INSOLVENCY & RESTRUCTURING - EUROPEAN UNION

European Commission proposes directive on preventive restructuring frameworks

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Introduction

Insolvency rules cover a wide range of measures, including:

- early intervention before a company experiences serious difficulties;
- timely restructuring to ensure that viable business parts are preserved;
- the liquidation of assets where companies cannot be saved; and
- the discharge of debt in order to give reliable entrepreneurs a second chance.

However, measures adopted by EU member states differ significantly. Many investors cite uncertainty over insolvency rules or the risk of lengthy or complex insolvency procedures in another country as the main reasons for not investing or entering into business abroad.

Consistent insolvency and restructuring procedures would facilitate greater legal certainty and encourage the timely restructuring of viable companies in financial distress.

The European Commission has therefore proposed a directive on preventive restructuring frameworks.

Objectives

The proposal's key objective is to reduce significant barriers to the free flow of capital caused by differences in member states' restructuring and insolvency frameworks. It aims for all member states to implement key principles for effective preventive restructuring and second-chance frameworks, as well as measures to improve the quality and efficiency of all types of insolvency procedure by reducing their length and associated costs. More specifically, such frameworks aim to:

- help to increase investment and job opportunities in the single market;
- reduce the unnecessary liquidation of viable companies;
- avoid unnecessary job losses;
- prevent the build-up of non-performing loans;
- facilitate cross-border restructurings;
- reduce costs; and
- increase opportunities for reliable entrepreneurs to be given a second chance.

In addition, tailored rules are necessary to increase the efficiency of restructuring frameworks. Rules regarding managers' duty of care when a company is facing insolvency are also important in developing a culture of rescuing – rather than liquidating – businesses, as they encourage early restructuring and prevent misconduct and avoidable losses for creditors. Rules regarding early warning tools are equally important.

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The proposal does not harmonise core aspects of insolvency, such as rules on conditions for initiating insolvency proceedings, or provide a common definition of insolvency. Above all, the proposal aims to foster a rescue culture in the European Union.

The proposed directive also aims to prevent forum shopping by relocating firms to another member state with more rescue-friendly procedures. It is expected to be finalised in 2019 and implemented in 2022.

Content

Title I
Title I of the proposal governs its scope, including:

- the preventive restructuring procedures available for debtors in financial difficulty when there is a likelihood of insolvency according to Article 1(1)(a);
- procedures for the discharge of debts incurred by entrepreneurs and allowing them a fresh start (Article 1(1)(b)); and
- various measures to increase the efficiency of these procedures and of insolvency procedures (Article 1(1)(c)).

Article 2 defines a number of terms, including:

- 'insolvency procedures' (1);
- 'restructuring' (2);
- 'over-indebted entrepreneur' (13);
- 'full discharge of debt' (14); and
- 'practitioner in the field of restructuring' (15).

Further, Article 3 provides that entrepreneurs must have access to early warning tools which can detect deteriorating business development.

Title II
The main focus of the proposal is the binding introduction of preventive restructuring frameworks in Title II. According to Article 4, preventive restructuring frameworks will be available to debtors in financial difficulty on application by debtors – or creditors with the agreement of debtors – to avoid insolvency. A judicial authority will be involved only where necessary and proportionate.

According to Article 5, although the proposal allows debtors to remain in control of their assets and the day-to-day operation of the business, in certain circumstances member states may require a restructuring practitioner.

Article 6 allows the debtor a stay of individual enforcement actions in respect of one or all creditors only where such a stay is necessary to support the negotiations of a restructuring plan. A stay is limited to four months, but can be extended to a maximum of 12 months if significant progress has been made in the negotiations. Creditors' interests may not be prejudiced by a stay of individual enforcement actions.

According to Article 7, the debtor's obligation to file for insolvency under national law is not suspended during the stay period of individual enforcement actions. Member states may deviate from this only where the debtor becomes illiquid and therefore unable to pay debts during the stay period. A general stay covering all creditors will prevent the initiation of insolvency proceedings at the request of a creditor and postpone the decision. The article also discusses whether a stay covering only one creditor would be sufficient. During the stay period, creditors may not terminate contracts. Contracting parties may not withhold performance or terminate, accelerate or otherwise modify executory contracts to the detriment of the debtor for debts incurred before the stay.

Articles 8 to 15 of the proposal govern the procedures for the adoption, acceptance and confirmation of restructuring plans. Significantly, creditors are treated in separate classes, with each class comprising interests that are sufficiently similar when voting on the adoption of a restructuring plan. There must be a minimum of two classes and the required majority for the adoption of a restructuring plan in a group of creditors should be no higher than 75% of the amount of claims or interests in each class (although member states may stipulate a lower majority). Where the necessary majority is not reached in a voting class, the plan may still be approved if it complies with certain requirements. In the case of a cram-down of dissenting classes, a restructuring plan must be approved by a judicial authority. The plan must also comply with the absolute priority rule (ie, a dissenting class must have been fully satisfied before a subordinate class can receive any payment or consideration).

Title III

Title III of the proposal provides for a binding introduction of a discharge procedure to give over-indebted entrepreneurs a second chance. According to Article 19, full discharge of debt is conditional on a partial repayment by the entrepreneur. Further, Article 20 provides that entrepreneurs may be fully discharged from their debts after no longer than three years.

Title IV

Title IV of the proposal states that the members of the judiciary and administrative authorities (Article 24) and the practitioners (Article 25 and following) appointed in restructuring, insolvency and second-chance matters should receive initial and subsequent training. Article 27 stipulates that member states should implement appropriate oversight and regulatory structures to ensure that restructuring, insolvency and second-chance practitioners are appropriately supervised. Further, according to Article 28, the use of electronic communication should increase efficiency, especially in cross-border transactions.

Future prospects

The proposed directive is expected to reduce the cost and duration of restructuring procedures. In addition, the possibility to stay individual enforcement actions during the preventive restructuring procedure will considerably improve a debtor's prospects in negotiations and prevent a minority of dissenting creditors and shareholders from jeopardising restructuring efforts.

Consequently, more viable firms should be saved, as creditors would be unable to destabilise negotiations in order to gain commercial advantage (eg, by enforcing early recovery of debts).

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