Spring | 19

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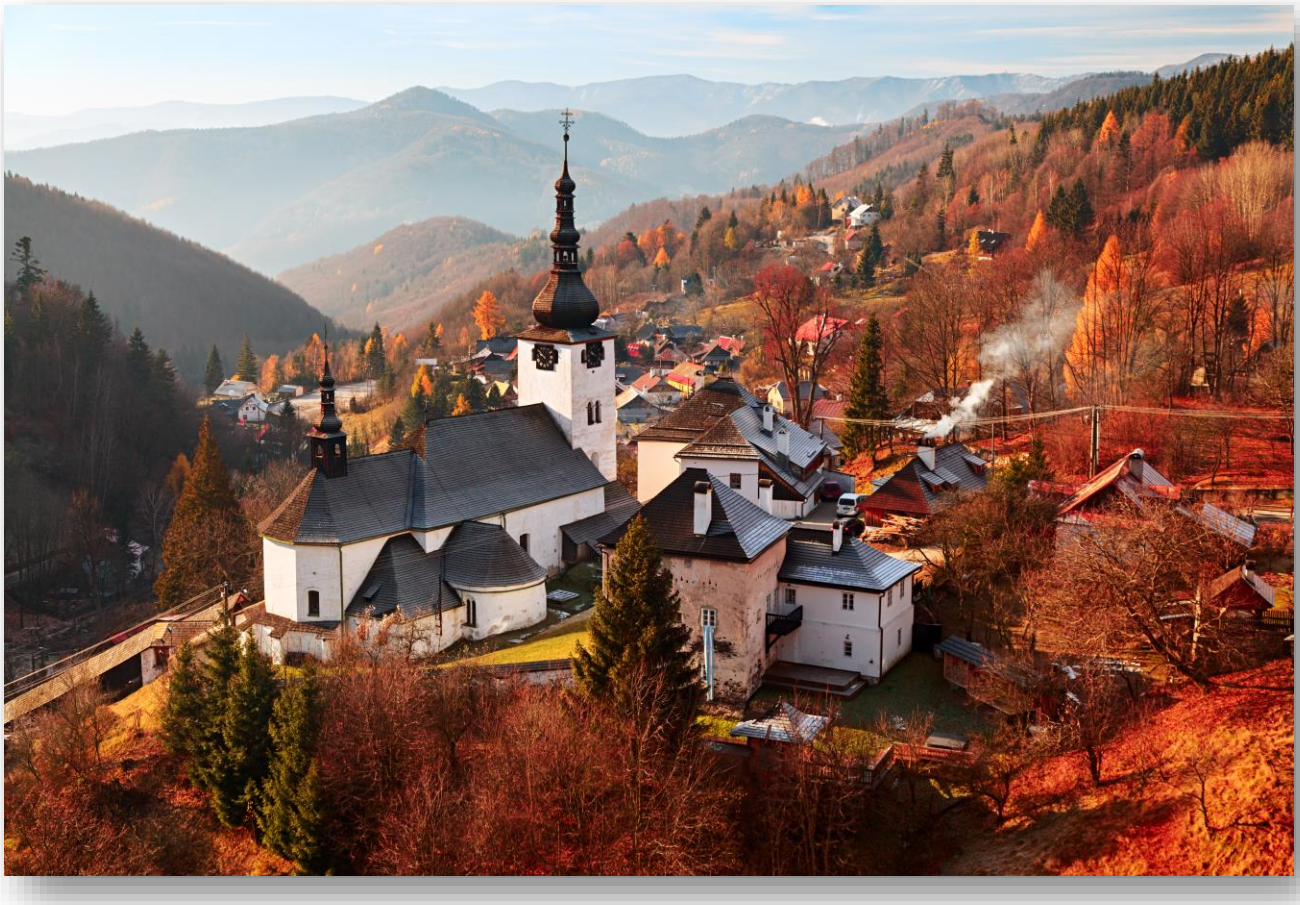

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Bankruptcy, Insolvency & Rehabilitation Proceedings in Slovakia

ILN RESTRUCTURING & INSOLVENCY GROUP

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KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER SLOVAKIAN LAW

1. Presentation of the bankruptcy/insolvency/rehabilitation proceedings in the Slovak Republic and their main differences.

Generally, under Slovak law, every subject is required to prevent bankruptcy, irrespective of whether it is a legal entity or a natural person, a businessperson or a non-entrepreneur. If the debtor is in danger of defaulting, it is obliged to accept without undue delay proportional and appropriate measures to avert loss.

This preventive duty is causally specific in relation to Section 415 of the Slovak Civil Code No. 40/1964 Coll. as amended by later regulations, according to which every person is obliged to act, inter alia, in order not to damage property.

The provision on the precautionary obligation is of a general nature and does not include a penalty in its structure nor does it define precisely what is meant by the "*proportional and appropriate*" measures to be taken. The proportionality and appropriateness of the measures should be assessed in the context of the fulfilment of the basic fiduciary duties of the members of the statutory bodies. This is in particular the *duty of care*, but also the *duty of loyalty*.

Proportional and appropriate measures to prevent bankruptcy are in particular: convening a general meeting, increase of shareholders' equity (in particular increase of share capital), negotiation with creditors on deferral of liabilities, debt settlement or other debt restructuring (informal restructuring), restructuring process, optimization of the debtor's activities (e.g., termination of the loss-making business), etc.

With regard to the measures to be taken by the debtor to avert or resolve bankruptcy and the sequencing of these measures, the debtor should always be the first (in terms of diligence and direct relevance to the satisfaction of creditors) to attempt informal restructuring. If informal restructuring is unrealistic, formal restructuring should be attempted and, if the assumptions or formal restructuring are not fulfilled, the ultimate solution should be to choose bankruptcy.

In that regard, the legislation differentiates these following basic proceedings:

(1) Liquidation proceedings of the company

If the assets of the company being dissolved do not pass on to a new legal entity, a settlement of the assets shall be made in liquidation proceedings. These proceedings are connected with the entire set of legal and economic relations aimed at the final settlement of the property and other legal relations of the liquidated entity without a legal successor.

It should also be pointed out that not in all cases where the company ceases to exist without a legal successor, must it necessarily also be wound up. Exceptions to this rule can only be determined by law upon which in the following cases no liquidation shall be required if:

- the company has no assets,
- the claim for bankruptcy was dismissed for lack of property,

- the bankruptcy has been cancelled on the grounds that the company's assets are insufficient to cover the expenses and remuneration of the bankruptcy administrator,
- bankruptcy proceedings have been suspended for lack of property,
- bankruptcy has been cancelled for lack of property, or
- no assets remain in the company after the bankruptcy proceedings have been completed.

By the way, the decision of the competent body of the company is not an irreversible process. Several changes may occur during the liquidation process, and the effect may also be that the shareholders eventually decide to cancel their original decision to wind up the company and bring it into liquidation.

(2) Restructuring proceedings

If an entrepreneur has financial problems, but there is still a chance to maintain its business after recovering, it may decide for a formal restructuring.

Restructuring proceedings are a legally and strictly defined process regulated by the Slovak Bankruptcy and Restructuring Act No. 7/2005 Coll., which is aimed at rescuing a debtor, where the debtor agrees with all creditors to settle their claims and maintains the next operation of the debtor's business including employment, even after the restructuring has ended.

In contrast to bankruptcy proceedings, after restructuring the debtor's business is maintained and its next business activities after recovering the debts are expected.

If a debtor, that is, a company in financial and existence problems, faces a declining situation (failure, complete cessation of activity) or is in a declining situation, it may entrust the restructuring administrator with the preparation of a restructuring opinion to determine whether the restructuring requirements and conditions are fulfilled.

The restructuring administrator may recommend restructuring of the debtor in the restructuring opinion only if *inter alia*:

(i) the debtor's financial statements give a true and fair view of the facts which are the subject of the accounts and of the debtor's financial situation,

(ii) at least two years have elapsed since the end of the other restructuring of the debtor or its legal predecessor,

(iii) it is reasonable to assume that at least a substantial part of the business of the debtor's business is maintained, and

(iv) in the case of restructuring proceedings, it is reasonable to assume that the debtor's creditors are more satisfied than in the case of bankruptcy.

One of the basic purposes of restructuring proceedings is to satisfy the debtor's creditors to a greater extent than in bankruptcy proceedings. Protection of the debtor's business activities remains, and, after restructuring, the debtor may continue in other business activities with its creditors.

The creditors' claims are satisfied in the agreed upon ratio written in the restructuring plan.

In Slovakia, restructuring proceedings used to be unsuccessful, generally many companies move to bankruptcy, mainly because of the

late start of restructuring, that an unfavourable financial situation is worsening, or disapproval of the restructuring plan by the creditors' committee or by the court.

(3) Bankruptcy proceedings

A bankruptcy is a distinctive type of civil procedure under the Slovak Bankruptcy and Restructuring Act No. 7/2005 Coll., the purpose of which is also to satisfy creditors' claims. In this case, however, receivables are satisfied collectively.

A debtor, which is unable to fulfil its obligations on time and is insolvent, is obliged to file a bankruptcy petition within 30 days, from when it learned or if it was able to learn about its situation. This obligation on behalf of the debtor is equally for a statutory body or a member of the statutory body of the debtor, the liquidator of the debtor and the legal representative of the debtor.

A penalty of 12,500 EUR must be enforced by the bankruptcy trustee against a person who has breached his/her obligation to file a bankruptcy petition on behalf of the bankrupt company in due time. Non-payment of this penalty leads to being listed in the Register for Disqualifications, which means that the breaching person cannot be appointed as a statutory body (or its member), member of a supervisory body, branch director or a proxy for a period of three years.

The creditor is also entitled to file a bankruptcy petition if it can reasonably assume the insolvency of its debtor. The insolvency of a debtor can be reasonably foreseen if the debtor is more than 30 days late in meeting at least 2 (two) financial obligations with more than one creditor and one of these creditors was formally summoned to pay. The creditor is obliged to prove his claim by:

(a) the written acknowledgement of the debtor with the certified signature of the debtor,

b) an enforceable decision or some other document based on which it is possible to order the enforcement of a decision or to perform an execution,

c) confirmation of an auditor, administrator or court-sworn expert that the petitioner keeps the receivable in their accounts in accordance with accounting regulations and, if it is a receivable acquired by transfer or passage, also by confirmation of an auditor, administrator or court-sworn expert that the receivable kept in the petitioner's accounts has the grounds of its origin documented, if they file a petition against a legal entity,

d) confirmation of the Ministry of Finance of the Slovak Republic on the existence of the State's receivable from a contribution provided to the debtor from the funds of the European Union,4a) that was approved and accounted by a certification body, or

e) a written declaration with the officially certified signatures of at least five employees or former employees of the debtor who are not their related parties, that the receivables of such persons regarding wages, severance pay, or severance, which are 30 days overdue, have not been fulfilled; the petitioner in this case can only be an employee or former employee of the debtor who is not a party related to the debtor, and

who is represented by a trade union, even if they are not its member.

If a petition in bankruptcy is filed by a creditor that has no residence, registered office or branch of an enterprise in the territory of the Slovak Republic, they are also obliged to state in the petition the representative to be served documents that has their residence, registered office or branch of an enterprise in the territory of the Slovak Republic; they are also obliged to attach to the petition any documents proving that the representative has accepted the authorisation to be served documents.

If the bankruptcy proceedings instituted on the basis of a bankruptcy petitioner's proposal terminate for the purpose of certifying the debtor's ability to pay, the creditor shall be liable to the debtor as well as to other persons for the damage arising from the commencement of the bankruptcy proceedings, unless it proves that submitting a petition for bankruptcy proceeded with professional care.

2. Regulation of protection granted to the debtor against its creditors in restructuring and bankruptcy proceedings.

In the scope of the purpose of the ILN Restructuring & Insolvency Collaborative Paper which focus on the protections that may be granted by law or court decision/order to a debtor, who declares bankruptcy or negotiates a rehabilitation agreement (in restructuring proceedings) with its creditors, we may concentrate in the following part of this document on the restructuring and bankruptcy proceedings which reflect the regulations in the Slovak Republic.

Both formal proceedings **depend on court decisions**, by whom protection to the debtor against its creditors is granted.

In restructuring proceedings, if the restructuring administrator recommends the restructuring by its opinion, and other requirements for the start of restructuring are fulfilled, the court shall decide about *the beginning of the restructuring process*. The court decision is published in the Commercial Journal.

The beginning of the restructuring process has the following serious effects, which mainly protect the debtor from breaking relations with creditors because of such recovering:

(a) the debtor is obliged to restrict the exercise of its activity to ordinary legal acts; other legal acts of the debtor are subject to the consent of the restructuring administrator,

(b) for a claim which is enforceable in a restructuring application, no proceedings for the execution of a decision or enforcement proceedings for assets belonging to the debtor may be commenced; the proceedings for the enforcement of the decision or the execution proceedings are suspended,

(c) for a secured claim that is enforced in the restructuring by an application, the exercise of the securing right over the assets belonging to the debtor cannot be commenced or continued,

(d) the other contracting party may not terminate the contract concluded with the debtor or withdraw from it for the debtor's default in respect of the performance to which the other party

has become entitled before the commencement of the restructuring operation; termination of the contract or withdrawal from the contract for this reason is ineffective,

(e) contractual arrangements allowing the other party to terminate a contract entered into or withdraw from the debtor by reason of a restructuring procedure are ineffective,

(f) a claim that is subject to restructuring under the terms of the application cannot be offset against the debtor,

(g) the amalgamation, merger or splitting-up of the debtor cannot be decided nor can any decision on the amalgamation, merger or splitting-up of the debtor be entered in the Commercial Register.

However, during the restructuring process the debtor (with its financial problems) is obliged to fulfil its obligations on time, meaning that the creditors who will continue to cooperate with the debtor must receive the goods delivered or the services paid in due and proper terms. The debtor must be prepared to fulfil its obligations before its decision to engage in restructuring.

On the other hand, *the commencement of bankruptcy proceedings* by court decision on the proposal of the debtor or its creditors protects generally the assets of the debtor before decreasing its value, therefore:

(a) the debtor is obliged to restrict the exercise of its activities to ordinary legal acts only; if the debtor violates this obligation, the validity of the legal act is not affected, however, the legal act may be contested in the bankruptcy,

(b) the assets of the debtor may not be the subject of proceedings for enforcement or execution; the proceedings for the enforcement of the decision or the execution proceedings already initiated shall be suspended,

(c) the exercise of a security right may not be initiated or continued in respect of property belonging to the debtor on the grounds of the debtor's obligation secured by security right,

(d) the winding-up of a company without liquidation shall be suspended,

(e) the amalgamation, merger or splitting-up of the debtor cannot be decided nor can any decision on the amalgamation, merger or splitting-up of the debtor be entered in the Commercial Register.

If the debtor has failed to bring about its ability to pay, the court shall generally declare bankruptcy of the assets of the debtor in a court resolution which shall be published in the Commercial Bulletin (*bankruptcy declaration*). This act has, in general, very serious effects on the debtor's business relations, assets and position as follows:

1. All rights to dispose of assets subject to bankruptcy are transferred to the bankruptcy administrator. Legal acts of bankruptcy made during bankruptcy, if they liquidate assets subject to bankruptcy, are irrelevant to their creditors.
2. Until the bankruptcy is discontinued, the liquidation of the company is suspended.
3. If the debtor has entered into a contract of mutual fulfilment before a bankruptcy

has been concluded, and the fulfilment has not yet been done or has been partially done, both the bankruptcy administrator and the other party may withdraw from the contract to the extent of the unfulfilled obligations.

4. Any unmatured receivables and obligations of the debtor that incurred before the declaration of bankruptcy and which relate to assets subject to bankruptcy are considered mature until bankruptcy is revoked.
5. All legal and other proceedings relating to bankruptcy assets are suspended, except tax and customs proceedings, maintenance of juvenile delinquency and criminal proceedings.
6. Bankruptcy's assets may not be the subject of proceedings for enforcement of the decision or execution proceedings.
7. Bankruptcy's assets may not, during the bankruptcy proceedings, give rise to a security right, other than the lien which applies to future assets, if it has been established and registered in the Notarial Central Register of Liens, Real Estate Cadastre or a special register, before the bankruptcy is declared and in addition to the lien established by the bankruptcy administrator.
8. Any company changes, i.e., an agreement on amalgamation, a merger or a bankruptcy's division project are subject to the bankruptcy administrator's consent.

The effects of the bankruptcy proceedings apply to all of the debtor's assets, i.e., any property that belongs to the debtor at the time the bankruptcy is declared, the assets acquired by the debtor during the bankruptcy, and the asset which secures the debtor's obligations. The legal regulation excludes only the assets that cannot be affected by court or decision execution, customs collateral up to the amount of the customs debt, tax guarantee under a special regulation, and assets which are not subject to bankruptcy according to special regulations.

Otherwise, formal restructuring proceedings include all of the debtor's assets.

The protection of the debtor in both proceedings **cover the debtor itself and its assets before all its creditors**. Each submitted claim shall be examined by the administrator and compared with the debtor's accounting and list of obligations.

If the administrator denies the claim, the creditor has *the right to apply to the court for the determination of the claim by an action*. In the action, the creditor may request the determination of the legal reason, the enforceability, the order and the amount of the receivable, the collateral security or the ranking of the security right. The creditor can only claim the maximum of what it stated in the application for the submitted claim.

This right must be enforced in court on time, otherwise it shall cease to exist. In such situation in restructuring proceedings, the claim of the creditor shall no longer be taken into account in restructuring, and in the case of confirmation of the restructuring plan by the court, shall be reclaimed.

Other persons such as guarantors, pledgees, and banks are allowed to apply their claims in the proceedings. Their positions depend on the

character of their submitted claims. An application may also be a future claim or contingent claim; in the event of a conditional claim, the creditor, especially guarantors, may exercise the rights associated with it only when the creditor establishes its origin.

In both proceedings, the protection of the debtor lasts **during the entire process till its ending by court decisions**.

In a restructuring proceeding, by publishing a court decision confirming *the restructuring plan* in the Commercial Journal, the right of creditors, who did not submit their claims and/or security rights relating to the debtor's assets, shall cease; this also applies to contingent claims which had to be enforced by a claim.

Therefore, a restructuring plan agreed by a court shall be deemed to be a legal act done in the form and manner required by special rules for the creation, modification or termination of rights or obligations contained in the plan. The plan shall not affect the rights of creditors to seek satisfaction of their original claims against the debtor's co-debtors and/or guarantors.

The debtor may also not be able to fulfill its obligation arising from the plan. In such a situation, the plan becomes ineffective to such creditor in respect of the affected receivable.

By publishing a resolution of the court *on the termination of restructuring*, the effects of the initiation of the restructuring procedure will cease and all suspended proceedings will be terminated.

After *termination of bankruptcy* by court decision, it is still possible for creditors to file a petition for the enforcement or for the execution for the established receivable which the debtor has not expressly objected to, unless the debtor ceases to exist.

As was mentioned above, both processes are strict and formal, which require the full cooperation of the debtor itself. For your information, the restructuring process lasts in Slovakia, in general, for one year; bankruptcy usually lasts even several years.

This overview is for information purposes only.

Under no account can it be considered as either a legal opinion or advice on how to proceed in particular cases or on how to assess them. If you need any further information on the issues covered by this overview, please contact Ms. Kristína Ňaňková (nankova@peterkapartners.sk) or Ms. Linda Beláková (belakova@peterkapartners.sk).

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