Actual ranking depends on the exact time when the filing for registration of the pledge/mortgage is submitted to the relevant registry (subject to actual registration).

2.3 Can ranking of consensual security be changed by agreement of the creditors?

By operation of Serbian law, a ranking of mortgage can be changed by the agreement of creditors, and this change has to be registered with the respective cadastre.

The change of ranking of a pledge is not allowed under Serbian law.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Pledge	Registration with the Pledge Register or physical delivery of the movable to the pledgee
ACCOUNT	Pledge	Registration with the Pledge Register and notification of account bank (still untested in Serbia)
SHARES	Pledge	Registration with the Pledge Register
REAL ESTATE	Mortgage	Registration with the respective cadastre or Land Register

2.5 Availability of floating charge

Serbian law does not recognize floating charges.

2.6 Trust and parallel debt issues

In Serbia there is no structure comparable with a common law trust.

The above issue is typically solved through a so-called "joint and several creditorship" concept, which has, however, not yet been legally tested in Serbia.

In addition, in the context of pledges of movable assets the pledgee can appoint a third party to hold the security and take legal actions to protect the creditor's interests and also to enforce the secured claims. The third party can also be entered into the Pledge Registry as holder of the security.

2.7 Availability of private sale and its main conditions

SECURITY INTEREST	ACCESSORY	PRIVATE SALE
GUARANTEE	No	N.a.
SURETY	Yes	N.a.
MOVABLES PLEDGE	Yes	Yes, if contractually agreed
ACCOUNT PLEDGE	Yes	Yes, if contractually agreed
RECEIVABLES PLEDGE	Yes	Yes, if contractually agreed
SHARE PLEDGE	Yes	Yes, if contractually agreed
REAL ESTATE MORTGAGE	Yes	Yes, if contractually agreed

2.8 Security and loan transfers

Accessory security will normally be transferred to the new creditor upon the assignment of the claim and it is advisable to notify the debtor subsequently about the transfer. Mortgages cannot be transferred independently of the underlying claim. Security can be "transferred" such that it is held by a third party to the benefit of the creditor.

Transfer of a mortgage will not be effective unless the new secured creditor is entered the cadastre on the basis of a Serbian notarial deed. Pledgees may be entered in the Pledge Registry on the basis of a notarized transfer agreement (which can be Serbian but also foreign).

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

There are two types of insolvency proceedings:

- **Bankruptcy proceedings** (*Bankrotstvo*) which generally lead to the liquidation of the assets forming the bankrupt estate; and
- **Restructuring proceedings** (*Reorganizacija*) which primarily aim at (partially) discharging the bankrupt debtor's debts while preserving its business as a going concern.

Upon the opening of bankruptcy proceedings, any obligations of the bankrupt debtor that are not yet due are assumed to be due.

3.2 Applicable insolvency test and directors' duty to file

Serbian insolvency law provides the following grounds for bankruptcy:

- continuing inability of the debtor to settle debts, i.e. the debtor has been in payment default for at least forty-five (45) days or has ceased to make payments for a period of at least thirty (30) days (= inability to pay);
- unsuccessful enforcement by a creditor of an enforceable claim of the creditor;
- a company's due and payable obligations exceed the value of the company's assets (= over-indebtedness); and/or
- failure to fulfil an adopted restructuring plan.

3.3 Describe bankruptcy proceedings

Upon receipt of an application to initiate insolvency proceedings, the court initiates so-called "preliminary insolvency proceedings" (*prethodni stečajni postupak*), which are aimed at determining the grounds for opening the insolvency proceedings.

Subsequently, the competent court appoints an insolvency administrator and convokes a creditors' hearing. The court's ruling on the initiation of the insolvency proceedings must be delivered to all relevant parties, including the creditors that are known to the court. Also, a special notification must be published in the Official Gazette of the Republic of Serbia.

As a general rule, in case restructuring proceedings have not been initiated and no restructuring plan has been adopted, the bankrupt debtor's assets are liquidated by way of selling these assets to the highest bidder. Liquidation proceeds are distributed to the company's creditors in accordance with the rules set out in the insolvency law.

The insolvency law sets out the following order of settlement of the bankruptcy creditors:

- costs of insolvency proceedings and the obligations of the insolvency estate;
- the unpaid net wages of employees as well as the unpaid social and pension contributions;
- claims based on any public revenues that fell due in the three (3) months preceding the institution of insolvency proceedings;
- claims of other unsecured creditors; and

- claims of related parties (pursuant to the definition of a related party in Article 125 of the Serbian insolvency law).

A person who has the right to request segregation of a certain asset from the bankrupt estate (e.g. a lessor repossessing a leased asset) is not treated as a bankruptcy creditor; such asset is not included in the bankruptcy estate.

3.4 Timing and costs of insolvency proceedings

Insolvency proceedings in Serbia in practice last an average of two point seven (2.7) years based on unofficial statistical data.

The insolvency law adopted in 2009 (as amended) aims to speed up the process and decrease the procedural costs of insolvency proceedings as well as to increase the debt recovery rate.

3.5 Challenge of preferential transactions and suspect periods

The insolvency administrator has the right to challenge preferential legal acts or transactions in the event:

- the bankrupt debtor granted certain creditors a preference (new security or settlement of claims), and such creditors knew or should have known of this intention (suspect period of six (6) months);
- of an act that causes direct damage to the bankrupt debtor's creditors (suspect period of six (6) months);
- of the provision of a security for, or settlement of, an obligation to which the creditor was not entitled, or was entitled but not in the way and at the time such security was provided or claim settled (suspect period of one (1) year);
- an insolvent debtor has repaid a loan granted by a related party (suspect period one (1) year);
- an insolvent debtor has intentionally put certain creditors at a disadvantage compared to its other creditors, and such other creditors knew of this intention (suspect period of five (5) years).

Providing security by the insolvent debtor to a related party has no legal effect in the insolvency proceedings in the period of one (1) year before the opening of insolvency proceeding, or when the insolvent debtor was permanently insolvent.

3.6 Impact of insolvency proceedings on security and enforcement

A validly established *in rem* security interest gives the secured creditor a preferential claim regarding the respective collateral. The collateral is separated from the insolvency proceedings.

If these creditors' claims are not settled in full by the sale of assets subject to security, they may claim the unsettled part as unsecured bankruptcy creditors.

Any security (consensual or liens arising at law) on the assets of the bankrupt debtor obtained within sixty (60) days prior to the opening of insolvency proceedings will not give the creditors the position of secured creditor. On the basis of the decision of the insolvency judge, the competent body will delete such rights from the respective public records.

3.7 Survival of powers of attorney

Powers of attorney (relating to the company's assets that form the bankruptcy estate) granted by a company's representative becomes ineffective as of the date of the opening of the insolvency proceedings.

3.8 Describe restructuring proceedings

Restructuring may be proposed simultaneously with filing the application to initiate insolvency proceedings but, in general, cannot be proposed later than ninety (90) days following the initiation of those proceedings. The bankrupt debtor remains under the insolvency administrator's supervision. Insolvency proceedings may be re-initiated if the bankrupt debtor is in breach of the obligations set forth in the restructuring plan and/or the insolvency law.

In the context of bankruptcy proceedings, creditors with at least thirty percent (30%) of the unsecured claims are entitled to propose a restructuring plan.

Restructuring proceedings are opened if and when the creditors adopt a restructuring plan submitted by the bankrupt debtor.

The restructuring plan is passed with a simple majority (in value) of the votes of each class of creditors (secured or unsecured) and requires subsequent court approval.

The approved restructuring plan creates binding and enforceable obligations for the bankrupt debtor.

Possible measures for implementation of a restructuring plan include debt to equity swaps as well as cancellations of the existing shares or issuance of new shares.

When approved by the creditors, the restructuring plan becomes a new agreement for the settlement of claims specified therein. However, the bankrupt debtor remains under the supervision of the named licensed independent expert and insolvency proceedings may be reinitiated if the bankrupt debtor is in breach of the obligations set forth in the restructuring plan and/or the insolvency law.

4. JUDICIAL ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

Out-of-court enforcement is standard market practice as regards pledges of ownership interests in limited liability companies, movables, mortgages and IP rights.

However, for various reasons, a secured creditor may have to pursue judicial enforcement with regard to its collateral in accordance with the law on enforcement and security (*Zakon o izvršenju i obezbeđenju*) which requires completion of the following steps:

- first, obtaining a directly enforceable title for enforcement;
- second, filing a motion for enforcement (*predlog za izvršenje*) with a competent court;
- third, enforcement by public auction or direct bargaining;
- finally, the proceeds are distributed to the secured creditor to settle secured claims.

A title for enforcement (*izvršna isprava*) may be:

- a final, conclusive and binding (i) court decision; (ii) court settlement; or (iii) arbitral award;
- a final, conclusive and binding decision adopted in administrative or misdemeanour proceedings;
- a directly enforceable mortgage agreement concluded in accordance with the law on mortgage, and/or pledge/mortgage deed;
- an extract from the Pledge Registry.

4.2 Timing and costs of enforcement proceedings

It is very difficult to assess the length of judicial enforcement proceedings. The duration of judicial enforcement proceedings depends on a number of issues such as the object of enforcement, the court's caseload, and any objections raised by the bankrupt debtor.

In practice, the enforcement proceedings in Serbia may take between three (3) months and several years.

MIROSLAV STOJANOVIĆ
Partner

Wolf Theiss, Belgrade

T. +381 11 330 2900
miroslav.stojanovic@wolftheiss.com

WOLF THEISS

SLOVAK REPUBLIC

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

A negative pledge undertaking is legally valid and binding only *inter partes*. Loan agreements customarily contain negative undertakings that the borrower e.g. cannot grant another pledge without the bank's consent.

1.2 Restrictions on accelerating a loan

Slovak law does not restrict the ability of the parties to a facility agreement to agree on any event of default.

1.3 Effectiveness of a non-assignment clause

Non-assignment clauses are legally valid. An assignment made in breach of such a clause is absolutely invalid (i.e. also *vis-à-vis* third parties).

1.4 Common methods for loan transfers

Under Slovak law, a creditor may assign its receivable to another person by means of a written contract even without the debtor's consent (assignment of the receivable). Assumption of debt can also be executed by means of a written contract; however, it is subject to the creditor's approval.

1.5 Effectiveness of a contractual subordination

Contractual subordination of claims is effective and explicitly regulated in Slovak law.

1.6 Subordination by operation of law

Subordination may be agreed contractually.

1.7 Validity of a forfeiture agreement

A forfeiture agreement (i.e. the secured creditor may keep the collateral in lieu of the secured liability) concluded prior to maturity of the secured liability is not legally valid.

1.8 Super-priority loans in bankruptcy

Super-priority loans are not regulated under Slovak law.

1.9 Varying interest rate and tenor of the loan – must security be retaken?

In general, it is not necessary to retake the security. In case of altering the conditions within the loan agreement which expressly relate to the security agreement, such modifications must be reflected in the security agreement accordingly, unless the security agreement refers to the loan agreement as amended at any time.

2. SECURITY INTERESTS

2.1 How to establish a security interest

A title instrument and usually also an act of perfection is required to establish a valid security interest.

Title instruments include movable pledge agreement, account pledge agreement, receivables pledge agreement, share pledge agreement and mortgage agreement.

A separate act of perfection – i.e. registration in a specific register (e.g. Central Notarial Register of Pledges) - is required in case of *in rem* rights. An act of perfection is not required in case of guarantees or sureties.

2.2 Ranking of securing charge/mortgage

The rank of a pledge depends on the timing of its registration or a respective agreement of the creditors.

The rank of a real estate mortgage depends on the exact time of its registration in the Land Register (subject to actual registration).

2.3 Can ranking of consensual security be changed by agreement of the creditors?

Creditors may agree on the rankings of their respective securities. Such an agreement becomes effective upon registration of the consensual rankings in the register. An agreement disadvantaging an enforcement right of a creditor who is not party to the agreement is invalid *vis-à-vis* this creditor.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Pledge	Registration in the Central Notarial Register of Pledges or hand-over of the movables to the pledgee/ appointed third party
ACCOUNT	Pledge or assignment	Registration in the Central Notarial Register of Pledges or a third-party notification to the account bank
RECEIVABLES	Pledge or assignment	Registration in the Central Notarial Register of Pledges or third party notification to debtor
SHARES	Pledge	Registration with the Commercial Register (limited liability company) / central securities depository (joint-stock corporation)
REAL ESTATE	Mortgage	Registered with the Land Register

2.5 Availability of floating charge

Slovak law does not recognize floating charges over all the assets of a company. A similar effect may be achieved by a pledge of enterprise or of the inventory.

2.6 Trust and parallel debt issues

Slovak law does not have a structure comparable to a common law trust. Legal scholars agree that a common law trust does not create the ownership over the secured claims which is required to create a valid and enforceable accessory security interest.

The above issue is typically solved by appointing the security agent as joint and several creditor of each and every obligation of the borrower towards each finance party (other than the security agent). This has not been tested in the courts.

2.7 Availability of private sale and its main conditions

SECURITY INTEREST	ACCESSORY	PRIVATE SALE
GUARANTEE	Yes	Yes, if contractually agreed
ACCOUNT PLEDGE	Yes	Yes, if contractually agreed
RECEIVABLES PLEDGE	Yes	Yes, if contractually agreed
SHARE PLEDGE	Yes	Yes, if contractually agreed
REAL ESTATE MORTGAGE	Yes	Yes, if contractually agreed

2.8 Security and loan transfers

Typically, security is transferred automatically upon an assignment; transfer of a contractual position in full may disconnect security.

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

Slovak law stipulates two kinds of insolvency proceedings:

- **Bankruptcy proceedings** (*konkurzné konanie*), generally leading to the liquidation of the company's assets;
- **Restructuring proceedings** (*reštrukturalizačné konanie*), the primary aim of which is to reorganise an insolvent company, approve a plan of modifying (cutting) and repaying the debtor's debts and ensure the debtor's existence as a going concern.

3.2 Timing and costs of insolvency proceedings

The duration of bankruptcy proceedings depends on several different factors (e.g. the amount of the debtor's assets and liabilities, number of creditors, whether an application for restructuring proceedings is filed, whether the bankruptcy trustee challenges any transactions of the debtor in court). In our experience more complex bankruptcy proceedings may take up to thirty-six (36) months.

Restructuring proceedings take nine (9) months; the timing of the stages of the restructuring proceedings is set in the Insolvency Act.

3.3 Applicable insolvency test and directors' duty to file

Two separate insolvency tests (each of which triggers insolvency) for a company are typically applied:

- **Balance sheet test:** a company which is obliged to maintain books for accounting purposes has more than one creditor and its due obligations exceed the value of its assets (= over indebtedness)
- **Cash flow test:** a company has defaulted for more than thirty (30) days in payment of at least two monetary obligations to at least two creditors (= inability to pay)

An over-indebted company and each director of such a company are obliged to file for bankruptcy proceedings within thirty (30) days. A director risks criminal liability and financial liability in case of non-compliance.

3.4 Challenge of preferential transactions and suspect periods

The bankruptcy trustee, and sometimes the creditor, has the right to challenge preferential legal acts or transactions of the debtor. Challenged transactions are invalid *vis-à-vis* the creditors.

The following preferential transactions are recognized:

- transfer of assets was effected without due consideration (general suspect period of one (1) year; in case of counterparties related to the debtor, three (3) years);
- debtor has intentionally put certain creditors at a disadvantage compared to the other creditors (general suspect period of one (1) year; in case of counterparties related to the debtor, three (3) years);
- the debtor intentionally entered into a transaction detrimental to its creditors and the other party knew or should have known of the debtor's intention (suspect period of five (5) years).

In addition, in case the bankruptcy proceedings were cancelled and reinitiated within six (6) months, the debtor's non-ordinary legal acts performed after the cancellation of the bankruptcy proceedings may be challenged.

3.5 Impact of insolvency proceedings on security and enforcement

Upon the opening of the bankruptcy proceedings all the debtor's obligations which are not yet due are accelerated and assumed to be due thus permitting liquidation of the assets.

Enforcement and execution proceedings are barred/cancelled.

In general, new security cannot be created over the debtor's assets. Existing security may be enforced only as set out in the Insolvency Act. Assets constituting the collateral form a separate bankruptcy estate.

Upon the opening of the restructuring proceedings enforcement and execution proceedings are barred or cancelled. New security cannot be created over the debtor's assets and, in general, enforcement of security is barred/stayed.

3.6 Secured creditors in insolvency proceedings

A validly established *in rem* security interest gives the secured creditor a preferential claim with regard to the respective collateral.

3.7 Survival of powers of attorney

Powers of attorney and similar authorizations granted by the debtor cease to be valid upon the opening of bankruptcy proceedings.

This may affect the secured creditor's ability to carry out a transfer of the collateral to a potential purchaser in a private enforcement since the bankruptcy trustee will have assumed control over the debtor's assets.

Authorizations are not affected by the opening of restructuring proceedings.

3.8 Describe bankruptcy proceedings

Bankruptcy proceedings are initiated by filing an application with the competent court. The application may be filed by the debtor, its creditor or an appointed liquidator.

Bankruptcy proceedings have two phases: examination phase and actual bankruptcy proceedings.

3.8.1 The examination phase

The examination phase starts on the date of the publication of the court's decision in the Commercial Gazette. As a result:

- the debtor is restricted and its actions are limited to ordinary legal acts;
- enforcement, execution and security enforcement proceedings cannot commence and on-going proceedings are stayed;
- winding-up proceedings are stayed;
- the debtor cannot merge, amalgamate or split-up.

If the bankruptcy application was filed by the debtor, the court will either declare the debtor's bankruptcy and open bankruptcy proceedings or, if it is unclear whether the available assets will suffice to cover the costs of the bankruptcy proceedings, appoint a preliminary bankruptcy trustee.

If the bankruptcy application was filed by a creditor, the court will forward the application to the debtor with a request to prove its solvency. If the debtor fails to do so, the court will either declare the debtor's bankruptcy or, if it is unclear whether the available assets will suffice to cover the costs of the bankruptcy proceedings, appoint a preliminary bankruptcy trustee.

If the available assets do not suffice to cover the costs of the bankruptcy proceedings, the proceedings are stopped.

3.8.2 The actual bankruptcy proceedings

The actual bankruptcy proceedings are commenced and the debtor is officially declared bankrupt on the day of publication of the court's decision in the Commercial Gazette. The court appoints a bankruptcy trustee and requests the creditors to lodge their claims. The bankruptcy trustee assumes control of the debtor's business and assets.

Restructuring proceedings cannot be initiated or continue during the bankruptcy proceedings.

The debtor's assets are liquidated; i.e. sold to the highest bidder. Liquidation proceeds are distributed per the principles set out in the Bankruptcy Code – in general, secured claims are satisfied from the separate bankruptcy

estate, standard claims are satisfied from the common bankruptcy estate and subordinated claims are satisfied from the remaining proceeds from the common bankruptcy estate. Slovak bankruptcy law does not recognize a priority claim as such; only claims against the bankruptcy estate (i.e. fixed fee of the bankruptcy receiver and reimbursement of his/her expenses, taxes, customs duties, health and social insurance contributions) have priority.

3.9 Describe restructuring proceedings

Restructuring proceedings are initiated by filing an application with the competent court. The application may be filed by the debtor or its creditor (with the debtor's consent) and must be accompanied by a restructuring evaluation report, prepared by an appointed restructuring trustee, recommending restructuring of the debtor.

Restructuring proceedings have two phases: examination phase and actual restructuring proceedings.

3.9.1 The examination phase

The examination phase starts on the date of the publication of the court's decision in the Commercial Gazette.

Commencement of the restructuring proceedings has the following effects:

- debtor can perform only ordinary legal actions; other actions are subject to the restructuring trustee's approval;
- enforcement, execution and security enforcement proceedings cannot commence and on-going proceedings are stayed;
- the second contractual party cannot withdraw from the contract on grounds of the debtor's delay in performance or commencement of its insolvency proceedings;
- set-offs cannot be effected;
- the debtor cannot merge, amalgamate or split-up.

The aim of the restructuring proceedings is to reorganize an over indebted entity and ensure its subsequent existence as a financially sound entity by way of the debtor and the creditors agreeing on a restructuring plan. Preconditions for restructuring proceedings are:

- the debtor conducts a business activity;
- the debtor is insolvent or at risk of becoming insolvent;
- it is possible to preserve a substantial part of the enterprise; and
- it is possible to satisfy the claims of the creditors to an extent greater than under bankruptcy proceedings.

3.9.2 The actual restructuring proceedings

The actual restructuring proceedings are commenced on the day of publication of the court's decision in the Commercial Gazette. The court appoints a restructuring trustee and requests the creditors to lodge their claims. After the period for lodging the claims, a creditor's meeting is held and the creditors' committee is elected. The creditors' committee represents the interests of all creditors.

Restructuring proceedings prevent the commencement or continuation of the bankruptcy proceedings. Further, stayed enforcement and execution proceedings are terminated. Court and arbitration proceedings are stayed.

The restructuring plan is prepared by (i) the debtor (if the restructuring proceedings were initiated by the debtor); or (ii) the restructuring trustee (if the restructuring proceedings were initiated by the creditors). In the restructuring

plan, the creditors are divided into groups and the amount and time frame for the satisfaction of the creditors per group is proposed.

The restructuring plan must be approved by:

- the creditors' committee – the restructuring plan may be passed for the creditors' approval only after it has been approved by the creditors' committee;
- all creditors – the restructuring plan must be approved by each group of creditors and simultaneously by the majority of votes of all creditors calculated by the amount of their respective lodged claims;
- the court.

Restructuring proceedings are terminated upon the court's approval of the restructuring plan. The debtor will be released from its novated debts upon fulfilment of the restructuring plan (cram-down).

4. JUDICIAL ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

A creditor holding a collateral (pledge) may decide to enforce the pledge either (i) pursuant to the provisions of the Enforcement Act, (ii) by auction, or (iii) in any other way agreed in the pledge agreement (e.g. private tendering procedure or direct sale).

If the creditor has to enforce its collateral in accordance with the Enforcement Act, the following is required:

- obtaining of a title for enforcement; e.g. ruling on non-payment by the borrower;
- filing of a motion for enforcement with the judicial enforcer;
- obtaining a decision of the competent Slovak court approving the judicial enforcement;
- enforcement through public auction;
- enforcement through payroll deduction; assignment of the debtor's receivables towards third parties; sale of movable or immovable assets, security bills or enterprise.

A title for enforcement may be in particular:

- a final, conclusive and binding judgment of a Slovak court;
- a final, conclusive and binding judgment by a court of a Member State as defined in Council Regulation (EC) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels 1a);
- a settlement effected before a Slovak court;
- a notary deed on acknowledgement of a debt and consent to direct enforceability;
- a final, conclusive and binding arbitral award in Slovakia or a member state to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958.

4.2 Timing and costs of enforcement proceedings

With regard to judicial enforcement proceedings, in our experience the enforcement procedure takes between six (6) months to one (1) year (starting with the filing of the enforcement application and ending with the distribution of the monies realized to the creditor(s).

KATARÍNA BIELIKOVÁ
Senior Associate

Wolf Theiss, Bratislava

T. +421 2 591 012 40
katarina.bielikova@wolftheiss.com

WOLF THEISS

SLOVENIA

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

In general, a negative pledge undertaking is legally valid and binding between the contracting parties. It will be effective in respect of third parties if the negative pledge is registered with the Central Securities Clearing Corporation for shares and with the Land Register for real estate, and, in our opinion, also if the third party was aware of the contractual agreement on the negative pledge.

1.2 Restrictions on accelerating a loan

In general, Slovenian law does not restrict the ability of parties to a facility agreement to agree on any event of default.

1.3 Effectiveness of a non-assignment clause

A prohibition of assignment with regard to monetary claims has relative effect if concluded between two business entities, i.e. such contractual prohibition is effective only between the parties to the facility agreement and any assignment by a lender to a third party is valid. Nevertheless, the debtor may still fulfill its obligation to either the lender or to a third party ("assignee").

1.4 Common methods for loan transfers

There are no special provisions governing transfers of loans. Under general rules of civil law, loans can be transferred by way of:

- an assignment of claim, or
- a transfer of contract.

The selected technique of the transfer depends on:

- the status of the loan (e.g. agreement terminated/accelerated, still in force);
- contractual provisions of the loan.

ASSIGNMENT OF A CLAIM	TRANSFER OF CONTRACT
Only rights (claims) of the creditor are transferred and obligations remain with the original creditor.	Full contractual position of the creditor (rights and obligations) is transferred to the transferee.
Debtor's consent is required.	Debtor's consent is required.
Used when: • loans are already accelerated, or • no remaining obligations of the creditor exist.	Used when: • loans have not been accelerated, or • remaining obligations of the creditor exist, or • where maximum mortgage is given as collateral.

Special rules apply to transfer of loans arising from consumer contracts and financial leasing agreements.

1.5 Effectiveness of a contractual subordination

Contractual subordination (i.e. an agreement between the debtor and the creditor that the claims arising from their relationship shall only be settled after settlement of other non-secured claims against the debtor) is expressly recognized in law.

1.6 Concept of equity-replacing shareholder loan

Pursuant to the Companies Act, a shareholder loan granted to a company in a financial crisis is treated similarly to equity contributions in case of bankruptcy proceedings or compulsory settlement (equity-replacing shareholder loan).

The provisions on equity-replacing shareholder loans refer to direct shareholders in limited liability companies and direct shareholders in joint stock companies whose voting rights exceed twenty-five percent (25%).

Any repayment of an equity-replacing shareholder loan is prohibited in insolvency.

Similar rules apply to security interests provided by a shareholder to its company's creditors while such company is in a financial crisis.

If an equity-replacing shareholder loan was repaid within one (1) year before the filing of an application for insolvency, the relevant shareholder has to repay the amount to the company.

1.7 Validity of a forfeiture agreement

An agreement for the forfeiture of the security interest (i.e. the secured creditor may keep the collateral in lieu of the secured liability) over financial security (i.e. financial instruments or loans) is legally valid and binding only if agreed in accordance with the Act on Financial Collateral.

In respect of other kinds of security interests (e.g. mortgage over real property, pledge of movables), a forfeiture agreement may only validly be entered into after maturity of the secured liability.

TYPE OF SECURITY	VALIDITY OF A FORFEITURE AGREEMENT
MORTGAGE OVER REAL ESTATE	Full contractual position of the creditor (rights and obligations) is transferred to the transferee.
NON-POSSESSORY PLEDGE OF MOVABLES	Debtor's consent is required.
POSSESSORY PLEDGE OF MOVABLES	Used when: • loans have not been accelerated, or • remaining obligations of the creditor exist, or • where maximum mortgage is given as collateral.
PLEDGE OF DEMATERIALIZED SECURITIES	Allowed by law.
PLEDGE OF BUSINESS SHARES IN A LIMITED LIABILITY COMPANY	Written form required/assumed in case of commercial contracts
PLEDGE OF CLAIMS (E.G. RECEIVABLES)	Allowed by law/assumed in case of commercial contracts

1.8 Super-priority loans in bankruptcy

Slovenian law recognizes super-priority of claims of creditors who are willing to finance the insolvent debtor in the course of formal insolvency proceedings (provided that such loan is obtained in compliance with statutory requirements).

1.9 Varying interest rate and tenor of the loan – must security be retaken?

In general, retaking of security is not necessary in case variable interest rate is agreed or if the tenor of the loan is changed. In case of mortgages or non-possessory pledges over movables, reductions of interest rates (in case of fixed interest rates, or in case of alleviating amendments of variable interest rates) may be registered with the respective registries.

2. SECURITY INTERESTS

2.1 How to establish and perfect a security interest

To establish a valid security interest, a title instrument and an act of perfection (i.e. an act of publicity) is required.

Title instruments include:

- movable pledge agreement, account pledge agreement, receivables pledge/assignment agreement, share pledge agreement and mortgage agreement, warehouse pledge agreement;
- guarantee agreement and surety agreement.

In case of a guarantee or surety (both personal security interests), the act of perfection falls together with the signing or handover of the respective title instrument.

In case of *in rem* rights, a separate act of perfection is required.

2.2 Ranking of securing charges/mortgages

The rank of a pledge depends upon when the respective act of perfection is made.

The rank of a real estate mortgage depends on the exact time when the application for registration of the mortgage is received by the Land Register (subject to actual registration).

2.3 Can ranking of consensual security be changed by agreement of the creditors?

In our view, ranking of consensual security may be changed by agreement of the creditors affected by such change. In any case, no change may have adverse effect against any third creditors.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Non-possessory pledge	Notarial deed and regularly also registration with a public register
ACCOUNT	Pledge	Notification to debtor
RECEIVABLES	Pledge or assignment	Notification to debtor
SHARES	Pledge	In case of a limited liability company: notification to the company / in case of joint stock company: registration with Central Securities Clearing Corporation
REAL ESTATE	Mortgage	Registration with the Land Register

2.5 Availability of floating charge

Slovenian law does not recognize the concept of a floating charge over all assets of a company.

However, with regard to "warehouse pledges", pledged inventories may be exchanged during the validity of the pledge.

2.6 Trust and parallel debt issues

There is no structure comparable with a common law trust in Slovenia, and the consensus in the legal community is that a common law trust does not create the ownership with regard to the secured claims that is required to create a valid and enforceable accessory security interest.

The above issue is typically solved through a so-called "parallel debt structure" whereby the parties to the facility agreement agree that the security agent shall be the joint and several creditor (*solidarni upnik*) of each and every obligation of the borrower towards each finance party (other than the security agent).

The above concept has as yet not been tested in Slovenian courts, but there are good legal arguments that such parallel debt concept, if properly implemented, will be upheld in Slovenia courts.

2.7 Availability of private sale and its main conditions

SECURITY INTEREST	ACCESSORY	PRIVATE SALE
GUARANTEE	No	N.a.
SURETY	Yes	N.a.
MOVABLES PLEDGE	Yes	Yes
ACCOUNT PLEDGE	Yes	Yes, if contractually agreed
RECEIVABLES PLEDGE	Yes	Yes, if contractually agreed
SHARE PLEDGE	Yes	Yes, if contractually agreed
REAL ESTATE MORTGAGE	Yes	No
LAND DEBT	No	No

2.8 Security and loan transfers

Collaterals are accessory rights and are therefore generally transferred by law to the assignee together with the transferred claim. An exception is the maximum mortgage, which is in principle non-transferable, but may be, in accordance with legal theory, transferred if the entire contractual position is transferred. Otherwise, a new maximum mortgage should be established by the mortgagor in favor of the new creditor (whereby in case there are any mortgages registered in favour of other creditors, the new maximum mortgage will have the last rank).

Additional documents and actions are required to perfect the transfer of some types of collateral:

SECURITY INTEREST	FORM REQUIREMENTS	PERFECTION REQUIREMENTS
GUARANTEE	N.a.	Notification of the guarantor
SURETY	N.a.	Notification of the surety
NON-POSSESSORY MOVABLES PLEDGE	Assignor's signature must be notarized	Registration with the Pledge Register
POSSESSORY MOVABLES PLEDGE	Assignor's signature must be notarized (to ensure enforceability of the pledge)	N.a.
ACCOUNT PLEDGE	N.a.	Notification of the bank
RECEIVABLES PLEDGE	N.a.	Notification of the debtor
SHARE PLEDGE – LIMITED LIABILITY COMPANY	Notarial deed	Registration with the Court Registry
SHARE PLEDGE – JOINT STOCK COMPANY	Written; additional requirements (usually personal identification) may be imposed by the pledge agent (brokerage company, bank etc.)	Registration with the Central Securities Clearinghouse Corporation
REAL ESTATE MORTGAGE	Assignor's signature must be notarized	Registration with the Land Registry
LAND DEBT	Endorsement and handover of the land charge certificate	N.a.

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

There are two main insolvency proceedings:

- **Bankruptcy proceedings** (*stečaj*) which generally lead to the liquidation of the assets forming the bankruptcy estate;
- **Composition proceedings** (*prisilna poravnava*) which primarily aim at eliminating a certain percentage of the debtor's debts while preserving its business as a going concern, by postponing maturity and reducing the amount of outstanding claims.

3.2 Applicable insolvency test and directors' duty to file

Detailed rules are provided for determining a company's insolvency. However, in practice the following two tests (each of them triggers insolvency) are typically applied:

- **Balance sheet test:** (i) company's due and payable obligations exceed the value of the company's assets (= overindebtedness) or (ii) the loss of the current financial year together with the loss(es) carried forward exceeds fifty percent (50%) of the registered share capital and such loss cannot be covered with profits and reserves.
- **Cash flow test**: due and payable claims in excess of twenty percent (20%) of the accounts payable as stated in the last audited financial statements against a company have been overdue for at least two (2) months (= inability to pay).

Within one (1) month after a company has become insolvent, the directors of the company must prepare a report on the matter, such report to be presented to the supervisory board and, if a share capital increase is proposed, to shareholders in a shareholders' meeting.

The management of a company is obliged to initiate bankruptcy proceedings within three (3) days after:

- the management has established in its report that the possibility of successful reorganization is lower than fifty percent (50%);
- the general meeting has not passed a resolution on an increase of subscribed capital as proposed in the management's report; or
- the resolution for the capital increase was passed, but the shares were not duly subscribed.

The management must initiate compulsory settlement proceedings no later than three (3) months after insolvency became apparent if no out-of-court settlement was possible and the management established in its report that the possibility of successful compulsory settlement is higher than fifty percent (50%).

A director risks claims for damages as well as criminal liability in case of non-compliance with the duty to report and to file for the opening of insolvency proceedings.

3.3 Describe bankruptcy proceedings

An application for opening bankruptcy proceedings may be filed by:

- the debtor;
- creditors (who, with reasonable certainty, prove their claim against the debtor and that the debtor is at least two (2) months late with its payment of that claim);
- a personally liable partner of a partnership;
- the Public Guarantee and Maintenance Fund of the Republic of Slovenia (*Javni jamstveni in preživninski sklad Republike Slovenije*) (who, with reasonable certainty, prove employees' claim against the debtor and that the debtor is at least two (2) months late with its payment of those claims).

The competent court appoints a bankruptcy receiver (*stecajni upravitelj*) who assumes control of the debtor's business and its assets.

Typically debtor's assets are liquidated, i.e. sold to the highest bidder. Liquidation proceeds (less preferred claims) are distributed to the debtor's creditors in accordance with the priority principles laid out in the Bankruptcy Act.

In accordance with the Bankruptcy Act the following order of payment applies:

- secured claims to be satisfied out of collateral;
- claims of unsecured creditors and of secured creditors to the extent not covered by collateral.

The Insolvency Act lists the following preferred claims:

- costs of the bankruptcy proceedings;
- costs for the maintenance and administration of the assets;
- employees' salaries for the three (3) months immediately prior to the bankruptcy proceedings;
- claims for damages incurred by employees in connection with their work, severance pay for the termination of employment contracts prior to or due to the commencement of bankruptcy proceedings;
- taxes and security contributions that must be paid together with the above mentioned salaries/ severance payments;
- claims of the tax authority originating in the year immediately prior to the commencement of bankruptcy proceedings;
- all claims arising out of legal acts of the bankruptcy receiver.

3.4 Timing and costs of insolvency proceedings

The duration of bankruptcy proceedings will depend on several different factors (e.g. the extent of the assets and liabilities of the obligor, the number of creditors, whether the bankruptcy receiver challenges any transactions of the obligor in court, etc.). Although there is no general rule, in our experience more complex bankruptcy proceedings may take up to several years.

3.5 Challenge of preferential transactions and suspect periods

The bankruptcy receiver and each creditor has the right to challenge legal acts or transactions which occurred within a certain period prior to filing a petition for the opening of bankruptcy proceedings, if such legal acts or transactions:

- have decreased the value of debtor's assets, which, as a consequence, put creditors at a disadvantage, or
- have resulted in the preference of an individual creditor provided that the debtor was insolvent at the time of entering into such legal acts or transactions and the counterparty knew, or should have known, that such debtor is insolvent. Such actual or assumed knowledge is not required if the transaction was not entered into at arm's length. Moreover, knowledge is assumed (but may be rebutted) in case the act or transaction (i) was unusual or (ii) was entered into within three (3) months prior to filing for bankruptcy.

The suspect period is one (1) year prior to filing for bankruptcy, extended to three (3) years where a gift or transaction was undervalued.

3.6 Impact of insolvency proceedings on security and enforcement

In principle, no enforcement proceedings can start following the initiation of insolvency proceedings.

3.6.1 Impact of composition proceedings on enforcement

Upon the initiation of composition proceedings, enforcement proceedings are stayed and can be continued only on the basis of an order of the insolvency court.

3.6.2 Impact of bankruptcy proceedings on enforcement

Enforcement proceedings are stayed unless the assets have already been sold.

Composition proceedings do not affect security rights and pertaining enforcement proceedings.

3.6.3 Impact of bankruptcy proceedings on security

Bankruptcy proceedings do not affect contractually established security. In respect of security obtained in course of enforcement proceedings:

- if the creditor has registered its secured claim in the bankruptcy proceedings within three (3) months following the initiation of bankruptcy proceedings, security stays in existence; otherwise, the security is lost.
- If security has been obtained in the course of enforcement proceedings and the assets were already sold, the creditor does not have to register its secured claim and bankruptcy proceedings do not affect security.

3.7 Survival of powers of attorney

Any appointment as a legal representative or as an agent granted by a company will automatically cease to be valid upon the opening of bankruptcy proceedings over its assets.

This may affect the secured creditor's ability to effect a transfer of the collateral to a potential purchaser in a private enforcement.

3.8 Secured creditors in bankruptcy proceedings

A validly established *in rem* security interest gives the secured creditor a preferential claim regarding the respective collateral.

Generally, collateral will be realized in the course of the bankruptcy proceedings. Enforcement proceeds are distributed in the order of priority as laid out in the Bankruptcy Act.

If the collateral agreement grants the creditor the right to enforce out of court, the creditor can continue with such sale outside of the bankruptcy proceedings.

3.9 Describe composition proceedings

Composition proceedings are initiated by the competent court upon a filing by a debtor who faces insolvency, by its personally liable shareholder(s), or by its creditors having a sum of financial claims against the debtor exceeding twenty percent (20%) of its financial liabilities.

The opening of composition proceedings becomes effective the day following the publication of the content of the composition edict in the Slovenian online insolvency database (*http://www.ajpes.si/*).

The competent court will appoint a composition administrator who supervises and supports the debtor; the debtor does not lose control over its business and assets, though it may need consent of the composition administrator, insolvency court, or creditors' council for some operations.

In composition proceedings, the debtor has the opportunity to negotiate for the discharge of its outstanding debts. The Insolvency Act does not limit the percentage of discharge.

A majority in number of the creditors, representing at least sixty percent (60%) in value, must agree to the settlement plan. If the judicial composition (and thereby the reorganization plan) is approved by the competent court, composition proceedings will be terminated and the debtor will be partially released from its debts upon fulfilment of the settlement plan.

Composition proceedings do not affect the position of secured creditors.

4. JUDICIAL ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

A secured creditor may have to pursue judicial enforcement with regard to its collateral in accordance with the Enforcement Act (*Zakon o izvršbi in zavarovanju*) which requires completion of the following steps:

- first, obtaining a title for enforcement (*izvršilni naslov*), e.g. ruling on non-payment by the borrower;
- second, filing of a motion for enforcement (*predlog za izvršbo*) with the competent Slovenian county court;
- third, obtaining a decision of the competent Slovenian county court that judicial enforcement is permissible (*sklep o izvršbi*);
- fourth, enforcement through public auction;
- finally, the proceeds of the public auction are distributed to the secured creditor to settle secured claims.

A title for enforcement may be, in particular,

- a final, conclusive and binding judgment by a Slovenian court;
- a final, conclusive and binding judgment by a court of a Member State as defined in Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters;
- a domestic arbitral award declared enforceable or a foreign arbitral award recognized pursuant to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958;
- a settlement effected before a Slovenian court;
- a directly enforceable notarial deed.

4.2 Timing and costs of enforcement proceedings

With regard to judicial enforcement proceedings, in our experience the enforcement procedure takes about one (1) to two (2) years (starting with the filing of the enforcement application and ending with the distribution of the monies realized to the secured creditor). This duration also depends on the court's case load and any defensive pleadings pursued by the secured creditor.

MARKUS BRUCKMÜLLER
Partner

Wolf Theiss, Ljubljana

T. +386 1 438 0000
markus.bruckmueller@wolftheiss.com

WOLF THEISS

UKRAINE

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

In general, under Ukrainian law a negative pledge undertaking is legally valid and binding.

1.2 Restrictions to accelerating a loan

There are no statutory restrictions for the acceleration of a loan in case of non-performance of payment obligations by the borrower. However, under the currency control regulations of the National Bank of Ukraine (the "NBU") which has introduced the temporary measures to stabilize the currency exchange market, Ukrainian borrowers are currently prevented from early repayment of cross-border loans. This restriction applies to the loan acceleration by a lender.

1.3 Effectiveness of a non-assignment clause

A prohibition of assignment with regard to monetary claims has absolute effect, i.e. it is effective *vis-à-vis* third parties. Any assignment by a lender in violation of such prohibition may be contested by the borrower. There are certain exceptions, for instance for a transfer of receivables based on a factoring agreement to a bank or a financial institution qualified to render factoring transactions and for the assignment of monetary claims by an insolvent bank to an appointed accepting bank.

1.4 Common methods for loan transfers

There is no special statutory act governing loan transfers except for the procedure for the loan transfer by an insolvent bank set forth by the deposit guarantee system laws.

Based on Ukrainian general civil law rules, claims under a loan can be transferred by virtue of (i) a sale or assignment of right to claims (receivables) on the basis of an assignment agreement or sale and purchase agreement, or (ii) factoring based on a factoring agreement.

1.5 Effectiveness of a contractual subordination

A contractual subordination agreed in a standard inter-creditor agreement may not be recognized in insolvency proceedings or in a voluntary winding-up to the extent that it alters the priority of claims established by Ukrainian statutory law.

1.6 Subordination by operation of law

Ukrainian banking law provides for the ranking of subordinated creditors of a bank below all other bank creditors. Regulations applicable to certain non-banking credit institutions (so-called "credit unions") set out criteria for loan subordination. However, as the insolvency of such institutions is subject to general insolvency proceedings (which do not recognize claim subordination), any claims ranking differently to the insolvency law ranking are unlikely to be supported.

Also, statutory subordination applies to registered encumbrances over the same collateral. Otherwise, the concept of subordination by operation of law (including shareholders' loans) is unknown under Ukrainian law.

Based on recently adopted law on financial subordination, the restructuring plan of a debtor which is subject to restructuring within the framework of the financial restructuring law may provide for different categories of creditors as well as established different terms for satisfaction of claims of creditors of a respective category.

1.7 Validity of a forfeiture agreement

An agreement for the forfeiture of the security interest, i.e. whereby the secured creditor may appropriate the collateral in case of non-performance of the secured claims upon their maturity, is legally valid and binding.

1.8 Super-priority loans in bankruptcy

As a matter of Ukrainian insolvency law, loans received for making redundancy payment to the dismissed employees of the insolvent debtor are treated as extra-priority claims. Otherwise, Ukrainian insolvency law does not provide for super-priority ranking of loans.

1.9 Varying interest rate and tenor of the loan – must security be retaken?

Generally, Ukrainian law does not require that the security created over the assets be retaken in cases of varying interest rate or loan tenor. This, however, may depend on the wording of the underlying security documents and description of the secured obligation provided therein. Also, depending on the wording of the security documents and their perfection, interest rate and/or tenor fluctuation may need to be reflected in the relevant state registers.

In case of suretyship agreements, increases of the interest rate and extension of loan maturity may be treated as an extension of liability of the surety and, unless it is allowed under the agreement, will require the surety's consent.

2. SECURITY INTERESTS

2.1 How to establish a security interest

To establish a valid security interest and depending on the type of collateral, (i) a security instrument; (ii) an act of perfection (publicity requirement); and (iii) other actions or documents may be required.

2.1.1 Security instruments

Security instruments should contain all essential conditions required by Ukrainian law (which includes among others the details of the security provider and security holder, amount and term of secured obligation and description of collateral). A security instrument for the attachment of security to immovable properties, transport vehicles or receivables under a notarized agreement should be notarized.

2.1.2 Perfection of a security interest

Perfection of a security interest over assets located in Ukraine is carried out by registration with (i) the State Register of Encumbrances over Movable Assets (the so-called "Encumbrances Register") for collateral over movable assets, and (ii) the State Register of Property Rights over Immovable Properties (the so-called "Immovable Properties Register") for collateral over real estate.

2.1.3 Other requirements

Depending on the type of collateral other requirements may come into play, such as for instance: (i) written notification of a debtor under the contract for the pledge of receivables thereunder; or (ii) handing over certain types of securities to a secured party for the creation of security over the rights arising from such securities.

2.2 Ranking of pledges/mortgages

As a general rule the ranking of security is determined by the respective act of perfection, i.e. by the order of registration with the Encumbrances Register or Immovable Properties Register. This general rule is subject to certain exceptions. For instance, the seller of goods sold on credit ranks the highest upon registration with the Encumbrances Register irrespective of other encumbrances registered earlier.

2.3 Can ranking of security be changed by agreement of the creditors?

Under Ukrainian law the statutory ranking of security cannot be changed by agreement of the creditors.

Also, based on the law on financial restructuring the restructuring plan of a debtor which is subject to restructuring under the financial restructuring law may provide for a change of priority of the pledge, mortgage or another encumbrance. However, the secured party should consent to the change of priority.

2.4 Common *in rem* security interests

ASSET	SECURITY	PERFECTION
MOVABLES	Pledge	▪ Registration with the Encumbrances Register; ▪ (for possessory charge) physical delivery of the movables to the pledgee or labelling the pledged movables.
BANK ACCOUNT RECEIVABLES	Pledge	▪ Notification to the account bank; and ▪ registration with the Encumbrances Register.
RECEIVABLES	Pledge	▪ Notification to the debtor; and ▪ registration with the Encumbrances Register.
EQUITY SHARES	Pledge	▪ Registration with the Encumbrances Register; ▪ (for registered shares) reflecting encumbrance (blocking) at the securities account maintained by a relevant depository institution.
REAL ESTATE AND CONSTRUCTION IN PROGRESS INCLUDING ANY RIGHTS THERETO	Mortgage	▪ Registration with the Immovable Properties Register.

2.5 Availability of floating charge

Ukraine law does not recognize the floating charge concept as existing in common law jurisdictions. However, a security interest over a fluctuating pool of assets can be created under Ukrainian law.

2.6 Trust and parallel debt issues

There is no structure comparable with a common law trust in Ukraine and therefore security should be granted directly to a finance party.

The above issue is typically solved through “parallel debt” and joint and several creditor structures whereby the parties to the foreign law governed facility agreement agree that the security agent shall be the joint and several creditor of each and every obligation of the borrower towards each finance party (other than the security agent).

As a result, the security is created in the name of the security agent (i.e. a secured creditor of record) for the purposes of security perfection with public registers.

The above structures have as yet not been tested in Ukrainian courts, but there is consensus in the legal community that, if properly implemented, they will be upheld by Ukrainian courts.

2.7 Availability of private sale and its main conditions

SECURITY INTEREST	ACCESSORY	PRIVATE SALE
GUARANTEE	No	N.a.
SURETY	Yes	N.a.
MOVABLES PLEDGE	Yes	Yes, if contractually agreed
BANK ACCOUNT RECEIVABLES PLEDGE	Yes	Yes, if contractually agreed
RECEIVABLES PLEDGE	Yes	Yes, if contractually agreed
SHARE PLEDGE	Yes	Yes, if contractually agreed
REAL ESTATE MORTGAGE	Yes	Yes, if contractually agreed

2.8 Security and loan transfers

Obligations of a security provider under a Ukrainian law governed security document are secondary to the primary obligations i.e. the secured claims. Accordingly, if a finance party assigns its rights under the secured claims, it must also assign its rights under the security documents.

Assignment of rights under the security documents will require registration of a new finance party (as a new security holder) with the Encumbrances Register or Immovable Properties Register. Assignment under the security documents executed in a notarized form requires notarization of the relevant transfer document.

3. INSOLVENCY PROCEEDINGS

3.1 Type of insolvency proceedings

Ukrainian insolvency law provides for the following three insolvency proceedings:

- **Asset management** (*rozporyadzhennya maynom borzhnyka*);
- **Financial rehabilitation** (*sanatsiya*); and
- **Liquidation** (*likvidatsiyna protsedura*).

An insolvency case ordinarily starts out with an asset management proceeding and depending on the results, the debtor will be subject to either a financial rehabilitation or liquidation proceedings. If rehabilitation proceedings are unsuccessful, liquidation proceedings will be opened.

At any stage of the insolvency procedure the parties may negotiate the terms of debt restructuring and commence an amicable settlement proceeding (*myrova ugoda*).

Depending on the type and/or activities of a debtor, its insolvency may be regulated by either special rules

envisaged by insolvency law or other statutory acts. For instance, insolvency of banks is regulated by banking law and the deposit guarantee system law.

3.2 Applicable insolvency test and directors' duty to file

Ukrainian insolvency law provides for the general criteria upon which the insolvency case may be initiated. Specifically, it may be started if one or more creditors have undisputed claims against the debtor in an amount of at least three hundred (300) minimum statutory wages[1] (approximately EUR 15,575 based on NBU UAH 2,793 / EUR 100 official exchange rate) which are overdue for at least three (3) months.

A claim is recognized as undisputed if:

- it is a monetary claim arising from the debtor's unsecured payment obligation, excluding penalties and other financial sanctions;
- it has been confirmed by an effective court decision; and
- an enforcement procedure to collect such claim from the debtor has been opened and such procedure remained open and the claim undischarged for at least three (3) months.

The debtor may initiate its own insolvency should the above insolvency criteria be present. The initiation of insolvency is mandatory for the debtor, if:

- satisfaction of the claims of one or several creditors results in the inability of the debtor to satisfy the claims of other creditors in full (so-called "threat of insolvency"); and
- in the course of a voluntary liquidation (out of the insolvency) of the debtor it becomes evident that all creditors' claims cannot be satisfied in full.

3.3 Describe insolvency proceedings

The court takes a decision on the commencement of the insolvency case at the preparatory hearing which generally must be held within fourteen (14) days after the acceptance of the insolvency application by the court. Simultaneously with the opening of the insolvency procedure, the court takes a decision on: (i) opening asset management proceedings and making the official announcements; (ii) introduction of a moratorium; and (iii) appointment of an insolvency (asset) manager.

Within thirty (30) days after the announcement, the creditors whose claims to the debtor have matured before the opening of the insolvency case are required to submit their claims to the commercial court handling the debtor's insolvency. Claims recognized by the court are included into the register of the creditors' claims. Failure to keep this deadline results in changing the ranking of the claim to the last priority.

The asset management proceedings should be completed within one hundred and fifteen (115) days (this term can be extended for an additional two (2) months). If, based on its results, the creditors or the court have not decided on the opening of a rehabilitation proceeding or execution of an amicable settlement agreement, the court declares the debtor bankrupt and opens a liquidation proceeding.

1 The minimum statutory wage is subject to regular change. At the moment, it equals UAH 1,450 and will be increased to up to UAH 1,600 beginning from 1 December 2016. Beginning from 1 January 2017 there will be a further increase based on the State Budget Law for the Year 2017 but the amount is not yet available.

In general, the liquidation of the debtor results in the seizure of all of the company's activities and collecting all its assets in order to satisfy as many creditors' claims as possible. If the bankrupt's assets are sufficient to satisfy all claims, the debtor will survive the liquidation and will be able to continue its business operations.

All distributions to the creditors in the course of insolvency are made in accordance with the register of the creditors' claims in the following order:

- first priority - employees' salary, other employment-related payments, reimbursement of expenses for the insolvency proceedings for *inter alia* publications, court fees, asset safekeeping, etc.;
- second priority - compensation of damage to life and health, state social security payments;
- third priority - taxes (duties) and related payments;
- fourth priority - all other unsecured claims (including post-insolvency creditors' claims);
- fifth priority - claims of employees to return contributions to the debtor's authorised capital, payment of the supplementary remuneration of the insolvency manager; and
- sixth priority - all other claims (e.g. amounts of penalties and other financial sanctions, pre-insolvency claims submitted after the deadline).

3.4 Timing and costs of insolvency proceedings

The timing of insolvency proceedings depends on a variety of factors (e.g. the amount of the assets and liabilities of the debtor, the number of creditors, etc.). Although there is no general rule, in our experience more complex insolvency proceedings may take up to several years.

The cost of the insolvency proceedings *inter alia* includes:

- court fee for (i) filing an insolvency application amounting to ten (10) minimum statutory wages (approximately EUR 480 based on NBU UAH 2,906 / EUR 100 official exchange rate); (ii) filing an application for recognition of a creditor's claim – approximately EUR 100;
- remuneration to the insolvency manager and reimbursement of his/her expenses incurred in the insolvency proceedings. The amount of remuneration is set forth by the insolvency law and consists of (i) a basic portion which is determined based on the debtor's CEO salary; and (ii) a supplementary portion which is linked to the amount of the debtor's assets collected/claim's discharge; and
- other amounts including *inter alia* expenses for the audit of the debtor, making official announcements, storage and sale of the debtor's assets.

3.5 Challenge of preferential transactions and suspect periods

The court, at the request of an insolvency manager or any unsecured creditor, may invalidate agreements executed, or challenge transactions (*maynovi diyi*) performed, by the debtor within one (1) year before or after the initiation of the insolvency proceedings based on the following grounds set forth by the insolvency law:

- gratuitous disposal of assets or waiver of property claims by the debtor, or assumption of obligations without consideration by the other party;
- performance by the debtor of property obligations prior to their maturity;
- assumption of liabilities by the debtor before the commencement of the insolvency procedure which resulted in its insolvency or inability to perform payment obligations towards other creditors (partially or fully);

- disposal, or acquisition, by the debtor of assets for a value lower or higher than their market value, provided that the debtor's assets were or have become insufficient for the satisfaction of all creditors' claims;
- payment to the creditor or acceptance of the assets as a consideration for the performance of debtor's claims at a time when the amount of the creditors' claims exceeded the value of the debtor's assets; and
- granting security by the debtor to secure its payment obligations.

Based on the above grounds, the court may invalidate debtor's agreements or transactions executed/performed one (1) year before the commencement of financial restructuring of such a debtor based on the financial restructuring law.

3.6 Impact of insolvency proceedings on security and enforcement

The moratorium (= automatic stay) that is introduced by the court simultaneously with the opening of the insolvency proceedings generally results in suspension of all enforcement procedures opened against the debtor as well as procedures to enforce security. The law allows completion of the enforcement procedures which, as of the opening of the insolvency proceedings, reached the stage of the sale of assets or distribution of the sale proceeds.

3.7 Secured creditors in insolvency proceedings

As a matter of Ukrainian insolvency law, the secured creditors i.e. the creditors whose claims are secured by the debtor's assets are in principle:

- not entitled to initiate insolvency proceedings (unless the collateral does not fully cover their claims), but they may join the opened process;
- not authorised to vote at the creditors' meeting (committee) but they are allowed to participate in the creditors' representative bodies with an advisory vote;
- entitled to block such strategic decisions as: (i) approval of the restructuring plan; and (ii) execution of an amicable settlement agreement; and
- treated as extra-priority creditors whose claims are repaid out of the sale of collateral.

3.8 Describe rehabilitation proceedings

A rehabilitation proceeding is initiated by a court ruling usually based on the application of the creditors' committee and shall be completed within six (6) months (this term can be extended for an additional twelve (12) months). Generally, the rehabilitation proceeding is comprised of a system of measures intended to foster the financial rehabilitation of the debtor. The list of such measures stated in the insolvency law is not exhaustive, it includes granting loans, corporate restructuring of the debtor, its debts and assets and/or the change of a debtor's legal form and its business operations.

Along with the opening of the rehabilitation proceeding, the court appoints a rehabilitation manager who takes over the authorities of the debtor's management which results in dismissal of the debtor's CEO and termination of the powers of the debtor's governing authorities. The rehabilitation manager receives full control over the company, including over the disposal of its assets.

The rehabilitation manager is responsible for the preparation and submission to the court of a restructuring plan (outlining the measures for the restoration of the debtor's solvency) which must be approved by the creditors' committee and the secured creditors.

A rehabilitation proceeding terminates based on an application of the creditors' committee to the court (i) due to the fulfilment of the restructuring plan and restoration of the debtor's solvency, (ii) requesting recognition of the debtor as bankrupt and opening a liquidation proceeding, or (iii) execution of the settlement agreement.

The insolvency law provides for a special type of rehabilitation proceedings which may be initiated by the management of the debtor. In this case the court does not open asset management proceedings but immediately introduces a rehabilitation proceeding. Among the benefits of this procedure for the debtors are the retain of control by the debtor's management over its business and enjoying a moratorium on forced collection of debts. Also, under this procedure the debtor has an opportunity to develop the restructuring plan for its rehabilitation and negotiate it with the creditors.

4. JUDICIAL ENFORCEMENT PROCEEDINGS

4.1 Describe judicial enforcement proceedings

The judicial enforcement of claims by a creditor including a secured creditor requires completion of the following principal steps:

- first, obtaining a title for enforcement, e.g. a court decision on debt collection from a debtor or levying execution on the collateral;
- second, obtaining a writ of execution from the competent court;
- third, submitting the writ of execution to the State Enforcement Agency or a private enforcement officer[2];
- fourth, conducting the enforcement procedure (e.g. search of the debtor's assets which can be foreclosed, foreclosure upon the collateral, etc.); and
- finally, distribution of the enforcement proceeds to the creditor.

Generally a title for enforcement which can be enforced in Ukraine may be:

- a final, conclusive and binding judgment by a Ukrainian court followed by a relevant writ of execution;
- a notarial writ of execution;
- a final, conclusive and binding arbitral award issued in a member state to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958. In order to recognize and enforce a foreign arbitral award in Ukraine a claimant should file an application on the recognition and enforcement of the arbitral award to a Ukrainian court of general jurisdiction at the location of the debtor i.e. the person against whom the collection under the award is sought.

If there is an agreement between the parties on extra-judicial enforcement on the basis of a notarial writ of execution, it is possible to apply to the State Enforcement Agency or a private enforcement officer for enforcement once the mentioned writ of execution is in place.

2 The institute of private enforcement officers will become operational in January 2017.

4.2 Length of enforcement proceedings

The law provides for specific deadlines for the completion of various steps within the enforcement procedure. However, the enforcement documents should be returned to the claimant if the debtor does not possess any assets upon which execution can be levied and the measures taken by the enforcement officers to find out the debtor's assets within one (1) year have been unsuccessful.

OKSANA VOLYNETS
Senior Associate

Wolf Theiss, Kyiv

T. +38 044 3777 500
oksana.volynets@wolftheiss.com

CONTACT INFORMATION

For further information about Wolf Theiss or the *Wolf Theiss Guide to: Restructuring Loans and Enforcement of Security*, please contact:

MARKUS HEIDINGER
Partner

WOLF THEISS Rechtsanwälte Gmbh & Co KG

Schubertring 6
1010 Vienna
Austria

T. +43 1 51510 5060
markus.heidinger@wolftheiss.com

MARCELL NÉMETH
Counsel

WOLF THEISS Rechtsanwälte Gmbh & Co KG

Schubertring 6
1010 Vienna
Austria

T. +43 1 51510 5066
marcell.nemeth@wolftheiss.com

OUR OFFICES

ALBANIA
Murat Toptani Street
AL - 1001 Tirana
T. +355 4 2274 521
E. **tirana@wolftheiss.com**

AUSTRIA
Schubertring 6
A - 1010 Vienna
T. +43 1 515 10
E. **wien@wolftheiss.com**

BOSNIA AND HERZEGOVINA
Zmaja od Bosne 7
BiH - 71 000 Sarajevo
T. + 387 33 953 444
E. **sarajevo@wolftheiss.com**

BULGARIA
29 Atanas Dukov Street
BG - Sofia 1407
T. +359 2 8613 700
E. **sofia@wolftheiss.com**

CROATIA
Ivana Lučića 2a/19
HR - 10 000 Zagreb
T. +385 1 4925 400
E. **zagreb@wolftheiss.com**

CZECH REPUBLIC
Pobřežni 12
CZ - 186 00 Praha 8
T. +420 234 765 111
E. **praha@wolftheiss.com**

HUNGARY
Kálvin tér 12-13
H - 1085 Budapest
T. +36 1 4848 800
E. **budapest@wolftheiss.com**

POLAND
ul. Mokotowska 49
PL - 00-542 Warszawa
T. +48 22 378 8900
E. **warszawa@wolftheiss.com**

ROMANIA
58-60 Gheorghe Polizu Street
RO - 011062 Bucuresti
T. +40 21 308 8100
E. **bucuresti@wolftheiss.com**

SERBIA
Bulevar Mihajla Pupina 6/18
SRB – 11000 Novi Beograd
T. +381 11 330 2900
E. **beograd@wolftheiss.com**

SLOVAK REPUBLIC
Aupark Tower, Einsteinova 24
SK - 851 01 Bratislava
T. +421 2 591 012 40
E. **bratislava@wolftheiss.com**

SLOVENIA
Bleiweisova cesta 30
SI - 1000 Ljubljana
T. +386 1 438 00 00
E. **ljubljana@wolftheiss.com**

UKRAINE
9A Khoryva Str.
04071 Kyiv
T. +38 044 377 75 00
E. **kiev@wolftheiss.com**

LIST OF AUTHORS

The entire guide has been coordinated by Marcell Németh, Counsel in the Vienna office.

The country chapters have been written by lawyers from the respective Wolf Theiss office as follows:

Albania:	Nako Sokol (Partner) and Olta Kore (Associate);
Bosnia:	Naida Čustović (Partner);
Bulgaria:	Katerina Kraeva (Partner) and Jasmina Uzova (Senior Associate);
Croatia:	Vedrana Iveković (Counsel), Ira Peric (Counsultant) and Jelena Orlić (Associate);
Czech Republic:	Mills Kirin (Counsel) and Radek Kraus (Associate);
Hungary:	Melinda Pelikán (Senior Associate), Zsófia Polyák (Associate), Diána Boross-Varga (Associate) and Enikő Lukács (Associate);
Poland:	Karolina Łapiak (Senior Associate) and Piotr Ziółkowsik (Associate);
Romania:	Claudia Chiper (Counsel), Ramona Hromei (Senior Associate) and Tudor Botea (Associate);
Serbia:	Miloš Anđjelković (Senior Associate), Katarina Stojaković (Senior Associate) and Nevena Skocic (Associate);
Slovak Republic:	Katarina Bielikova (Senior Associate) and Radana Bernátová (Associate);
Slovenia:	Markus Bruckmüller (Partner) and Žiga Dolhar (Associate);
Ukraine:	Oksana Volynets (Senior Associate).

WOLF THEISS is one of the largest and most respected law firms in Central, Eastern and Southeastern Europe (CEE/SEE). Since starting out in Vienna 60 years ago, we have grown to a team of several hundred people, with offices throughout the region. During that time, we have worked on many cases that have broken new ground.

We concentrate our energies on a unique part of the world: the complex, fast-moving markets of the CEE/SEE region. This is a fascinating area, influenced by a variety of cultural, political and economic trends. We enjoy analysing and reflecting on those changes, drawing on our experiences, and working on a wide range of domestic and cross-border cases.

www.wolftheiss.com