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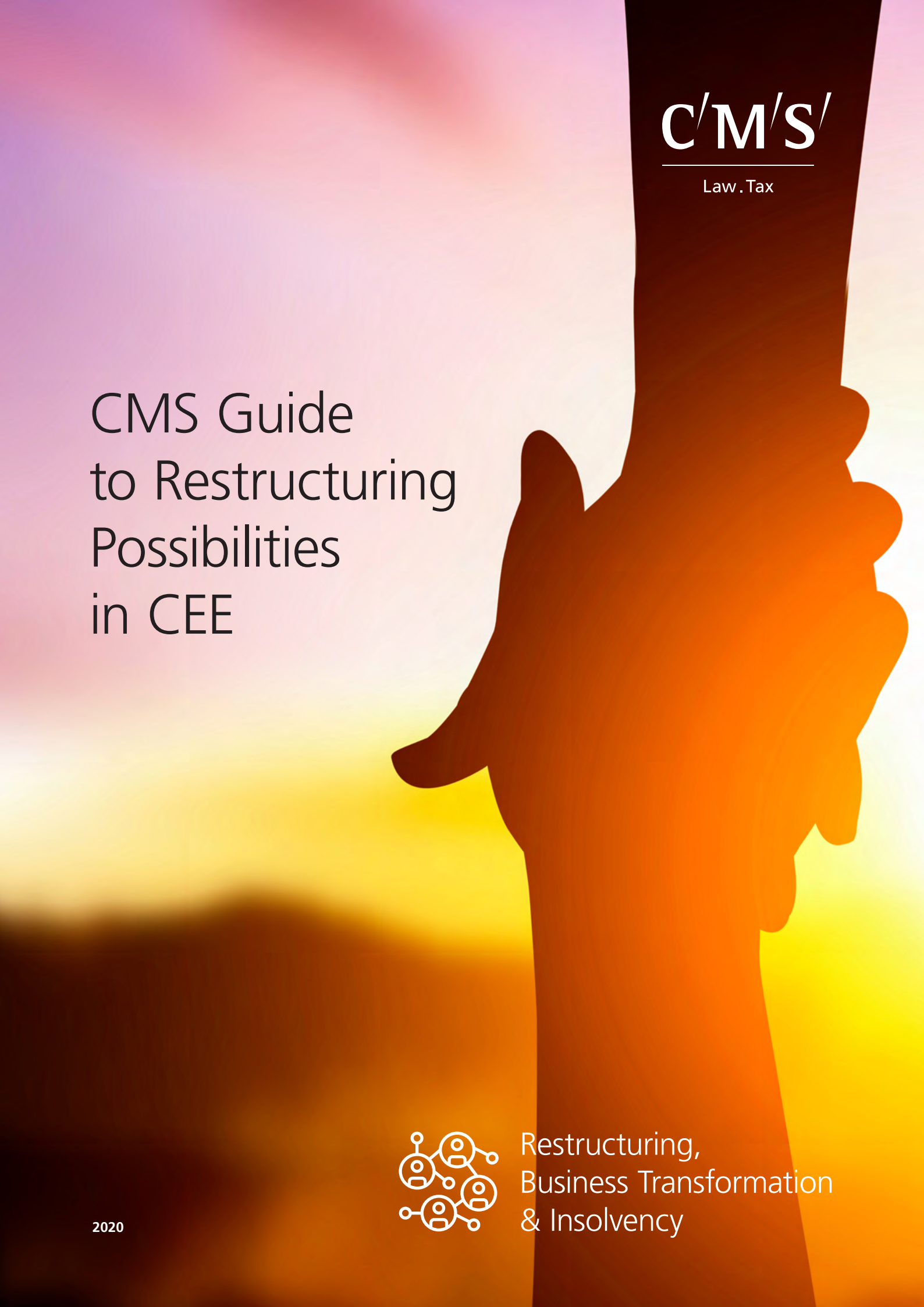
# CMS Guide to Restructuring Possibilities in CEE



Restructuring, Business Transformation & Insolvency

2020

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НАРОДНО СЪБРАНИЕ

# Bulgaria

## Voluntary restructuring

It is not specifically regulated under Bulgarian law, but creditors and the debtor may enter into a voluntary agreement for restructuring of a loan or to execute a standstill agreement while considering a restructuring plan.

Restructuring can be distinguished from renegotiation. Renegotiation would be the case where the terms of the loan agreement are amended with a voluntary agreement between the parties, but the conditions for restructuring are not met. Renegotiation can be pursued at any time during the term of the loan agreement.

### Restructuring methods

The restructuring techniques depend on the purpose of the restructuring: whether it aims for the company's survival or an orderly sale of the company's assets/business.

If the main purpose of the restructuring is the continued survival and stabilisation of the debtor, the creditor and the debtor could use various methods, such as remission of part of the debt, postponing/rescheduling the debt, additional financing, financial support by the shareholders and the subordination of their receivables to the bank's receivables, new collaterals, additional guarantees, the debtor's reorganisation, and the sale of assets which are not essential to the debtor's business, among other things.

If the main purpose of the restructuring is to sell the company's assets/business, the restructuring methods may include debt-for-equity swaps, rescue sales, or distressed debt trading, including through the assignment of receivables/debts, factoring, and novation.

The above restructuring methods can be used separately or in combination.

Under Bulgarian law, a debt-for-equity swap can be effected using an in-kind contribution procedure. The Bulgarian National Bank has used its discretion under CRR1 to prohibit qualifying holdings in undertakings that are not financial sector entities in excess of 15% of the eligible capital on an individual basis and 60% on aggregate. Therefore, if the lender wishing to swap debt for equity is a bank, the resulting equity participation must not exceed the statutory requirements.

Under Bulgarian law, loans can be transferred either by assignment or by novation. Assignment is the most common method of loan transfer, and it occurs in the form of an assignment of rights/receivables and an assumption of obligations. Novation is an alternative to assignment when there is a change of lender and the terms of the loan are varied. Novation takes effect by discharging the original rights and obligations and replacing them with new ones.

Another technique is step-in-debt. The most common use of step-in debt is where the original lender and the new lender agree to be jointly liable for the outstanding obligations towards the borrower. The borrower's consent is not required. On the borrower's side, step-in-debt (also known as assumption of obligations) means that a third party enters as a co-debtor under the agreement. The co-debtor and the original debtor are jointly liable for the outstanding debt towards the creditor. If the creditor approves the step-in debt agreement, this agreement cannot be repealed or amended without the creditor's consent.

### Pros and cons

**Pros:** In many cases, the creditor and the debtor may protect their respective interests more effectively through direct negotiations and voluntary restructuring compared to individual enforcement, bankruptcy or restructuring proceedings.

**Cons:** however, from the perspective of the creditor, it must consider certain risks, including:

— Any security granted after the court decision on opening insolvency proceedings is null and void against the company's creditors.

— Bulgarian legislation provides that certain transactions entered into during "suspect periods" can be challenged and revoked.

From the perspective of the debtor, voluntary restructuring may be difficult to negotiate in a scenario with multiple creditors with varying interests; the debtor may consider whether it would be eligible for a formal restructuring (stabilisation) proceedings to cramdown any non-consenting creditors.

Directors' liability may be another factor that imposes time pressure on any voluntary restructuring negotiations. As stated below in the section Insolvency Proceedings, even if the directors of a company want to enter into a voluntary restructuring agreement with the bank(s), if the company is in fact insolvent or over-indebted and the company's distress in not temporary, the company's directors are obliged to file for the opening of insolvency proceedings within 30 days of the occurrence of the insolvency/over-indebtedness. Failure to comply with this obligation can result in civil and criminal liability of the directors.

### Additional issues

There are data protection and confidentiality issues which could prevent a lender from selling or transferring the loan. Bulgarian banking secrecy laws and data protection laws prohibit the disclosure of banking secrets and personal data without the subject's consent. It is therefore standard practice to include in the original loan agreement the borrower's prior consent to disclosure for the purposes of loan trading.

There are also requirements regarding the transfer of collaterals and supplemental registrations necessary in this regard which vary depending on which restructuring methods are used. Different rules also apply to the different forms of the agreements, their execution and perfection.

## Other restructuring proceedings

Bulgaria has not yet transposed Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on the discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning the restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency). However, Bulgaria has adopted in its national legislation restructuring proceedings (производство по стабилизация) pursuant to Commission Recommendation 2014/135/EU of 12 March 2014 on a new approach to business failure and insolvency.

### Opening of restructuring proceedings

In contrast with insolvency proceedings, restructuring proceedings can be initiated only by the company, not by the creditors. The purpose of restructuring proceedings is to avoid the initiation of insolvency proceedings by an agreement reached between the company and its creditors on the settlement of the company's debt. The procedure aims to enable viable companies in financial difficulty to restructure their debt at an early stage and continue in business.

### Conditions for opening proceedings

Restructuring proceedings may be initiated for any company that is not insolvent but which is in imminent danger of insolvency. A company will be considered in imminent danger of insolvency when in view of the maturity of its obligations, the company faces an inability to meet certain payment obligations or is expected to stop paying within six months following the submission of its restructuring petition.

Restructuring proceedings may not be initiated in the case of: (i) a failure by a company to request the publication of its financial statements in the Commercial Register; (ii) the initiation of restructuring proceedings by the company in the three years before the filing of the restructuring petition; (iii) a petition on the initiation of insolvency proceedings lodged before the restructuring petition; or (iv) obligations to related parties and parties which have acquired over the last three years receivables from related parties, which exceed one-fifth of the company's obligations.

The petition for the initiation of restructuring proceedings will be rejected if, among others things, the proposed restructuring plan does not meet the requirements set by law; there are grounds for the initiation of insolvency proceedings; the restructuring proposal does not correspond to the company's economic or financial condition; or the company has acted in bad faith or without due care in its business endeavours.

Restructuring proceedings are governed by the court and are initiated by a petition in writing submitted to the court by the company. The petition should contain detailed information on the company's debt, its creditors, a description of its assets, and the proposed restructuring plan.

### Restructuring methods

When the court initiates restructuring proceedings, it appoints a trustee and an open court hearing to endorse the restructuring plan. In addition, security measures may be granted or a registered auditor appointed. The court will impose certain restrictions on the company's business and may terminate contracts to which the company is a party.

In contrast with the recovery plan in insolvency proceedings, the adoption of a restructuring plan in restructuring proceedings is mandatory. The restructuring plan is subject to discussion in an open court hearing with the participation of the company, the creditors eligible to vote on the plan, and the trustee.

The restructuring plan includes the payment terms of the creditors' claims, the extent of their satisfaction, and any offered guarantees and securities. The plan may provide for the sale of the whole company, a separate part of its business or a property right.

In a similar manner to insolvency, in the restructuring plan the creditors are divided into classes: secured creditors, employees, creditors with public law receivables, unsecured creditors, and creditors that are related parties. The restructuring plan is voted on by the classes of creditors separately. The claims of the creditors in the same class are satisfied pro rata. If the restructuring plan is not approved by the creditors entitled to vote or endorsed by the court, the restructuring proceedings will terminate.

The restructuring plan endorsed by the court is binding on the company and its creditors that have claims before the date of the court resolution endorsing the plan, even if these creditors have not taken part in the proceedings or if they voted against the plan. The claims of these creditors will be converted in accordance with the terms of the plan. However, the plan has no effect on any creditor who has not been included on the list of creditors or who was not given an opportunity to vote to approve the plan. The plan shall not affect the rights of the creditors over securities established by the company or third parties. The restructuring proceedings will be terminated on the court endorsing the restructuring plan.

If a creditor's claim is not paid in full or in part in accordance with the terms specified in the plan, the creditor can request the issuance of a writ of execution and has the right to collect its claim in its full initial amount. The conversion effect of the restructuring plan regarding that creditor is retroactively cancelled.

### Success rate

Restructuring proceedings are a new procedure and there is currently no public data available on the number of successfully completed restructuring plans. The novelty of the procedure, its length, cost and formality make it rather unpopular form of debt restructuring compared to the voluntary restructuring.

## Insolvency proceedings

### Opening of insolvency proceedings

Pursuant to Annex A to Regulation (EU) No. 2015/848 of the European Parliament and the Council of 20 May 2015 on insolvency proceedings (recast) (the "Regulation"), the corresponding Bulgarian procedure is the insolvency procedure (производство по несъстоятелност). Insolvency proceedings are governed by the court and are initiated by a petition in writing submitted to the court. The petition must be submitted by the debtor itself or, respectively, by the liquidator (in the event of voluntary liquidation), or by a creditor. It can also be submitted by the national tax authorities or the labour authorities.

### Conditions for opening proceedings

Under Bulgarian law, there are two triggers for insolvency proceedings: insolvency and over-indebtedness. These triggers are not cumulative, it is sufficient that a company is either insolvent or over-indebted for it to be obliged to enter insolvency proceedings or its creditors to be entitled to enforce the same.

A company is insolvent when it is unable to meet: (i) a due and payable payment obligation caused by or related to a commercial transaction, including its validity, performance, non-performance, termination, invalidity and rescission or the consequences of its termination; or (ii) a public obligation to the state and municipalities related to its commercial activity (such as tax); or (iii) an obligation under 'private state receivables', such as receivables of the state under contractual agreements; or (iv) an obligation to pay wages to at least one-third of the employees, which has not been discharged for more than two months. There is a legal presumption in favour of insolvency if the company: has not applied for publication in the Commercial Register of its annual financial statements for the past three years; has ceased to make due payments; or the claim of the creditor who has filed for insolvency has remained outstanding for more than six months under enforcement proceedings. A company may also be insolvent if it is able to pay only some of its debts and such difficulties are not temporary in nature.

A company will be considered over-indebted if its assets are insufficient to cover its monetary (payment) obligations. The definition provided by law is very broad, but in accordance with prevailing case law, the most common test is whether the total value of the company's cash, cash equivalents, and fast liquid assets is lower than the total value of the company's short-term liabilities, i.e. liabilities which are expected to mature within a year.

However, even if the company is deemed insolvent or over-indebted, the court shall not commence insolvency proceedings if it is of the opinion that the company's distress is of a temporary nature or the company's assets are sufficient to cover all of its liabilities without endangering the interests of creditors.

### Restructuring methods

Apart from operating as an enforcement procedure, bankruptcy proceedings can be viewed as a way for the company to recover financially. During court proceedings, a recovery plan may be adopted to that effect. However, this is not an obligatory stage of the bankruptcy proceedings. The right to propose a recovery plan is vested with the company, the bankruptcy administrator, creditors holding one-third of the secured receivables/unsecured receivables, partners/shareholders holding at least one-third of the capital of the company, unlimited liability shareholders, and 20% of the company's employees.

The recovery plan may include postponing or rescheduling payments, writing-off debts in full or in part, reorganising the enterprise, or undertaking other acts or transactions. The entire company or a separate part of its business could be sold as a part of the recovery proceedings. In such case, a draft of the agreement, signed by the purchaser, must be attached to the recovery plan. The recovery plan may also provide for the election of a supervisory body to monitor the implementation of the recovery plan.

For the purposes of the recovery plan, all creditors are divided into classes: secured, employees, unsecured creditors, creditors under shareholder loans, etc. The recovery plan should be such that debts of a certain class are treated equally. The recovery plan will be voted on by the classes of creditors separately.

The recovery of the company may include debt-to-equity swaps. If this is agreed, the recovery plan includes a list of the creditors who have agreed to subscribe to a quota/shares of the capital.

The court passes a decision whereby it allows the creditors' meeting to vote for the approval of the recovery plan. After the plan has been approved, it goes unchallenged, and all other statutory requirements have been fulfilled, the court approves the recovery plan. As a consequence of the approved recovery plan, the bankruptcy proceedings are terminated.

If the company fails to implement the recovery plan, its effectiveness can be suspended and the bankruptcy proceedings may be re-opened. This can happen at the initiative of creditors' holding at least 15% of the receivables against the debtor or on the supervisory body. In re-opened bankruptcy proceedings, no recovery proceedings are allowed.

### Court decision declaring the debtor insolvent

If no recovery plan is adopted, a proposed recovery plan is not approved, or the company's assets are insufficient to meet the insolvency expenses, the court will declare the debtor insolvent. Following this declaration, the court will suspend the debtor's business, terminate the rights of the debtor's competent bodies, impose a general restriction over the debtor's assets, and deprive the debtor of its right to manage and transfer its assets. At this point, the liquidation of the company's assets begins, i.e. conversion of the assets of the bankruptcy estate into cash. After the bankruptcy estate is converted into cash, the creditors' claims are paid according to their ranking and priority.

### Out-of-court settlement

During each stage of the bankruptcy proceedings, but after the court has approved the list of the creditors to the bankruptcy estate, the debtor can enter into a settlement agreement with all such creditors. The debtor (the company) is not represented by the bankruptcy administrator in the negotiations and signing the agreement, therefore in practice it should be an initiative by the shareholders or the creditors. The only requirements for such agreement are that: (i) it is made with all creditors on the approved list; and (ii) it is in writing. If the executed settlement agreement complies with these requirements, the court adopts a decision to terminate the bankruptcy proceedings. If the debtor fails to meet its obligations under the settlement agreement, the bankruptcy proceedings can be re-opened.

### Success rate

Successful restructuring plans in the course of insolvency proceedings are rare in our experience. Insolvency proceedings in general are lengthy and expensive, and are the least favoured option for creditors, companies and shareholders alike.

### Pros and cons

**Pros:** Among the positive aspects of the insolvency procedure for creditors is the opportunity to request the court to impose preliminary security measures to protect the debtor's property, such as the appointment of a temporary bankruptcy trustee; imposing attachment or other security measures; terminating individual enforcement proceedings against the debtor's property; securing the available assets of the debtor; and ordering the sealing of the debtor's premises, equipment, and transport vehicles if there is danger of dissipation, destruction, or concealment of the property. From the perspective of the debtor the insolvency may be the last chance to propose and get approved a restructuring plan, although in our experience restructuring is rarely a viable option for the business of the debtor at this stage.

**Cons:** The insolvency procedure is a comparatively long process governed by the court and can be very costly (costs for the insolvency proceedings, security measures, court expertise, etc).

The directors of an insolvent/over-indebted company are obliged to file for the opening of insolvency proceedings within 30 days of insolvency/over-indebtedness occurring. Failure to comply with this 30-day deadline can result in personal liability to the company's creditors for damage caused by the delay and possible criminal liability, including a fine or imprisonment.

Under Bulgarian law, a person that has been a member of a managing or controlling body of a company dissolved due to bankruptcy in the two years preceding the date of the court's decision on declaring bankruptcy, and provided that unsatisfied creditors remain, cannot be a director of a limited liability or a joint stock company. Such right of the individual can be reinstated by the court if the unsatisfied creditors have been fully repaid or the directors have proved that the company was declared bankrupt due to adverse changes in the economic environment.

# Czech Republic

## Introduction

Under the Czech Insolvency Act, debtors' insolvency can be resolved by: (i) a formal reorganisation (reorganizace) that enables the debtor to continue in business; (ii) bankruptcy liquidation (konkurs) leading to the liquidation of the insolvent debtor; or (iii) a discharge of debts (oddlužení) as a specific method applicable mostly to individuals.

The Czech Insolvency Act regulates the process after the occurrence of the insolvency (úpadek) of a debtor who has multiple creditors. It sets out the criteria of two forms of insolvency: (i) debtor's inability to pay overdue debts (the liquidity test); and (ii) over-indebtedness (the balance sheet test).

The insolvency proceedings are opened on the basis of an insolvency petition filed by the insolvent debtor or by a creditor. The insolvency court examines whether the criteria of insolvency are met and, if so, confirms the debtor's insolvency and appoints the insolvency administrator. Creditors can register their claims within two months following the declaration of insolvency. Known creditors from the EU may register their claims in the period set out by the court in a letter addressed to them (usually 30 days following delivery). After the expiry of this period, the creditors' committee and the insolvency court decide which method of resolution of the debtor's insolvency will apply. The entire process of the insolvency proceedings, including filings made by the parties, resolutions of creditors' bodies, and decisions of the insolvency court, are available online on the website of the Czech Ministry of Justice. The proceedings are therefore (almost) fully public.

## Restructuring (pre-insolvency)

### Conditions for opening proceedings

A restructuring of loans or other debts before the opening of insolvency proceedings against the debtor is not expressly regulated under Czech law. It is usually based on contractual arrangements, such as standstill agreements or restructuring agreements, between the borrower (debtor) and the bank(s) (creditor(s)). We note that the EU Directive on preventive restructuring has not been implemented into the Czech legal system yet.

The methods and solutions used at this stage are fully up to the parties and their negotiation. They usually include restructuring of existing debts, new financing under new terms; capital contributions of existing or new investors or a sale of assets. It is advisable that creditors respect the general insolvency principles, such as fairness among creditors, to decrease the risk that the restructuring will later be challenged by the insolvency court or other creditors in the event of debtor's subsequent insolvency.

### Success Rate

The success rate will depend on the terms of the standstill or restructuring agreement in an individual case. In addition to the adopted economic measures, agreeing on a clear rights and obligations of the parties in the restructuring agreement appears to be one of the most important factors deciding the success of the restructuring.

### Pros and cons

**Pros:** The process is very flexible allowing the parties to be creative and less formal comparing to the formal methods. In addition, restructuring usually does not adversely affect reputation of the debtor and allows the debtor to keep the relations with the suppliers and clients without material deterioration.

**Cons:** The risks for the creditor are significantly higher than in the case of a formal post-insolvency reorganisation process. For example, risks include: the ineffectiveness of legal acts made by the debtor which prefer some of the creditors over others or which are detrimental to some of the creditors, e.g., additional security related to existing financing; and the consequences of subsequently opening insolvency proceedings, e.g.: (a) interruption of the process of registration (perfection) of new security; (b) ineffectiveness of security registered after the opening of insolvency proceeding; or (c) agreements made within the scope of pre-insolvency restructuring which are detrimental to some of the creditors can be declared ineffective for the purpose of the insolvency proceedings.

There is a civil liability risk for the directors towards the company and third parties. There is also a risk of criminal liability for directors, e.g., in the case of intentional preferential act made by a director of an insolvent debtor in favour of certain (preferred) creditor, where the pre-insolvency restructuring has not been approved by all creditors.

## Reorganisation (formal restructuring)

### Conditions for opening proceedings

A reorganisation is an alternative to insolvency proceedings, particularly where the process should not lead to the liquidation of a debtor. In practice, this method applies in the following cases:

— "Standard" reorganisation, which only applies to debtors that meet the following quantitative criteria: (a) total aggregate turnover in the previous financial year of at least CZK 50m (EUR 2m); or (b) employment of at least 50 full-time employees; and

— reorganisation on the terms agreed between the debtor and creditors before the initiation of the insolvency proceedings and presented to the insolvency court in the form of pre-agreed reorganisation plan (a "pre-packed" reorganisation). For a pre-packed reorganisation, the above quantitative criteria does not apply.

In addition to the standard conditions for opening insolvency proceedings described below, the insolvency court will decide on the reorganisation if: (a) it is proposed in the insolvency petition filed by the debtor or by a creditor (if certain conditions are met); or (b) if this method is chosen by a resolution of creditors' meeting or agreed by a majority of the secured and a majority of the unsecured creditors (in the case of pre-packed reorganisation). The reorganisation is carried out by the debtor, which remains in possession, under a reorganisation plan prepared by it, or a creditor. After the reorganisation plan has been approved by the creditors' (voting at the creditors' meeting in classes), it must be also approved by the insolvency court. If any of the creditors reject the plan and cram-down does not apply, or the court rejects the reorganisation plan and no new plan is approved in a repeated process, the court will decide that the debtor's insolvency will be resolved by way of a bankruptcy liquidation.

### Restructuring methods

The contents of the reorganisation plan can be negotiated between the debtor and the creditors. There are no specific statutory requirements for the reorganisation plan, however the following principles should be complied with: (i) priority rule (satisfaction of claims in priority reflecting the creditors' classes: secured creditors, unsecured creditors, subordinated creditors, shareholders); (ii) feasibility of restructuring (the restructuring and the debtor's performance of agreed obligations will not lead to the debtor's further insolvency); (iii) equal treatment of receivables (within the classes of claims); and (iv) fairness (in the distribution of profits).

Typical forms of reorganisation used in the Czech Republic are: (i) new financing of the borrower's enterprise (or its part) under new terms; (ii) restructuring the creditors' claims; (iii) a sale of assets (insolvency estate) or some of them or a sale of the enterprise; (iv) the merger of the debtor with another entity or transfer of the debtor's assets to its shareholder (creditors' rights continue to exist vis-à-vis the new debtor or renegotiation of such creditors' rights); or (v) the transfer of the debtor's assets and property to the creditors or to a newly incorporated entity in which the creditors hold a stake.

### Success rate

The success rate in the case of reorganisation depends on the terms of the respective reorganisation plan as well as on the underlying economic situation of the debtor. Reorganization usually does not adversely affect reputation of the debtor and allows the debtor to keep the relations with the suppliers and clients without material deterioration. It keeps the control over the business in the hands of the debtor's management (with some supervision of creditors and the insolvency administrator), who may propose its own terms and negotiate the restructuring measures with the creditors. From the perspective of all creditors (secured and unsecured) on average, the overall satisfaction is usually higher than in the case of a bankruptcy liquidation proceedings.

### Pros and cons

**Pros:** The reorganisation enables the further operation of the debtor's enterprise (as a going concern) under the remedial actions set out in the reorganisation plan. The costs of resolving the debtor's insolvency are split among all groups of creditors, in contrast with the case of bankruptcy, the costs are not borne mostly by unsecured creditors.

The reorganisation plan is subject to review and approval both by the creditors and the insolvency court. Additionally, the creditors can continuously inspect whether the debtor acts in compliance with the terms set out in the reorganisation plan. Reorganisation is less detrimental to the debtor's reputation than bankruptcy liquidation and is usually supported by its suppliers and off-takers.

**Cons:** From the perspective of the secured creditors, this method may mean that the recovery of their claims, as set out in the reorganisation plan, will take more time than in the bankruptcy liquidation leading to the debtor's liquidation. Claims of new lenders providing post-insolvency financing of the debtor within the scope of reorganisation are pari passu with the claims of secured creditors. Reorganisation is not permitted for debtors in liquidation, securities and commodities exchange brokers, and traders.

## Bankruptcy liquidation proceedings

### Conditions for opening proceedings

The conditions for opening insolvency proceedings as bankruptcy liquidation proceedings are: (i) the initiation of insolvency proceedings; (ii) a decision by the insolvency court declaring that the debtor is insolvent; and (iii) a decision by the insolvency court that the debtor's insolvency will be resolved in a bankruptcy liquidation.

### Restructuring methods

As a result of the bankruptcy proceedings, the creditor's claims are satisfied from the proceeds of the sale of the debtor's property (insolvency estate). This process leads to the liquidation of the debtor (in the case of legal entities). In this type of proceedings, there is no negotiation regarding the restructuring of the debtor's obligations or its corporate restructuring. The sale of the debtor's assets is in the hands of the insolvency administrator, who decides on the sale method with the consent of the creditors' committee, and in the case of a secured asset sale, the relevant secured creditor.

### Success rate

Secured creditors usually prefer bankruptcy proceedings. Their claims up to 100% of the value may be satisfied from the proceeds of the enforcement of security, typically a sale of the property or assets which are subject to security. If the enforcement proceeds are insufficient, the unpaid portion of the claim is registered as an unsecured claim. Regarding unsecured creditors, usually only a small portion of their registered claims is satisfied; in our practical experience, this is usually less than 5%.

### Pros and cons

**Pros:** The process is formally less complicated and secured creditors have a decent chance to have their claims repaid, depending on the value and ranking of the security) This method of resolving insolvency prevails under Czech law concerning insolvent corporate debtors, in particular if the debtor's business case is not viable.  This method has only limited advantages for debtors; however if the debtor's enterprise or its strategic assets are sold in bulk, the healthy part of the debtor's business can resume operations under a new investor relatively quickly.

**Cons:** Only a small part of unsecured creditors' claims is usually satisfied. The role of the insolvency administrator and the insolvency court prevails over the role of the creditors, i.e. this method does not encourage the creditors' pro-active approach. In more complicated cases, creditors' satisfaction may take several years. Debtors lose control over the business, which is fully taken over by the insolvency administrator and the possibility of the shareholders to satisfy any of their investments is practically excluded.

## Discharge of debts (individuals)

The discharge of debts is as a specific method of resolving insolvency that traditionally applies to individual debtors and entities whose debts do not originate from their entrepreneurial activity. It should be also noted that the fact that the debtor's obligations originated in their business activities may not be a strong hurdle anymore. In addition, a number of business entities invest in large NPL portfolios of debtors being under the discharge of debts. The proper understanding of the proceedings, and its likely outcome for creditors may be therefore crucial.

The debtor must request the court to approve the discharge of debts. There is no fixed satisfaction rate that would be required for the court to allow the debtor to start the proceedings, however the debtor must be able to repay at least approx. EUR 35 per month, insolvency costs and mandatory alimony. Creditors' claims can be satisfied (i) in a sale of the debtor's assets; or typically, (ii) pursuant to a repayment schedule approved by the court under which the debtor must pay a fixed sum (subject to a statutory maximum) to its unsecured creditors every month for up to five years together with a sale of the debtor's assets. The fixed sum is distributed among unsecured creditors in proportion to the value of their claims. During this period, the debtor only retains the minimum amount necessary for the debtor's personal needs.

The success rate for the creditors is rather low. In this method of resolving insolvency, the social interests of debtors are preferred to the economic interests of the creditors. The court can cancel a debt discharge on a number of grounds, e.g. debtor's failure or inability to comply with the terms of the discharge approved by the court, or if the debtor misuses the discharge scheme, and open standard insolvency proceedings. If the debtor fulfils all the conditions of the approved proceedings, the court will discharge all of the debtor's remaining debts.

# Hungary

## Voluntary restructuring

Under Hungarian law, restructuring tools are not yet regulated, except for those which bankruptcy proceedings can offer. However, this does not prevent the parties from reaching an agreement on a contractual basis using general Hungarian civil law. Additionally, Hungary is currently implementing Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on the 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).

Dealing with restructuring happens on an ad-hoc basis in Hungary. Furthermore, in syndicated deals banks usually do not see a common platform for restructuring.

The restructuring techniques most commonly used in Hungary are:

— obtaining more security;

— delegating a board observer;

— a haircut;

— a debt-to-equity swap;

— joint sale and sharing of income.

The Budapest Rules, which mirror the London Rules, have been adopted by the Banking Association. These rules are a non-binding set of principles together with template documentation for those banks who accept them. These rules helps creditors work together to reach a collective view on how a debtor should be given support (e.g. standstill, restructuring of loans and assistance with dealing with non-bank creditors who may bring down the company). Debtors also welcome the application of the rules which enable them to survive.

## Bankruptcy proceedings

Bankruptcy proceedings (csődeljárás) as listed in Annex A to the Regulation.

### Conditions for opening proceedings

The main conditions for a court to open bankruptcy proceedings are:

— the consent of the shareholder(s), although these proceedings can only be opened at the request of the debtor company;

— the annual account or interim balance sheet prepared within three months before the date of the bankruptcy request;

— the list of creditors;

— the payment of a court fee.

### Restructuring methods

During the proceedings, the debtor company is granted a payment moratorium to reach a settlement with its creditors. If the parties reach a successful settlement, the company can survive and avoid liquidation.

### Success rate

The number of successful bankruptcy settlements is low. This might be a consequence of how these proceedings are regulated. Under the current legislation, due to the rules regulating creditors' voting rights and the different interests of the two classes (secured and unsecured) of creditors, it is difficult to reach and then comply with a settlement agreement.

### Pros and cons

**Pros:**

— The debtor company can restructure its debts in a timely manner and survive which creditors can also benefit from (mitigating loss by avoiding the sale at liquidation price if the debtor goes insolvent), unless negotiating the settlement agreement is difficult given the high number of unsecured creditors (e.g. suppliers).

— Management remains in place and will be monitored by a court appointed administrator.
Cons:

— The debtor company can win time or "misuse" with the payment moratorium of 120 days that can be extended up to 365 days.

— The settlement agreement binds each creditor, although in practice it results in creditors losing a significant portion of their claims, e.g., 90%, due to the current regulations (the method under which the voting classes must be set up).

## Winding-up proceedings

### Liquidation proceedings

The Hungarian felszámolási eljárás means insolvency proceedings as referred to in the Annex A to the Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (the "Regulation").

### Conditions for opening proceedings

The main conditions for a court to open liquidation proceedings are:
If the request is submitted:

— by the debtor company, it must file the following documents:

- the annual accounts or interim balance sheet prepared within three months before the date of the liquidation request to certify that the debtor meets the insolvency test, i.e. that the company's debts exceed its assets or that the company does not, or foreseeably will not be able to, comply with its payment obligations when they are due and the its shareholders refuse to give an undertaking to guarantee the company's payment on time;
- the consent of its shareholders;
- a list of creditors; and
- a declaration that the company does not intend to request a bankruptcy moratorium.

— by a creditor, it should be evidenced that:

- the company failed to fulfil or to dispute its previously undisputed and acknowledged debts within 20 days of the due date, and failed to fulfil such debt on receipt of the creditor's written payment notice if the amount of the debt exceeds HUF 200,000 (EUR 670);
- the company failed to timely fulfil a payment obligation set out in a final and binding court judgment if the amount of the payment obligation exceeds HUF 200,000 (EUR 670);
- judicial enforcement proceedings against the company were unsuccessful; or
- the company failed to comply with its payment obligations set out in a bankruptcy settlement agreement,
- or the court ex officio opens liquidation proceedings if the bankruptcy proceedings were terminated due to a failure by the debtor to enter into a settlement agreement with its creditors, or at the request of the court of registration or the criminal court.

### Payment of a court fee

Liquidation proceedings cannot be opened if bankruptcy proceedings, which are reorganisation insolvency proceedings under Hungarian law, are pending against the debtor company.

### Restructuring methods

There are two exit options that allow the debtor company to be restructured:

— the payment of all the debts to each creditor; or

— reaching a settlement agreement with a majority of the creditors.

### Success rate

Liquidation proceedings end in the sale of all of the debtor's assets to satisfy its creditors' claims. If the creditor's claim is secured with a pledge, this secured creditor can expect to receive around 90% of the purchase price, while other creditors are highly unlikely to receive anything as the income from an asset sale is generally only sufficient to cover the liquidation costs.

### Pros and cons

**Pros:** minimum practical benefit for creditors but debtors may close business without generating more debts.

**Cons:**

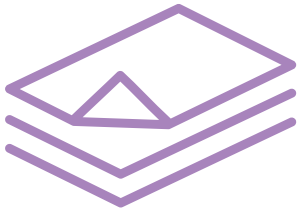
— If none of the exit options are used, the company will terminate as a result of the liquidation proceedings.

— There is no statutory deadline to complete the proceedings.

— The chance of the creditors fully recovering their claims is very low.

— Certain agreements and declarations by the debtor company can be challenged by the liquidator or any creditor as a result of which agreements and declarations may be invalidated.

— The liquidator has wide-ranging powers because he or she takes over the representation of the company regarding the liquidation of assets. Most of the decisions are subject to his or her discretion, although such decisions may be challenged before the court by the party affected by such decision, including the debtor, any of the creditors, or the creditors' committee.



# Poland

## Introduction

### Structure of restructuring proceedings

Insolvency law in Poland has undergone a significant reform over recent years intended to improve the efficiency of proceedings as well as to provide better opportunities for creditors and debtors threatened with insolvency (or already insolvent) to conclude an arrangement. The reform introduced a clear separation between restructuring law, currently regulated by the Restructuring Law dated 15 May 2015 and effective as of January 2016 (the "Restructuring Law"), and bankruptcy law regulated by the Bankruptcy Law dated 28 February 2003 (the "Bankruptcy Law").

The Restructuring Law provides for four types of restructuring proceedings, all designed to facilitate reaching an arrangement with creditors, and most not only offering debtors restructuring tools, but placing them on relatively safe ground for the distressed period in order to let them work out a solution and conduct the arrangement process:

— arrangement approval proceedings (postępowanie o zatwierdzenie układu);

— fast-track arrangement proceedings (przyspieszone postępowanie układowe);

— ordinary arrangement proceedings (postępowanie układowe); and

— remedial ("sanation") proceedings (postępowanie sanacyjne).

The structure of these proceedings is designed to reflect the rule of "gradation", where the scope of protection given to the debtor and restructuring instruments available in the relevant proceedings correspond with the scope of managerial powers that the debtor needs to give up, as further described below.

In principle, restructuring proceeding can only be initiated by an eligible debtor (except for remedial proceedings where the creditors are also entitled to file such petition regarding an insolvent entity), namely, a debtor that is insolvent (niewypłacalny) or threatened with insolvency, i.e. a debtor that despite discharging its liabilities will soon become insolvent. An entity will be considered insolvent if it meets any of the following criteria: (i) it is unable to pay its overdue debts (liquidity test), in which case insolvency will be presumed if the delay in payment exceeds three months; and (ii) over-indebtedness (balance sheet test), which test determines if the debtor's pecuniary obligations, excluding future liabilities and liabilities towards affiliates, exceed the value of its assets and if this continues for longer than 24 months.

There are two key requirements for most restructuring petitions; specifically, the attachment of a provisional restructuring plan as well as a specification of the choice of method for restructuring the debtor's liabilities. Despite the original application, the restructuring method can be changed to an alternative arrangement proposal at a later stage by a motion submitted by an eligible applicant.

The Restructuring Law has been prioritised over the Bankruptcy Law, which is reflected in the general rule that the bankruptcy court should suspend consideration of the bankruptcy petition until the restructuring petition is finally resolved. A further notable difference between bankruptcy proceedings and restructuring proceedings is that the latter does not provide a debt notification procedure. The list of creditors is determined by the court supervisor (nadzorca sądowy) or administrator (zarządca) based on the accounts of the debtor; in some circumstances, creditors have the right to appeal against the decision to place or omit their claims.

All restructuring proceedings focus on leading to an arrangement with the creditors that should cover all debt (including interest) which arose before the opening of given proceedings, subject to some exceptions provided by mandatory provisions of law. The arrangement is concluded by a voting procedure, which leads to a determination of whether the majority of creditors required by law supports the proposed arrangement. The arrangement, adopted by a suitable majority of the creditors, is subject to final approval by the court. The ultimate arrangement is binding on all of the creditors, both those who voted in favour of the agreement and those who opposed it, as well as those who did not take part in the procedure. The creditors are protected against the dismissal of restructuring proceedings or rejecting of the arrangement by enabling them in such circumstances to file a simplified bankruptcy application.

### Protections available to the debtors

In all new proceedings, except for arrangement approval proceedings, a debtor can be granted protection against its creditors. All enforcement proceedings concerning claims covered by the arrangement will be stayed by operation of law on the commencement of fast-track or ordinary arrangement proceedings. Such protection against enforcement goes even further in remedial proceedings, where a stay of all pending enforcement proceedings and a prohibition on commencing any new proceedings may also encompass creditors holding in rem security interests on the assets of the distressed entity, which, as a rule, are not covered by the arrangement. Furthermore, the scope of sanctions regarding the ineffectiveness of a debtor establishing security interests or disposing of its assets at the "pre-bankruptcy" stage has been extended to cover "pre-remedial" stage.

### No termination of credit agreements by banks

Furthermore, in principle a bank must not terminate a credit agreement entered into with a company in restructuring in reference to the events arising before the commencement of restructuring proceedings. The Restructuring Law also provides an express prohibition on the termination of tenancy and lease agreements concerning real property where the entity undergoing restructuring conducts its business (debtor's premises). These prohibitions apply respectively to lease and insurance agreements, bank account agreements, sureties, guarantees and letters of credit issued before the institution of restructuring proceedings.

### Arrangement with some creditors

The Restructuring Law introduces a possibility to enter into an arrangement with only some creditors. This legal instrument is mainly dedicated to large and very large enterprises, where the most effective method of restructuring is an arrangement with a specific group of creditors, singled out on the basis of objective, unambiguous and economically reasonable criteria (e.g. with banks). In such a situation, an arrangement with all of the creditors could be pointless, particularly if the debtor may reasonably assume that as a result of entering into an arrangement with some groups of creditors, it will be possible to satisfy 100% of the claims of the rest of them.

### Computerisation of restructuring and bankruptcy proceedings

Poland is in the process of implementing Directive (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on restructuring by establishing an electronic National Debt Register (Krajowy Rejestr Zadłużonych) (the "NDR"). The NDR will contain all of the decisions and rulings issued in proceedings as well as documents and other communications concerning each respective restructuring and bankruptcy case. The participants in proceedings should be able to file the required motions and documents through the register. It is intended also to operate as a "case-law" portal. The NDR is expected to be fully operational from 1 December 2020.

### General overview of the Bankruptcy proceedings

Bankruptcy proceedings can only be initiated in relation to a debtor who has become "insolvent". The debtor is deemed insolvent if the "insolvency test" (described in more details above) conditions are met. A claim can be filed either by the debtor or by its creditors (independently or jointly). If the debtor's assets are not sufficient to meet the costs of the proceedings or are sufficient to meet solely those costs, the court shall dismiss the application for a declaration of bankruptcy. The court may also dismiss the application if the debtor's assets are encumbered with collateral in rem (e.g. mortgage, pledge, registered pledge) to the extent that the remaining assets are insufficient to meet the costs of the proceedings.

In bankruptcy proceedings, the basic right of creditors is the right to submit claims in the course of proceedings. After the list of claims has been drawn up, creditors may object to the recognition or refusal of the claim. Objections shall be heard by a judge-commissioner at a hearing. An institution of the creditors' council is also available in such proceedings, regulated in the same way as in restructuring proceedings.

Following submission of the insolvency petition, the debtor's assets may be secured by a court decision or upon request. The security of the debtor's assets may consist in particular in the appointment of an interim court supervisor (tymczasowy nadzorca sądowy). In such a situation, after its establishment, the debtor is entitled only to perform ordinary management activities. Activities exceeding the scope of ordinary management require the consent of the interim court supervisor under pain of nullity. Moreover, at the request of the applicant, debtor or temporary court supervisor, enforcement proceedings may be suspended and the seizure of the bank account may be revoked. In certain situations it is also possible to apply other methods of security, including the establishment of forced administration over the debtor's assets.

The main effect of declaring bankruptcy is the fact that all monetary liabilities of the bankrupt, which have not yet been paid, become due on the date of declaring bankruptcy. On the other hand, non-monetary property liabilities are transformed into monetary liabilities and also become due and payable on the date of announcing bankruptcy. The assets of the bankrupt becomes a bankruptcy estate, which serves to satisfy the creditors of the bankrupt. The composition of the bankruptcy estate is determined by making an inventory and a list of receivables. On the date of declaring bankruptcy, the bankrupt loses the right of management and the possibility to use and dispose of the property included in the bankruptcy estate. The legal actions of the bankrupt regarding the property entering the bankruptcy estate are invalid. It is worth mentioning that after the declaration of bankruptcy, the debtor cannot be encumbered with any security interest (e.g. mortgage, pledge, registered pledge) to secure the claim arising before the declaration of bankruptcy.

Submission of a petition for bankruptcy may also results in the ineffectiveness of some of the legal transactions of debtor in relation to the bankruptcy estate, for example, legal transactions executed by the bankrupt within one year before the day of submission of a petition for bankruptcy disposing of the bankrupt's assets, if they were performed gratuitously or non-gratuitously but the value of the benefit provided by the bankrupt grossly exceeds the value of the benefit received by the bankrupt or reserved for the bankrupt or a third person.

The ultimate objective of these proceeding is the liquidation of the debtor's assets. The management of the enterprise is taken over by the trustee (syndyk), who should aim to sell the whole enterprise. If this is not possible, individual assets are sold. Once all of the assets have been sold and the amounts recovered, the trustee will distribute such amounts to the creditors in the order of preference determined by the mandatory provisions of law. A creditor of a registered pledge may be satisfied by taking over or disposing of the pledged asset if the agreement on the establishment of the pledge provides for such satisfaction of the pledgee and if such right is exercised within a time limit set out by the court.

The legal institutions provided in the Restructuring law often intermingle with the provisions of the Bankruptcy law. An example is the simplified bankruptcy petition, regulated in the Restructuring Law (as mentioned above), even though it initiates the procedure provided for in the Bankruptcy Law. On the other hand, the Bankruptcy Law leaves the institution of an arrangement in bankruptcy, to which the provisions of the Restructuring Law apply accordingly.

### "Pre-packs"

The reform introduced major changes to bankruptcy proceedings in Poland by limiting bankruptcy provisions to a single regular bankruptcy liquidation and bringing to the Polish legal system the institution of "pre-packaged sale" ("pre-pack"). The essence of a pre-pack is that all of a bankrupt's enterprise, or an organised part of it, or assets constituting a substantial part of its enterprise, is/are sold on terms negotiated with a potential buyer before formal proceedings commence. The court will consider a motion to accept the terms and conditions of the sale simultaneously with a bankruptcy petition. An approved sale will operate as an enforced sale (i.e. free of encumbrances) and the buyer will not be held liable for the debtor's obligations (including tax duties). In this solution, the sale is effective on the declaration of bankruptcy rather than after months or years of bankruptcy proceedings. On 24 March 2020, further changes to the pre-pack institution entered into force, which are aimed at increasing the protection of creditors and potential buyers. It should be stressed that the procedure will thus be extended in relation to the previous regulation. The following list underlines the major changes to the procedure:

— additional protection of creditors' rights through an obligation to attach a list security interest (known to such applicant) to the pre-pack application.

— each participant of the proceedings will be entitled to file a pre-pack application (also a debtor who did not file for bankruptcy);

— the possibility of selling components of the enterprise to more than one buyer;

— the purchaser will be able to file an application to repeal or amend the decision on the approval of the terms and conditions of sale (e.g. in the case of a significant change in the value of the enterprise disclosed after the decision on the approval of the sale);

— each submitted application for a pre-pack will be disclosed and in the case of several applications for a pre-pack, an auction will be held between the interested parties;

— the appointment of a temporary court supervisor or forced administrator mandatory if a pre-pack application is filed; and

— impose an obligation on the prospective buyer to pay a deposit of one tenth of the offered price.

### COVID-19 measures

A draft amendment to the insolvency law is envisaged in order to tackle the negative effects of the state of epidemic threat on the entrepreneurs. Pursuant to the proposed new rules, the obligation of board members to file for the bankruptcy of the company with liquidity problems which arose during an epidemic will be postponed to three months after the official date of cancellation of state of epidemic threat. Additionally, the restructuring cases will be further prioritised by the court at the time of the epidemic in order to save companies from liquidation.

## Types of restructuring proceedings

## Arrangement approval proceedings (postępowanie o zatwierdzenie układu)

### Conditions for opening

The proceedings for the approval of an arrangement are considered the least formal type of restructuring proceedings. The minimum participation by the court ensures that the burden of carrying out these proceedings lies firmly with the debtor. These proceedings are available to debtors threatened with insolvency who can reach an agreement with the required majority of creditors. The condition for initiating these proceedings is to prove that the total sum of disputed liabilities does not exceed 15% of all receivables whose holders are entitled to vote on the arrangement.

### Course of proceedings

The debtor remains in the possession of its business, however the due maintenance of the assets is overseen by a licensed supervisor (nadzorca układu) appointed by the debtor. The supervisor acts as an economic and legal advisor to the debtor, assisting the debtor in preparing restructuring plans, arrangement proposals and other actions, e.g. collecting the creditors' votes. The debtor and licensed supervisor enter into a civil law agreement whose provisions cannot in any way prejudice the debtor's right to manage the assets. Once the parties reach an agreement on the arrangement, the debtor will file a motion with the court seeking judicial approval of the arrangement. The only decision on merits issued by the court is on the acceptance or rejection of the motion.

### Success rate

Despite the simplified and debtor-friendly procedure, the market responded positively to these arrangement approval proceedings, which seems to be due to the lack of protection of the debtor against enforcement by its creditors at the pre-litigation stage. The success rate of arrangement approval proceedings is estimated at 87.5% for the period from 2016 to Q1 of 2019, however the number of such proceedings in comparison with other types is marginal.

### Pros and cons

**Pros:** The proceedings are formally less complicated and more flexible for the creditors and the debtor. From the legal perspective, these proceedings should move quickly as many of the actions should happen within a specific timeframe, e.g. the filing of the arrangement should happen within three months of the appointment of the supervisor and the court should make a decision within two weeks from the date of application. Consequently, given the confidentiality of the arrangements between the parties at the pre-litigation stage and promptly advancing the process of restructuring, this option is also attractive to debtors to avoid damage to the debtor's corporate reputation deriving from its financial difficulties.

**Cons:** From the debtor's point of view, the major disadvantage is the lack of protection of its assets against enforcement, i.e. until the arrangement is approved, enforcement proceedings are not suspended and any seizure of bank accounts is not revoked. The debtor's commercial agreements may also be terminated during the pre-litigation stage, e.g. lease agreements or financing agreements. Despite the appointment of the supervisor, the management of the debtor may be liable for damages. If the claims are widely dispersed, it may be difficult to meet short deadlines for conducting certain actions.

## Fast-track arrangement proceedings (przyspieszone postępowanie układowe)

### Conditions for opening

Fast-track arrangement proceedings can be initiated if the sum of contested liabilities does not exceed 15% of the total sum of liabilities. This type of restructuring procedure is characterised by several simplifications, compared to ordinary arrangement proceedings, that aim at reaching an agreement in the shortest possible time of around two to three months. The proceedings are carried out by the court and commence with the filing of a petition.

### Course of proceedings

An application to open fast-track arrangement proceedings is examined by the court based solely on the documents attached to the application. A positive decision leads to the court appointing a supervisor (nadzorca sądowy). The supervisor prepares and submits a restructuring plan, a list of receivables, and a list of disputed receivables (no list of inventories is made) to the judge-commissioner within two weeks from the date proceedings are opened. The debtor will continue to manage its enterprise; however, the debtor must obtain the supervisor's approval to conduct any activities exceeding the scope of ordinary management (exceptionally, an administrator (zarządca) may be appointed to take over full management). In this procedure, unlike in arrangement approval proceedings, enforcement proceedings carried out against the debtor regarding the debt which constitutes a part of the arrangement, are in principal suspended. The regulations enable a judge-commissioner to revoke seizures made in enforcement proceedings that commenced before the date of restructuring proceedings were opened.

### Success rate

The success rate in fast-track arrangement proceedings is average and has fluctuated around 53% since the Restructuring Law became effective. However, the number of initiated proceedings vastly exceeds the figure of other types of restructuring proceedings combined together.

### Pros and cons

**Pros:** The debtor's assets are protected by the suspension of enforcement proceedings concerning the claims covered by the arrangement (stay of enforcement relating to claims not covered by the arrangement may be ordered for up to three months if the asset is necessary for running of the enterprise), and their initiation after the opening of the proceedings is inadmissible. Fast-track arrangement proceedings are available to bond issuers. Any decision by the debtor which exceeds the scope of ordinary management must be validated by the supervisor before or within 30 days from the day when it was performed. This regulation eliminates the risk of decision blockages in current operations and delays in making larger payments under contracts. A decision on the adoption and approval of the arrangement is made quickly and can therefore benefit the creditors.

**Cons:** The inability to object to the list of receivables, i.e. the creditor cannot challenge the amounts of claims determined in the list or any omissions of claims. There is also time pressure due to the relatively short duration of the proceedings.

## Ordinary arrangement proceedings (postępowanie układowe)

### Conditions for opening

Ordinary arrangement proceedings are for debtors whose sum of disputable claims exceeds 15% of their total debt. The model of ordinary arrangement proceeding adopted by the Restructuring Law is broadly equivalent to one of the restructuring options available before the reform, i.e. bankruptcy proceedings aimed at an arrangement with creditors.

### Course of proceedings

Submitting a motion to initiate ordinary arrangement proceedings empowers the court to suspend enforcement proceedings conducted against the debtor and revoke seizures of its bank accounts by appointing a temporary court supervisor (tymczasowy nadzorca sądowy). The commencement of proceedings is subject to the debtor substantiating an ability to satisfy the costs of the proceedings and liabilities arising after the proceedings are initiated. For this purpose, the debtor must justifiably demonstrate that it has the means to cover these expenses or that it is or will be able to generate enough revenues. Regardless of the formalities, these proceedings are similar, in terms of the impact on the debtor's management rights and the protection from creditors, to fast-track arrangement proceedings.

### Success rate

Ordinary arrangement proceedings are lengthy due to the higher percentage of disputed claims. According to publicly available statistics, ordinary arrangement proceedings are less effective compared to other types of restructuring proceedings. The final outcome of the ordinary arrangement proceedings in the form of cancellation of the whole process occurs almost twice as frequently compared to reaching an agreement on arrangement. This lack of effectiveness means that the market shows little interest.

### Pros and cons

**Pros:** In principle, unlike remedial proceedings the debtor is not deprived of the possibility to conduct its business; creditors have a real influence on the proceedings on the creditors' committee and can challenge the list of claims.

**Cons:** There is no statutory deadline to complete the proceedings.

## Remedial ("sanation") proceedings (postępowanie sanacyjne)

### Conditions for opening

Remedial proceedings are intended to enable deep economic restructuring of the debtor's assets and obligations, and may be initiated with a motion to the court filed by the debtor or its creditors. Two key factors that distinguish remedial proceedings from other restructuring proceedings are: multiple restructuring options and the broadest scope of protection of the debtor's assets against the creditors.

### Course of proceedings

After the initiation of the proceedings, the debtor's estate becomes the "remedial mass" (masa sanacyjna) and the debtor is in principle deprived of its managerial powers. The elements of the remedial mass are determined by the administrator (zarządca) appointed by the court, however the Restructuring Law provides for the possibility of the debtor to manage its assets (under certain conditions) within the scope of the debtor's ordinary management.

Remedial proceedings offer certain remedial options that have a significant impact on the achievement of restructuring objectives, which include: (i) the possibility to withdraw from executory contracts ("cherry picking right"), regardless of the provisions contained in them concerning their termination; (ii) the option to adjust the employment level to the needs of the reorganised undertaking; (iii) the expiration of powers of attorney and commercial proxies (prokura) by virtue of law; (iv) the ineffectiveness of the debtor's acts regarding the remedial mass under certain circumstances, e.g. security established by the debtor in one year before the date of filing the application to open remedial proceedings which has not been established directly in connection with the receipt of the performance by the debtor; and (v) the possibility to dispose of redundant assets on principles analogous to those of bankruptcy proceedings (free of encumbrances). All of these remedial powers are under the restrictive supervision exercised by the judge-commissioner and the creditors.

Remedial proceedings should, in principle, take 12 months until the decision to approve or refuse to approve the arrangement becomes final, during which time, due to the implementation of the arrangement with the creditors, the debtor should regain the ability to fulfil its obligations and be able to bear the costs of the arrangement.

### Success rate

In terms of their effectiveness, remedial proceedings stand out negatively from the other types of restructuring proceedings. The outcome of the proceedings is more often the annulment of the proceedings rather than an arrangement being agreed. This is partly because remedial proceedings are chosen by companies in the most difficult situation; formalised framework of the procedure consumes enormous amount of time compared to remaining forms of restructuring proceedings.

### Pros and cons

**Pros:** They provide the debtor with the strongest protection against enforcement of debts, e.g. preventing the enforcement of pledges or mortgage. Among other things, the court administrator is also entitled to terminate agreements which are disadvantageous to the debtor, irrespective of any provisions to the contrary. The debtor may be able to resume its business and the creditors will be adequately satisfied in accordance with the adopted arrangement.

**Cons:** From the perspective of the secured creditors, this method may mean that the recovery of their claims will take more time than in bankruptcy liquidation leading to debtor's liquidation. Additionally, the inadmissibility of enforcement raises the fear of cooperation with debtors forcing prudential solutions, which may hinder the proper functioning of the debtor's enterprise or obtaining financing.

# Romania

### Preventing insolvency

Romanian insolvency legislation provides debtors in financial distress with the option of the preventive concordat, a pre-insolvency proceeding aimed at reaching an agreement between debtor and creditors for avoiding insolvency.

### Preventative concordat provided by the Insolvency Law

Preventive concordat is a contract agreed by the syndic judge between the debtor, on the one hand, and creditors holding at least 75% of the value of claims accepted and uncontested, on the other hand, where the debtor proposes a plan to save its business and to cover the receivables of these creditors against it, and the creditors agree to support the debtor's efforts.

### Preventive concordat procedure

Applications to open the preventive concordat procedure are exclusively the competency of the syndic judge in whose jurisdiction the debtor's head office is situated, and are ruled on within 48 hours of receipt.

The debtor must file an application with the tribunal that has jurisdiction over its headquarters to open the preventive concordat procedure and propose a provisional conciliator from among insolvency practitioners (the fee will be borne by the debtor).

The conciliator performs the following tasks:

— draws up a list of creditors, including challenged creditors or those whose claims are in dispute, and a list of concordat's creditors;

— develops, with the debtor, the proposed preventive concordat, with its components, namely the plan of the preventive concordat and the recovery plan;

— takes the necessary steps for the amicable settlement of any dispute between debtor and creditors or between creditors;

— requests the syndic judge to affirm the preventive concordat;

— oversees the fulfilment of the obligations assumed by the debtor through the preventive concordat;

— informs the meeting of the concordat's creditors immediately of the failure of the debtor to perform/properly perform its obligations;

— prepares and submits to the meeting of the concordat's creditors monthly or quarterly reports on its activities and those of the debtor; conciliator reports contain his/her opinion on the existence or, where appropriate, absence of a reason for the rescission of the preventive concordat;

— convenes the meeting of the concordat's creditors;

— requests the court to close the preventive concordat procedure;

— performs any other duties stipulated by this law, established through preventive concordat or set up by the syndic judge.

### The proposed plan

Within 30 days of its appointment, the provisional conciliator will, together with the debtor, compile a list of creditors and a proposal of the preventive concordat which will be promptly notified to the creditors by the provisional conciliator in a manner which ensures the possibility to verify receipt of the offer.
The proposal of the preventive concordat must be filed with the court and include the proposed preventive concordat, to which must be attached the debtor's statement regarding its financial difficulty and the list of known creditors, including those whose receivables are challenged in whole or in part, specifying each receivable's value and the collateral accepted by the debtor.

The proposed preventive concordat should include a recovery plan of the business and the ratio of receivable satisfaction, which should be of at least 20% as a result of the implementation of the recovery measures proposed during the first year.
For this purpose, the debtor can propose, among other things, an increase in the share capital, bank loans, or loans provided by the shareholders, and the selling of assets. The deadline set for the payment of the receivables established through the preventive concordat plan should be 24 months from concluding the preventive concordat, subject to a possible extension of another 12 months.

### Effects

From the moment the court validates the preventive concordat, the enforcement procedures commenced by the concordat's creditors are suspended by effect of law. The lapse of any statute of limitation for enforcement against the debtor is also suspended.

On the same date, accrual of interest and penalties are suspended regarding the concordat's creditors unless expressly decided to the contrary within the preventive concordat project.

All of these effects occur from the date of the notice of the decision acknowledging the preventive concordat, only during the concordat period and only regarding the concordat's creditors.

The debtor carries on its business as usual, in accordance with the preventive concordat and under the supervision of the conciliator.

### Outcome of proceedings

If the preventive concordat procedure completes successfully and the syndic judge finds that the object of the preventive concordat has been accomplished, the alteration of the receivables (related to the concordat's creditors) as provided by the preventive concordat remains irrevocable.

If during the preventive concordat proceedings, before reaching its deadline, the conciliator considers that success cannot be reached for reasons not related to the debtor, he/she may request the proceedings to be closed.

### Conclusion

Such proceedings are used infrequently because creditors often consider that actual insolvency provides them with greater control over the debtor. At the same time, debtors prefer the more thoroughly regulated insolvency proceedings, in which a lower number of creditors must cooperate.

### Insolvency proceedings

Insolvency proceedings commence on the filing of a request before the tribunal that has jurisdiction over the debtor's headquarters, regardless of any changes in headquarters that occur after the filing of the insolvency request.

### Who can file for insolvency

A claim can be filed either by the debtor or by its creditors (independently or jointly).

By the debtor: if the debtor files for its own insolvency, it must already be insolvent or insolvency must be imminent. If the debtor is already insolvent, it must file for insolvency within 30 days of the date the insolvency status arises (debts exceeding RON 40,000, approximately EUR 8,300). Additionally, the debts owed by the debtor to the state must be lower than 50% of the total value of debts declared.

By the creditors: any creditor can file for the insolvency of the debtor if it has a claim which is due, certain, and has a monetary value higher than RON 40,000 (approximately EUR 8,300). When such claim is filed by a debtor's employee(s), the value of the claim should at least equal six average gross salaries in Romanian economy (as calculated by the Romanian Institute for Statistics).

### How to open insolvency proceedings

Insolvency is opened on a court decision rendered by a syndic judge (a judge who specialises in insolvency matters) from the tribunal where the debtor is headquartered (exclusive jurisdiction). The judge will appoint a temporary judicial administrator and set up the milestones for important matters, e.g., by when the creditors should submit their claims; by when the preliminary receivables chart will be prepared and published; and by when the creditors' assembly will be set up.

### Restructuring actions

In the same court decision, the debtor can preserve its administration rights under the supervision of the appointed judicial administrator, or, conversely, any further debtor's activity will be coordinated by the judicial administrator.

In addition, the judicial administrator will review all the contracts the debtor concluded in the two years before the opening of the insolvency proceedings. If the judicial administrator decides that such previous contracts were concluded with the sole purpose of damaging the creditor's rights, he/she can request the syndic judge to annul the contracts. The syndic judge will render a decision regarding such annulment.

Equally, the judicial administrator will review all pending contracts and, if they are detrimental to the debtor, may decide to terminate them.

### Reorganisation plan

The debtor, the judicial administrator, or the creditor/(s) (with at least 20% of the value of the receivables) can propose a reorganisation plan. The plan can be for up to three years initially, plus a single extension up to four years that may be voted by creditors.

The plan must address several issues, including the treatment applied to unfavoured (delayed or reduced) receivables, payments to be received by each group of creditors compared to their bankruptcy quota estimated based on a valuation report, sources of paying current receivables, etc.

Equally, through this plan it will be decided how the debtor's activity will be restructured, e.g., merger, selling assets, restructuring employment, keeping or terminating contracts, modifying the debtor's constitutive acts and redistributing the managing powers.

If the reorganisation plan fails, the debtor will enter bankruptcy proceedings leading to liquidation. Any amendments of receivables through the reorganisation plan will be reverted in the case of bankruptcy after an unsuccessful reorganisation.

### Success rate

As the Insolvency Law does not set out any economic conditions to be fulfilled by the reorganisation plan, and merely allows the judge to check the approval conditions of the plan, in practice only a few reorganisation plans are successful.

### Pros and cons

**Pros:** the reorganisation allows debtors to reduce their financial burden and to continue operating. Also, it is a legal requirement that a reorganisation plan provides creditors with a better recoevery than in case of bakruptcy.

**Cons:** however, given several broadly interpretable provisions of the Insolvency Law, reorganisation plans are sometimes used fraudulently by Romanian debtors. Additionally, reorganisation usually delays recovery by secured creditors, which may prefer faster recovery through liquidation.

## Bankruptcy proceedings provided by the Insolvency Law

### Conditions for opening

These proceedings can be opened directly as described above in point II on Insolvency proceedings, by a court decision rendered on a claim filed in this respect, or on a failure to achieve positive results during insolvency proceedings.

Thus, the bankruptcy proceedings are also opened through a court decision. The syndic judge will appoint a judicial liquidator and set up the milestones for important matters.

If bankruptcy follows the insolvency proceedings, the most important matters are already established, e.g. the receivables chart and the categories of creditors to receive receivables.

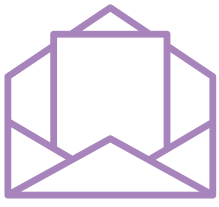
If bankruptcy has directly been requested, the syndic judge and the judicial liquidator must perform the tasks described above in insolvency proceedings to identify the creditors, their rank, the value of their claims, and to set up the receivables chart.

### Pre-liquidation measures

The judicial liquidator will: identify, catalogue, and value all of the debtor's assets; immediately sell any perishable goods; secure the remainder of the goods/assets; and take all the necessary measures to preserve the debtor's assets. All findings will be set forth in a final evaluation report.

### Asset liquidation

Once the pre-liquidation measures have been taken, the judicial liquidator will propose to the creditors' assembly the methods of selling the assets, e.g. individually or as a whole. The assets might be sold directly or in a public tender. The judicial liquidator will also have to advertise the sale of the assets.



### Distribution of collected amounts

Once all of the assets have been sold and the amounts recovered, the judicial liquidator will distribute such amounts to the creditors in the following order of preference:

— Taxes, stamp duties, and other expenses incurred in the insolvency proceedings, including costs for the preservation and administration of the debtor's assets and the fees for the judicial administrator/liquidator and experts hired by the former.

— Creditors with real securities, e.g. mortgages over immovable or over movable assets.

— Creditors who provided financial support during the early insolvency period.

— Receivables accrued from labour agreements.

— Receivables consisting of debts resulting from the debtor's usual business after commencing the insolvency proceedings.

— Tax duties.

— Receivables consisting of maintenance, children allowances or other alimony.

— Bank loans, interest and other corresponding expenses, receivables from the supply of products, services or works, rent.

— Other unsecured receivables.

— Subordinated receivables; in the following order of preference:

  - receivables owned to bad-faith (sub)/owners of the debtor's goods; loans granted to the debtor by associates holding at least 10% of share capital, or by a member of the economic interest grouping;
  - receivables from free transfers.

### Pros and cons

**Pros:** bankruptcy proceedings allow certain creditors (usually only secured creditors) to recover most of their receivables in a timely manner.

**Cons:** however, in times of economic restraint, creditors may find difficult to sell the debtor's assets at reasonable prices, as a significant number of other debtors are also selling on the same market and healthy companies are reluctant to invest during an economic crisis.

# Slovakia

## Introduction

Slovak insolvency law recognises the following processes available to debtors in financial difficulties: (i) bankruptcy liquidation pursuant to part 2 of the Slovak Insolvency Act (konkurz) as a process leading to the liquidation of the insolvent debtor; (ii) formal restructuring (reštrukturalizácia), which enables the debtor's business to continue; and (iii) the discharge of debts as a specific process applicable only to individuals (oddĺženie).

The Slovak Act on Bankruptcy and Restructuring (the Slovak Insolvency Act) regulates the process after the occurrence of insolvency (úpadok) or impeding insolvency (hroziaci úpadok). It sets out the criteria of two forms of insolvency: (i) the debtor's inability to pay its overdue debts (the liquidity test); and (ii) over-indebtedness (the balance sheet test).

## Restructuring (informal restructuring, pre-insolvency)

### Conditions for opening

A restructuring of loans or other debts before the opening of insolvency proceedings against a debtor is not expressly regulated under Slovak law. It is usually based on contractual arrangements such as standstill agreements or restructuring agreements between the borrower (debtor) and the bank(s) (creditor(s)). We note that the new EU Directive on preventive restructuring has not been implemented into the Slovak legal system yet.

The measures used at this stage are similar to those described in restructurings. It is advisable that creditors respect the principles set out for the restructuring plan to decrease the risk that the restructuring will later be challenged by the insolvency court or other creditors in the event of the debtor's subsequent insolvency.

### Success Rate

The success rate will depend on the terms of the standstill or restructuring agreement in each individual case. Selection of appropriate financial, management, structural and technical measures as well as precise specification of rights and obligations of the parties to the standstill agreement are one of the crucial aspects of the successful restructuring.

### Pros and cons

**Pros:** the advantages of this process are similar to the (post-insolvency formal) restructuring, except for the fact that the process is less formal and more flexible for the creditors and the debtor.

**Cons:** the risks are significantly higher than in the case of a formal (post-insolvency) restructuring process. For example, risks include: (i) the ineffectiveness of legal actions taken by the debtor which prefer some of the creditors over others, or which are detrimental to some of the creditors, e.g., additional security related to existing financing; (ii) the consequences of subsequently opening insolvency proceedings, e.g.: (a) interruption of the registration process (perfection) of new security, (b) ineffectiveness of security registered after insolvency proceedings are opened, or (c) agreements made in the scope of pre-insolvency restructuring which are detrimental to some of the creditors that can be declared ineffective in insolvency proceedings; (iii) a risk of penalties imposed on and the civil liability of directors to the company and third parties.

There is also a risk of criminal liability on directors, e.g., in the case of an intentional preferential act done by a director of an insolvent debtor in favour of certain (preferred) creditors, where the pre-insolvency restructuring has not been approved by all creditors.

## Restructuring (formal restructuring)

### Conditions for opening

As an alternative, the debtor's insolvency (or impeding insolvency) can be resolved by restructuring, which is used when insolvency proceedings should not lead to the debtor's liquidation. The debtor or its creditor (with the debtor's consent) may file a petition for restructuring if they authorised an insolvency administrator to prepare an expert opinion on the feasibility of the restructuring and such expert opinion supports the restructuring. The insolvency court will decide on the restructuring if: (a) it is proposed in the insolvency petition filed by the debtor or by a creditor, as described above; (b) the debtor is a legal entity in insolvency (or impending insolvency) carrying out business; (c) the expert opinion supporting the restructuring is not older than 30 days and meets statutory required conditions, was prepared by a competent insolvency administrator, and is clear and comprehensible. The restructuring is carried out by the debtor, who remains in possession, under a restructuring plan prepared by the debtor or a creditor. Creditors have to register their claims in 30 days following the approval of restructuring; the late registration is disregarded and after the approval of the plan by the court, such creditors lose the right to enforce such claims. After the restructuring plan has been approved by the creditors' (voting by the board of creditors and at the creditors' meeting in classes), it must also be approved by the insolvency court. If either of the creditors' classes rejects the plan and the cram down does not apply, or the court rejects the restructuring plan, the court will decide that the debtor's insolvency will be resolved in a bankruptcy liquidation.

### Restructuring methods

The restructuring plan shall be drawn up on close cooperation between the debtor, the board of creditors and the insolvency administrator. The restructuring plan must ensure the highest possible satisfaction for the debtors' creditors while still being realistic and sustainable. Further, the restructuring plan must guarantee to all unsecured creditors that the satisfaction of their claims is at least 20% higher than in a hypothetical bankruptcy.

Typical measures adopted in restructurings in the Slovak Republic are: (i) restructuring of the creditors' claims; (ii) sale of assets (insolvency estate) or their part or the sale of the enterprise (or its part); (iii) issuance of new shares in the debtor; (iv) corporate transformation of the debtor, e.g. merger of the debtor with another entity or transfer of the debtor's assets to its shareholder (creditors' rights continue to exist vis-à-vis the new debtor or renegotiation of such creditors' rights); (v) transfer of the debtor's assets and property to the creditors or to a newly incorporated entity in which the creditors hold a stake; or (vi) changes to the corporate documents of the debtor or structure of the ownership rights of the debtor's shareholders.

### Success rate

The success rate in restructurings depends on the terms of the respective restructuring plan. From the perspective of all creditors (secured and unsecured), on average overall satisfaction is usually higher. Similarly as in case of informal restructurings, main factors influencing success of the restructuring process are selection of appropriate financial, management, structural and technical measures as well as precise specification of rights and obligations of the parties to the restructuring plan.

### Pros and cons

**Pros:** the restructuring enables further operation of the debtor's enterprise (as a going concern) under the remedial actions set out in the restructuring plan. The restructuring plan is subject to review and approval both by the creditors and the insolvency court. Additionally, the creditors can continuously inspect whether the debtor acts in compliance with the terms set out in the restructuring plan. Restructuring is less detrimental to the debtor's reputation than the bankruptcy liquidation and is usually supported by its suppliers and off-takers. Restructuring is typically a quicker process than bankruptcy due to certain statutory periods.

**Cons:** From the perspective of secured creditors, this method may mean that the recovery of their claims, as set out in the restructuring plan, will take more time than in bankruptcy leading to the debtor's liquidation, as the recovery can be split to instalments payable in several years. Restructuring is not permitted for debtors in liquidation, securities and commodities exchange brokers, or traders.

## Bankruptcy liquidation proceedings

### Conditions for opening

The conditions for opening insolvency proceeding as bankruptcy liquidation proceedings are: (i) commencement of insolvency proceedings; and (ii) a decision of the insolvency court declaring the bankruptcy liquidation of the debtor.

Insolvency proceedings are opened on an insolvency petition filed by the insolvent debtor or by its creditor. The petitioner is required to deposit EUR 1,500 to cover insolvency costs. The insolvency court examines whether the insolvency criteria are met and if there are sufficient funds for the debtor to undergo the insolvency process, and, if so, confirms the debtor's insolvency and appoints an insolvency administrator. Creditors can register their claims in the standard period of 45 days following the declaration of insolvency. If the claim is not registered within the registration period, a creditor cannot exercise its voting rights or other rights related to the claim; if the claim is secured and it is not registered within the 45-day period, the security rights shall be disregarded. Most of the insolvency process, from the decision of the insolvency court on the commencement of insolvency proceedings and including reports by the insolvency administrator and the decisions of the insolvency court, are available on the website of the Slovak Ministry of Justice.

### Restructuring methods

As a result of the bankruptcy proceedings, the creditor's claims are satisfied from the proceeds of the sale of the debtor's property (insolvency estate). The process usually leads to the liquidation of the debtor, in the case of legal entities. In this type of proceedings, there is no negotiation regarding restructuring the debtor's obligations or its corporate restructuring. Any sale of the debtor's assets is in the hands of the insolvency administrator who decides on the sale method based on the instructions of the creditors' committee, and in the case of a secured asset sale, the relevant secured creditor(s).

### Success rate

Bankruptcy proceedings are usually preferred by secured creditors, whose claims up to 100% in value may be satisfied from the proceeds of the enforcement of security, typically selling the property or asset which is subject to security. If the proceeds of enforcement are insufficient, the unpaid portion of the claim is registered as an unsecured claim. Regarding unsecured creditors, usually only a small portion (if any) of their registered claims is satisfied.

### Pros and cons

**Pros:** the process is formally less complicated and secured creditors have a decent chance to have their claims repaid, depending on the value and ranking of the security. This method of resolving insolvency prevails under Slovak law regarding insolvent corporate debtors, in particular when the debtor's business is not a going concern.

**Cons:** only a small part of the unsecured creditors' claims is usually satisfied. The role of the insolvency administrator and the insolvency court prevails over the role of the creditors, i.e. this method does not emphasise creditors' pro-active approach. In more complicated cases, creditors may have to wait several years for satisfaction.

## Discharge of debts (individuals)

The discharge of debts is a specific method of resolving insolvency that applies only to individual debtors (individual persons as well as entrepreneurs), while the insolvency of entrepreneurs may also be resolved through bankruptcy liquidation proceedings. In the current practice of Slovak insolvency courts, the discharge of debts represents the vast majority of the insolvency courts' agenda. An adequate knowledge of the process, its rules and impact it may have on the creditors is essential for the businesses investing in NPL portfolios.

The debtor must request the court to approve the discharge of debts and in the proceeding he/she must be represented by the Centre for legal aid, or by an attorney-at-law appointed by the centre for legal aid. The discharge of debts is for an individual debtor available only once every ten years and only if there is an ongoing execution or similar proceeding concerning the debtor (debtor's assets).

Creditors' claims can be satisfied: (i) by a sale of the debtor's assets in bankruptcy proceedings; or (ii) pursuant to a repayment schedule approved by the court under which the debtor must pay a fixed sum to its unsecured creditors (by monthly/semi-annual/annual instalments or in a lump sum) for five years. Under the repayment schedule, at least 30% of the unsecured claims must be satisfied and the overall satisfaction rate of the unsecured creditors must be at least 10% higher than in a hypothetical bankruptcy. During this period, the debtor only retains the minimum amount necessary for his/her personal needs.

The success rate for creditors is rather low. In this method of resolving insolvency, the social interests of the debtors are preferred to the economic interests of the creditors. The court can cancel a debt discharge on a number of grounds, e.g. the debtor's failure or inability to comply with the terms of the discharge approved by the court, or if the debtor misuses the discharge scheme. If the debtor fulfils all of the conditions of the approved proceedings, the court will discharge all the remaining debts, i.e. debts which can be satisfied only in bankruptcy or via the repayment schedule to the extent they were not satisfied in the insolvency proceedings.

# Ukraine

## Introduction

Ukraine has experienced several economic crises over the last 30 years: in 1998, 2008, 2014 and most likely in 2020. Each crisis was accompanied by a wave of debt restructurings in several sectors of economy and also in significant debt write-offs of many borrowers as well as numerous insolvencies. The banking crisis of 2014 and 2015 led to massive insolvencies among commercial banks: over half of the commercial banks (95 banks) went insolvent and came under temporary administration of the Deposit Guarantee Fund; the largest bank, Privatbank, was taken over by the state of Ukraine.

This dire situation in the banking sector and inefficient corporate insolvencies have resulted in the adoption of the Law of Ukraine On Financial Restructuring, which is seen as a solution for the non-performing assets issue for banks to agree on voluntary restructuring with their borrowers, and the adoption of the new Bankruptcy Code of Ukraine.

For a long time, insolvency proceedings in Ukraine were regulated by the Law of Ukraine "On Solvency Rehabilitation of the Debtor or Declaring Its Bankruptcy" dated 14 May 1992, which demonstrated its absolute ineffectiveness and outdatedness. In response to this, on 18 October 2018, the Ukrainian Parliament adopted the Bankruptcy Code, which became effective on 21 October 2019 (the "Bankruptcy Code"). The Bankruptcy Code introduced a range of changes to strengthen the transparency and efficiency of insolvency proceedings, including a concept of consumer insolvency, i.e., the insolvency of individuals (previously insolvency proceedings existed only for individuals registered as private entrepreneurs).

## Out-of-court rehabilitation procedure

### Pre-bankruptcy restructuring proceedings

Pre-bankruptcy restructuring proceedings are considered an out-of-court and out-of-bankruptcy settlement as no formal insolvency proceedings are commenced. At the same time, the court decides whether to accept the application to approve the restructuring plan, and whether to approve the plan itself. If the court finds that the restructuring plan does not meet the requirements of the Bankruptcy Code (e.g. the amounts, procedure, and terms of repayment of the creditors' claims or scope of the trustee's powers were not indicated in it), the initiation of pre-bankruptcy proceedings will not be approved. Thus, notwithstanding the "out-of-court" nature, pre-bankruptcy proceedings still require the court's involvement.

### Conditions for opening

Only a debtor (based on the decision of the founders (participants, shareholders)), but not the creditors, does have the right to initiate the pre-bankruptcy restructuring procedure. No specific conditions are provided in law for starting this procedure. However, the main purpose of the procedure is to prevent the debtor's bankruptcy by taking relevant and efficient organisational, management, financial and other measures regarding the debtor's activity.

### Restructuring methods

The procedure includes the elaboration and adoption of the restructuring plan, which may consist of the same restructuring methods as in bankruptcy proceedings. Additionally, the restructuring plan can provide for the adoption of measures to obtain loans, as well as propose the split of creditors participating in the restructuring proceedings into different categories. To approve the restructuring plan, the debtor convenes a meeting of creditors by written notification of all creditors who are to take part in the restructuring. In case the restructuring plan provides for participation of secured creditors, such plan must be approved by the secured creditors (in each category) holding 2/3 of creditors' votes out of the total amount of secured claims included in the restructuring plan. If the restructuring plan foresees a change in the priority of the claims of secured creditors, each of them has to vote for such a plan. Moreover, the restructuring plan must be approved by unsecured creditors (in each category) holding more than 50% out of the total amount of unsecured claims included in the restructuring plan. The application of any restructuring methods should be approved by the court and should not take longer than 12 months.

### Pros and cons

**Pros:** pre-bankruptcy restructuring proceeding allows creditors to participate in the restructuring proceedings and agree on a restructuring plan which best fits their interests and allows debtors to continue their business during the restructuring process. It is up to the debtor to decide which creditors to invite to the procedure and include in the restructuring plan depending on whether or not the debtor's obligations toward a creditor need to be restructured. During the period specifically indicated in the restructuring plan, it is not possible to start bankruptcy proceedings or recover any debts in a way that is not prescribed by the restructuring plan, which is a big advantage for the debtor. Moreover, only debtor decides which creditors will be included in the restructuring plan, which may have a positive influence on the restoration of the debtor's solvency. The pre-bankruptcy restructuring proceedings provide a lot of freedom to both debtor and creditors in negotiating and finding the most appropriate way of restructuring through adoption of relevant and efficient organisational, management, financial and other measures regarding the debtor's activity.

**Cons:** no moratorium or standstill (that would be enforceable by law and not just by parties' performance) is available for the period of developing and negotiating the restructuring plan. Moreover, the term of restructuring procedure is limited to 12 months, which may be not sufficient to implement all the necessary measures to restore the debtor's solvency. Additionally, those creditors who were not included in the restructuring plan may use other restructuring methods (e.g., commence the insolvency proceedings), which may affect the debtor's ability to follow the restructuring plan approved within the pre-bankruptcy restructuring procedure.

### Success rate

The option of pre-bankruptcy proceedings has been in place in Ukraine for more than ten years, though its terms undergone various changes. During this period, it has been used quite rarely and based on the public information, it has not proved its efficiency so far. This can be explained by a common tendency to use the available bankruptcy procedures at a quite late stage, when the debtor's financial difficulties were far too serious. This may, however, change, with the new Bankruptcy Code in place and given that many businesses, in the circumstances of global difficulties as a result of the COVID-19 pandemic, may need more or less simple restructurings to address temporary issues they experience, which would be easier to which within such out-of-court procedure as pre-bankruptcy restructuring.

## Financial Restructuring Proceedings

Financial restructuring is a new special voluntary procedure of financial restructuring of Ukrainian companies' debts introduced by the Law of Ukraine "On Financial Restructuring" on 14 June 2016 (the "Restructuring Law"). The Restructuring Law was adopted as a temporary measure to reduce the amount of bad loans and restore bank lending.

### Conditions for opening

Financial restructuring proceedings may be commenced only by a debtor, not by the creditors. These proceedings may be initiated by any legal entity that has a debt to at least one financial institution. State enterprises with a special status (kazenni pidpryiemstva) and financial institutions cannot act as debtors under the Law of Ukraine "On Financial Restructuring" (the "Restructuring Law"). To be eligible to initiate voluntary financial restructuring, a debtor should be in a critical financial condition (i.e. not able to perform its liabilities towards creditors as they fall due), but its business must be recognised as potentially viable by an independent auditor selected by the creditors. The debtor has the right to select any of its creditors to participate in the voluntary financial restructuring, one of which should in any case be a financial institution. Voluntary financial restructuring will be possible provided it is agreed by financial institutions holding at least 50% of the financial institutions' claims (excluding the claims of financial institutions that are the debtor's related parties).

### Restructuring methods

The restructuring plan can specify different ways of restructuring claims, including: (i) termination or amendment of agreements; (ii) issuance of securities; (iii) satisfaction of claims; (iv) reorganisation, e.g. merger, corporate consolidation, spin off and split; (v) debt forgiveness; (vi) attracting new investments to the debtor's capital.

### Success rate

Based on the publicly available information, as of 16 March 2020 there were 36 financial restructuring proceedings conducted under the Restructuring Law. Given that this law has been in force for almost four years, the number of restructuring cases is not significant. In addition, most of the restructurings were those effected regarding debtors' indebtedness toward state banks. Thus, the law is seen as being mainly of use to state banks as the only clear legal grounds enabling them to use such restructuring methods as debt forgiveness without bearing the risk of criminal liability towards the state. Therefore, the Restructuring Law has not met the expectation of the lawmakers and has shown its inefficiency.

On 19 September 2019, the Law of Ukraine "On Amendments to Certain Laws of Ukraine on Improvement of Financial Restructuring Procedure" was adopted, which extended the legal force of the Restructuring Law for another three years until 19 October 2022 and introduced a new procedure, namely a joint financial restructuring procedure for several debtors (related parties) that have different creditors. These legislative changes aim to reduce regulatory restrictions on financial restructuring and facilitate the full implementation of bank restructuring practices, which may give another life to the financial restructuring procedure under the Restructuring Law.

### Pros and cons

**Pros:** under the Restructuring Law, a moratorium is imposed for the period of the voluntary financial restructuring up to 180 days, unless terminated earlier by the creditors. A moratorium extends to the creditors' claims (subject to certain exceptions) and to any claims of a debtor's related parties. If a moratorium is terminated, a debtor and the creditor(s) may enter into a standstill agreement to agree not to enforce their claims for a specific period of time. This is the only restructuring proceeding where a standstill agreement, if entered into, would be enforceable. As a general rule, the restructuring plan must be approved by all the creditors participating in the financial restructuring proceedings. If, however, the restructuring plan is approved only by creditors holding more than two-thirds of the creditors' claims and not all the creditors, it may be further approved by the arbitration committee at the request of any of the creditors participating in the financial restructuring proceedings.

**Cons:** financial restructuring proceeding cannot be used by the debtors who have no debts toward financial institutions.. The Restructuring Law provides that creditors that are financial institutions must enter into a framework agreement providing the common principles and procedures for their cooperation during the restructuring. The framework agreement approved by the National Bank of Ukraine is very basic and more formal rather than practical. Other creditors, which are not financial institutions and so are not parties to the framework agreement, may separately agree on the procedure and amount of votes necessary for the approval of the restructuring plan. Thus, different approaches by different creditors may cause inconsistencies and inefficiency of the decision-making process during the procedure. Finally, specially established bodies (involving state and governmental representatives) participate in the restructuring procedure, which adds another layer of complications.

### Other restructuring proceedings/techniques

The debtor and its creditors may create arrangements on a voluntary basis by renegotiating the agreement under which indebtedness exists or entering into a settlement and other similar agreements. However, the specific terms of such arrangements would bind the parties to the arrangement only and would not be enforceable in bankruptcy proceedings.

## Insolvency Proceedings

From 21 October 2019, there have been two types of insolvency proceedings in Ukraine: (i) corporate insolvency proceedings; and (ii) consumer insolvency proceedings. Both are regulated by the Bankruptcy Code, which applies uniformly throughout Ukraine.

## Corporate insolvency proceedings

### In-court rehabilitation procedure

### Conditions for opening

Under the Bankruptcy Code, the rehabilitation procedure is held in the formal insolvency proceedings, which can be initiated by a debtor or any creditor if there are outstanding claims whose fulfilment term is due and which a debtor is not able to satisfy, or if there is a risk of the debtor's insolvency. The Bankruptcy Code neither specifies the timeframe for claims to be overdue nor provides any requirements for their amounts.

The court assesses whether the documents provided with the application for opening the insolvency proceedings evidence the debtor's inability to repay its debts and decides at its own discretion on the opening of the insolvency procedure. It is mainly up to the creditors to decide whether to proceed with the debtor's rehabilitation or go into liquidation. If the creditors fail to adopt a restructuring plan within the period provided by the Bankruptcy Code, the court will declare the debtor bankrupt and launch liquidation proceedings.

### Restructuring methods

The Bankruptcy Code provides for the following restructuring methods that may be used by the debtor and creditors in the rehabilitation procedure: (i) debtor's reorganisation, e.g. merger, corporate consolidation, spin off and split; (ii) postponement/rescheduling of debts; (ii) a debt-to-bond conversion; (iii) a debt-to-equity conversion; (iv) the sale of some or all of the debtor's assets; (v) an owner of the debtor's property recovering the debts (state authorities regarding state and municipal enterprises); (vi) assignment of debts; and (vii) increase in the debtor's share capital.

The above list is not exhaustive and other restructuring methods can be proposed. However, the application of any restructuring method should be approved by the commercial court that started insolvency proceedings.

### Success rate

Historically, in-court rehabilitation procedures were rarely used to restore a debtor's solvency. Even if used, the result was far from that desired. This was because in most cases, the parties tried to restructure the debts out-of-court first; if they did not succeed, then they went into insolvency to go directly to liquidation, to get whatever was possible out of the debtor's assets. As a general rule, insolvency proceedings were lengthy and generally inefficient. As a result, insolvency proceedings did not compensate creditors for the time and money spent. However, the adoption of the Bankruptcy Code specifically aimed to change this practice and to put more emphasis on the debtor's rehabilitation. Given that the Bankruptcy Code has been in force for less than five months, it is too soon to see whether the new corporate insolvency proceedings in Ukraine have indeed become more efficient.

### Pros and cons

**Pros:** a well-prepared and properly followed rehabilitation plan may result in the recovery of most debts. Insolvency proceedings may be initiated when the insolvency risk exists, i.e. at quite an early stage of financial difficulties. Proper restructuring measures taken well in advance increase the chances of successful rehabilitation. As of the commencement of insolvency proceedings, a moratorium on the satisfaction of all of the creditors' claims (with some exceptions) is imposed and they can be discharged only within the framework of the insolvency proceedings. The newly adopted Bankruptcy Code does not specify the maximum term of a rehabilitation procedure or the duration of the restructuring plan. Additionally, there are no limits on the restructuring methods that can be employed. All of the debtors' creditors are involved, but the restructuring plan must be approved by all secured creditors and at least 50% of the unsecured creditors. All of this, together with quite broad powers vested in the creditors, enables participants in the restructuring procedure to collaborate in a more efficient manner and develop a really workable restructuring plan resulting in successful rehabilitation of a debtor.

**Cons:** the hardening period has been aligned with the statutory limitation period and thus extended to three years. Thus, an asset manager can claim the invalidity of certain contracts and actions of the debtor that were performed after the commencement of insolvency proceedings or during the three years before the commencement of such proceedings. In addition, within three months after the debtor has entered into a period of rehabilitation, the assets manager has a "cherry-picking" right and can refuse to perform obligations (agreements) on behalf of the debtor undertaken before the insolvency proceedings began. Thus, while in certain cases this may be favourable for some creditors and return the assets to the debtor, in others this may only complicate the restructuring and cause delays which may have a negative impact on the restructuring process overall.

## Consumer insolvency proceedings

Conditions for opening

The Bankruptcy Code allows consumer insolvency proceedings to be initiated only by a debtor. The debtor may apply to a commercial court to start insolvency proceedings if at least one of the following conditions is met:

— the value of the debtor's overdue obligations exceeds 30 times the minimum wage;

— during enforcement proceedings, it has been declared that the debtor has no assets against which creditors can enforce their claims;

— within the previous two months, the debtor failed to pay at least 50% of the monthly amount due under loans or other scheduled payments; or

— the risk of insolvency exists; however, no specific criteria are set in law to determine such risk, except for a general rule that such risk exists where the satisfaction of claims towards one or several creditors may cause a debtor's inability to satisfy the claims of other creditors in full.

### Restructuring methods

The consumer insolvency proceedings suggest that a restructuring plan should be approved by the creditors and the court. The restructuring plan may provide for various restructuring options, such as: (i) rescheduling, postponing or writing-off some or all of the debt; (ii) changing the manner and procedure of fulfilling the debtor's obligations, including the amount of the claims and repayment terms; (iii) selling some of the debtor's assets in the restructuring; (iv) third parties fulfilling the debtor's obligations; (v) other measures aimed at restoring the debtor's solvency (e.g. retraining, employment). If the creditors reject the restructuring plan, they can request the commercial court to launch a debt repayment procedure with the proceeds from the sale of the debtor's assets. Following the debt repayment procedure, the commercial court closes the insolvency proceedings and makes a decision to release the debtor from its remaining debts.

Currently, mortgaged residential property securing FX consumer loans cannot be enforced (subject to certain exemptions), including under insolvency proceedings, due to an existing moratorium. From 21 October 2020, however, creditors will be able to enforce indebtedness secured by a mortgaged residential property. At the same time, within five years from the adoption of the Bankruptcy Code (until 18 October 2023), an individual debtor can, by initiating an insolvency procedure, restructure its indebtedness under foreign currency loans granted by Ukrainian banks to individuals by preparing a debt restructuring plan or by an amicable settlement, the terms of which must not be worse than those established by law.

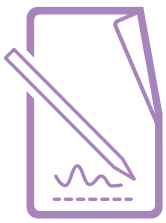
### Success rate

As the institute of consumer insolvency in Ukraine has only been established recently, there is no sufficient public information available regarding its efficiency.

### Pros and cons

**Pros:** consumer insolvency can be initiated only by the debtor himself/herself, which is more a drawback from the creditors' perspective. Consumer insolvency proceedings, if a restructuring plan is approved by the creditors and the court, may lead to the effective discharge of debts, which is favourable for both creditors and the debtor. As a result of successful restructuring, the debtor can pay off its debts and (re)start its business.

**Cons:** the commencement of consumer insolvency proceedings may be used by unscrupulous debtors trying to avoid repaying their debts. Creditors cannot initiate insolvency proceedings against a debtor. As of now, we are not aware of any court practice of the successful rehabilitation of a debtor-individual in consumer insolvency proceedings.



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