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Briefing note

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Restructuring the Slovak restructuring proceedings – one step forward or two steps back?

On 29 April 2015 a substantial amendment to Slovak insolvency law (the "**Amendment**") became effective. The scope of the Amendment is very broad and goes beyond the restructuring laws, amending other legal acts too (e.g. Act No. 513/1991 Coll., the Commercial Code, as amended). In this client brief we will address the amendments to Act No. 7/2005 Coll., on Bankruptcy and Restructuration, as amended (the "**Bankruptcy Act**"), in particular the changes to the restructuring process. The Amendment derogates from a few basic principles of the current insolvency law, such as the principle of a "clean slate" for the debtor after the conclusion of the restructuring process. Another novelty is a creditor's quasi right to share in the profit of the debtor. In the following text we will focus on the most important issues introduced by the Amendment, in particular with respect to restructuring proceedings, which may preclude insolvent debtors from opting for restructuring proceedings in the future. In any case, unfortunately it seems that the Amendment opens up several uncertainties and leaves space for various interpretations instead of resolving particular issues.

Pre-restructuring assessment

Pursuant to the Amendment, more focus is given to the pre-restructuring management of the debtor and the particulars of the restructuring opinion drafted by the trustee. The trustee examines any legal acts concluded between the debtor and its related parties (e.g. any persons directly or indirectly holding at least 5% share in the debtor, the "**Related Parties**") which might have led or contributed to the debtor's insolvency, especially with respect to the debtor's compliance with general corporate rules prohibiting the repayment of capital contributions to shareholders, any transactions with a conflict of interest, and the rules on profit distribution. The restructuring opinion also has to provide information on the profit distributed to shareholders over the period of the previous two years. The purpose of this measure is to examine both the financial management and financial transfers of the debtor, and to determine the minimum amount of new capital required to be injected into the debtor (see below).

New capital requirements and debt-equity swap

Under the Amendment, in order for the restructuring plan to be approved by the court, the debtor has to raise new capital which must, as a minimum, equal to the profit distributed to shareholders over the previous two years as stated in the restructuring opinion. New capital can be raised by the issuance of new shares or other capital interests in exchange for new monetary contributions, or by way of debt-equity swap with respect to receivables of the debtor's unsecured creditors. This does not apply to subordinated creditors (e.g. claims held by Related Parties). If the restructuring plan does not contain an obligation to raise new capital or to perform a debt equity swap in the above minimal amount, the restructuring plan will be rejected by the court. The Amendment also allows the creditors to exchange their claims for shares or other capital interests in the debtor following the approval of the restructuring plan and during its performance upon mutual agreement between the debtor and particular creditor. In such cases, the restructuring plan will be ineffective with regard to the particular creditor in relation to that particular claim, i.e. the debt-equity swap may be realised up to the amount of the original receivable (less any amounts satisfied pursuant to the restructuring plan).

Derogation of "clean slate" principle

Prior to the Amendment, the restructuring procedure under the Bankruptcy Act was based on a "clean slate" principle which meant that following the restructuring the debtor would have begun with a "fresh start" with its debts written off. Those creditors' claims which have not been satisfied ceased to exist, with the amount of the claims to be satisfied and the debt to be written off being agreed in the restructuring plan. The Amendment effectively repeals this principle, stating that the unsatisfied claims of creditors will not cease to exist and will, in specific circumstances set out in the Amendment, still burden the debtor after its restructuring.

Pursuant to the Amendment, the debtor cannot distribute any profit or other financial resources to its shareholders following the restructuring until the unsecured creditors' claims (other than subordinated claims, e.g. held by Related Parties) registered in the restructuring process are satisfied in their original amount. For these purposes, 50% of the original receivable does not cease to exist and the remaining 50% are transformed into specific capital interest which represents the creditors' right to be satisfied from the profits or other financial resources of the debtor. In other words, the creditors will still hold up to 50% of the amount of their original unsecured claims following the conclusion of the restructuring procedure regardless of the provisions of the restructuring plan, and the remainder of the claim will be converted into a specific right to be satisfied from the debtor's profit or other financial resources. The wording of the Amendment seems to suggest that the unsecured creditors have to be satisfied in full prior to the distribution of any profit to the debtor's shareholders. However, this specific right cannot be enforced during the restructuring process. Following the conclusion of the restructuring proceedings and the performance (or ineffectiveness) of the restructuring plan the unsecured creditors may commence an action against the debtor for non-compliance with the above mentioned obligations. The court judgment will be a valid execution title. These claims can also be made against the legal successors of the debtor. Any distribution of profit or other financial resources contrary to the above rules may be challenged in any subsequent bankruptcy proceedings in respect of the debtor.

The above measures have been adopted on the premise that a debtor cannot profit from the writing off of its debts in restructuring proceedings and that it must pay off its debts from future profits.

Furthermore, if the debtor generates any profit which is not needed for the operation of the debtor's business or a substantial part thereof pursuant to the restructuring plan, the creditors have the right to share in the profit in order to satisfy their original claims. By means of this provision, the legislator grants the unsecured creditors the quasi right to share in the profit of the debtor. This right is binding also upon the debtor's legal successors. According to the explanatory report to the Amendment, this measure has been adopted on the grounds that it would be justified for the debtor to "share its success" with the original creditors if the debtor is more successful in its operations than originally anticipated.

Transitional provisions

The Amendment's effective date is, with some exceptions, the date of its publication (29 April 2015). Those restructuring procedures that had commenced before the Amendment became effective will follow the rules contained in the wording of the Bankruptcy Act effective until 28 April 2015. However, those sections that

Key issues

- Detailed examination of related parties transactions in restructuring opinion
- Mandatory injection of new capital during the restructuring
- Post-restructuring survival of unsecured claims

cover the full satisfaction of the creditors (the derogation of the "clean slate" principle), the quasi right to a share of the profit and the option to exchange receivables for shares (debt-equity swap) will also apply to any pending restructuring proceedings where the application for the approval of restructuring plan has not submitted to the court by 29 April 2015.

Bank contributions

In addition to the changes to the Bankruptcy Act, the Amendment also introduces a substantial change to the Act No. 384/2011 Coll, on Special Levy of Certain Financial Institutes, as amended (the "**Levy Act**"). The Levy Act imposes a levy on certain financial institutions which is collected into a special purpose fund. These financial resources are intended to ensure the stability of the banking sector and to cover the costs of a potential banking crisis. Pursuant to the Amendment however, the resources collected under the Levy Act can be used to strengthen the financial resources of a legal entity owned completely by the state and designated in a Government regulation. Any such state-owned legal entity can then use the financial resources for a purpose that is stipulated in the governmental regulations.

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