WOLF THEISS

THE WOLF THEISS GUIDE TO:

Restructuring Loans and Enforcement of Security in Central, Eastern & Southeastern Europe

2020 Edition

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Restructuring Loans and Enforcement of Security

This 2020 Wolf Theiss Guide to Restructuring Loans and Enforcement of Security 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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FOREWORD

Economies move in a cyclical pattern: expansion is followed by contraction, periods of boom end when economic indicators fall. Leverage incurred at a time of rapid growth may be excessively burdensome for debtors in a time of bust, with companies experiencing financial difficulties or facing insolvency.

However, financial distress also creates opportunities for restructuring, turnaround, and investment in distressed companies and assets. There is a wide range of possibilities provided by the law or crystallised in private restructuring techniques to save or reorganise viable businesses, or to commence insolvent liquidation if the distribution of assets among qualifying creditors is the only option. As complexities arise even in domestic restructurings, choosing the optimal restructuring technique in a cross-border context can prove a challenging task for stakeholders.

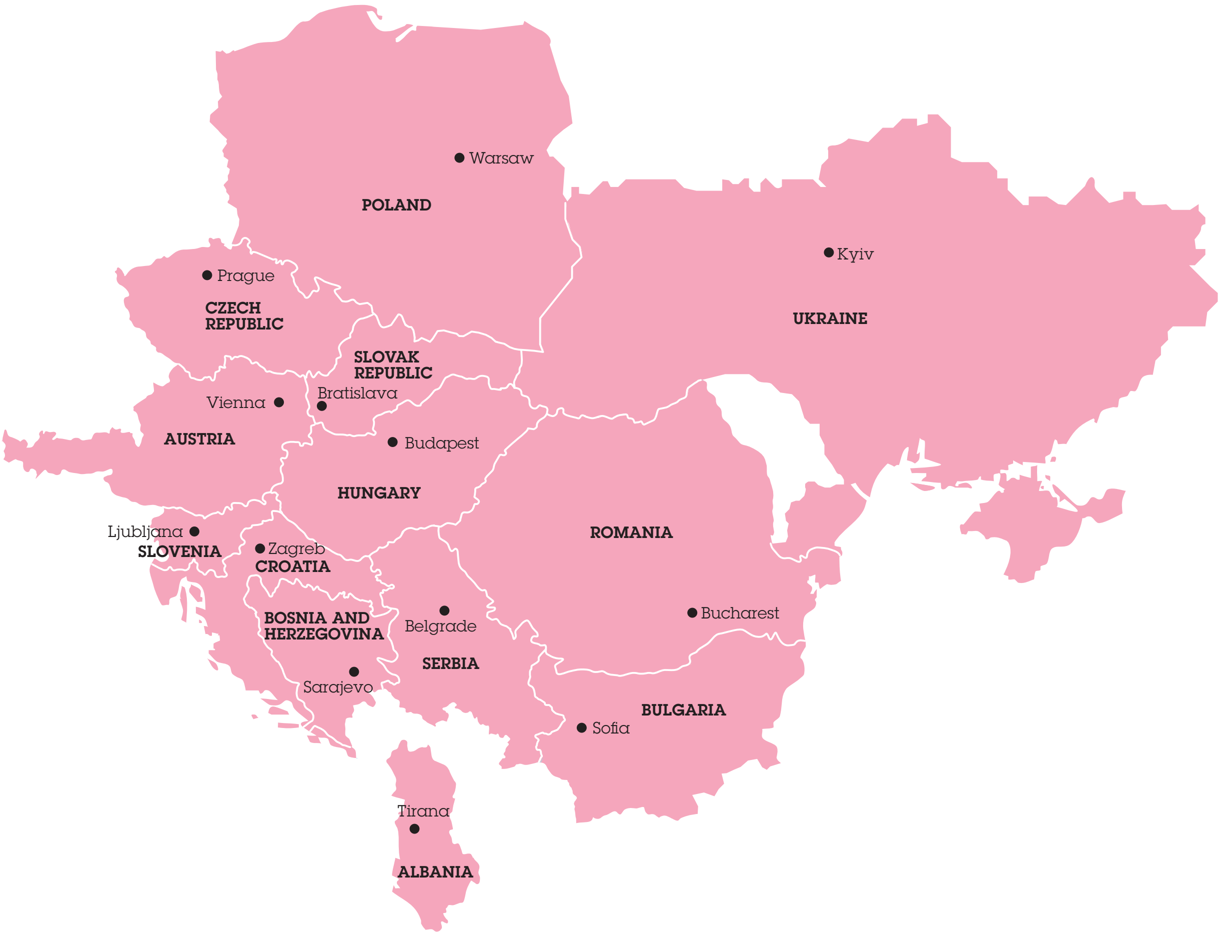
Our updated guide provides a comprehensive summary of the restructuring and insolvency regulations of 13 jurisdictions in CEE/SEE and offers the reader practical insight into the available options for the restructuring or winding up of businesses. The structure of the individual country chapters allows an easy comparison between the national rules applicable in the given situation of the debtor and the impact of relevant legislation that has been issued on an EU level.

Wolf Theiss is able to draw on the expertise of experienced practitioners from the entire CEE/SEE region and beyond. Cross-disciplinary resources, consisting of finance, corporate, employment and litigation experts, allow us not only to advise our clients on the right solutions in this complex area of law, but also to develop state of the art innovative solutions in cases where no precedent exists.

We are pleased to offer this 2020 Wolf Theiss Guide to Restructuring Loans and Enforcement of Security to our clients and interested readers. My special thanks go to all contributors. Our experts named in the country chapters remain available for any additional enquiries.

Marcell Németh ▪ October 2020

Partner, Wolf Theiss, Vienna



WOLF THEISS REGION

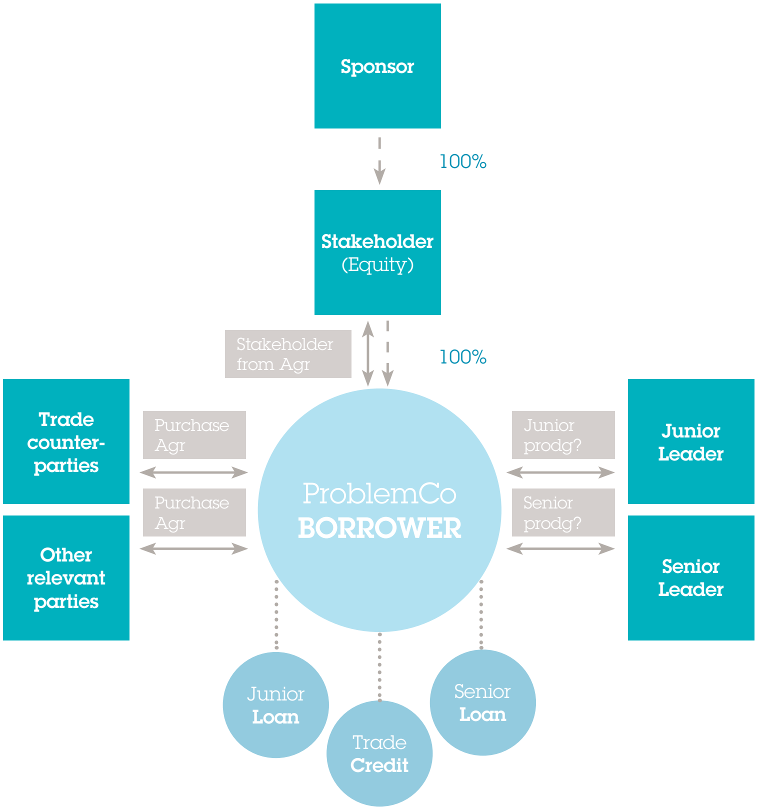
EUROPE

INTRODUCTION

The introductory chapter to the updated WOLF THEISS Guide to Restructuring Loans and Enforcement of Security 2020 intends to give the reader a general overview and highlight the key stages of a consensual restructuring process. While private restructuring is very much on the ascendancy and creditor driven arrangements have been given ample attention throughout introduction, the main themes of court driven rehabilitation and liquidation proceedings are also covered. In what follows, we summarise the major issues and outline potential decision points which, in our view, stakeholders in a financially distressed company will be facing before a final determination can be made concerning the viability of a work-out or the need for the enforcement of security which may trigger the insolvent liquidation of the debtor.

This introduction is not jurisdiction specific (for specific points relevant for our 13 jurisdictions, please see the country chapters within this guide) and is no substitute for legal advice, which in each case must be sought in case of looming insolvency.[1]

The stakeholders in a typical restructuring situation involving a relatively highly leveraged borrower include:



1 When summarising these key points, we have assumed that the stakeholders are all commercial entities and assets involved are not subject to any special legal regime relating to consumers or residential or matrimonial property. We have also assumed that facilities agreements and other finance documents are drafted according to market standard templates adopted for cross-border lending activities for international banks. Whilst bond financings may include similar provisions and many of the points made in this guide are relevant for bond documents, the incentives of bondholders and bond trustees to engage in, and their motivations to turn around a company by way of restructuring tend to be quite different to those of commercial lenders and their corporate borrowers.

1. CONSENSUAL RESTRUCTURING

Companies facing financial difficulties may need to significantly restructure their operation, debt, equity and ownership structure in order to restore the commercial viability of the business. The combination of all of these relevant corporate and commercial actions is called restructuring (or sometimes workout or turnaround)[2]. Restructuring is usually private, fully contractual and implemented by the amending and restating of the existing finance documents of the debtor. However, there are statutory reorganisation processes available where the resulting contractual scheme is enforceable by virtue of legislation (in that case, however, courts or other competent authorities may be involved in order to sanction the agreed scheme or deal with challenges).

The stakeholders in a typical restructuring situation involving a relatively highly leveraged borrower include:

1.1 Early warning signs

1.1.1 Commercial

Business is cyclical and is exposed to changes in the markets and macro-economic processes.

Cause of financial difficulties 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;
- poor management; or
- very often a combination of the above factors.

Usually one can distinguish three stages of decline of financial performance before complete failure of a business:

- underperformance;
- financial distress;
- financial crisis.

Whether a business can be rescued and the company could be turned around in any of the above phases depends on a wide variety of factors, including but not limited to the sheer willingness of creditors to embark on what may end up being a full restructuring, or the lack of sufficient unity and support shown by the various types or classes of creditors or other stakeholders. However, it is of key importance that the signs of decline are detected early on so that if there is a willingness to restructure, the necessary steps can be made in a timely fashion. Well drafted credit documentation will greatly help lenders to identify those signs.

1.1.2 Legal

In legal terms, each jurisdiction has its own definition (or test) for insolvency, but overall, the main definition that seems to have emerged across jurisdictions is the concept of "inability to pay the debt" and therefore susceptibility to be wound up by the court. Generally, a company is assumed to be unable to pay its debt when:

2 In this guide we use the term "restructuring" to describe an essentially consensual and out-of-court process aimed at reorganising the debt structure of a company or group.

- it fails to pay or satisfy the debt based on statutory demand within the time period defined by law;
- an enforcement process conducted by a creditor was unsuccessful;
- even if solvent at any given point in time, on balance of probabilities, its cash flow will not be sufficient in the near future to meet its obligations (cash flow insolvency), unless proven to the contrary;
- its liabilities exceed its assets (balance sheet insolvency); or
- or a combination of the above.

Applicable laws may require that directors file for insolvency when any of the above is triggered.

1.2 The loan documentation

Lenders typically do not have statutory protections in respect to their investment in a solvent company, but the finance documents will invariably contain representations and warranties, covenants and events of default which provide a certain level of control for the lenders over how the debtor's business is conducted, and are designed to preserve the conditions prevailing in the borrower's business when the loan was made to it. Accordingly, if well drafted, breach of certain representations and covenants should provide early warning to lenders regarding the deterioration of the borrower's financial or other performance, and thereby secure for the lenders an early opportunity to enter into restructuring discussions with the borrower or any other relevant stakeholder.

1.3 Early action

Well drafted credit agreements will allow lenders early on to:

- spot and act upon problems signalled by breaches;
- "have a seat at the table" when it comes to discussing restructuring options;
- through the threat of acceleration, leverage on the breach and propose terms for remedy and turn-around, if possible;
- recover their loans through repayment or refinancing, whilst the borrower is technically and legally solvent.

On the other hand, belated action, even if payment is made by the borrower, may be vulnerable to creditor preference, claw-back and similar avoidance rules on insolvency. Further down the line, when default is widespread and affects several credit agreements, the race between creditors begins, and in the absence of an inter-creditor arrangement in place and unless an orderly restructuring is agreed, priorities will be decided upon by applicable legal rules, chiefly on a secured and non-secured basis.

1.4 Misrepresentation

Common representations which, if breached may signal problems early:

- no material adverse change since the most recent financial statements delivered;
- no default under the financing documents or other project agreements;
- no incorrect or misleading information provided (accounts, reports or information memoranda).

These representations are usually repeated during the lifetime of the loan and breach occurs when they are deemed repeated periodically (typically on interest payment dates). Misrepresentation operates as a draw-stop and unless remedied or waived, will usually trigger an event of default.

1.5 Breach of covenant

As opposed to warranties which are deemed to be repeated from time to time, covenants are undertakings which must be complied with by the borrower on a continued basis, and if well negotiated and drafted, any actual or potential covenant breach should be indicative of the difficulties the borrower is experiencing, well before an actual payment default. Of particular relevance in this context are:

- notification of default;
- financial covenants.

Financial covenants are useful tools to measure financial performance, but because they are tested on specific dates (quarterly, semi-annually or annually) based on historic financial information, the compliance certificate delivered on any particular testing date may not catch the deterioration since the most recent accounts have been drawn and financial covenants generally designed to signal steady decline rather than a sudden and material drops in the borrower financial strength. Unexpected dramatic events may be caught by the material adverse change (**MAC**) clause if adopted as a standalone event of default, but the usefulness of the MAC clause greatly depends on the actual drafting of the MAC definition and the facts of the case. Usually, courts require an objective demonstration of the occurrence of a MAC and generally, the invocation of the MAC is expected to be supported by information that is derived from the borrower's financial statements. Nonetheless, directors of well managed borrowers know well in advance the actual testing date if a financial covenant is likely to be breached on that next testing date and therefore a potential default might be outstanding, which in turn should be notified to the lenders under the information covenants.

1.6 Default

The occurrence of an event of default allows the lenders to demand immediate repayment of the loan or place a term loan on demand.

Typical events of default include:

- payment default;
- misrepresentation;
- breach of financial covenant;
- breach of other undertaking;
- cross-default or cross-acceleration;
- criteria of applicable insolvency test met;
- opening of insolvency proceedings;
- attachment by other creditor(s);
- auditor's qualification;
- MAC; and
- other events of default, on a deal specific basis.

Whilst the occurrence of an actual event of default can hardly be considered as an "early warning sign", credit agreements usually make a distinction between default and event of default. Drafting to this effect customarily states that default is "any event or circumstance which would, on the giving of notice, expiry of any grace period, making of any determination under the facility documents or satisfaction of any other condition (or any combination thereof), become an event of default".

Therefore, since the absence of any default is warranted on the submission of a utilisation request, the occurrence of a default should result in the banks' right to refuse to lend when the potential for an event of default subsists, and generally, the borrower is required to let the banks know of such default under the notification clause.

However, representations, warranties, covenants and defaults customarily contain qualifications and other limitations that need to be analysed before the clause can be triggered, including:

- grace/remedy periods and deadlines for such actions;
- monetary thresholds;
- "best of knowledge" qualifiers;
- materiality and MAC qualifiers;
- legal reservations;
- requirements as to act reasonably or in good faith;
- discretion might need to be exercised rationally and not in an arbitrary fashion etc.;
- similar restrictions under local law.

In summary, the likely effects of a default include:

- no further utilisations;
- notification obligation triggered;
- distribution lock-up;
- cross-default clause potentially triggered (and adverse action by other creditors);
- if unremedied by the borrower, waiver or permanent amendment requested.

In turn, an actual event of default will most likely result in:

- acceleration of the loan, including:
  - cancelling of commitments;
  - declaring the loan immediately due and payable;
  - declaring the loan payable on demand;
  - instructing the security agent to enforce the transaction security.
- cross-acceleration triggered (and domino accelerations in other financings);
- usual trigger for a free transfer of the loan (without borrower consent or other limitations);
- additional capital charges, reserve requirements, reporting of bad loan;

- unilateral action by the borrower’s directors (insolvency filing, bankruptcy protection);
- trade credit evaporates, customers may suspend payments;
- other reputational issues, including downgrades in credit ratings.

Other relevant issues to consider on acceleration, arising under local law requirements if any:

- requirement to act in good faith when accelerating and duty to cooperate;
- mandatory notice periods;
- mandatory cure periods before security can be enforced;
- judicial control over commencing enforcement of security over certain assets;
- currency controls when accelerating foreign currency loans;
- restrictions on automatic termination or cancellations;
- restrictions on termination or cancellation on actual or deemed insolvency;
- payment of stamp duties or court fees before enforcement can begin; and
- statutory payment moratoria (also in the context of the recent COVID-19 pandemic).

Whilst the lender is not obliged to do any of the above under the credit agreement and may in theory opt to do nothing when it learns about the default, the risk this lender will be running is that the borrower might argue that inaction implied a waiver and therefore the lender is prevented to invoke that default further down the line. This argument may or may not succeed but it is best to avoid a dispute and prudent lenders will, nevertheless, act in one of the following ways when a default has occurred:

- waive the default;
- issue a reservation of rights letter (if it needs more time to decide);
- accelerate and enforce the security (in the last resort).

1.7 Borrower action

As noted above, it will be prudent of borrowers to notify the lenders about potential breaches early on and consider the options available with the most significant group of lenders (or other funders, such as bondholders or their trustee).

Borrowers typically will:

- seek, if possible, to remedy the default at their own initiative within the framework of the agreed provisions of the credit agreement, or request temporary or permanent waivers;
- if permitted as a remedial action:
  - might provide new or additional security (subject to negative pledge clauses in other financings and hardening periods under insolvency codes);
  - inject additional money (equity or subordinated debt) in the business (“equity cure”);

  - reduce leverage by partial prepayment;
  - dispose of assets (including subsidiaries or business lines) against cash (subject to any restrictions in the covenants and subject to the release of any relevant security);
  - procure the buy-back of debt (subject to the standard restrictions in the credit agreement);
- propose credible cash flow projections and business models that will convince lenders of the temporary nature of the problem; failing which
- initiate a wider balance sheet restructuring process with the creditors; failing which
- file with the competent court for insolvency proceedings if the situation is hopeless or the law requires such filing (pertinent duties of directors and other officers to be analysed in each case).

1.8 Creditor options

Assuming that the default was not remedied or waived, in which case the default is deemed to continue, the lenders may:

- exit by transferring the loan;
- negotiate a restructuring plan and related documentation; or
- accelerate the loan and enforce the security (triggering most likely an insolvent liquidation of the borrower).

1.9 Exit

Defaulted loans are usually capable of being transferred to any class of potential transferees (including “vulture” funds who loan to own strategies). Nonetheless, lenders may wish to check their credit agreements against any technical requirements relating to loan transfers, and applicable laws (the laws governing the loan agreement, or the laws applicable to the lender as seller and the new lender as buyer) may contain restrictions in respect to:

- method of transfer (novation, assignment or sub-participation);
- consents (borrower and regulator);
- automatic transfer of security;
- confidentiality undertakings by lenders and bank secrecy laws that may be applicable in any relevant jurisdiction and data protection;
- stamp duties and taxes;
- potential licensing requirements for the buyer.

1.10 Enforcement of security

As noted above, enforcement of security is usually the last resort for a lender after all other available options have been exhausted, including agreeing to waivers, permanent amendments or restructuring. The relevant security document (failing which, applicable law) will specify how and when the security can be enforced. It is prudent for lenders to commission a review of the security before enforcement is started in order to make sure that the security is valid and all conditions for enforceability on the agreed priority are still met (registration or its renewal, stamp duties, court fees etc.). For a detailed overview of the relevant issues in respect to each Wolf Theiss jurisdiction please see the country sections of this guide.

1.11 Security interest – types

Personal security interests:

- guarantee and suretyship;
- bank guarantees and obligations coterminous with the underlying debt.

Comfort letters and similar documents encompassing a promise to maintain ownership of shares, financial standing of a subsidiary or provision of necessary funding for a business or project do not typically amount to guarantees, but the parties' intent and proper construction of the document may alter this position.

In rem security interests:

- mortgage, charge, pledge;
- assignment.

1.12 Security interest – accessory nature

Accessory security interests are typically pledges and mortgages.

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 jurisdictions typically do not recognize trust arrangements whereby security can be granted in favour of the security agent as trustee for the Finance Parties. Usually, parallel debt or "joint and several creditorship" structures are used instead.

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.

1.13 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.

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.

In many jurisdictions, notarization is recommended as a form to ensure or preserve priority on enforcement, or when lenders want to use the private enforcement route (please see below).

1.14 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.

1.15 Private enforcement

Private sale:

- typically, sale of collateral through public auction;
- requires that the mortgagee/pledgee/assignee is able to affect a transfer of the collateral to a potential purchaser.

Certain legal limitations may apply:

- foreclosure (e.g. acquisition of the title to the secured asset on enforcement may be illegal in many jurisdictions);
- 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.

Insolvency proceedings will stay most enforcement proceedings and the relevant assets subject to security or the relevant proceeds will be distributed according to the general rules.

1.16 EU dimension – the financial collateral directive

The financial collateral directive[3] has created a harmonised EU legal framework for the receipt and enforcement of financial collateral.

A key instrument designed to facilitate trade in the single market and improve the efficiency of secured transactions, the directive:

- has scrapped many requirements as to form, including registration of the financial collateral;
- allows immediate private enforcement of the collateral outside insolvency proceedings;
- requires recognition of title transfer and close-out netting arrangements; and
- clarifies certain conflict of laws questions in that the law applicable to most issues relevant to financial collateral is the law of the country where the account is maintained on which the relevant securities are held.

3 DIRECTIVE 2002/47/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 6 June 2002 on financial collateral arrangements

1.17 The restructuring option

If the borrower's business plan is viable and there is certain flexibility in restructuring the debt service (for example, an extension), restructuring may be an attractive option for lenders because:

- it often minimizes loss (as opposed to insolvency which crystallizes the loss); and
- recoveries tend to be higher on consensual restructuring than on formal insolvency (going concern vs gone concern).

However, a successful restructuring is predicated upon:

- the support of the company, its directors and the creditors;
- the position of shareholders in the process, especially if equity holders and junior creditors are out-of-money but may have the ability to block the restructuring effort;
- inherent value being available in the company or the business;
- a viable restructuring plan (which is acceptable to all creditor classes);
- a workable business plan and cash-flow models and projections;
- more often than not, new money being injected in the business (fresh liquidity or long-term funding); and
- positive macro-economic trends and broader policy issues (for example, in strategic or otherwise sensitive industries).

Please note that consensual restructuring could be combined with statutory reorganization proceedings if available in the jurisdiction, which may further assist the consensual process through mandatory stays, legal protection (or even super-priority) of new money paid to the debtor or cramming down non-consenting creditors. Please review the country chapters of this guide to see if such processes are available in a particular jurisdiction.

Especially in a cross-border restructuring context, the following legal matters should be given further consideration when developing a consensual restructuring strategy:

- availability and enforceability of inter-creditor agreements;
- availability and enforceability of subordination agreements (for example, senior creditors can prove junior debt and can vote instead of the junior debt);
- hardening periods for new security (also in the context of new money provided to the business);
- vulnerability of transactions agreed in the restructuring plan;
- claw-back in respect of payments made to creditors;
- financial assistance and capital maintenance requirements;
- robustness of transaction security and reliable and efficient insolvency regime with reasonably speedy liquidation of assets, ensuring the realization of at least the expected break-up value of the business at acceptable transaction costs.

1.18 Steps in a typical restructuring

- Appointment of Coordination Committee:
  - formed by one or more lenders and bondholders, or their respective groups in larger financings;
  - acts as an interface between the creditors and the debtors (including in terms of sharing information);
  - sounding board of interests;
  - leads the process in negotiating the standstill and the terms of the restructuring and addresses intercreditor issues (Standstill Agreement, Restructuring Agreement and Intercreditor Agreement); and
  - appoints external advisors.
- Coordination Committee defines agreed action plan but does not make commercial decisions.
- Lenders will need to decide how much power to give to the Coordination Committee and they must agree on procedure in the appointment letter.
- Appointment letters are relatively standard and straightforward documents but indemnities, liability exclusions and cost protection for committee members are negotiated on a deal specific basis.
- Appointment of external advisors:
  - Lawyers:
    - structuring and implementing restructuring plan and drafting of the standstill, restructuring and override agreements as relevant;
    - legal due diligence;
    - assistance in contingency planning (insolvency);
  - Accountants and auditors:
    - investigations and forensic issues (if necessary)
    - check financials;
    - provide information to review Restructuring Plan that proves business case for recovery;
    - make valuations.
- Agree on Standstill Agreement – definition, principles and content
  - A 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.
  - Standstill Agreement is only necessary if no statutory stay or moratorium applies (in case the private restructuring effort is combined with a statutory process).

- 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.
- 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.

  - 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.

- Restructuring Agreements are permanent amendments to finance documents on restructuring and typically include:
  - an extension of maturity or partial write-off the debt;
  - interest capitalization, PIK interest;
  - adjustment of margin and other elements of pricing (commitment fees etc.), equity kickers or warrants;
  - payment of restructuring fee and a success fee;
  - tightening of security structure;
  - further restrictions on disposals, dividend payments etc., (the so called short-leash covenants);
  - resetting financial covenants and reviewing the definition of the accounting group;
  - increased disclosure obligations;
  - implementation of agreed restructuring plan (disposals of non-core assets, acquisitions, corporate actions etc.), proceeds typically used to repay the debt;
  - general reorganization of the business (creation of new SPV which acquires assets and lefts losses in the old vehicle);
  - injection of new equity or subordinated debt;
  - debt-equity swaps/exchange offers (so that lenders and bondholders can take an upside if the company survives); and
  - issuance of the pertinent shares or loan notes, or other instruments (warrants etc.).

- Restructuring Agreements may technically take the form of Override Agreements which create consistency across several facility agreements and implement all the permanent changes and other issues agreed on restructuring consistently across the existing facilities agreements (override).
  - The position needs to be checked in respect to ancillary lenders/facilities and hedging. Inter-creditor agreements typically contain additional rules regarding voting and priorities and sharing of security.

2. NON-CONSENSUAL RESTRUCTURING – STATUTORY COMPROMISES

Statutory compromises are a form of corporate rehabilitation whereby an insolvent company may be able to reach a compromise with its creditors within a statutory, usually court driven framework. Note the array of names used for this type of procedure – bankruptcy, moratorium, composition, compromise, arrangement, voluntary arrangement, scheme (of arrangement) etc. The key factor and common denominator of these processes is that a reorganization (rehabilitation) of the business is intended (other than winding-up and final liquidation) and the law provides a framework for the work-out (which will not be a private and contractual exercise, although the combination of the two is very common and should be possible in all advanced jurisdictions). We tend to use the term “statutory compromise” in this guide, but other concepts are equally acceptable and are in frequent use by practitioners and courts alike.

Purpose of statutory compromises is:

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

Statutory compromises 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.

In comparison to fully private arrangements, advantages (from a debtor’s perspective) of a statutory compromise may include:

- relative ease of entry (although this is very much jurisdiction specific) – the level of proof required for the long-term viability of the company may be very low;
- directors may be very much incentivized to file on grounds of concerns regarding wrongful trading;
- the process tends to provide for an immediate moratorium for 60 to 90 days or more;
- enforcement and requests for winding up are stayed;
- albeit judicial control will be there, the administrator may have the power to terminate contracts that are seen disadvantageous from the debtor’s perspective and he or she may be able to secure rescue financing;
- courts may have an easier access to assets abroad, which are part of the estate and are required for the compromise (but otherwise would be up for grab for creditors who are not bound by the scheme).

Typically, only the debtor may file a petition for statutory compromises.

As noted above, the effects of the statutory compromise are:

- a stay on enforcement and a moratorium on the payment of the debt is ordered by the court;
- debtor stays in charge of assets, subject to judicial control;
- the debtor or the administrator, bankruptcy trustee etc. proposes a scheme to the creditors court-approved scheme to achieve Cram-Down;
- all creditors are bound, but secured creditors are not affected unless they consent.

Certain majority of the creditors may agree to a restructuring plan which ensures repayment of a specific quota of outstanding debt; thus, it can help to deal with hold-out lenders or subordinated lenders who are out of the money. Lenders must watch out for potential super-priority creditors in such a situation – tax authorities, for example.

2.1 EU dimension – the restructuring directive

In contrast with the US Chapter 11 regulation, there is no single European bankruptcy code that would provide substantive rules applicable to cross-border restructurings of companies that have assets or operations in more than one member state of the EU.

Therefore, lenders and investors still face a multiplicity of bankruptcy regimes in cross-border restructurings and reorganizations. Fully consistent implementation of restructuring plans may not be possible across all relevant jurisdictions due to differences in national laws. This means that similar to the COMI (centre of main interest) being a key factor in the law applicable to the primary insolvency proceedings, the location of the debtor and its operations, and the whereabouts of its assets still have a very significant impact on what can be achieved within the proposed scheme for reorganising the debtor's business in the various member states involved, and the relevant national laws tend to differ widely in respect of the rights and remedies creditors have in voting, adopting and implementing such a scheme.

As noted below, the Insolvency Regulation concerns chiefly applicable law, jurisdiction and other procedural issues when it comes to cross-border insolvency procedures. Although preventive restructuring regimes (if any) of the member states might be caught by the regulation in procedural terms (that is it may be a primary or secondary proceeding for the purposes of the regulation), the purpose of this regulation is not to eliminate the substantive differences between the applicable national codes and, therefore, presents no solution to the problem of heterogenous restructuring regimes across the EU.

It is against this background that a new directive[4] was adopted in 2019 (the EU Restructuring Directive), which requires member states to harmonise their laws so as to ensure that the pre-insolvency regime incorporated in the directive becomes national law by July 2021 as a set of minimum standards aimed at facilitating out-of-court restructuring without the need to access the courts or other elements of the judicial system. Technically, directives are instruments that are not directly enforceable in the member states and, therefore, national law must be passed (or amended)oto give effect to the contents of a directive in the EU.

Inspired in many ways by US Chapter 11 and other internationally accepted restructuring tools such as the English law scheme of arrangement, the stated aim of the EU Restructuring Directive is to make sure that debtors whose business is viable have access to binding restructuring proceedings in order to restructure their operations and save jobs instead of undergoing insolvent liquidation.

The key provisions of the EU Restructuring Directive are set out below

- **Debtor-in-possession (DIP)** – the directive requires that member states implement legislation which ensures that debtors accessing the preventive restructuring regime remain, wholly or at least partially, in possession of their assets in order for them to continue their business activities. Whilst under the US Chapter 11 regulation DIP debtors may continue running their business, although in the best interests of the creditors and subject to court approval in respect to activities and transactions that fall outside the ordinary course of business, the directive is not specific on these issues but as a safeguard against abusive exercise of the DIP status, member states may require the mandatory appointment of an insolvency officer to oversee the activities of the DIP. However, the judicial oversight of the DIP activities will be mandatory if the proposed restructuring plan will require the sanction of the court (in the case of a cross-class cram-down, for example).

4 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 (Directive on restructuring and insolvency)

- **General stay of enforcement** – under national law that will implement the Preventive Restructuring Directive, individual enforcement actions against the debtors will have to be stayed during the negotiation of the proposed restructuring plan. The maximum length of such a stay will be about 120 days, and members states are given a relatively wide range of discretion to decide whether the stay covers all enforcement actions, or certain types of creditors or claims only. Furthermore, through a combination of legislative and judicial discretions member states are allowed to extend the stay up to on) year, except when as a result of an obvious attempt at forum shopping under the Insolvency Regulation, the COMI of the debtor was moved to the member state where the application is sought within a period of about 90 days prior to the filing being made, in which case the maximum of the stay that may be given to the debtor is 120 days. Finally, member states will have the authority not to grant or revoke the stay if it is unlikely to contribute to the overarching goal of the directive or where creditors would be unfairly prejudiced, including if they could become insolvent as a result of postponing the recovery of their claims.

- **Safe harbour** - unless the debtor is clearly insolvent, the stay overrides any duty to file for insolvency by the debtor under national law. Directors must have due regard to the interests of creditors, shareholders and other stakeholders when running the business of the debtor in case of looming insolvency, but have under the terms of the directive no positive duty to file for insolvency and in fact, the directive requires that they take steps to avoid insolvency.

- **Automatic termination (“ipso facto”) clauses** – conscious about business continuity, the EU Restructuring Directive seeks to ensure that national law prohibits the early termination (automatic or otherwise), acceleration or amendment (to the detriment of the debtor) of contracts that are essential for the debtor’s business solely due to non-payment by the debtor during the negotiation of the restructuring plan or by virtue of the stay being applied. It should be noted that these provisions will be without prejudice netting (including close-out netting) transactions if otherwise available and enforceable under national law.

- **Voting majorities** – the key document which contains the terms of the reorganisation of the debtor’s business is the restructuring plan which is essentially an offer by the debtor to change the capital structure of the company which if accepted by the required majority of creditors, becomes a binding restructuring agreement subject to the sanction by the court if required. Generally, a restructuring agreement may be agreed by the majority in the amount of the claims or interests of the creditors in each creditor class (national law may require 75 % but not more) and national law may also require that consent of the majority in the number of the creditors in each class is obtained. Equity holders, deeply subordinated creditors and parties related to the debtor (where a conflict of interest may arise) may be excluded from the voting by national law.

- **Class formation** – according to “sufficient commonality of interest based on verifiable criteria”, creditors will be allocated into separate classes. Secured and unsecured creditors are as a default position to be treated as a separate class. The appropriateness of the formation of each class is subject to judicial scrutiny in each case when the restructuring agreement must be sanctioned by the court.

- **Sanctioning by the court** – although national law may define other instances where this is required, the directive provides that as a minimum harmonisation rule, a restructuring agreement which affects the interests of dissenting creditors or which foresees rescue financing, will not be binding on all affected parties unless approved by the court. Essentially, the court should not sanction an agreement if the procedural requirements (including those relating to notification of creditors or class formation were not observed) or there is a rescue financing involved but the terms are unfair on the existing creditors and finally, if the plan fails to ensure that no affected party is worse off by implementation of the plan than it would be on insolvency of the debtor (the so called “best interests of creditors” test).

- **Cross-class cram-down** – dissenting creditors can be “crammed down” and so bound by the plan that was adopted despite their disagreement if (and in the absence of higher number of consenting classes required by national law):

- the plan meets those criteria pursuant to which the court is able to sanction the plan (see above);
- the majority of the creditor classes has approved the plan and at least one consenting class is a class of secured creditors; or failing this, at least one of the voting classes (other than equity) or (if so provided by national law) an impaired or "out-of-money" class has approved the plan;
- dissenting creditors are not worse off than creditors in the same class or rank and are treated more favourably than the junior classes (the "absolute priority" test); and
- no creditor class receives more than the full amount of its claims.

▪ **Position of equity** – since the equity class will most likely be out of money and would receive no value on the insolvent liquidation of the debtor, the working assumption of the directive (subject to national law providing to the contrary) is that preventive restructuring is a creditor driven process where equity holders have no vote when it comes to approving the restructuring plan. Accordingly, the main concern of the legislator is to ensure that shareholders are not able to unreasonably block the restructuring effort as between the creditors and the debtor. Equity holders can form a class but will either not vote or can be easily crammed down (see above).

▪ **Statutory valuation of the debtor's business** – as it will be recalled, preventive restructuring under the directive is intended to be a private effort to reorganise the debtor, and therefore statutory valuation will be required only in exceptional cases. These instances are in fact limited to challenges in respect of the restructuring plan on grounds of an alleged failure to meet the best interest of creditors test or the conditions under which the cross-class cram-down was carried out. The directive requires that member states ensure that proper expertise is available for the competent authorities when dealing with these challenges.

▪ **Anti-avoidance protections** - under national law, transaction made by or with the debtor during the period running up to insolvency may be vulnerable and set aside by the court, and provision of new funding to an insolvent business may attract civil, administrative or even criminal liability. Subject to a few overriding principles such as absence of fraud or bad faith, the directive seeks to provide protection for such transactions:

- rescue financing: financings required to preserve value ("interim financing") or to implement a restructuring plan sanctioned by the court ("new financing") may be accorded super-priority on the debtor's insolvency and should not generally be set aside and the lenders should not be subjected to liability on account of such funding; and
- other transactions **(including asset sales)**: transactions that are "reasonable and immediately necessary" to negotiate or implement the restructuring plan should not be declared void or be set aside on the ensuing insolvency of the debtor, unless, in each case, national law provides otherwise including when the funding was provided at a time when the debtor was beyond doubt unable to pay its debts.

▪ **Key exemptions** – because these are regulated institutions with specialist insolvency and resolution regimes, the framework laid down in the directive will not apply to banks, brokers, insurance companies, exchanges, depositaries and certain other regulated financial institutions. Generally, the directive should not affect payment finality, financial collaterals and transactions with central counterparties and repositories that remain enforceable in accordance with the relevant national law.

Lastly, it is important to note that the EU Restructuring Directive provides additional flexibility for debtors envisaging a preventive restructuring by allowing member states to derogate from corporate law requirements[5] such as mandatory winding up on substantial loss of capital or technical rules relating to the increase or decrease in the

5 Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law

registered capital if and to the extent such derogations are necessary to implement the preventive restructuring framework in national law.

2.2 Cross-border aspects – the 1997 UNCITRAL Model Law on Cross-Border Insolvency

The main aim of the Model Law is:

- the facilitation of the recognition of foreign insolvency proceedings, and
- the coordination of proceedings between the relevant courts and other authorities.

The preamble to the Model Law sets forth the following key objectives in the context of cross-border insolvency proceedings:

- judicial co-operation;
- greater legal certainty for trade and investment;
- fair and efficient administration of cross-border insolvencies;
- maximisation of the value of the debtor's assets; and
- helping to rescue financially troubled businesses.

The Model Law has no binding force as an international treaty andrfor it to have any effect, it must be adopted in national law in the relevant jurisdiction. Whilst key players of the global economy (US, Canada, UK, Australia and Japan, for example) have adopted the Model Law, at the time of writing, only five jurisdictions in the CEE/SEE (Montenegro, Poland, Serbia, Slovenia and Romania) have adopted the Model Law in their jurisprudence. This means that these countries, irrespective of being a member in the EU or not, may have effective tools at hand when it comes to the recognition, coordination and handling of insolvency proceedings aiming at the rescue or liquidation of businesses connected to the other relevant jurisdictions.

Further aspects of the recognition and coordination of international insolvency are a complex area; may be based on bilateral and sometimes antiquated treaties and principles of judicial cooperation and comity and therefore requires specific analysis in all the relevant cases.

For further jurisdiction specific details of statutory compromises, please see the country chapters of this guide. As noted above, the EU Restructuring Directive will need to be implemented by member states by July 2021.

3. WINDING UP PROCEEDINGS (LIQUIDATION)

Winding-up or liquidation results in the dissolution of the debtor and its assets are distributed amongst creditors based on their hierarchy and relative priorities as set out in the relevant insolvency laws.

Liquidation proceedings aim at:

- resolving the debtor's insolvency by realizing its assets;
- collectively satisfying the creditors on a pro rata basis.

In contrast to a statutory compromise, the effects of liquidation are:

- a stay on enforcement and a collective realization of the debtor's assets;
  - a court-appointed bankruptcy practitioner is in charge of the debtor's assets;
  - the insolvent company is wound up;
  - all creditors are bound, but secured creditors have preferential rights to their collateral;

Usually, either the debtor itself or its creditors may file a petition for bankruptcy.

Petition for the initiation of liquidation which is not filed in a timely manner may result in criminal and/or civil liability of:

- 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 in liquidation and therefore will be subordinated to other creditors.

The bankruptcy practitioner may challenge preferential transactions and repayments made in hardening period prior to insolvency.

For further jurisdiction specific details of statutory compromises, please see the country chapters of this guide.

3.1 EU dimension – the Insolvency Regulation

Where debtors have operations ("establishments") or assets in several countries in the EU, insolvency and insolvency procedures affecting those entities clearly have a cross-border effect. Jurisdictional and conflict of law issues relating to those insolvency procedures have been covered on the EU level since at least 2000 by way of a regulation[6] which has been recast in 2015 (**Insolvency Regulation 2015**)[7] and applies to insolvencies commencing after June 2017.

The main effect of the Insolvency Regulation 2015 is that in the context of a cross-border insolvency, the courts of the member state where the debtor's centre of main interest (**COMI**) is situated will have the right to open the so-called main (or primary) insolvency proceedings in respect of the debtor and its assets that may be scattered through a number of member states of the EU. Accordingly, primary proceedings will not be capable of being opened in any jurisdiction other than that of the COMI, although secondary or territorial proceedings may still be opened if the conditions set out in the regulation are met.

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 overriding principle of the Insolvency Regulation 2015 is that by analogy to ordinary court judgements issued by an EU court, an EU court's decisions ordering the insolvency of the debtor rendered in the jurisdiction of the COMI should be recognised in any other member state of the EU, which essentially means that the law of the main proceedings will:

6 Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings

7 REGULATION (EU) 2015/848 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 May 2015 on insolvency proceedings (recast)

- have the same effect in other relevant jurisdictions where assets are located (for example, a stay on enforcements),
- govern procedural issues in any other relevant jurisdiction, including the scope of assets forming the insolvent estate or transactions that may be avoided by the insolvency officer or the court; and
- not be capable of being challenged as the law governing the main proceedings and proceedings that may opened in any other relevant jurisdiction may be secondary or territorial proceedings only.

Specifically, COMI determines amongst other things:

- the conditions for the opening of the proceedings as well as their conduct, their closure;
- the powers of the insolvency officer;
- the effects of proceedings on individual creditors, contracts and claims;
- rules relating to the avoidance, voidability, or unenforceability of legal acts;
- steps in respect of acts detrimental to all creditors (challenge).

Because of the key importance of COMI, the Recast Insolvency Regulation seeks to reduce the possibility for parties to engage in "forum shopping" in relation to the COMI of the debtor; the registered seat will thus be considered as the COMI of the relevant corporate debtor only if this seat was not moved to the given jurisdiction during a period of three months immediately preceding the request for the opening of the insolvency proceedings.

As noted above, secondary or territorial proceedings may be opened in respect of the same debtor in a jurisdiction other than that of the COMI only if the debtor has carried out business in a permanent fashion involving personnel and assets in that other country during the period of three months prior to the opening of the main proceedings and any such proceedings are limited in their scope to the assets of the debtor in that jurisdiction. Technically, secondary proceedings are opened after the main proceedings have been opened. Territorial proceedings are those secondary proceedings that are exceptionally opened prior to the commencement of the main proceedings in case the legal conditions for opening the main proceedings have not been met in the COMI jurisdiction (but have been triggered in another country where the debtor has an establishment) or creditors or public authorities specifically request the opening of those proceedings.

Secondary proceedings effectively limit the powers of the insolvency officer appointed in the main proceedings and may restrict the ability of that officer to remove assets from the jurisdiction where the secondary proceedings were opened, unless the office holder provides an undertaking to the creditors who would otherwise be able to request the opening of the secondary proceedings, which provides the necessary reassurance to those creditors as to the treatment of the assets located in that jurisdiction. The relationship between the various classes of proceedings is a complex matter and legal advice must be sought when these issues are encountered.

The introduction was written by Marcell Németh.

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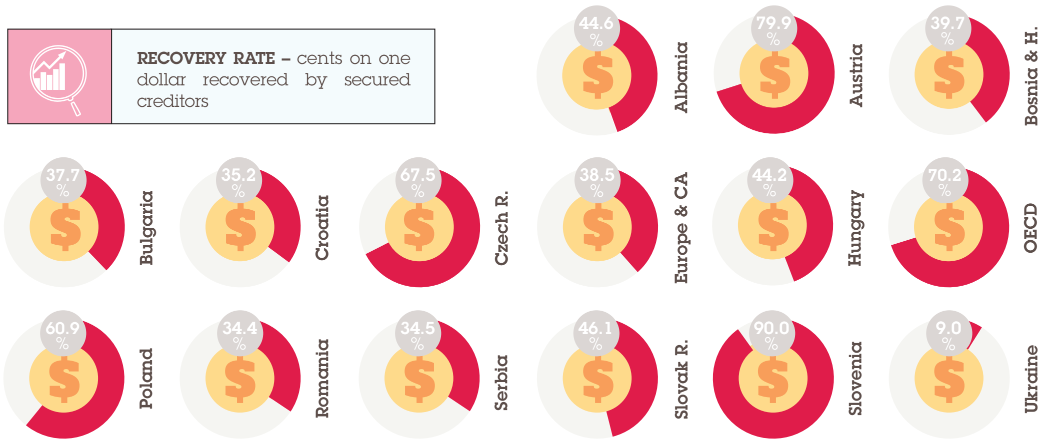
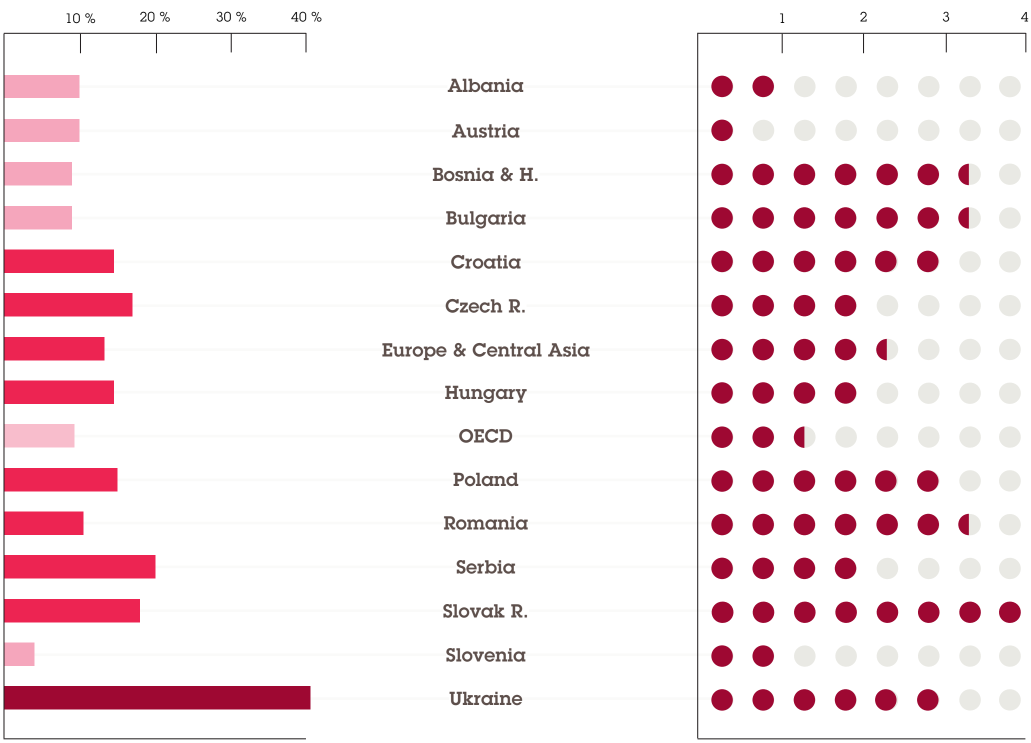
RESOLVING INSOLVENCY
INDICATORS*

RECOVERY RATE – cents on one dollar recovered by secured creditors



COST OF INSOLVENCY PROCEEDINGS – costs as percentage of the value of debtor's assets

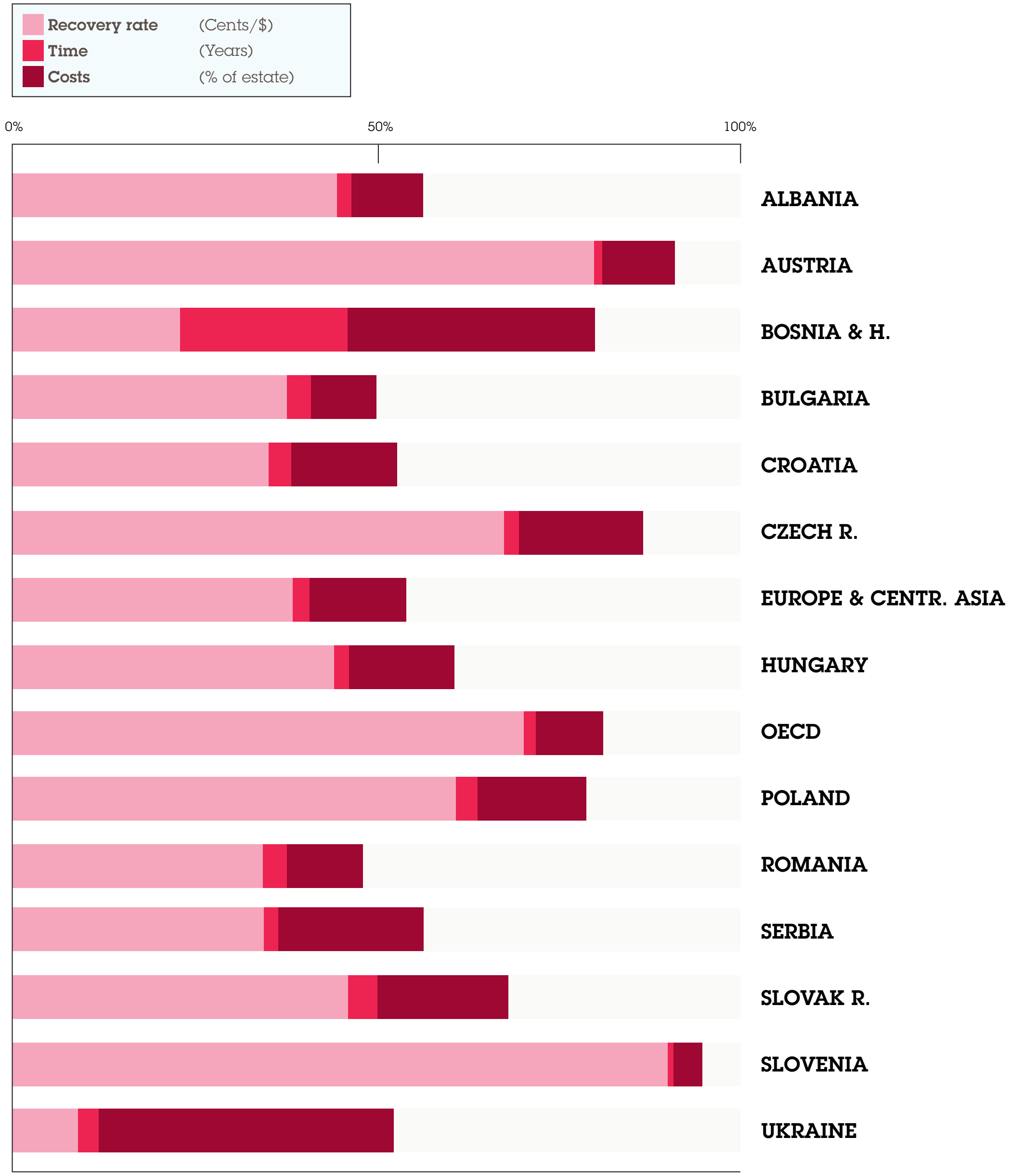
TIME OF INSOLVENCY PROCEEDINGS – time starting from the company's default until the payment of some or all of the money owed to the bank



RESOLVING INSOLVENCY

INDICATORS COMBINED –

Country information about key indicators illustrating the efficiency of insolvency proceedings in our 13 jurisdictions



* **Source:** The World Bank, Doing Business

ROMANIA

1. GENERAL ISSUES AFFECTING LENDERS

1.1 Validity of a negative pledge clause

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

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

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 publicity against any third party. A creditor may challenge such a disposal if it has not consented to it (expressly or implicitly) and where it becomes impossible for such creditor to enforce the mortgage in accordance with its ranking.

1.2 Restrictions on accelerating a loan

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

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; or where the security provider does not properly maintain the charged assets; or other factual circumstances occurring as a result of the debtor's actions, which may render the enforcement of the mortgage difficult or impossible.

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 prohibitions of the underlying agreement. Breach of such obligations may entitle the non-defaulting party to claim damages.

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

Parties must be mindful that licensing restrictions apply with respect to the ability to purchase performing loans.

1.5 Effectiveness of a contractual subordination

Contractual subordination is not regulated, and in absence of case law it is possible that it may be disregarded by the court, the insolvency administrator or liquidator in an insolvency procedure.

There are arguments to support contractual subordination given that Romanian insolvency law provides for the subordination of shareholder loans or loans granted by affiliates.

1.6 Subordination by operation of law

Shareholder loans granted by shareholders holding at least 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 third party creditors agree and such consent is granted after the event of default which triggered the enforcement 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 necessitate amending or retaking 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. Personal guarantors must consent to such changes in order for the personal security to cover any such changes.

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 pledges/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 National Register of Publicity over Movable Assets (the "National Register")
BANK ACCOUNT	Movable mortgage	Registration with the National Register, notification of account bank with bank account control granted by account bank to creditor
RECEIVABLES	Movable mortgage or assignment	Registration with the National Register and third-party notification of the debtors; movable mortgages over rent receivables and insurance proceeds under insurances related to immovable assets should also be registered with the Land Register
SHARES	Movable mortgage	Registration with the National Register 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, because the nature and content of the universality must be described as accurately as possible, and any asset exiting the universality is transferred free of any encumbrances, usually such a mortgage contains also a provision regarding the creation of security over distinct 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 but not widely used in practice
ACCOUNT PLEDGE	Yes	Yes, if contractually agreed but not widely used in practice
RECEIVABLES PLEDGE	Yes	Yes, if contractually agreed but not widely used in practice
SHARE PLEDGE	Yes	Yes, if contractually agreed but not widely used in practice
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*) which means that parties must be mindful of the transfer formalities and the costs entailed.

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 Types 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;
- 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 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 30 days of the date of actual insolvency. In case of non-compliance, the director risks criminal liability.

3.3 Describe insolvency proceedings

3.3.1 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 extra judiciary 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;
- 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
- 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.

3.3.2 Reorganisation process

Within 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 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 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 of the plan or, in the event there are only two classes, the class with a higher value of claims has voted in favour of the plan; (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 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).

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 fraudulent acts or transactions, as follows:

- gratuitous transfers (save for sponsorships with humanitarian purposes) performed within a period of two years prior to the opening of the insolvency proceedings;
- any commercial transaction not completed at arm's length concluded within a period of six 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 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 months);
- establishment of a preference right for an unsecured debt (hardening period of six 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 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 years); and
- transactions concluded with certain persons who had a legal relationship with the debtor (e.g. member of the board or director, shareholder, member of the supervisory board or spouse or next of kin (up to fourth degree) of such persons) if such transactions result in defrauding other creditors (hardening period of two years).

The right to challenge the above transactions is subject to a statute of limitation which cannot exceed 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 extra-judiciary 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 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 in 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 days from the date of the request.

3.7 Secured creditors in insolvency 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 affect a transfer of the collateral to a potential purchaser in a private enforcement.

4. JUDICIAL 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 15 days of the receipt of the summons, the bailiff proceeds with the sale of the mortgaged assets 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 National Register and the Trade Registry.

If within 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 6 to 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 0.5 % of the amount exceeding RON 400,000 of the claim which is subject to enforcement.

The creditor must advance the enforcement costs.

This chapter was written by Claudia Chiper.

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