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protecting creditors against dishonest actions by debtors

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Protecting the interests of creditors against dishonest actions by debtors

Adam Studziński

A creditor affected by asset-stripping by a debtor doesn't have to remain a passive victim of dishonesty.

Creditors have probably had trouble since time immemorial with dishonest debtors—ones who deliberately and unlawfully attempt to escape from their obligations. Thanks to globalisation, today's world may be shrinking, but with the increased cross-border flow of persons and capital, the relative ease of creating various types of legal entities (companies, foundations, trusts and so on), and the multiplicity of available financial instruments, it can be particularly difficult for creditors to protect against asset-stripping by debtors. It is also objectively difficult to locate assets and secure them in due time so that the creditors can be satisfied. The economic crisis, or a weak rebound, contributes further to creditors' problems.

The commonly known methods of leaving creditors high and dry are numerous. If that weren't enough, "consultants" appear on the internet bluntly offering to "help you escape from your creditors."

As a result, in the media and in private, businesspeople trade stories of clever debtors who managed to avoid paying anybody anything. Some of them set up new companies—in the name of friends or relatives—and transferred their assets there. Others encumbered their assets to make them unsalable because of the gross reduction in their economic value or the price they could obtain at auction. Yet others sold off their assets in deals far removed from any sound business principles, rendering the debtor insolvent and leaving the creditors with nothing. All too often in such stores one detects a note of admiration for the "inventiveness" or "virtuosity" of the debtors, and barely concealed irony about the creditors who were so easily led down the garden path.

Nonetheless, creditors who encounter asset-stripping by debtors should not give in to defeatism. This is precisely what dishonest debtors are seeking to achieve, waging a psychological war to wear down and discourage their creditors.

The truth is that a dishonest debtor is an economic sociopath, chopping away at the foundations of the society. They should not be hailed as geniuses or virtuosos, but labelled for what they are: frauds. Such people are not tolerated. That is how their actions are viewed by the legal system, which can and should be used to protect the rightful interests of creditors.

Creditors injured by the dishonest actions of debtors should remember that there are a whole series of investigative and legal instruments that can reverse the effects of asset-stripping.

As we know from detective fiction, there is no such thing as the perfect crime. We should also remember that there is no dishonest act that leaves no trace or evidence of its unlawful purpose. Fictitious contracts, collusive transactions, draining of funds or creation of artificial entities is not that hard to recognise.

The legal system provides cures for all such acts, offering appropriate legal instruments that can at least limit the negative consequences of such acts for creditors.

First it is typically necessary to locate and secure, as quickly as possible, the evidence demonstrating the true nature and purpose of the acts of a dishonest debtor. To this end, we use **auxiliary (investigative) instruments** for combating dishonest debt practices:

- Economic intelligence, at home and abroad (particularly involving asset investigation)
- Forensics—gathering and examining evidence through investigation of accounting and IT
- Analysis by experts in finance, business, and asset valuation
- Review of economic events from the point of view of tax law and regulatory restrictions under public law, including initiation and monitoring of administrative proceedings to identify the true content and course of economic events.

It is not always necessary to deploy all of these instruments fully in every case, but it should be borne in mind that they are available.

In turn, the **principal (legal) instruments** in Poland for protection of creditors against dishonest actions by debtors include:

- Civil-law instruments for protection of creditors—a claim to invalidate an agreement to the detriment of creditors, a fraudulent conveyance action, a claim to hold an agreement to be ineffective, and securing and executing on claims when there is a threat of asset-stripping
- Criminal-law instruments for protection of creditors—initiating, conducting or monitoring of criminal proceedings involving commercial offences; pursuing and enforcing redress of injury in criminal cases
- Insolvency instruments—initiating and conducting bankruptcy proceedings or seeking a ban on serving as a board member or conducting business activity
- Foreign instruments—fundamental instruments related to the foregoing or serving a similar function, which may be applied in other jurisdictions in connection with protection of creditors against unlawful or dishonest actions by debtors.

In practice, the principal legal instruments and the auxiliary instruments should be applied in conjunction with one another. It is also very important to coordinate investigative and legal measures.

It should also be added that the ability to obtain essential information or recover a debtor's assets located abroad often depends on the ability to effectively ascribe offences against creditors to the debtor. This is particularly true for territories famed for offshore activity or specific foundations frankly aimed at hiding debtors' assets. Thus criminal-law instruments for protection of creditors—contrary to popular opinion—should be regarded as among the most effective, but they require close professional cooperation with law enforcement authorities at home and abroad.

All is not lost for injured debtors. They have numerous opportunities for effective action, but they must be aware of them.

Offence of fraudulent encumbrance of assets to frustrate satisfaction of creditors

Natalia Kobyłka

Sham encumbrance of assets to convince third parties of non-existent legal consequences may constitute a crime. Incurring fictitious obligations is an example.

Poland's Penal Code offers protection to creditors when a debtor frustrates or reduces the satisfaction of a creditor by removing, concealing, selling, donating, destroying, actually or apparently encumbering, or damages its assets which are seized or at risk of seizure, or removing indications of seizure. If the purpose of such action is to frustrate enforcement of a ruling of a court of other state authority, it is subject to imprisonment from 3 months to 5 years under Penal Code Art. 300 §2.

Difficulties may arise in defining the types of rulings by courts or other state authorities for which frustration of enforcement is punishable under the Penal Code. Generally, this clearly applies to any judicial ruling imposing on the debtor a direct obligation to pay money—but not only. Such a ruling could also include a court order declaring the debtor bankrupt. With respect to such rulings, it should be determined whether the debtor's act was made for the purpose of sham encumbrance of assets that have been seized or are only under threat of seizure. In the case of execution proceedings, the Civil Procedure Code precisely defines the moment at which seizure occurs. This is not so clear in the case of bankruptcy proceedings, particularly if the debtor made the sham encumbrances of assets after the declaration of bankruptcy but before the bankruptcy trustee took any action.

This was the type of case faced by the Wrocław Court of Appeal, which attempted in its judgment of 24 August 2012 (Case No. II AKa 189/12) to define when in the case of a bankruptcy proceeding the debtor makes a sham encumbrance of its assets seized during the course of the proceeding, and when the assets are only threatened with seizure. In the court's opinion, the mere declaration of the debtor's bankruptcy does not yet cause its assets to be seized. Seizure requires manifestation, as in the case of execution against real estate (Civil Procedure Code Art. 847 §1). Thus it is only inclusion of a specific asset of the debtor's in the inventory by the bankruptcy trustee that causes seizure of that asset. Until that point the debtor's assets are only threatened with seizure.

The ruling was issued under the following facts. In 2004, the court declared the bankruptcy of a debtor operating as a sole trader. During the bankruptcy proceeding, the attorney for a creditor filed a proof of claim for a promissory note obligation in the amount of PLN 800,000, allegedly secured by a cooperation agreement between the creditor and the debtor from 2002. During the proceeding, the court found that the encumbrance on the debtor's assets was

a sham, and the promissory note was issued by the debtor only to create the appearance that his assets were encumbered. Thus, in the court's view, the debtor's action was clearly intended to frustrate the enforcement of a court order by fictitiously encumbering his assets.

In the justification for the judgment, the court of appeal stated that the offence defined in Penal Code Art. 300 §2 is an individual offence of which only the debtor can be the perpetrator. The sham encumbrance of assets as referred to in the code should be interpreted, according to the court, to mean any behaviour consisting of creating circumstances to convince third parties that the legal effects in question were achieved, when in reality they did not occur at all. Sham encumbrance of assets in this respect could take various forms, including more specifically incurring fictitious obligations.

This judgment counsels great caution when approaching any acts by the debtor in the face of even a threat of seizure of its assets. From a literal wording of the law, only actions consisting of sham encumbrance of assets are threatened with criminal liability, which could suggest that this has to do only with actions involving establishment of liens against property. But the court of appeal interpreted this provision more broadly, also treating incurring fictitious obligations as a form of sham encumbrance of assets. Unfortunately, the court did not explain what it meant by a "fictitious obligation," but it may be inferred from the facts of the case that this has to do not only with backdating agreements, but also incurring obligations which the parties from the start never intend to perform, e.g. by entering into an agreement in which the debtor will provide cash consideration but will not demand that the other party provide its non-cash consideration.

Under such a broad conception of actions qualifying as offences under Penal Code Art. 300 §2, creditors clearly obtain an additional mechanism for protection of their rights against dishonest debtors. It should be pointed out that under Civil Code Art. 58, transactions that are contrary to law are invalid. The state of being contrary to law may also involve violation of mandatorily applicable provisions of public law, including criminal regulations (Supreme Court of Poland judgment of 28 October 2005, Case No. II CK 174/05, published at OSNC 2006 No. 9 item 149). Thus if a creditor seeks to set aside a sham transaction by the debtor, it may achieve the same purpose by demonstrating that the transaction was a sham under Civil Code Art. 83 §1 or by demonstrating the transaction was used to achieve criminal purposes and thus is invalid under Civil Code Art. 58 §1.

Selective payment of creditors can be a crime

Natalia Kobyłka

Arbitrary, selective payment of only certain debts may result in criminal liability of the debtor, including in a case where it is only threatened with insolvency, if such action exposes other creditors to a loss.

Poland's Penal Code provides an equal measure of protection to all creditors of a debtor threatened with insolvency. Although no provision of law specifies in advance the order in which creditors must be paid, a general prohibition against arbitrary and selective payment of debts may be inferred from Penal Code Art. 302 §1, which provides that a debtor faced with the treat of insolvency or bankruptcy, who cannot satisfy all of his creditors but pays or secures only certain of them, to the detriment of the others, is subject to a fine, probation or imprisonment up to 2 years.

A response to the question of when a debtor is threatened with insolvency and what actions by a debtor may be regarded as exposing the other creditors to a loss may be found in the judgment of the Wrocław Court of Appeal of 5 November 2008 (Case No. II AKa 203/08, published at OSA/Wr. 2009 No. 3 item 140).

In this case, the court first pointed out that there is a qualitative difference between a state of insolvency and a threat of insolvency. Insolvency is defined in Art. 11 of the Bankruptcy & Rehabilitation Law of 28 February 2003, which provides that a debtor is insolvent when it has ceased to pay its due and payable monetary obligations, and, with respect to a legal person or organisational unit without legal personality which is vested with legal capacity under other laws, a debtor is also regarded as insolvent if its obligations exceed its assets, even if it is performing its obligations on a current basis. The threat of insolvency is defined in Art. 492 §2 of the Bankruptcy Law, which provides that a business entity is threatened with insolvency if, even though it is performing its obligations, based on a rational assessment of its economic situation it is obvious that within a short time it will become insolvent. In the justification for the ruling discussed above, the Wrocław court stated that by the nature of things, a state of being threatened with insolvency must precede a state of insolvency, and the court deciding on criminal liability is required to examine not only whether a state of insolvency existed, but also whether there was at least a threat of insolvency, which could be indicated by the debtor's liquidity problems.

If a debtor is threatened with insolvency and unable to pay all of its creditors out of its assets, it may not secure or pay only certain creditors to the detriment of other creditors. Payment of a debt should be understood to mean not only transferring funds to the creditor, but also any legal act seeking to satisfy the obligation other than by payment. An example could be assignment of a receivable. In the justification for the case discussed above, the court of appeal correctly found that making an assignment of receivables to only certain creditors in a situation of a threat of insolvency meets the definition of the offence under Penal Code Art. 302, because if the debtor had not concluded the assignment agreement, the receivable would be applied toward payment of all creditors and each of them would be satisfied proportionately.

The legal literature also provides other examples of acts that are prohibited when the debtor is under a threat of insolvency. These include "dation" (*datio in solutum*), i.e. satisfying an obligation by providing some other consideration in its place, such as discharging a monetary obligation by turning over tangible property instead of cash, as well as actions to secure certain creditors against others, such as establishment of a pledge or mortgage.

In order to commit the offence under Penal Code Art. 302, the debtor must be aware that he is acting to the detriment of certain of his creditors. But it is a technical offence, and it is not necessary that the creditors suffer actual injury.

Thus in any situation in which the debtor is aware that his assets are insufficient to pay all his debts, he must consider that paying or securing only certain of his creditors at the expense of others may subject him to criminal liability.

Banks lose privileges

Marcin Smolarek, Mateusz Tusznio, Paweł Szalon

Until now, it has been distinctly easier for banks in Poland to secure and later enforce their receivables than for other creditors. Will a new amendment to the Banking Law change this?

On 19 April 2013, the Sejm adopted an act amending the Banking Law and the Investment Funds Act. The Sejm later rejected revisions proposed by the Senate and submitted the bill to the President of Poland, who signed it into law on 18 June 2013. It goes into effect 14 days after publication.

The act added a new par. 1a to Art. 95 of the Banking Law—a seemingly small change, but one with an immense impact on the position of banks in a judicial dispute with their debtors.

The existing Art. 95(1) of the Banking Law provides that bank statements and certain other bank documents signed by authorised representatives of a bank and bearing the seal of the bank have the legal force of an official document and may be used, for example, as grounds for entry in the land and mortgage register. Art. 95(3) provides, in turn, that such bank documents shall be the basis for entry of a mortgage securing the bank's claims against its debtor. The new Art. 95(1a) provides, however: "The legal force of official documents referred to in par. 1 shall not apply with respect to the documents referred to in such provision in a civil proceeding."

It should be pointed out by way of introduction that the amendment to the Banking Law was adopted in order to bring the law into compliance with the judgment of the Polish Constitutional Tribunal of 15 March 2011 (Case No. P 7/09), which held that Banking Law Art. 95 was inconsistent with Art. 2, 32(1) and 76 of the Polish Constitution insofar as it gave the legal force of an official document to a bank's accounting records and bank statements with respect to the rights and obligations arising out of banking activities, in a civil proceeding against a consumer.

While a thorough analysis of the reasoning of the Constitutional Tribunal and its correctness is beyond the scope of this article, it must be pointed out that the amendment adopted by the Sejm went well beyond the scope of necessary changes to the law required by the judgment of the Constitutional Tribunal, because the amendment excludes the force of an official document for bank documents in any civil proceeding—not only a proceeding against a consumer, but also against other legal entities, such as businesses.

While no one seems to dispute the need for solutions expediting civil proceedings, particularly for businesses, the amendment in question eliminates legal instruments which effectively served to expedite court cases. Moreover, the changes reveal a certain inconsistency.

Apart from far-reaching consequences for commercial practice, the amendment will probably generate problems in interpretation.

The first problem that is raised involves the ability to establish a mortgage on the basis of bank documents. A proceeding before the land and mortgage register court is a non-adversarial proceeding under property law, which means that it is undoubtedly a type of civil proceeding. Thus an analysis of the new Art. 95(1a) suggests that bank documents on the basis of which a mortgage is established for a bank are deprived of the legal force of an official document in a land and mortgage register proceeding. Consequently, it would appear that Polish banks will be required to use the form of a notarial deed in order to establish a valid mortgage on their behalf. But before reaching that conclusion, it must be considered that the existing par. 3–5 of Art. 95, which govern the procedure for establishing a mortgage on the basis of bank documents, were left unchanged. A reading of the amended Art. 95 leads one to conclude that the Sejm fell into a kind of legislative dissonance. If creation of a bank mortgage now requires a notarial deed, then the existing Art. 95(3)–(5) should have been repealed. That, at least, should be concluded if one assumes that the legislature was acting rationally.

One defensible interpretation is that the intention of the drafters was not to eliminate the ability to establish a mortgage in favour of a bank on the basis of bank documents, without the need for the owner of the encumbered real estate to submit a statement establishing the mortgage in the form of a notarial deed, but only a statement in writing.

This is the impression given by the justification for the bill (Sejm Document No. 605 of 12 June 2012), which does not mention the procedure for establishing a mortgage for a bank under Banking Law Art. 95. The justification focuses only on carrying out the recommendations of the Constitutional Tribunal, stressing the need to eliminate the evidentiary privileges of banks and the reversed burden of proof in favour of banks. The bill thus sought to eliminate the privileged position of banks in civil proceedings, as a stronger, dominant party in relation to other entities, including business entities. The amendment provides that bank documents generally do not have the force of official documents in a civil proceeding, but at the same includes an exception to this rule for bank documents necessary to establish a mortgage securing the bank's claims against the debtor.

This appears to be the only logical interpretation of Art. 95 in its amended form which is justified both systemically and functionally. After all, the purpose of the amendment (drawn primarily from the justification for the judgment of the Constitutional Tribunal, whose implementation was the occasion for the amendment) is primarily to protect other entities in a judicial dispute with a bank—not to eliminate the simplified procedure for establishment of mortgages for banks.

Our doubts concerning interpretation are reflected in the wording of the bill as submitted to the Sejm by the Senate on 15 June 2012 (i.e. the original wording, subsequently revised by the Sejm as requested by the Public Finance Committee),

and in the wording of the revisions requested by the Senate in its resolution of 16 May 2013. It is amazing that intentionally, on two occasions, a phrase was deleted from the bill during the legislative process which expressly reserved the ability to use a bank document to make an entry in the land and mortgage register, even though the bank document had lost the legal force of an official document in a civil proceeding. In an opinion on the bill, the Senate Legislative Office again confirmed the existence of the interpretational controversy discussed above: "It must be stressed that the regulation adopted in the Senate proposal, despite depriving documents of banks and securitisation funds of the force of official documents regardless of the type of proceeding, nonetheless provided that such documents will continue to serve as the basis for making entries in the land and mortgage register. The current wording of the bill in question appears not to provide for an exception in this regard."

In summary, it should be concluded that the simplified procedure for establishment of a bank mortgage nonetheless will remain unchanged after entry into force of this amendment. Yet it is disappointing that the Parliament has once more enacted imprecise regulations, sowing the seeds for uncertainty in interpretation.

This amendment to the Banking Law is only one aspect of a noticeable recent trend toward elimination of privileges for banks. The notion of eliminating bank writs of execution also fits into this trend. Currently work is underway in this respect in the parliamentary Subcommittee for Financial Institutions. This work is also directly connected with the Constitutional Tribunal judgment which was the impetus for amending Banking Law Art. 95. In pushing through these changes, however, the need and purpose for such changes should be considered, as well as the multifaceted ramifications such changes may have on commercial dealings in Poland.

When may a creditor assert a fraudulent conveyance action despite the debtor's entering bankruptcy?

Ludwina Klein

A fraudulent conveyance action protects creditors in the event of the debtor's insolvency. The ability of specific creditors to use this instrument is limited, however, because of the importance of protecting the interests of all creditors within a bankruptcy proceeding.

Ineffectiveness of acts of a debtor before it is declared bankrupt

Before discussing fraudulent conveyance actions in the context of a bankruptcy proceeding, it should be pointed out that under the Bankruptcy & Rehabilitation Law of 28 February 2003, certain acts by the debtor are ineffective against the bankruptcy estate by operation of law—without the need to file suit. This is the case, for example, with transactions by which the debtor disposed of its assets without adequate consideration within one year prior to filing of the bankruptcy petition. The same treatment is applied to transactions for consideration made by a corporate debtor within six months prior to filing of the bankruptcy petition with the company's shareholders or their representatives or with affiliated companies. Certain transactions by the debtor may also be held to be ineffective by the judge-commissioner.

Otherwise, challenges to transactions by the debtor to the detriment of creditors are governed by Art. 132–134 of the Bankruptcy Law and, as relevant, by the provisions of the Civil Code on protection of creditors in the event of the debtor's insolvency (i.e. Civil Code Art. 527 and following, governing fraudulent conveyance actions). These specific regulations (discussed in more detail below) are applicable only to actions involving assets of the bankruptcy estate. But if the action seeks to hold ineffective a transaction by the debtor concerning assets which would not enter the bankruptcy estate, then after declaration of the debtor's bankruptcy such action may be asserted, under the general rule of Civil Code Art. 527, only by the creditors. This is because bankruptcy has no effect on assets of the debtor that do not become part of the bankruptcy estate.

What enters the bankruptcy estate?

Under Art. 62 of the Bankruptcy Law, all of the property of the debtor as of the date of declaration of bankruptcy generally enters the bankruptcy estate, as does property acquired by the debtor during the course of the bankruptcy proceeding. This covers all of the assets of the debtor with financial value and which are capable of reducing to cash,

regardless of whether they are used by the debtor to operate its business or not.

Exceptionally, property that does not belong to the debtor may also enter the bankruptcy estate. For example, if a transaction made by the debtor prior to declaration of bankruptcy to the detriment of creditors is held to be ineffective, whatever was lost from the debtor's property or did not enter the debtor's property as a result of the transaction becomes part of the bankruptcy estate.

Property that is exempt from execution under the Civil Procedure Code does not enter the bankruptcy estate, nor do certain assets listed in the Bankruptcy Law (e.g. the debtor's salary in the portion exempt from garnishment) and assets that are excluded from the bankruptcy estate by resolution of the creditors.

Permissibility of asserting a fraudulent conveyance action after the debtor is declared bankrupt

If the debtor is declared bankrupt, standing to assert a fraudulent conveyance action is vested in the bankruptcy trustee, the judicial supervisor or the administrator, depending on the type of bankruptcy proceeding. Thus, after declaration of bankruptcy, creditors do not have standing to commence such actions. Similarly, they cannot join actions commenced by the bankruptcy trustee, judicial supervisor or administrator as auxiliary intervenors, because the trustee, supervisor or administrator stands in for all creditors and the creditors themselves no longer have a legal interest in joining the case. If a creditor had already commenced an action under Civil Code Art. 527 and following, after the debtor is declared bankrupt the action is subject to dismissal because the plaintiff no longer has standing to pursue the claim.

Transactions by the debtor may not be held to be ineffective more than two years after the declaration of bankruptcy. This limitations period is a rule of substantive law and cannot be extended. Expiration of this period does not restore standing to specific creditors to bring such actions. The ability to challenge a transaction by the debtor is also subject to a limitations period of five years from the date of the transaction.

Effects of declaration of the debtor's bankruptcy after a creditor has filed a fraudulent conveyance action

If an action seeking to hold a transaction of the debtor to be ineffective was commenced by a creditor before the debtor is declared bankrupt, the bankruptcy trustee, judicial supervisor or administrator may replace the plaintiff who challenged the transaction by the debtor. This may occur at any stage of the proceeding, including on appeal. Entry into a pending case is decided by the trustee, supervisor or administrator and does not require the consent of the parties to the proceeding. If the proceeding is joined, however, the trustee, supervisor or administrator will reimburse the creditor for its litigation costs out of the proceeds recovered by the bankruptcy estate.

If the bankruptcy trustee, judicial supervisor or administrator refuses to join the pending proceeding, the creditor may continue the proceeding in its own name. But even if the creditor obtains a favourable ruling, it will not be permitted to require that the third party who has unlawfully obtained a benefit turn over the benefit to the creditor. Instead, recovery obtained by the creditor after declaration of bankruptcy through a judgment holding a transaction by the debtor to be ineffective must be turned over to the bankruptcy estate.

The creditor's dilemma: Join forces or go it alone?

Konrad Grotowski

When assets are being removed from a debtor threatened with insolvency, the creditors face a choice of seeking to set aside such transactions independently, or filing a bankruptcy petition and relying on the actions of the bankruptcy trustee.

Assets which should be used to satisfy creditors are often removed for a fraction of their true value from companies threatened by bankruptcy. Then the creditor faces a dilemma: Should it use its own efforts to seek to set aside such transactions, or file a bankruptcy petition against the company and leave it to the bankruptcy trustee to recover the assets? Which option is more beneficial to the creditor is not easy to determine and depends on numerous factors.

Transactions by a debtor (e.g. disposal of real estate at a reduced price or for free) may be challenged pursuant to a fraudulent conveyance action as provided in Art. 527 of the Polish Civil Code. Through such an action, the creditor may obtain a judgment enabling it to execute its claims against the debtor company from the assets of a third party, i.e. the individual or legal entity which has obtained the assets removed from the debtor. The transaction between the debtor company and the third party will remain valid (the parties will not be required to restore the consideration exchanged between one another), but pursuant to the judgment the transaction becomes ineffective against the creditor. But in order to begin execution, the creditor must hold an executable writ, authorising execution by the bailiff against the debtor. Typically this is a legally final judgment ordering the debtor to pay money to the creditor. But it may also be an unperformed settlement concluded with the debtor before the court, or a confession of judgment (a notarial deed in which the debtor submits to execution). If the creditor does not hold an executable writ, then alongside the fraudulent conveyance action against the third party it must also file a claim for payment against the debtor. Both of these proceedings may cost time and money. When filing each statement of claim, the creditor will have to pay a court fee equal to 5% of the amount in dispute (but no more than PLN 100,000).

Here is where the dilemma arises. Art. 127 and following of the Bankruptcy & Rehabilitation Law provide for the ineffectiveness of certain transactions by the debtor by operation of law, i.e. automatically, without the need to obtain a judgment (following possibly protracted litigation). This applies, for example, to transactions by the debtor within one year prior to filing of the bankruptcy petition in which the debtor disposed of its assets for no consideration or for consideration grossly below the value of the consideration provided by the debtor. After the debtor's bankruptcy is declared, certain transactions by the debtor for consideration within 6 months prior to filing of the bankruptcy petition will also become ineffective against the bankruptcy estate. In the case of an individual debtor, this applies to transactions with the debtor's spouse or relatives, and in the case of a corporate debtor, transactions

with its shareholders or affiliates, shareholders of affiliates, or a parent or subsidiary. If transactions detrimental to the creditors were conducted earlier than the times indicated above, they do not become ineffective by operation of law, but the creditors can cause the bankruptcy trustee to seek to set aside the transactions. This is relatively inexpensive, because the bankruptcy trustee is exempt from court fees.

It should be borne in mind that after a declaration of bankruptcy, the bankruptcy trustee may step into the shoes of a creditor who has been acting on its own to seek the ineffectiveness of a transaction by the debtor, in the interest of all the creditors. If the trustee decides to do so, the other creditors will, in a sense, benefit from the litigation commenced and paid for by one creditor. The Bankruptcy Law provides, however, that in that case the bankruptcy trustee must apply the proceeds obtained to reimburse the creditor's litigation costs (court fee and attorney's fees). The right to reimbursement of such costs is an independent claim and does not require a proof of claim, and is subject to satisfaction out of the proceeds of the action with priority over other costs of the bankruptcy proceeding.

The creditor may thus come to the conclusion that instead of litigating with the debtor itself, paying court fees and risking replacement by the bankruptcy trustee, it is better to file a bankruptcy petition against the debtor and leave the issue of the ineffectiveness of the debtor's transactions to the bankruptcy trustee. This could be an even more attractive option if there are grounds for the debtor's transactions to be regarded as ineffective by operation of law. Moreover, holding a legally final judgment ordering the debtor to pay money is not a condition for filing a bankruptcy petition or allowance of the claim.

But compared to a freestanding fraudulent conveyance action by the creditor against the debtor, a drawback to the bankruptcy petition is that the proceeds executed against the other party to the transaction with the debtor do not go into the pocket of the creditor who has fought the fight, but into the bankruptcy estate—a common fund for satisfaction of all the creditors. And priority first goes to payment of (i) costs of the bankruptcy proceeding (typically in the tens of thousands of zloty at least), (ii) employees' salary claims arising prior to the declaration of bankruptcy, (iii) social insurance claims for the two years preceding the declaration of bankruptcy, and (iv) taxes. It may thus turn out that after satisfying secured creditors and claimants with statutory priority, there will little or nothing left to pay trade creditors.

This all leads to the conclusion that the creditor's lawyer must carefully analyse all the pros and cons before drawing up a precise action plan to suit the specific factual situation.

A dishonest party may be required to pay a debt through criminal proceedings

Janusz Tomczak, Adam Studziński

The penal sanction of the duty to redress loss or provide satisfaction for injury, which may be imposed on a dishonest debtor by the criminal court, protects the interests of creditors.

Creditors seeking to make up for the negative consequences of illegal asset-stripping by a debtor should bear in mind the penal sanction under current law in Poland consisting of the "duty to redress loss or provide satisfaction for injury," which may be imposed on the perpetrator of offences against creditors (set forth in Art. 300–302 of the Penal Code).

The practice of the justice system we have observed in criminal cases indicates that judges have taken to heart the intention of the Parliament that in criminal cases the rights of crime victims should be upheld to the fullest and the injury caused by the perpetrators should be compensated for.

Many practical considerations may counsel in favour of applying much more radical legal measures against dishonest debtors in a specific case than the measures provided by the civil law. The creditor will find such measures in criminal law. Among other measures, the criminal law enables exertion against the debtor of various forms of compulsion (including psychological), and provides for a number of evidentiary measures to be pursued outside of Poland with the assistance of foreign law enforcement officials, reducing the time a creditor must wait for a judicial ruling setting aside transactions by the debtor, and generally avoiding the short limitations periods found in civil law. Effective pursuit of criminal measures may result in effective satisfaction of a claim which the debtor has illegally attempted to evade, specifically through the criminal measure of the duty to redress loss.

Therefore, in a criminal case in which the debtor is charged with an offence causing injury to a creditor, the creditor can and should seek an order under Penal Code Art. 46 imposing the sanction of the duty to redress loss. If the creditor fails to file such an application, it risks the loss of a favourable ruling by the criminal court in this respect. Such an application may be filed until the end of the first interrogation of the injured party at the main hearing, but may also be made earlier, in writing or orally for inclusion in the minutes of the testimony of the injured creditor as a witness.

In the criminal judgment, the court does not set a deadline for performance of the duty to redress loss, but the convicted debtor is required to perform the duty without delay. When the sentence imposing this sanction becomes legal final, it constitutes an enforceable writ just like a judgment in a civil proceeding. After issuance of an enforcement

clause, it may be enforced by the injured party through an execution proceeding conducted by the bailiff. The limitations periods provided by civil law do not apply to a claim for redress of loss caused by a criminal offence.

Finally, it should be pointed out that the criminal court may make acknowledgement or performance of the duty to redress a loss caused by a criminal offence a condition for suspension of a sentence of imprisonment imposed on a dishonest debtor (Penal Code Art. 72 §2). This may be of great importance in practice. Not many debtors are so determined not to pay their debts that they are willing to sacrifice their personal freedom to this end. If the debtor refuses to carry out the sanction—i.e. is capable of redressing the loss in whole or in part but fails to do so—the court may revoke the suspension of the sentence of imprisonment imposed on the perpetrator.

I have yet to encounter a situation in which the creditors were without hope

An interview with Jan Ciećwierz, a partner Wardyński & Partners, on how debtors avoid paying their obligations and how the law protects creditors from such actions.

What are difficult receivables?

Jan Ciećwierz: Performance of a commercial contract and payment of the contractual fee should mark the culmination of a business-to-business relationship. Unfortunately, the reality can be different. Sometimes the contract is not performed properly, giving rise to liability in damages, and sometimes the agreed fee is not paid. Even a legally final judgment in favour of the creditor and ordering the debtor to pay a specific sum of money, with enforcement backed by the weight of the Republic of Poland, is no guarantee that the fee or damages will be paid within a reasonable time. This state of affairs is largely due to actions by the debtor, often undertaken in the period leading up to commencement of litigation, with the goal of dissipating the debtor's assets so that they cannot be executed against in the future. The debtor's property may be concealed, transferred to third parties, or encumbered with other obligations, often enjoying priority in satisfaction above the claims of the creditor. In a situation that like that, we are dealing with the recovery of difficult receivables.

What measures to debtors take to prevent enforcement of their obligations?

There are several measures seeking to conceal assets from creditors or dispose of assets to frustrate execution that are the most common. Sometimes debtors will set up a separate legal entity to which they then transfer all or part of their assets. The inventiveness of debtors in such cases is

boundless. The debtor may, for example, use a series of legal and procedural steps to transfer its assets to a separate entity not directly owned by the debtor, but whose shares are held by another entity controlled by the debtor. The debtor may also enter into an agreement with a third party to sell specific assets without proof of payment of the purchase price, or at a price well below the market value of the assets. Another method is to transfer assets to relatives through gifts or fictitiously. The debtor may also transfer (or sell) all of its assets connected with operation of the debtor's business to a third party. It may place encumbrances on its assets for repayment of debts created for the purpose of "watering down" its true debt. Or it may conceal assets (chiefly cash) by transferring them abroad.

These are obviously just some examples, not an exhaustive list, as it is not our intention to inspire debtors to replicate the methods for a debtor to evade its obligations which we have encountered in our practice.

What instruments do creditors have at their disposal to protect themselves against such damaging actions by debtors?

The law is not helpless in the face of actions taken by dishonest debtors. The basic instrument for negating acts by debtors detrimental to creditors is the fraudulent conveyance action, which is aimed at obtaining a judgment against a third party who knew (or with due diligence should have known) of the injury to creditors but obtained a benefit at the expense of the debtor's assets and thus in concert with the debtor rendered the debtor insolvent, or insolvent to a greater degree than before the transaction. The effect of the ruling holding the transaction to be ineffective is that the creditor may execute its claim not only against the debtor but also against the third party, up to the amount of the benefit obtained by the third party.

If the debtor transfers its entire enterprise to a third party, the third party may be held jointly and severally liable with the debtor for obligations arising out of the operations of the enterprise, also up to the value of the enterprise acquired.

Transactions by debtors to the detriment of creditors may also be negated through a judicial ruling holding the transaction to be invalid. This results in restoring the specific assets or receivables to the debtor. Such situations result from the debtor's conclusion of a transaction contrary to law—typically sham transactions.

An equally interesting group of cases are those in which it is not necessary to commence a separate proceeding against a third party seeking payment, because it is sufficient to extend the effectiveness of an existing judgment against the debtor for monetary relief (an executable writ) in a proceeding for issuance of an additional enforcement clause against third parties. Such an enforcement clause may be sought against the debtor's spouse, or against the acquirer of the debtor's enterprise if the acquisition occurred before the executable writ became legally final.

The ability to pursue a claim against the personal assets of members of the management board of a company, rather than the assets of the company itself, is a separate issue. This is possible when it is found that the management board failed to file a bankruptcy petition for the company by the statutory deadline.

Without exhausting the catalogue of measures that may be pursued against dishonest debtors, I should also mention the criminal aspects of debtor's liability when by their actions they frustrate the just and lawful enforcement of their debts.

The examples you describe involve legal instruments that may be applied in a situation in which the creditor is aware that the debtor has shifted its assets around. But generally, when a creditor begins seeking enforcement it does not know about such manoeuvres by the debtor. How can the creditor find out?

I'm not sure that this is the right place to reveal this type of information. Just as law enforcement authorities do not disclose their

investigative techniques, out of concern that evidence of criminal conduct may be covered up, I need to protect the techniques developed by the law firm for pursuing information about actions by debtors designed to prevent enforcement of their debts. I can only say that any action by a debtor leaves a trail. Finding the trail requires work and inventiveness of lawyers, sometimes together with external specialists. The same thing is true when it comes to identifying the debtor's assets. It is encouraging to note that in my professional life I have yet to encounter a situation in which the creditors were without hope. Whether the creditors have sufficient determination, often combined with a willingness to incur costs, in order to ultimately obtain due satisfaction of their claims, is another issue.

Is that all that creditors can do?

No. There is much more they can do, but at the stage when they are drafting contracts with other parties rather than at the stage of execution of a legally final judgment. There is nothing quite as effective in assuring due performance of mutual obligations as properly securing the obligations at the stage of contract negotiation and signing. But that is a topic for another conversation.

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