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Impact of amendments to the Bankruptcy Law on automatic early termination and insolvency events of default

The new restructuring law of 15 May 2015 (the "**Restructuring Law**") will enter into force on 1 January 2016. The Restructuring Law introduces new restructuring procedures, allowing the restructuring of a debtor's business and avoiding its liquidation. It also introduces major amendments to the Bankruptcy and Recovery Proceedings Law of 28 February 2003 (the "**Bankruptcy Law**").

Under the Bankruptcy Law, when the bankruptcy tests provided for in the Bankruptcy Law are met, the debtor is obliged, and each of its creditors has the right, to file a bankruptcy petition with a court. Only after having examined the merits of the petition and being satisfied that the requisite bankruptcy tests have been met, may the court issue an order declaring the debtor bankrupt.

Currently, Article 83 of the Bankruptcy Law invalidates any contractual provision which purports, in the event of the declaration of bankruptcy, to modify or terminate a legal relationship to which the bankrupt is a party. The amendments to the Bankruptcy Law that will enter into force on 1 January 2016 extend the scope of this provision so that it covers not only the declaration of bankruptcy but also the filing of a bankruptcy petition.

Automatic early termination

This amendment may be particularly important in the context of agreements with automatic early termination clauses.

Under the law currently in force, terms of an agreement providing for automatic early termination triggered by a declaration of bankruptcy are ineffective. As a rule, automatic early termination triggered by an event of default preceding the declaration of bankruptcy is valid. Therefore, some agreements (in particular those governed by foreign law) were sometimes modified so that automatic early termination was triggered not by the declaration of bankruptcy (which, as mentioned above, would be ineffective), but by the filing of a bankruptcy petition. It can be argued that under the law currently in force such modified automatic early termination clauses would be effective (although there is some ambiguity in this regard stemming from a provision of the Bankruptcy Law under which a term of an agreement preventing or hindering the aim of bankruptcy proceedings against the bankrupt party to the agreement is ineffective vis-à-vis the bankrupt's estate).

This will change when the amendments to the Bankruptcy Law enter into force. Under the amended law, a contractual term providing for a modification or termination of the agreement upon the filing of a bankruptcy petition or upon one of the parties being declared bankrupt (such as an automatic early termination clause triggered by the filing of a bankruptcy petition) will be invalid.

Although disapplying the automatic early termination provisions set out in master agreements for financial transactions (such as the ISDA Master Agreement, GMRA, GMSLA) is currently a standard practice when contracting with counterparties that might become subject to Polish bankruptcy proceedings, it may be worthwhile for market participants to check their contracts to confirm whether the automatic early termination clause is excluded. If the automatic termination clause is not excluded and it may be triggered by the filing of a bankruptcy petition or declaration of bankruptcy, a party to such a contract should bear in mind that if such an event of default occurs, it will not result in automatic termination of the contract. However, this will not impact on the other provisions of the contract, including those which provide for automatic termination if an event of default other than those mentioned above occurs.

Events of Default

While it is undisputable that the Bankruptcy Law provision discussed above applies to automatic termination, there is some suggestion that it could also apply to termination of an agreement by notice.

As mentioned above, under the amended Article 83 of the Bankruptcy Law, contractual provisions providing for a modification or termination of an agreement in the event of declaration of bankruptcy or the filing of a bankruptcy petition will be invalid. It might be argued that in a situation where events of default specified in an agreement comprise declaration of bankruptcy or the filing of a bankruptcy petition, and the occurrence of an event of default entitles a party to terminate the agreement, such a situation is not within the scope of Article 83 of the Bankruptcy Law. This is because the agreement is not actually amended or terminated by the opening of the bankruptcy proceedings or the filing of a bankruptcy petition, but rather the contract is performed in accordance with its terms which give a party to the agreement a right to terminate.

Nonetheless, it seems that the current market practice position is to interpret the scope of this provision of the Bankruptcy Law to cover not only automatic early termination clauses but also termination by notice upon the occurrence of an event of default. Consequently, the terms of agreements are quite often formulated in such a way that it is the filing of a bankruptcy petition and not the opening of bankruptcy proceedings that constitutes an event of default. If this market consensus interpretation is correct, then, when the amendment enters into force, termination by notice following an occurrence of that event of default will be ineffective.

The Bankruptcy Law provides for special treatment of master agreements. A master agreement in the meaning of this provision is an agreement that provides that "term financial contracts" (i.e. derivatives), "lending of financial instruments" and/or "contracts for the sale and repurchase of financial instruments" will be entered into in performance of the master agreement and that termination of the master agreement results in termination of all transactions entered into in its performance. The Bankruptcy Law provides that when a party to a master agreement is declared bankrupt, either party may terminate the master agreement and the settlement method that is provided for therein will be respected. This is a statutory right which may be exercised even if a master agreement does not give a party the right to terminate in the given circumstances. The provision in question is set out in a section of the Bankruptcy Law which deals with the consequences of declaration of bankruptcy. The right to terminate under this provision may be exercised after a party to the master agreement has been declared bankrupt.

The question arises as to what will happen if a party has not yet been declared bankrupt but a bankruptcy petition has been filed with respect to it – will its counterparty be able to terminate the master agreement by exercising the statutory right provided for in the above-mentioned provision of the Bankruptcy Law, or will such termination prior to the declaration of bankruptcy be ineffective based on Article 83? It seems that the latter interpretation is hardly the intention of the legislator and the teleological interpretation should be applied here. If the Bankruptcy Law gives the right to terminate a master agreement even if bankruptcy is declared, in our view the relevant provisions should be interpreted in such a way that there should be no limitations in this regard if bankruptcy has not yet been declared, even if a petition for bankruptcy had been filed. Nonetheless, until there is an established practice in this regard and court precedents addressing this issue are available, when the amendments enter into force, particular care is recommended with regard to the termination of master agreements as a result of the filing of a bankruptcy petition under the Bankruptcy Law.

Restructuring Procedures

Under the Restructuring Law, provisions similar to the above-discussed Article 83 and Article 85 of the Bankruptcy Law will apply to the new types of restructuring procedures. Provisions in an agreement will be ineffective if they provide for a modification or termination of the agreement in the event of a filing for the opening of restructuring procedures and in the case of the opening of restructuring procedures. Also in this case it is not clear whether a party to a master agreement will have a right to terminate the agreement if restructuring procedures have been opened, or indeed if a petition for the opening of restructuring procedures has been filed.

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