Country Reports

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Updates from Slovakia, Cyprus and Lithuania

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Cyprus: New laws to improve the legal framework on Non-performing loans

Several new laws were enacted in July 2018 to facilitate the reduction of non-performing debt in the Cyprus banking system. The main changes are summarised below.

- Law 83(I) 2018 amends the Companies Law in order to facilitate debt restructuring and promote corporate rescue. The moratorium during the tenure of an Examiner ceases if the company does not meet its obligations.
- Law 85(I) 2018 amends the Law of 2015 on Insolvency of Natural Persons (Personal Repayment Plans and Debt Relief Orders) in order to simplify procedures and facilitate the rehabilitation of the debtors who have not committed offences by speeding up their return to productive economic activity.
- Law 86(I) 2018 amends the Law of 2015 on Sale of Credit Facilities and Related Matters in order to remove all fees on the transfer of property or of a charge payable by the buyer. In addition, it clarifies the rules regarding the outcome of the sale of credit facilities, the transfer of rights and obligations, priorities, the continuation of lawsuits and the retention of documents.
- Law 87(I) 2018 amends the Law of 1965 on Transfer and Mortgage in order to enable a lender to split an existing mortgage into two or more mortgages for the same aggregate amount. The priority among the split mortgages is decided by the lender, but the order of priority in relation to other charges over the same assets is unchanged. The lender may sell any mortgage, irrespective of any notices issued before the new law took effect. No government fees are payable by the buyer.
- The Securitisation Law (Law 88(I)2018) establishes a framework for debt securitisation under the supervision of the Central Bank of Cyprus. The debtor's obligations and rights do not change with the securitisation of the loan and the securities are unaffected. The sale and transfer of the loan to the SPV is final and binding on the transferor and in the event of the subsequent insolvency of the transferor, there will be no recourse against the transferee.

The current exemptions from income tax, capital gains tax, SDC tax, stamp duty and transfer fees for transfers of immovable property from a borrower to the lender in the course of loan restructuring have been extended to borrowers who dispose of the property themselves in the open market. Both sets of exemptions will continue until the end of 2019.

The Insolvency Practitioners Regulations have also been amended in order to increase by 50 percent the fee payable to the insolvency practitioner for successful implementation of a personal restructuring plan.

To further facilitate the reduction of non-performing debt, a debt relief programme known as ESTIA will come into force at the beginning of 2019. Any loan secured on a principal private residence with a value of €350,000 or less will be written down to the market value of the property and extended up to 25 years at a below-market interest rate. The government estimates that the scheme, which will be administered by the Cyprus Land Development Corporation and funded by the government for the next 25 years, will benefit approximately 15,000 debtors, with total debts estimated at €3.4 billion. ■

> “A DEBT RELIEF PROGRAMME KNOWN AS *ESTIA* WILL COME INTO FORCE AT THE BEGINNING OF 2019”

Slovakia:
Shareholders and grey eminence – be aware

Piercing the corporate veil when the responsible company bodies disregarded legitimate creditors' interests and did not take reasonable steps to avoid insolvency or at least to take immediate steps to minimise the losses for creditors was impossible in Slovakia. The lack of legal measures to avoid and penalise such situations required an adequate reaction from the lawmakers. Happily, the responses are coming.

Extension of liability in case of bankruptcy

The recent amendment to the Slovak Commercial Code introduces a new liability of controlling entities – shareholders and/or other parent entities – for the insolvency of the controlled company if the shareholder contributes to the controlled company's insolvency and causes the creditor's claims not to be duly satisfied. There are two basic requirements for the establishment of the liability:

- Firstly, the controlling entity's actions must result into insolvency of the controlled company. In contrast to the liability of managing directors, standards for the behaviour of controlling entities are lower since they are *ex lege* not obliged to act with professional care.
- Secondly, the actions of the controlling entity must have significantly contributed to the insolvency of the controlled entity but they need not be the primary or the sole reason for the insolvency. However, there must be a causal relationship between the influence of the controlling entity's acts and the insolvency of the controlled entity.

The insolvency of the controlled entity is presumed if the insolvency proceedings could not be opened or were stopped due to the lack of assets. A welcome aspect of this new regulation is that it creates an additional legal basis for creditors to claim damages besides the general rules under the civil code. Moreover, the creditors will no more be dependent on the insolvency practitioner ("IP") who may bring actions only within pending insolvency proceedings.

To minimise the possibility of hiding from the liability for harmful conduct, the law also extended the liability for damages to persons who factually exercise the function of a statutory body without a formal appointment – so-called *de facto directors*. Those grey eminencies can be held liable in the same way as the statutory body. This means that those persons are not ultimately covered by the protective shield of a corporate entity anymore.

Shareholders and grey eminencies held liable for such damage may discharge themselves from liability only if they prove that they were acting informed and in good faith that their actions were in favour of the controlled company.

Stricter rules on liability for damages in case of bankruptcy

Laws on holding the statutory body accountable for insolvency are not new in Slovakia. However, the laws must be very precise or the application of these legal measures may turn ineffective.

In case of indebtedness of the company the managing director/liquidator/legal representative of the company is obliged to file for insolvency (Section 11 (2) of the Act 7/2005 Coll. on bankruptcy and restructuring ("Bankruptcy Act")).

To set up stricter rules concerning the statutory body (that is, the obligation to avoid insolvency and to act on time in case of insolvency), the legislator has introduced already several years ago a fixed contractual penalty established by virtue of law between the bankrupt company and its statutory body in the amount of €12,500. This contractual penalty cannot be waived, limited or excluded by any contract including articles of association or deeds of foundation. The person entitled to enforce the penalty is the IP. The IP may enforce the penalty individually against each of the persons who are required to file the bankruptcy petition, regardless whether acting individually or jointly.

After being previously removed from the Bankruptcy Act, its recent amendment re-established unlimited liability for damages caused by not filing the petition for insolvency on time. If the person who was required to file a bankruptcy petition on behalf of the debtor fails to file for insolvency timely, he/she will be liable to the creditors for the damage which arose as a consequence thereof, unless he/she proves to have acted with professional care. The liable person is given the opportunity to prove that even the timely filing of the bankruptcy petition would not lead to a better satisfaction of the creditor. Since it is a direct claim for damages to creditors, it will not be claimed by the IP but directly by the creditors. Unless proved otherwise, the damage suffered by the creditor is deemed to equal the value of the unsatisfied claim of the creditor.

Conclusion

The stricter rules on shareholders and persons acting on behalf of the company supported by the rules' precise application should help satisfying the creditors' claims. However, the creditors must also keep an eye on the actions of the IP and make sure that he/she is taking all the steps necessary to protect their interests. Besides that, the creditors can go after the liable persons on their own. ■

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"GREY EMINENCIES CAN BE HELD LIABLE IN THE SAME WAY AS THE STATUTORY BODY"

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Lithuania:
Draft Law on the Insolvency of Legal Entities

In order to consolidate bankruptcy and restructuring processes into a single statute, to combine the bankruptcy and restructuring professions into one, to resolve the issue of self-governance of this combined profession and to clarify the interpretation of the provisions of the bankruptcy and restructuring laws, the Draft Law on the Insolvency of Legal Entities (hereinafter – the Draft) was prepared in Lithuania in 2018.

In preparing the Draft, it was established that historically the law presented many deficiencies: the percentages paid to creditors were extremely low; the bankruptcy process took too long; the regulation of the profession of insolvency administrators was inadequate; and the administrative expenses and the administrator's remuneration lead to extended legal disputes as a result of which an insolvent legal entity suffered excessive litigation expenses and delays. The Draft therefore includes the following new ideas:

Enlargement of the concept of insolvency

The definition of insolvency is probably the most controversial issue of the Draft. Currently, insolvency is perceived as the state of an undertaking when overdue liabilities exceed half of the value of assets according to the balance sheet. The Draft provides a more modern definition of a company's insolvency as being its unability to fulfil overdue obligations and/or its having liabilities in excess of the value of its assets.

"THE DEFINITION OF INSOLVENCY IS PROBABLY THE MOST CONTROVERSIAL ISSUE OF THE DRAFT"

It is feared that if this definition of insolvency is included in the law, the risk of bankruptcy will arise for any undertaking temporarily unable to trade profitably, as even temporary negative results could be the basis for the initiation of insolvency proceedings. For this reason, some business organisations and lawyers propose to retain the old definition of insolvency fearing a significant rise in the number of Lithuanian enterprises becoming insolvent. In addition, in Lithuania it is believed that newly founded companies usually operate at a loss in the first few years, and the proposed change would result in companies having to initiate bankruptcy proceedings prematurely.

Agreement on assistance to overcome financial difficulties (hereinafter – "Agreement on Assistance")

The Draft introduces the new pre-insolvency Agreement on Assistance by creating the preconditions for solving financial difficulties without involving the court: as many actions as possible could be carried out during the restructuring stage and the court would only be implied where it is necessary and proportionally, in order to protect the rights of the creditors and the interests of the other parties affected by the restructuring plan.

Administration of enterprises without assets

To deal with legal entities which do not have sufficient assets to cover court and administrative expenses, such bankruptcies are usually administered by the bankruptcy administrators at their own expense. Creditors rarely agree to initiate such processes at their own expense and it is proposed that the court will open a bankruptcy case only if the petitioner pays a deposit specified by the court to cover the bankruptcy administration costs within a period not exceeding 14 days.

Change of rank of the creditors' claims

To encourage attempts at restructuring that require additional capital to be injected, it is proposed that the claims of creditors who provide financing for the restructuring of companies would rank equally with former employees and creditors. If the restructuring fails, such a proposal would affect the rights of the former employees since their potentially recoverable amounts from the company's assets would be significantly reduced. The claims of the other creditors, including tax authorities, would rank after, so that the State would lose the priority right of claim in bankruptcy proceedings.

Administrators as a sole profession

Another important novelty is the merger of the professions of bankruptcy and restructuring administrators into a sole profession, that of insolvency administrators. It is proposed to change the current insolvency administrator system by creating an effective self-governing body of insolvency administrators, i.e. the Chamber of Insolvency Administrators of Lithuania, whose functions would include the organisation and implementation of qualification examinations for insolvency administrators, the organisation and control of professional qualifications and the establishment of principles of professional ethics and of rules for their enforcement. The harmonisation of the state supervision of insolvency administrators and the delegation of certain functions to a professional organisation would lead to more effective implementation of each function. It is preferred that the profession itself should set professional ethics standards and take care of their enforcement, rather than the State.

The preparation of the Draft was prompted by the European Commission Recommendation 2014/135/EU of 12 March 2014 on a new approach to business failure and insolvency, the World Bank "Doing Business" report and the findings of the relevant public authorities of Lithuania.

It is planned that the Draft and the accompanying legal acts could be adopted by the Seimas (Parliament of Lithuania) in the autumn session of 2018. The Draft itself states that its entry into force is expected on 1 May 2019 (with the exception of relevant provisions, the entry into force of which is expected from 1 January 2022). ■