DISTRESSED M&A

Poland

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Distressed M&A

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Quick reference guide enabling side-by-side comparison of local insights, including market climate and legal framework; transaction structures and sale process; due diligence and mitigation of related risks; valuation and financing; documentation; regulatory and judicial approvals; dispute resolution; and recent trends.

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MARKET CLIMATE AND LEGAL FRAMEWORK

Market climate

How would you describe the general market climate for distressed M&A transactions in your jurisdiction?

Distressed M&A transactions occurred very rarely in Poland at the time of the economic boom following Poland's accession to the European Union. During the upcoming crisis associated with the war in Ukraine, distressed M&A transactions are much more likely to occur in various business sectors, including construction, food, automotive, steel and other sectors with high consumption of energy. While the distressed funds have a great appetite for these types of projects, likely buyers will also be quite opportunistic, including strategic players.

Law stated - 29 September 2022

Legal framework

What legal and regulatory regimes are applicable to distressed M&A transactions in your jurisdiction?

There is no specific legal regime applicable to distressed M&A in Poland. The safest approach for an investor to enable an acquisition free and clear of encumbrances will be with the use of bankruptcy liquidation (pre-packed or classical), acquisition of assets in court enforcement proceedings or acquisition of (non-core) assets in deep reform restructuring proceedings. A riskier approach that is considered on various occasions (due to the length and unpredictable nature of court proceedings and other delaying factors) would be the use of a more classical setting, including through a sale and purchase agreement or acquisition of a business as a going concern. The way to mitigate the legal risks involved would be to involve an insurer of transactional reps and warranties with the buyer named as the beneficiary of such insurance.

Law stated - 29 September 2022

Main risk in distressed M&A transactions

Summarise the main risks to all parties involved.

Shareholders of a distressed business do not arguably have any risk because there is no equity value prior to the launch of a distressed M&A. However, they may benefit from a certain upside in the future if the transaction is run as a share deal and they retain some equity that regains its value in the future. The buyers may suffer the costs if the process is competitive or not completed. If a potential M&A deal happens out of court on the verge of bankruptcy, there is also a risk that the deal negotiations may be interrupted by a bankruptcy filing and the appointment of a temporary administrator, whose consent to the distressed M&A deal would be rather unlikely.

The main risk, however, is the residual liabilities of the business if the acquisition does not occur by way of a sale that is statutorily free and clear of encumbrances. A recourse to directors or third parties who contributed to a loss may be limited.

Law stated - 29 September 2022

Director and officer liability and duties

What are the primary liabilities, legal duties and responsibilities of directors and officers in the context of distressed M&A transactions in your jurisdiction?

Directors and officers are truly conflicted in the course of transactions outside a bankruptcy or restructuring process because of their personal liability for the lack of a bankruptcy filing or commencement of restructuring steps (mitigated at the time of covid-19 in Poland in that the directors were not required to file for insolvency during the state of pandemic despite the satisfaction of insolvency tests). Hence, running an M&A process in the framework of restructuring proceedings would be the best solution for them. If it is out of court, they should seek to enter into a standstill agreement with their creditors, suspending the creditors' enforcement actions or bankruptcy filings.

Law stated - 29 September 2022

Differences from non-distressed M&A

In general terms, what are the key legal and practical differences between distressed and non-distressed M&A transactions in your jurisdiction?

The key difference would be the use of court procedures to achieve the effect of acquisition, free and clear of claims and encumbrances by the investor. If an acquisition is conducted out of court then insurance with respect to reps and warranties of the seller or management would be more critical than for non-distressed M&As.

Law stated - 29 September 2022

Timing of transactions

What key considerations should be borne in mind when deciding when to acquire distressed companies or their assets?

There may be several different considerations for particular transactions, but the following are arguably common to various types:

- comparison between the price pre-bankruptcy and in bankruptcy;
- whether a business is likely to operate during bankruptcy;
- deal complexity;
- potential impact of bankruptcy on the continuation of licences or concessions belonging to a business; and
- level of competition with the other potential investors and the likelihood of interference of the debtor's creditors with the process.

Law stated - 29 September 2022

TRANSACTION STRUCTURES AND SALE PROCESS

Common structures

What sale structures are commonly used for distressed M&A transactions in your jurisdiction? What are the pros and cons of each, and what procedures and legal requirements apply?

Asset sales (in bankruptcy or enforcement proceedings) and share sales in out-of-court transactions are dominant. Mergers are rather unlikely and loan-to-own transactions have not really occurred in the Polish market to-date.

Law stated - 29 September 2022

Packaging and transferring assets

How are assets commonly packaged and transferred in a distressed M&A transaction in your jurisdiction? What procedural, documentary and other requirements apply?

If a distressed deal is conducted out of court, there are effectively no differences in comparison to healthy M&As. As regards court procedures, single assets would typically be acquired in court enforcement proceedings, while an entire business would only be purchased in bankruptcy proceedings. Single assets could also be purchased in bankruptcy and deep reform restructuring proceedings, although the latter route is completely untested.

Law stated - 29 September 2022

Transfer of liabilities

What legal requirements and practical considerations should be borne in mind regarding the acceptance and transfer of any liabilities attached to the distressed company or assets?

If the buyer acquires distressed assets in the framework of the court procedures (bankruptcy, court enforcement or deep reform restructuring), the acquisition occurs free and clear of any claims (except for certain rights of a different nature, such as easements on the land in the case of a bankruptcy sale). Therefore, there is no transfer of liabilities. If the acquisition of a business occurs out of court, the general provisions of the Polish Civil Code concerning successor liability would apply. Another practical consideration is that the transfer of a business as a going concern only covers the rights held by the seller under the respective contracts. A separate arrangement with a counterparty to such contracts is necessary for the transfer of obligations under such contracts.

Law stated - 29 September 2022

Consent and involvement of third parties

What third-party consents are required before completion of a distressed M&A transaction? What are the potential consequences of failure to obtain these consents? In what other ways are third parties commonly involved in the transaction?

A sale during or in connection with court proceedings would obviously involve administrators, judge-commissioners, and bankruptcy or restructuring courts. Various consents and actions of the relevant office holders or judicial bodies would be required, absent which the sale would be invalid. In addition, both in the case of court-approved sales and out-of-court sales, antimonopoly clearances would be needed. The Polish Antimonopoly Office has also been recently empowered with a right to exercise control over foreign investments in designated sectors of economy from outside OECD countries (when the investors take control of businesses or acquire a 20 per cent equity stake). This legal regime also applies to distressed M&As. The consequences of a failure to clear would differ depending on the breach in question.

Law stated - 29 September 2022

Time frame

How do the time frames and timelines for the various transaction structures differ? Can these be expedited in any way?

If a transaction is conducted out of court, then there would not be significant differences with non-distressed M&As, although the negotiation and signing of a standstill agreement at the initial stage could significantly delay the process. Among the various court processes, the fastest would be a bankruptcy sale within an already opened and pending bankruptcy proceeding, although this is relative to the stage of bankruptcy proceedings that may have been pending for some time. A pre-packed bankruptcy happens at an earlier stage and is prepared ahead of bankruptcy filing and declaration. By way of such structure, the buyer and bankruptcy petitioner attempt to expedite the acquisition and minimise the period of operations of the business in bankruptcy.

However, the actual transaction can only be completed once the bankruptcy court has reviewed the bankruptcy petition along with the pre-pack motion and the court decision has become final and non-appealable (following the review of potential challenges from the creditors). Therefore, a pre-pack process lasting up to one year is not unusual. Sales during court enforcements are run by bailiffs and are fairly time-consuming. Sales of (non-core) assets within deep reform restructuring proceedings should be fairly quick (relative though to the stage of restructuring proceedings the debtor is in), but are completely untested.

Law stated - 29 September 2022

Tax treatment

What tax liabilities and related considerations arise in relation to the various structures for distressed M&A transactions in your jurisdiction?

Tax liabilities of the debtor do not attach to the assets upon a distressed sale that happens free and clear of claims and encumbrances. In the case of out-of-court sales, successor liability issues may arise. Distressed sales both within a court process and outside the court process are subject to the same transaction taxes, namely, VAT or civil transactions tax depending on the type of assets in question.

Law stated - 29 September 2022

Auction versus single-buyer sale process

What are the respective pros and cons of auction sales and single-buyer sales? What rules and common practices apply to each?

Like in the other sales processes, maximisation of price and competitiveness would be the principal reason for a seller to hold an auction. A buyer would obviously prefer being a sole bidder able to dictate the terms of sale. While auctions are, as a rule, used in court-approved transactions, proprietary deals would be more likely to happen in transactions run out of court. Despite the deal being run as an auction in the first place, a buyer would typically require exclusivity at the negotiations or even due diligence stage once the key terms of the deal have been agreed upon.

Law stated - 29 September 2022

DUE DILIGENCE

Key areas

What are the most critical areas of due diligence in a distressed M&A transaction?

While a distressed M&A transaction would likely not be very different from a healthy one in terms of operational due diligence, legal due diligence should focus not only on material risks pertaining to an acquired business, but also on certain factors that could be deal stoppers themselves, such as:

- potential insolvency of the company and timing of the directors' duty for bankruptcy filing;
- threatened insolvency filings or seizures by company creditors;
- pending insolvency or restructuring petitions;
- wrongful trading or fraudulent conveyances by the company directors;
- breach of covenants and cross-defaults by the debtor; and
- demand letters or acceleration by creditors.

The above considerations would not be relevant for court-approved deals where the acquisition occurs free and clear of claims and encumbrances. The most important element here would be the proper assessment of operational performance of the business and establishing the existence and quality of assets.

Law stated - 29 September 2022

Searches

What searches of public records should be conducted as part of a due diligence exercise in distressed M&A transactions in your jurisdiction?

Searches of public records in court-approved transactions are limited to the establishment of title to a particular asset if such assets are listed in a public register (real estate would be the most obvious example). Other elements corresponding to the due diligence areas listed in the previous section would need to be searched in the transactions taking place out of court. Searching the security coverage of secured creditors and insolvency filings against the seller would be a good example. Insolvency and restructuring filings, key announcements of decisions adopted in the pending insolvency and restructuring proceedings, and certain information about the assets comprising an insolvency estate can now be searched online in the public portal of the Central Register of Debtors. Access to more detailed information in the same register is reserved to the participants in relevant proceedings.

Law stated - 29 September 2022

Contractual protections and risk mitigation

What contractual protections and other strategies are commonly used to mitigate diligence gaps in a distressed M&A transaction?

No reps and warranties other than with respect to the physical condition of assets are made in the transactions approved by the court. However, the acquisition occurs free and clear of encumbrances and claims. While there are not many precedents for out-of-court transactions, insurance of reps and warranties of the seller or management is starting to be relied upon.

Law stated - 29 September 2022

VALUATION AND FINANCING

Pricing mechanisms and adjustments

What pricing methods, adjustments and protections are commonly used in the valuation of distressed M&A transactions in your jurisdiction and what are the pros and cons of each? How are they used to balance the interests of the parties?

Valuations make distressed M&As attractive for buyers and are always close to the liquidation value of an asset. With respect to protections, escrows may be used in out-of-court transactions, but in the case of enforcement or bankruptcy sales, the purchase price must be paid to the account of the administrator or the court account ahead of the completion, and this sequence cannot be reversed. The risk of a purchaser is almost non-existent in this respect, in that the grant of title is governed by the mandatory provisions of law. The auction mechanism has always been present in regular bankruptcy sales and the Bankruptcy Law was also amended in 2020–2021 to add further transparency rules and an auction mechanism to pre-pack sales, including the rules for bid bonds.

Law stated - 29 September 2022

Fraudulent conveyance

What rules govern fraudulent conveyance of distressed assets sold undervalue in your jurisdiction? How can clawback risks be mitigated when negotiating the deal price?

The main rules governing fraudulent conveyance are contained in three bodies of law:

- the Bankruptcy Law;
- the Restructuring Law (specifically with respect to deep reform restructuring proceedings); and
- the Civil Code (actio pauliana).

The issue of protections against clawback risks is irrelevant in the case of court sales owing to the nature of such sales and the free and clear effect of acquisitions. There are not many precedents for protections in out-of-court sales, but the most common routes are third-party valuations prepared by independent appraisers and escrow arrangements.

Law stated - 29 September 2022

Financing

What forms of financing are available and commonly used in distressed M&A transactions? How can financing be secured?

Following the addition of the Restructuring Law to the Polish legal System as of 1 January 2016, a legal infrastructure for financing of distressed business, including in connection with distressed M&A transactions, is in place. However, these amendments did not go as far as to introduce priming lien for rescue financiers. Yet, apart from the sale of non-core assets in deep reform restructuring proceedings (not really tested to date), there is no safe harbour for the acquisition of distressed assets free and clear of claims and encumbrances in connection with a pending restructuring.

Generally, Polish banks have to date shown little interest in the financing of distressed deals in connection with pending

restructurings. Out-of-court transactions have been funded from the equity of the buyers thus far. While the area of financing of distressed M&A transactions approved by the court is not well developed, there have been precedents for such transactions, and financing in this area is likely to grow, especially with respect to pre-packaged liquidations.

Law stated - 29 September 2022

Pre-closing funding

What provisions are typically agreed to secure pre-closing funding of distressed businesses and assets?

There are no standard provisions or precedents in this respect. Generally, Polish banks show little interest in the financing of distressed deals in connection with pending restructurings. Out-of-court transactions have been funded from the equity of the buyers thus far. While the area of financing of distressed M&A transactions approved by the court is not well developed, there have been precedents for such transactions, and financing in this area is likely to grow, especially with respect to pre-packaged liquidations.

Law stated - 29 September 2022

DOCUMENTATION

Closing conditions

What closing conditions are commonly agreed in distressed M&A transactions? How do these differ from non-distressed transactions?

Albeit the safest and most common, distressed deals approved by the court are the simplest type. The only and key condition to closing (which in bankruptcy proceedings would mean the signing of a purchase agreement but in court enforcement proceedings would not) is the payment of the purchase price into an administrator's or a court account. The purchaser could not expect any meaningful reps and warranties from the administrator and no reps from the bailiff.

Distressed sales effected out of court would resemble non-distressed transactions to a greater degree. Therefore, certain approaches from the latter, such as escrowing a portion of the purchase price, could well be adopted. Required regulatory approvals (including antimonopoly clearance) would be a condition in all types of transactions.

Law stated - 29 September 2022

Representations, warranties and indemnities

What representations, warranties and indemnities are commonly given in distressed M&A transactions?

Virtually no reps and warranties would be given in court-approved transactions other than with respect to the scope of assets sold. While the sale of assets would in principle occur free and clear of claims and encumbrances, they would be sold on an 'as is' basis. Reps and warranties could play a greater role in the transactions effected out of court. However, given the likely problems with recourse for the breach of such reps and warranties, buyers may seek an insurance of such reps and warranties. Such reps and warranties may be insured by a third-party insurer.

Law stated - 29 September 2022

Remedies for breach

What remedies are available and commonly sought for breaches of closing conditions, representations, warranties and indemnities in distressed M&A transactions?

Given that the distressed assets are sold free and clear of encumbrances and on an 'as is' basis in the course of bankruptcy sales and court enforcements (and are also subject to a court approval that needs to become final and non-appealable), there is hardly any space for disputes of the type common to regular M&A transactions. Such transactions would be practically irreversible (other than perhaps in connection with a fraud affecting the court approval process). Reps and warranties may be included in the transactions effected out of court, but the remedies may be limited for practical reasons, such as liquidation of the seller, hence the growing importance of insurance arrangements with third-party insurers.

Law stated - 29 September 2022

Insurance

Is warranty and indemnity (W&I) insurance available for distressed M&A transactions in your jurisdiction? If so, what provisions and exclusions are commonly included in W&I policies?

W&I insurance is becoming available for distressed M&A transactions in Poland. A typical exclusion would be with respect to fraud in relation to a transaction itself or the directors' or owners' behaviours in relation to the assets in question.

Law stated - 29 September 2022

REGULATORY AND JUDICIAL APPROVALS

Merger control

What merger control rules and filing requirements govern the acquisition of distressed businesses and assets in your jurisdiction? Is the 'failing firm' defence recognised in your jurisdiction?

Merger control rules and filing requirements under Polish law on the protection of competition and consumers may apply to the sale of distressed businesses. Acquisition of a failing firm by way of bankruptcy sale does not require an antimonopoly clearance unless the purchaser is a competitor of the bankrupt party.

Law stated - 29 September 2022

Foreign investment review

Are distressed M&A transactions subject to foreign investment review in your jurisdiction? What rules, procedures and common practices apply?

Yes. The Polish Antimonopoly Office has recently been empowered with a right to exercise control over foreign investments in designated sectors of economy from outside OECD countries (when the investors take control of businesses or acquire a 20 per cent equity stake). This legal regime also applies to distressed M&As. The consequences of a failure to clear would differ depending on the breach in question.

Law stated - 29 September 2022

Bankruptcy court

What rules and procedures govern the bankruptcy court's approval of distressed M&A transactions in your jurisdiction?

The administrator of a failed company procures the preparation of distressed valuation of the business at an early stage of the proceedings. Once this valuation is in place, the administrator organises a tender for the sale of business, which, including the terms thereof, needs to be approved by the judge-commissioner. In principle, the business needs to be disposed of in its entirety, and an approval of the judge-commissioner is required for a piecemeal liquidation.

The asking price in the tender typically corresponds to the distressed valuation in place. The first tender is rarely successful, and the next tenders are often at a lower asking price but not by more than 10 per cent. The administrator typically requires a deposit (up to 10 per cent of the purchase price) that works as security for completion. Once the administrator has received a bid matching the terms of tender, he or she can choose such bid, the selection of which is also subject to the formal approval of the judge-commissioner.

The insolvency administrator enters into the sale agreement once the entire purchase price is paid into his or her account. If the creditors' council has been appointed in the particular proceedings, it may also have a say regarding the bankruptcy sale. In particular, it may adopt a resolution setting a minimum price of sale and recommending that the administrator launches a free-hand sale that is typically also a kind of tender that is less formalised. Such resolution of the creditors' council would as a matter of practice be adopted not earlier than upon the closure of the first unsuccessful tender sponsored by the judge-commissioner.

In the case of a pre-packed sale, the rules are somewhat different, in that a bidder commissions the preparation of valuation by a licensed court appraiser and attaches it to its bid. If there is only one bid, the court approves the bid as long as the offered price is higher than the amount that may be recovered in liquidating insolvency minus the costs of proceedings and other debts of the insolvency estate arising in such proceedings. In the case of multiple bids, an auction among such bidders is mandatory. The auction is conducted in an open court hearing by the temporary court administrator or compulsory administrator (supervised by the bankruptcy court), who also chooses the winning bid. When issuing a decision of bankruptcy, the court also approves the selected bid. A decision of the bankruptcy court dismissing the motion for the approval of the bid (technically terms of sale) can be appealed by the debtor or the bankruptcy petitioner while a court decision approving the bid (terms of sale) can be appealed by the debtor and each of its creditors. Once the decision is final and non-appealable the sale agreement is signed by the buyer and insolvency administrator within 30 days following the court's decision becoming final and non-appealable. Within the same term, the insolvency administrator may move to set aside or amend the decision on the approval of terms of sale in case the circumstances have changed or have been revealed as having a significant impact on the value of assets subject to sale.

A potential court decision in this respect can be challenged and hence the entry or lack of entry into the sale agreement will eventually depend on the outcome of the proceedings commenced by a potential motion by the insolvency administrator. The above procedure serves as a safeguard of creditors' interests and potential maximisation of distributions to them, but is likely to be resorted to only in extraordinary circumstances.

Law stated - 29 September 2022

DISPUTE RESOLUTION

Common disputes and settlement

What issues commonly give rise to disputes in the course of distressed M&A transactions and what practical considerations should be borne in mind when seeking to settle such disputes out of court?

Court-approved deals are practically irreversible, although an administrator could arguably be sued in a court of common jurisdiction if he or she does not deliver according to the terms of contract. If the purchase price is not paid in its entirety upon completion of an out-of-court deal, the balance would likely be escrowed. It is conceivable that a dispute over the release of funds from the escrow could follow and such dispute could be subject to resolution by a court of common jurisdiction or arbitration. It would, as a rule, be difficult to chase sellers on the breach of reps and warranties because they could well be subject to liquidation. If not, they would tend to sell the assets 'as is'.

Law stated - 29 September 2022

Litigation and alternative dispute resolution

What litigation forums are used to resolve disputes arising from distressed M&A transactions in your jurisdiction and what procedures apply? Is alternative dispute resolution (ADR) commonly used?

Disputes in distressed M&A transactions taking place out-of-court could be resolved in courts of common jurisdiction or by arbitration. There are no precedents for ADR for such transactions.

Law stated - 29 September 2022

UPDATE AND TRENDS

Recent developments and outlook

What have been the most significant recent developments and trends affecting distressed M&A in your jurisdiction, including any notable court decisions, regulatory actions and deals? What is the general outlook for future transactions?

The largest distressed M&A transaction that has taken place in the Polish market was the sale of assets of the distressed wind farm group Inventus to Tauron Polska Energia in 2019 for approximately €137 million. The buyer also acquired the bank debt from the lender – Hamburg Commercial Bank AG. Interestingly, both in-court and out-of-court tracks were considered, with the parties eventually choosing the out-of-court route. Given the looming economic crisis, the number of distressed M&As in Poland is likely to grow during 2023.

Law stated - 29 September 2022

Jurisdictions

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