

Don't hit the wall: how to deal with (and prevent) default in real estate projects

Real Estate and Insolvency Commissions

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National report - Slovak Republic

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1. Construction Contracts

1.1. Defending Employer's interests

1.1.1. Before entering into a construction contract, how can the employer check the financial standing of the contractor? Is credit/financial information publicly available in your jurisdiction?

Most of the information about the financial standing of business entities is available online for free. The employer can check the website of the [Companies Register](#) and the [Business Journal](#) whether the contractor did not enter into liquidation, declare bankruptcy or whether its restructuring did not begin.

The financial statements of all corporations (from year 2009) are available on the website of the [Registry of financial statements](#). Further, the employer can ask the Collection of Deeds for all/older financial statements (i.e. before the year 2009) in hardcopy after paying a fee in a certain amount, providing that the corporation fulfilled its legal obligation to publicize it. The corporations that are obliged to have the financial statements audited are also publicly available on the website of the Business Journal. One can check information about turnovers, profits etc. of the contractor for a couple of years back in time. The financial statements from year 2011 can be searched on the website of the Business Journal directly by entering the business name of the company and its identification number, while the financial statements from year 2004 can only be found by searching in particular editions of the Business Journal according to the date of its publication. Please note that in all cases only year-end financial statements are publicized, not the continuous ones. Unfortunately, the financial statements of sole traders (a personal entity conducting business) are not publicly available.

Further, the employer can check whether the contractor has a lien to movable registered in the [Notarial Central Register of Liens](#)¹, which is also available online for free.

If the contractor owes money for the social or health insurance or taxes, the employer can find it out by looking into the lists of debtors of the respective authorities, which are available on their websites.

What is considered as indicative information about the credibility of the contractor is whether it owns any real property. Ownership to real property and liens established to them can be discovered by random lustration on the website of the [Land Registry](#). But if one knows just the contractor's business name and identification number and wants to find out, whether it has any real property in a certain region or district, it can only be done by searching in individual municipalities and cadastral areas (for example in Bratislava region there are 121 cadastral areas, i.e. 121 searching possibilities).

1.1.2. Does your jurisdiction have standard conditions for construction contracts? If yes, what type of clauses do they provide for employers in case of contractor's insolvency?

Construction contract is not a separate contractual type in Slovak jurisdiction, but it falls under the contract for work. Legal regulation of the contract for work contains standard conditions used in such contracts, but the contracting parties can agree otherwise, because majority of its provisions is non-mandatory.

¹ All liens except for the possessory ones (when the lien is established by handing the pledge over to the pledgee or a third person) and those established by its registration in particular evidence (e.g. liens to trademarks) have to be registered in the Notarial Central Register of Liens.

In the case of insolvency of any of the contracting parties, provisions of the Act on Bankruptcy and Restructuring are applied.

Moreover, contracts for work in Slovak jurisdiction do not (usually) contain provisions directly for the case of the contractor's insolvency². However, it is a common practice for the contracting parties to declare that they are not aware of their insolvency or any facts or circumstances that might lead to the bankrupt, restructuring, liquidation or similar precautions in the representations and warranties of the contract.

The contract for work is regulated in two separate acts – the Commercial Code and Civil Code. Besides the difference in regulation of the contracts themselves under these Codes, general provisions about contractual relationships regarding e.g. the length of the limitation period, withdrawal from the contract, indemnification, contractual penalty etc. are different as well. What is the same in relation to both types of contract for work are the technical requirements for constructions. These are subject to a special law.

Below find standard legal conditions in the Slovak jurisdiction protecting the employer for the case of insolvency **indirectly**:

- a) **Civil Code** - its provisions will be used in case the contract is concluded between an entrepreneur as a contractor and non-entrepreneur as the employer, while the contract for work is regulated in its Sections 631 – 656. The provisions applicable for the indirect protection of the employer are stated as follows:

The price for the work is paid after the work is completed. Only if the work is executed by parts or it demands significant costs, the contractor is entitled to ask the employer for advance payments (these are common when the constructions are concerned).

The employer is entitled to withdraw from the contract if it is clear that the work will not be completed in time or that it will not be duly executed (this is usually clear in case of insolvency as the contractor is not able to pay for materials needed for construction i.e.) and if the contractor fails to remedy this even within a reasonable period provided.

- b) **Commercial Code** - its provisions will be used in case the contract is concluded between two entrepreneurs or between an entrepreneur and non-entrepreneur that agreed so, while the contract for work is regulated in its Sections 536 – 576. The provisions applicable for the indirect protection of the employer are stated as follows:

If the contractor builds the construction on employer's premises or on the premises the employer provided, the employer becomes automatically the owner of the construction and bears the risk of damages from the beginning of the construction works (unless agreed otherwise).

Claim for the payment of the price for work arises at the time determined in the contract; unless it follows otherwise from the contract or Commercial Code, the entitlement to the price shall arise upon completion of the work.

² Insolvency means (according to the Slovak legal regulation) that the debtor is not able to pay at least two financial obligations 30 days after their maturity to more than one creditor or the debtor, who is obliged to keep accountancy records, has more than one creditor and the amount of its obligations exceeds the amount of its property.

1.1.3. What kind of securities does the employer usually demand from the contractor?

Generally speaking, it is difficult to name typical securities in the contracts (for work). The securities demanded in practice in contracts for work are different according to the size of the business.

When it comes to small businesses or when the employer is a natural person, the contracting parties usually agree on a retaining lien of employer related to the price for work. The employer is entitled to retain certain amount of per cent of the price for work (usually around 5 %) for agreed period of time (usually a year or for the whole guarantee period) as a guarantee for the quality of work.

On the other hand, in the large construction projects the employer usually demands guarantee of the parent company/other connected company for the finishing of the construction or bank guarantee. Establishment of a retaining lien is also a common practice.

Further, the employer can ask the contractor to have the construction insured for the case of any risks or damages that may occur during its building.

1.1.4. In case of contractor's insolvency during the project, what alternatives does the employer have in order to carry it through?

As a result of insolvency of the contractor, bankruptcy on its property can be declared, or its restructuring may begin, depending on whether there is a possibility that at least a part of its business can be preserved (if so, the restructuring is usually the option).

In case of bankruptcy of the contractor providing that the construction is not built up yet or is built partially, the contract for work can be (and usually is) terminated by the employer or the bankruptcy trustee to the extent of the obligations not fulfilled (under the conditions stated in Section 45 of the Act on Bankruptcy and Restructuring – see the answer on the question 1.2.3. letter a)). Afterwards the employer may conclude a contract for work with other contractor and carry the construction through. In order to enable the new contractor to finish the construction, it is advisable to include (besides the securities mentioned in question 1.1.3.) the obligations of the contractor/subcontractors to continuously hand over the project documentation, keep records of its changes during the construction works etc. in contracts concluded with them.

The **restructuring** basically presumes continuing of the contractor in its business activity, i.e. also in the contract for work. The particularity of the restructuring is that the employer loses its right to withdraw from the contract for the contractor's default in its fulfillment, if the employer's claim arose before the restructuring began. The fate of the contractor's obligations under the contract depends on the restructuring plan afterwards. It decides whether the contract will be terminated or not and what happens to the mutual claims of the contracting parties. For the purposes of the successful continuity of the contract for work the same applies as stated in case of the bankruptcy above.

1.1.5. What kind of role do clauses regarding transfer of title play in construction contracts? Are clauses under which the contractor's materials, equipment and tools are deemed to be the property of the employer upon the moment the contractor brings these to the site valid in your jurisdiction and do they limit the powers of the bankruptcy estate?

The legal regulation of the contract for work under the Commercial Code expressly states, that if the construction is executed at the employer, on its premises or on the premises the employer provided, the ownership right to the construction belongs to the employer in any phase of its execution, in case the contracting parties do not agree otherwise. Although it is not expressly stated in the Civil Code (but in the case law and legal theory as well), the

employer also owns the construction already in the phase of beginning of the construction work, if the contract for work is concluded thereunder.

The contracting parties can agree (and usually do so) that the ownership right to the construction belongs to the contractor and it passes on the employer later on, for example after the price for the construction is fully paid.

It is not usual for the contracting parties to expressly agree on the ownership right to materials, equipment and tools of the contractor, so the legal regime as follows is commonly applied. As far as the ownership to the materials is concerned, these belong to the contracting party that provided them until the moment they become a part of the construction in the process of its building. After that, the materials follow the legal status of the construction, i.e. if the construction belongs to the employer, the materials that cannot be separated from it also belong to the employer. Depending on who owns the materials when the bankruptcy is declared, the materials are included in the bankruptcy estate or not – if the employer owns them, they cannot be included therein.

Although it is not expressly stated in legal regulation, the tools and equipment brought by the contractor to the site are its property (or the property of a third person that provided it – e.g. on the lease relationship basis); there is no reason for the transfer of the ownership right to them on the employer, because they do not become a part of the construction. Therefore, if the bankruptcy is declared, the tools and equipment usually become a part of the bankruptcy estate, because it is the contractor who is commonly their owner.

1.1.6. In case of employer's insolvency or loan default of the employer, is it typical that construction contracts contain instruments (e.g. novation agreements) for the financier to take over the project and the construction contract?

Such agreements are not typically part of the contract for work.

1.2. Defending Contractor's interests

1.2.1. What kind of securities does the contractor usually demand from the employer? Are any of these securities mandatory in your jurisdiction?

None of the securities used in the contract for work is mandatory. The securities demanded in practice in contracts for work are different according to the character of the employer/construction.

If the employer is a natural person/construction is private home, the contractor usually does not demand any security, but requires advance payments and/or partial payments after finishing of a part of the construction (payment schedule) instead. In some cases it may demand a guarantee, even a bank guarantee or rarely a notarial custody.

If the employer is a corporation/construction is not built for private purposes, besides the payment schedule a whole system of securities (guarantee of a parent/related company, bank guarantee, notarial custody) is commonly demanded by the contractor.

1.2.2. What other provisions (e.g. title retention, down-payment clauses etc.) are usually included in a construction contract to protect the contractor?

Apart from the securities under the answer to the question 1.2.1., the most common provision of the contract for work that protects the contractor is a so called tension of title. It means that the ownership right passes on the employer when the price for the construction is fully paid up.

1.2.3. Please describe the main effects on the contract in case of insolvency of the employer and focus on the following points:

As already mentioned, in case the contractor becomes insolvent, the bankruptcy on its property can be declared or its restructuring may begin, depending on whether at least a part of its business can be preserved for the future (if so, the restructuring usually begins). In case of declaration of the bankruptcy the **contracts** concluded with the contractor **are not terminated automatically by law**. The bankruptcy trustee or in even the contractor terminate it depending on the circumstances.

a) Does your jurisdiction have standard rules for termination of a contract in case of insolvency of the employer? If yes, can the parties deviate from these rules in their contract?

There are standard rules for termination of contracts in general for the case of insolvency of the debtor. These rules apply for the contract for work as well.

In case of declaration of the **bankruptcy**, there are several possible situations that may occur and are regulated in the Slovak jurisdiction as follows:

- If the employer fulfilled its obligation under the contract before the declaration of bankruptcy and the contractor's obligation is not fulfilled or is fulfilled just partially at the time of the declaration of bankruptcy, the bankruptcy trustee may demand the fulfillment of the contractor's obligation or it may withdraw from the contract. If the contractor fulfilled its obligation partially, the trustee may withdraw from the contract only to the extent of the obligations not fulfilled by the contractor;
- If the contractor fulfilled its obligation under the contract before the declaration of the bankruptcy and the employer's obligation is not fulfilled or is fulfilled just partially at the time of the declaration of bankruptcy, the contractor may withdraw from the contract to the extent of the obligations not fulfilled by the employer. The contractor's claims from such withdrawal can be applied for the bankruptcy only as a conditional claim³;
- If obligations of the contracting parties under the contract are not fulfilled at all or are fulfilled just partially at the time of the declaration of bankruptcy, the bankruptcy trustee or the contractor may withdraw from the contract to the extent of the obligations mutually not fulfilled. Claims of the contracting party from such a withdrawal can be applied for the bankruptcy only as a conditional claim³;
- If the contractor is obliged to fulfill its obligation (under the contract concluded with the employer before the declaration of bankruptcy) beforehand, it can refuse to fulfill it until the mutual fulfillment is provided or secured by the employer.

In case of **restructuring**, the contractor cannot withdraw from the contract or denounce it for the employer's default in fulfillment of the obligation if the claim for such fulfillment arose before the restructuring (see the details in answer to question 1.1.4). Such denouncement or withdrawal for such reason is ineffective. Also, provisions of the contract that enable the contractor to denounce the contract or withdraw from it for the reason of the bankruptcy or restructuring proceeding are ineffective.

The contracting parties cannot deviate from the abovementioned rules in their contract (for work). Once the employer declares bankruptcy or its restructuring begins, the contracting parties are obliged to follow the respective legal regulation.

³ Such receivable will be satisfied from the bankruptcy estate after the claim arises or after the condition under which it shall arise is fulfilled.

b) If the contract does not end by law, who gets to decide whether the contract is terminated or not?

Bankruptcy trustee or the contractor may terminate it by withdrawal from it, according to the rules mentioned in letter a) above.

c) If the contract is carried forward, is the employer still in charge or does the liquidator take over?

In case of bankruptcy of the employer it is not in charge, because the bankruptcy trustee takes over. The trustee has exclusive right to dispose of the employer's property and to act on its behalf with respect to it. It makes decisions as stated in point a) above, i.e. withdraws from the contract or asks the employer to fulfill its obligation under the contract, but usually does not continue in fulfillment of the contractor's obligations under it.

In case of restructuring, the employer acts in its own, but its legal acts other than the common ones (those that are necessary for the proper execution of its scope of business) are subject to the approval of the trustee to the extent determined by the court. The trustee will not approve of the acts that may reduce the value of the employer's property or make the restructuring unsuccessful.

1.2.4. What happens to the claim for remuneration of the contractor towards the employer:

a) In case of termination of the contract?

If the contract is terminated for the employer's bankruptcy according to the question 1.2.3. letter a) by the contractor, the contractor's claim for its remuneration will be satisfied from the bankruptcy estate after filing an application⁴ of a conditional claim for the bankruptcy proceeding. After filing an application the contractor is in the same position as other creditors and claimed receivables shall be settled by the bankruptcy trustee on the basis of a distribution plan; if receivables may not be settled to the entire extent, they shall be settled on a pro rata basis according to their mutual amounts.

In case of restructuring, the contractor has to apply its claim for payment of the price for construction in the restructuring proceeding within 30 days as of the permission of the restructuring. It will be satisfied according the restructuring opinion, which rearranges the establishment, change and expiry of all the employer's obligations applied for in the restructuring proceeding. Other claims (those not applied for) will lapse by the publication of the resolution on confirmation of the restructuring opinion by the court in Business Journal.

b) In case the contract is carried forward?

Provided that the bankruptcy is declared on employer's property, the contract will usually not be carried forward and will be terminated by the bankruptcy trustee or the contractor, under the conditions stated in the answer to the question 1.2.3. letter a). However, the bankruptcy trustee can decide to continue in the operation of the contractor's business or its part (so in the contract for work as well) under certain conditions stated in the Section 88 paragraph 1 of the Act on Bankruptcy and

⁴ Please note that the contractor does not have to decide on withdrawal from the contract immediately when the bankruptcy is declared (it may withdraw from it later on), but if it wants its claim to be satisfied in the bankruptcy proceeding, it must file an application therefore in such proceeding. The application must be filed within 45 days as the declaration of the bankruptcy and must state termination or future termination as the fact based on which the receivable is to arise or the condition on which the arising of the receivable depends.

Restructuring, mainly if higher degree of settlement of receivables of the creditors can be attained that way.

The claims that arose as a consequence of such continuance in the business during the bankruptcy are claims against the general bankruptcy estate that does not have to be applied. These claims are settled by the bankruptcy trustee from proceeds of the property that underlies bankruptcy or other activities of the bankruptcy trustee (such as lease of property etc.) separately (other claims are settled according to the specific schedule approved by the court). Although the creditors do not have to apply these claims for the bankruptcy proceeding, they must demand the reimbursement of these claims in particular amount in other way (e.g. by submitting the invoice or decision of respective authority). The trustee is obliged to settle such claims continuously depending on their maturity.

The contract can be carried forward in the restructuring process. The fate of the claim for remuneration depends on the restructuring opinion, which rearranges the establishment, change and expiry of all the employer's obligations applied for in the restructuring proceeding. The contractor's claim must be however applied for in the restructuring proceeding, otherwise it lapses by the confirmation of the restructuring opinion by the court.

1.2.5. During the project, who usually owns the parts of the building that have already been finished? Are there any rules in your jurisdiction that would allow the contractor to get a freehold of the construction site and continue the project with a different employer?

For the answer to the first part of the question see the answer to the question 1.1.5.

There are no particular rules in Slovak jurisdiction that would allow the contractor to get a freehold of the construction site. The opportunity of the contractor to continue the project with a different employer depends on whether it owns the land which the finished parts of the construction are built on and the finished parts of the construction themselves. If so, it can continue the project with a different employer.

1.2.6. What kind of provisions should/can a contractor include in the contracts with his subcontractors to protect himself in case of the employer's insolvency?

As the provisions focused specifically on the case of the insolvency of the employer are not typically part of the contracts for work, it is necessary to check the credibility of the employer and require all the suitable securities from it as stated in the answer to the question 1.2.1.

The contract concluded between the contractor and its subcontractors should contain a provision under which the contractor is entitled to withdraw from the contract in the case of the employer's insolvency.

2. Lease contracts

Lease contract is regulated under the Civil Code, Act on lease and sublease of non-residential premises and Act on the adjustment of certain conditions related to the lease of a flat and residential refund.

2.1. Is a lease affected by the foreclosure of a mortgage or other in rem guarantee over the leased property? May the new landlord terminate the lease?

Lease in general is not affected by in rem guarantees over the leased property. In case of change of the ownership right to the leased property, the new owner *ex lege* acquires the legal position of the landlord and the tenant is entitled to relieve itself of its obligations towards the former owner as soon as the change is notified to it or proved by the new owner.

The lease of real property remains unaffected as well. The change of the ownership right to the real property cannot be a reason for the termination of the lease by the landlord. Only the tenant can terminate the lease, even if the contract is concluded for a definite period of time and it must do so within the first upcoming termination period.

2.2. Does your jurisdiction afford any protection for the tenant in this case, for example, by guaranteeing the continuity of the lease agreement or a right of first refusal for acquisition of the leased property? Are there any requirements that need to be fulfilled if the tenant wishes to oppose these rights (if applicable) against his new landlord.

In Slovak jurisdiction the continuity of the lease agreement is guaranteed. The tenant is protected in case of change of the ownership right to the leased immovable as stated in the answer to the question 2.1. There are no specific requirements to be fulfilled except for those in the answer to the question 2.1. As a special kind of protection of the tenant can be considered the obligation to register the lease of the landed estate that lasts or is supposed to last at least 5 years in the Land Registry.

2.3. In case of insolvency of the tenant, is the landlord entitled to terminate the lease? Are insolvency clauses common in lease agreements in your jurisdiction? Are they normally upheld in court?

The lease agreements do not usually contain any insolvency clauses in Slovak jurisdiction and termination of the lease is regulated by the mandatory provisions of the Civil Code. In general the landlord is not entitled to terminate the lease immediately for the insolvency of the tenant.

Lease agreements on property other than flat or non-residential premises may be withdrawn by the landlord if the tenant, despite being warned, failed to pay the due rent before the next rent payment becomes due. If such a period is shorter than three months, then it shall be within three months.

Slovak jurisdiction provides particular mandatory provisions on termination of the lease agreement on a flat. If the tenant is a natural person and it fails to pay the rent or the payment for the performance provided along with the use of the flat for more than three months, the landlord will terminate the lease of a flat. If the notice on termination of lease by landlord has been given, but the tenant proves that it was without means of subsistence for objective reasons from the day of the delivery of the notice, the period of notice shall be extended for a protective period of six months.

Also, if a tenant (who is a natural person) that is without means of subsistence for objective reasons pays the landlord the due rent prior to the lapse of the protective period of six months, or agrees with the landlord in writing on the method of rent payment, it shall mean that the reason for the termination of the lease of the flat has lapsed.

2.4. What kind of securities does the landlord usually demand from the tenant? How tenant's insolvency may affect the ability of the landlord to execute these guarantees and collect rent and other monies due to under the lease?

In order to secure the payment of the rent, the landlord of a real property has, according to the Section 672 of the Civil Code, a **legal lien to the movables** located in the leased property and belonging to the tenant or to persons living with it in a common household, except from the property that may not be a subject of execution (e.g. necessary household equipment such as beds, table and chairs, fridge, washing machine etc., things of the tenant used for its business or fulfillment of its working tasks amounting to EUR 331.94, cash money amounting to EUR 99.58 etc.).

However, the lien shall expire if the property is removed earlier than a court enforcement officer lists the property, unless the lessor claims its rights at the court within eight days after the execution and such property of tenant was removed under an official court order. If the tenant is moving out or the property is being removed, even though the rent has not been paid or secured anyhow, the landlord may retain the property at its own risk. It shall simultaneously ask the court enforcement officer to draw up a list of the property within eight days or release the property. The court enforcement officer may also be a court executor.

After the bankruptcy proceeding has begun, the execution of such lien is considerably limited. In fact, the exercise of any security right may not be initiated or continued in respect of the property belonging to the tenant on the grounds of the tenant's obligation secured by such security right. Although the landlord is not entitled to execute the lien (and any of the security rights as well), its position within the bankruptcy is better than the other creditors have (that do not have any security right established to the property underlying bankruptcy). Its claim will be settled (preferentially) from the property that the lien is related to (along with other creditors who have any other security right established to such property)⁵. Only if its claim is not fully settled, it will be settled from the rest of the property that underlies bankruptcy together with other creditors.

Further, it is common at the beginning of the lease relationship (mainly when it comes to the lease of flats or non-residential premises) that the landlord asks a **deposit** in the amount of one or two rents from the tenant. The landlord holds the deposit for the whole period of lease to secure the possible damages that may occur and its claim for the rent. The contracting parties usually agree that the landlord is entitled to use the deposit if the tenant is in default in payment of the rent for the agreed period.

If the tenant is in default in payment of the rent and the landlord's claim for the deposit arises before the bankruptcy is declared, the deposit can be used for payment of the unpaid rent. But the use of the deposit for payment of the unpaid rent after the bankruptcy was declared is limited; as stated in Section 54 of the Act on Bankruptcy and Restructuring, a receivable that arose for the bankrupt after the declaration of bankruptcy may not be set off against a receivable that arose towards the bankrupt before the declaration of bankruptcy.

⁵ In order to use this *advantage*, the landlord has to apply the security right (together with the secured claim) in the application for the bankruptcy (within 45 days from the declaration of the bankruptcy); otherwise the security right will lapse.