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Bankruptcy law at the time of the COVID-19 epidemic

- ✓ What are the provisions of the Act on the anti-crisis shield?
- ✓ What is the key for the entrepreneurs to survive?
- ✓ How to avoid insolvency?
- ✓ What are the obligations of entrepreneurs and management board members?

Bankruptcy law at the time of the COVID-19 epidemic

The key for the entrepreneurs to survive the crisis caused by COVID-19 is to maintain liquidity and avoid bankruptcy.

This has not been made any easier by the so-called anti-crisis shield.

The Act on the shield does not suspend the obligation resting on the entrepreneurs and on management board members of capital companies to file a petition for declaration of bankruptcy within 30 days of the date on which the state of bankruptcy arose.

Despite the outbreak of COVID-19 epidemic **sanctions for non-performance of this obligation** are still binding, that is:

- liability of management board members for the civil law and tax obligations of the company,
- criminal liability and stigmatizing penalties imposed by the bankruptcy court (including prohibition to conduct business activity or to hold functions on the bodies of companies).

The petition for declaration of bankruptcy may be filed not only by the entrepreneur individually or by a management board member of a company but also by **each creditor**. The so-called anti-crisis shield does not deprive creditors of such right during the COVID-19 epidemic.

The problem affects not only large corporations and holdings but also persons who conduct individual business activity, the so-called self-employed who provide B2B services. These persons are most exposed to loss of liquidity. Before the outbreak of the COVID-19 epidemic they successfully functioned in the catering, hotel, entertaining or tourist industry. This business practically ceased to exist, and the service providers were deprived of contracts and sources of financing. However, the obligation to file a petition for bankruptcy and the sanctions for failure to comply with such obligation remain.

It is vital to review the activities and legal measures that the entrepreneurs and persons managing the companies should consider when developing the survival strategy for their companies.



1. It is crucial to avoid insolvency

Bankruptcy law regulates two scenarios in which an entrepreneur is considered insolvent:

- 1) in the case the entrepreneur loses its ability to meet its financial liabilities when they become due (loss of liquidity). Example: lack of funds to pay all current financial liabilities in their full amount (VAT invoices).

Bankruptcy law provides for presumption of loss of liquidity – when delays in payments to at least two creditors exceed three months, for example a liability towards Creditor 1 is already 3 months overdue; a liability towards Creditor 2 is also overdue and on 31 March 2020 the 3rd month of delay in payment will lapse – as of 1 April 2020 state of insolvency will arise;



- 2) In the case financial liabilities exceed the value of the entrepreneur's assets (property) and this situation persists for at least 24 months (the property prerequisite, of excessive debt). The property prerequisite is tested on the basis of the most recent balance sheet of the company, taking into account the following:

- all assets as per their market value, including also assets not disclosed in the balance sheet (for example, receivables before issuance of the accounting document - invoice), *versus*
- financial liabilities due and not yet due, with the exclusion of:
 - provisions for liabilities;
 - future liabilities;
 - liabilities towards related entities, towards a stakeholder or a shareholder in respect of loans or similar transactions;
 - disputed liabilities – if the dispute is objective and real (that is relates to the nonperformance or improper performance of an obligation, the company has reasonable arguments to defend itself, the dispute was not created to avoid payments).

2. Measures to avoid loss of liquidity

To avoid loss of liquidity the following activities may for example be considered:

- **Renegotiation of contracts with key contractors** – it is worthwhile to enter into negotiations with key partners (suppliers, financing entities) to work out mechanisms preventing the increasing payment delays, such as deferral of payment deadlines, arrangement of payment in installments, *standstill* or *pactum de non petendo* agreements.
- **Procurement of cash** by, for example: factoring, intensified sale and reduction of warehouse inventory (if possible), shortening the deadlines for deliveries and payments for goods.
- **Aid package prepared for companies by BGK in connection with the coronavirus**

Bank Gospodarstwa Krajowego is working on special solutions for companies affected by the difficult situation connected with the coronavirus (information available at:

<https://www.bgk.pl/aktualnosci/pakiet-pomocowy-bgk-dla-firm-w-zwiazku-z-koronawirusem-2644/>)

The first solution suggested by BGK consists in increasing the maximum level of the de minimis guarantee to 80 % of the loan amount. Additionally, BGK will not charge commission on granting the guarantee which at present is 0.5 % of the guarantee value. The second solution proposed by BGK is said to comprise a scheme of subsidies to the interest on the loans granted to the entrepreneurs by the banking sector.

Aid package under the Shield Act

E-commerce – if the business profile allows it, it is worthwhile to consider implementation of the Internet business model which will allow for delivery of the products ordered by the customers to their homes. This may mitigate the loss of revenues generated from traditional/stationary sale.

3. Measures to avoid excessive balance sheet debt

It is required to verify the most up to date balance sheet and to carry out the test for excessive debt (financial liabilities vs. property).

To avoid excessive debt it may be of help to, *inter alia*, increase share capital or update the value of amortized assets.

4. Obligations of entrepreneurs and management board members

Each entrepreneur (companies, individual entrepreneurs) and management board members of capital companies are obliged to file a petition for the declaration of bankruptcy within 30 days of the date state of insolvency occurred.

This also applies to a situation where the insolvency arose as a result of the outbreak and at the time of the COVID-19 epidemic. The so-called anti-crisis shield does not suspend this obligation.

Failure to comply with this obligation may result in:

- liability of management board members for the civil law and tax obligations of the company;
- criminal liability of management board members under Art. 586 of the Commercial Companies Code;
- prohibition on the conduct of business activity or holding functions on the company bodies (stigmatizing penalties imposed by the bankruptcy court).



5. Alternative solutions

In the difficult economic environment caused by the outbreak of the COVID-19 epidemic, an alternative for filing a bankruptcy petition is to **open a restructuring procedure**. The purpose of such procedure is to avoid declaration of bankruptcy by the entrepreneur and to restore such entrepreneur's capacity to conduct profitable activity on a given market. This is done by restructuring debt pursuant to a settlement with creditors by, for example, deferral of payment deadlines, arrangement of payment in installments, debt conversion to shares or stakes.

In the period of restructuring, the entrepreneur does not pay debts which arose before the day the procedure was opened, except for obligations towards the employees and liabilities secured by a mortgage or a pledge, and is granted protection from enforcement of such debts. Restructuring law also **makes it possible to annul the already effected seizures of bank accounts**.

Opening the restructuring procedure before lapse of 30 days of the date the state of insolvency occurred will allow management board members of a capital company to avoid responsibility for civil law and tax obligations of the company. It should also protect from criminal liability under Art. 586 of the Commercial Companies Code and from stigmatizing penalties.

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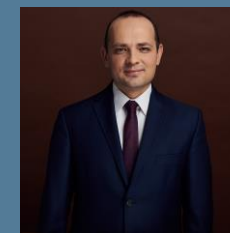


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