Company in Crisis:
A new legal concept in Slovakia

Dávid Oršula and Filip Takáč ask if this new legal concept will help create a better business environment

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Mid-life crisis, couple-relation crisis…. As if this wouldn't be enough. In Slovakia, companies can be in crisis too, now. An entirely new legal concept – a "company in crisis" has been introduced into Slovak law. According to the law, any limited liability company, joint-stock company or limited partnership, whose limited partner is not a natural person, can find itself in "a crisis".

A company is in a crisis if it is (i) bankrupt or (ii) threatened by bankruptcy.

Bankruptcy

Obviously, a debtor company (a legal person) is bankrupt if it is a) insolvent or b) over-indebted:

a) An insolvent legal person is a company that is unable to pay at least two monetary debts to more than one creditor 30 days after their due date.
b) An over-indebted legal person is a company which is obliged by law to keep accounts (book-keeping), has more than one creditor and the value of its debts exceeds the value of its assets.[1] When assessing over-indebtedness the *value of debts towards affiliated parties is not considered*.

Bankruptcy threat

A company is threatened by bankruptcy if the ratio between its net equity and its debts is lower than 4:100. This ratio applies in 2016. In the following years the ratio will gradually increase. In 2017 it will be 6:100 and from 2018, 8:100.

The ratio between the company's net equity and its debts is based on the company's book-keeping.

The statutory body is obliged to monitor the value of the company equity and its debts and to evaluate whether the company is in crisis on an ongoing day-to-day basis. *This obligation is continuous*. For practical reasons, we recommend monitoring these values at least once a month.

Consequences of a crisis

If a company is in crisis, there are consequences for the statutory bodies as well as for the company itself. If the statutory body (managing director, board of directors) determines or, considering all facts, can determine that the company is in crisis, directors are obliged, in compliance with the requirements of necessary professional or due care, to do everything that a reasonable person would do in a similar situation to overcome the crisis.

The wording of this provision is very general and vague. The exact meaning of the legal term "requirements of necessary professional or due care" is unclear. Moreover, there is neither relevant legal practice nor case law.

The Commercial Code does not provide statutory bodies with any guidelines advising on how to act during a crisis. Therefore, their respective steps will depend mainly on specific circumstances. However, in our opinion, adequate steps of a statutory body in connection with a crisis include, for example, suggesting measures to overcome the crisis and convening a general meeting where these suggestions will be discussed.

As a consequence of a crisis, a new legal instrument, '*ban on disbursement of a company's own capital replacing performance*', has been introduced.

The law defines a company's own capital replacing performance as:

(i) a credit or a similar performance which economically corresponds to it;
(ii) any performance provided to a company before the crisis, whereas the maturity of this performance was postponed or prolonged during the crisis, such as prolongation of maturity of an invoice; or
(iii) any performance provided by the so-called controlling person.[2]

The above-mentioned ban also applies to accessory claims and contractual fines. The company also cannot return a company's own capital replacing performance if doing so would trigger crisis as a consequence.

The law also specifies what is not a company's own capital replacing performance:

(i) Performance or security provided during a crisis pursuant to the restructuring plan for the purpose of its overcoming.
(ii) Provision of financial means for a duration which does not exceed 60 days (this does not apply in case of repeated performances).
(iii) Postponement of maturity of obligations from delivery of goods or provision of services

for not longer than 6 months (this does not apply to repeated postponements).
(iv) Free of charge provision of assets or rights.

The provision of a guarantee, lien or other security by the controlling person is similarly regulated in the Commercial Code. If the controlling person secures the company's obligations during a crisis through a guarantee, lien or other security, a creditor can satisfy its claim from this security without having to enforce its claims against the company first. In such an instance, the controlling person who, as guarantor, satisfies a liability on the company's behalf, is not entitled to compensation if:
(i) the company is in crisis, or
(ii) the company would face a crisis as a result.

Liability

Company directors are personally liable against the company and its creditors for disbursement of performances in contradiction to the statutory ban as explained above. In such a case the directors will become guarantors of the wrongfully disbursed payments by the operation of the law.

Ways to overcome a crisis

If a company wants to overcome a crisis under the Commercial Code, it has to stock up its net equity in such a way that its ratio to the company's debts is higher than 4% (2016), 6% (2017) and 8% (from 2018 and later). Basically, the equity can be increased in two ways, namely:
(i) through increase of the company's registered capital, or
(ii) through a debt-to-equity swap.

Other ways of increasing equity include:
(i) mandatory increase of the reserve fund based on the memorandum of association, and
(ii) waving of intercompany loans (tax consequences must be taken into account).

Practical impact and conclusion

Practical impact

1) Banks consider the crisis as an event of default under standard loan agreements.
2) Companies operating business models with low net equity equipment, such as leasing companies, are forced to stock up their registered capital, unless they assume the trouble with companies providing their financing.

Conclusion

It must be clear that any shareholder's or similar financing during a crisis must be properly considered by the statutory bodies, because this can have a significant impact on the company as well as on the liability of the statutory bodies.

Nevertheless, prevention is of utmost importance in this regard. If a company wants to prevent being in a crisis in the first place, the statutory body must duly and periodically monitor the financial indicators of the company (liabilities) which might indicate the problems.

In summary, the new legal concept of "Company in Crisis" and related issues can be regarded as a step forward in creating a better business environment in Slovakia. Let's wait and see. ■

Footnotes:

1 If a person is over-indebted, it is obliged to file for bankruptcy within 30 days from learning of this fact or from the moment it could have learned of this fact with due care.
2 A controlling person is a member of the statutory board, managerial employee, proxy, branch director, board member, the person who holds a direct or indirect share which forms at least 5 % of the registered capital of the company or voting rights in the company or a party that has the possibility to exercise such influence over the company which is comparable to the influence corresponding to this share, a silent shareholder or a party close to the enumerated parties.

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