Slovakia: Quick and (un)reasonable reaction?

Filip Takáč reports on the recent amendment of The Slovak Bankruptcy and Restructuring Act

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Váhostav – SK, a.s. ("Váhostav"), the largest Slovak construction company, is currently undergoing court-supervised restructuring.

Under the pretext of helping certain of Váhostav's unsecured creditors, and in response to related developments, on 23 April 2015 the parliament adopted significant amendments to the Bankruptcy and Restructuring Act (**"Bankruptcy Act"**) and to the Commercial Code (**"Commercial Code"**).

The amendments have already been dubbed "Lex Váhostav". Váhostav owes millions of euros to hundreds of unsecured creditors, many of them small and medium-sized companies that are subcontractors of Váhostav in its public procurement contracts with the government. Váhostav first offered an 85% haircut to its unsecured creditors. The subsequent uproar of both the creditors and the general public awakened the authorities.

The government tried to cool down the situation with a rapid solution to bail out creditors. On 14 April, the government proposed buying the debt, which would lead to the government obtaining Váhostav shares. Although the unsecured creditors welcomed this solution, the opposition and legal experts were lukewarm about it.

Because of the ongoing public debate, the government and parliament reacted rapidly to the situation, in an effort to find a quick political and populist solution to a long-term problem that would also be acceptable to experts.

However, the proposed amendments may not have the desired effect. In fact, not only does Lex Váhostav not solve the current problems of Váhostav's restructuring, it introduces changes which will negatively affect all entrepreneurs. It is almost certain that the "knee-jerk" Lex Váhostav will not provide a useful and systematic solution.

Lex Váhostav presents a brushed-up amendment to the Commercial Code which is connected with amendments to other laws. The amendment to the Commercial Code introduces several new legal provisions, to wit:

(i) a registry of disqualifications to include persons who are forbidden to act as statutory bodies or members of supervisory boards in business companies and cooperatives;
(ii) a definition of a company in crisis, that is, a company with a debt to equity ratio of less than 4 to 100 (in 2016), 6 to 100 (in 2017) and 8 to 100 (from 2018);
(iii) prohibition of repayment of shareholders' contributions; and
(iv) introduction of liability of shareholders for certain acts.

All these changes should lead to greater responsibility of statutory bodies and shareholders for the company's economic situation by increasing financing from the equity capital of shareholders. But the collateral effects of these changes are unclear, since, in some cases, they can lead to lower investment in the development of a company and to complicating business activity. On the other hand, these changes might free the business sphere from undercapitalised companies and make statutory bodies more responsible for company decisions. This aspect of Lex Váhostav seems to offer positive changes for business in Slovakia. However, as we will see, it raises more interesting topics for discussion when considering its effects on restructuring.

Lex Váhostav's restructuring issues

Under the proposed amendment, after successful completion of the restructuring, the debtor can distribute profit or other equity among its shareholders only if the creditors with unsecured claims (unrelated parties) are satisfied to the full amount of their acknowledged claims, i.e., up to 100%.

The worst aspect of this is that the Parliament seems to have opened the door for "corrupt behaviour" by legalising arrangements where a company might use future profits to satisfy current claims in exchange for approval of the plan. If the debtor makes a profit, it has to be distributed among the creditors who requested it proportionally to the amount of the claims of other creditors in their group. There is no specific key ensuring fair distribution that leaves room for agreement. It seems impossible for a creditor to prove disproportionality in the payment of claims to individual creditors.

This most clearly illustrates how hastily the amendment was drafted. The wording is insufficient, easy to circumvent and does not give creditors security that they will ever see a

part of their claim, even if the company is successful in the future.

To ensure greater protection, especially for small, unsecured creditors, specifying a limit of xx% and x months in order to ensure that a minimal part of the claim must be satisfied within a maximum period would be helpful. Minimal satisfaction of creditors would be specified by law (or decree of the Ministry) according to the restructuring plan. The designation of limits and whether the limits themselves should be specified in the opinion or only in the plan should be left for expert discussion and not be decided behind closed doors by the government or the Ministry.

Provisions on an exchange of creditors' claims for shares in the company, the so-called "debt-to-equity swap", are quite usual. However, in the case of Lex Váhostav, entrepreneurs clearly stated that they did not want shares in the company but cash. It is probable that all the small creditors took the one-time offer of the government and sold their claims against Váhostav to the state Slovak Guarantee and Development Bank (**"SZRB"**) in return for 50% of their nominal value. The SZRB will then collect payments from future Váhostav profits. Small creditors said that they preferred receiving 50% immediately to collecting the full amount from future Váhostav profits.

The possibility of a debt-to-equity swap especially protects unsecured creditors and is used in various legal systems, including Germany and Austria. However, its introduction to our legal system was not prepared in a detailed and systematic way, especially with regard to sustainability and an acceptable debt burden for the debtor. As such, the new regulation can cause more harm than good. The supervisory administration of the debtor and its new earnings as well as the sustainability of the plan must be specified in more detail. Questions regarding the debtor's current shareholders and their participation as well as the shares of creditors after satisfaction of their entire claim also need to be addressed.

Other significant changes

Possibility of employees to file a petition for bankruptcy

At least five employees represented by a trade union can file a petition for bankruptcy against their employer for a relatively small administrative and financial burden. This is mainly in response to practical situations in which employees are not paid their wages. On the one hand, this provision looks fair, but on the other hand it could be abused, for example, by former employees filing a petition for bankruptcy as revenge and causing a company substantial damage.

Merger or demerger of a company

An agreement on the merger or demerger of a debtor company must be approved by the trustee. Although the courts would

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probably see through speculative acts by a debtor, the Parliament played it safe and conditioned the possibility of registration in the companies register on the trustee's consent.

Reservation of title

Before Lex Váhostav, if someone owned an item of property which the debtor had unjustly retained, their only recourse was to file a motion to exclude the item from the bankruptcy estate. Now, they can also claim this right similarly to a security right, such as a lien. However, the benefit of such a claim is doubtful since not everyone wants their property to be sold and converted into money, even if they get to keep the proceeds. We take the view that such items should not be sold, but returned to their rightful owner instead.

Granting voting rights (also in bankruptcy and restructuring)

Although voting rights in bankruptcy could be granted before, Lex Váhostav enables:

- creditors whose claims are contested by other creditors, or
- creditors with claims already adjudicated by the court or another authority, and
- secured creditors

to be granted voting rights by preliminary decision of the court. Lex Váhostav correctly applies this possibility in restructuring, though insufficiently, i.e., only to adjudicated and secured claims.

Preparation and requirements for a restructuring opinion and petition for a restructuring permit

In this respect, several changes have been adopted which should specify the requirements for transparent book-keeping by the debtor and provide a true and precise picture of its financial situation. The trustee has new obligations to thoroughly assess the acts of the debtor in regard to related parties, which could lead to the debtor's "doom". This should allow the court and, especially creditors, to evaluate the amount of satisfaction of their claims offered in restructuring as compared to bankruptcy.

Conclusion

Lex Váhostav grants some increased protection to creditors and introduces new measures to increase their protection, but the essential parts of restructuring law remain unchanged. Assessing whether a specific case of restructuring or bankruptcy is illegal remains mainly with the court, the Ministry of Justice, and the criminal authorities. The responsible authorities need to accept responsibility for bankruptcy and restructuring matters and start to apply the provisions they have at their disposal. Even the best amendment to the Bankruptcy Act is only a piece of paper unless supported by actual results and actions. Exemplary sanctions might potentially discourage speculators. ■

A detailed analysis of Lex Váhostav can be found at: www.bnt.eu/en/country-news/slovakia/1944-quick-and-un-reasonable-amendment-of-slovak-bankruptcy-and-restructuring-act

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