Legal framework for distressed M&A transactions in Poland

Andrzej Wierciński, Jakub Jędrzejak and Klaudia Frątczak-Kospin write on the new opportunities for investment in Polish distressed businesses

ANDRZEJ WIERCIŃSKI
Senior Partner,
WKB Wierciński, Kwieciński, Baehr

JAKUB JĘDRZEJAK
Partner,
WKB Wierciński, Kwieciński, Baehr

KLAUDIA FRĄTCZAK-KOSPIN
Senior Associate,
WKB Wierciński, Kwieciński, Baehr

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With the enactment of the new Polish Restructuring Law and a substantial reform to the Bankruptcy Law as of 1 January 2016, the legal framework for distressed M&A transactions in Poland has been significantly changed and new legal tools became available to implement it.

Firstly, the introduction of procedures in the form of 'pre-pack' has played an important role, allowing debtors to maximise their assets' value (or what is left of it), accelerate the distressed business sale process, and ensure the continuity of operations. Polish pre-pack is increasingly viewed as a prime opportunity for a speedy and effective sale of distressed enterprises, however, it is not an ideal solution, with a number of issues still needing to be fine-tuned. And neither is it a magical and always suitable solution, since there are attractive alternatives to 'pre-packs' with regard to the acquisition of distressed enterprises in Poland.

Acquiring businesses within bankruptcy proceedings

The acquisition of an enterprise subject to Polish bankruptcy proceedings has, in theory, been an appealing opportunity for potential investors, even prior to the 2016 amendments of the Polish insolvency laws. The primary reason for this was, and still is, that such buyers are freed from the liability for the bankrupt's debts, for which the acquirer, in the case of an ordinary enterprise transfer, would be liable. Moreover, assets sold within liquidation proceedings are sold free from pretty much all encumbrances established thereover.

Polish law provides that the trustee of the bankruptcy estate should undertake all reasonable steps to complete the liquidation of the estate within six months from the opening of the bankruptcy proceedings. In practice, this time-limit has rarely been met, with most proceedings (including direct asset sales) taking many more months, or, in certain cases, even years.

The estate is usually liquidated through a public auction or tender, although going outside this standard procedure is permitted, allowing the entire, or a part of the estate to be sold to a single bidder (which requires the consent of the creditors' committee). The fact that all these processes are, and frequently have been, protracted, usually results in the bidder losing interest, with the enterprise itself deteriorating all the while, and with business partners ceasing co-operation and key employees jumping-ship due to the stigma of co-operating with a business labelled as 'bankrupt'. Therefore, the greatest issue with the ordinary process was, and continues to be, the amount of time that must pass from the opening of the bankruptcy for the transaction to be finalised.

'Pre-packed' solution for a pre-existing problem?

The "pre-pack" was intended to be a remedy for the above. Since, on the one hand, the new Polish "pre-pack" has been broadly discussed by other authors, and on the other omitting it from the discussion on distressed M&A transactions would render such discussion futile, we will only touch upon it in passing, focusing on the practical aspects of its application.

Under the amended Polish bankruptcy law, an application for the approval of the terms of sale of an enterprise (or an organised part thereof, or a substantial part of the debtor's assets), submitted together with a bankruptcy petition, may be approved by the court. Such a sale, cannot in principle, include assets encumbered with registered pledges (provided that the pledgee has a right under the respective pledge agreement to seize the ownership of the encumbered assets or to request their sale within a special accelerated procedure, which is almost always the case), unless, consented to by the pledgee or, which view has been criticised by some, the court.

The court must approve the pre-pack application if the purchase price offered by the potential investor is higher than the estimated proceeds to be generated within the ordinary bankruptcy proceedings (less liquidation costs). According to a *Court Watch Polska Foundation's* report, the time from filing to decision for the pre-pack applications accepted in 2016, was between 4 and 307 days, averaging 121. However, complete statistics for the last year in this regard are not yet available.

Notably, the pre-pack process allows for an accelerated disposal of an otherwise sound business that has got into distress, though, even accelerated, such a distressed transaction may in practice still require a good deal of time to be closed. This may be difficult to accept by potential investors. Especially in a situation where, in order to take immediate possession and management of the business subject to pre-pack, the proposed buyer decides to deposit the full price as proposed under the 'pre-pack' upon submitting the pre-pack application, in which case, the proposed buyer can manage the enterprise in the interim, but risks that its financial resources will sit on the deposit account during the entire process and that at the end of the day the transaction will not be completed (e.g. if the creditors successfully challenge the court's approval of the terms of pre-pack).

Nevertheless, the 'pre-pack' solution is increasingly popular, and recent cases show that even larger enterprises are being considered for sale in this way. For instance, the recent approval of the pre-pack sale terms of Alma, a major retailer, permitted the company to raise PLN 94 million and satisfy its core investors.

Acquisition of distressed assets – alternatives to pre-pack

Given the aforementioned flaws of the Polish pre-pack, it is worth mentioning that in addition to pre-pack procedures, the new Polish Restructuring Law also provides for an interesting legal framework for distressed M&A.

Liquidation arrangement

Although generally intended to restore the debtor's ability to function and compete in the market, restructuring proceedings allow for the so-called "liquidation arrangement", where the creditors' claims are to be satisfied through the liquidation of the entire (or arguably, a part of) enterprise of the debtor. Such a sale would permit a third party to acquire the enterprise, but, contrary to acquisitions within bankruptcy proceedings, such a sale would not release the acquirer from the liability for the enterprise's liabilities incurred prior to the sale (though such liability is generally limited by the terms of the arrangement with creditors and it is also limited in time and capped at the value of the enterprise) nor would it result in the release of encumbrances established over the enterprise/assets sold.

It should be noted that it is possible for the debtor company to be leased at the stage of the arrangement proceedings. Such a lease requires the consent of the creditors' council (or, if the creditors' council is not established within the given proceedings, then of the judge-commissioner). This may serve as an interim instrument of vesting the buyer with control over the business, pending agreement on a structure for, and implementation of, its ultimate sale (and subject to anti-trust approval, where relevant).

Debt-for-equity swap

The arrangement between the debtor company and its creditors may also provide for a debt-for-equity swap provision. If additionally protected by way of a back-to-back agreement with a third party consisting of investors interested in buying the shares acquired as a result of the swap, this provision permits potential investors to acquire the enterprise through a share deal.

Providing additional funding

Providing funding to a debtor company within restructuring proceedings is now also subject to certain additional protection measures which may further encourage and facilitate such funding before the transaction's closing. Namely, since the enactment of the new Restructuring Law, the Bankruptcy Law provides that if the restructuring fails and the debtor subsequently goes into bankruptcy, the claims for the return of the funding provided in the course of restructuring proceedings or for the implementation of the arrangement shall enjoy priority of satisfaction before unsecured creditors (subject to meeting certain additional conditions).

Although we note a growing interest in applying the above-mentioned mechanisms for the implementation of distressed M&A transactions regarding debtors at the edge of, or subject to restructuring proceedings, we would argue that the Polish Restructuring Law does not yet include a comprehensive set of instruments which would be designed specifically for, and would enable smooth processing of distressed M&A (at least not in a way that the Bankruptcy Law purports to do with "pre-pack").

Consequently, although implementation of the new Polish Restructuring Law was definitely a step in the right direction, from a distressed M&A perspective there is still some room for improvement. ■

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