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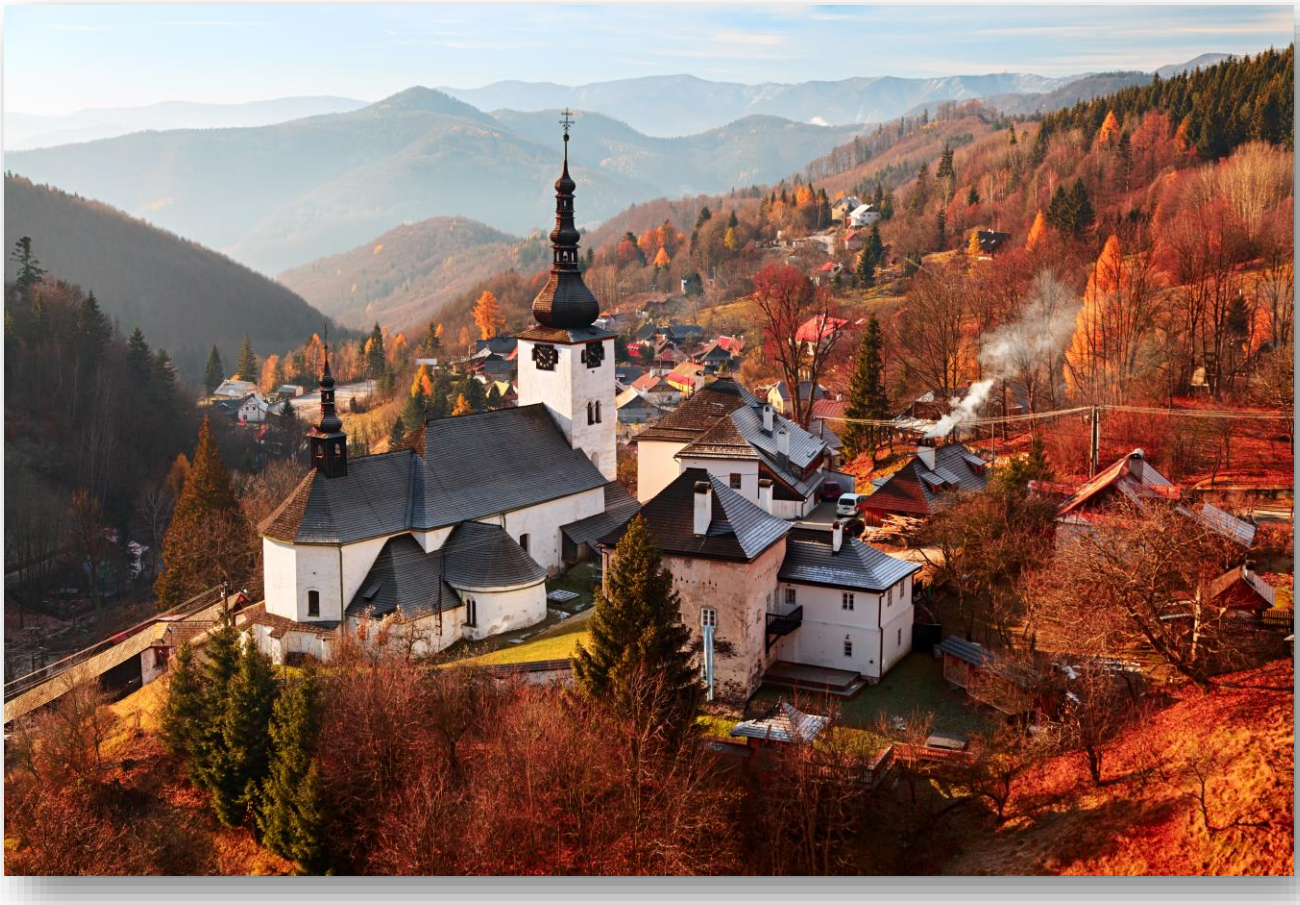

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Bankruptcy, Insolvency & Rehabilitation Proceedings in Slovakia

ILN RESTRUCTURING & INSOLVENCY GROUP

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

We present here the following answers to the questions mentioned in the ILN Restructuring & Insolvency Collaborative Paper which reflect the regulations in the Slovak Republic. We have dealt with proceedings related to a business company in the position of debtor. We mostly focused on the regulation of preventive restructuring proceedings recently introduced into Slovak commercial law.

Should you have any questions, or issues to discuss, please do not hesitate to contact us. We would gladly answer your questions.

Presentation of preventive restructuring/bankruptcy/restructuring proceedings in the Slovak Republic and their main differences.

In Slovakia, there are several ways to avoid the imminent bankruptcy or insolvency of a debtor and ways to proceed.

(1) Higher creditor's protection under Commercial Code

A special regime is applied to a business company that is in crisis. A company is "in crisis" if it is technically in bankruptcy or bankruptcy is imminent or if its equity to liabilities ratio is less than 8 to 100.

A company may not return the "performance replacing (the company's) own resources" along with interest and contractual fines, if it is in crisis, or if it would fall into crisis as a result of such performance.

"Performance replacing own resources" includes providing a credit facility (for a period of at least 60 days) or other similar performance with the same economic effect on the company during its crisis (or even before its crisis, if the payment term was postponed or extended during the company's crisis) by *inter alia* a member of the statutory body, proxy, director of the branch, or member of the supervisory board, by a person/entity whose direct or indirect share represents as least 5 percent of the registered capital or on the voting rights or he/she has a similar influence on the company or a person acting on their behalf. Unless otherwise is proven, it is assumed that any performance provided by a person where it is impossible to identify the final beneficiary is considered "performance replacing own resources".

Periods for the return of "performance replacing own resources" are suspended during the periods when it cannot be returned due to the mandatory provisions of Slovak commercial law.

If the "performance replacing own resources" is returned to the creditor despite the statutory prohibition, members of the statutory body (e.g. directors, members of the BoD) who held office at the time the performance was provided and those who held offices as the members of the statutory body in the period in which the company did not claim the return of the performance shall be jointly and severally liable for its return towards the company as well as the company's creditors.

Another aspect of holding company law included in the Slovak Commercial Code is that a controlling person, i.e., a person who holds a majority of the voting rights either by virtue of ownership of a business share or by virtue of a shareholders' agreement, is liable to the creditors of the controlled person for damage caused by the bankruptcy of the controlled person, provided that the controlling person's conduct considerably contributed to the

bankruptcy of the controlled person. The controlling person shall be released from such liability if it proves that it acted in an informed manner and that they were acting in good faith for the benefit of the controlled person. Unless a different amount of damage is proved, it shall be deemed that the creditor incurred damage to the extent to which its receivable was not satisfied from the proceeds after the bankruptcy proceedings held against the controlled person is terminated due to lack of property, cancellation of the bankruptcy declared against the property of the controlled person due to lack of property, termination of execution or similar enforcement proceedings conducted against the controlled person due to lack of property, or the dissolution of the controlled person without a legal successor.

(2) Preventive restructuring proceeding

Since July 2022, a new Act No. 111/2022 Coll. *On the Resolution of Impending Bankruptcy* (the "Act"), has been adopted in Slovakia, which provides for a new type of procedure – preventive restructuring and temporary protection of the debtor. This law is a consequence of the transposition of Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency, and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

When a debtor (legal entity only) discovers that it is at risk of insolvency in the next 12 calendar months, i.e., the debtor is more than 90 days late in meeting at least two financial liabilities with more than one creditor, it is obliged to monitor its financial situation very closely and to take appropriate measures to avert it without undue delay. To assess whether insolvency is imminent, it is important to calculate the "coverage gap", i.e., if the difference between due cash liabilities[1] and cash assets[2] is more than 1/10 of the debtor's due cash liabilities "*coverage gap*" and it will not be able to reverse this situation within 60 days, the debtor is deemed to have become insolvent. Being registered on the list of debtors for social/health insurance or taxes signals a risk of bankruptcy. In these cases, the debtor should take appropriate precautionary measures, including a preventive restructuring proceeding.

Debtor may initiate preventive restructuring proceeding provided that there is a chance of preserving and recovering its business, it is not yet bankrupt, and no execution or other enforcement proceedings have been commenced against the debtor to enforce a pecuniary claim.

[1] For the purpose of determining the coverage gap, the number of due cash liabilities shall not be taken into account:

- which are linked to a subordinated obligation or would be satisfied in the bankruptcy proceedings in the order of subordinated claims if the creditor has agreed in writing to their temporary non-performance,
- the debtor and the creditor are mutually negotiating to change or modify their maturity and the creditor has an interest in negotiating, which the debtor has confirmed in writing to the creditor at the time of the negotiation.

[2] For the purposes of determining insolvency, cash assets are:

- cash,
- claims on an account, deposit or other form of deposit in a bank or branch of a foreign bank
- monetary claims, securities and financial instruments maturing within 30 days, where, in the exercise of professional diligence, their due and punctual fulfilment can reasonably be expected,
- monetary claims, securities and financial instruments not more than 30 days overdue if, in the exercise of professional diligence, they can reasonably be expected to be duly settled within 30 days of their due date,
- cash receivables, securities and financial instruments that are repayable on demand (sight), if it is reasonable in the exercise of professional diligence to expect that they would be duly and punctually discharged if they were called for repayment on the following day.

There are two different types of preventive restructuring – public and non-public. Public preventive restructuring in principle deals with all monetary liabilities (except those of "unaffected creditors", e.g., a small creditor with a claim in the amount up to EUR 5,000, persons with an employment claim against the debtor, non-monetary creditor, etc.), while non-public preventive restructuring deals only with the claims of licensed creditors (e.g., banks, leasing companies).

- **Process of Public preventive restructuring**

The application for public preventive restructuring must be submitted by the debtor to the court. The debtor must be registered in the Register of Public Sector Partners (all companies doing business with state, municipalities or state/municipality organisations must be registered in this register. Verifying ownership structures up to UBOs is part of registration process) at the time of the submission of the application.

The application must include a draft restructuring plan with the proposed measures aimed at averting the debtor's insolvency and to ensure the viability of the debtor's business.

A creditors' committee for the debtor is appointed by the court after the authorization of public preventive restructuring. The creditors' committee has the power to determine the debtor's acts, which are subject to the approval of the creditors' committee or a designated consultant, and to approve such acts.

If the court has granted public preventive restructuring, the debtor is entitled to reapply no earlier than two years after the end of the preventive restructuring.

- **Consultant**

The legal and/or economic steps to be taken during preventive restructuring often go beyond the experience of the usual course of business of the debtor and therefore, it is obligatory (with a few legal exceptions) to engage a professional consultant. The debtor may choose one or more consultants, usually lawyers, investment/economic advisors, which can be found *inter alia* on the list published on the website of the Ministry of Economy of the Slovak Republic.

The consultant supports the debtor while preparing the restructuring plan, continuously monitors the debtor's economic situation and development trends and replies to creditors' questions. The consultant is required to act with professional care and is liable for damages towards the debtor and the creditors for which he/she must arrange professional liability insurance.

Once the court approves the public preventive restructuring the consultant(s) is usually replaced by a trustee appointed by a court.

- **Information on bankruptcy**

The debtor's statutory body is obliged to inform the court, the trustee, the creditors' committee, and the creditors who gave their consent to temporary protection, of the debtor's bankruptcy occurring during the public preventive restructuring. Nevertheless, preventive public restructuring is not automatically suspended in such case, provided that it can be reasonably assumed that the debtor will be able to fulfil properly and in a timely manner all new obligations and the restructuring plan will be confirmed by the court, or the debtor will avoid bankruptcy in another way.

Breaching this obligation by a statutory body (directors, members of the BoD) is sanctioned by a penalty of EUR 12,500 and they are also liable for damages vis-à-vis the debtor and its creditors. Failing to pay the penalty leads to being listed in the Register for Disqualifications causing that the breaching person cannot be appointed as a statutory body or its member, member of a supervisory body, branch director, or a proxy in a Slovak company for a period of three years.

- **Restructuring plan**

Restructuring plan includes one or more legal or economic measures to avert the debtor's insolvency, in particular:

- Restructuring of the debtor's obligations towards the creditors concerned, in particular the postponement or partial remission of their repayment, their security or the modification of their security or their satisfaction otherwise than in cash,
- Restructuring of the debtor's assets, in particular the sale, transfer or encumbrance of the debtor's property, undertaking or part of an undertaking, or the lifting of an encumbrance on the debtor's assets,
- Restructuring of the debtor's capital structure, in particular sale, transfer or issue of new shares, amendment of the memorandum of association, articles of association or other similar documents or the addition to the debtor's capital, or the same measures in the case of a connected person,
- Restructuring of the human resources of the debtor's business, in particular the creation or termination of employments, change of the employment terms,
- Restructuring of the management and control of the debtor, in particular the appointment, removal or replacement of a statutory body or a member thereof or of a supervisory body or a member thereof.

Restructuring plan must also include the expected rate of satisfaction of each of the creditors concerned in the best alternative scenario and the proposed rate of satisfaction of each of the creditors concerned, and a justification of the reasonable prospects of the public plan to avert imminent insolvency and ensure the viability of the debtor's business and an identification of the necessary preconditions for the achievement of that objective, a description of how the debtor's property, business or part of the debtor's business is to be disposed of if it shall be transferred, encumbered or unencumbered, a description of how new shares are to be issued by the debtor or the person involved, and a description of how current shares or new shares are to be disposed of if current shares are to be transferred or unencumbered or new shares are to be issued, name of the entity providing new financing to the debtor or the person involved, the terms and conditions of the new financing, and any other agreed-upon details of the new financing.

A restructuring plan is approved by the concerned creditors, if:

- Each group of the secured creditors has voted in favour of the public plan,
- In each group of the unsecured creditors, at least a 3/4 majority of the voting creditors in that group, calculated on the basis of the number of claims, have voted in favour of the public plan,
- In each group of the unsecured creditors, a majority of creditors with claims exceeding 1 % of the number of claims of the voting

creditors in that group, calculated on the basis of the one vote per creditor rule, have voted in favour of the adoption of the public plan,

- In each group of the creditors with related claims and subordinated creditors, a supermajority of the voting creditors in that group, counted according to the number of claims, voted in favour of the adoption of the public plan,
- In each group of the shareholders, a majority of the shareholders voted in favour of the adoption of the public plan.

If any of the groups does not approve the restructuring plan, the debtor is entitled to ask the court to confirm the plan, i.e., to substitute the consent of that group by a court order. The disapproving creditor has the right to comment on the proposal of the restructuring plan.

If the court confirms a restructuring plan it is binding for the debtor and the affected creditors and the debtor's statutory body must exercise the plan and refrain from any action that may frustrate or impede its orderly or timely implementation.

For greater certainty that the debtor will follow the restructuring plan, the plan may establish a supervisory administration by a supervisory trustee to supervise and control the debtor's business activities until the restructuring plan is accomplished.

(3) Temporary protection

In addition to the application for public preventive restructuring, the debtor may also apply for *"temporary protection"*, which provides time and material space for effective restructuring. The temporary protection may be granted for a period of 3 months and with the consent of the creditors it may be extended up to 6 months in total.

The temporary protection must be approved by:

- a majority of creditors, calculated as per their outstanding claims; or
- at least 20% of all creditors, calculated as per the amount of their unrelated outstanding claims, and provided that partial remission of the claim or the recognition of its partial unenforceability does not exceed 20% of any creditor's claim in the draft plan and the deferral of repayment of any claim does not exceed one year.

During the temporary protection, the debtor is obliged to limit its activities to those not materially altering composition of its assets, liabilities or obligations; any other activity is subject to the consent of the creditors' committee.

<u>Effects of the temporary protection:</u>

a) **Active bankruptcy immunity –** The debtor is not obliged to file for a bankruptcy proceeding during the temporary protection. This is without prejudice to the information obligation of the debtor's statutory body to inform the court and the creditors on the bankruptcy;

b) **Passive insolvency immunity –** During the period of temporary protection, the debtor cannot be declared bankrupt or restructured and the related proceedings are suspended;

c) **Execution immunity –** No enforcement proceedings can be brought against the debtor (except for the statutory claims);

d) **Priority of the satisfaction of new and unrelated liabilities**;

e) **Temporary impossibility to exercise security rights related to the property of the**

debtor, which however does not apply to the claims of the debtor's employees from employment relations;

f) **Prohibition of setting off a related-party claim against the debtor** (related claims of the debtor's statutory body, proxy, a person who has a qualifying holding in a legal entity – debtor);

g) **Restriction on change of content and termination of the contractual relations –** In case of the debtor's default, which occurred before temporary protection was granted, the creditor may not (over the duration of the temporary protection) terminate the contract, withdraw from the contract, refuse performance under the contract or change the content of the rights or obligations under the contract (the exception is a performance by the other party which is not to be used in connection with the ordinary course of the debtor's business);

h) **Impossibility to terminate the debtor's financing –** The financing agreed between the creditor and the debtor prior to the providing of a temporary protection cannot be terminated during the temporary protection due to the debtor's failure to comply with the terms of the financial ratios. The debtor cannot draw on the financing agreed before the temporary protection was granted without the approval of the creditors' committee;

i) **Suspension of limitation periods for the time-barring of claims.**

The debtor may accept crisis financing during the temporary protection, subject to the consent of the creditors' committee, up to a maximum amount of 6 months of the average debtor's monthly operating costs for the previous year.

(4) Restructuring and Bankruptcy proceedings

Act no. 7/2005 Coll. *On Bankruptcy and Restructuring* as amened recognizes two forms of bankruptcy:

- **Insolvency** – a legal entity is insolvent if it is unable to fulfil at least two monetary obligations to more than one creditor 90 days after their due date. The debtor shall be deemed insolvent if a monetary obligation cannot be collected through the enforcement;
- **Over indebtedness –** An entrepreneur is overindebted if he/she has more than one creditor and the value of his/her liabilities[3] exceeds the value of his/her assets.

If the debtor finds out that the above criteria are met, so it is bankrupt (contrary to imminent insolvency that may be dealt with within the preventive restructuring proceeding), it may decide for formal **restructuring proceedings** and entrust the restructuring trustee with the preparation of a restructuring opinion to determine whether the restructuring requirements and conditions are fulfilled. If not,

[3] The sum of the subordinated claims and claims of related parties shall not be included in the calculation.
A related party is:
a) the (member) statutory body, manager, proxy, or a member of the supervisory board of the legal entity,
b) a natural person or some other legal entity that has a qualified participation in the legal entity; qualified participation shall mean a direct or indirect share equal to at least 5% of the registered capital of the legal entity or of the voting rights in the legal entity or an option to exercise the influence on the management of the legal entity that is comparable to the influence corresponding to such share;
c) the statutory body or a member of the statutory body, manager, proxy, or a member of the supervisory board of the legal entity stated in paragraph b),
d) a close person of a natural person stated in paragraphs a) through c),
e) some other legal entity in which the legal entity or any of the parties stated in paragraphs a) through d) has a qualified participation.

they must file for initiation of **bankruptcy proceedings**.

The restructuring administrator may recommend **restructuring** of the debtor, if it is reasonable to assume that at least a substantial part of the business of the debtor's business is maintained, and 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. A restructuring proceeding is a strictly defined process, 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.

A debtor who is a legal entity is obliged to file for **bankruptcy proceedings** within 30 days from the day it ascertained or, if exerting professional care, could have ascertained its bankruptcy (both in the case of insolvency and over indebtedness).

A person obliged to file for bankruptcy in the debtor's name (e.g., a statutory body or member of the debtor's statutory body, the debtor's liquidator, and the debtor's statutory representative) failing to comply with such obligation must pay a penalty of EUR 12,500 and is liable for damages towards the debtor and its creditors. Unless a different amount of damage is proved, the creditor shall be presumed to have suffered damage to the extent that the creditor's claim has not been satisfied after the bankruptcy proceedings have been discontinued for lack of the debtor's assets, the bankruptcy declared on the debtor's assets has been annulled for lack of assets, or the execution or similar enforcement proceedings against the debtor have been discontinued for lack of assets. A penalty is enforced by the bankruptcy trustee and its non-payment leads to entering such person into the Register for Disqualifications.

The creditor is also entitled to file a bankruptcy petition, if it can reasonably assume insolvency of its debtor or if the debtor is presumed to be bankrupt due to the publication of a notice in the Commercial Bulletin (e.g., a notice of dissolution of a company, notice of termination of the enforcement proceeding).

Unlike in the case of preventive restructuring proceedings, both restructuring proceedings and bankruptcy proceedings resolve all of a debtor's claims. Both proceedings are very strict, formal, and lengthy. Restructuring proceedings in Slovakia last approximately one year and bankruptcy proceedings even several years. It is not uncommon that the restructuring proceedings are unsuccessful, the process does not lead to the debtor's recovery and only extends the time gap between the start of the economic problems and entering into bankruptcy proceedings, and consequently even decreases the creditors' satisfaction rate.

Bankruptcy proceedings always lead to termination of the activity of the legal entity, since the debtor is deleted from the Commercial Register, and it ceases to exist as the legal entity after the scope of the application is fulfilled.

(5) Bankruptcy trustee

A new regulation implemented by amendment to Act No. 8/2005 Coll. o*n Bankruptcy Trustees* particularly covers specific requirements for the special bankruptcy trustees who will be able to manage large bankruptcy or restructuring proceedings (with a large number of creditors, with a large number of employees, or with a large volume of assets, etc.) or bankruptcy or restructuring proceedings of special entities (e.g., financial institutions).

Only a person who is professionally qualified, has at least five years of professional experience as a bankruptcy trustee, successfully passes a special trustee exam which also includes verification of knowledge in the field of financial analysis and business management, can be a special bankruptcy trustee.

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. Should you need any further information on the issues covered by this overview, please contact Ms. Kristína Ňaňková (nankova@peterkapartners.sk) or Ms. Nicole Šrolová (srolova@peterkapartners.sk).

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