CHSHCEE Newsletter

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CHSHCEE | Austria

Crowd financing at risk? Court rulings challenge the concept of subordinated loans

Rulings by the Regional Court of Graz and the Higher Regional Court of Graz have recently been challenging one of the most popular forms of crowd financing in Austria: subordinated loans.

In recent years the terms crowd funding and crowd investing have become more and more popular and financing a business project through different forms of "public participation" is already well established within the mainstream of corporate financing. Especially in the case of funding for SMEs or start-ups, the recent financial crisis has resulted in banks introducing more restrictive loan policies. In turn this led to the creation of different forms of crowd financing as an alternative to the less exciting and harder-to-get bank loans.

In Austria a specific form of crowd lending (or lending-based crowd funding), i.e. where a multitude of investors (private individuals as well as companies) grant micro-loans to a company, has risen to fame and has recently led to court decisions that could shut down major parts of the domestic crowd financing scene.

The reason lies in the details of the loan agreements used by a large part of Austrian crowd lending providers. They include a so-called qualified subordination clause, which puts the lenders in a similar position to the shareholders of the company they invest in, at least with regard to the repayment of the funds they invest. Under a subordinated loan agreement, a lender may not demand repayment of the principal, as well as any interest due thereon, so long as the company is insolvent or over-indebted, or if one of these circumstances were to arise as a result of the repayment.[1] As a consequence, subordinate lenders are regularly at risk of losing their entire investment in the event the company experiences financial difficulty.

The reason why subordinated loans are used instead of regular loan agreements for the purposes of crowd lending is quite simple. By granting only a conditional repayment

[1] *Simonishvili/Zollner*, Nachrangdarlehen und Prospektpflicht, ÖBA 2016, 804.

claim to the lenders, it is possible to avoid the need for a banking license under the Austrian Banking Act (*Bankwesengesetz*).[2] The requirement to obtain a banking license for any form of crowd financing would render this method of funding pretty much useless, especially to SMEs and start-ups.

From a civil law perspective it is not entirely clear how subordinated loan agreements should be assessed. Given that, based on these kinds of loan agreements, money is being collected from a multitude of (micro) investors, they are usually classed as General Terms and Conditions[3] (GTCs) and consequently become subject to two specific tests applicable to GTCs.

It should first be assessed whether a given qualified subordination clause is so unusual, prejudicial and surprising that it fails to become an integral part of the agreement at all. This first hurdle should not be too much of an issue as long as the agreements are designed and drafted in such a way that makes its subordinated character obvious to prospective lenders (e.g. by specifically pointing out the subordination clause to the prospective investor).

Additionally, a clause included in GTCs that does not specify any of the principal obligations of either side may not put the contracting parties at a gross disadvantage, otherwise such a clause is declared null and void. This is the issue when it comes to subordinated loan agreements.

In June 2016 the Regional Court of Graz concluded that a qualified subordination clause in a consumer loan contract constitutes a significant departure from legal default rules regarding loan agreements and would therefore require objective justification.[4] The fact that these kinds of loan agreement often stipulate an above-average interest rate is, according to the court, insufficient justification because a subordination clause assigns entrepreneurial risk (to the extent of the loan) to the lenders without them participating in any potential commercial success of the company. The main argument against the validity of subordination clauses can therefore be summarized as follows: if a loan agreement – through the inclusion of a subordination clause – puts the lenders in a

[2] *Waldherr/Ressnik/Schneckenleitner* in Dellinger, Bankwesengsetz[8] § 1 Rz 22.

[3] *Haghofer*, Zur Wirksamkeit qualifizierter Nachrangklauseln, VbR 2015/27.

[4] Decision issued by the Regional Court of Graz on 10 June 2016 in case 35 Cg 153/15t.

similar position to the shareholders regarding the potential downside associated with such a position (getting paid last in the event of financial difficulty), they should also be in a similar boat when it comes to the potential upsides of being a shareholder.

This decision was confirmed in its main parts by the Higher Regional Court of Graz in March 2017.[5] The consequence of this legal view is that qualified subordination clauses in consumer loan agreements will be declared ineffective and therefore the precondition for being exempted from banking license requirements would cease to exist, meaning almost all crowd lending providers in Austria would be at risk of being in violation of banking supervision law. Since it is not a feasible option for them to obtain a banking license, this type of funding could very well cease to exist.

The Austrian crowd lending scene therefore eagerly awaits a decision by the Austrian Supreme Court regarding this matter that hopefully clarifies the legal situation of subordinated loan agreements. Alternatively it would be in the hands of the legislator to finally regulate subordinated loans in a comprehensive fashion and put an end to ongoing discussions regarding this financial instrument.

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[5] Decision issued by the Higher Regional Court of Graz on 30 March 2017 in case 4 R 142/16h.

CHSHCEE | Belarus

Securitization of Receivables Introduced in Belarus

Edict No. 154 of the President of the Republic of Belarus "On the Financing of Commercial Entities Against the Cession of Rights (Claims)" (the "Edict") was adopted on 11 May 2017 and will enter into force on 1 July 2018. It provides Belarusian companies with the possibility to receive financing by means of the securitization of their receivables.

How does securitization work?

Securitization is a complex transaction. Initially, a company with receivables (the “Initiator”) assigns its claims under loan and/or credit agreements to a special financial organization (the "SFO") and receives financing from this SFO. The funds for financing an Initiator stem from bonds issued by an SFO. The bonds are collateralized with the assigned claims. An SFO pays off the issued bonds upon recovery of the outstanding receivables. The margin between the collected receivables and payments under the retired bonds constitutes the income of an SFO.

In fact, securitization is a new type of financing in Belarus, which creates a great opportunity for Belarusian banks and other companies that have significant receivables.

What are the mandatory requirements for securitization?

First, the securitization services in Belarus may be rendered by SFOs only.

Second, a cession contract between an Initiator and an SFO must provide for the following mandatory conditions:

- A cession contract must be made in writing. Otherwise, it is considered null and void.
- A cession contract must clearly set out the procedure for recovery of the receivables by an SFO.
- An Initiator must assign to an SFO all monetary claims vis-à-vis a debtor including but not limited to the principal, penalties, interests, pledge rights and other similar rights.

Third, the total value of bonds issued by an SFO in order to provide financing for the Initiator may not exceed certain limits vis-à-vis the amount of underlying debts. The debt-bond ratio will be established by the Securities Department of the Ministry of Finance of the Republic of Belarus.

Finally, the Initiator is required to purchase 5% of the respective bonds issued by the SFO.

What are the requirements for providers of securitization services?

Only companies meeting the following criteria may qualify as an SFO and provide securitization services, in particular:

- Exclusive business. An SFO must not conduct any other type of business except for securitization services and some related transactions.
- Sole depositary. An SFO may not engage with more than one specialized depositary company. Such specialized depositary company must consolidate, store and keep records with respect to all assigned claims and all other financial assets of an SFO.
- Professional staff. A sole CEO of an SFO, members of an SFO's collective management body (if any) and other employees of an SFO authorized to sign on behalf of an SFO must have professional certificates evidencing their qualifications as securities market experts issued by the Securities Department of the Ministry of Finance of the Republic of Belarus.
- Annual audit. An SFO must ensure an annual audit is conducted of its financial reports.
- Statutory fund. The statutory fund of an SFO may be paid in cash only. In-kind contributions of any kind are prohibited.

Summary

Although securitization has been used for decades in many countries, for Belarus it is a new and undoubtedly progressive instrument that could be used by companies for the purpose of raising funds. In addition, securitization will provide creditors with an opportunity to minimize the risk of default under outstanding credits and/or loans. Therefore, the Edict is welcomed by the business community as it will potentially contribute to improving its economic freedom and stability.

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CHSHCEE | Bulgaria

Amendments to labour legislation

- Amendments to Regulation No. 5/2002 on the content of and procedure for sending notifications under Article 62 para. 5 of the Labour Code were published on 17 March 2017, effective as of 1 April 2017. The amended regulation defines the content of and procedure for sending the notifications that employers are required to submit to the National Revenue Agency in relation to the execution, modification and termination of labour contracts. The amendments introduce new templates and requirements for additional information provided by employers. As the new provisions also apply to employment contracts executed before April 2017, employers would have to provide updated information in relation to all current employees not later than 30 October 2017. This may prove to be a significant burden on employers with a large workforce.

- Amendments to the regulation of working hours, work breaks and holidays were published on 23 May 2017. The amendments relate to the processing of and the templates used for recording working hours, breaks and holidays, and they also provide detailed rules applicable to the so-called summation of working time.

- A new regulation on medical examinations was published on 27 June 2017, replacing the previous regulation from 2010. The new legislation regulates such topics as employee sick leave, disability, issuance of medical sick notes, and occupational diseases.

Amendments to Regulation No. 16/2009 on the licensing of payment institutions, electronic money institutions and payment system operators

Amendments to Regulation No. 16/2009 on the licensing of payment institutions, electronic money institutions and payment system operators, issued by the Bulgarian National Bank, were published in June 2017. The most significant changes relate to:

- notifications and the reporting requirements imposed on payment institutions, electronic money institutions and payment system operators.

- Credit institutions licensed in other member states will no longer be able to provide money remittance services through agents. Such credit institutions are required to comply with the new rules not later than 1 April 2018. Providing money remittance services through agents will continue to be available to payment institutions licensed in other member states.

Significant case law

In order to harmonise and unify court practices, the Bulgarian Supreme Court of Cassation recently ruled on the interpretation of certain legislation in relation to enforcement proceedings. The court's Interpretative Decision No. 3 of 10 July 2017 is aimed at unifying inconsistent court practices on various topics, such as controversial practices relating to public sales of real property, defining which acts taken by enforcement officers can be appealed, the admissibility of certain enforcement claims, and the guidelines for some enforcement methods.

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CHSHCEE | Czech Republic

New protection measure under Czech criminal law enabling the seizure of property

With effect from 18 March 2017, the Criminal Code and the Code of Criminal Procedure (including another related piece of criminal legislation) were amended by Act No. 55/2017 Coll. (the “**Amendment**”). The Amendment introduced into Czech law a new protection measure which enables the authorities to seize part of a convicted person’s property in favour of the state. The Amendment has transposed into Czech law Directive 2014/42/EU of the European Parliament and of the Council of 3 April 2014 on the freezing and confiscation of instrumentalities and proceeds of crime in the European Union.

Who might be affected

The new kind of protection measure is enshrined in Section 102a of Act No. 40/2009 Coll., Criminal Code, as amended (the “**Criminal Code**”) and entitles the Court to seize part of a convicted person’s property if the Court suspects that the convicted person financed the purchase of the respective property with funds from criminal activity given that the value of the property is grossly disproportionate to the convicted person’s income derived from gainful employment or another fact justifies the drawing of such a conclusion. The five years preceding the commission of the crime of which the person is convicted is used to evaluate the convicted person’s income.

The protection measure can only be applied to some offenders. The first condition which has to be met is that by committing the crime the offender acquired or at least attempted to acquire a material gain for himself or for a third party. Moreover, a legally effective judgement for an intentional crime for which the maximum sentence is a term of imprisonment of at least four years, as prescribed by the Criminal Code, has to be present.

A further condition is the existence of a legally effective judgment for an intentional crime for which the Criminal Code prescribes a maximum custodial sentence of four years. Regardless of the upper limit, the protection measure may also be applied in the

case of some crimes exhaustively stated in the Criminal Code, such as bribery or indirect corruption.

The Criminal Code also governs these situations when the offender tries to keep the property acquired from criminal activity by transferring it to a third party. Section 102a of the Criminal Code entitles the Court to seize part of the property if the offender transferred such property to: (i) a third person free of charge or under remarkably unfavourable conditions and such person knew or should have known that the transfer is being made in order to avoid the seizure or that the property was acquired using funds gained from criminal activity, (ii) a close person, (iii) a legal person over which the offender has a decisive influence, (iv) a trust, or (v) the offender acquired the property into common property of spouses. During the criminal procedure, these persons are given a chance to prove the origin of the funds used to purchase the property in order to avoid the seizure. Last but not least, it has to be said that a legal person as well as a natural person may be held criminally liable under Czech law and therefore the Amendment potentially influences all of the companies operating in the Czech Republic.

Declaration of assets and execution of the protection measure

In order to enable the smooth execution of the protection measure in practice the Amendment also introduces some new provisions into Act No. 141/1961 Coll., Criminal Procedure Code, as amended (the "**Criminal Procedure Code**"). Under Section 7a of the Criminal Procedure Code, the Court, and – during pre-trial proceedings – also the prosecutor and police authority, is newly entitled to ask a person whose property is under investigation (or a person close to this person) to make a declaration on assets. The declaration is intended to identify the bank accounts of those concerned and provide information and clarification regarding the employer, salary/wage, all assets owned and its location.

Furthermore, the prosecutor or the Court is entitled to ask the tax authority for information on declared income tax and the provision of such information is not deemed a breach of a confidentiality obligation under the tax code. In a similar way, some of the information subject to banking secrecy may be disclosed on the basis of provisions of the Criminal Procedure Code.

Finally, if the accused person is prosecuted for a crime in respect of which property can be seized and it is likely that the conditions for applying this protection measure will be met the Court (and in pre-trial proceedings the prosecutor) is entitled to freeze the property of the accused person under Section 358b of the Criminal Procedure Code.

Conclusion

It is clear that the Amendment will not only become an effective instrument in the fight against crime, but it will also be the subject of many legal disputes in light of the vague term "gross disproportion" and the relatively long decisive period related to the evaluation of income. With respect to the recent date of effectiveness of the Amendment, it is necessary to await respective case-law. However, what is already certain is that internal compliance programs may not ignore the Amendment since suspicion alone is all it takes for a company's assets to be frozen.

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CHSHCEE | Hungary

New rules on the liability of ex-directors of failed companies

An amendment to Hungary's Bankruptcy Act has introduced new rules applicable to lawsuits that are filed in "findings" and "award" procedures after 1 July 2017. The changes are two-pronged: on the one hand, the rules on exemptions have become more restrictive, but on the other, creditors should not be too happy either because some of the rules now make it harder for them to recover their claims.

In short, management liability as regulated under Section 33(A) of the Bankruptcy Act means that the creditors of a company that is subject to compulsory liquidation may seek

to recover debts owed to them directly from the company’s director if the director is liable for the fact that the creditor’s claims cannot be satisfied. A director is a person who directed the company’s operation and disposed over its assets before the start of its compulsory liquidation (i.e. not only executive officers who are recorded in the company register, but shadow directors as well). If a director of a company that has become or is close to becoming insolvent makes decisions or takes actions that prevent the company’s creditors from fully recovering their claims, the creditors will be able to seek satisfaction of their claims from the director’s private assets. Such decisions and actions typically include making unsecured loans to companies with liquidity problems, the sale of the company’s assets in exchange for unrecoverable debts, or a situation where the director cannot account for the company’s assets. A director may be instructed by a court to pay off the company’s creditors in a two-stage procedure: in the first stage, it is established whether the director is indeed liable for the situation (the “findings” procedure), and if the director is found liable, the court instructs him or her to make the payment (the “award” procedure). Another special feature of this combined process is that the petitioners in the findings procedure and the award procedure are not necessarily one and the same. The court may establish the director’s liability on the basis of a lawsuit filed by a single creditor, and then the director will be required to make a payment to all creditors who/which have not received the full amount of their claim in the compulsory liquidation procedure and have initiated an award procedure.

The amendment once again means creditors are unable to file a lawsuit against directors during the compulsory liquidation procedure on the basis of an interim balance sheet. Additionally, the deadline to file a lawsuit in an award procedure has been extended from 60 to 90 days after the judgment is made in a findings procedure, and the liquidator is now required to inform all creditors that a findings procedure has been initiated against a director. The purpose of these modifications is to protect the interests of creditors who do not participate in the findings procedure.

The modifications make it clear that the purpose of a findings procedure is to determine whether the director had regard for the interests of the creditors after the situation that threatened the company with insolvency first arose, i.e. whether he or she took action to prevent the reduction in the value of the assets available for the payment of creditors. If the director did not comply with this duty and the value of the company’s assets diminished, or he or she otherwise created a situation that prevented the full satisfaction of all creditors’ claims, the director will held liable and pay such claims from his or her own private property. However, any payment that reduces the value of a company’s

assets (e.g. the ongoing payment of accounting fees) will also reduce the value of assets available for satisfying the creditors' claims, and therefore, as a result of the modification, directors will be exempt from liability not only if they can prove that they took all reasonable steps to avoid losses and requested action from the company's main decision-making body, but also if they can prove that the payments did not constitute unreasonable risks in light of the company's financial situation. Consequently, the Bankruptcy Act now implies that actions involving unreasonable risks violate the creditors' interests (a typical example would be unsecured lending as noted above).

The rule that makes it difficult for directors to seek exemption from liability if they failed to publish the annual report or deposit it with the court of registration remains in place. The Bankruptcy Act now makes it clear that the strict rules apply not only if a director did not prepare or publish the annual report but also if he or she did not comply with this obligation properly. On the other hand, the stricter rules will only apply to a failure to fulfil these obligations if the director is at fault for such non-compliance.

There is a major change in the way in which the security that can be requested in a findings procedure is regulated. The purpose of this modification is to secure the claims of the creditors who bring an action against directors in the follow-up award procedure. The modification does indeed offer stronger protection for creditors, but it also adds extra requirements that they or the liquidator have to meet in the award procedure. Under the previous rules, the determination that a director was liable, or even the likelihood of such determination, was enough to require him or her to provide security (on the grounds that the existence of liability reasonably raised the prospect that the director might not be willing to pay at the end of the award procedure). However, from now on creditors or the liquidator must provide evidence why the court should instruct the director to provide such security. The Bankruptcy Act does not offer any guidance about what such evidence should be, and courts will probably use the rules on interlocutory injunctions or precautionary measures as a starting point. In our view, however, it is highly questionable how liquidators and creditors, who generally have no access to the relevant information and evidence, will be able to meet this extra requirement. On the other hand, the position, also espoused by the Supreme Court, that a request for the provision of security can be filed at any time during the findings procedure and that the court must make a decision on such a request in an expedited procedure (rather than only in the final judgment issued in the case) is now regulated in the Bankruptcy Act. The purpose of the incorporation of this rule in the Act is to

neutralise a drawback of the two-phase procedure because creditors often end up after years of litigation with nothing more than a moral victory and no money recovered.

Finally, the modification makes it clear that the various levels of priority in which the creditors' claims are satisfied in a compulsory liquidation procedure will not apply in an award procedure, i.e. the various priority categories dissolve and the petitioners in the award procedure (i.e. creditors who did not receive any payment from the debtor and filed the lawsuit in the award procedure) will proportionately share the security, which must be provided in cash by the director after the establishment procedure is concluded.

In summary, the modification of the rule on the liability of directors is certainly welcome, but it is likely to fall short of the goal of bringing to account directors who engage in wrongful trading because they tend to exhibit great creativity in avoiding liability. Additionally, the prohibition of seeking an award on the basis of an interim balance sheet and the introduction of stricter rules on securities will reduce the chances of creditors recovering their claims.

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CHSHCEE | Romania

Use of buildings for which fire authorization has not been obtained

Under the Romanian Law on Fire Protection, fire authorization must be obtained before the construction of any building begins. This obligation also exists if certain modifications are made to such buildings. The building categories for which fire authorization must be obtained are approved by a Government Decision. In this respect, the building categories for which a

fire safety permit and/or fire security approval is mandatory are regulated by a Government Decision.

According to the legal provisions, fire authorization must be obtained for buildings with certain minimum surface areas. For example, it is mandatory for fire authorization to be obtained for the offices of local and central public authorities with a surface area higher than or equal to 600 sqm, whereas under the old legislation it was mandatory for fire authorization to be obtained irrespective of the surface area of the building. The Romanian Law on Fire Protection also states that fire authorization must be obtained by the beneficiary of the investment or by the natural/legal person financing or making a capital investment in the pre-existing building.

With regard to buildings constructed in respect of which fire authorization was not obtained, the legislator established an obligation to obtain such fire authorization no later than 30 June 2017. The deadline by which fire authorization must be obtained was postponed until 30 September 2017.

In light of the extended deadline for obtaining fire authorization, the legal provisions lay down that no fine will apply in the case of beneficiaries who submit documentation by 30 September 2017 or have projects which are in the process of receiving financial approval. According to the legal provisions, the fine will not be applied if the compliance term does not exceed 31 December 2017.

It is important to note that according to the legal provisions, if fire authorization is lacking, the beneficiary of the investment is liable until fire authorization is obtained.

Although the buildings constructed may be used until 30 September 2017 in the absence of fire authorization, there may be certain situations in which the competent authorities decide to restrict any and all use of the building until such time as fire authorization is actually obtained.

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CHSHCEE | Slovak Republic

Discharging debts

The amendment to Act No. 7/2005 Coll. on Bankruptcy and Restructuring, as amended (hereinafter referred to as the “ABR”), effective from 1 March 2017, has implemented into Slovak law a new instrument for discharging the debts of natural persons.

Pursuant to the latest amendment, debts may be discharged by one of two procedural methods stipulated in the fourth part of the ABR. The first option is discharge by bankruptcy and the second option is discharge in the form of a repayment schedule. The debtor is able to choose the procedural method subject to fulfilling legal requirements. In case both discharge methods apply, it must be demonstrated that enforcement or similar proceedings are held with respect to the debtor. At the same time, the mandatory representation of the debtor by the Legal Aid Centre or by an Attorney-at-Law designated by the Legal Aid Centre was introduced in order to prevent surreptitious actions and an unnecessary decrease in the insolvency assets due to the costs of representation. Only the debtor is authorised to file for bankruptcy or file an application for a repayment schedule. The court decides on the discharge by issuing one decision together with a declaration of bankruptcy or by introducing a repayment schedule. The ABR precisely determines which receivables may be settled in bankruptcy proceedings or by introducing a repayment schedule, which receivables are excluded from settlement and which receivables remain unaffected. In case debts are discharged by bankruptcy being declared, the debtor benefits from the right to exclude part of his/her dwelling from bankruptcy proceedings, which – pursuant to the Order of the Government of the Slovak Republic No. 45/2017 Coll. implementing certain provisions of the ABR – is set at EUR 10,000. The debtor is entitled to use no more than EUR 250 per month from this amount from a separate bank account. It is necessary to draw attention to the fact that the discharge by bankruptcy also brings with it another consequence: termination of undivided co-ownership of spouses (hereinafter referred to as the “UCS”). UCS assets form part of the bankruptcy assets. The other spouse has a right vis-à-vis the bankruptcy assets to have the untouchable value of the dwelling released from the bankruptcy assets, in case a dwelling of the debtor belonging to the UCS was included in the bankruptcy assets.

In our opinion, discharge by introducing a repayment schedule may be more advantageous for the debtor due to the fact that the debtor will not lose all his/her property which would be subject to bankruptcy, but the debtor would be obliged to meet the repayment schedule over a period of five years. The legislator determines the conditions which must be met when determining the repayment schedule. The repayment schedule must satisfy receivables of at least up to 30%. Under the repayment schedule, the receivables of creditors must be satisfied by at least 10% more than they would be satisfied in bankruptcy proceedings. The repayment schedule becomes ineffective if a declaration of bankruptcy is issued regarding the assets of the debtor. The legal certainty of creditors may be negatively affected by a repeated discharge of the debtor who is entitled to seek a repeated discharge by bankruptcy or by the introduction of a repayment schedule after ten years have elapsed since bankruptcy was declared or a repayment schedule was introduced.

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