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ARTICLE

Distressed Asset Restructuring in Poland

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Distressed asset management may not be a new phenomenon in Poland, but for various reasons it may be an activity that will attract new interest. In this article we will look at the legal and economic environment surrounding the distressed market in Poland and the background to distressed assets related transactions.

Background

The mid-late 1990s in Poland saw the first wave of transactions that could be considered as management of distressed businesses. Some of the transactions conducted in the 1990s or even the early 2000s have triggered processes which even today have not come to an end. Examples of such restructurings may be found in the history of the Gdynia Shipyard, the insolvency proceedings of a leasing company Cliff, and the changes in the ownership structure of a computer company Optimus. A number of reorganisations in the early days came in the aftermath in legal proceedings and disputes of various types such as claims for compensation, proceedings resulting from changes in control exercised over a given company, or public prosecutors conducting investigations of transactions.

Later transactions were not immune from such types of problem and current restructurings of distressed businesses are also by definition potential targets for various challenges, which are in the worst case examples aimed at either invalidation of a restructuring transaction or a change of the terms of restructuring. A specific source of concern relates to restructurings of state-owned distressed businesses, which are often subject to post-transaction checks.

The early 2000s saw the introduction of new legislation applicable to distressed asset restructurings, in particular the Commercial Companies Code (the 'CCC') (2001) and the Bankruptcy and Recovery Law (the 'BRL') (2003), both of which have cleared some legal concerns existing before that time and updated Polish legislation to the European regulations, but which at the same time have not been free of new problems for restructuring practitioners.

Legal environment

The BRL defines two grounds for declaration of insolvency.[1] First, a company may be declared insolvent if it has stopped paying its current liabilities (i.e. cash flow insolvency) and second, even if its current liabilities are met, a filing should be made if the (current market) value of the company's assets surpasses its total liabilities (i.e. over indebtedness). The definition of the second ground for declaration of bankruptcy causes numerous practical problems as *prima facie* it is clear that when the provision refers to the term 'liabilities' it does not distinguish between conditional and unconditional liabilities. An interpretation *verbatim* implies that all liabilities should be considered and taken into account, whereas clearly from a rational point of view this does not make any sense, as any sort of long term financing would by definition be prohibited if the balance between all liabilities – including long term liabilities – and the value of (currently possessed) assets be abused. Clearly, this is one of the major hiccups of the definition of insolvency and even though the legislator has noticed the problem (in one of the Parliamentary drafts for amendment of the BRL provisions, the second ground for declaration of insolvency was deleted in full) in the current draft of the amended law this provision remains unchanged. A subsequent problem, which may be found when interpreting this provision, is whether to account for conditional liabilities when summing up all liabilities. One possible approach suggested is to value conditional liabilities by making reference to market valuations on the terms offered by financial players who would value such risk.

Notes

1 Please see art. 12 of the BRL , which reads:
'The court may dismiss a bankruptcy petition where the delay in the discharge of obligations has not exceeded three months and the sum of the outstanding obligations is no higher than 10 per cent of the balance-sheet value of the debtor's enterprise.'

This approach may be supported by the fact that conditional liabilities are not directly accounted for in the balance sheet, but are separately accounted for as out of balance sheet obligations.

In resolving the above problems one may also refer to the formal definition of 'liabilities' as provided by the Accounting Act.[2] Clearly the use of this definition makes more sense than relying on a civil understanding of the term that generates the above controversies. Logic, however, may not always prevail as in making a formal interpretation of this provision it is necessary in the first instance to apply the explanation of the term provided by civil law and civil jurisprudence. Similar definitions may be found in insolvency regulations of other European states, but it would seem that the Polish legislator cannot make its mind up, whether to keep in law the obligation to file for insolvency when there is over indebtedness or to delete it from law. Noteworthy is the fact that this provision of law is not used in practice.[3] Most probably not a single declaration of insolvency has been ordered by insolvency courts in Poland on this basis.

On the other hand, changes which are expected to be introduced to the BRL in the fall of 2007/2008[4] are set to improve the situation in making the recovery law which formally is part of the BRL (an equivalent of the US chapter 11) not the dead instrument it is now, but a real instrument to cure a business finding itself in a pre-insolvency situation. This is to be achieved by allowing insolvency judges to reject applications for insolvency and at the same time accept applications for the start of recovery proceedings when the value of current and due liabilities of a distressed company does not exceed 10% of the value of its assets (insolvency and recovery proceedings are different types of proceedings under the BRL).

Also, some of the provisions of the CCC may be problematic. For some legal practitioners, limitations on financial assistance set in relation to a joint stock company,[5] where a joint stock company cannot directly or indirectly finance or secure the acquisition of shares in its own share capital are justified; it is, however, the practical application of these provisions which creates problems and which at the same time gives lawyers something to argue about. The problems stem mostly from the undefined term 'indirect' financing. One of the aims of the provision is to prohibit the creation of a cyclone where cash may flow within the same holding (upstream or downstream) and be used a number of times to cover shares in an increase in share capital. The source of the financing and the actual terms and conditions of any transactions are areas where additional scrutiny should be applied in order to avoid an acquisition for which indirect financing is granted. Such restrictions do not apply to limited liability companies, although the introduction of similar provisions in respect of limited liability companies was planned at some stage.

In a limited liability company, the CCC provides for a particular protection of the company's share capital[6] – should a shareholder obtain payment from a company under any type of agreement (from whatever legal title, i.e. as dividend, remuneration under a contract, for redeemed shares, etc.) in a situation when such payment would cause the value of the company's assets to fall below that of the nominal (registered) amount of the share capital; the shareholder in question would be under an obligation to return any payment obtained from a company, as this would constitute a direct breach of the above provision of law.

The CCC also contains some other peculiar provisions,[7] which de facto imply that one cannot rely on information with respect to the names of the persons authorised to represent a company and evidenced in the public register of companies. When entering into a contract with a person whose data appears in the regis-

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2 Please see art. 3 section 1 para. 20 of the Accounting Act , which reads:
'liabilities – it refers to a duty, resulting from past events, to make performances of a reliably fixed value which will make the entity use its currently owned or future assets;'

3 In the years 2003-2006 there was no single application submitted in the Warsaw district to start recovery proceedings.

4 Whether this is a realistic explanation is yet to be seen after the parliamentary elections taking place in October 2007.

5 Please see art. 345 of the CCC, which reads:
'§ 1. The company shall not make loans, provide security, make advance payments or in any other manner, whether directly or indirectly, finance the acquisition or taking up of its shares.
§ 2. The provision of paragraph 1 shall not apply to performances made in the ordinary course of business of financial institutions, as well as to such performances made to employees of the company or its related company as have been arranged with a view to facilitating the acquisition or taking up of the shares issued by the company, provided a reserve capital was previously created for this purpose out of an amount distributable pursuant to Article 348, paragraph 1.'

6 Please see art. 189 para. 2 of the CCC, which reads:
'The shareholders shall not receive, on whatever account, payments out of these company's assets which are necessary for the initial capital to be fully paid up.'

7 Please see art. 202 para. 4, which reads:
'The term of office of the management board member shall also expire by the member's death, resignation, or removal from the board.'
and art. 369 para. 4 of the CCC, which reads:
'The term of office of the management board member shall expire no later than on the day on which the general meeting was convened to approve financial statements for the last full financial year in which the member served on the management board.'

ter of companies one cannot be certain that such data is not out of date, namely that a person whose name is registered and who one would assume is authorised to represent a company can indeed formally do so. This is a consequence of the fact that a mandate of a person registered may have terminated, since the person may have resigned or may have been recalled from a board, or a term of office may have ended. It may be also a consequence of the negligence of the new board members who have failed to update information normally submitted to the Companies Registry. Any transaction entered into with a person representing a company can only be valid if such a person holds a valid mandate in the company's board of directors and the lack of an entry of such a person's name in the registry of companies has no real effect on the validity of representation of a company. From a formal point of view such invalidity (although difficult to trace), may cause fundamental legal and practical problems as there is really no fully effective cure for this type of problem.

Another problem not found in the legislation of European states may be found in CCC.[8] This provision imposes an obligation on parties to a sale of shares agreement in a limited liability company to have the signatures under a contract certified by a public notary. Without this formality a share transfer agreement would be invalid. What sometimes makes the application of this provision difficult is that in some jurisdictions, notably in the UK and the USA, professionals who are qualified under local laws as notaries do not have to be treated as being notaries for the purposes of Polish law, which in turn (although this probably has not yet been tested in court) may result in the invalidity of a share sales agreement certified by a foreign notary.

Another legal catch[9] refers to transactions in a limited liability company that go beyond the day-to-day routine (beyond the scope of what is treated as standard management) and which are entered into between subsidiaries and their holding parent companies if such companies hold all the shares in the subsidiaries. This should also be subject to particular attention, as non-compliance with the form of a signature certified by a public notary on the part of the parent's representative results in invalidity of a transaction.

These are but a few of the worst case examples. And there are also other provisions, which although they do not have to result in invalidity of an act may, however, also have an adverse effect for those who do not comply with the formalities required by law.

Finding distressed companies

Surprisingly, the currently booming Polish economy with a GDP growth rate of 7.4% for the first quarter of 2007 may be a good market place for acquisition of assets from companies facing financial difficulties. Management know-how and restructuring of businesses facing insolvency on a market where demand for goods and services is rising and where the real estate values have increased between 40-90% during the last year (although prices are now stabilising), and where stock market values were constantly rising, makes the prospects of attaining benefits and values from restructuring that much more attractive.

There is also a much wider spectrum of business that may be on offer. A number of businesses were created or reactivated over the past two decades. The potential for growth, access to materials and financing made them grow very fast. Sometimes this was too fast for the management to control the business or too fast to understand that the business was not being run in an isolated environment and could also be affected by competition. However, finding businesses which are in distress is becoming much more difficult. The need to organise financing at short notice and match needs of distressed business is one area where institutional improvement would help the market. Those few attempts which have been made have had a limited impact on the market. The basic source of information on businesses which are in need of rescue is still those which are publicly announced, and when formal insolvency proceedings have been started these public announcements are made by insolvency courts.

Directors' duties, liquidation and insolvency

The CCC regulates and defines the structure, rights and obligations of shareholders and partners, and the functioning of company bodies. It is based on a two-tier model of corporate governance. The CCC, being a fairly new regulation, replaced the commercial code (in force since 1934) in 2001 and implemented (at least this is what most assume) the majority of provisions found in the EU corporate law Directives.

Polish law does not contain a formal definition of a 'distressed' business or company (as opposed to a definition of bankruptcy). The main benchmark to which reference is usually made is whether an obligation to file

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8 Please see art. 180 of the CCC, which reads:
'The transfer of a share or of a part or fraction thereof, likewise pledging the same, shall be executed in writing, with the signatures notarially certified.'

9 Please see art. 173 para. 2 of the CCC, which reads:
'In matters transcending the scope of ordinary acts of the company the declaration referred to in paragraph 1 shall be in the written form with the signature certified notarially.'

for insolvency arises and any restructuring, in particular disposal or transfer of assets. It is sometimes the case that a pre-insolvency restructurings list is attempted at a very late stage, when there is no option left for considering the initiation of recovery proceedings under the BRL. By definition this is only permitted when the grounds for insolvency have yet not arisen, but may only be rationally anticipated in the future and with no fault for their occurrence on the part of the distressed business.[10]

Attempts to restructure a financially disturbed company business, no matter whether initiated by creditors or by directors, are usually associated with a situation where at least one of the two grounds for filing for insolvency is met, this usually being the second (see above) ground (value of liabilities higher than assets) with short term liquidity secured for the business.

To understand distressed restructuring under Polish law, one should make a distinction between a solvent and insolvent liquidation. One of the reasons for initiating a solvent liquidation – and this type of liquidation is only regulated by the rules of the CCC, in both a limited liability and a joint stock company – is when the balance sheet loss exceeds the sum of the reserve and supplementary capital and half (in a limited liability company[11]) or one third (in a joint stock company[12]) of the share capital. Should the above situation arise at any moment in time, company directors have an obligation under law to convene without delay a shareholders meeting to decide whether the company should continue or whether it should be dissolved (liquidated). The shareholders need to decide what measures may be adopted to improve the financial situation, and how much time to give the company directors to come up with a rescue plan to improve the situation. It is however only up to the shareholders meeting to decide whether or not to vote for a resolution on a solvent liquidation and winding up of the company, and this decision does not have to be justified. Even though Polish law makes a clear distinction between a solvent and an insolvent liquidation, the fact that a company is already covered by solvent liquidation under the rules of the CCC does not imply that it may not be declared insolvent; and in a worst case solvent liquidation may need to be terminated and be replaced by insolvent liquidation in accordance with the BRL rules. Should a company be subject to solvent liquidation, the obligation to file for insolvency within a fortnight lies with the liquidator(s).

A failure to submit an application for declaration of bankruptcy may result in directors' personal liability for the liabilities (uncovered during insolvency proceedings) of the insolvent entity, and further may result in imposition of a ban on directors carrying out corporate duties (i.e. holding posts as directors, both executive and non-executive, for a period of up to 3 years[13]).

Notes

10 Please see art. 492 para. 2 of the BRL, which reads:
'An entrepreneur shall be threatened by insolvency if, despite performing his obligations, it is obvious that according to a reliable assessment of his economic situation he will soon become insolvent.'

11 Please see art 233 of the CCC, which reads:
'§ 1. Where the balance sheet prepared by the management board shows a loss in excess of the sum total of the supplementary and reserve capitals and half of the initial capital, the management board shall forthwith summon a meeting of shareholders with the object of adopting a resolution on the continued existence of the company.
§ 2. The provision of paragraph 1 shall apply respectively where the company's balance sheet was prepared pursuant to Articles 223 to 225.'

12 Please see art. 397 of the CCC, which reads:
'Where the balance sheet prepared by the management board shows a loss in excess of the sum total of the supplementary and reserve capitals, and one third of the initial capital, the management board shall forthwith summon a general meeting with the object of adopting a resolution on the continued existence of the company.'

13 Please see art. 373 of the BRL, which reads:
'1. The court may adjudicate the deprivation of a person, for a period from three to ten years, of the right to carry on economic activity on their own account and to perform the function of a supervisory board member, representative or attorney in a commercial company or partnership, State enterprise, cooperative, foundation or association, who, through his fault:
1) being obliged to do so by operation of statutory law, did not file a bankruptcy petition within two weeks from the day of arising of the grounds for declaration of bankruptcy; or
2) after declaration of bankruptcy did not release or indicate assets, commercial books, correspondence or other documents of the bankrupt, which he was obliged to release or indicate by operation of statutory law; or
3) after declaration of bankruptcy hid, destroyed or encumbered assets which formed part of the bankruptcy estate; or
4) as the bankrupt in the course of bankruptcy proceedings did not perform other duties borne by him by operation of statutory law or imposed in a pronouncement of the court or the judge-commissioner, or in other manner rendered the proceedings difficult.
2. When adjudicating on the prohibition referred to in paragraph 1, the court shall take into consideration the degree of fault and the results of actions taken, in particular, reduction in the economic value of the bankrupt's enterprise and the measure of detriment to the creditors.
3. The court may adjudicate on the deprivation for a period from three to ten years of the right to carry on economic activity on their own account and to perform the function of a supervisory board member, representative or an attorney in a commercial company or partnership, State enterprise, cooperative, foundation or association concerning a person in respect of whom:
1) bankruptcy has been declared at least once, with the debts of the said person being annulled after completion of the bankruptcy proceedings;
2) bankruptcy was declared not earlier than five years before another declaration of bankruptcy.'

Directors' criminal liability should also not be excluded.[14] Personal liability of directors in many cases also creates a limitation for successful running of the restructuring processes. In many distressed scenarios the company may be saved provided that repair activities are implemented safely. Should this require external help or a decision of shareholders to replace current directors, the placement of a new director with restructuring experience may become problematic. Interim restructuring directors do not necessarily want to take the risk of being personally charged for potential misconduct of other remaining directors. Consequently, they are not interested in taking a position giving them personal liability, as until proven otherwise the directors are jointly and severally liable. On the other hand, engaging them using the formula of *procura* (commercial proxy) does not always give them adequate control and influence on change.

There is no clear practice yet developed as how to limit interim directors' personal liability. However, the following solutions may be considered:

- obtaining Directors and Officers insurance – such type of insurance is widely available in respect of directors of companies which are not in distressed situations. For interim directors such insurance needs to be traced on the market;
- signing an indemnity with the mandator, i.e. new owner or financier of restructuring (obviously not with the company that is to be the subject of restructuring, as this may be worthless). This sort of protection may not be very popular among mandators, but some sort of sound compromise might be reached by limiting or excluding liability by reference to misconduct of the director in question;
- a successful restructuring, i.e. one which limits the exposure and in the worst case scenario the liability of each creditor, if proven, constitutes a very strong argument in defending directors when claiming their personal liability; the argument in terms of defense of directors' interests is that should restructuring be successful, the creditors would get a higher or full return on their already endangered receivables. This in turn would be a decisive argument[15] in attempting to provide a successful defense against creditors;
- as Directors who are management board members have a duty to submit an application for insolvency within a period of 14 days from the date when the obligation to do so arises, it maybe argued that within that 14 days they can resign and should not be liable for not filing for insolvency. They may of course be liable for taking other measures that have been detrimental to the company and in consequence to its creditors.

No sanction, however, may be imposed on directors who do not initiate recovery proceedings under the BRL, since the starting of a recovery procedure is a right and not an obligation.

Restructuring – investor's 'watchdog' list of points of special care when acquiring or financing distressed assets

Creditors and potential investors should be aware of certain provisions which clearly affect their rights and duties in case a restructuring process is not successful, even more so if the risk of failure is exacerbated by a business being in distress, with a potential for declaration of insolvency in the short term. A bullet point summary of the key areas to watch is as follows:

- Although this is stating the obvious, it is always better to be a secured creditor than a non-secured creditor. Creditors' rights may be safeguarded by the establishment of collateral in the form of rights *in rem* such as mortgage (in Poland *hipoteque*), pledge, registered pledge, sea mortgage (on ships), which under the BRL provisions does allow claims to be satisfied (with minor limitations) from the liquidation (sale) of the assets upon which the collateral was established. Unsecured claims fall into the third rank of claims[16] and are likely to be satis-

Notes

14 Please see art. 300 of the Polish Penal Code, which reads:

'§ 1. Whoever, in case of threatened insolvency or bankruptcy, prevents or reduces the satisfaction of his creditor through removing, concealing, selling, donating, destroying or by actually or purportedly encumbering his assets shall be subject to the penalty of deprivation of liberty for up to 3 years.

§ 2. Whoever, in order to prevent the execution of a ruling by a court or other public authority, prevents or fails to fully compensate his creditor through removing, concealing, selling, donating, destroying or by actually or purportedly encumbering his assets forfeited or under threat of forfeiture shall be subject to the penalty of deprivation of liberty for a term of between 3 months and 5 years.

§ 3. If the act specified in § 1 caused damage to many creditors, the perpetrator shall be subject to the penalty of deprivation of liberty for a term of between 6 months and 8 years.

§ 4. If the injured party is not the State Treasury, the prosecution of the offence specified in § 1 shall occur on a motion of the injured person.'

15 Please see art. 373 of the BRL (see footnote 13 for text).

16 Please see art. 204 of the BRL, which reads:

'1. The members of the committee of creditors shall discharge their duties personally or through their governing bodies.

fied, if at all, to a minor extent. In case a majority of the assets that can serve as collateral are used, the securing of a new debt becomes more and more difficult. This in many cases limits the provision of fresh capital required for restructuring of the company. Since many bankers would adhere to the rule 'never throw good money after bad', the company under distress will find it more and more difficult to obtain financing for restructuring. Unless the new owners are providing support in the form of share capital or additional guarantees, they may expect that getting recovery capital may be connected with higher cost and an additional collateral requirement. Furthermore, with a distressed company it is usually very difficult to find real value in any new assets, as all assets and shares have already been subject to security granted to existing lenders.

– Any transactions entered into with a company up to one year prior to the declaration of the insolvency date should be watched carefully, as these may by law, or as a result of judicial proceedings, be treated as ineffective towards the bankrupt estate. What this implies is that such a transaction is treated as being invalid among the parties to a given transaction and the parties involved need to return to each other whatever was given under the original terms and conditions of contract. In practical terms what this also implies is that should the above principle apply, a receiver in a liquidation insolvency may demand a return of any payment, service or good provided under contract by the insolvent, whereas the contractor of the insolvent is allowed to make its claim to the insolvency estate and in consequence is satisfied as an unsecured creditor. BRL[17] and articles of the Polish Civil Code (the 'CC'), cover the above mechanism in detail. Following these provisions, financing parties who are at the same time shareholders should avoid any transactions that are made between related parties (i.e. a company and its shareholders), as in case of declaration of insolvency these would be treated as ineffective towards the bankrupt estate, notwithstanding their terms and conditions. A creditor should also make sure that a transaction concluded with any other non-related parties be performed on an arm's length basis, paying par-

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2. A member of the committee of creditors may, with the consent of the judge-commissioner, act also through an attorney, and where a body of public administration is a member of the committee of creditors – also by a person appointed by this body. The power of attorney shall be issued in writing with the signature certified by a notary. Power of attorney given to an advocate or legal counsel shall not require the certification of the signature by a notary.'

17 Please see art. 127 of the BRL, which reads:

'1. Acts in law whereby the bankrupt exercised control of his assets, performed by the bankrupt within one year before the filing of the bankruptcy petition, shall have no effect on the bankruptcy estate if performed gratuitously, or for a consideration but with the value of the bankrupt's performance being drastically in excess of that received by the bankrupt, or of that reserved for the bankrupt or for a third party.

2. The provision of paragraph 1 shall apply respectively to an court settlement, admission of an action, and waiver of a claim.

3. Also without effect shall be a security and the payment of an unenforceable debt, given or made by the bankrupt within two months before the filing of the bankruptcy petition. However, one who received the payment or the security may, by bringing an action or charge, seek the recognition of such acts as effective if at the time when the same were performed he was unaware of the existence of grounds for the declaration of bankruptcy.

4. The provisions of paragraphs 1 to 3 shall not apply to securities created before the date of the declaration of bankruptcy in connection with the financial futures contracts or repurchase contracts in securities referred to in Article 85, paragraph 1.',

art. 128 of the BRL, which reads:

'1. Acts in law for consideration which the bankrupt transacted within six months preceding the date of the filing of the bankruptcy petition together with his or her spouse, 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, or an adoptee or an adoptive parent shall be without effect on the bankruptcy estate.

2. The provision of paragraph 1 shall apply respectively to those acts which a bankrupt 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.

3. The provision of paragraph 1 shall also apply to those acts of a bankrupt company which it transacted with another company, in the event of either being the dominant company'

and art. 527 of the CC (*actio pauliana*), which reads:

'§ 1. If, as a result of an act in law by the debtor effected to the detriment of the creditors, a third party gained a material benefit, each of the creditors may demand that the said act in law be declared ineffective with respect to him if the debtor acted deliberately to the detriment of the creditors and the third party knew that or could learn that if he showed due diligence.

§ 2. An act in law effected by the debtor shall be to the detriment of the creditors if as a result of that act the debtor became insolvent or became insolvent in a greater degree than before effecting that act.

§ 3. If, as a result of an act in law effected by the debtor to the detriment of the creditors, a material benefit was gained by a person who was in a close relationship with him, it shall be presumed that the person knew that the debtor acted deliberately to the detriment of the creditors.

§ 4. If, as a result of an act in law performed by the debtor to the detriment of the creditors, a material benefit was gained by a person who was in permanent business relationships with the debtor, it shall be presumed that the person knew that the debtor acted deliberately to the detriment of the creditors.'

ticular attention to the fairness of the terms of the transaction. Reference should be made to the market terms of similar transactions prevailing at the time (a professional valuation should be considered in case of doubts as to the value of goods or services acquired).

– Although the provisions of CC[18] state that if a debtor has become insolvent a creditor may claim an immediate fulfillment of its obligation, since the fall of 2003 when the BRL came into force this provision may in some circumstances have limited impact, the BRL[19] would treat contractual provisions covering changes (i.e. termination) of contract triggered by a declaration of insolvency as invalid.

– In case of a transaction where the seller reserves itself the ownership right of sold goods (for example until payment is obtained) or a transfer of receivables or rights is used as collateral to safeguard payment of receivables, such agreement, to be effective towards the insolvency estate, requires execution with a so-called 'secure date'. The easiest method of having a secured date on a document is to have a notary to certify each page of the document. Failing to comply with such a small formality may have adverse consequences for a creditor, as in case of declaration of insolvency the reservation of ownership would not be effective towards third parties and a creditor would lose the right to claim ownership of either the sold goods or the security, which right would be replaced by a monetary claim to be satisfied in accordance with the standard ranking of claims applicable to non-secured creditors.

Restructuring mechanisms

Although it is impossible to cover all types of restructuring scenarios, any restructuring process evolves around one of the following mechanisms:

1. Merger or de-merger of a company in accordance with the rules set by the CCC;
2. Sale or purchase of a continuing business or transfer of title to a continuing business in exchange for shares (asset or debt equity transaction); or
3. Sale or purchase of assets or group of assets.

The above does not limit the available options under Polish law for restructuring: debt equity swaps, increases/decreases of share capital (issue of new equity), redemption of shares, issues of options, bonds, transfers of receivables with collateral, etc., are all possible and in practice applicable in Polish restructurings, and may be used in conjunction with one of the above mechanisms.

The transfer of the title to a whole business or group of assets always involves an obligatory transfer of the employees to the purchaser. In this respect Polish law is no different to other legislation in other European countries.

Merger or de-merger

An analysis of the process of merger/de-merger of a company goes beyond the scope of this article. The CCC follows the mechanism established by the corporate EU Directives, so a merger of two or more companies may be performed either by establishment of a new company, or by the transfer of assets of all or some companies to an existing company in exchange for shares in the surviving company. The businesses of the merged companies need to be managed by the surviving company separately over a 6-month period, and creditors of respective merged companies have a priority in settling their claims from the respective companies' businesses.

Only solvent companies can merge, although the test is formal and not practical – only a judicial court order on the declaration of insolvency would present an obstacle. A situation where a company should be subject to insolvency proceedings but is not covered by judicial insolvency proceedings does not constitute such an obstacle.

De-merger, on the other hand, results in formation of one or more companies and transfer of assets from the de-merged business in proportions agreed between the shareholders. The companies founded on the basis of a de-merged business are jointly and severally liable towards the (prior to de-merger) creditors.

The merger and de-merger mechanisms are not very popular in Polish practice in pre-insolvency restructuring transactions.

Notes

18 Please see art. 458 of the CC, which reads:
'If the debtor becomes insolvent or if, due to circumstances for which he is responsible, the security of the receivable debt is considerably reduced, the creditor may demand performance regardless of the stipulated time limit.'

19 Please see art. 83 of BRL, which reads:
'Provisions of a contract which provide, in the event of the declaration of bankruptcy, for a revision or for the termination of a legal relationship to which the bankrupt is a party, shall be invalid.'

Sale of business

A sale/purchase of a continuing business may occur not only when a purchaser acquires the title to all assets of the seller's business, but it may also occur when the seller's company is running more than one business and the businesses are independent from each other in terms of function, organisation, management and financing, so that each of them can be treated as a separate enterprise (continuing business) in the meaning of the CC.[20] A sale of the whole business results in joint and several liability of the purchaser with the seller for the liabilities which can be attributed to the businesses. Liability of the purchaser is limited by the value of the acquired business.

The only way of avoiding this joint liability is to perform a due diligence investigation, which should prove that the purchaser despite having acted with due care could not have known about the liabilities related to the purchased business, or to obtain a waiver from all of the creditors of the business. The latter is a long and cumbersome process as every creditor needs to be persuaded that after the sale all of his current or due receivables or other performances shall be paid or performed in accordance with the original terms agreed with the seller of the continuing business. Any purchaser of a continuing business (and for that matter this is also applicable to a sale of assets transaction) can also obtain a tax certificate with the seller's consent,[21] which evidences the seller's current due tax liabilities and in accordance with this provision sets the potential maximum joint liability of the purchaser for any tax arrears of the seller. The subject of the purchaser's liability for the tax areas of the seller is controversial if that acquisition takes place from an official receiver during liquidation insolvency. The interpretation of insolvency practitioners is that no such liability exists, as the seller is the receiver who acts in his/her own name for the account of the insolvent company and thus any joint liability for tax, if any, would have to be that of the receiver and not of the company as the seller. Such liability, however, cannot exist by definition since the acquisition of a business (unless the law provides specifically otherwise) is free from any liabilities and charges during insolvency proceedings. Jurisprudence has also developed a theory that this is an acquisition *ab initio*, i.e. as if there was no previous owner, and thus such an acquisition must be free of any liabilities or charges. Unfortunately, this view is not shared by the fiscal authorities and administrative courts, which favour the view of joint and several liability of the purchaser of a business acquired from an insolvency receiver. Until a ruling of the Supreme Court on this issue is obtained, any potential purchaser is well advised to take into account the risks resulting from the practice of the fiscal authorities.

In terms of other formalities, a contract of purchase of a continuing business also requires the signatures of the parties to be certified by a public notary, for

Notes

20 Article 55(1) reads: 'An enterprise shall be an organized complex of material and non-material components designed for carrying on economic activity. It shall particularly include:
1) a designation that identifies an enterprise or its separate parts (the name of the enterprise);
2) ownership of immovable or movable properties including devices, materials, goods and products, and other proprietary rights to immovable and movable properties;
3) rights under contracts of lease and contracts of tenancy of immovable and movable properties and rights to use immovable and movable properties under other legal relationships;
4) receivable debts, rights attached to securities, cash means;
5) concessions, licenses and permissions;
6) patents and other industrial property rights;
7) author's economic rights and neighboring economic rights;
8) business secrets of an enterprise;
9) books and documents connected with the economic activity carried on.'

21 Please see art. 112 of the Polish Tax Ordinance, which reads:
'§ 1. The acquirer of: (1) an enterprise; (2) an organized part of an enterprise; (3) component assets connected with the economic activity carried on, mentioned in paragraph 2, if their unit value on the day of transfer is at least 15,000 zloties; – shall be responsible with all the assets, jointly and severally with the taxpayer for tax arrears arisen until the day of the acquisition, such tax arrears being connected with the economic activity carried on.
§ 2. The component assets connected with the economic activity carried on shall include fixed assets within the meaning of provisions on accounting, except for long-term debtors, loans granted and long-term prepayments and accruals.
§ 3. The scope of the acquirer's responsibility shall be limited to the value of the acquired enterprise, its organized part or component assets.
§ 4. The scope of the acquirer's responsibility shall not comprise: (1) the dues listed in Article 107, paragraph 2, subparagraph 1; (2) default interest on tax arrears and interest referred to in Article 107, paragraph 2, subparagraph 3 arisen after the day of acquisition.
§ 5. The provision of paragraph 4 shall not apply to acquirers being spouses or members of family of the taxpayer, as referred to in Article 111, paragraph 3.
§ 6. The acquirer shall not be responsible for tax arrears not revealed in the certificate referred to in paragraph 306 g.
§ 7. The acquirer shall also be responsible for tax arrears and other dues of the transferor referred to in Article 107, paragraph 2, subparagraphs 2 to 4, subject to paragraph 4, subparagraph 2, arisen after the day of issuing the certificate referred to in paragraph 306 g and before the day of acquisition of the enterprise, its part or component assets if, between the day of issuing the certificate and the day of transfer: (1) 30 days lapsed – in the case of transfer of an enterprise or its part; (2) 3 days lapsed – in the case of transfer of component assets.'

otherwise the transaction would be void (judicial practice, however, recognises that a gradual, step-by-step acquisition of assets between the same parties without such compliance also constitutes an acquisition of a business). Shareholders' authorisations of transactions are always required on the part of the seller and often on the part of the purchaser, and of the prime duties one should always check whether any clearances from competition authorities and consents for the purchase of real estates are required.

Sale of assets

Problems related to the acquisition of individual assets or groups of assets which cannot be treated as a continuing business (Polish civil law practice also recognises the concept of an organised part of a continuing business, which term is defined only by the corporate income tax act) are few and mostly stem from the nature of the assets and not the form of a transaction.

The obvious issue when acquiring groups of assets is avoiding the problem of post-transaction qualification of a sale of assets as being the sale of a continuing business. There are no general protective measures that may be applied, as each case is different. One way to cover (tax) risks related to different qualification of a transaction (and this is crucial for VAT and transfer tax and related problems) is to obtain a formal interpretation of the nature of a transaction from a tax office and to comply with that interpretation in practice. This, however, would not solve problems related to other types of creditors' actions.

Apart from checking the title and the existence of any charges (which is sometimes difficult to do in practice), one should make sure that transfer protocols evidencing the actual transfer of possession of assets are put in place. This should allow the avoidance of possible legal disputes as to what has in fact been transferred between the parties, and in what condition, as part of the transaction involving assets.

Conclusions

As in any jurisdictions, the restructuring of distressed assets in Polish companies also requires due care and consideration for the local rules. Some of the areas of concern are not Polish peculiarities, but some may prove to be difficult to understand and justify. Negligence of these may result in consequences and problems of a magnitude that is disproportionate to the nature of breach of a formality.

With a distressed asset restructuring, the role of advisers should also be perceived differently – it would not only be for the adviser to show how to effectively achieve and execute a successful closing of restructuring, but the adviser should also be in a position to judge the predictable risks and together with the investor weigh the benefits and the risks of restructuring so as to facilitate a rational investment decision.

A time of market growth may not be perceived as the best period in which to look for deals in the Polish distressed asset market (there have been a decreasing number of insolvency filings in the 2006/2007 period in Poland) but in any market including one of growth it is the speed of growth and competition from new players that in fact causes distress to established players in the market, who may not be in a position to adapt to new market needs and in consequence face restructuring or insolvency proceedings. The time of growth is also bringing overly optimistic scenarios, resulting in acquisitions and large investments not always corresponding to the capacities of the market and real expansion potential. Such visions financed at high leverage frequently result in distress. The experts are already trying to envisage the business that will start the waterfall of distress restructuring applications.

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