Greek Insolvency Law and the Greek Economic Crisis

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Greece has spent the last two years in a "perfect storm". It started as a precipitous decline of the creditworthiness of the Greek state; which became unable to raise funds through the markets and turned to the IMF and the EU. Funding was agreed subject to very strict conditions that are monitored by a group representing the ECB, the Eurogroup and the IMF, known as the "troika". The troika has also sought to impose a "haircut" on private institutional holders of Greek bonds. The proposed discount has raised the issue of revaluation of the bond portfolios held by Greek banks, pension funds and other Greek institutional investors.

2012 is now expected to be the third year in a row in which the Greek economy will contract significantly. Unemployment now stands around 17% and in reality may be much higher. There has been much talk of default or even return to the drachma (or departure from the Euro, voluntary or otherwise). As a result, depository funds have moved away from Greece and its banks, reducing their liquidity and, among other things, limiting credit expansion which further exacerbated the recession. In addition, access to new funds has become more difficult for most private enterprises, since the lenders willing to take on Greek credit risk require very high, one may even say exorbitant, ROIs and usually on a senior basis.

Many local enterprises are under tremendous operational and financial strain and are at the point of insolvency. In response, the Greek government has revamped its restructuring or pre-insolvency proceedings (known as "Recovery" under the amended statute). The new proceeding has only been in effect since September 15, 2011, and it may be premature to judge its effectiveness after such a short time, but there is evidence that it is not functioning properly. The functioning of that statute is of critical importance to the Greek economy as a whole, as it may contribute to a much needed turnaround and rationalization, stem the loss of employment positions and encourage foreign direct investments and M&A activity in promising but fragmented sectors.

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An effective statute will reward efficiency and deter the flow of funds into unproductive uses – from that perspective it may be seen as assisting the change of the country's business model.

Such a critical piece of legislation is therefore worthy of review. Does it provide new restructuring opportunities to Greek debtors? Is it up to the challenge set by the extraordinary situation in which Greece finds itself?

The answer to the first question is affirmative, overall. The new statute represents a clear improvement on the previous Conciliation proceeding as it incorporates the ability of the majority to cram down on dissenting minority creditors, the ratification of sales on a pre-pack basis and far greater flexibility than before on the types of agreements that can receive ratification.

However, the answer to the second question at this early stage is no, it is not up to the challenge. The current extraordinary circumstances require extraordinary measures; debtors relying even on the newly available set of tools and solutions are more likely to fail than be reinvigorated.

The current crisis has exacerbated long term problems of the Greek insolvency practice, such as the excruciatingly slow pace of the judicial process. A newly commenced commercial action will receive its first hearing after three years. Injunction hearings are heard more than six months after the application, while even applications for preliminary orders require one week to be heard. Similarly, the ratification decision on a restructuring agreement may require close to one full year. While the need for open contested hearings for the protection of all stakeholders is clearly understood, the attendant efficiency costs are very substantial. Most stressed debtors entering the proceedings will become illiquid before their application is finally heard. The need to streamline the process by reducing the frequency and degree of court involvement in the proceeding is manifest.

Another major problem is that insolvency matters are entrusted to courts of general civil and criminal jurisdiction. Given the complex questions that judges have to address in insolvency cases (and the fine balancing of the competing interests of the various stakeholders that they are required to attempt), it is not surprising that judges faced with a new complex restructuring hearing often seem inclined to adjourn (as the case will then be handed over to someone else, at a much later date). Delays in the issuance of decisions may also be attributed to lack of expertise. The need for a specialized group of judges dedicated exclusively to restructuring and insolvency proceedings is acute.

Court appointed experts also lack insolvency qualifications. While their role requires legal, financial, accounting, tax and negotiation skills and sectoral experience, there are no selection criteria that reflect the above requirements. As a result, experts do not add value to the process and therefore the process is less effective for small companies who cannot afford a restructuring expert to drive the process. The need for regulation of the profession through chartered institutes, in line with international practice, is apparent.

Given the current precipitous decline in operating incomes, in most cases restructuring will require the shedding of employment positions. However, Greek employment law is both inflexible and hostile to lay-offs. All collective redundancies, unless agreed to by the unions, require administrative consents that are very rarely provided. This reticence puts many restructuring efforts into question. In the view of the authors, the law should not focus on labor rights of an individual but on the preservation of jobs through the restructuring of viable enterprises. Therefore, it would be appropriate to allow collective redundancies under a ratified restructuring plan without any additional administrative consent.

Further obstacles to restructuring have been set up by the superpriority accorded to claims by employees, the revenue office and social security institutions both in collective proceedings and the realization of secured assets. In effect, those categories of creditors have little incentive in sharing part of the pain that is

inevitably involved in a restructuring and even less in a situation of severe pressure on liquidity and uncertainty as to business conditions (since partial satisfaction though a forced sale may be a better choice than the potential upside from a revitalized enterprise). One can observe that while the State is trying to encourage restructuring as insolvency legislator, it is making it difficult as superpriority creditor. In normal business conditions, such conflicts may be normal and tolerable. Not so in times of crisis. Our view is that, instead of only considering short term debt collection through liquidation, the State should establish a specific service that will act and deal with claims against restructuring debtors in accordance with financial viability criteria and by taking into account the future value to be gained from an operating business.

A special feature of the current Greek crisis is that the banks are themselves strapped for cash and in need of additional capital both for funding and regulatory purposes. The delays in achieving a restructuring agreement inevitably increase the funding needs of the borrower while banks are inclined not to provide emergency funding for which no specific provision exists and is only adding pressure on their liquidity and their capital requirements. Given the critical role of DIP financing in dealing with the current crisis, the case for special seniority treatment of DIP loans may be strong.

The crisis also affects the ability of debtors to restructure through the sale of assets or of businesses. For example, the market in commercial real estate has all but frozen up and debtors are not able to take advantage of the cash raising potential (under normal circumstances) of their non-core real estate assets. The same applies also to other kinds of debtor investments (e.g. listed securities that have returned in the local stock market to valuations last seen in the early 90's). Our view is that the law should provide specific tax incentives to lenders to acquire such assets through debt to asset swaps both in origination as well as at the time when the assets obtained through the swap are realized.

One final but crucial issue is the balance between creditor and debtor protection. The recent amendments of Chapter 6 of the Greek Bankruptcy Code were heralded as further evidence of the reorientation of Greek insolvency law towards greater debtor friendliness, in line with international trends. However, debtor friendly laws presuppose a degree of corporate governance among debtors that protects creditors from the abusive exercise of the newly expanded debtor rights (in Greece most companies are family owned and there is no distinction between management and owner). The statistics in Greece clearly show that such abusive exercise is prevalent. There are more than 5,000 applications for standstill orders but actual restructuring negotiations number in a few hundreds. The inability to proceed to meaningful negotiations may be due in part to the strains of the crisis and the difficulty in developing a plan leading to a viable future. Waiting in such circumstances may be as good a tactic as any. Nevertheless, the need for greater balance between creditor and debtor rights and for greater visibility on the part of the lenders is only too apparent. For instance, creditors of debtors that have sought judicial protection (through an application for a standstill order) should be able to appoint management representatives and have full and easy access to necessary information upon demand while creditors should also be able to commence the Recovery process (currently, the application may only be made by debtors).