



Public aid as part of the restructuring procedure: Private Creditor Test exemplified by limited liability company under restructuring

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Abstract When the new Restructuring Law entered into force on 1 January 2016, it opened a lot of possibilities for entrepreneurs to use aid for the purpose of keeping a company on the market. As part of the procedure, it is necessary to determine whether the granted aid does not constitute incompatible public aid that disrupts free market rules. The answer to this issue is provided by the private creditor test and the private investor test. The objective of the article is to present the developed method of a private creditor test for the restructuring of a company in which one of the authors participated as an auditor. The article presents the method which allows verification of justifiability of participation of a public creditor in the process of debtor restructuring. The method was developed on the basis of hitherto studies and practical experience of the authors. The Wilcox method was used in one of the test stages to assess property. The prepared method has been successfully applied in other cases of company restructuring, and the case presented in this article is used to explain the principles of operation.

Key words: restructuring, creditor's test, *de minimis* aid

JEL codes: at least, two, JEL, codes

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1. Introduction

Changing economic and legal environment, coupled with ongoing development of economy, poses a great challenge to persons who pursue or manage economic activities. It requires not only continuous analysis of the environment and introduction of changes which may enhance the competitiveness of products or services offered on the market, but also ensure liquidity and profitability for the operating company.

Every entity pursuing economic activities has to take risks to which it is exposed into account and should be able to identify them. Risk is more dangerous when a company is less resistant to threats and the managers are not aware of their occurrence. Incorrect interpretation of risks and absence of proper correcting activities may compromise liquidity and profitability of the conducted business and, in consequence, cause its insolvency and bankruptcy. The Restructuring Law, introduced on 1 January 2016 (Journal of Laws [Dz.U.] of 2016, item 1574), which allows for the performance of restructuring activities aimed at maintenance of conducted activity, is intended to prevent such a status. Introduction of new legal regulations offers a number of possibilities for escaping a difficult situation, yet it also carries a number of restrictions in this area. In particular, this refers to the public aid. Art. 140 of the Restructuring Law specifies that “if, during a restructuring procedure, aid is granted to an entrepreneur by the state or with the use of state resources,” the prepared restructuring plan should contain a private creditor test or a private investor test.

In the literature and in practice, the term private creditor test and the method of its performance in relation to absence, in the bankruptcy law, of relevant regulations for the restructuring process of companies, has not functioned to-date. Relying on hitherto studies and experience, the authors have prepared and conducted a method of verifying the economic justifiability of public creditor’s participation in the process of a debtor's restructuring.

Issues related to the preparation of a private creditor test will be presented using the example of a limited liability company from the furniture industry with respect to which sanation proceedings were initiated based on a court decision.

2. Public aid in Polish and European legislation

Polish economy, as well as the economies of the EU states rely on the principles of maintaining competition among entrepreneurs, implementation of market economy and sustainable development principles. Regulations in this respect are contained in the Treaty on the Functioning of the European Union (TFEU) of 30 April 2004. In line with Art. 107 of the TFEU, any aid granted by a Member State or through State resources in any form whatsoever, which distorts or threatens to distort competition, is incompatible with the internal market regulations. The provisions on granting public aid by State authorities and through State resources are regulated in Art. 140 - 149 of the Restructuring Law in the Polish legislation.

On account of the fact that the regulations of the Restructuring Law are, in principle, aimed at offering support to the debtor by creditors in general, it is necessary to specify, in the strict sense, what constitutes public aid and whether it is compliant with the common market regulations. Not every form of aid is considered incompliant with the binding rules of the free market. Granting *de minimis* public aid to an entrepreneur in the course of subsequent three years, not exceeding a specific amount depending on the sector of economy is permissible; the following limits were determined for economy sectors (Geronim 2016: 101):

- road transport sector: EUR 100,000;
- agricultural sector: EUR 15,000;
- sector of companies providing services in general economic interest: EUR 500,000, sector of other companies: EUR 200,000.

In line with the applicable legal doctrine, forms of public aid include (Gurgul 2016: 1099):

- funds directly expended from the budget. Such aid includes all types of financial and material subsidies, preferential loans, investments made from public funds, use of privileged position during tenders for certain entities;
- the state and territorial government authorities refraining from enforcement of funds due to them, mainly in the form of exemptions and tax discounts;
- indirect form of assistance which constitutes an individual discount in the form of repayment of debt in instalments or deferred repayment date.

Granting public aid in the restructuring process is possible after fulfilment of the following terms, which should be contained in the restructuring plan:

- allowing the entrepreneur to return to the competitive market and accomplish a capacity to cover the cost of current operational activities in a short-term perspective, as well as accomplish long-term profitability and capacity to generate positive profit;
- granted funds should allow for removal of the causes of a difficult economic situation;
- maintenance of the company helps reduce social difficulties and overcomes market imperfections manifested via the risk of quitting the market by an entrepreneur who conducts innovative activity, quitting the market by an entrepreneur that has local connections, which may have adverse consequences for a given region, including the risk of growing bankruptcy of local companies and higher unemployment.

A measure that allows evaluating whether given aid granted to an entrepreneur by the State authorities does not violate the principles of fair competition is the private creditor test or the private investor test.

3. Private Creditor and Private Investor Test

If a restructuring plan assumes financing a debtor from public funds, it is necessary to conduct a private creditor test, determining whether a public creditor behaves like a private creditor acting in standard market conditions (Art. 140.2 of the Restructuring Law) and the private investor test (Art. 140.4), aimed at “evaluation of activities undertaken by a financing entity, performed to ascertain whether support does not constitute public aid.” Support, which is offered on terms which would be acceptable for a private investor and with respect to which the question whether the debtor could procure similar financing on the free market is answered positively, does not constitute public aid. Financing in the restructuring procedure most frequently has the form of reduction of the principal receivable and interest vested in institutions and authorities representing the State Authority. Public law creditors who are vested with claims in a restructured company can agree to finance such a process via reducing the amount of such claims, yet only in the situation and upon terms acceptable for any other private creditor (non-public law). It is necessary to conduct a private creditor test to see whether the planned restructuring process balances the public law receivables with private receivables.

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The private creditor test should offer an answer to the question whether the proposed terms for a public law creditor are reasonable and whether a private creditor would accept such proposed terms of arrangement. The information should contain the amount of public law liabilities covered by the arrangement with respect to individual creditors and the content of arrangement proposals for every group of creditors.

To calculate the degree of satisfaction of claims, it is necessary to assume the value of property, along with indication of encumbrances and specification of its value, calculated with the use of the liquidation assessment, estimated costs of bankruptcy proceedings, divided into costs of termination of employment relationships, securing the property, costs of sale, remuneration of the receiver and persons hired by the receiver. The calculated value should offer an answer to the question whether the creditor would be satisfied to a higher degree via the performance of a restructuring procedure or whether the creditor would receive higher satisfaction in the course of the bankruptcy procedure (Zimmerman, 2016: 1307).

The private investor test is a type of private creditor test and it should contain the following information (Zimmerman, 2016: 1308):

- the expected level of return from the employed capital, specified on the basis of interest rate contained in the credit or loan agreement granted by a public entity;
- average date of return from the employed capital of comparable investments, determined on the basis of a financial market research;
- expected level of investment risk, which may be accompanied by individual risk assigned to a specific debtor, its financial standing, risk of undertaken specific investment, taking into account the industry risk, change of rates and legal and tax regulations;
- average level of risk of comparable investments, taking into account the general risk, industry risk and individual risk.

The private creditor test refers to receivables which emerged earlier, whereas the private investor test refers to receivables which may emerge as part of the constructed restructuring plan and performed arrangement in the form of new financing being granted. It may happen that the financing entity acts both as the investor and the creditor and then both tests should be performed.

If, during the restructuring procedure, a public law creditor is satisfied to a higher degree than in the course of the bankruptcy procedure, acceptance of arrangement proposals will entail

that the creditor behaves like a private creditor. The positive result of a private creditor test does not oblige the creditor to vote in favour of concluding the restructuring arrangement (Geronim, 2016: 102).

4. Private Creditor Test exemplified by a Limited Liability Company under restructuring

Legal provisions do not contain a methodology or operating principles for conducting a private creditor test. In the course of the study and during participation in restructuring proceedings conducted under the supervision of the District Court in Kielce, the authors drew up a method/model (describing its stages and tools) for conducting a private creditor test.

The authors present the prepared methodology of drawing up a private creditor test using the example of a limited liability company from the furniture industry under restructuring. The company operates on the market in Warsaw, which is characterised by severe competition, but also offers a number of possibilities of development and successful performance of a restructuring process.

At the first stage of preparing a private creditor test, it is necessary to determine all of the receivables held, which are going to be covered by the arrangement, along with taking into account the division into public law receivables, materially secured receivables, as well as other receivables.

In the case under discussion, the creditors that are covered by the restructuring arrangement include:

- public creditors:
 - the Social Insurance Company (ZUS), Warsaw Branch (table 1),
 - State Treasury - Head of the Tax Office in Warsaw (table 2),
- all creditors (table 3).

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Table 1. Breakdown of premiums for the Social Insurance Company covered by the restructuring arrangement

| | Social premiums (employer) | Health Insurance Fund | Interest and additional costs | Total |
|--------------|-----------------------------------|------------------------------|--------------------------------------|--------------|
| Total | 337,988.60 | 156,247.89 | 50,948.19 | 545,184.69 |

Source: Authors' own elaboration based on available financial data

Table 2. Breakdown of receivables from VAT and PIT

| Title: | Principal receivable | Fees and costs | Total |
|---------------|-----------------------------|-----------------------|-------------------|
| VAT-7 | 165,185.84 | 2,128.23 | 167,314.07 |
| PIT-4 | 135,781.90 | 5,084.00 | 140,865.90 |
| Total | 300,967.74 | 7,212.23 | 308,179.97 |

Source: Authors' own elaboration based on available financial data

Table 3. Breakdown of all receivables

| | Principal receivable | Fees and costs | Total |
|--------------------------|-----------------------------|-----------------------|---------------------|
| All creditors | 3,808,821.39 | 98,323.04 | 3,907,144.43 |
| Social Insurance Company | 494,236.50 | 50,948.19 | 545,184.69 |
| Head of Tax Office | 300,967.74 | 7,212.23 | 308,179.97 |
| Total | 4,604,025.63 | 156,483.46 | 4,760,509.09 |

Source: Authors' own elaboration based on available financial data

The next step is determination and assignment of receivables to relevant categories. In this case, creditors are divided into seven groups. In each of them, apart from group 5, reduction of interest and costs of proceedings was planned.

Table 4. Breakdown of all receivables

| Category | Creditors: division according to the amount of receivables in PLN (PLN) | Proposal of repayment of the principal receivable in % | Amount of reduction determined in % | Total receivables covered by the arrangement under the law | Costs and interest (PLN) | Amounts to be repaid after reduction (PLN) | Repayment start date | Date of repayment in month | Value of debt reduction (PLN) |
|----------|---|--|-------------------------------------|--|--------------------------|--|---|------------------------------|-------------------------------|
| 1 | Up to 10,000.00 | 80% | 20% | 185,528.77 | 0.00 | 148,423.02 | 8 months after final and legally binding approval of the arrangement | 18 | 37,105.75 |
| 2 | From 10,000.01 to 100,000.00 | 70% | 30% | 724,051.71 | 0.00 | 506,836.20 | 11 months after final and legally binding approval of the arrangement | 36 | 217,215.51 |
| 3 | Above 100,000.01 | 60% | 40% | 2,255,679.82 | 0.00 | 1,353,407.89 | 14 months after final and legally binding approval of the arrangement | 48 | 902,271.93 |
| 4 | Public law creditors excluding category 5 | 100% | 0% | 300,967.74 | 0.00 | 300,967.74 | 14 months after final and legally binding approval of the arrangement | 48 | 0.00 |
| 5 | Social Insurance Company | 100% | 0% | 545,184.69 | 50,948.19 | 596,132.88 | 14 months after final and legally binding approval of the arrangement | 48 | 0.00 |
| 6 | Claims of lessors | 100% | 0% | 12,065.73 | 0.00 | 12,065.73 | Until 30 day from final and legally binding approval of the arrangement | One-time | 0.00 |
| 7 | Creditors materially secured on the debtor's property | 100% | 0% | 631,495.36 | 0.00 | 631,495.36 | On individually agreed terms. | On individually agreed terms | 0.00 |

Source: Authors' own elaboration based on available financial data.

The next stage is determination of arrangement proposals for a public law creditor. For the Social Insurance Company, the following arrangement proposals were foreseen: repayment of interest in whole, repayment of the main receivable in whole (100%), in 48 instalments in the period of 14 months after final and legally binding approval of the arrangement.

For the State Treasury - Head of the Tax Office in Warsaw, the arrangement proposals include: forgiveness of interest in whole, forgiveness of costs of court and enforcement proceedings

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in whole and repayment of the principal receivable in whole (100%) in 48 instalments in the course of 14 months after legally binding approval of the arrangement.

With respect to private creditors, reduction of receivables depending on the value was foreseen: 20%, 30% and 40%. Assuming that a public law receivable has the character of a private receivable, it would be reduced by 40%. Arrangement proposals in this respect are more favourable for a public creditor.

After determination of all creditors and claims with which they are vested and after assigning them to a relevant group and offering arrangement proposals, it is possible to move to the next stage, which is the performance of the private creditor test based on the property held, shown in the inventory list and its assessment through one of the liquidation methods.

To carry out the private creditor test, the property was assessed at the liquidation value with the use of the premises of Wilcox method. **Wilcox Method:** it is a simplified method for assessing liquidation value of a company, aimed at determining the possibility of satisfying claims of the company's creditors (Hołda, 2015: 147). According to this method/ formula, the liquidation value is calculated as follows:

Figure 1. Wilcox Method

Wilcox Method/ Formula

| |
|--|
| 100% of the value of <u>the legal tender</u> |
| + 70% of the accounting value of <u>provisions</u> |
| + 50% of the value of remaining <u>assets</u> |
| - 100% of the value of <u>short-term liabilities</u> |
| - 100% of the value of <u>long-term liabilities</u> |
| = <u>Liquidation value of a company</u> |

Authors' own elaboration

It is a simple method for assessing the liquidation value of individual property assets in the case of a forced sale. The value of property subject to the test was corrected by the value of leased fixed assets on account of the nature of contracts: operating lease and a short term of lease.

The value of property applying the principles of assessment in liquidation value according to **Wilcox** method is presented below (table 4).

Table 4. Breakdown of all receivables

| Property items | Estimated market value | Estimated liquidation value |
|---|-------------------------------|------------------------------------|
| 1. Cash in hand | 4,283.90 | 4,283.90 |
| 2. Cash on bank accounts | 12,702.99 | 12,702.99 |
| 3. Real property and right of perpetual usufruct | 0.00 | |
| 4. Movable | 394,935.28 | 224,674.50 |
| 4.1. Fixed assets and equipment | 258,901.00 | 129,450.50 |
| 4.2. Fixed assets under lease | - | - |
| 4.3. Finished products and semi-finished products | 133.688,48 | 93.581,94 |
| 4.4. Materials (fabric) | 2.345,80 | 1.642,06 |
| Total assets | 411,922.17 | 241,661.38 |
| Fixed assets which are the object of security | 1,871,000.00 | 935,500.00 |
| Total assets including secured assets | 2,282,922.17 | 1,177,151.38 |

Source: Authors' own elaboration based on available financial data

Another step in the creditor test carried out is adoption of the premise that no arrangement proposals will be adopted and that it is necessary to determine the costs of the procedure in case the court declares bankruptcy. Such costs are determined in line with Art. 342 and 343 of the Bankruptcy Law. It is estimated that in relation to the bankruptcy procedure, costs with relevant structure and values will occur. After determination of the amounts that may be obtained from liquidation of the debtor's property in the situation when the arrangement proposals are not accepted and as a result of declaration of bankruptcy by the court, apart from the costs of bankruptcy procedure, creditors secured in line with Art. 345 of the Restructuring Law are also satisfied.

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In the discussed case, the costs of the procedure exceed the estimated receipts from the liquidation of property. The costs of bankruptcy procedure are on the level of PLN 1,230,3403.30, whereas the receipts that can be accomplished from liquidation of property amount to PLN 1,177,151.38. As indicated in the forecast, the amounts received from liquidation of the bankruptcy estate will suffice to cover the costs of bankruptcy procedure and potential satisfaction of secured creditors on the condition of rapid monetisation of the secured assets. The estimated level of satisfaction of public law creditors in a situation of adoption of arrangement proposals or carrying out of the bankruptcy procedure is presented in the table below:

Table 4. Creditors and degree of their satisfaction in a restructuring and liquidation procedure

| No | Creditors | Total receivables | Value of satisfaction in restructuring | Level of satisfaction in arrangement | Value of satisfaction in liquidation | Level of satisfaction in liquidation |
|----|---|-------------------|--|--------------------------------------|--------------------------------------|--------------------------------------|
| 1 | Up to 10,000.00 | 185,528.77 | 148,423.02 | 80% | 0.00 | 0% |
| 2 | from 10,000.01 to 100,000.00 | 724,051.71 | 506,836.20 | 70% | 0.00 | 0% |
| 3 | Above 100,000.01 | 2,255,679.82 | 1,353,407.89 | 60% | 0.00 | 0% |
| 4 | Interest other creditors | 156,483.46 | 0.00 | 0% | 0.00 | 0% |
| 5 | State Treasury Tax Office | 300,967.74 | 300,967.74 | 98% | 0.00 | 0% |
| 6 | Interest and other tax offices | 7,212.23 | 0.00 | | 0.00 | 0% |
| 7 | Social Insurance Company - employer | 494,236.50 | 494,236.50 | 100% | 0.00 | 0% |
| 8 | Social Insurance Company interest | 50,948.19 | 0.00 | | 0.00 | 0% |
| 9 | Social Insurance Company - employee | 374,008.98 | Outside of arrangement | 100% | 0.00 | 0% |
| 10 | Claims of lessors | 12,065.73 | 12,065.73 | 100% | 0.00 | 0% |
| 11 | Lessor's interest | 6.53 | 0.00 | | | |
| 12 | Creditors materially secured on the debtor's property | 631,495.36 | 631,495.36 | 100% | 631,495.36 | 100% |

Source: Authors' own elaboration based on available financial data

Public law creditors, as a result of performance of arrangement proposals in a restructuring procedure, will be satisfied in the proposed amounts. On the other hand, if the liquidation procedure is performed, public law creditors will not be satisfied, due to the fact that the forecast costs of liquidation procedure exceed the forecast receipts from liquidating the unit's property.

As a result of performance of arrangement in sanation proceedings, the public law creditor Social Insurance Company will be satisfied in 100%, whereas the public law creditor the State Treasury - Head of the Tax Office will be satisfied in 98%. As a result of the bankruptcy procedure, the Social Insurance Company and the State Treasury - Tax Office will not be satisfied in relation to the costs of the bankruptcy procedure. The more favourable variant for the creditors, both public law and other creditors, is to vote in favour of arrangement.

5. Recapitulation

The regulations introduced in the Restructuring Law facilitate the performance of restructuring for insolvent entities or entities threatened with insolvency. The success of a restructuring procedure very often requires reaching for the state resources in the form of reduction of receivables on account of taxes or social insurance. In relation to this, two types of public aid were distinguished in the context of restructuring: compatible and incompatible. The index that makes it easier for the courts and out-of-court authorities which participate in a restructuring procedure to answer the question whether adoption of arrangement proposals leads to the granting of incompatible public aid is the private creditor test. The mode (method) of its conduct requires knowledge from the area of law and economy along with experience in company management. The authors have prepared a methodology of conducting a private creditor test specifying its individual stages and tools used to determine whether adoption of arrangement proposals foreseen for public law creditors is classified as public aid.

The authors prepared and conducted the method of reaching the answer to the issues presented above with respect to five restructuring procedures. In this method, it is necessary to determine the type and the value of public receivables, identify the range and the type of composition proposals, market and liquidation assessment of the market value of assets, including assets forming the subject of security, estimate costs of bankruptcy and, eventually, determine the level of satisfaction in the restructuring and bankruptcy procedure. The stages presented above

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provided the answer to the question whether the restructuring process of public law receivables constitutes public aid.

In the discussed example, the creditors receive higher satisfaction of their claims in the case of the performed restructuring procedure than in the case of the bankruptcy procedure aimed at liquidation of the property held. Furthermore, all participants (creditors) receive an answer to the question about the degree to which their claims will be satisfied and whether the degree of satisfaction will be higher in the restructuring procedure or as a result of carrying out the bankruptcy and liquidation procedure.

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Pomoc publiczna w ramach postępowania restrukturyzacyjnego – Test prywatnego wierzyciela na przykładzie spółki z o.o. w restrukturyzacji

Streszczenie

Wejście w życie z dniem 1 stycznia 2016 roku nowej ustawy Prawo Restrukturyzacyjne dało wiele możliwości przedsiębiorcom do skorzystania z pomocy w celu utrzymania przedsiębiorstwa na rynku. W ramach tego postępowania konieczne jest ustalenie czy udzielona pomoc nie stanowi niedozwolonej pomocy publicznej zakłócającej reguły wolnego rynku. Odpowiedź na to daje przeprowadzenie testu prywatnego wierzyciela, testu prywatnego inwestora.

Słowa kluczowe: restrukturyzacja, test wierzyciela, pomoc de minimis .