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Greece – Pre-insolvency proceedings under Greek Law: Some critical thoughts

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Greek bankruptcy law underwent a major reform in 2007 when the first Bankruptcy Code was introduced. One of the main features of the code was the introduction of the pre-insolvency regime which – following subsequent amendments – comprises the rehabilitation procedure and the special liquidation process. Filings under the current pre-insolvency regime are treated as an attempt for corporate reorganisation aiming at the rescue of viable enterprises facing liquidity problems. This article examines basic aspects of the proceedings, provides some evidence on the popularity of the institutions under consideration, while at the same time highlighting certain potential issues requiring corrective action, and also sets out a brief outline of recent developments in insolvency legislation.

In 2007, Law 3588/2007 came into effect entailing a substantial overhaul of the national insolvency and restructuring legal framework through the codification of the Greek Bankruptcy Code (the "GBC"). The GBC actually replaced primary legislation on insolvency which until that time could be found scattered in various legislative acts. Apart from the codification, such reforms were also meant to serve the objective of the modernisation of pre-insolvency procedures aimed at assisting debtors in avoiding ordinary bankruptcy. In this regard, Law 3588/2007 introduced the conciliation procedure, inspired by the relevant pre-insolvency regime of France. However, the application of the provisions of the conciliation procedure for more than four years has given rise to a number of controversies, which – assisted by the financial circumstances prevailing in the country – resulted in its substitution and the introduction of a new pre-insolvency regime with Law 4013/2011, which was put into effect as of September 2011.

The GBC as it currently stands provides for the following two pre-insolvency procedures: (i) the rehabilitation procedure (articles 99 – 106i of the GBC) and (ii) the special liquidation process (article 106ia of the GBC).

One of the main drawbacks of the conciliation procedure was found in the absence of the element of the "collective action": the conciliation agreement did not have a cram-down effect and was not binding on dissenting creditors. The provisions of the rehabilitation procedure have been introduced mainly in an effort to mitigate such a problem. Apart from this, another basic aspect of the rehabilitation procedure is the adoption of the flexibility for the conclusion of the agreement by means of confidential negotiations in a manner similar to the Anglo-Saxon model of the "pre-packaged plans". Besides, the rehabilitation procedure is open to enterprises that have already reached the state of the cessation of payments.

The special liquidation process, on the other hand, (which was re-introduced with the amendment of the GBC in 2011[1]) aims at the sale of the totality of the assets (or sub-totals of individual assets forming operational units) of a company by means of a public auction, under a specific procedure prescribed in the law. The basic advantage of the process of special liquidation mainly concerns the avoidance of the "depreciation effect" that an enterprise may suffer in the event of its direct entry to bankruptcy. Again, the introductory report of Law 4013/2011, acknowledges itself that the rehabilitation is a preferred procedure in comparison to special liquidation, as it has higher chances for success.

The main idea running through the GBC was to keep the debtors as far away as possible from the "stigma" effect, which is native to some bankruptcy laws.

The relevant initiatives mainly aimed at the formation of more efficient sets of procedures alternative to the ordinary bankruptcy, during the implementation of which the creditor's satisfaction will be timely tested before resorting to bankruptcy and the enterprise will be given a second chance.

Pre-insolvency proceedings

The rehabilitation procedure

The rehabilitation procedure is available to any company that faces financial difficulties and is in a state of present or threatened inability to fulfil its due payment obligations. Debtors who have already reached the state of the cessation of payments are also eligible to file for entry. In essence, the rehabilitation

procedure grants to the company the opportunity to conclude with its creditors a special rehabilitation agreement which will enable it to avoid bankruptcy and will serve to the rescue of the enterprise without however undermining the collective satisfaction of its creditors.[2] The procedure may be either Court supervised or not. In either case, the procedure ends up with the ratification of the concluded agreement through the relevant decision of the Court.

Judicial procedure. The judicial rehabilitation procedure starts with the submission of an application for entry. Such application is filed at the initiative of the Board of Directors of the company and is mandatorily accompanied by an expert's report[3] which must contain all the necessary elements on the financial condition of the company, as prescribed by law. The expert holds a key role in the procedure since it certifies to the Court the fulfilment of the necessary financial requirements for entry into the procedure.

The Court issues a decision ordering the opening of the procedure, while no judicial recourses are allowed; appeal may only be filed against decisions rejecting the opening. A mediator or a special attorney-in-fact may optionally be appointed by the Court. Likewise, the decision opening rehabilitation may decide on the convocation of a creditors' assembly, in which case the appointment of the mediator becomes mandatory. In practice, the convocation of an assembly of creditors in order to vote on the agreement is optional, but useful in cases where a large number of creditors render direct negotiations more difficult. The scope of the agreement may vary, including any adjustment whatsoever with respect to the debtor's assets and liabilities.

In order for the assembly to validly resolve on a rehabilitation agreement, a quorum of creditors representing at least 50% of the totality of claims is required. For the acceptance of the agreement – whether concluded through the creditors' meeting or not – a majority of creditors representing 60% of claims is required, including at least 40% of creditors secured by *in rem* securities or holding a special lien or a pre-notice of mortgage.

Upon filing for the opening of the rehabilitation procedure and after a two-month period following the decision for the opening, a moratorium/stay on all enforcement actions against the company's assets may be granted by the Court upon application of the debtor.

The agreement shall be ratified by the Court in the event that: (i) the company is deemed to be viable through the rehabilitation agreement; (ii) there is no impairment of the collective satisfaction of creditors; (iii) the rehabilitation procedure is not the product of fraud or any other unfair or bad faith acts of the debtor, a creditor or a third party and does not violate mandatory law; and (iv) it provides for equal treatment of creditors ranking in the same position.

The GBC adopts the international trend on the super-seniority of "new money" in an attempt to encourage new lending, since post-application loans are considered super-privileged.

Non-judicial procedure ("pre-pack"). The non-judicial procedure aims at the direct ratification of the rehabilitation agreement skipping the stage of the submission of an opening application. This option actually grants to the debtor the opportunity to conclude the rehabilitation agreement through confidential negotiations and present it directly to the Court only for ratification avoiding all negative publicity that the formal opening of the procedure may reserve for the enterprise. A company may opt for the non-judicial rehabilitation procedure, once it has ensured the consent of the required majority of creditors representing 60% of the total claims – 40% of which should be secured – in order to reach the agreement. For the validity of the agreement by means of confidential negotiations, the agreement may be circulated for signature or signed within an unofficial meeting by creditors representing the above majority. Again an expert's report should mandatorily accompany the application for ratification of the agreement, while the option of preventive measures for the stay of enforcement actions is also available in this case.

Likewise, the provisions on the super–seniority status regarding new money are also applicable under the pre-packaged option above.

Special liquidation process

The procedure of special liquidation has been re-instated with various amendments mainly concerning cases where it is possible for the business to be rescued as a going concern by means of a swift sale of its assets to interested investors though public auction conducted by a liquidator appointed by the Court. The debtor should only submit to the Court the application for special liquidation together with: (i) a certification of a bank or an investment firm confirming the existence of a solvent investor interested in purchasing the assets of the enterprise; and (ii) declaration of the liquidator, who is recommended by the debtor, that he is willing to assume such a task and a relevant expert's report, together with a statement for the existence of the required funds. Following the decision which accepts the application, the court appoints a liquidator who is responsible for conducting a number of actions in order to transfer the assets of the enterprise and to satisfy the claims of creditors out of the proceeds of the liquidation.

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The Court accepts the application once it ascertains that the prospects for the preservation of the business are enhanced and that a number of working places are rescued without however the collective satisfaction of creditors being impaired. Together with the decision that accepts the application, the Court appoints the liquidator.

Evidence on the popularity of the proceedings

Since the codification of the GBC in 2007, the introduction of the pre-insolvency regime of the conciliation procedure was considered an exceptionally popular tool for enterprises facing financial difficulties. Notably, it has been reported[4] that from December 2009 until September 2010, 1,000 applications for the opening of the conciliation procedure were accepted. The trend has continued at a more moderate pace also with respect to the current rehabilitation procedure. A significant number of companies have filed for opening and according to official data of the Ministry of Justice made public,[5] as from September 15, 2011 – the day of enactment of rehabilitation – until mid-December 2012, 640 companies filed for the opening of rehabilitation procedure, while 174 of those applications were approved.

In contrast, it seems that the number of filings of companies for special liquidation before the Athens Court is very limited, while there is a growing trend to follow pre-packs wherever possible.

Concluding remarks

The law on rehabilitation in the short period of its implementation in practice has revealed a number of issues, which have been seen to weaken the effectiveness of the institution in general. Firstly, the time-consuming Greek judicial system imposes serious obstacles to a firm's attempt for rescue. Although the GBC provides for rather short deadlines on the whole court supervised process, starting from the opening of the procedure until the ratification of the rehabilitation agreement, these are practically rarely met due to the difficulty of the system to manage the overfull dockets of the Courts. Needless to say, that for financially distressed companies, time is what matters the most. Although, there are procedural methods which can often work in practice with the view to mitigating the above inefficiencies, an attempt to ensure that the deadlines provided in the GBC will be observed as far as possible in practice is more than welcome.

Another argument which is also raised at times is that the rehabilitation procedure and more particularly the provisions on the preventive measures (protection from creditors), in practice can become a tool in the hands of a debtor who wish to simply earn some more time, to "legally" delay payments and suspend enforcement actions against its assets for a certain period of time. However, this may consist of a "necessary evil", since the availability of a mechanism for moratorium is vital in serving the objective of reorganisation. In the absence of similar provisions, the procedure could have been easily upset by one or more of the creditors ("free riders"), who would attempt to block any progress made to attain their individual goals.

The above being so, the – desired in principle – diversity of options available for the debtor to reach an agreement, court-supervised procedure or the pre-pack solution[6] leaves room for procedural abuse, if used in an evasive manner; in this context, often debtors have been tempted to follow parallel or separate sets of proceedings at the same time (both ordinary proceedings and/or pre-packs). For instance, a debtor may file for the opening of a court-supervised procedure which is scheduled to be heard on a certain date, while it could possibly have informed certain creditors for such action, or even be under negotiations with some of them, who are waiting to participate at the hearing of the case. At the same time and while the hearing is still pending, the same debtor may file for the ratification of a pre-packaged plan agreement with the required majority, while the initial group of creditors are not aware of such a development. This may initially provide to unscrupulous debtors the illusion that they are kept beyond the reach of some creditors; however, in most cases they end up affecting the trust embraced in the creditor-debtor relationship and finally in the whole procedure as an institution.

The idea of a temporary relief towards creditors proves to be short-lived, when creditors hit back to them exhausting the legal means available.

Similar manipulation of the proceedings and abusive acts in general may be limited through the introduction of the proper legal provisions in the interest of the fair rescue of the business, which will serve procedural economy and benefit creditors and debtors alike.

Since the codification of the GBC in 2007 until now, the pre-bankruptcy regime has been the object of debate and negative publicity particularly regarding the possibility of abuse. Its efficiency and contribution to the business sector and the economy in general, especially under the current adverse financial conditions, may only be measured in a reasonable time-span, when gradually jurisprudence on the relevant provisions will also be maturing.

Future developments

A new reform (adjustment) of insolvency legislation was announced in January 2012; if this proceeds, it will be the fifth attempt for changes in a period of more

than five years.[7] It has been announced that the amendments will be two-fold: on the one hand an attempt to transform the provisions of the post-bankruptcy reorganisation procedure (restructuring plan) of art. 107 of the GBC with the view to rendering them more workable in practice;[8] on the other hand, it was reported that the provision allowing the Greek State and social security funds to participate in rehabilitation procedures and the relevant agreements compromising their claims as any private creditor would (e.g. agreeing haircuts, extension of payment schedules) will change, thus keeping such public-sector creditors completely out of the rehabilitation procedures in an effort to avoid that their position as creditors is in any way diminished.

While there can be no objection as to any efforts to enhance the operation in practice of the legal framework of the reorganisation of art. 107 of the GBC, objections have already been voiced against any transformation concerning the position of the Greek State, as a creditor.

Practical experience in this respect shows that any attempts of debtors to render the Greek State subject to limitation of its claims has very rarely been accepted by jurisprudence and debtors have more often than not avoided affecting the position of public-sector creditors, for fear of introducing a significant negative element of prejudice to their restructuring plans.

Lastly, in the directors' liability front, the recent strong tendency of public prosecutors in activating the severe provisions of law on criminal liability of managers, in cases of debts to the State, the social security organisations as well as employees,[9] has certainly not gone unnoticed. On a relevant note, it can be expected that a similar tendency may gradually appear in cases of abuse and defrauding creditors, by application of the detailed criminal provisions of insolvency law.[10]

Notes:

1 A similar procedure was in use before the introduction of the GBC on the basis of art. 46a of Law 1892/1990.

2 The principle of non-impairment of the "collective satisfaction" of creditors is repeatedly met in the GBC concerning the restructuring tools available and seeks to ensure that creditors will not receive less than they would through ordinary liquidation.

3 The expert may be an auditor (individual or firm) or credit institution.

4 "Kathimerini" newspaper 19-9-2010.

5 Before the Greek Parliament – doc. No 763/24-1-2013.

6 Pre-packs may be introduced for almost an unlimited number of times, while a rehabilitation agreement has still not been ratified by the Court.

7 The introduction of the GBC in 2007 also included.

8 This process although is prescribed in detail in the GBC has very seldom – if at all – been implemented in practice.

9 Such liability can be considered *quasi* objective, since in some cases it can be imposed on directors, simply for holding the relevant office at the time when the respective debts were created.

10 The GBC (art. 171-177) contains a full spectrum of insolvency crimes ranging from illegal disposal of assets during the suspect period to preferential treatment of a creditor, etc.

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