Charles University in Prague

Faculty of Social Sciences

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MASTER THESIS

Economic Rationale behind the Evolution of Slovak Insolvency Law

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Declaration of Authorship

The author hereby declares that he compiled this thesis independently, using only the listed resources and literature.

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Prague, May 20, 2011

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Signature

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Abstract

The Slovak insolvency law reform, which came into effect on 1 January 2006, introduced a brand new restructuring option for business debtors. In this thesis, we present the first complex empirical analysis of all restructuring attempts allowed in the period 2006-2010. Results, based on a large amount of data, which we gathered for this purpose, suggest that the restructuring option is much more viable than the composition option under the previous Bankrupcty and Composition Act. The system is characterized by very high success rates (in terms of plan confirmation) and speedy proceedings. The size of the debtor affects neither the prospects for success, nor the length of proceedings significantly. We conclude that, even though a lot of improvements still need to be done, the reform moved the Slovak insolvency law closer to the standards of the best-performing jurisdictions.

JEL Classification D23, K12, K20

Keywords insolvency law, reform, restructuring, bankruptcy, restructuring plan, trustee

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Abstrakt

Reforma slovenské insolvenční legislativy, která nabyla platnosti 1. ledna 2006, přinesla zcela nový institut restrukturalizace pro dlužníky z podnikatelské sféry. V této práci přinášíme první komplexní empirickou analýzu všech pokusů o restrukturalizaci, které byly povoleny v letech 2006-2010. Výsledky, jež jsou založeny na velkém množství dat pro tento účel získaných, naznačují, že institut restrukturalizace je mnohem životaschopnější než byl institut vyrovnání podle předchozího zákona o konkurzu a vyrovnání. Systém vykazuje vysoké míry úspěšnosti (co se týče potvrzení plánů soudy) a zrychlené konání. Velikost dlužníka zásadně neovlivňuje naděje na úspěch ani délku konání. Soudíme, že i když je ještě potřeba vykonat spoustu úprav, reforma posunula slovenskou insolvenční legislativu blíže standardům těch nejvýkonnějších jurisdikcí.

Klasifikace JEL	D23, K12, K20
Klíčová slova	insolvenční právo, reforma, restrukturalizace, konkurz, restrukturalizační plán, správce
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Master Thesis Proposal

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Proposed Topic:

Economic Rationale behind the Evolution of the Slovak Insolvency Law

Topic Characteristics:

There are three agency problems inevitably embedded in corporations by their nature: between the managers and shareholders (owners), between majority and minority shareholders and finally between shareholders and creditors. These problems stem from different interests and motivations on both sides and as such are consequence of their rational behaviour. There are many tools and strategies how to solve or at least limit these problems. These can basically be divided into two cathegories: market solutions and law regulations.
Differences in motivation and interests of agent and principal become even more striking when corporation is facing a threat of bankruptcy. Such a situation therefore requires a special attention.
In case of Slovakia, a transitive country, further specific problems emerged during the transition period. Moreover, immature markets had market tools limiting agency problems almost completely missing and therefore the importance of quality insolvency law and regulation even increased.
This thesis will concentrate on the evolution of the Slovak insolvency law and regulations, its gradual development and the way of reflecting agency problems in corporations. Firstly, it will introduce concepts of corporation, agency problems, insolvency and implied variations of agency problems in such a situation. Then it will examine changes in the Slovak insolvency law and economic rationale behind them. This part will also try to take into account specific issues and problems which emerged during the transition and to show how the Slovak regulation dealt with them. Ambition of this work is also to analyze empirical data in order to support hypotheses about the positive impact of incorporated changes in regulation and overall improvement of the quality of the insolvency law. For this purpose, data mainly from the Insolvency register and the Business register will be used and will be further supplemented with data from annual reports and other internet sources.

Hypotheses:

1. Changes in the Slovak insolvency law were necessary because of insufficient previous regulation which did not adequately reflect problems arising in corporations in Slovakia.
2. New insolvency law more successfuly reflects the most striking issues which could possibly arise during insolvency proceedings.
3. The Slovak insolvency law and regulations have achieved qualities comparable to the jurisdictions in the countries of the Western Europe.

Methodology:

The objective of the work is to provide both theoretical and empirical analysis of manifestations of agency problems in corporations when facing bankruptcy and to show how the Slovak insolvency law and regulation evolved to reflect them. Standard approaches of Law and Economics, mainly the principal-agent theory will be used to examine economic rationale behind these changes. The selection of empirical concepts and models to examine the impact of adopted changes will depend on the quality/availability of necessary data.

Outline:

1. Introduction
2. Corporation:
    - basic characteristics
    - agency problems
    - solutions designed to limit agency problems: - market solutions
      - regulation
3. Insolvency:
    - definition of basic notions
    - manifestations of agency problems when facing insolvency
    - overview of worldwide used solutions to limit them
4. The Slovak insolvency law and regulations:
    - specifics of the Slovak transition path
    - evolution o thef insolvency law and regulations in Slovakia
    - economic rationale behind changes
5. Empirical issues:
    - overview of existing empirical literature
    - description of the concepts/models used
    - interpretations of results
6. Conclusion

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1 Introduction

A declaration of bankruptcy carried a great stigma in the past. Punishment was severe. In ancient Rome, bankrupt debtors were enslaved or cut to pieces. In England, they were imprisoned and sometimes sentenced to death. A custom of breaking a moneylender's bench over his head, when he declared bankruptcy, was widespread in medieval Italy. It became so associated with insolvency that from banca rotta (Italian for „broken bench"), words bankrupt in English, bankrott in German or banqueroute in French were derived.

Recent insolvency laws take a much less punitive approach. Liquidation of financially distressed companies and distribution of their remaining assets among creditors is no longer the only formal option to resolve insolvency. Solid restructuring procedures have been developed to give economically viable businesses, experiencing only temporary problems, a chance to survive. Developed insolvency regimes thus separate efficient companies in temporary distress, that should be rehabilitated, from inefficient ones, that should be liquidated. Since the ultimate goal of bankruptcy is universal – to maximize the total value of proceeds received by creditors, shareholders, employees and other stakeholders, the option which generates the highest total value should be employed.

During recent global financial and economic crisis, provisions on insolvency were tested more than any other business regulations. Separating and saving viable businesses became especially important. A viable option of restructuring helps to preserve jobs and to avoid losses incurred by premature liquidation of efficient businesses, suffering only from temporary economic downturn.

A well-functioning insolvency regime can also significantly speed up recovery after crisis since its positive effects for the economy are far-reaching. Higher recovery rates lead to better availability and lower cost of debt financing. Creditors expect that more assets would be available to them in insolvency. Therefore, they are more willing to lend and require less collateral. Effective exit process for inefficient companies fosters reallocation of resources. People and capital are put to the more effective use and overall productivity increases. Easier exit encourages new business creation and entrepreneurship.

Therefore, the debate among policymakers, economists and lawyers on how to improve existing insolvency laws is present all around the world. In the Slovak Republic, there is another good reason for such discussion. In years 2004-2006, a sweeping reform of

insolvency law, inspired by the legal concepts of best-performing jurisdictions, was introduced. In line with recent reform trends, it established a brand new restructuring option for business debtors, expanded creditors‘ rights in the proceedings, tightened statutory time limits, minimized court powers to make commercial decisions and developed the trustee profession. After five years of new legislation being in force and new provisions being stress-tested by the economic crisis, it is possible to draw first conclusions about its effects.

The focus of this thesis is the empirical analysis of all restructuring attempts allowed in the period 2006-2010. This way, we try to make original contribution to the discussion on the Slovak insolvency law reform since, even though various legislative interventions are already being prepared, we are not aware of any similar analysis evaluating the impact of reform or supporting recommendations for adjustments by empirical evidence. We hope to support our hypothesis that the new restructuring option is, unlike the composition option under the previous Bankruptcy and Composition Act, a viable option to resolve insolvency and, in terms of speed and success, is comparable to the rescue measures adopted by the most developed jurisdictions.

The paper proceeds as follows. Chapter 2 describes the reform and the restructuring procedure itself. It is not meant to be an exhaustive description of all provisions one by one but rather a brief overview of those provisions that the reader needs to familiarize with for better understanding of the core, empirical part of the work. Moreover, the changes which we consider to be the most interesting or the most controversial are highlighted and compared with the perspective of the insolvency law theory. Chapter 3 maps the practical application of restructuring provisions in the period 2006-2010. Statistics on the use of proceedings, on the debtors, on the success rates and on the proceedings‘ timeline are presented and interpreted. Chapter 4 concludes.

2 Slovak Insolvency Law Reform

On 9 December 2004, the Slovak parliament enacted Act No. 7/2005 Coll. on Bankruptcy and Restructuring (the Insolvency Act) and Act No. 8/2005 Coll. on Insolvency Trustees (the Insolvency Trustees Act). In these two pieces of legislation, the Slovak insolvency law was completely overhauled. Changes came into force in two stages: the Insolvency Act applied to insolvency proceedings that commenced on or after 1 January 2006 and the Insolvency Trustees Act applied to insolvency proceedings that commenced on or after 1 July 2005.

The insolvency law reform was prepared in quite a revolutionary way, at least in Slovak circumstances. Legal concepts introduced by the reform were based on the large amount of insolvency law research put together by the World Bank, UNCITRAL[1] and other institutions and both acts were co-drafted by the Ministry of Justice and Allen and Overy Bratislava with the assistance of the Institutional Development Fund grant from the World Bank. Without any doubts, these two factors influenced significantly the quality of approved law even though the relevant draft statutes were subject to much restatement later on in the legislative process and the approved law diverged from them to a large extent.[2]

2.1 The necessity of insolvency law reform

New legislation replaced Bankruptcy and Composition Act No. 328/1991 Coll. which had been amended more than twenty times (therefore not providing an easy survey) and suffered from serious deficiences. Report on the Observance of Standards and Codes[3], prepared by the World Bank and covering insolvency regime and creditor rights systems in the Slovak Republic, pointed out:

- orientation almost exclusively to liquidation
- length of bankrupcty proceedings, taking 3-7 years
- extremely low recovery rates (unsecured creditors recovery typically nothing, secured creditors 5 – 10 %, after administration costs)
- fragmented, inadequate and inefficient legal framework supporting creditor's rights
- low creditor participation and creditor-imposed discipline
- slow and unreliable judicial enforcement procedures

[1] United Nations Commission on International Trade Law
[2] Allen and Overy (2005), Richter (2005b)
[3] ROSC (2002)

- ineffective constraints on abusive filings
- poorly developed collateral mechanisms
- judicial corruption
- lack of transparency
- lack of trustees‘ professional development, no formal education process or mandatory training for them

Low enforcement rate of creditors‘ claims, length of proceedings, limited creditors‘ control over the management and the outcome of proceedings and rare use of composition proceedings designed to facilitate corporate recovery outside bankrupcty proceedings were the most striking problems also according to Allen and Overy (2005). Pospíšil (2003) stated, among all these issues, also the lack of cross-border insolvencies regulation and conflict of the bankruptcy law with other legal systems. These all were problems that reform aimed to tackle.

2.2 The purpose and the conception of the reform

The main purposes of the reform included[4]:

- to avoid any loss on the value of the bankrupt’s property in the period just prior to the commencement of bankruptcy proceedings and in the course of the proceedings
- to ensure an acceleration in the proceedings – instituting tighter control over proceedings and stricter timeframes within which key events within the process must be accomplished to shorten the time required to complete the procedure
- to take measures stimulating the parties involved to act promptly and to have a pro-active approach in the proceedings
- to facilitate a possibility of informal restructuring as an alternative to the formal proceedings
- to increase the responsibility of all parties involved in the proceedings, mainly the bankruptcy trustees
- to limit a potential room for corruption
- to avoid the existing absence of international private and procedural law in the area of bankruptcy

[4] As presented in the interviews with authors of the reform and in the Legislative intent and Explanatory report to Act No. 7/2005 Coll. on Bankruptcy and Restructuring.

To achieve these goals, the entire conception of the Slovak insolvency system had to be changed. The new conception is built on these key components:

- Pro-creditor oriented system as a basis: protection of creditors‘ rights and creditors‘ control over the proceedings are enhanced to reduce the cost of debt financing and to increase its availability. Empowering creditors is definitely a step in the right direction, but new law contains also measures which are evidently pro-debtor, e.g. strict requirements on creditors‘ petitions for the bankruptcy to prevent abusive filings. Generally, it is often difficult to distinguish between pro-creditor and pro-debtor oriented systems since several measures which at first glance seem to be in favour of creditors actually benefit debtors and vice versa.[5]

  One of the most accurate indicators, which are used to differentiate pro-creditor and pro-debtor attitudes to insolvency, is Philip Wood's litmus test of jurisdictions. Its key criterion is whether set-off is allowed, eventually compulsory (favouring creditors) or set-off rights of creditors are prohibited or limited (favouring debtors) on insolvency. Solution of this policy collision as to who to protect on insolvency then reveals the underlying approach to insolvency[6]. In jurisdiction of the Slovak Republic, disallowance of set-off in certain insolvency proceedings is applied (no claims that originated before the commencement of the restructuring proceedings can be set-off against the claims of the debtor).[7]

  In this context, it is also interesting to mention the position of World Bank which in its annual report Doing Business 2004 (p. 77) states that *„reform to improve bankruptcy is not about being friendly to creditors or to debtors. Singapore is extremely creditor-friendly, closely followed by Ireland. Germany, Japan, the Netherlands, and Norway are thought to balance the interests of debtors and creditors. Belgium is very debtor-friendly. Yet all those jurisdictions have quick and cheap bankrucpty procedures, reach the efficient outcome, and maintain the absolute priority of claims.“*
- Decisions which are commercial in nature rather than legal are placed in the hands of stakeholders, mainly creditors. Negotiations between debtor and creditors are stressed over court involvement. The shift of the decision-making authority from judges to creditors makes sense for many reasons. From all of the participants, creditors have

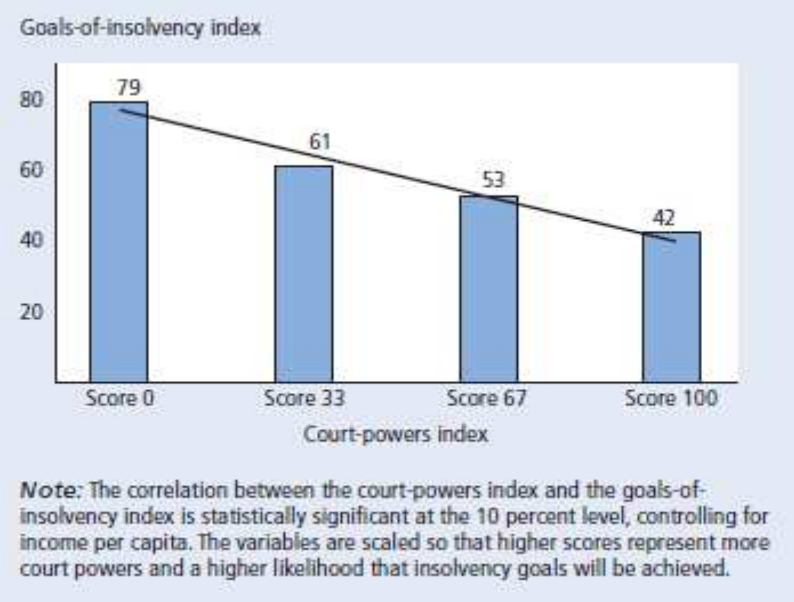
[5] E.g. improvements in the creditors' protection reduce their risk (they expect to get more in insolvency) and that consequently leads to lower cost of debt which is to benefit of debtors.
[6] For more, see Wood (2007).
[7] Allen and Overy (2009a), Allen and Overy (2009b)

the best incentives to take economically efficient decisions. The experience with judicial decison-making based on commercionality has been bad in all post-communist countries.[8] This can be, among other reasons, ascribed to the lack of business/economics training of judges. Judicial corruption has been one of the most pressing problems in Slovakia. Moreover, courts have been overburdened and *„whenever the court system is involved,...delays are the rule rather than the exception and serve to diminish the value of assets and reduce recovery based on time value of money.“*[9]

This concept is consistent with the findings of World Bank (Figure 1) that *„countries with more court power are less likely to achieve the goals of insolvency, even controlling for income. Moreover, higher levels of court power are associated with more corruption - again, even controlling for income. In such jurisdictions, less court involvement is needed, not more. Involving creditors and other stakeholders in the bankrupcty process is important.“*[10]

Figure 1

More Court Power – Less Likely to Achieve the Goals of Insolvency



Note: The correlation between the court-powers index and the goals-of-insolvency index is statistically significant at the 10 percent level, controlling for income per capita. The variables are scaled so that higher scores represent more court powers and a higher likelihood that insolvency goals will be achieved.

Source: Doing Business 2004, p. 78

[8] Richter (2005b)
[9] ROSC (2002), p. 4
[10] Doing Business 2004, p. 78

- The trustee becomes the key person for the success of bankruptcy proceedings in Slovakia. This is probably the riskiest part of the reform[11]. Trustees are given several key competencies in the proceedings although there have been reasonable doubts about their integrity and competency. Richter (2005b; p.2) states that *„...the trustee needs to be competent and honest. Potentially this could be the Achilles' heel of the entire reform; a good number of the current trustee would not pass on either test."* Similar doubts are expressed in the ROSC (2002; p. 8-9) by the World Bank:*„Creditors, debtors and judges are uniform in complaining about trustees. There is a widespread perception that the profession is corrupt and incompetent...The power to have a trustee of choice appointed is perceived as the power to control the proceeding, rather than as a way to ensure fairness."*

  It is important to note here that the architects of the reform have acknowledged these limitations. Regulation of the trustee profession is one of the major parts of the reform. In previous system, trustees were not accountable to any governing body and oversight of the Ministry of Justice was inefficient since there was not *„enacted legislation or regulations to properly ensure that trustees are held to a high standard and to provide for monitoring, investigation and discipline for misconduct or incompetence. Requirements in the Bankruptcy Law for appointment are minimal and general, i.e. no criminal record, "appropriate professional qualifications" (undefined), and unbiased individuals. Once appointed, trustees enjoy life tenure. There is no procedure for challenging or revoking a trustee's right to practice."* (ROSC, 2002, p 9.)

  New Insolvency Trustees Act tightens up the regulation of trustees. The profession is supervised by the Ministry of Justice (§ 27) which has the authority to license trustees, maintain a list of licensees, impose fines and remove trustees from the register (§ 19). The act introduces new formal pre-conditions which have to be met to qualify as an insolvency trustee (§ 21-23). Requirements include passing a professional exam in front of a committee and participation in a professional training and learning programme (§ 16-17). Establishing mandatory qualification requirements follows intuitive logic that *„where qualified insolvency professionals are involved, viable businesses should have higher chances of survival and nonviable ones should generate higher proceeds in liquidation."*[12] Allen and Overy (2005) highlights that legal entities are no longer disqualified from holding the office of insolvency trustee (§ 2) and

[11] Richter (2005a) refers to this concept as "bet on the wild card".
[12] Doing Business 2011, p. 81

perceive this *„as a great opportunity for professional firms to expand their scope of business into this lucrative area“*. That could contribute to the further development of the insolvency profession. The Act also states a duty to act with professional care and other standards of conduct to be observed by a trustee (§ 3). The most important rule regarding the liability of trustees is the liability for any damages resulting from breach of these duties (§ 12).

2.3 Insolvency tests

The trigger criterion belongs to the key features of the insolvency law. There are several requirements which the trigger criterion should meet. Falke (2003) indicates that the most vital question is the question of balance. If the trigger is pulled too early, it may have devastating effects for the debtors who attempt to save their business but on the contrary, if it is pulled too late it may harm the interests of creditors since the assets of the debtor may have depleted before creditors were allowed to initiate insolvency proceedings.

The Insolvency Act states two tests for insolvency: the cash-flow test (inability to pay debts as they fall due) and the balance-sheet test (overindebtedness). The debtor is insolvent if either of these tests are met. If the debtor files a petition for declaration of bankruptcy or a petition for the approval of restructuring, it shall mean that the debtor is insolvent (§ 3).

2.3.1 The cash flow test

The cash flow test is met if a debtor has more than one creditor and is not able to fulfil more than one monetary obligation after 30 days from the due date. When reviewing the debtor's insolvency, all receivables that originally belonged to a single creditor during a 90-day period prior to the submission of a petition for declaration of bankruptcy are deemed to constitute one receivable.

The obvious advantage of the cash flow test is that it ensures the timely commencement of the insolvency proceedings and therefore may reduce losses born by creditors and increase the chances of success for the rescue. On the other hand, it should be considered with caution since it often reflects only a temporary phase of illiquidity.

2.3.2 The balance sheet test

The definition of overindebtedness was missing in the Act on Bankruptcy and Settlement. Under the Insolvency Act, the balance sheet test is met if a debtor that is obliged to keep its

books under the Accounting Act, has more than one creditor and the value of its obligations exceeds the market value of its assets.

The balance sheet test is designed to identify debtors whose assets are insufficient to cover all their debts prior to the point when their insolvency is demonstrated by their inability to pay debts as they fall due. For creditors of overindebted business, this is issue of high importance since riskiness of their investment has increased (often without their knowledge) by turning from a debt investment into a residual investment. When insolvency law treats such a debtor as insolvent, the debtor's management is pushed either to disclose the real situation by commencing insolvency proceeding or to increase equity. Another option is to take none of these steps and to risk liability to creditors if the debtor ends up in insolvency proceedings anyway.[13]

Falke (2003), however, doubts the adequacy of the balance sheet test approach to measure insolvency. He argues that domestic accounting standards and valuation techniques may lack accuracy and may generate distorted values, not reflecting fair market values. When employing surveys of qualified accounting and valuation experts, the whole process becomes costly and time-consuming. Finally, the balance sheet test might force viable companies with low debt-equity ratios into insolvency proceedings.

2.3.3 Directors' duties and liabilities[14]

Meeting either the cash flow test or the balance sheet test triggers the obligation to file for formal proceedings. The relevant period for filing is 30 days after becoming insolvent and personal liability for damages caused by late filing may be imposed on directors unless they prove that they acted with professional care.

However, as Allen and Overy (2009a) highlights, to offer the companies some flexibility in choosing between a private work-out and formal proceedings, the Insolvency Act specifically recognises management's rescue efforts if the effort is bona fide, realistic and acknowledged in writing by a relevant creditor. Historically, directors' duties have been prosecuted and liability has been invoked very rarely, but Allen and Overy (2009b) expects an increase in director's liability litigation as sophisticated foreign-owned creditors and investors attempt to import this international trend into Slovakia.

[13] For more detailed description, see Richter (2009).
[14] For more detailed discussion of executive directors' duty to commence formal proceeding and of liability for damage caused by violation of this duty, see Kukučková (2009).

2.4 The types of proceedings

The Insolvency Act offers two types of formal insolvency proceedings: bankruptcy proceedings (liquidation) and restructuring proceedings (reorganisation). If a petition for bankruptcy and a petition for restructuring are submitted at the same time, the priority is given to restructuring (§ 16(1)).

The purpose of the bankruptcy proceeding is to resolve the debtor's insolvency by selling off its assets to collectively satisfy its debts and to achieve proportionate (pari passu) satisfaction of the debtor's creditors.[15] A bankruptcy petition may be filed by a debtor, creditor[16], the liquidator of a debtor, or another legally appointed person. Petitions are submitted to the relevant court.

The purpose of a restructuring is to resolve the debtor's insolvency by satisfying the debtor's creditors in the way agreed in the restructuring plan. The restructuring process can be initiated not only if the debtor is already insolvent, but also in case that insolvency is imminent. This rescue measure should only be used in case it is not detrimental for creditors, or in other words, business should be kept going only if it is reasonable to expect that it will result in better satisfaction of debtor's creditors than the piecemeal realisation of assets in bankruptcy proceedings.[17]

Richter (2005; p.3) points out here, that *„the critical question is not so much who will decide whether a reorganisation will be approved or disapproved, but rather who has the right to decide that reorganisation will be attempted at all, and for how long*[18]*."* Legislators face here the challenge to find such equilibrium between the conflicting interests of secured creditors (which have virtually no incentive to restructure and in most cases prefer liquidation) and shareholders/management (which have incentive to attempt restructuring also when it is not economically justifiable) that businesses with negative going concern value will end up in liquidation and businesses whose going concern value is positive will be rescued. This

[15] Allen and Overy (2009b)

[16] Under the new law, creditors' petitions for the bankruptcy proceedings are strictly regulated. A creditor is entitled to file a petition for declaration of bankruptcy if the debtor is in delay with the fulfilment of its monetary obligation towards the creditor for more than 30 days and simultaneously it can be reasonably assumed that this debtor is insolvent. Insolvency of the debtor can be reasonably assumed if the debtor is in delay with fulfilment of at least two monetary receivables of at least two creditors that are enforceable or recognized in writing for more than 30 days in spite of the fact that the creditors have delivered him a written notice to pay these receivables ((§ 11(3)). These strict requirements should prevent abusive filings by creditors..

[17] Allen and Overy (2009b)

[18] Law and Economics refers to such authority as 'gatekeeper'.

„filtering“, by which economically viable but financially distressed companies are separated from inefficient ones, is one of the key features which well-functioning bankruptcy system should have.

A private (informal) work-out, as a privately agreed restructuring of the company's debt (agreed between the company and its main creditors, without any judicial intervention) and an alternative to the formal proceedings, is not specifically recognised by the Slovak legislation, nonetheless it is feasible based on the doctrine of freedom of contract. There are some considerable advantages of informal work-outs: avoiding „stigma“ of insolvency and related negative publicity and speculation, preserving confidentiality, higher flexibility, involvment only of the most sophisticated creditors (limited involment of small creditors), no involvment of court (therefore promoting out-of-court workouts can ease the burden on courts) and also faster and less costly process. However, since no official guidelines exist, market familiarity with the London Approach or INSOL Principles based work-outs is low and they are very rarely used in practice.[19]

2.5 The gatekeepers of restructuring

The key role of the gatekeeper is committed to the trustee. A debtor is entitled to file a petition for a restructuring only if it has appointed a licensed trustee who has evaluated the business and prepared an expert opinion, not more than 30 days old, in which the restructuring is recommended (§ 111(2)).

The trustee's recommendation is then binding for the court in the sense that the court has a capacity to issue a restructuring resolution only in case trustee has recommended restructuring measures (§ 116(2)). It is possible that the trustee albeit recommends the restructuring however the court does not issue a restructuring resolution, but only in case the opinion suffers from evident deficiencies. Allen and Overy (2009b) emphasises that the court does not analyse the economic feasibility of the restructuring.

The problematic feature of such a solution is that on one hand it eliminates the risk of judicial discretion, but on the other hand it creates a new risk of discretion on the side of trustees. Therefore a success of this solution is crucially dependent on the quality and integrity of trustees. Tightening up the regulation of the trustee profession can certainly help to increase the quality of trustees, however it may be too optimistic to expect that it is the ultimate

[19] Allen and Overy (2009a)

answer. Even more when the period to reach required standard was quite short (half a year between the effective dates of respective acts).

Experience shows that after the Insolvency Trustees Act came into force, the number of licensed trustees in the Slovak Republic rapidly decreased from about 1500 to current 543.[20] This development is undoubtedly positive, but, in the opinion of Branislav Pospíšil, this number is still too high[21] and not all trustees are capable of conducting restructuring in the right way. This is one of the reasons why there are considerations to introduce two separate lists of trustees in the future (one list for liquidation and another one with even stricter requirements for restructuring).

Another feature which increases the risk of trustees‘ opportunistic behaviour is the missing regulation of trustees‘ remuneration. Richter (2005a) notes that, according to Branislav Pospíšil, it has been a legislative intent to attract renowned companies from the sphere of financial advisory and accounting to enter the market of bankruptcy trustees. However, if it is debtor (or its management) who appoints and pays a trustee, it potentially creates a high risk of collusion between trustee and debtor. Regarding remuneration of trustees, World Bank recommends to pay trustees for maximizing the estate value to set incentives for them to maximize proceeds. According to its research, by doing so, recovery rates are increased by 20% on average.[22]

The existence of the second gatekeeper – the creditors‘ committee with its power to reject restructuring plan even before creditors vote on it – could be used as a counterargument to the risk of trustees‘ discretion. There are, however, several reasons why creditors‘ committee is by definition a much weaker gatekeeper than trustee could be. Richter (2005b, p. 3) summarizes that *„it will only decide on a draft plan, not actually put it together – this means that between 90 and 120 days worth of time and transaction costs will have passed by the time the commitee has a say. Secondly, and perhaps more importantly, the committee will have to rely on the trustee's information, unless it wants to spend substantial transaction costs on evaluating the plan.“* Moreover, a trustee has some control over the composition of creditors‘ committee.

[20] Own calculation based on the List of registered trustees (1.4.2011).
[21] In the interview (22.11.2010), Branislav Pospíšil estimated the optimal number of trustees in the Slovak Republic at 150.
[22] Doing Business 2005

The fact that during the first 90 days creditors can not revoke and replace the trustee (as contrasted to liquidation proceedings) appointed by the debtor is another manifestation of the key trustee's role in restructuring proceeding. Essentially, the trustee creates the whole conception of restructuring (§ 109(1); § 110(2)(c)) and therefore also the court must in restructuring resolution appoint a trustee who prepared the opinion (§ 116(4)). There is perceptible logic behind this limitation of creditors but it can pose a great danger for creditors in case of collusion between the debtor and the trustee[23].

Then, the protection of creditors is safeguarded only through the legal requirement, often referred to as the best interest rule, that the extent of satisfaction of any creditor must be higher than through liquidation proceedings. This general rule can however lead to the situation which Branislav Pospíšil considers as one of the main problems revealed in practice: the debtor gives creditors only minimum of inevitable (more than they can achieve in liquidation) instead of maximum possible.[24]

Taking all the arguments into account, debate about more appropriate or safer "gate" to the restructuring is definitely not beside the point. The choice of more objective quantitative criterion differentiating corporations into two groups (debtors for which restructuring would be a priori available and debtors to which restructuring would not be available without further arrangements) with the possibility to control inevitable mistakes on both sides[25] (to allow restructuring for corporations, which would not meet the size criterion but would be economically viable, in a way of pre-packed restructuring and conversely, to give creditors of corporations, which would meet the size criterion but their going concern would be negative, possibility to reject the restructuring process) could be alternatively a better solution for the economy with an imperfect institutional framework.

2.6 Restructuring

Branislav Pospíšil in the interview admitted that during the preparation of the insolvency reform, the greatest attention was devoted to the liquidation since it was considered to remain the vastly prevailing type of proceeding. This could be partially a reason why the part about restructuring seems to be less elaborated and to suffer from much more imperfections, as concludes Richter (2005a).

[23] Richter (2005a)
[24] Interview with Branislav Pospíšil, 22.11.2010
[25] Underinclusivity and overinclusivity.

However, practice has shown that, from the equity point of view, restructuring proceedings prevail.[26] Such a disproportion is good motivation to focus more on the description and analysis of restructuring.

2.6.1 Restructuring procedure in more detail

As already mentioned, a petition for restructuring can be filed if the debtor is insolvent or insolvency is imminent. The possibility to apply for restructuring before a company is insolvent is a significant change which reflects the principle that an early initiation of proceedings greatens the chances of successful rescue. It should help to avoid situations when companies do not enter insolvency proceedings until it is too late and financial problems are critical.

A petition for restructuring must be supported by an opinion of an independent trustee who assesses the feasibility of the restructuring. In opinion, prepared in an impartial manner and with professional care (§ 109(2)), the trustee may recommend restructuring only if all the preconditions for the debtor's restructuring are satisfied: the debtor performs its business activity, is insolvent or insolvency is imminent, it is reasonable to expect that at least a major part of the debtor's business operations can be preserved and that the satisfaction of creditors will be higher than in case of a bankruptcy proceeding ((§ 109(3)).

Not only the debtor, but also the debtor's creditors are entitled to appoint a trustee and to file a petition for restructuring. However, proper preparation of the opinion requires extensive cooperation on the side of the debtor (providing necessary documents or information) and therefore, as Allen and Overy (2009b) comments, *„unless the debtor agrees to restructuring, a successful initiation of this type of insolvency proceedings by creditors is unlikely to occur in practice."* Branislav Pospíšil also considers creditor restructuring unreal in practice because of the nature of debtors, the nature of the creditor sector and the size of the market.[27]

The Insolvency Act also facilitates a possibility of pre-packed restructuring. The concept of pre-packed restructuring combines the benefits of informal restructuring with the advantages of formal restructuring proceedings in a way that arrangements, which are under normal circumstances supervised by the insolvency trustee and the court, are worked out and voted on in advance of the restructuring filing. This simplifies the whole process, saves time and administrative costs.

[26] Interview with Branislav Pospíšil, 22.11.2010
[27] Interview with Branislav Pospíšil, 22.11.2010

A common shortcoming of the informal restructuring is the fact that the final restructuring agreement is a private contract among the parties and non-binding for creditors not party to it. Applying formal restructuring proceedings can help to overcome the situation, when some creditors refuse to participate in negotiations at all or to consent to a proposed plan, by imposing a pre-negotiated restructuring plan, approved by the necessary majority of creditors, among dissenting or unwilling creditors.[28] According to § 110(3), the trustee's opinion may contain a draft restructuring plan and a binding declaration of the debtor and of one or several creditors of the debtor regarding the draft restructuring plan.

Once a petition for restructuring is filed, is supported by the trustee's opinion and formally complies with the statutory requirements, the court is obliged to commence restructuring proceedings within 15 days (§ 113(1)). The court resolution must be without delay published in the Commercial Bulletin (§ 113(3)). The effects associated with the commencement of restructuring proceeding become effective on the next day after such publication.

As soon as restructuring proceedings have been commenced, it is the court's duty to examine whether all preconditions necessary for restructuring have been satisfied. If there are no apparent deficiencies in the trustee's opinion recommending restructuring (reminding that the court should not assess the economic aspect of the restructuring), the court must issue a restructuring resolution within 30 days (§ 116(1)). In it, the court is obliged to appoint the trustee who prepared the opinion. Again, resolution must be without delay published in the Commercial Bulletin and also served to the participants of the restructuring proceedings, to the appointed trustee, to the respective tax authority and to the customs headquarters (§ 116(4)).

2.6.2 Restructuring plan

After the publication of resolution, the restructuring commences. Its main goal is the preparation of a restructuring plan. § 132 defines the restructuring plan as a document, consisting of two parts (a descriptive part and a binding part), and providing for the creation, variation and termination of rights and obligations of those persons identified in it, as well as providing for the scope and method of satisfaction of those parties to the plan who are either creditors with filed claims or the debtor's shareholders.

[28] Falke (2003)

The restructuring plan is prepared by the debtor[29] (§ 133), in close cooperation with the trustee and members of the creditors committee (§ 134(2)). Allen and Overy (2009b) points out high flexibility of the measures to be adopted by the plan, e.g. *„they may include a typical plain vanilla restructuring of the debtor's financial debt, the conversion of the debt to equity, the transfer of the debtor's assets or business to a newly established entity, merger, amalgamation or division of the debtor or a change of its legal form"*.

Once the plan is approved by a relevant majority of the creditors (in some cases also by the shareholders) and confirmed by the court, it becomes binding on all parties to the plan.

2.7 Creditors

2.7.1 Filing claims

The Slovak insolvency reform institutes a creditor-driven process. As a consequence, it is a matter of crucial importance to find out as soon as posssible, who the creditors are. At the same time, it is necessary to pay special attention to abusive filings of claims since enhanced creditors' control over the proceedings might tempt to file non-existing claims.[30]

The Insolvency Act includes several measures designed to protect from abusive filings. The period when creditors may file their claims is shortened to 45 days in case of bankruptcy (§ 28(5)) and to 30 days in case of restructuring (§ 121(1)).[31] There are strict formal requirements imposed on application. Failure to meet them results in a claim not being taken into consideration (§ 29(1); § 122(1)). Neither the trustee, nor the court is obliged to invite a creditor to supplement or correct an incomplete or incorrect application (§ 29(9); § 122(8)). The most important measure is the introduction of penalties for filing unsubstantiated proofs of claim.

According to § 30(1) and § 125(1), the creditor is responsible for inaccuracy of the data stated in its application. If the trustee rejects the creditor's claim and the court states, within the proceedings on determination of a rejected claim, that the creditor was not entitled to the payment of the amount of the filed claim, or that the creditor was entitled to the payment of the amount below 75 percent of the filed amount of the claim, the creditor is obliged to pay a

[29] In case of restructuring initiated by creditors, the restructuring plan is prepared by the trustee.
[30] Richter (2005a)
[31] As mentioned in chapter 2.2, instituting tighter timeframes to shorten the time required to complete the procedure was one of the main goals of the reform.

penalty in the amount determined by the court in favour of the affected estate, unless the creditor proves that it proceeded in filing its claim with due care.

The same applies in case the court states, within the proceedings on determination of a rejected claim, that the creditor was not entitled to a lien filed in its application, was entitled to a lien in worse order than filed in its application, or was entitled to a worse order for satisfaction of its claim from the general estate than filed in its application. The amount of penalty is determined according to § 30(2) and § 125(2).

Last but not least, under the Insolvency Act, only the trustee can reject the filed claims within 30 days after expiry of the period for filing claims (§ 32(4) and § 124(2)). Creditors with filed claims are entitled only to propose to the trustee the rejection of other creditors‘ filed claims (§ 32(4) and § 124(2)).

In practice, rejecting claims as a method of evading creditors has turned out to be one of the major problems of new law. The creditor, whose filed claim is rejected, does not have the right to vote at the creditor's meeting (§ 146(5)). According to Branislav Pospíšil, there are two different ways of dealing with this problem considered recently: either creating a separate class for creditors with rejected claims, with the right to vote on a plan but also with an option of binding dissenting creditors to the plan (cram-down) or employing another trustee in the proceedings who would have the only task – to deal with rejecting claims.[32]

2.7.2 Secured debt

2.7.2.1 Recognition of title finance

In a credit-based market economy, the different techniques of title finance, such as retention of title, finance lease, sale and lease back, sale and repurchase, hire purchase, factoring, etc., which have a similar economic effect as security, are frequently employed instead of security. The financier retains title or ownership of the asset. As Falke (2003) notes, the advantage of title finance is that although having a similar effect as security, it is not regulated by the strict pledge laws. Moreover, in transition and post-transition economies, the importance of security devices like title finance arrangements and their treatment in insolvency is even higher due to a lack of the availability of universal security.

Richter (2005a) highlights that the Insolvency Act in § 8 (and for bankruptcy proceedings also in § 50(3)) re-characterises these arrangements as security arrangements. As a consequence,

[32] Interview with Branislav Pospíšil, 22.11.2010

the title holder is treated in the same way as a secured creditor and is also subject to the same restrictions.

On one hand, the policy decision to re-characterise title finance arrangements as security arrangements increases the chances of successful restructuring of the debtor and fosters more asset-maximisation (in comparison with another policy option to exclude title financing from insolvency proceedings) and also honours the principle of equitable treatment of similarly situated creditors (par conditio creditorum)[33]. On the other hand it goes against the principle of market conformity which is one of the main objectives of the insolvency law. According to this principle, the insolvency law should honour pre-insolvency rights and entitlements existing outside insolvency and avoid weakening or redistributing them, otherwise there is a risk that the insolvency proceedings will be strategically misused by participants to circumvent such entitlements.[34]

2.7.2.2 Valuation of security

In cases when the sale's valuation of property is not possible (going concern sale, restructuring), the insolvency law must provide procedure to value a creditor's interest in property of the estate. The creditor's claim is then designated a secured claim to the extent of the value of such creditor's interest and any remaining claim amount is designated as an unsecured claim.[35]

For the bankruptcy proceedings, the Insolvency Act states rule for valuation in § 77. Valuation is normally carried out by a trustee, but the trustee must have the expert opinion prepared if requested by secured creditor or by the creditors committee. However, there is no such provision in the restructuring part. According to § 138(1), for the purpose of dividing claims into classes, valuation is left on the professional care of the party submitting the plan. Secured creditor has a right to ask for change of its classification (§ 145(1)), but as Richter (2005a) emphasises, if the party submitting the plan rejects, there is no alternative for secured creditor but to litigate over nullity of the plan. In this manner, decision about the value of creditor's interest, which is the decision commercial in nature, is placed in the hands of the court. This is apparently against conception of the reform.

[33] From the economic point of view, the purpose and the result of the title finance arrangements are virtually the same as in case of security arrangements, the difference lies only in the formal classification of these arrangements.
[34] Falke (2003)
[35] Baird (2006)

Branislav Pospíšil notes one possible safeguard against the opportunistic behaviour of the party submitting the plan when valuing creditor's security interest. According to § 161(1), if creditor succeeds in litigation over nullity of the plan, the debtor is obliged to pay filed and admitted amount of claim to the creditor, together with lawful interest (§ 501 of Commercial Code), calculated from the date of commencement of the restructuring proceeding.[36]

Nevertheless, in the interview, Branislav Pospíšil admitted that valuation of the security, together with rejecting claims, rank among two main imperfections of the new insolvency law revealed in practice. According to his opinion, considerations about how to deal with this problem tend towards leaving valuation on the professional care of the trustee and in case of its failure, the secured creditor should have the right to have their own expert opinion prepared (debtor would have to provide all necessary cooperation), which would be determining.[37]

2.7.3 Creditors in restructuring

As mentioned before, initiation of restructuring proceedings by creditors is theoretically possible, but unlikely to occur in practice. Therefore the existence and functionality of control mechanisms over the proceedings are the key issues for the creditors in restructuring.

2.7.3.1 Creditors' committee

The first possibility to affect the proceedings by creditors is through preliminary approval/rejection of the restructuring plan in the creditors' committee (§ 144). The plan must be submitted to the creditors' committee for preliminary approval within 90 days of the restructuring order, with a possible extension of 60 days (§ 143).

The creditors' committee is a representative body of creditors which facilitates their active participation in proceedings. The size of the committee is specified to three or five persons (§ 127(1)) to ensure the achievement of a majority rule. The appointment of the committee is placed in the hands of creditors (at the first creditors' meeting) what may encourage their confidence in insolvency proceedings. In restructuring (contrary to bankruptcy proceedings), the committee is voted upon by both secured and unsecured creditors, their representation in the committee should be in principle balanced (§ 127(1)) and the committee represents the interest of all creditors (§ 127(4)).

[36] Richter (2005a)
[37] Interview with Branislav Pospíšil, 22.11.2010

Such an approach to the formation of the creditors‘ committee is not a standard one[38] but it can be justified since the commitee is responsible for making important decisions (above mentioned preliminary approval/rejection of the restructuring plan) and the exclusion of secured creditors may negatively affect their interests.[39] Similarly argues Richter (2005b, p. 1) that *„giving the secured creditor neither control over, nor information about, the proceedings, would prove too costly. In other words, pushing secured creditors too hard may defeat the very purpose of security – reducing the cost of debt financing and increasing its availability.“*

2.7.3.2 The voting on the approval of the restructuring plan at the creditors‘ meeting

If the committee rejects the plan or does not approve it within 15 days of submitting, the trustee must without delay petition the court to declare a bankrupcty ((§ 144(2)). The committee can also refer the plan back for further adjustments. The adjusted plan must be submitted to the creditors' committee for final decision within 15 days ((§ 144(1)).

If the creditors‘ committee approves the restructuring plan, the voting at the creditors‘ meeting takes place (§ 144(3); § 146). However, the creditors‘ right to become familiar with the plan is negatively affected by the decision to make the plan neither public nor to submit it to the creditors whose rights are affected. Availability of the restructuring plan only in the office of the trustee (§ 146(2)) creates inefficient transaction costs and makes the whole process less transparent. On the other hand, the possibility to vote per procurationem or in writing (§ 146(6)) decreases the transaction costs and can help to limit the common problem of rational creditors‘ apathy.

The voting on the approval of the plan at the creditors‘ meeting takes place in at least two classes – one for secured creditors whose rights are affected and a second for unsecured creditors (§ 137(1)).[40] Another class may be formed by the shareholders. The shareholders' consent may me required if a restructuring plan proposes a debt-to-equity conversion or other solution having a direct impact on their rights.[41] The party submitting the plan may divide these classes into further separate classes according to the principle that those claims of

[38] See UNCITRAL (2005): "As a general rule, secured creditors are not represented on a creditor committee if they are fully secured or over-secured." (p. 193) or "…creditor committees generally represent only unsecured creditors…" (p. 198)
[39] UNCITRAL (2005)
[40] Problem of valuation of security and resulting problem of claims' division into secured and unsecured is discussed in chapter 2.7.2.2.
[41] Allen and Overy (2009a)

creditors or shareholders having identical economic interests belong to the same class (§ 137(2)).

In simplified terms, the relevant majorities necessary for the restructuring plan to be approved are following (§ 148(1)):[42]

- in each class of secured claims, more than two-thirds majority of votes by value
- in each class of unsecured claims, a simple majority of votes by value
- in each class of shareholders, a simple majority of votes by value
- in aggregate, a simple majority of votes by value of creditors attending the confirmatory creditors‘ meeting

Subsequently, the restructuring plan needs to be confirmed by the court.

2.7.3.3 Option of binding dissenting creditors to the plan

There is an option of binding dissenting creditors to the plan by the court (cram-down) to further enhance the chances of a restructuring, if following conditions are met (§ 152(1)):

- the best interest rule – requirement that any dissenting creditor is entitled to receive at least as much as he would have received in bankrupcty proceeding
- a majority of classes approved the plan (by the relevant majority in respective classes)
- a simple majority of creditors attending the confirmatory creditors‘ meeting (votes by value) approved the plan

There are several questionable issues with such an approach to a cram-down. Above all, junior classes (general creditors, shareholders), which naturally favour restructuring proceedings since it increases their prospects of higher returns, can possibly outvote secured creditors according to the test of majority of classes. As Richter (2005a) highlights, the only viable ex-ante strategy of secured creditors to protect their interests is then to hold a simple majority of claims by value.

Moreover, the risk that interests of secured creditors could be impaired is even higher since the cram-down definition does not apply absolute priority rule. This rule is designed to protect mainly secured and priority creditors in a way that a dissenting class of creditors may not involuntarily receive less than the full value of their claim if creditors of a junior class receive

[42] Allen and Overy (2009b)

any value.[43] The absence of this crucially important element, which is widely used in other jurisdictions, is a serious shortcoming of the cram-down rule in the Insolvency Act.[44]

Finally, the application of the best interest rule requires from the court to make a commercial decision about the likely extent of satisfaction in bankruptcy proceedings. This is again inconsistent with the overall concept of the insolvency reform. From the practical point of view, the realistic and objective valuation of the restructuring and liquidation scenarios is often very difficult.

Branislav Pospíšil reacts to concerns about the cram-down of secured creditors with statistics that it has never happened in the practice. According to his opinion, the concept of voting on the plan could be improved in the near future by the requirement to create a separate class for every secured creditor in order to ensure that the party submitting the plan would have to negotiate individually and reach the agreement with every secured creditor.[45]

2.7.3.4 Interest payments to secured creditors

As Falke (2003) highlights, the principle of market conformity[46] gives another reason for protection of secured creditors. Recalling shortly that according to this principle, rights and entitlements, established outside insolvency, should be recognized and protected, in both their existence and value.

Then in cases where the insolvency law intereferes with the pre-insolvency rights of the secured creditor (e.g. the imposition of automatic stay which interferes with the right of the secured creditors to seize and sell the collateral and obtain the proceeds of the sale if debtor fails to repay its obligation) and deteriorates the time value of the pre-insolvency secured interest by delays, the law should provide for compensation for this loss in order to restore financial situation of the secured creditor as it would be without intereference by the insolvency law. That could be implemented by the interest payments, by compensation for depreciation of value during the stay or the compensation for the use of collateral.

Similar logic implies that the inclusion of the secured creditors, who are generally interested in fast proceedings to be satisfied as soon as possible from the proceeds of the collateral hold, into the often long-lasting restructuring attempts, is in favour of unsecured creditors and

[43] Falke (2003)
[44] For discussion of ex ante costs of violating absolute priority in bankruptcy, see Bebchuk (2001).
[45] Interview with Branislav Pospíšil, 22.11.2010
[46] Introduced in chapter 2.7.2.1.

shareholders. *„Therefore, it is fair, to recquire a contribution from them in the form of additional compensation and interest payments to secured creditors...With other words, market conformity requires that those interested in delay and inclusion pay those who are interested in avoiding it. That in turn reduces the incentive for junior classes to prolong proceeding.“*[47]

However, the Insolvency Act in § 138(2)) does not follow this logic and excludes from the plan, among others, also claims of secured creditors on interest accrued after the commencement of restructuring proceedings. Richter (2005a) emphasizes that the duty to pay interest payments to secured creditors during automatic stay would be the only realistic safeguard to balance the risky "bet" on trustee as the only gatekeeper. The absence of this duty, along with the problematic definition of the cram-down rule, can negatively affect the cost and the availability of secured debt financing in the Slovak Republic.

2.8 Debtor in restructuring

The Insolvency Act adopts the debtor-in-possession concept – a debtor remains in control of its business. Motivation for such approach is obvious – debtor's familiarity with the business may enhance the chances of a successful restructuring. However, it may also increase the risk of debtor's opportunistic behaviour to act irresponsibly or even fraudalently during the period of control. To mitigate this risk, several safeguards have been adopted.

Until the successful completion of the restructuring, the debtor stays under the supervision of a trustee, the court and the creditors. The trustee is a main *„guardian of the restructuring eligibility“* who must ensure that the debtor does not diminish the value of its assets.[48] Moreover, in the period between the commencement of restructuring proceedings and the restructuring order, the debtor must restrict its activities to ordinary legal acts only[49], other legal acts are subject to prior approval by the trustee (§ 114(1), § 114(3)). In the restructuring resolution, the court may determine the scope of those legal acts of the debtor that, during the restructuring, will be subject to prior approval by the trustee (§ 130(1)). The creditors' committee may extend the scope of these legal acts (§ 130(2)).

The validity of legal acts, which were subject to prior approval by the trustee, but were done without such approval, is not affected. However, these legal acts may be successfuly avoided

[47] Falke (2003), p. 226
[48] Allen and Overy (2009b)
[49] As defined in § 10.

if a bankrupcty is declared on the debtor's estate during restructuring or within one year of its completion (§ 130(4)).[50]

The shareholders' right to vote on the plan was already mentioned in chapter 2.7.3.2.

2.9 Conversion of the restructuring into bankruptcy proceedings

There could be several reasons for conversion of restructuring proceedings into bankruptcy proceedings. In general, these can be summarized as cases where the course of proceedings indicate that there is no longer reasonable likelihood of the business being successfully restructured or where it is apparent that the debtor is not acting in good faith. According to § 129, the trustee must without delay petition the court to convert the restructuring into bankruptcy proceedings if:

- the debtor seriously or repeatedly breaches its legal obligations (§ 129(1))
- the financial or the business situation of the debtor changes to the extent that the successful completion of restructuring can no longer be reasonably expected – the trustee must therefore with a professional level of care continually monitor developments in the financial and business situation of the debtor (§ 129(2))

Moreover, according to § 131(2), the court converts the restructuring into bankruptcy proceedings automatically (without petition) if:

- the trustee repeatedly or seriously breaches its legal obligations
- creditors fail to meet in a necessary quorum or fail to vote the creditors' committee
- a final proposal of the plan is not submitted to the creditors' committee for preliminary approval within the time limit specified by the law
- the creditors' committee rejects the plan or does not approve it within the time limit specified by the law
- the plan is not approved by the relevant majorities at the confirmatory creditors' meeting
- the party submitting the plan fails to petition the court to confirm the plan within the time limit specified by the law

After the liquidation order, it is not possible to convert liquidation into restructuring (§ 23(2)).

[50] Or within two years after the commencement of restructuring proceedings, according to (§ 114(2)).

2.10 Post-petition financing

The way the insolvency law treats the post-petition financing (new money) is one of the principal questions for a viability of restructuring. The key feature is whether the post-petition financing has priority over pre-existing creditors in case the restructuring of the debtor proves unsuccessful and the bankrupcty is declared. If not, creditors will be highly reluctant to provide new money for restructuring. However, negative ex-ante effects of such priority on the cost and the availability of debt financing should also be considered.[51]

As Allen and Overy (2009a, p. 10) highlights, the Insolvency Act treats new money *„as a preferred post-moratorium administrative claim. This means that post-petition unsecured loans of new money will benefit from priority over pre-existing unsecured loans and can be repaid, unlike the pre-existing claims, even during the period in which the company is protected by a court. New money can also be secured on the debtor's unencumbered assets, if these are available. Conversely, it is not possible to trump the pre-existing secured creditors, unless they agree.“*

Richter (2005a) notes that this solution could partly compensate for negative ex-ante effects of other provisions[52] on secured creditors since in practice, unless the debtor owns a large amount of unencumbered assets, the only creditors, willing to finance the operation of the debtor's business during restructuring, will often be the pre-existing secured creditors. If pre-existing secured creditors refuse to provide post-petition financing, the restructuring attempt will fail very soon for want of funds.

2.11 Avoidance of antecendent transactions and stay

The very basic problem that insolvency law is designed to handle is often called a common pool problem. In situation when a debtor has more liabilities than assets, every creditor has a strong incentive to collect the debt individually, on a "first-come, first-served" basis. The pursuit of individual interest by each creditor might often leave the creditors as a group worse off.[53] To avoid this race on assets and debt-collection by means of individual creditor remedies, insolvency law provides a way to make creditors act as one by imposing

[51] Richter (2005a)
[52] Aforementioned absence of duty to pay interest payments to secured creditors during automatic stay or absence of absolute priority rule in the definition of cram-down.
[53] E.g., a collecting creditor might seize assets critical to the company's operation (Bhandari & Weiss, 1996)

a collective and compulsory proceeding on them – all assets and liabilities are identified and translated to the bankruptcy forum.[54]

However, a change in the rules of the collection game may reintroduce the original problem. The descent of a debtor into insolvency is often slow and creditors may often learn about the problems. The creditors that are first to learn about the debtor's difficulties have again strong incentive to act uncooperatively and may try to collect what they are owed before the collective proceeding starts. Moreover, the efforts of creditors to "opt out" of an impending collective proceeding are not the only problem to address. A somewhat related problem exists since, as insolvency looms on the horizon, the shareholders no longer have much of an incentive to watch out for the interests of the creditors.[55]

Therefore, to avoid losses on the value of the debtor's property in the period just prior to the commencement of insolvency proceedings, all developed insolvency laws standardly provide for a legal mechanism, referred to as avoidance of the antecendent transactions. It allows to avoid the suspect transactions made by the debtor in the twilight period prior to the formal insolvency proceedings. The Insolvency Act contains these provisions in § 57 – 66 (part about liquidation). Allen and Overy (2009a) divides the transactions that can be avoided into the three groups:

- intentional prejudicial transactions – Pauline actions (fraud of creditors) – requires an element of intention by a debtor to somehow disadvantage its creditors (e.g. by moving its assets outside their reach), suspect period is 5 years
- undervalued transactions – requires that the relevant transactions occur after the debtor has become insolvent or themselves render the debtor insolvent, suspect period is 1 year (or 3 years in case of related parties transactions)
- preference of the other creditors of the debtor – the same as for undervalued transactions

Considering this, it is clear that stricter tests and longer suspect periods are applied if a related party is involved. Furthermore, the insolvency of a debtor is assumed by the law if a transaction is done with a related party.

[54] Jackson (1985), Jackson (2001)
[55] Jackson (2001)

However, as Richter (2005a) points out, even though the provisions on the avoidance of antecendent transactions are well-elaborated in part about liquidation, they are completely missing in the part about restructuring which is a very serious deficiency of the new legislation.

The same aim that is pursued by the avoidance of antecendent transactions before the commencement of insolvency proceedings, is pursued by the automatic stay after the commencement of insolvency proceedings.[56] According to § 114(1), after the commencement of restructuring proceedings, creditors‘ attachments and the enforcement of security actions are stayed, set-off is not permissible and insolvency termination clauses are invalid. Creditors are protected through the legal requirement that the extent of satisfaction of any creditor must be higher than in the bankruptcy proceedings.[57]

[56] To avoid losses on the value of the debtor’s property in the course of proceedings.
[57] Reminding again that the realistic valuation of restructuring and liquidation scenarios is in practice often difficult.

3 Empirical analysis of restructuring attempts allowed in the period 2006 - 2010

3.1 Absence of empirical analyses

Since 1. January 2006, when the Insolvency Act came into force, more than five years have passed. Such a period seems to be long enough to present a promising opportunity to observe the outcomes of the modernised insolvency law in practice. Moreover, this period also includes years when global financial and economic crisis hit the Slovak Republic and triggered the wave of bankruptcies, which (unfortunately) significantly enlarged available empirical dataset.

One would expect that several empirical analyses will be elaborated on to assess the impacts of such sweeping change in the Slovak insolvency law, to identify potential imperfections of the reform and to support recommendations for legislative intervention by carefully gathered empirical evidence. Surprisingly, this is not the case.

To our knowledge, there is no single publicly available empirical study which would complexly deal with the practical application of new provisions on restructuring of business debtors. Short analyses of some aspects of restructurings (number of restructuring attempts allowed, their regional distribution and division according to the business sectors) were published by the Slovak Credit Bureau (SCB), however, the data used in these analyses are not fully accurate, as we show later on.

Other data about the impact of the Slovak insolvency law reform (recovery rate, time and cost) are provided by The Doing Business Project of the World Bank (Table 1), whose aim is to provide *„objective measures of business regulations and their enforcement across 183 economies.“*[58] An obvious advantage of these indicators is the possibility to compare insolvency laws across economies and over time. By way of illustration, we compare the Slovak Republic with the Czech Republic, USA and OECD average.

[58] http://www.doingbusiness.org/about-us

Table 1

Closing a Business

Year	Slovak Republic			Czech Republic		
	Recovery rate (cents on the dollar)	Time (years)	Cost (% of estate)	Recovery rate (cents on the dollar)	Time (years)	Cost (% of estate)
2004	39.8	4.8	18	15.4	9.2	18
2005	39.6	4.8	18	16.8	9.2	18
2006	38.6	4.8	18	17.8	9.2	15
2007	48.1	4	18	18.5	9.2	15
2008	45.2	4	18	21.3	6.5	15
2009	45.9	4	18	20.9	6.5	15
2010	45.9	4	18	20.9	6.5	15
2011	55.3	4	18	55.9	3.2	17
	USA			OECD		
2004	80.3	1.5	7	65.5	2	9
2005	80.5	1.5	7	66.7	2	9
2006	80.2	1.5	7	67	2	9
2007	77	1.5	7	66.6	1.9	10
2008	75.9	1.5	7	66.7	1.8	10
2009	76.7	1.5	7	65.8	1.8	9
2010	76.7	1.5	7	65.8	1.8	9
2011	81.5	1.5	7	69.1	1.7	9

Source: Doing Business database.
Note: OECD data are calculated as an average of 30 countries by author.

The Slovak Republic was labelled as *„the top reformer in 2005/2006"* in the world, when new law sped up bankruptcy by at least 9 months and expected recovery rates increased to 48 cents on dollar.[59] Presently, indicators for the Slovak Republic and the Czech Republic show similar values, but it is worth noting that starting position of the Czech Republic in 2004 was much more difficult. Despite improvements, both countries are still lagging behind the most developed countries, represented here by USA and OECD.

However, The Doing Business Project does not use real empirical data. The data is derived from survey responses by local law firms (members of the International Bar Association). Their responses are based on the hypothetical corporate bankruptcy scenario with strong assumptions about the business (a limited liability corporation, 100% domestically owned, operating in the country's most populous city, with 201 employees, 50 suppliers, etc.), about

[59] Doing Business 2007, p. 54

procedures, about information availability and about legal options.[60] Moreover, from the indicators, it is impossible to derive values exclusively on restructurings and therefore, these numbers are not very useful for our purposes.

To conclude, we are not able to provide any overview of existing empirical literature for the most simple reason – we do not have information about any groundbreaking empirical study on Slovak restructurings. Instead, we humbly try to contribute to filling this gap by our empirical analysis of all restructuring attempts allowed in the period 2006 – 2010.

3.2 Data and methodology

There are two sources of basic data on restructurings widely used in the Slovak Republic: official statistics of the Ministry of Justice, which are freely available at the ministry's website[61], and statistics of the aforementioned Slovak Credit Bureau, which are presented in the quarterly published reports (statistics are based on the data from the business information portal Universal Register Plus of the Slovak Republic, data from the portal are available only after purchase of access licence).

Standard expectation, before the comparison of the data on number of restructuring orders from these two sources, would be that these numbers are identical or the difference between them is almost negligible. However, after their comparison, we found out that these statistics differ, and they differ significantly (Table 2). Which statistics then correctly reflect the real number of restructurings so that we can employ it in our analysis? Such a discrepancy in the very basic piece of information about size of the sample motivated us to manually compose our own database of all restructuring attempts which were allowed in the period 2006 – 2010.

This was not a simple task. Information about restructurings in the Slovak Republic is very scarce. In absence of any publicly available insolvency register[62], the only way to get to the relevant information about restructurings, is the Commercial Bulletin. We manually reviewed all publications of the Commercial Bulletin from the period 2006 – 2010, that is tens of thousands of pages (1249 publications whose extent ranges from several pages to hundreds of pages). The extremely difficult and time-consuming process to get the relevant data is

[60] For more detailed description of methodology, see any of the Doing Business annual reports.
[61] http://www.justice.gov.sk/
[62] Good example, how to make the whole process more transparent, is the Czech Republic. On-line insolvency register was introduced as part of the insolvency law reform enacted in 2006 and includes all important information about insolvency proceedings, easily accessible and concentrated in one place.

definitely one of the main reasons for the lack of empirical studies in this field. Despite these obstacles, we were able to identify 182 restructuring attempts allowed in the respective period (Table 2).[63]

Table 2

Number of restructuring resolutions issued in the period 2006 – 2010

Year	Statistics of the Ministry of Justice	Statistics of Slovak Credit Bureau	Our statistics based on the information from the Commercial Bulletin
2006	2	2	2
2007	8	9	10
2008	10	11	10
2009	58	62	60
2010	87	104	100
Total	165	188	182

Source: The Ministry of Justice, The Slovak Credit Bureau, own calculation based on the information from the Commercial Bulletin.

Surprising about these numbers is the fact that neither statistics of the Ministry of Justice, nor the statistics of the Slovak Credit Bureau reflect the number of restructuring resolutions correctly.[64] The Ministry of Justice, as the source of official statistics often used and refered to in the daily and economic press[65], considerably understates the number of restructurings allowed. The Slovak Credit Bureau, though being much closer to the exact statistics, overestimates these numbers. The ascertainment that not only are there no empirical analyses of restructuring proceedings in the Slovak Republic, but we do not even have reliable information on the number of restructurings allowed, speaks for itself.

Once we identified all debtors, we manually gathered all information, included in court's resolutions, in trustees' announcements, in records from creditors' meetings and deliberations of creditors' committees, published for each individual case in Commercial Bulletin. This way, we obtained information about the date of commencement of restructuring proceedings, about the date of restructuring resolution, about respective district court which allowed for restructuring, about the trustee appointed to prepare expert opinion and to administer and supervise the whole process, about the type of petition (debtor or creditor), about the date of

[63] See also appendix for complete list of restructurings.
[64] Here, I owe my thanks to Mrs. Jana Marková, the main analyst of SCB, who, after my inquiry, confirmed my data and admitted small inaccuracy of SCB statistics caused partially by human factor and partially by the automatic method of data processing.
[65] For example, one of the most actual articles, based on the information of Ministry of Justice, was published 2.4.2011 in SME which is one of the most influential newspaper in the Slovak Republic (SITA, 2011).

the first creditors‘ meeting, about potential extension of time limit to submit the restructuring plan (number of days), about the date of submitting the plan to the creditors‘ committee for preliminary approval, about the potential decision of creditors‘ committee to refer the plan back, about the date and result of creditors‘ committee voting on plan, about the date and result of voting on the approval of the plan at the creditor’s meeting, about the confirmation of the plan by the court or about the conversion to liquidation proceedings, about potential cram-down, about potential institution of supervisory administration and in few cases also about the date of fulfilment of the restructuring plan. This database constitutes a basis for our empirical analysis. Since many of the restructurings allowed in the second half of the year 2010 are still in progress, all statistics and conclusions mentioned in this paper refer to the state as of 1 April 2011 which is the decisive date for our analysis.

There is one thing worth noting here. One would expect that the case number, as the only identification sign, would be unique for each individual case. The reality is different again. Two, three and sometimes even four restructuring cases from different district courts are assigned with the same case number. This makes an already very lenghty data gathering process even more difficult and confusing.

However, not all relevant information can be extracted from the Commercial Bulletin. To a certain extent the most interesting information about the proposed restructuring measures, the proposed pay-outs to the secured and unsecured creditors and the schedules of payments are not available anywhere. Since our ambition was to construct a complex empirical analysis including these key data about restructurings, we decided to compose a short questionnaire and ask all respective trustees, who have administered at least one restructuring allowed in the period 2006 - 2010, to fill it out. The questionnaire consisted of two sets of questions: first set was focused on the basic information about the company (turnover, book value of assets, number of employees, number of secured and unsecured creditors and amount of secured and unsecured debt), second set included questions on the restructuring plan (main restructuring measures proposed, the classes of creditors formed by the plan and their vote on plan at the creditors’ meeting, the proposed pay-outs and the schedules of payments).

182 restructurings were administered by 70 different trustees.[66] Electronically, we sent 157 questionnaries to 53 of them[67], with a cover letter explaining the purpose of survey. The result

[66] More detailed statistics regarding trustees are presented in chapter 3.4.4.

was rather disappointing. Only eleven trustees responded, six of them negatively. Five trustees offered at least some kind of assistance. In the end, from various sources we were able to get some information about pay-outs, schedules of payments and restructuring measures proposed in 15 restructuring cases. This sample certainly is not representative, but it offers at least a rough idea about the likely outcome of restructuring.

We can just wonder about reasons for such unwillingness of trustees to provide elementary data on restructuring plans, even for academic purposes. All data was supposed to be processed and presented exclusively in aggregate form, not individually for particular debtors, to prevent any possiblity of misuse. No doubt, outputs of such analysis would be very interesting and useful also for trustees themselves. We can only speculate why trustees obstruct any attempt to shed more light on these issues. On the other hand, it is true that new legislation does not oblige trustees to publish information about the restructuring plans and ambiguous definition in § 8(4)[68] of the Insolvency Trustees Act yet serves them as the argument not to provide any information even when requested. We believe that if there is no legislative intervention in this area, which makes the whole process more transparent, it will be almost impossible to construct empirical analysis of this type in the Slovak Republic. On-line insolvency register, introduced by the new Czech Insolvency Act, where all reorganization plans (and other documents produced in the course of proceedings) must be obligatorily published, can serve as a guide for such intervention. Even cheaper alternative would be an obligation to file the plan with the Commercial register or, for sole proprietors, the Trade register.

Fortunately, thanks to helpfulness of Mrs. Marková and Mrs. Špeťuchová from SCB, who granted us one-week free access to the business information portal Universal Register Plus of the Slovak Republic, we were able to supplement our database with some basic information about debtors. These include registered share capital, ownership type, employees count, sales and business sector. Even though these data are not complete for all debtors (in some cases, information about employees count or sales are missing) and they come from different years

[67] To all trustees whose e-mail contact we were able to get. The only contact information published in the list of trustees at the ministry's website, is an office address and telephone number. Therefore, we had to look for email contacts in other sources. We were not successful with all subjects.

[68] § 8(4): „The right to inspect the file is granted to persons administering the supervision according to this law, to court, to participants of the proceedings and their representatives, to prosecuting authorities and other subjects, if special notice provides so." Ambiguous in the sense that, from the definiton, it is not clear whether subjects specified are the only subjects with the right to inspect the file or whether these subjects have right to inspect the file which must not be withold from them, and it can be (but also does not have to be) withold from other subjects.

(2007-2010), we believe that, when used carefuly, they allow us to divide debtors into two categories according to their size. We used registered share capital as the first criterion and divided debtors into two groups of the same size (below/above median). Debtors without registered share capital (sole proprietors) were automatically assigned to the below median group. Second division was based on the data on employees count and sales. Debtor was assigned to the group of larger enterprises if it was employing at least 100 employees or its sales were higher than 4,000,000 EUR, otherwise it was assigned to the group of smaller enterprises. These thresholds were not chosen randomly. They approximately correspond to the entry criteria of size test introduced by the new Czech Insolvency Act, which is convenient for the purpose of comparison. When both figures were missing, we assigned debtor automatically to the group of smaller enterprises since our assumption is that quality of reporting is positively correlated with the size of a company.[69]

Our approach to the empirical analysis of restructurings was significantly inspired by two recent empirical studies: Warren and Westbrook (2009), who successfully challenge the mistaken conventional view on US Chapter 11 as a system suffering from high failure rates and endless delays, and Richter (2011), who presents first observations on the workings of the new Czech insolvency law in the years 2008 and 2009. This fact predetermines also our reference countries we compare our findings with. Throughout the analysis, we mostly use methods of descriptive statistics and present all results in the numerous graphs and tables.

3.3 GDP changes and the use of insolvency proceedings (liquidations to restructurings ratio)

„The main test of whether bankruptcy laws and judicial procedures are good is whether financially distressed companies and their stakeholders use them. If companies do not see incentives to enter bankruptcy,...,few bankruptcies will take place.“[70] Applying the same assumption also for the restructuring proceedings, we should see an increasing number of restructuring cases emerging if legislators succeeded in their objective to make restructuring a more viable and attractive option for companies in financial distress than composition option under the previous Bankruptcy and Composition Act. A change from almost exclusively liquidation-oriented system to a more balanced one should lead to a higher proportion of restructurings out of the total number of insolvency cases. Table 3 shows data

[69] This assumption is supported by the empirical analysis in Tomis (2008).
[70] Doing Business in 2004, p. 78

on the annual changes in the Slovak GDP, proportion of non-performing loans, number of liquidation[71] and restructuring resolutions issued and their ratio.

Table 3

GDP changes and the use of insolvency proceedings

Year	Annual change in GDP	Proportion of non-performing loans (%)	Liquidation resolutions	Restructuring resolutions	Liquid./restruct. ratio
2006	8.5	3,26	249	2	124.5
2007	10.5	2,77	197	10	19.7
2008	5.8	3,21	225	10	22.5
2009	-4.8	5,5	285	60	4.75
2010	4	6,01	379	100	3.79
Total			1335	182	7.34

Source: Statistical Office of the Slovak Republic (GDP figures), National Bank of Slovakia (proportion of non-performing loans), Slovak Credit Bureau (number of liquidation resolutions), own calculations (restructuring resolutions).
Note: GDP data for the years 2009 and 2010 are preliminary.

Data on liquidation and restructuring resolutions issued seem to be in line with the expectation given the development of GDP. Impact of the economic crisis became evident in 2009 and deepened further in 2010, even though GDP already started to recover. There are several possible explanations for the surprisingly low number of liquidation resolutions (e.g. in comparison with the Czech Republic). Most importantly, many liquidation proceedings were terminated for the lack of assets before a liquidation resolution could be issued. Strict requirements imposed on the creditors‘ petitions for the bankruptcy proceedings could be another significant factor.

Restructuring option was rarely used during the period 2006-2008. Starting from 2009, situation changed completely and the number of restructuring resolutions increased significantly from 10 in 2008 to 60 in 2009 and 100 in 2010. We see two effects behind this restructuring boom in the Slovak Republic. The first was already mentioned before. In the years 2009 and 2010, the economic crisis hit Slovak economy with full force. The number of companies becoming insolvent and considering options for resolving their insolvency sharply increased. This effect could partially explain the increase in the absolute number of restructurings cases. However, other explanation is needed for a significant relative change in the number of restructurings to number of liquidations.

[71] We used SCB statistics on number of liquidation resolutions issued. They are probably not fully accurate but based on the experience with restructuring resolutions, we believe that they are much closer to the real numbers than official statistics of the Ministry of Justice.

The likeliest factor behind this development is time passed from the enactment of the new insolvency law. The full benefits of the new legislation take time to materialize. It required some time for companies and their stakeholders to recognize the benefits of formal restructuring and to familiarize with the brand new provisions on restructuring. Successful application of these provisions to several groundbreaking cases contributed to their wider recognition and consequently to their more frequent use. The restructuring boom in the years 2009 and 2010 lead to the drop of liquidations to restructurings ratio from approximately 20 liquidations to 1 restructuring in the years 2007 and 2008 to less than 4 liquidations to 1 restructuring in the year 2010.

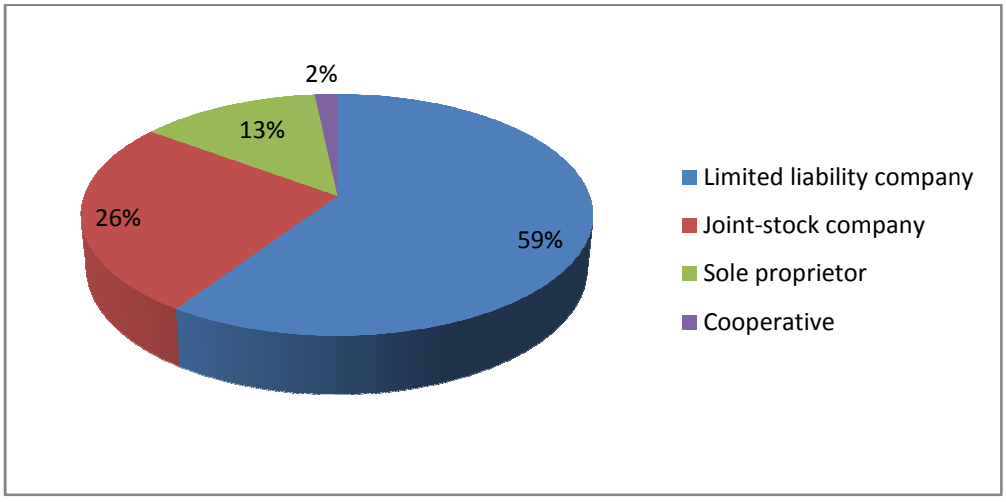
3.4 Initial observations on the debtors

3.4.1 Legal form

Figure 2 divides all restructuring attempts, allowed in the period 2006 – 2010, into four groups according to their legal form. Vast majority of debtors (108) were incorporated in the legal form of the private limited liability company. 47 debtors were incorporated in the legal form of the joint-stock company. Surprisingly, there is a relatively high proportion of the unincorporated sole proprietors (24). That is a result of the decison not to specify any size criteria for entry into restructuring. Finally, 3 debtors were incorporated in the legal form of cooperative. No restructuring was allowed to debtors incorporated in the legal form of commercial partnership or in the legal form of limited partnership.

Figure 2

Legal form of debtors



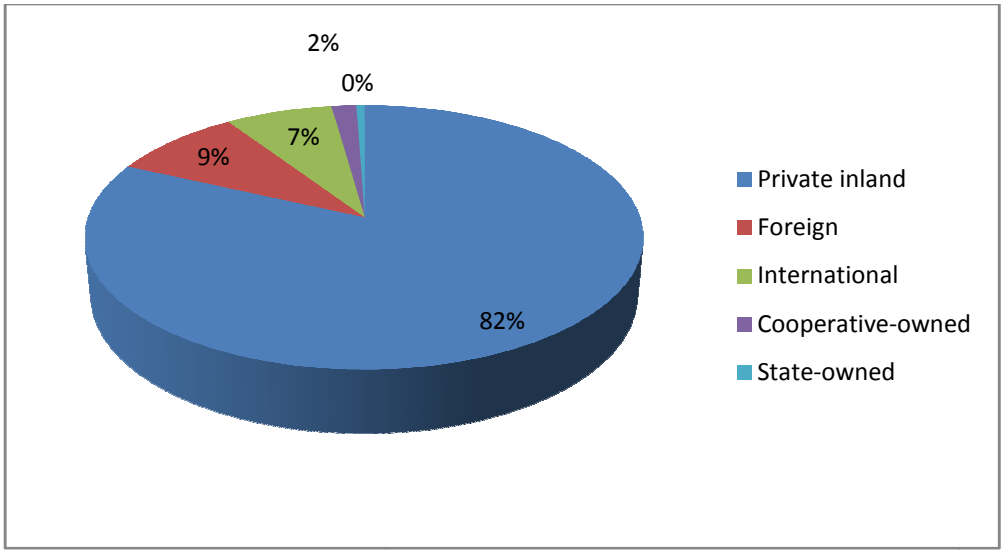
Source: Own dataset.

3.4.2 Ownership type

Figure 3 shows data about the ownership type of debtors.[72] As expected, private inland ownership (149 debtors) is prevailing in the dataset. 16 debtors are foreign-owned companies, 13 are international companies[73] with the preponderance of private sector. 3 debtors are cooperative-owned[74] and only one debtor is state-owned.[75]

Figure 3

Ownership type of debtors



Source: Own calculation, based on the information from Universal Register Plus of the Slovak Republic.

3.4.3 Regional distribution

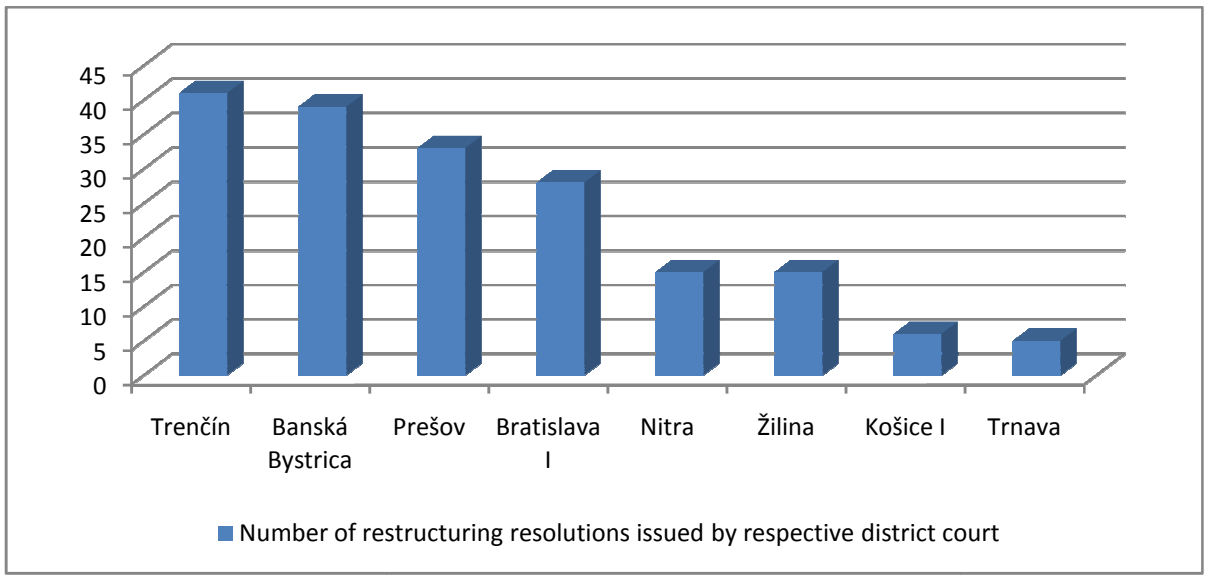
Regional distribution of restructuring attempts (according to the respective district court which allowed restruturing) is presented in Figure 4. It is apparent that this distribution was very uneven. The highest number of restructuring attempts was allowed by the District court Trenčín (41), relatively closely followed by the District courts Banská Bystrica (39), Prešov (33) and Bratislava I (28). On the other side, during the period 2006-2010, only 5 restructuring cases were allowed by the District court Trnava, 6 by the District court Košice I and 15 by both District courts Nitra and Žilina. Four district courts with the lowest number of restructuring resolutions issued thus together allowed for the same number of restructuring attempts as the District court Trenčín itself, or other way around, four district courts with the

[72] Classification according to categories used by the Statistical Office of the Slovak Republic.
[73] Companies owned partly by foreign entities and partly by inland entities.
[74] Stavebné bytové družstvo, Poľnohospodárske družstvo Vlára Nemšová, KOVOTVAR, výrobné družstvo
[75] Vojenský opravárenský podnik Trenčín, a.s.

highest number of restructuring resolutions together allowed for more than 77% of all restructuring attempts.

Figure 4

Regional distribution of restrucutrings



Source: Own dataset.

3.4.4 Trustees

As already mentioned, of the current number of 543 licensed trustees, only 70 trustees have administered at least one case of restructuring during the period 2006-2010, creating an average of 2.6 restructurings per trustee for 5 years period. These numbers do not seem to be too exceptional, but when we examine them more closer, we get a very interesting picture of how much the market of trustees is concentrated. Of the total number of 70 trustees, 38 have administered only one and 17 trustees only two restructuring attempts. Data on the number of restructuring attempts administered by remaining 15 trustees are presented in Table 4.

Table 4

Trustees with more than two restructuring attempts administered

Trustee	Number of restructuring attempts administred	Cumulative percentage of all restructurings
JUDr. Danica Birošová	29	15.9%
Ing. Štefan Tichý	19	26.4%
Ing. Mgr. Tomáš Oravec	8	30.8%
Mgr. Ladislav Barát	8	35.2%

Ing. Ladislav Kokavec	5	37.9%
JUDr. Ing. Veronika Škodová	5	40.7%
JUDr. Jozef Tuhovčák	5	43.4%
Mgr. Robert Antal	5	46.2%
Prvý správcovský dom,k.s.	5	48.9%
JUDr. Marián Novikmec	4	51.1%
JUDr. Matúš Boľoš	4	53.3%
Mgr. Ing. Vladimír Neuschl	4	55.5%
KONKURZNÝ SPRÁVCA, k.s.	3	57.1%
Mgr. Miloš Ágg	3	58.8%
Pospíšil & Partners, k.s.	3	60.4%

Source: Own calculation based on the composed dataset.

Two "outliers" of the sample, with by far the highest number of restructuring cases, have together administered more than one quarter of all restructuring attempts. When we take first four trustees with the highest number of restructuring cases, it makes for more than one third of all cases. More than half of all restructuring attempts were administered by the first ten trustees. Finally, fifteen trustees with more than two restructuring cases during 2006-2010 have conducted together more than 60% of all restructuring cases.

Another fact worth mentioning is that even though the replacement of the trustee, who prepared an expert opinion and was appointed in restructuring resolution, during proceedings is not standardly assumed in the Insolvency Act[76], one such case occurred. In the restructuring of Ružomberská energetická spoločnosť, a.s., trustee JUDr. Vladimír Herich was replaced by Prvý správcovský dom,k.s. only 24 days after the restructuring order.

3.4.5 Business sectors

The debtors, who attempted restructuring, came from various business sectors.[77] Manufacturing of fabricated metal products (except machinery and equipment) was represented most heavily (25 debtors), followed by construction (22 debtors), wholesale trade (19 debtors), transport (14 debtors), retail trade (13 debtors), manufacturing of machinery and equipment (11 debtors) and manufacturing of wood and of products of wood and cork (including furniture, 9 debtors). All business sectors represented by at least one debtor are presented in Table 5.

[76] Richter (2005a)

[77] We followed (with some small adjustments) statistical classification of economic activities SK NACE Rev. 2 to classify debtors into various business sectors.

Table 5

Business sectors of debtors

Business sector	Number of debtors
Manufacturing of fabricated metal products (except machinery and equipment)	25
Construction	22
Wholesale trade	19
Transport	14
Retail trade	13
Manufacturing of machinery and equipment	11
Manufacturing of wood and of products of wood and cork (including furniture)	9
Agriculture and forestry	6
Real estate activities	6
Manufacturing of food products	5
Sale of motor vehicles, motor vehicle parts and accessories, maintenance and repair of motor vehicles	5
Manufacturing of plastics products	4
Manufacturing of wearing apparel	4
Food and beverage service activities	3
Manufacturing of beverages	3
Office administrative, office support and other business support activities	3
Sports activities	3
Accomodation	2
Advertising and market research	2
Architectural and engineering activities; technical testing and analysis	2
Manufacturing of basic metals	2
Manufacturing of computer, electronic and optical products	2
Repair of fabricated metal products, machinery and equipment	2
Cleaning activities	1
Education	1
Legal and accounting activities	1
Manufacturing of articles of concrete, cement and plaster	1
Manufacturing of bodies (coachwork) for motor vehicles	1
Manufacturing of man-made fibres	1
Manufacturing of military fighting vehicles	1
Other professional, scientific and technical activities	1
Publishing of books, periodicals and other publishing activities	1
Rental and leasing activities	1
Repair of computers and personal and household goods	1
Security and investigation activities	1
Steam and air conditioning supply	1
Washing and (dry-)cleaning of textile and fur products	1
Waste collection	1

Source: Own calculation based on data from Universal Register Plus of the Slovak Republic.

3.5 Observations on the proceedings

3.5.1 Type of petitions

Of the total number of 182 restructurings allowed in the period of 2006-2010, 175 were initiated by debtors. Only 7 proceedings were allowed based on a creditor petition. These numbers are in line with our previous expectations[78] that debtor petitions for restructuring will be absolutely prevailing. However, 7 restructurings successfuly initiated by creditors prove that the option of creditor restructuring is not purely theoretical if creditors have proactive approach and use possibilities given to them by legislation.

On the other hand, even though facilitating a possibility of pre-packed restructuring was one of the reform's aims and pre-packed restructuring is explicitely recognized by the legislation, none of the proceedings were a pre-packed restructuring. Local banks and other relevant players seem to be unfamiliar with this method[79] or tend to overlook benefits arising from acceleration of the proceedings.

3.5.2 Success rates

It is a very difficult task to define what success in the context of restructuring means. As Falke (2003) notes, some consider it success when the business of the debtor is preserved even when management or ownership changes, while for others success means the maintaining of jobs for employees even if it affects the debtor's viability in the long run. Again different opinions consider restructuring success when returns to creditors flow in a short term.

Warren and Westbrook (2009, p. 612) argue that plan confirmation results *„constitute the most important single criterion for judging benefits of the Chapter 11 system.“* Their arguments are straightforward. *„A system that does not lead to confirmed plans cannot achieve its objectives...Further, confirmation generally requires the debtor to accomplish a number of tasks suggestive of future success, including garnering the support of supermajority of creditors and persuading a court of a plan's feasibility.“*[80] Another obvious advantage of such criterion is a fact that confirmation rates can be easily measured.

[78] See chapter 2.6.1.
[79] Allen & Overy (2009a)
[80] Warren and Westbrook (2009, p. 611-612)

Certainly, satisfaction of formal insolvency requirements and confirmation of a plan are not perfect measures of success. Warren and Westbrook also emphasize that confirmed plan does not automatically guarantee a successful future for the business and *„smooth sailing post-bankruptcy.“*[81] Many companies enter insolvency proceedings again, shortly after the confirmation of a plan and successful completion of the restructuring. However, it is again very difficult to determine what constitutes success following confirmation of plan, or in other words, for how long must the company be alive for a post-restructuring to be deemed a success. Another question arises also in the form of liquidating plans if we understand restructuring strictly as a rescue measure for viable businesses. Confirmation of such a plan is recorded as success but it does not necessarily represent the realization of going-concern value.

Having acknowledged these caveats, we follow Warren and Westbrook in choosing plan confirmation rates as the central measure of success for restructuring attempts. However, we complement these numbers also with analysis of post-restructuring existence of debtors to provide the reader with a more complex perspective of the outcomes of new provisions on restructuring.

3.5.2.1 “Naive“ confirmation rates

Warren and Westbrook (2009) label figures on overall confirmation rates “naive“ because they imply false proposition that all Chapter 11 cases are plausible candidates for reorganization. Since there is virtually no gate to reorganization in the US legislation and Chapter 11 is a nearly uniform choice among companies filing for bankruptcy, it is highly unlikely that all these companies, using their right to try, are realistic candidates for reorganization. Chapter 11 thus serves as a critical screening function to sort out the sure losers from those with a realistic chance of survival. Using total confirmation rates when evaluating the outcomes of Chapter 11 does not make much sense because *„the large front door for Chapter 11 is likely to yield lower total confirmation rates, even if the system is wildly successful in dealing with businesses that have any hope of reorganization.“*[82]

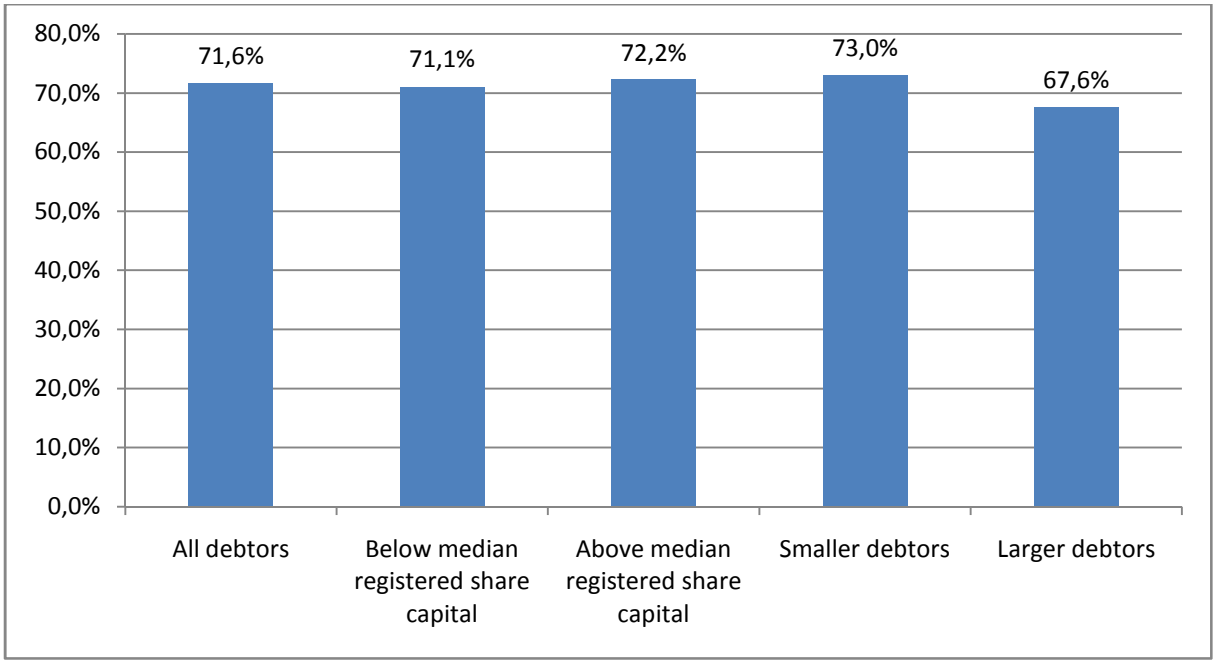
However, this does not apply fully for the Slovak restructurings. An expert opinion on feasibility of a restructuring, which serves as an entry ticket to restructuring, should sort out the hopeless cases before entering formal proceedings. Therefore, if this screening works

[81] Warren and Westbrook (2009, p. 610)
[82] Warren and Westbrook (2009, p. 617)

well, naive metric should also yield relatively acurate figures on how successful the system is in dealing with debtors in restructuring. Figure 5 shows figures on overall confirmation rates for all debtors and also compares outcomes for companies in restructuring by size. As mentioned in chapter 3.2, for these purposes, we used two different metrics: metric of registered share capital (below median registered share capital, above median registered share capital)[83] and metric of sales and employees count (smaller companies = 135 debtors under defined thresholds, larger companies = 47 debtors above defined thresholds).[84]

Figure 5

Restructuring plan confirmation rates: The naive metric[85]



Source: Own calculation based on composed dataset. Classification of debtors by size based on data on registered share capital, sales and empoyees count from the Universal Register Plus of the Slovak Republic.

[83] Registered share capital median = 33,193.5 EUR (approximately 1,000,000 SKK)
[84] Classification of debtors into the respective groups is indicated in Appendix 1.
[85] Figure 5 presents the following data:

Naive metric	Plan confirmed	Conversion	In progress	Confirmation rate
All debtors	106	42	34	71.6%
Below median registered share capital	54	22	15	71.1%
Above median registered share capital	52	20	19	72.2%
Smaller debtors	81	30	24	73.0%
Larger debtors	25	12	10	67.6%

Relatively high overall plan confirmation rates are the most striking point from Figure 5. Approximately seven out of ten debtors, whose restructuring attempt was allowed, finished restructuring proceedings successfuly by confirmation of their restructuring plan. Moreover, these figures seem to be independent of the debtor's size since confirmation rates are roughly the same for both above and below median groups and smaller and larger companies.[86]

As expected, thanks to the prescreening by expert opinion on feasibility of a restructuring, calculated confirmation rates for Slovak restructurings are considerably higher than the US Chapter 11 confirmation rates reported by Warren and Westbrook (2009) which range around 30% (the naive metric). However, we keep their label "naive" since we consider the preposition implied, that trustees in their opinion recommend restructuring only for plausible candidates and perfectly identify and sort out the implausible candidates, as naive as well. We presented several reasons for such considerations in chapter 2.5 (appoinment and remuneration of trustees, questions about overall quality and integrity of trustees). Therefore, if we admit that restructuring was allowed also in cases which were hopeless from the very beginning[87] and we succeed in isolating these cases from those debtors that had a reasonable prospect of success, we could develop a more realistic confirmation rates. Warren and Westbrook proposed two independent metrics which we follow: whether the debtor ever proposed plan of restructuring and the length of time the debtor remained in restructuring proceedings.

3.5.2.2 Realistic confirmation rates: Companies with a plan

The rationale behind this approach lies in the assumption that the debtors, who failed to propose any plan of restructuring during proceedings, were doomed from the beginning and their restructuring was very unlikely. There is no information about any restructuring plan proposed in 27 cases out of the total number of 42 conversions in our sample.[88] Figure 6 shows the revised confirmation rates after these no-plan-ever restructuring cases were sorted out.

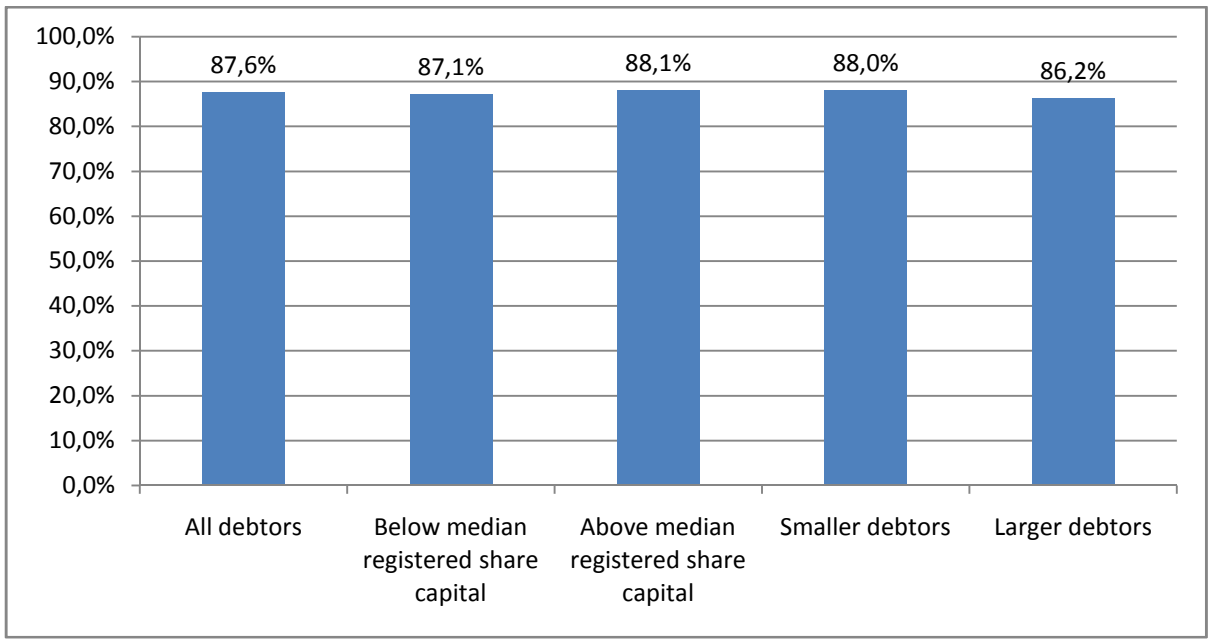
[86] We do not consider a difference of 5% in confirmation rates between smaller and larger companies as very significant (e.g. Warren and Westbrook report that success rates of bigger cases in Chapter 11 are more than two times higher than success rates of their smaller counterparts) and worth of further interpetation. Due to the possible inaccuracy in reporting of figures on sales and employees count, the classification of debtors into these categories does not have to be absolutely precise. Moreover, the number of debtors in group of larger companies is significantly lower and therefore the weight of each debtor's outcome for the total confirmation rate is relatively high.

[87] Warren and Westbrook (2009) refer to such cases as "DOAs" (dead-on-arrival)

[88] As mentioned in chapter 3.2, the only data available on restructuring proceedings are information published in the Commercial Bulletin. Therefore, it is possible that some of these 27 debtors actually proposed some version of restructuring plan, but no such information was published (we have this suspicion in at least three cases).

Figure 6

Restructuring plan confirmation rates: Cases with plan proposed[89]



Source: Own calculation based on composed dataset. Classification of debtors by size based on data on registered share capital, sales and empoyees count from the Universal Register Plus of the Slovak Republic.

At first glance, it is clear that confirmation rates have considerably increased. Almost 88% of cases, in which debtor proposed plan of restructuring, resulted in confirmed plans. Again, confirmation rates are almost identical in all samples regardless of debtors‘ size and we can conclude that the chances of small and big companies to confirm a restructuring plan (if they are able to propose it) are practically the same.

There could be several reasons why some debtors failed to propose any plan of restructuring even though a restructuring was supported by a trustee‘s opinion. Firstly, elaboration of restructuring plan is a more complex task, requiring deeper understanding of the debtor’s business operations to be able to identify its problems and to develop a credible strategy to

[89] Figure 6 presents the following data:

Cases with plan proposed	Plan confirmed	Conversion	Confirmation rate
All debtors	106	15	87.6%
Below median registered share capital	54	8	87.1%
Above median registered share capital	52	7	88.1%
Smaller debtors	81	11	88.0%
Larger debtors	25	4	86.2%

solve them. During this stage, relevant players may have realized that debtor's problems were so severe that restructuring could no longer be reasonably expected and liquidation became inevitable. During the plan preparation phase, new facts may have emerged in the light of which the restructuring was not feasible anymore. Finally, we can not rule out the possibility that at least some debtors with no chance of restructuring and no true aspiration to prepare a restructuring plan only abused the restructuring procedure to delay liquidation.

3.5.2.3 Realistic confirmation rates: Companies that survived the cull

Another independent metric, proposed by Warren and Westbrook (2009) to isolate debtors with no hope on successful restructuring from candidates with a reasonable prospect of success, takes a rather different approach. It does not focus on the action of the debtor (proposing a plan of restructuring) but on the actions driven by the creditors and trustees and resulting in early conversions to liquidation proceedings. The underlying logic is clear – if the creditors and trustees can push the hopeless cases out quickly, then survival time in restructuring proceedings might indicate that it is not only the debtor themself who believes in successful restructuring.

Of course, in Slovak circumstances, this approach can be questioned since the creditors do not have (without cooperation on the side of trustee) powers to invoke the conversion of the restructuring into bankruptcy proceedings during the first 90 days after the restructuring resolution. Powers of trustees to petition the court to declare a bankruptcy anytime in the course of the restructuring proceedings are much more extensive. However, there are several reasons to raise doubts whether this early screening by trustees occur.

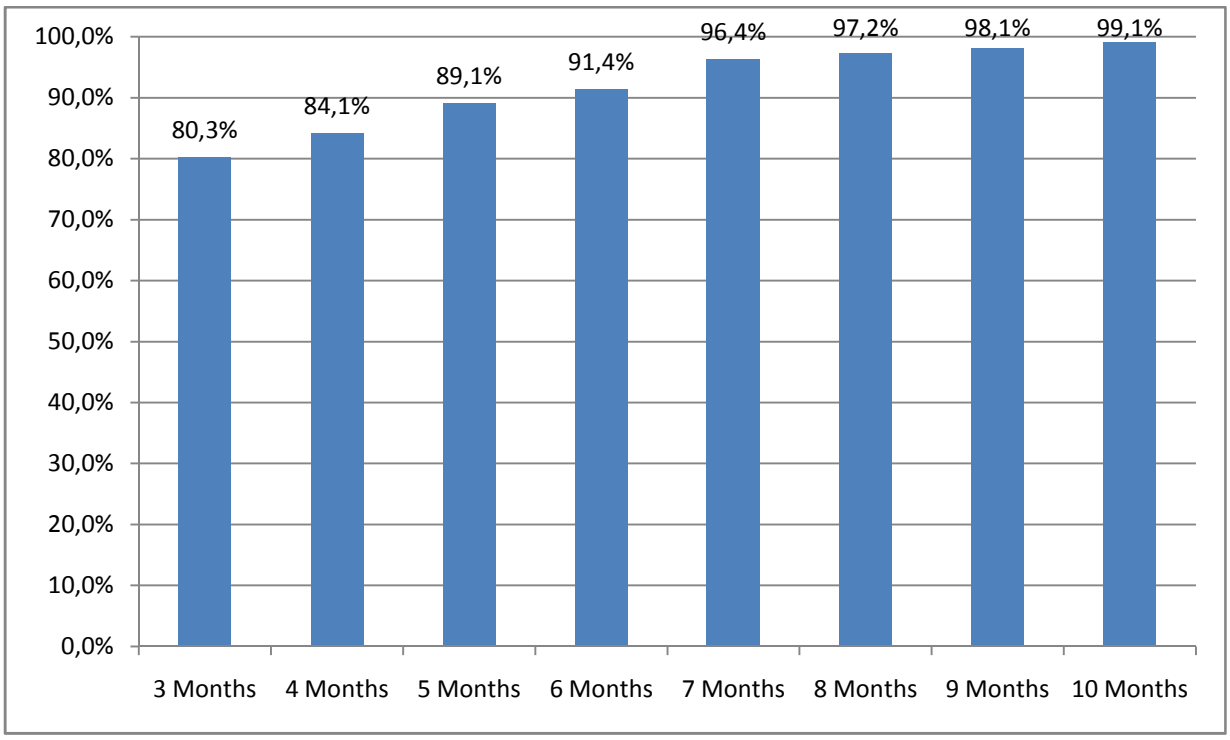
Under the new legislation, prescreening in form of expert opinion on feasibility of restructuring takes place before any debtor can enter restructuring proceedings. As we discussed earlier, it is likely that some of the hopeless cases survive this prescreening. One can, however, reasonably doubt if another screening by the same trustees, who recommended restructuring, can push out these debtors. By petitioning the court to declare a bankruptcy soon after the restructuring was allowed, trustees would cast doubt upon their own expert opinions.[90] Finally, if there is a collusion between trustee and debtor, early conversion can not be reasonably expected.

[90] This argument would not hold if the financial or business situation of the debtor changes after the restructuring resolution to such extent that restructuring becomes hopeless or the debtor seriously breaches its legal obligations.

Despite these considerations, we constructed analysis using this metric. Figure 7 reports the results for cases (regardless of size) that survived early screening.

Figure 7

Cumulative confirmation rates, by the length of survival in restructuring proceedings



Source: Own calculation based on composed dataset.

As the data from Figure 7 illustrates, substantial screening occured early in a case. If a restructuring was not converted into bankruptcy proceedings within the first three months after the restructuring resolution, a chance of confirming a plan increased by 9% compared to naive confirmation rate. After six months, the confirmation rate was higher than 91%, thus nine of ten restructuring cases, that survived this period, resulted in confirmed plans. At the seven-month mark, the confirmation rate exceeds 96%.

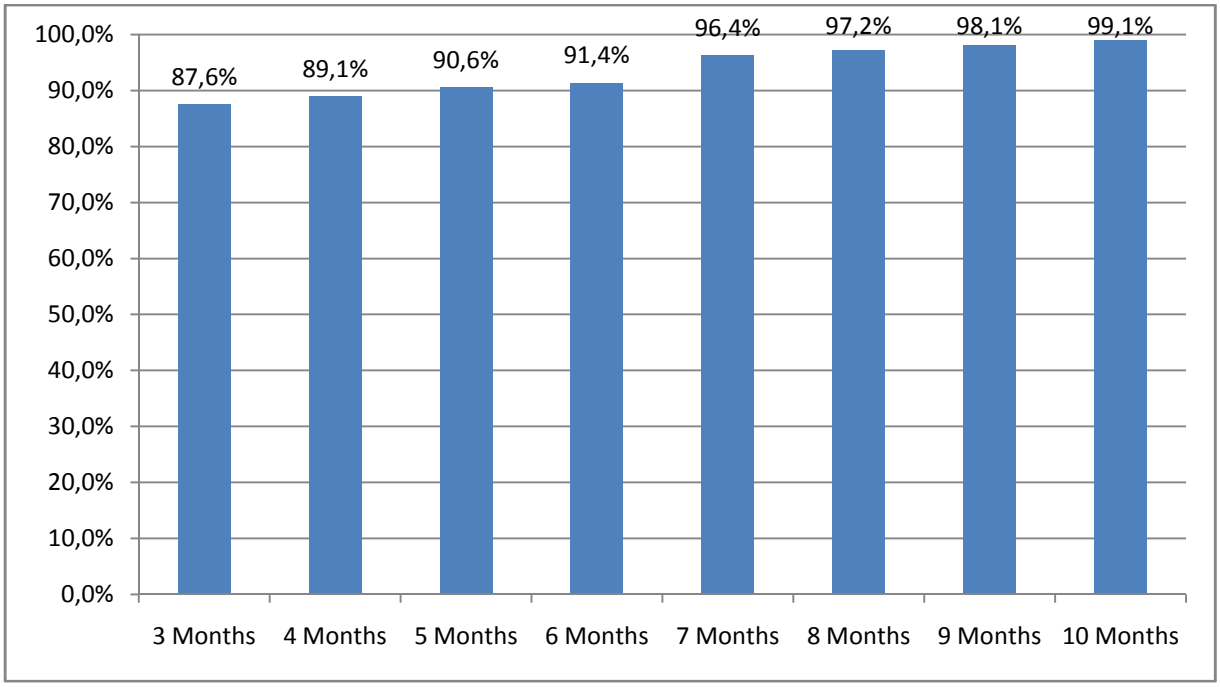
This data suggests that implausible candidates for restructuring, which somehow survived initial prescreening by expert opinions, were in most cases pushed out from the system very quickly anyway. On the other hand, the absolute majority of remaining debtors managed to confirm a plan of restructuring.

3.5.2.4 Realistic confirmation rates: Companies that survived a double screening

Finally, to sort out the hopeless cases from serious candidates for restructuring, both above-used metrics can be combined together. Then, implausible candidates for restructuring were debtors which either could not propose a plan or could not survive respective period[91], or both. As Figure 8 shows, more than 90% of the debtors managed to confirm a plan if they remained for five months at least in a restructuring procedure and submitted a plan.

Figure 8

Cumulative confirmation rates for cases that proposed a plan by time of survival



Source: Own calculation based on composed dataset.

Analysis of confirmation rates using different metrics and samples clearly showed high formal successfulness of the restructuring option, introduced by the insolvency reform. However, confirmed restructuring plans are only one dimension of success. Now, we turn our attention to the time required to satisfy all insolvency requirements and to confirm a restructuring plan.

[91] Cumulative confirmation rates for survival period 6 months and longer are identical with those from Figure 7 since there could not be a debtor who did not propose a plan and simultaneosly survived longer than 6 months (see also statutary time limit for the submission of the plan, chapter 2.7.3.1).

3.5.3 Proceedings‘ timeline

There are two main reasons to examine the time needed to restructure the businesses more closely. Firstly, reported high success rates are certainly good news, but the question of time is of equal importance. If it lasts too long to confirm a plan, for creditors, who are unable to collect on their debts during the automatic stay, the costs of reaching plan confirmation may exceed the benefits of successful restructuring. This is a direct consequence of the fact that the costs of restructuring consist not only of direct costs (the professional fees, etc.) but also of indirect costs of delay (loss of value by time). Problem of abuse-by-delay may emerge and long-standing restructuring procedure may *„become a haven for businesses that want to hide out from their creditors...These businesses seek only delay and strategic advantage, not true reorganization, and their creditors bear the costs.“*[92] Therefore, the speed of proceedings and quick resolution is another important dimension of success.

As mentioned in the very beginning[93], the Slovak legislators addressed these issues by instituting strict statutory time limits within which key events of the process must be accomplished. And this is the second reason to examine the average timelines. It is of high importance (also from the policy-making point of view) to find out whether the restructuring practice is able to work within these time limits or whether they were set out too strictly and need further adjustments. We study the average timelines between the key procedural milestones of the restructuring process one by one and compare them to the statutory time limits, set out by the Insolvency Act. When applicable, other interesting observations are included. Figure 9 at the end of this chapter provides a nice overview of the whole procedure.

a) On average, 24 days (median 27 days) passed between the commencement of restructuring proceedings and the restructuring order[94], the lowest value being 4 days and the highest value being 45 days.[95] The statutory time limit for the court to order restructuring is 30 days from the commencement of restructuring proceedings.

b) On average, 63 days (median 63 days) passed between the restructuring order and the first creditors‘ meeting, the lowest value being 60 days and the highest value being 69

[92] Warren and Westbrook (2009. p. 624)
[93] Chapter 2.2
[94] It would be more logical to start with the average timeline between the filing of the restructuring petition and the commencement of the restructuring proceedings. However, the data on filing of the restructuring petition are not published in the Commercial Bulletin. The statutory time limit for the court to commence restructuring proceedings is within 15 days of restructuring petition receipt.
[95] All 182 debtors were included in this observation.

days.[96] The first creditors‘ meeting must take place between the 61st and 65th day following the restructuring order (not earlier than the first day and not later than the fifth day after expiry of the period for rejecting claims).

c) On average, 126 days (median 141 days) passed between the restructuring order and the submission of the restructuring plan to the creditors‘ committee for preliminary approval, the lowest value being 62 days and the highest value being 153 days.[97] The statutory time limit for the submission of the plan to the creditors‘ committee is 90 days following the restructuring order, with a possible extension of 60 days. These facts imply that the vast majority of debtors submitting the plan had to request for extensionof time limit. According to our statistics, the time limit for plan submission was extended in 128 cases (in 4 cases, the request for extension of time limit by 60 days was denied), out of which in 110 cases by maximum number of 60 days. The average extension of the time limit was 56 days. We believe that the statutory time limit for the submission of the plan is too strict and difficult to meet. We would come to the same conclusion by simple reasoning, without any statistical data. If we consider 30 days period for filing claims, followed by 30 days period for rejecting claims, only 30 days are left to prepare and adjust the plan to the amount of proven claims. For the more complicated cases, with plenty of dubious claims filed, 90 days time limit is clearly insufficient.

d) Out of 141 restructuring cases in which creditors‘ committee voted on plan, the members of creditors‘ committee decided to refer the plan back for further adjustments in 74 cases. On average, 25 days (median 28 days) passed between the first submission of the plan and the submission of the revised plan, the lowest value being 4 days and the highest value being 32 days.[98] The statutory time limit for creditors‘ committee to decide on plan is 15 days from the restructuring plan receipt and the statutory time limit for party submitting the plan to submit the revised version of plan is 15 days following creditors‘ committee vote.

[96] 173 debtors were included in this observation.
[97] 111 debtors were included in this observation. We have information about 141 plan submitted until decisive date (1 April 2011), but in 30 cases, the exact date of plan submission was not published.
[98] 48 debtors were included in this observation. In the remaining 26 cases, one or both dates of plan submission were not published.

e) On average, 22 days (median 15 days) passed between the first submission of the restructuring plan to the creditors‘ committee and the creditors‘ committee final vote on approval of the plan, with the lowest value being 0 days and the highest value being 45 days.[99] The maximal period between these two procedural milestones is set out to 45 days (15 days limit for the creditors‘ committee to decide on submitted plan, 15 days limit for the debtor to submit a revised plan in case that creditors‘ committee refers plan back, 15 days for the creditors‘ committee to vote on revised plan). Other statistics extracted from the composed dataset show that 63% of the creditors‘ committees had 3 members and 37% had 5 members.[100] In the vast majority of cases (76%), the creditors‘ committee approved the plan unanimously, by all votes of attending members.[101]

f) On average 27 days (median 27 days) passed between the creditors‘ committee final vote on approval of the plan and the creditors‘ meeting vote on approval of the plan, with the lowest value being 17 days and the highest value being 47 days.[102] Creditors‘ meeting must be called by trustee within 30 days of request receipt (after the approval of the plan, the creditors‘ committee must request trustee to call the creditors‘ meeting without delay).

g) On average, 28 days (median 25 days) passed between the approval of a plan at the creditors‘ meeting and the court’s order confirming a plan, with the lowest value being 9 days and the highest value being 171 days.[103] If there are no reasons to refuse the plan, the court must confirm the plan within 15 days of proposal receipt (the party submitting the plan must deliver the proposal for plan confirmation to the court in ten days following the creditors‘ meeting approval of plan). Three “outliers“ in our sample (171 days, 133 days, 130 days) are restructuring attempts in which the respective district courts refused the plans but the appeals lodged against these decisions to the respective regional courts were successful (the regional courts quashed the decisions of the district courts) and consequently, the district courts confirmed the plans.[104]

[99] 103 debtors were included in this observation.
[100] 128 debtors were included in this observation.
[101] 122 debtors were included in this observation.
[102] 125 debtors were included in this observation.
[103] 105 debtors were included in this observation.
[104] If we do not include these three “outliers” in the calculation, the average period between the approval of a plan at the creditors’ meeting and the court’s order confirming a plan will be 24 days (median 25 days).

Other statistics worth mentioning relate to the application of the cram-down rule. The courts used the option of binding dissenting creditors to the plan in 13 restructuring cases. In most cases, it was the cram-down of unsecured creditors (in one case together with cram-down of shareholders), but two cases of cram-down of secured creditors also occured. In three restructuring cases, the courts refused the request for cram-down.

h) On average, 75 days (median 67 days) passed between the submission of the restructuring plan to the creditors‘ committee and the court’s order confirming a plan, the lowest value being 35 days and the highest value being 201 days.[105]

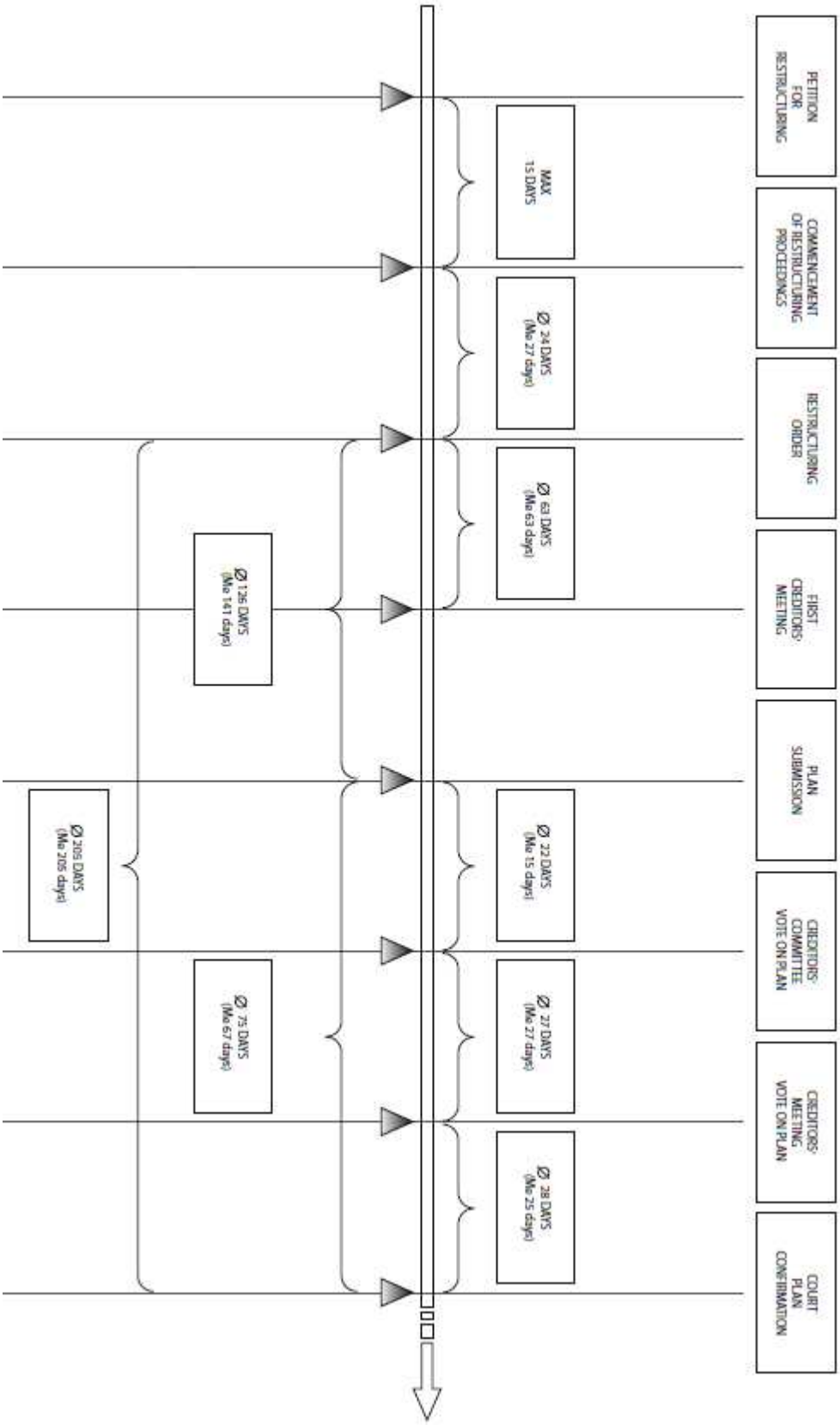
i) On average, 205 days (median 205 days) passed between the restructuring order and the court’s order confirming a plan, the lowest value being 109 days and the highest value being 350 days.[106] These statistics imply that all debtors, who confirmed a plan in the respective period, managed to do so in less than 1 year.

j) On average, 130 days (median 119 days) passed between the restructuring order and the court’s order converting restructuring into liquidation in 42 proceedings where a plan was not confirmed at all, the lowest value being 24 days and the highest value being 470 days. In 27 proceedings, there is no information available about any restructuring plan proposed, in 6 proceedings, restructuring was converted into liquidation after the creditors‘ committee refused the plan, in the 2 proceedings, conversion into liquidation followed after the creditors refused the plan at the creditors‘ meeting and in 5 proceedings, restructuring was converted into liquidation after the court refused to confirm the plan. In 2 proceedings, conversion into liquidation followed soon after the debtor submitted the plan, however no information are available about reasons for conversion.[107]

[105] 79 debtors were included in this observation.
[106] 106 debtors were included in this observation.
[107] There are no information about the creditors’ committee vote on plan published in the Commercial Bulletin.

Figure 9

The proceedings‘ timeline



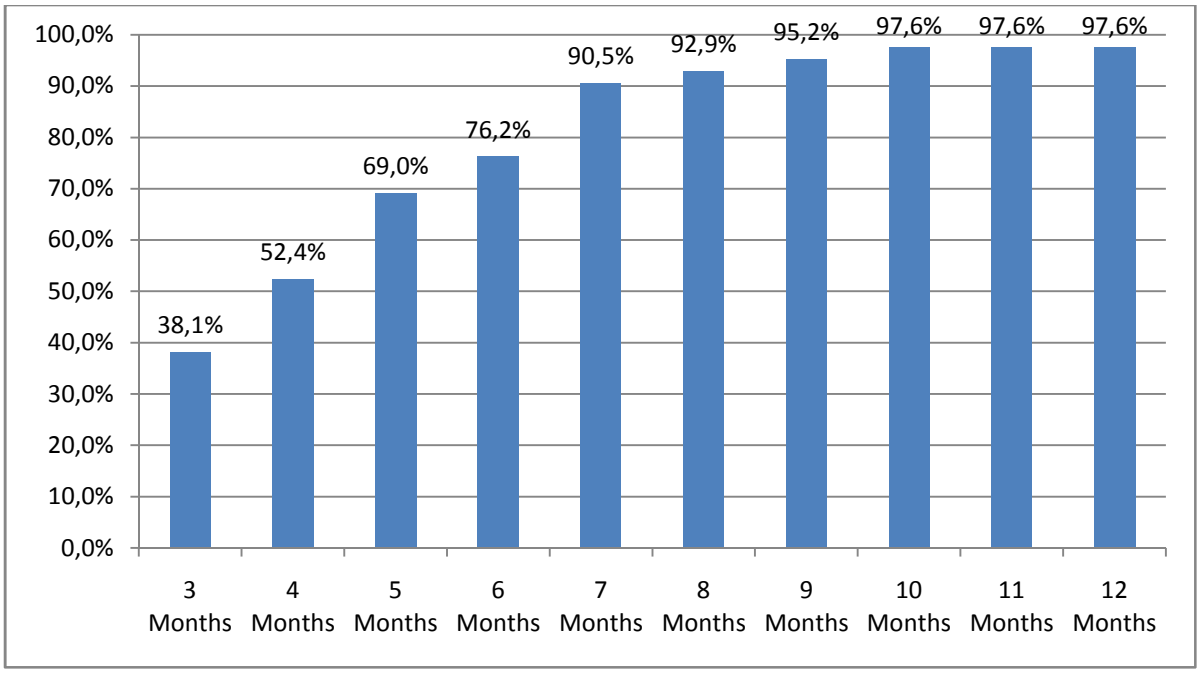
Source: Own calculation based on composed dataset.

3.5.3.1 Time to conversion and time to confirmation

More detailed analyses of time to conversion and time to confirmation are provided in Figure 10 and Figure 11. As Figure 10 illustrates, more than a half of the unsuccessful restructuring attempts were converted into liquidation proceedings in less than 4 months. More than three quarters of the conversions occurred within half a year after the restructuring order. Within 9 months, 95% of the unsuccessful cases moved out of the system. These numbers suggest that the restructuring system was very quick in dealing with failing cases. Moreover, it seems that time to conversion is not affected by the size of the debtor since the average time to conversion (130 days) was approximately the same for all subgroups divided by size (below median/above median registered share capital, smaller/larger companies according to their sales and employees count).

Figure 10

Conversion over time



Source: Own calculation based on composed dataset.

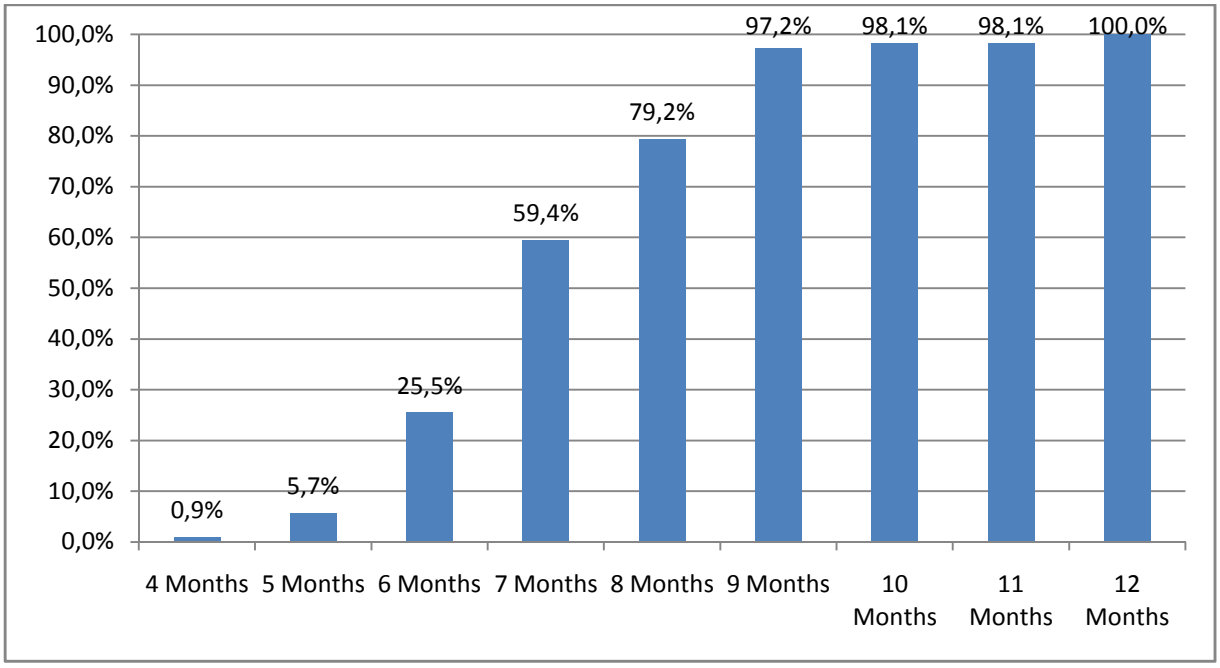
The average time to confirmation was about a half longer than the time to conversion. It reflects the time required to prepare, successfuly negotiate and approve a plan. However, Figure 11 shows that more than a quarter of debtors managed to confirm a plan in the first 6 months. Within 7 months, almost 60% of cases were finished successfuly by confirmation of

a plan. Virtually in all successful restructurings, a plan was confirmed within 9 months. This evidence proves that the system's performance is very quick.

The size of a debtor affects the time to confirmation only slightly. Both metrics showed that bigger companies need approximately one week more to confirm a plan than their smaller counterparts (average time to confirmation was 208 days for above median registered share capital group and 211 days for companies with sales and employees count above defined thresholds while the average time to confirmation for below median group was 202 days and for companies under defined thresholds 203 days). This is quite an intuitive result if we consider that larger companies have usually more complicated business operations to deal with and the restructuring plan must therefore be more complex and negotiated with more creditors.

Figure 11

Cumulative confirmation times for cases with confirmed plans

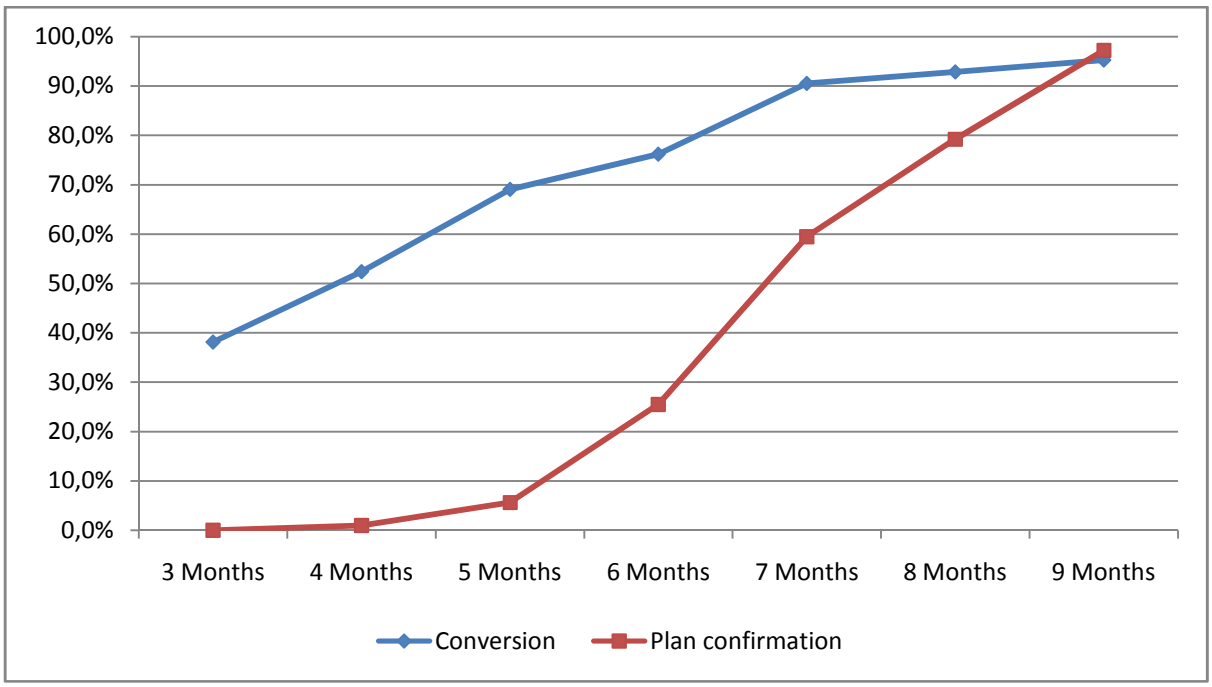


Source: Own calculation based on composed dataset.

Similarly to Warren and Westbrook (2009), we summarize the time to confirmation and the time to conversion in Figure 12. The top line demonstrates that failures are pushed out of the system quickly, while the bottom line shows a naturally slower pace of successful restructuring. We conclude that practically all restructuring cases were resolved (regardless of the outcome) within 9 months after the restructuring order.

Figure 12

Cumulative dispositions over time, by plan confirmation and conversion



Source: Own calculation based on composed dataset.

3.6 Observations on the restructuring measures and proposed pay-outs

In this chapter, we hoped to provide the reader with an unique overview of the restructuring measures and the pay-outs proposed to both secured and unsecured creditors in all restructurings allowed in the period 2006-2010. Despite our best effort, we were not able to compose dataset which would include enough debtors to be representative.[108] However, in the absence of any similar analysis, we think it could still be beneficial to report our results even for the sample with relatively low number of debtors.[109]

3.6.1 Restructuring measures

The restructuring plans, submitted by debtors in our sample and confirmed by the court, contained plenty of restructuring measures. Similarly to Richter (2011), we divided them into several categories:

[108] Reasons are described in more detail in chapter 3.2.
[109] As already mentioned in chapter 3.2, we were able to get necessary information about 15 out of the total number of 106 debtors, who managed to confirm a plan in the respective period (until 1 April 2011).

a) eight plans where the restructuring measures were solely on the capital side – changes in the amount and due date of the debtor's debts

b) three plans where the restructuring measures on the capital side were combined with a sale of debtor's assets

c) two plans under where restructuring measures on the capital side were combined with operational measures (in particular decrease in number of employees) and a sale of debtor's assets

d) one pure sale plan – plan where the assets of the estate were sold to a new investor

e) one plan combining capital side measures with accession of a new business partner

3.6.2 Proposed pay-outs

Typically, only two classes of creditors were formed in the plans: one for creditors with secured claims and the other for creditors with unsecured claims. In a few cases, separate class for the unsecured part of claims filed as secured was created.

The pay-out proposed to secured creditors in almost all plans was 100% of the face amount of the debt. The only exceptions were two plans. In one of them, only 20% pay-out was proposed to secured creditors who were the business partners of the debtor at the same time. In the second plan, 100% pay-out was proposed to one of the secured creditors, but only 30% pay-out to another secured creditor.[110]

The schedules of payments varied much more, from almost immediate payment upon plan confirmation (shortest payment schedule of 3 months) to payment in installments over 66 months thereafter (the longest one). The average payment schedule was approximately 41 months (median 47 months) after the confirmation of the restructuring plan.

Average pay-out to unsecured creditors was approximately 33% (median 30%) of the face amount of their claims, the lowest value being 9% and the highest value being 100%. The average payment schedule was approximately 34 months (median 36 months) after the

[110] Separate classes were created for each of these two secured creditors.

confirmation of the restructuring plan, the lowest value being 3 months and the highest value being 60 months.

3.6.3 Observations on the post-restructuring period

From the legal point of view, a court's confirmation of a plan successfuly finishes restructuring. However, the application of restructuring measures, approved in the plan, and thus the "real" economic restructuring of business, follows the confirmation of the plan. Formally successful restructuring, which our previous methodology recorded as success (in terms of plan confirmation), can end up in liquidation very soon anyway if the plan is not being fulfilled. Therefore, we believe it is of high importance to observe also the post-restructuring period of each debtor to find out whether time dedicated to restructuring procedure helped to preserve debtor's business or if it just delayed liquidation.

Obviously, we are limited here by the fact that our data on restructuring attempts is quite recent and post-restructuring period is in many cases too short to draw any conclusions. Therefore, to figure out the percentage of debtors, who succeeded to confirm a plan, but ended up in liquidation afterwards, we decided to examine only debtors, whose plans were confirmed before 1 April 2010, i.e. at least one year passed from the successful completion of restructuring. Even though this period is more or less arbitrarily chosen (it is probably not possible to set some period which would be an objective measure of success), it makes sense for two reasons. Firstly, it still leaves enough debtors, who meet this condition, in our dataset. Secondly, the first year after the confirmation is probably the most difficult one and if debtor survives this period, chances for a successful future significantly increase.

More than 18% of debtors (8 out of 44 debtors), who confirmed a plan before 1 April 2010, ended up in liquidation anyway. On average, 487 days (median 505 days) passed between the court's order confirming a plan and the liquidation order, the lowest value being 78 days and the highest value being 902 days. In simplified terms, the restructuring procedure delayed liquidation on average by 2 years in these cases - on average 706 days (median 726 days) passed between the restructuring order and the liquidation order.

No doubt a more logical approach would be to examine what percentage of the confirmed plans was actually fulfilled. However, there are two obstacles to such approach. As our analysis of proposed pay-outs indicates, it takes on average more than three years to fulfil the plan. When we consider again that our dataset is recent, probably only a few plans were already fulfilled. Moreover, information about the fulfilment of the plan is published in the

Commercial Bulletin only in case that a supervisory administration was instituted over the debtor. It is very difficult to get such information otherwise.

In the binding part of the plan, a supervisory administration (as supervision over adherence to the fulfilment of the restructuring plan) can be instituted over the debtor, for the time after the plan confirmation until the plan fulfilment (§ 162). Approximately every third plan (36 out of 106 confirmed plans) instituted the supervisory administration over the debtor. On average, 14 days (median 10 days) passed between the court's order confirming a plan and the institution of supervisory administration. According to our statistics, 6 debtors, over which the supervisory administration was instituted, already fulfilled the plan. In these 6 cases, only 231 days on average (median 190 days) were needed to fulfil the plan.

4 Conclusion

In this thesis, we focused on the practical application of new provisions on restructuring which came into effect on 1 January 2006. For this purpose, we manually composed unique dataset of all restructuring attempts allowed in the period 2006-2010. We believe that statistics and analyses presented above allow us to draw the following conclusions:

- The restructuring option under the new Insolvency Act proved to be much more viable than the composition option under the previous Bankruptcy and Composition Act. After some time, which was necessary for debtors to familiarise with brand new provisons, the number of restructuring attempts allowed sharply increased.

- The system is characterized by very high success rates. Seven out of ten restructuring attempts allowed resulted in confirmed plans. The chances of plan confirmation among debtors, who at least proposed a restructuring plan or survived in restructuring procedure longer than five months, approached 90%. Moreover, confirmation rates seem to be independent of the debtor's size. Thus, small companies have virtually the same prospects for plan confirmation as their larger counterparts.

- The speed of proceedings is remarkable. Average time between the restructuring order and the court's order confirming a plan was 205 days. In practically all successful restructuring attempts, the plan was confirmed within nine months after the restructuring order. The unsuccessful cases were weeded out of the system even more promptly, with average time to conversion being 130 days. Again, the size of the debtor affects the length of proceedings only a little. The restructuring practice seems to be able to work within the strict statutory time limits, set out by the Insolvency Act. However, data indicate that the statutory time limit for the submission of the plan to the creditors‘ committee for preliminary approval is too strict. In the absolute majority of cases, the maximum extension of 60 days was requested.

- Intuitive assumption that a confirmed plan does not guarantee a successful future for the business proves to be right. Observations on post-restructuring period of debtors, who confirmed the plan before 1 April 2010, suggest that almost every fifth debtor had problems with fulfilment of the plan and ended up in liquidation soon. Since our

dataset is quite recent, these figures are only preliminary and with the passage of time, we expect them to increase considerably.

- Legislative intervention aimed at increasing transparency of the process is the most needed change. Even though we identified and described several dubious provisions of the Insolvency Act in the first part of the paper, we consider lack of transparency to be the most serious problem. We were encountering problems with missing or inaccurate data on restructuring attempts the entire time during preparation of this thesis. We believe that it is also the main reason why there were no empirical analyses, evaluating the effects of the reform, prepared so far.

- No doubt, the reform moved the Slovak insolvency law closer to the standards of the best-performing jurisdictions. However, a lot of improvements still need to be done. Only a broad discussion, based on the empirical observations and exact statistics, can lead to further positive changes. This paper is our attempt to spur such debate.

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Appendix

File "Dataset.xls" enclosed.