The EU preventative restructuring framework – harmony or discord?

In 2014 the European Commission decided that a harmonised approach to restructuring proceedings was required to reduce the build-up of non-performing loans in EU banks, improve returns to creditors and encourage inward investment. It was also a key milestone in the capital markets union plan. The EU Directive on preventative restructuring frameworks, on discharge of debt and disqualifications and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt (the **Directive**) was finally agreed on 20 June 2019.

Unlike the Recast Insolvency Regulation which provides an operational framework for cross-border insolvencies but doesn't alter national insolvency laws, the Directive will require Member States to make substantive changes to their national restructuring and insolvency laws, and has to be implemented by 17 July 2021. It includes:

- Preventative restructuring frameworks;
- Procedures leading to a discharge of debt incurred by insolvent entrepreneurs; and
- Measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt.

This summary focusses on the preventative restructuring framework.

The Framework

Member States must provide debtors with access to a preventative restructuring framework (**PRF**) when there is a likelihood of insolvency. Debtors can then use the PRF to restructure and return to viability. Non-viable or insolvent debtors must be excluded from the process.

During the process, debtors will remain in control of their assets and the day to day operation of their business. Supervision by an insolvency practitioner (**IP**) will be decided on a case by case basis, although Member States can provide that the appointment of an IP is mandatory in certain circumstances. This move to a more Chapter 11 style "debtor in possession" process will be a significant change for a number of EU jurisdictions.

The stay

The debtor can apply to court for a stay of enforcement actions, covering both secured and unsecured claims. The stay will last for four months but Member States can allow courts to extend the stay to up to 12 months.

National laws requiring a debtor to open insolvency proceedings must be suspended during the stay. Member States can specify that the suspension will not apply if the debtor is cashflow insolvent, but the court must be able to decide to keep the stay in place if the opening of insolvency proceedings would not be in the general interests of creditors.

Creditors covered by the stay cannot withhold performance or terminate, accelerate or in any other way modify essential executory contracts necessary for the day to day operation of the business for non-payment of debts that existed prior to the stay. Creditors are also unable to withhold performance or terminate contracts solely by reason of the opening of the PRF or the stay.

Restructuring plans

As part of the PRF, the debtor can put forward a restructuring plan. The plan will be voted on by the affected parties who have to be split into classes which reflect commonality of interest based on verifiable criteria. Member States can choose to exclude equity holders from the classes. However, as a minimum, secured and unsecured creditors have to be put into separate classes.

The plan will be adopted if approved by at least 50% by value of each class. Member States can increase that percentage but to no more than 75%.

The plan has to be confirmed by the court in certain circumstances, including where the plan affects the claims or interests of dissenting affected parties. Where court confirmation is required, certain tests have to be met, including the "best interests of creditors test" where a value challenge is brought. This requires no dissenting creditor to be worse off than it would be if normal ranking of liquidation priorities under national law were applied either in the event of liquidation or in the event of the next-best-alternative scenario if the restructuring plan were not confirmed.

Even where there are dissenting creditors, the court can still confirm the plan using a cross-class cram down mechanism. The mechanism can only be used if (a) the plan meets the best interests of creditors test, (b) the plan has been approved by either a majority of the voting classes including a secured or senior class of creditors or by at least one class of affected or impaired creditors (excluding equity and any class which would be out of the money on a liquidation), and (c) dissenting creditors are treated at least as favourably as any other class of the same rank and more favourably than any junior class.

Plans which are approved or confirmed by the court are binding on all affected parties, but they can be appealed.

Protections are given to new and interim financing so that on any subsequent insolvency the financing can't be declared void, voidable or unenforceable. Member States can limit this protection to financing provided for a restructuring plan which is approved. They can also provide that such financing is given priority on any subsequent insolvency – although it is not clear whether this means the financing will rank ahead of secured debt.

Comment

Although the Directive is a welcome attempt to make restructuring in the EU a more predictable and faster process, the extent to which we end up harmonised approach has to be questioned:

- No attempt is made to harmonise the test for insolvency which will continue to be judged as a matter of national law. This can differ significantly from jurisdiction to jurisdiction;
- Member States are given a number of options in the way in which they implement the requirements, with some of the optionality being in significant areas such as the restructuring plan voting requirements.

The view from the UK: if Brexit happens before 17 July 2021 (as currently appears likely), the UK will be under no obligation to implement the Directive. However, many of the features of the Directive are mirrored in the 2016 corporate insolvency reform proposals and the UK may choose to bring in these reforms to remain an attractive place to restructure.

The view from Italy: On 10 January 2019, the Italian Government enacted the new Business Distress and Insolvency Code, which was drawn up taking into account the (then draft) Directive. The Italian Code is now more harmonized with the EU principles and in line with the Directive.

The Code will enter into force on 15 August 2020. Moreover, following a parliamentary enquiry on 8 March 2019, the Italian Government has received the authority to amend the Code, in order to eventually overcome certain persistent inconsistencies with the Directive's principles before the deadline for the transposition of the Directive.

The view from France: French law has already developed a strong culture of prevention with several tools and proceedings that comply with the Directive. However, French law will have to review its voting process on the plan to introduce separate classes of creditors (as opposed to the existing larger creditors' committees), the cross-class cram down and the "best interest of creditors'" test that requires a liquidation value test of the business as a going concern, today unknown in France. A recent Law enables the Government to transpose the Directive by Order (and not by Law) to accelerate and simplify the transposition process.

The view from Germany: The implementation of the Directive will be especially beneficial to Germany, one of the few remaining EU jurisdictions without pre-insolvency restructuring proceedings. Although Germany currently allows debtor-in-possession proceedings, these proceedings are only available once a debtor files for insolvency, as is the so-called protective shield proceeding. However, German insolvency law already includes a number of the features

of the PRF (such as the unenforceability of certain termination rights, the stay of individual enforcement actions and the concept of an insolvency or restructuring plan). The challenge for the German legislator will be to ensure the new process fits neatly with the existing insolvency proceedings.

The view from the Netherlands: On 5 July 2019 – only nine days after the publication of the Directive – the Netherlands Ministry of Justice published draft legislation addressing the PRF. This draft legislation was already being prepared for other purposes but prior to it being published it was updated to bring it in line with the relevant provisions of the Directive. Separate legislation will be published in due course implementing the Directive. A special feature of the proposed law is that it provides for both public and private pre-insolvency restructuring proceedings. The European Commission will be requested to bring the public proceedings within the scope of the EuInsVO (Annex A).

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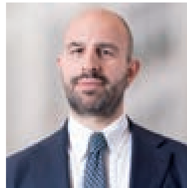

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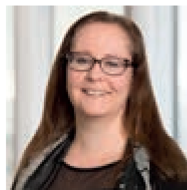

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