

Pre-Packs in Poland: 18 months on

Karol Tatara, Marcin Kubiczek and Mateusz Kaliński comment on the convenient judicial proceedings after the first year and a half since implementation



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The pre-packaged liquidation/administration proceedings often shortened simply to ‘pre-packs’ – have been in force in the Polish Insolvency Law framework since 1 January 2016.

Pre-packs are, in Poland, judicial proceedings, where the decision whether to approve sale-purchase conditions is made by the Bankruptcy Court, together with the decision regarding declaring bankruptcy. The main feature of pre-packs is the possibility to sell the insolvent debtor’s assets to the investor, within bankruptcy proceedings, without auction or tender. Pre-packs are intended for selling the enterprise as a going concern, with execution sale effect, meaning that the investor is not liable for old liabilities and commitments of the debtor.

The first year and a half of functioning of this legal institution is a now an occasion for some summary and evaluation, together with some proposals of amendments to the law.

In Poland, this legal institution is yet not as popular as for example in the USA or UK, where around 25% of all administration is pre-packed, and some of the highest value acquisitions are made within pre-packaged liquidation proceedings. However, there are solid grounds to predict that the pre-packs should also be very popular in Poland.

Short timescale

First of all, sale-purchase operations within the pre-pack proceedings are really quick – not

only compared to the sale-purchase within traditional bankruptcy proceedings, but also to a traditional asset deal, when, for instance, long due diligence is highly recommended. When acquiring assets within pre-packs, as mentioned above, the investor enjoys execution sale effect, which means that the investor is not liable for old liabilities and commitments of the debtor, and as a consequence there is no long and complicated due diligence.

From a practical point of view, the pre-pack proceedings last

approx. four months when there is no complaint filed in the Court, and approx. eight to nine months when the Higher Instance Court will decide about a complaint. Taking into consideration Polish standards, timing is very attractive to potential investors. The trustee, generally, shall enter into sale-purchase agreements, on the terms approved by the Court, no later than within thirty days of the day on which the decision became valid and final.

Moreover, in pre-pack proceedings the subject of the



sale-purchase agreement may be the company as a going concern or just some of the important assets of the insolvent company. Therefore, the investor has a wide range of possibilities depending on what assets draw his attention. This is also a matter of quickness, because in traditional bankruptcy proceedings, the trustee was obliged to try to sell in the first place the enterprise as a whole, and could move to another asset when there was no party interested in acquiring it. This significantly lengthened the proceedings.

Thanks to pre-packs, the investor can negotiate the terms of the acquisition with the debtor from the very beginning, choosing only those assets which he deems interesting for him. However, not every single asset can be the subject of a pre-pack sale, but only those that comprise important parts of the enterprise – like real estate or machinery used for production purposes.

The investor acquires an

already functioning company, ready to continue to conduct business. In traditional bankruptcy proceedings this was not frequent, and the trustee usually stopped the operating business of the debtor, and fired the crew. In pre-packs there is even the possibility of immediate release of the pre-pack subject to the acquirer – upon the Court's decision, when a proof of payment of the full price into the court's deposit account has been attached to the motion to approve the purchase conditions.

This means that pre-packs are beneficial for the whole economy in Poland, because the worst situation is when there are non-working assets – empty enterprises, shut-down machines etc.

Valuation

Another advantage of the pre-pack proceedings is that the affiliated companies can participate in the sale-purchase

process. In this case the price should not be below the price estimated by the Court's expert, this being completely different from the insolvency proceedings where no expert estimation is recommended.

Affiliation and association

Affiliation and association are treated as in other bankruptcy cases, namely according to Article 128 of the Bankruptcy Law¹.

A statement on affiliation with the investor should be attached to the motion for the approval of the sale-purchase conditions.

Furthermore, in the sale-purchase to non-affiliated entities (which is the general, model situation) the price can be lower than the valuation of the expert appraiser when it is warranted by an important public interest or if the debtor's enterprise could be thus preserved. As a general rule, the price should be higher than an amount obtainable in bankruptcy proceedings through liquidation according to general principles, where the costs of the proceedings are to be deducted.

Fair price

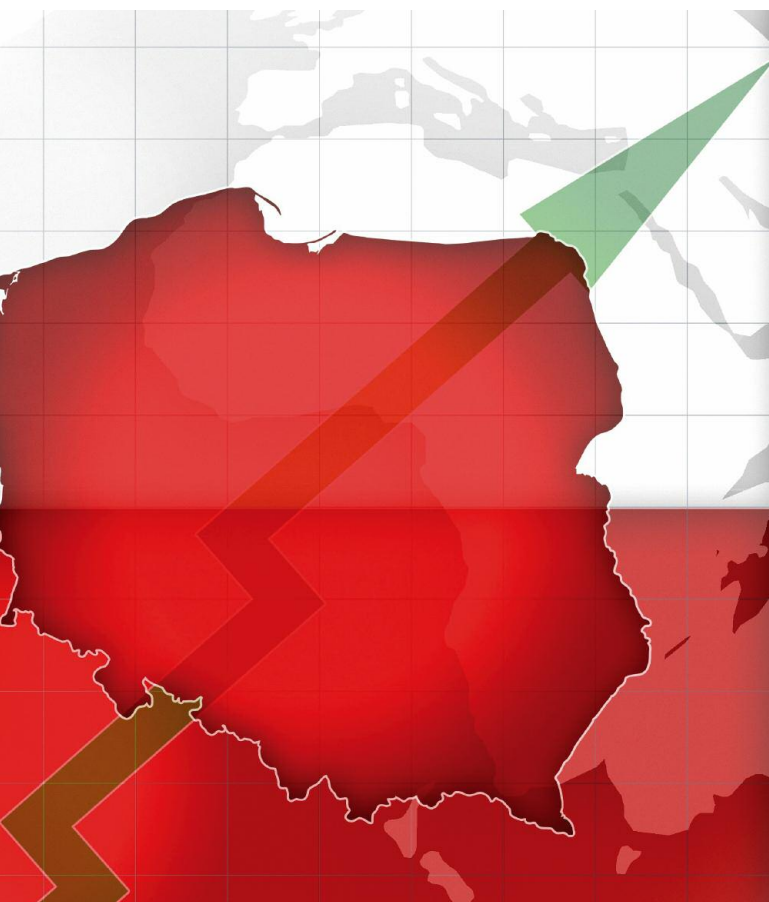
As a result, the price should be realistic, including a fair sale discount, which should be treated as something natural and should not raise questions which sometimes appear in bankruptcy situations, especially as it is quite easy to find arguments for sale-purchase conditions with a lower price than the one indicated by the expert appraiser.

Also important is that the details of the transaction remain confidential, because it is only mandatory to indicate to the Court the price and the identity of the buyer, the draft of the agreement not being required.

The circle of bidders is also limited due to the fact that the Court receives information about the potential investor/acquirer and the price and is not expected to intervene. In other words, the role of the Court is not to set the highest possible price, or to organize an auction of tender for



NOT EVERY SINGLE ASSET CAN BE THE SUBJECT OF A PRE-PACK SALE, BUT ONLY THOSE THAT COMPRISE IMPORTANT PARTS OF THE ENTERPRISE – LIKE REAL ESTATE OR MACHINERY



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PRE-PACKS ARE THE FUTURE OF POLISH INSOLVENCY/ BANKRUPTCY PROCEEDINGS

all interested entities, but simply to evaluate and approve concrete transaction details (the price and the identity of the acquirer). This limitation can be beneficial for the potential investor, especially when competitors file unrealistic price proposals just to delay the Court's decision or to create the impression that the assets could be sold at a higher price. Such declarations are usually unrealistic, and sometimes are made in bad faith.

On the other hand, the transaction is under the control of the Court, and thus should not be questioned as favourable or unfair.



Efficient procedure

From the Bankruptcy Courts' point of view, pre-packs are beneficial mainly because they avoid long and costly bankruptcy proceedings. In pre-packs, after the conclusion of the sale-purchase agreement, the trustee has only to list the creditors, to distribute the sums obtained and close the proceedings.

In 2016, the Bankruptcy Courts in Poland received 30 motions to declare bankruptcy

together with motions to approve sale-purchase conditions. Such motions can be filed both by the debtor and by the creditors. Only in one case, the Court decided to refuse sale-purchase conditions, in all other cases it approved such conditions. However, in one case the Higher Instance Court decided to refuse sale-purchase conditions after analysing the complaint filed by the creditor. These cases are rare incidents, which proves that the motions are well-prepared and the Courts are careful to be impartial.

Weaknesses

The current regulation of Polish pre-packs also presents some weaknesses.

It is not clear whether pre-packs can be used in consumer bankruptcy proceedings, which are more popular in Poland. In the opinion of the authors of this article, there is no legal obstacle, but some experts believe that pre-packs are only for entrepreneurs.

Another weakness is a practical one, because the banks do not have a special model of financing pre-pack acquisitions

and treat them as traditional asset deals, not including the differences and nuances of the nature of the transaction, especially the need to secure the full price amount before the transaction.

There are also some legal concerns whether existing contracts of the enterprise can be acquired, mainly because of Article 317 of the Polish Bankruptcy Law which regulates: *"The acquirer of the bankrupt's enterprise shall acquire it in a condition free from encumbrances and shall not be liable for the bankrupt's liabilities"*. In the view of the authors this is not a legal problem, but some experts disagree, therefore this issue can be controversial.

Legislature intervention may overcome the legal disadvantages, and the practical aspects can be solved by simply higher popularity of pre-packs, while the banks will clearly support this kind of proceedings.

Conclusion

The indicated disadvantages and weaknesses cannot change the authors' opinion that pre-packs are the future of Polish insolvency/ bankruptcy proceedings, because of the benefits for all interested parties – insolvent debtors, creditors, the economy and the judiciary. ■

Footnotes

¹ Article 128 of the Bankruptcy Law: "a relative by blood or by affinity in the direct line, a relative by blood or affinity in the collateral line up to the second degree, a person cohabitating with the bankrupt, maintaining a common household with him, or with an adoptee or an adoptive parent as well as partnership or company in which the bankrupt is a member of the management board or, as the case may be, the sole partner or shareholder, and with partnerships or companies in which persons referred to in above are management board members, or the sole partners or shareholders and also partnership or company performed with another partnership or company, where one of the companies was the controlling company, also where the same company is the controlling company in respect of the bankrupt and the other party to the act, together with partnership, company, or legal person transacted with its partners or shareholders, their representatives or spouses of the same, also with related partnerships or companies, their partners or shareholders, representatives, or spouses of the same".