Restructuring frameworks undergoing change

Wolf Theiss

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This 2022 Wolf Theiss Guide is intended as a practical guide to the general principles and features of the basic legislation and procedures in countries included in the publication.

While every effort has been made to ensure that the content is accurate when finalised, it should be used only as a general reference guide and should not be relied upon as definitive for planning or making definitive legal decisions. In these rapidly changing legal markets, the laws and regulations are frequently revised, either by amended legislation or by administrative interpretation.

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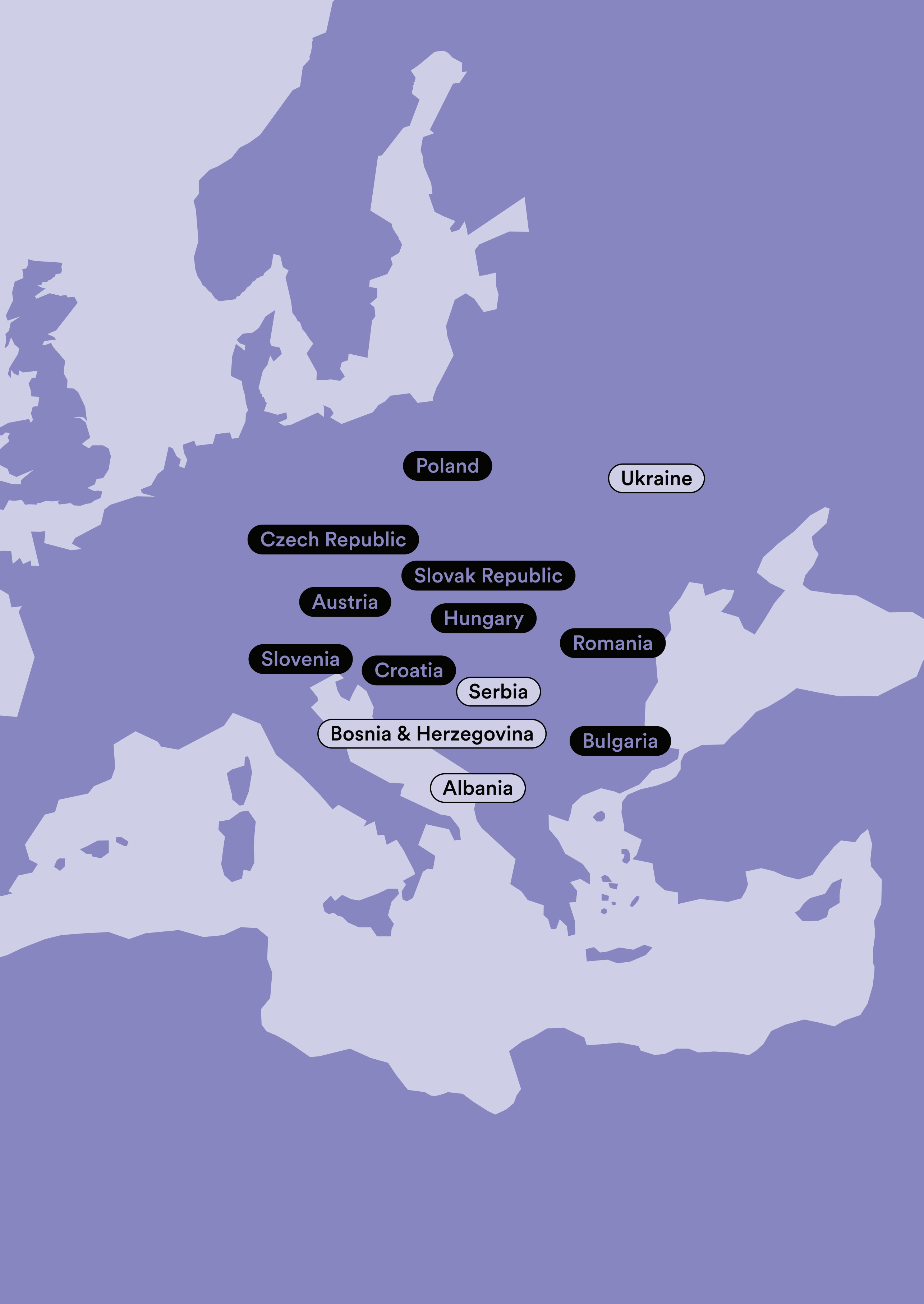
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Restructuring frameworks undergoing change

Part I:
Cross-border recognition of restructuring proceedings

Wolf Theiss

Cross-border recognition of restructuring proceedings

How can complex, costly and time-consuming recognition processes or parallel restructuring proceedings in different jurisdictions be avoided?

Whilst the avenue for the EU-wide automatic recognition of restructuring proceedings has now been opened for several jurisdictions by an amendment to the **European Insolvency Regulation** ((EU) 2015/848) (EIR), the query above remains unanswered as regards restructuring proceedings falling outside the scope of application of the EIR.

Background

Annexes A and B to the EIR list national insolvency proceedings and practitioners to which the latter Regulation, including its recognition mechanism, applies. By the Regulation (EU) 2021/2260, the annexes have been replaced with new ones and are now supplemented with new types of restructuring proceedings and practitioners which eight Member States have introduced in local restructuring and insolvency laws following the implementation of the European Restructuring Directive ((EU) 2019/1023) (**ERD**).

Under the ERD, Member States must implement "preventive restructuring frameworks" in national law. In doing so, the European legislator has given Member States an option: such restructuring frameworks may comply with the requirements of the EIR, but they do not have to. However, if Member States do make use of such option, the restructuring framework must be a public proceeding according to Art. 1 (1) of the EIR. Only such public proceedings are included in Annex A to the EIR and thus enjoy EU-wide recognition (see below).

Currently, several Member States have made use of such option. In Austria, for example, the new Restructuring Code (*Restrukturierungsordnung*) (**RC**) (see A giant leap forward? The new draft for a restructuring code in Austria) introduced, as an alternative to regular restructuring proceedings, which are of a private nature, European Restructuring Proceedings (Europäisches Restrukturierungsverfahren), the initiation of which (i) may be chosen by the debtor and (ii) according to Sec. 44 of the RC needs to be published in the publicly available Austrian Edicts Database (Ediktsdatei). Contrary to regular restructuring proceedings under the RC and in line with the requirements of Art. 1 (1) of the EIR, the European Restructuring Proceedings have been included in Annex A to the EIR.

Similarly, new types of insolvency proceedings of other Member States, namely the Netherlands (WHOA), Germany (StaRUG), Italy, Lithuania, Cyprus, Poland and Hungary (see country update below), have been included in Annex A to the EIR.

Inside the scope of application of the EIR

By including European Restructuring Proceedings in Annex A to the EIR, such proceedings are deemed to be "insolvency proceedings" within the meaning of the EIR and thus, in particular subject to the EIR's directly applicable rules concerning international jurisdiction and recognition.

The centre of the debtor's main interests (COMI) is therefore relevant for the international jurisdiction as regards cross-border European Restructuring Proceedings.

Those furthermore enjoy EU-wide recognition. This particularly concerns the opening of European Restructuring Proceedings which shall, in principle, (i) according to Art. 19 of the EIR, be automatically recognised in all other Member States and (ii) according to Art. 20 of the EIR, produce the same effects in any Member State (in each case other than in Denmark).

The above consequences may be of practical relevance in particular if the opening of European Restructuring Proceedings is associated with court ordered stay of enforcement actions with a view to foreign assets.

Outside the scope of application of the EIR

Whether and how private restructuring proceedings under the RC can be recognised in Member States is still unclear in Austria. As they are not listed in Annex A to the EIR, they do not fall within the scope of its respective rules. According to academic literature on the subject, the applicability of Regulation (EU) 1215/2012 is in question; on the contrary, some have argued that national procedural rules and the rules on international private law are applicable. Accordingly, the same queries arise as regards the international jurisdiction for private restructuring proceedings under the RC with a cross-border element.

If a debtor – not willing to reveal its financial distress to a wider audience – decides against the initiation of European Restructuring Proceedings, it may thus face legal uncertainty concerning the cross-border treatment of its restructuring.

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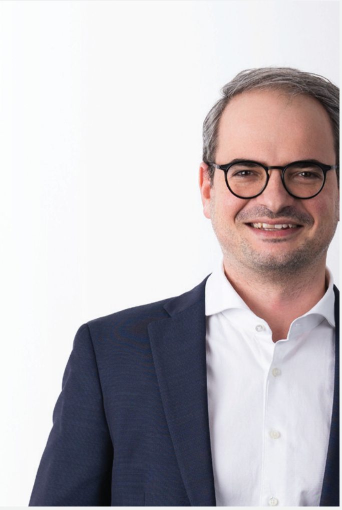

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Restructuring frameworks undergoing change

Part II:
Implementation of the Restructuring Directive

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Restructuring frameworks undergoing change
Implementation of the Restructuring Directive

Croatia

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Croatia: paving the way for restructuring

Implementation of the Restructuring Directive

The Directive (EU) 2019/1023 on Restructuring and Insolvency (the **Directive**) has finally been transposed into Croatian legislation. Implementation has been carried out through extensive amendments to the Insolvency Act (the **IA**) and partial amendments to the Consumer Insolvency Act (the **CIA**). Both are in force as of **31 March 2022**.

The amendments revolve around fine tuning the restructuring process that was already set out by the IA through the pre-insolvency proceedings while also harmonising it with the Directive.

Objectives

The primary aim of the amendments relating to the restructuring regime is to harmonise the IA with the *acquis communautaire* and to follow the general trend of departure from formal insolvency proceedings by opening a window into private regulation. At the same, the amendments are intended to ensure effective, simple and flexible management of the procedure, with precisely defined deadlines and clear consequences of procedural actions.

What to expect in practice?

The nature of the provisions that were introduced suggest that the biggest benefit will be reaped by companies which are well organised, financially stable and have a good business perspective, albeit their progress and development are hurdled by a negative balance sheet.

Focal points – first outline

When can a restructuring process be initiated?

The process can be initiated when there are certain indicators that the debtor will not be able to timely fulfil its outstanding obligations and is under the threat of becoming insolvent. The initiative lies exclusively with the debtor, on whom also rests the burden of proof evidencing the likelihood of insolvency. In case that the debtor is over-indebted or insolvent in the sense of insolvency law, insolvency proceedings should be initiated.

When insolvency or liquidation proceedings are already under way, the restructuring procedure cannot be initiated. Restructuring is not permissible, among other reasons, if two years have not elapsed from the fulfilment of obligations arising from a previous restructuring plan.

Certain debtors (such as government-financed funds, municipalities, financial/credit institutions or natural persons who are not entrepreneurs) are excluded from the restructuring regime set out by the IA.

A novelty introduced by the amendments is that the restructuring process may be carried out against a debtor who has been convicted of a criminal offense of breach of trust in business operations, fraud in business operations, causing bankruptcy, favouring creditors or breach of the obligation to keep trade and business books under the Croatian Criminal Code only if the debtor in question took appropriate measures to address the problems that led to that conviction and informed its creditors of the undertaken measures and their results during restructuring negotiations and provided them with detailed information on the measures taken and their results in the application for initiation of restructuring proceedings.

Which documents are required?

An application for initiation of proceedings is to be submitted to the competent commercial court. The application must be accompanied by annual financial statements (not older than three months), a statement on the number of employees (as at the last day of the month that precedes the day of the application) and a proposal for a restructuring plan (if drafted).

In case a restructuring plan has not been submitted with the application, the debtor must submit the plan no later than twenty-one days after the day on which the decision on acknowledged and disputed creditors' claims has become final and binding.

Additional documentation that may prove useful for restructuring negotiations or which may aid the approval of the restructuring plan is most welcome.

What is a restructuring plan?

The restructuring plan is the foundation for the restructuring process. It provides the basis and outlines the financial and operational measures that will be undertaken, among other actions, for the purpose of the debtor's recovery. Of course, this is all with the consent of the deciding creditors and with the approval of the court.

The amendments to the IA introduced an exhaustive list of mandatory contents that must be included in the restructuring plan, with the aim to speed up the process by precisely covering all relevant aspects of restructuring. However, such an exhaustive list of mandatory contents may prove to be an obstacle to restructuring when it comes to smaller companies and entrepreneurships.

How is the restructuring plan voted on?

Voting on the proposed restructuring plan takes place at the voting hearing that is to be held within 30 days after the decision on acknowledged and disputed claims becomes final and binding. Creditors vote in writing by filling in a prescribed voting form that is to be delivered to the court before the voting hearing commences. If creditors do not deliver the form timely or the voting form is unclear, they will be presumed to have voted for the approval of the restructuring plan.

Creditors are divided into voting classes depending on the nature of their claims. Each formed class votes separately and it is presumed that the restructuring plan is accepted if, in each class, a majority of creditors voted in favor of the plan and the sum of claims of the creditors who voted for the plan exceeds twice the sum of claims of creditors who voted against the plan.

If such majority is not accomplished in a specific class, it is possible for a majority of creditors to override dissenting creditors (‘*cross-class cram-down*’). In that case, the restructuring plan will be presumed as accepted, but this is possible only with the debtor’s consent or upon his proposal. Also, the following conditions must be fulfilled: (i) the creditors of the dissenting class are not put in a worse position as a result of the restructuring plan than they would have been if the restructuring plan had not existed, (ii) the creditors of the dissenting class participate appropriately in the economic benefits to be accorded to the participants under the restructuring plan, and (iii) a majority of classes have accepted the restructuring plan by the required majority, provided that at least one of the classes that has accepted the plan must not be a group of shareholders or a class of creditors with lower payment claims within the meaning of the IA.

What effects does the restructuring plan have?

After the restructuring plan is accepted by the creditors and approved by the court, the now approved restructuring plan has legal effect towards all its participants. The claim of a creditor who has not filed his claim in the restructuring proceedings, although duly notified of its opening, may be settled only in the manner, within the time limits and under the conditions provided for in the restructuring plan for the claims of the appropriate class of creditors to which he would have been placed.

A debtor whose obligations have been written off on the basis of an approved restructuring plan shall be obliged to keep the resulting profit until the expiry of the deadline for fulfilling all obligations arising from the restructuring plan.

At the same time, a creditor who, in accordance with an approved restructuring plan, writes off a claim against the debtor, the amount of the written-off claim shall be determined as a tax-deductible expense.

Are (interim) financing arrangements protected?

Yes, to an extent. New financing and interim financing are generally protected. This protection is twofold. In case of subsequent liquidation proceedings: (i) the creditors who provided new financing or interim financing in the restructuring procedure will have a privileged payment priority rank, and (ii) their claims are generally undisputable.

Is there a simplified restructuring procedure?

The IA does not envisage a simplified restructuring procedure.

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Restructuring frameworks undergoing change
Implementation of the Restructuring Directive

Hungary

Wolf Theiss

Hungary: sneak peek at the new restructuring regime

Implementation of the Restructuring Directive

The Directive (EU) 2019/1023 on Restructuring and Insolvency represents a fundamentally new era for restructuring measures outside of insolvency. Restructuring frameworks should, above all, enable debtors to restructure effectively at an early stage and to avoid insolvency, thus limiting the unnecessary liquidation of viable companies.

By implementing the Directive into Hungarian law, important changes were introduced in the Hungarian legal system.[1] The new regime will constitute a radical change compared to the existing regime concerning restructuring, insolvency and discharge of debt.

The most striking features – a first overview

The new restructuring measures provide a new concept in the existing gap between contract-based restructuring and formal insolvency proceedings. The novelties in the new set of measures include the following points below.

When can a restructuring process be initiated?

According to the restructuring rules, the debtor may decide on restructuring if there is a likelihood of insolvency. The likelihood of insolvency means a situation in which there are reasonable grounds for believing that the debtor will be unable to meet its outstanding payment obligations when they fall due, unless further measures are taken. The aim of restructuring is to adopt and implement a restructuring plan with some or all of the creditors, thus preventing the debtor's future insolvency and ensuring the debtor's viability.

There is an important distinction between insolvency and the threat of insolvency which are defined under the Bankruptcy Act, which allows for the opening of liquidation proceedings.

Within the scope of the Restructuring Act, a debtor is a legal person carrying out economic activities, except for certain entities which cannot be debtors in restructuring (for instance an insurance company, a credit institution).

1 Act No. LXIV of 2021 on Restructuring, implementation of the Directive (EU) 2019/1023 on Restructuring and Insolvency

The debtor's decision-making body cannot take a decision to open restructuring procedure if bankruptcy or liquidation proceedings are pending. In other words: (i) if restructuring procedure is pending, bankruptcy proceedings cannot be opened; (ii) if the court, at the debtor's request, orders a moratorium, the creditor affected by the moratorium cannot in the meantime initiate liquidation proceedings.

A restructuring decision cannot be taken if 3 years have not yet elapsed since the start of the previous restructuring procedure.

What documents are required?

The debtor's decision-making body decides on restructuring on the basis of a proposal by the chief executive officer which includes, among others, the following: (i) the debtor's assets and financial situation, (ii) facts and circumstances supporting the likelihood of insolvency and that there are no legal obstacles to the decision on restructuring, (iii) the affected creditors' claims, (iv) any changes affecting the debtor's operations during the restructuring, (v) legal, economic and other aspects justifying the need for restructuring, (vi) circumstances which make it likely that negotiations with creditors can be successfully conducted and the restructuring plan can be accepted.

The request to open the restructuring procedure shall be submitted by the debtor. The request shall be accompanied by the debtor's decision on restructuring and the debtor's interim balance sheet not older than 6 months and the last available financial statements.

What is a restructuring plan?

The restructuring plan is the key element of the restructuring procedure as the aim of restructuring is to prepare a restructuring plan which is confirmed by the creditors. It is precisely the restructuring plan that allows the debtor to restore its economic and financial situation.

According to the general principles, restructuring measures shall ensure equal treatment of creditors of the same class and the restructuring plan shall not be targeted only at partial or total waiver of creditors' claims. As required by law, the restructuring plan has a minimum content but may contain additional explanations (for example criteria on the basis of which creditors are classified).

How is the restructuring plan voted on?

For the purpose of adopting a restructuring plan, the affected creditors' claims are grouped into the following classes: (i) secured creditors' claims, (ii) creditors' claims related to the debtor's economic activity, (iii) other creditors' claims, (iv) creditors' claims arising from transactions which are of interest to the debtor. This order of the creditors' classes does not constitute an order of satisfaction.

The debtor and the affected creditors who have the right to vote are involved in the adoption of the restructuring plan. Voting on the restructuring plan takes place in a meeting of creditors requiring personal attendance or by decision without a meeting. The plan must be approved by a numerical majority of the affected creditors with voting rights in each class of creditors, and a majority of the total number of votes that can be cast in that class of creditors is necessary.

In the restructuring procedure, it is possible for a majority of creditors to override dissenting creditors ('*cross-class cram-down*'). If the restructuring plan is not deemed to have been adopted – but it has been approved by at least one class of creditors – the debtor, the equity holders who have majority control or the affected creditors with voting rights (with the debtor's agreement) may file a request with the court regarding confirmation of the restructuring plan, making it binding upon the dissenting creditors and the creditors' classes.

What effects does the restructuring plan have?

Creditors vote on whether to accept the proposed restructuring plan, but the final confirmation rests with the court.

The restructuring plan is accompanied by the debtor's statement that the creditors' claims not affected by the restructuring plan are covered and the debtor must state that the implementation of the restructuring measures will not deprive non-affected creditors of the funds to satisfy their claims.

In order to facilitate negotiations on the restructuring plan and to ensure that the restructuring goal is achieved, the court may, on the application of the debtor, order a stay of individual enforcement actions (moratorium). The stay of individual enforcement actions may be general, covering all creditors, or it may be limited, covering one or more individual creditors or categories of creditors. The duration of a stay of individual enforcement actions shall be the duration defined in the application of the debtor, but it shall be limited to a maximum period of 4 months. The total duration of the stay of individual enforcement actions, including extensions and renewals, shall not exceed 12 months.

During the period of a stay of individual enforcement actions, the creditors to which the stay applies shall not initiate enforcement proceedings, liquidation proceedings against the debtor, and shall not set-off their claims. The time limits for launching a litigation to enforce pecuniary claims are extended by the duration of the stay of individual enforcement actions, but the stay does not affect pending litigations. During the period of a stay of individual enforcement actions, the debtor is also entitled to a payment moratorium in respect of the creditors' claims that became due before the stay.

Are (interim) financing arrangements protected?

Yes. Under a restructuring plan, new financing and interim financing is largely protected against insolvency clawback mechanism. Following the failure of restructuring, the creditors, who provided new financing or interim financing in the restructuring procedure have a privileged status in the ranking of liquidation priorities in liquidation proceedings.

Is there a simplified restructuring procedure?

No.

Takeaways

The new Restructuring Act shall enter into force on 1 July 2022 and represents a new era for restructuring law outside of insolvency. Overall, it remains to be seen whether the new restructuring process will indeed foster the resolution of insolvency situations and will change the approach of debtors and creditors and thus change current practice, which would be a positive development. We draw attention to the following:

- Restructuring measures encourage debtors to apply for restructuring at an early stage of their financial difficulties as they remain in control of their assets and the day-to-day operation of their business.
- The new restructuring procedure enables creditors to actively participate in the choice of measures envisaged in relation to the objectives of the restructuring operation, and creditors are granted special procedural rights during the restructuring procedure.
- A restructuring practitioner assists the parties with negotiating and drafting a restructuring plan and supervises the debtor's activities but without the debtor losing control of its business.

- In restructuring procedures, the stay of individual enforcement actions (moratorium) does not automatically apply to all creditors. The purpose of the protection is to give the debtor sufficient time to negotiate a restructuring plan with the affected creditors in order to continue and restore the financial situation when it appears likely that the debtor's insolvency may be prevented. The stay of individual enforcement actions can be general or limited. A limited stay of individual enforcement actions covers one or more creditors or a group of creditors based on the debtor's decision. Considering that a court order on a limited stay is not published, creditors (in particular financial creditors) will not be aware of the stay and hence it will not affect any other contractual relations of the debtor.
- The Restructuring Act lays down minimum standards for the content of a restructuring plan, so the debtor and creditors may formulate a plan which may contain additional explanations and key factors. The restructuring plan on the one hand focuses on the payment extensions expected from the creditors, on the other hand contains measures undertaken by the debtor.
- Generally, some creditors can have contractual rights, provided for in so-called ipso facto clauses, entitling them to terminate or modify a contract solely on account of insolvency of the debtor, even if the debtor has duly met its obligations. In restructuring procedures, creditors are not allowed to invoke ipso facto clauses which make reference to the restructuring or the stay of individual enforcement actions.
- As an important creditor protection rule, it should be recognised that satisfying the 'best interest of creditors' test means that no dissenting creditor is worse off under a restructuring plan than in liquidation proceedings.
- An important feature of the restructuring plan is the so-called cross-class cram-down. It allows the debtor to apply to the court for approval of a restructuring plan, even where there are dissenting creditors' classes, and the court may approve such a restructuring plan if certain conditions are met. This is to ensure that creditors do not unduly impede the adoption of a restructuring plan which will make the debtor viable again.
- Last but not least, from a precautionary point of view, restructuring measures should be considered if a debtor in financial difficulties is not economically viable or cannot be readily restored to economic viability, and the restructuring efforts could result in the accumulation of losses to the detriment of creditors. Therefore, in case of non-viable businesses with no prospect of survival, the insolvency proceedings should be considered.

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Restructuring frameworks undergoing change
Implementation of the Restructuring Directive

Slovak Republic

Wolf Theiss

Slovakia: latest changes to insolvency legislation

Implementation of the Restructuring Directive

New Slovak legislation on preventive restructuring – "An ounce of prevention is worth a pound of cure."

On 16 March 2022, the Slovak Parliament passed the Act on Resolution of the Imminent Insolvency and on changes and amendments to certain acts (the Act), implementing the EU Directive on restructuring and insolvency1. The Act became effective as of 1 May 2022; however, most of its provisions will become effective as of 17 July 2022.

Among other things, the Act introduced a new legislative framework for preventive restructuring. The preventive restructuring is designed as an early intervention procedure for businesses which find themselves in financial difficulties, while still being at the stage when the company is not technically insolvent and can be preserved as a going concern. As such, preventive restructuring offers an alternative to more invasive insolvency-driven procedures such as bankruptcy or formal court-administered restructuring.

Although informal standstill arrangements between debtors and their key creditors have been used in practice even before the adoption of the new legislation, the formal recognition of preventive restructuring is widely considered as a step in the right direction. While it is too early to judge whether the new legislation will in fact achieve the desired impact and some of its aspects would certainly require further clarification and fine tuning, the early sentiment from the business community is welcoming towards the changes.

Imminent insolvency – new rules

A corporate debtor may consider preventive restructuring as a route to solving its financial difficulties if it meets the test of imminent insolvency.

Even though the concept of imminent insolvency as such is not completely new in the Slovak insolvency regulation, the term has lacked a comprehensive definition backed by consistent practice. Although the exhaustive definition of imminent insolvency continues to be missing, the new legislation clarifies that a debtor is in imminent insolvency particularly when it is at risk of cash-flow insolvency. This condition is satisfied when, considering all circumstances, a debtor can reasonably expect to become cash-flow insolvent within 12 calendar months.

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

The definition and consequences of cash-flow insolvency are also set to change. Until 16 July 2022 (i) a company is deemed to be cash-flow insolvent when it has more than one creditor and more than one financial obligation 30 days overdue, provided that such overdue obligations are not covered by the company's financial assets. In the event of cash-flow insolvency, there is no statutory obligation for the company (and its directors) to apply for bankruptcy – this statutory obligation exists only if the company meets the balance sheet insolvency test.

Under the new legislation a company will be deemed to be cash-flow insolvent when it has more than one creditor and more than one monetary obligation 180 days (during the period from 17 July 2022 to 31 December 2022) or 90 days (from 1 January 2023 onwards) overdue, provided that such overdue obligations are not covered by the company's financial assets. In the event of cash-flow insolvency occurring as from 17 July 2022, the company (and its directors) will be obliged to apply for bankruptcy.

The above changes are designed to incentivise companies to take a more forward-looking approach to their cash-flow projections and, in the event of expected financial turbulences, consider preventive restructuring as a solution to their financial difficulties well in advance.

Proactivity and transparency as key imperatives

If the company decides to resolve its imminent insolvency in preventive restructuring, directors of the company are obliged to act proactively with a view to finding a consensual arrangement in cooperation with the company's creditors.

The element of proactivity is vested under the broadened scope of duties associated with imminent insolvency. A company must continuously monitor its financial condition as well as the state of its assets and liabilities, in order to detect imminent insolvency in a timely manner. If an imminent insolvency occurs, the company must take appropriate measures to avert it without undue delay.

If the company is listed in a public registry of debtors (e.g. due to unpaid taxes, social security or health insurance levies etc.), this automatically signals that it may be at risk of imminent insolvency and the company must make an assessment to determine whether the risk of imminent insolvency exists. If the directors of the company do not possess sufficient expertise to make such an assessment, they are obliged to seek expert advice for this purpose.

Hand in hand with a more proactive role of the directors, the Act emphasises the role of advisors who will assist companies and their directors in their decisions concerning imminent insolvency and potential preventive restructuring. As a part of its role, the advisor prepares and comments on cash flow projections, income and cost projections, analysis factors affecting sustainability of the debtor's business and its ability to continue as a going concern, and provides opinions on draft restructuring plans and matters relating to the resolution of the debtor's imminent insolvency, among other things.

The new legislation also addresses the information asymmetry which may exist between the company facing an imminent insolvency and its creditors by emphasizing transparency and imposing an explicit obligation on directors to: (i) provide creditors with all important information for the purposes of making informed decisions and, (ii) refrain from any actions which could potentially frustrate the aims of preventive restructuring.

Private preventive restructuring

Preventive restructuring can be conducted as either a private or a public process.

Private preventive restructuring can be agreed between one or more institutional creditors (supervised either by the National Bank of Slovakia or an equivalent foreign regulator) and the debtor who is in imminent insolvency, and who is not subject to the effects of other bankruptcy or restructuring proceedings. Private preventive restructuring proceedings commence upon notification of the debtor to the competent court, provided that the debtor can give such notification only with the prior consent of the creditors being party to the private preventive restructuring proceedings.

Within three months of the notification of commencement of the private preventive restructuring proceedings, the debtor must submit to the court for its approval the concept of the preventive restructuring plan. If the debtor fails to do so, the private preventive restructuring proceedings are automatically terminated.

The Court shall reject the concept of the plan if it finds it potentially damaging to the economic interests of creditors who are not party to the private preventive restructuring. If the court approves the concept of the plan or fails to reject it within 15 days of its submission, the plan is deemed to be approved.

As opposed to publicly-held preventive restructuring, the approved plan in the private preventive restructuring is legally binding only upon creditors who have agreed to it, but not on other creditors.

Public preventive restructuring

In order to initiate a public preventive restructuring the debtor must submit an application to the competent court. The concept of the public preventive restructuring plan must be attached to the application.

The concept of the plan must be certain, comprehensible, realistic, sustainable, preferably consensual, and should contain all the necessary information for the affected creditors in order to vote on the public plan in an informed manner. Among other technical details, the concept of the plan must contain the debtor's cash-flow projections for the upcoming 6 months.

For the sake of transparency, at the time when the application for public preventive restructuring is filed, a debtor must be registered in the Slovak registry of public sector partners – a step requiring disclosure of the ultimate beneficial owner.

The Act provides for a list of parameters, upon which the competent court shall assess an application for public preventive restructuring. A court may only approve public preventive restructuring if: (i) the debtor is in imminent insolvency, (ii) the business of the debtor is considered viable (in Slovak "životaschopný»); and (iii) there is no other obstacle stipulated by the Act.

Further, the Act provides for a demonstrative list of scenarios when the business of the debtor shall not qualify as being viable. Among other things, these include situations where (i) there are grounds for debtor›s dissolution, (ii) the debtor was already dissolved or entered into liquidation, (iii) the debtor is subject to the effects of other insolvency or restructuring proceedings, (iv) a third party commenced court-ordered enforcement proceedings (in Slovak: exekúcia) or enforcement of security in respect of debtor's assets and the debtor is unable to prove that the underlying debt owed by it to such a third party has been duly discharged; (v) the debtor failed to comply with its accounting obligations or its obligation to file the annual accounts; or (vi) the debtor has taken other actions threatening its financial stability (which includes payment of dividends or other equity distributions affected over the previous 12 months).

The court shall decide on the approval of the proposed public preventive restructuring within 10 days of the date of receipt of the completed application.

Once the court has approved the public preventive restructuring, the court would also appoint a trustee (selected on a random basis from the register of trustees kept by the Ministry of Justice) whose role is to oversee the debtor and its business in the course of public preventive restructuring. In the case of public preventive restructuring, the appointment of a trustee is not automatic – it is only required if: (i) as a part of the public preventive restructuring the court has also granted the debtor with temporary protection (see below), (ii) the appointment of a trustee was proposed by the debtor or by the majority of its creditors; or (iii) based on the concept of the plan there are reasonable grounds to believe that a certain class of creditors affected by the public preventive restructuring would not approve the plan and the debtor would need to seek a court's decision substituting such creditor's approval. The debtor shall bear fees and expenses incurred by the trustee, unless the appointment of a trustee has been proposed by creditors (in which case they shall bear the costs jointly and severally).

Temporary protection during public preventive restructuring

Once the court has approved the public preventive restructuring it can also grant temporary protection to the debtor for the duration of three months. The court may grant temporary protection to the debtor only if such a measure has been approved by (i) the majority of creditors holding claims which do not qualify as related-party receivables, or (ii) at least 20% of all creditors (calculated based on the total amount of claims which do not qualify as related-party receivables) provided that pursuant to the concept of the plan the proposed write-off (if applicable) does not exceed 20% of claim(s) and the proposed extension of maturity (if applicable) does not exceed one year for any of the creditors.

The decision of the court to award the debtor with temporary protection gives rise to significant protective effects. The debtor is protected against bankruptcy, restructuring, execution and enforcement proceedings. Similarly, it is not permitted to enforce any pledges against the assets of the debtor nor to set off a related-party claim against the debtor.

In case of a default of the debtor which occurred before temporary protection was granted, the creditor may not (over the duration of the temporary protection) terminate the contract, withdraw from the contract, refuse performance under the contract nor change the content of the rights or obligations under the contract. Further, the creditor is not permitted to terminate any financing agreements with the debtor, which was agreed before the temporary protection was granted on the grounds that the debtor does not fulfil the agreed financial covenants.

Hand in hand with the protective effects described above, the discretion of the debtor is limited over the duration of the temporary protection. As a part of their consent with the temporary protection, the creditors may determine which actions of the debtor are subject to the approval of the designated advisors. In addition, the debtor is generally obliged to limit its activities to actions which do not materially alter the composition of his assets. Other actions of the debtor are permitted subject to the approval of the creditors committee.

Affected vs. unaffected creditors

The public preventive restructuring is legally binding on all affected creditors.

In general:

- any creditors whose claim arose before the decisive date2 as well as;
- shareholders of the debtor, to the extent that the plan contemplates the sale, transfer or issue of new shares in the debtor, a merger, amalgamation, division or change in the legal form of the debtor, or a change in the memorandum, Articles of Association or other similar documents of the debtor,
- qualify as affected creditors for the purposes of public preventive restructuring. That said, certain categories of creditors (e.g. employees, minor creditors, tax and customs authorities, etc.) are expressly named as unaffected creditors and, as such, exempted from the effects of the public preventive restructuring.

Voting on the plan and cram down

Once the competent court has approved public preventive restructuring, the debtor shall convene a creditors' meeting, which shall be held no earlier than 60 days and no later than 70 days after the court's approval of the public preventive restructuring. The purpose of the creditors' meeting is to inform the affected creditors of the reasons for the imminent insolvency, to present them with the plan and to invite them to vote on the adoption of the plan. Any creditor claiming to be an affected creditor has the right to attend the creditors meeting. The trustee, the debtor's advisor and the judge overseeing the public preventive restructuring shall also attend the creditors meeting.

The plan is subject to approval by the respective classes of creditors. For this purpose, a separate creditors class shall be created for: (i) each secured creditor, (ii) unsecured creditors, (iii) creditors of claims which qualify as related-party receivables, (iv) subordinated creditors, and (v) shareholders.

The Act prescribes detailed thresholds by which the plan must be approved by individual creditors classes.

2 The first day of the calendar month preceding the calendar month in which the application for public preventive restructuring was submitted to the court.

The debtor may request the court to confirm the plan within 7 days after the creditors' meeting was held. In parallel with the application to the court, the debtor must forward the confirmation application to each of the creditors who voted against the adoption of the plan at the creditors meeting. Such non-consenting creditors may file their objections against proposed confirmation of the plan within 10 days following their receipt of the confirmation application. The court shall rule on the application for confirmation of the plan within 30 days following the lapse of the statutory period during which the non-consenting creditors could file their objections against the application. If the plan has not been approved by one or more creditors classes, the debtor may, along with its application for confirmation of the plan, apply for a court's decision substituting approval by the respective creditors class (cram down decision). The Act specifies detailed conditions which must be satisfied in order for the court to issue a cram down decision. This is to ensure fair treatment of different creditors classes and prevent abuse of the cram down mechanism in the public preventive restructuring,

Expected impacts in practice

While the introduction of legislative framework for preventive restructuring in Slovakia is widely perceived as a positive development, from a business point of view the current status quo is generally seen as work in progress rather than a final cut.

One of the key topics which continues to be unresolved is the tax treatment of creditors' claims during preventive restructuring. In case of bankruptcy or formal court-administered restructuring, a creditor who filed its claims in the said proceedings can create provisions in respect of such claims and benefit from their tax deductibility. No such regime currently exists in respect of the preventive restructuring which, from a tax perspective, is likely to make preventive restructuring a less attractive option for creditors compared to bankruptcy or formal court-administered restructuring. Consequently, it is expected that, as a part of their decision-making, banks and other creditors will meticulously calculate the financial viability of the preventive restructuring, including the tax elements, against the anticipated costs in standard insolvency proceedings. Against this background, there is a strong argument that further amendments are needed to make the tax treatment of claims in a preventive restructuring more creditor-friendly, in order to incentivise the creditors to proceed with preventive restructuring instead of formal insolvency proceedings such as bankruptcy or formal court-administered restructuring.

Aside from implementing the new framework for preventive restructuring, the new legislation also introduced a handful of noteworthy changes into the formal insolvency proceedings, in particular in the field of digitisation. These include the requirement to conduct acts related to bankruptcy and insolvency proceedings in electronic form (including claims filing) as well as the option to hold creditor meetings by means of video conferences. The outlined changes have been implemented with the aim of making insolvency proceedings more creditor friendly and less administratively burdensome, an initiative which was supported and well received by the local business community.

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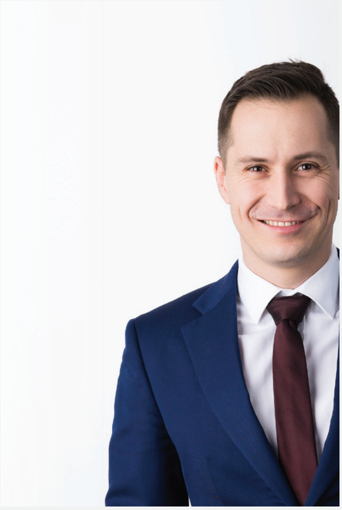

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Restructuring frameworks undergoing change
Implementation of the Restructuring Directive

Slovenia

Wolf Theiss

Slovenia: draft amendment to the Insolvency Act in limbo

Implementation of the Restructuring Directive

Background of the current status of implementation

As the 17 July 2022 deadline for Slovenia to implement the Directive (EU) 2019/1023 on Restructuring and Insolvency ("***the Directive***") is fast approaching, it is still not entirely clear exactly when and how its provisions will be transposed into Slovenian law.

A draft amendment of the main Slovenian insolvency law, the Financial Operations, Insolvency Proceedings, and Compulsory Dissolution Act ("***Insolvency Act***") that (among several other topics) provides for transposition has been in circulation among various state authorities and the interested public for over a year. This draft was prepared under the previous government; however, it has not been finally confirmed by the executive, nor has it been proposed to the National Assembly for adoption.

The necessity for insolvency law reform has been mentioned as necessary by the newly elected Government; nevertheless, whether or not it will adopt the draft in its current form remains to be seen.

In the course of public consultations, there have been notable criticisms to the proposed changes. The re-composition of the Government and National Assembly may offer those voices an opportunity to revisit these issues and pressure for different solutions.

The new Government and National Assembly would have to move quickly, if the deadline for transposition of the Directive is to be respected. However, Slovenia has missed such deadlines in the past, and it is conceivable that it may happen again, considering the broad scope of other legislative reforms announced by the Government.

Against this backdrop, it is impossible to accurately predict if, when and in what form the current draft amendment of the Insolvency Act will be adopted. Nevertheless, it remains possible that the mechanism of implementation of the Directive provided under the draft may survive any potential redrafts.

Contemplated scope of implementation

The current Insolvency Act already provides for a preventive restructuring mechanism for companies at risk of becoming insolvent within one year. The preventive restructuring process was introduced in late 2013 and provides for the restructuring of financial receivables of small, medium and large companies.

The process is a mix of contractual and court restructuring. It is formally initiated by the court and stops all enforcement of financial receivables. The debtor proposes the initiation of the process; however, creditors holding over 30% of all financial receivables must consent to it, and creditors holding over 30% of all financial receivables may validly oppose it.

The product of a successful preventive restructuring process is a financial restructuring agreement. This agreement, however, needs to be confirmed by the court in order to take effect. If creditors holding over 75% of the financial receivables consent to the financial restructuring agreement, it is confirmed. Thereafter, it bindingly regulates all financial receivables of the company, regardless of whether an individual financial creditor provided their consent or not.

Under the available draft amendment of the Insolvency Act, the above process would remain as is. However, a second, broader process would be introduced that expands the scope of preventive restructuring to companies of all sizes (with the exception of banks and insurance companies) all types of receivables.

This so-called “court restructuring process due to threat of insolvency” essentially mirrors the existing compulsory settlement model, applicable in situations where the debtor has already become insolvent. There are, however, three notable differences between the compulsory settlement and the new court restructuring process:

- there is no possibility of a debt-to-equity swap under the court restructuring process;
- unlike with compulsory settlements, creditors cannot initiate the court restructuring process;
- if the court restructuring process is unsuccessful, the court does not automatically initiate bankruptcy proceedings (which is the case in compulsory settlement proceedings).

When would a court restructuring process be initiated?

The draft amendment of the Insolvency Act provides that a court restructuring process may be initiated, if the debtor is at risk of becoming insolvent within a year. The aforementioned condition is deemed as fulfilled if creditors holding over 30% of all receivables against the debtor agree with the initiation of the process.

The process may not be initiated if:

- less than three years have passed since the debtor has fulfilled its obligations under a confirmed compulsory settlement;
- less than two years have passed since (i) the debtor withdrew a proposal for compulsory settlement or (ii) such a proposal was rejected by the court (and bankruptcy proceedings were not initiated);
- the debtor has not fulfilled their duties in respect to submission of annual reports in accordance with the Slovenian Companies Act;
- the debtor submitted false, incorrect or incomplete data to the tax authority, which resulted in a subsequent imposition of additional tax obligations exceeding EUR 4,000;
- the debtor was convicted of a criminal offence in relation to employment relationships, assets, the economy or transactions.

The initiation of the process may be proposed by the debtor or by the personally-liable shareholder(s) of the debtor.

What would be the effects of initiation?

Once the court restructuring process is initiated, all ongoing enforcement and security proceedings against the debtor would be stopped, and new proceedings would not be initiated for a period of up to four months following initiation. It is possible to extend this period for up to 12 months.

The management of the debtor would become supervised by the court and a court-appointed administrator. Further, contracts essential for the ongoing operation of the debtor could not be terminated during this period.

Which documents would be required?

With its proposal for the initiation of the court restructuring process, the debtor would have to provide the following documents:

- a report on the financial situation and operation of the debtor;
- an auditor's report on the above containing an opinion with no reservations;
- a financial restructuring plan;
- a report from a certified business appraiser with a positive opinion.

The financial restructuring plan could offer creditors a reduction of their receivables and interest rates and / or an extension of the term of repayment.

How is the restructuring voted on and what is the result?

The voting on the restructuring plan would be the same, as in the compulsory settlement proceedings. Each individual receivable is multiplied by a particular quotient, depending on the nature of the receivable (secured, unsecured, conditional unsecured, etc.). The restructuring is confirmed, if creditors holding an amount of at least 60% of the multiplied total of the receivables against the debtor vote in its favour.

The restructuring would be confirmed by the court and would regulate all the receivables covered under the plan. The court decision would also constitute a directly enforceable title for such receivables in the event that the debtor fails to meet its obligations under the confirmed restructuring.

Is there a simplified restructuring procedure?

The Insolvency Act provides for a relatively simplified procedure for the restructuring of financial receivables with less procedural burdens and formal requirements, as well as less court interference.

In respect to the court restructuring process, the rules for a simplified compulsory settlement for small businesses would also apply to court restructurings of such enterprises (no auditor or certified business appraiser's opinion would have to be obtained, among other simplifications).

Takeaways

The Insolvency Act is already considered one of (if not the most) complex and challenging pieces of legislation due to many inconsistent and unclear rules. This is particularly the case with respect to rules governing compulsory settlements, where courts and legislators alike have struggled to strike an adequate balance between ensuring the continued operation of the debtor and the interests of creditors.

The draft amendment of the Insolvency Act contains very few provisions specifically regulating the new court restructuring process; instead, the process is governed almost exclusively by the existing rules of compulsory settlement proceedings. This approach may be problematic in several ways:

- all the issues of compulsory settlement proceedings that have not been properly addressed either in legislation or judicial practice will be transferred to the pre-insolvency court restructuring process;
- the compulsory settlement proceeding is a "last chance" proceeding – an alternative to bankruptcy and liquidation, once the debtor is already insolvent. The direct application of its rules to a pre-insolvency situation without clear guidance or proper re-calibration opens an entirely new set of challenges and uncertainties that will take a considerable amount of time to uniformly resolve through the courts;
- larger creditors holding decisive influence over the outcome of any restructuring effort would appear to have very little incentive to agree to such process or vote in favour of such restructuring, as they are likely to find existing alternatives of voluntary out-of-court contractual restructurings and compulsory settlements much more attractive[1];
- the process would be as cost-, effort- and time-intensive for the debtor, as a compulsory settlement proceeding. However, a court restructuring process does not contain the implied threat of liquidation inherent to a compulsory settlement proceeding, which serves as a motivator for creditors to agree to the proposed settlement terms. Coupled with considerations under point iii., there may be comparatively few incentives for debtors to consider the new court restructuring process as well.

1 Compulsory settlement proceedings provide larger creditors with the possibility to (i) initiate the proceeding and drive the proposed settlement and restructuring measures, (ii) take over the management of the debtor during the proceeding, and (iii) to force a debt to equity swap, which provides them with the opportunity to reap the rewards of a successful turnaround beyond a proportionally higher repayment of their receivables than in the case of bankruptcy. The same may in essence be provided in voluntary out-of-court restructurings; however, this is not the case in the currently envisioned pre-insolvency court restructuring proceeding.

To sum up, while the draft amendment of the Insolvency Act does formally provide new restructuring tools in line with the Directive, their practical value would appear to be severely limited. These tools would appear most useful to companies that have a dispersed debt structure and principally require the restructuring of unsecured commercial claims.

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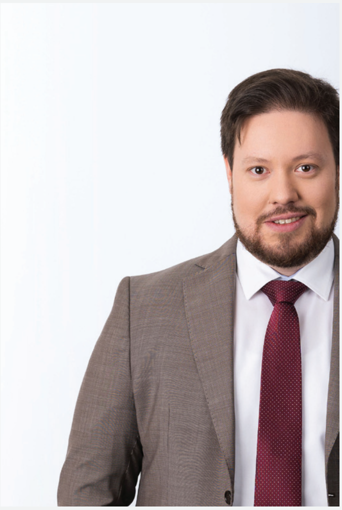

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