

# The State's role in restructuring and insolvency procedures

Dragoş Ghiţă overviews the different roles that state entities have in restructuring or insolvency procedures – be it that of a creditor or a shareholder for the insolvent company



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**State entities have a number of different roles in restructuring or insolvency procedures – be it that of a creditor or a shareholder for the insolvent company. This is really important, especially in economies where state owned enterprises/large companies enter restructuring/insolvency procedures, as these are the economies that are very sensitive to the market turbulence that is usually implied.**

As is known, different roles will impose specific behaviour by the state entity in its main goal: be it that of loss minimization or gains maximization and, in some cases, managing the social cost of such a procedure.

In the European insolvency framework, there are two legislative tendencies related to state actors' debt treatment in insolvency/restructuring procedures: one in which state creditors are given a privileged position in the hierarchy of debt (a reflection of protectionist views on behalf of public entities), or the one in which state actors are treated the same as other actors in that procedure.

Starting from this, we can see that the first view can and could generate a less proactive approach in dealing with outstanding debt, as the higher position in the hierarchy of claims basically creates a safety net for public entities that ensures no sanctions can be applied if no usually proactive behaviours are adopted before the procedure commences. In post-centralized economies that have been through a privatization process, we see that most of the

restructuring/insolvency procedures of large companies (total assets valued at over EUR 10m) are indebted mostly towards state actors as a natural consequence of measures aimed at increasing the companies' attractiveness towards potential investors (debt forgiveness policies, public debt waivers, etc.).

## Different types of roles

It would be simplistic to state that all creditors are the same because they aim to maximize their debt recovery rate and minimize potential losses, and this statement is even more nuanced when it comes to the different "hats" that a public entity wears in different procedures.

## Regulatory agencies

Large companies usually act in highly regulated domains, which, naturally may lead to certain pecuniary incidents arising from the normal activity of the company. In this case, the regulatory agency's initial purpose (ensuring specific legislation is respected) will be shifted into new territory – recovering debt in a highly specialized and collective procedure, in which limited experience is held.

In the case of a European insolvent company active in the chemical processing industry, the most important creditor was the national environment agency that fined the company subject to the procedure. However, the environmental agency had to postpone its recovery in order for the processing plant and business to be sold and continue its activity. Moreover, given the fact that the

agency's statute limited its options in enforcing the administrative decisions rendered before it, it could not have taken action meant to conserve or preserve the assets and, unfortunately, the procedure was extended, and the recovery grade of the debt diminished.

## Fiscal creditors

This is the most frequent "hat" that state actors put on, and rightly so, derived from the fiscal collecting obligations that fall onto ulterior insolvent companies.

From experience in practice, fiscal authorities in insolvency/restructuring procedures tend to aim mostly to maximize their debt recovery and minimize procedural costs. In the past, in some procedures, this translated to cost lowering decisions (selecting assessors, auditors, insolvency practitioners), multiple layered decisions, prolonging restructuring measures and effectively lowering the debt actually recovered.

For example, in one bankruptcy case, the fiscal creditor hesitated to vote in the creditors' meeting in order to select the electrical company that was to provide electricity to the industrial plant, and, as a result, the security services firm could not operate at full capacity, the consequence being the occurrence of thefts and devaluation of the main asset.

On the other hand, we see that, starting in the Covid-19 era, several European states adopted debt restructuring measures aimed at preventing insolvencies or bankruptcies that may have commenced as a result of outstanding fiscal debt. These measures usually involved an opportunity analysis of



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restructuring debt, rather than recovering it by classical procedures.

This is, of course, a result of historical low rates of recovering debt through insolvency procedures or forced execution, as these procedures are and can be delayed by other participants (at times -abusively by exploiting procedural incidents).

In one recent case, a large factory that was put up for privatization at the dawn of the 2000s, as a result of measures aimed at making it more attractive for investors, benefited from an actual waiver of execution from the fiscal authorities, ensuring that any investor would not be put in difficulty by the fiscal authorities.

After an analysis of the assets and securities structure, in a classic recovery procedure, the state would have recovered at most about 7% of its total debt over a period of at least 4 years (principal and interest up until the time of the analysis, not taking into account litigation costs associated with the procedure). Accessing the restructuring measure insured that an advance payment from the principal was made, with half of the principal being phased over 5 years, effectively bringing the recovery rate up to 30% of the total debt, which is an obviously better result from a private creditor's point of view.

It is our opinion that this type of savvy commercial behaviour is to be preferred over classical rigid decision making in the case of public debt recovery and we salute these types of restructuring mechanisms that give actual second chances to companies in order to avoid classic insolvency procedures that might not be the best fit for the particular case.

### Shareholders

Another interesting role that state entities can have is that of shareholders of the insolvent company itself – usually in this case there is a political factor involved – in the form of a national ministry or agency. A defining characteristic in this case

is the political and social factors that are taken into account when implementing or voting for certain measures in a state-owned company.

Before implementing a plan meant to restructure its public debt and revitalize its business, the public shareholders of a large manufacturing plant put forth several iterations of measures aimed at downsizing the asset-base of the company and the sale of non-core assets in order to gain short term liquidity needed to overcome its financial difficulties. The process of implementing such a measure extended across several months, after which subsequent leadership inside the shareholders' structure changed direction and went against the initial plan. All this resulted in a blockage of the restructuring process of the company, which had its debt continuously raised as a result of this lack of implementation.

### Best Practices – in lieu of Conclusions

Considering our past practice and some of the examples set out in this article, we can firmly say that some of the strategies that state actors have successfully adopted in raising their recovery rates have been along the following lines:

#### **Streamlining decision making**

Several public entities have implemented sleeker departmental structures that leave decision making to be faster and closer to the “action”, effectively removing formalistic approaches to procedural acts and diminishing response times.

#### **Opportunity costs**

In both restructuring and insolvency procedures, EU Law has already defined the “private investor/private creditor” concept as one that is to be taken into account when accepting an alternative form of payment of the debt which is to be recovered, but even more state actors have been seen to use concepts such as net present value of money over time, which leaves a lot of the



arbitrary aspects of arguing in favour of debt restructuring, giving it a “mathematical” sense of precision.

#### **Pooling the recovery effort**

We have seen that creating specialized public agencies aimed at recovering state debt in restructuring or insolvency procedures is far more efficient for public interests, as it pools all the effort, expertise and resources in one centralized and effective organization, rather than it being spread out across all the institutions in the country. ■



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