NEW EU RESTRUCTURING DIRECTIVE: HARMONY IN TROUBLED TIMES

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EU Restructuring & Insolvency Alert

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INTRODUCTION

Following recent proposed changes to UK restructuring and insolvency law, a new European Union ("EU") directive concerning restructuring within EU Member States proposed by the European Commission ("Commission") has reached an advanced stage. First, the Committee on Legal Affairs of the European Parliament ("Parliament") adopted its legislative report on the proposal and, more recently, the Council of the European Union ("Council") reached its general approach. These three main EU institutions are now ready to start negotiation meetings (the so-called 'trilogues') in order to find a compromise on the final legal text. The directive would lay down harmonised rules in relation to:

- preventive restructuring frameworks available for debtors in financial difficulty (and, where provided under national law, non-financial difficulty), when there is a likelihood of insolvency;
- procedures leading to a discharge of debt incurred by insolvent entrepreneurs and any linked disqualification periods; and
- measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt.

This alert will set out the main provisions of the draft directive and outline its route and timetable to implementation.

1. AVAILABILITY OF PREVENTIVE RESTRUCTURING FRAMEWORKS

If the Directive is implemented, EU Member States will need to ensure that, where there is a likelihood of insolvency, debtors have access to a national preventive restructuring framework that enables them to restructure with a view to preventing insolvency and ensuring their viability. In this context, the Parliament would limit such access to enterprises that have not been sentenced for serious accounting and bookkeeping breaches. The Council would confer on Member States the opportunity to introduce or maintain a viability test with the purpose of excluding debtors that do not have a prospect of continuing viability and which can be carried out without detriment to the debtors' assets.

The number of times a debtor can access such a preventive restructuring framework may be limited within a certain period. The framework may consist of one or more procedures, measures or provisions.

Provisions may be put in place limiting the involvement of a judicial or administrative authority to where such involvement is necessary and proportionate. The framework may be available on application by debtors or creditors.

2. DEBTOR IN POSSESSION AND INSOLVENCY PROFESSIONALS

Debtors accessing preventive restructuring procedures must remain totally, or at least partially, in control of their assets and the day-to-day operation of the business.

Where necessary, the appointment by a judicial or administrative authority of a practitioner in the field of restructuring shall be decided on a case-by-case basis, except in certain circumstances the mandatory appointment in every case of such a practitioner may be required.

3. STAY OF INDIVIDUAL ENFORCEMENT ACTIONS

Debtors may benefit from a stay of individual enforcement actions (including secured claims and preferential claims) to support the negotiations of a restructuring plan in a preventive restructuring framework.

The stay of individual enforcement actions can be general, covering all creditors, or can be limited, covering one or more individual creditors or categories of creditors. Workers' claims may not be stayed.

The initial duration of the stay of individual enforcement actions must be limited to a maximum period of no more than four months. However, judicial or administrative authorities may be enabled to extend the duration of the stay of individual enforcement actions or to grant a new stay of individual enforcement actions, upon request of the debtor, a creditor or, where applicable, a practitioner in the field of restructuring. Such extension or new period of stay of individual enforcement actions shall be granted only in well-defined circumstances where such extensions or new periods of stay are duly justified. In the view of the Commission and the Council, the total duration of the stay of individual enforcement actions, including extensions and renewals, shall not exceed twelve months. The Parliament however recommends a possible extension of up to ten months. These are maximum time periods and Member States would be allowed to introduce shorter stays.

4. CONTENT OF RESTRUCTURING PLANS

Member States shall require restructuring plans submitted for adoption or confirmation by a judicial or administrative authority, to contain at least the following information:

the identity of the debtor;

a valuation of the debtors' assets and liabilities at the moment of submission of the restructuring plan as well as a description of the economic situation of the debtor and a description of the causes and the extent of the difficulties of the debtor;

the affected parties, whether named individually or described by categories of debt, as well as their claims or interests covered by the restructuring plan;

the classes into which the affected parties have been grouped for the purpose of adopting the restructuring plan and the respective values of claims and interests in each class;

the parties, whether named individually or described by categories of debt, together with a description of the reasons why it is proposed to not affect them;

the terms of the restructuring plan, including, in particular:

its proposed duration

any proposal by which debts are rescheduled or waived or converted into other forms of obligation;

any new financing anticipated as part of the restructuring plan; and

the Council would also include in the plan any proposed restructuring measures and the Parliament suggests adding a proposal for a stay of individual enforcement actions, the provision of information to and consultation with workers' representatives and employment issues (e.g. dismissals, part-time work or similar); and

a statement of reasons which explains why the restructuring plan has a reasonable prospect of preventing the insolvency of the debtor and ensuring the viability of the business, including the necessary pre-conditions for its success.

5. VOTING TO ADOPT THE PLAN

Affected parties must have a right to vote on the adoption of a restructuring plan; however they may exclude equity holders.

Affected parties must be treated in separate classes which reflect commonality of interest. As a minimum, secured and unsecured claims shall be treated in separate classes for the purposes of adopting a restructuring plan. Member States may also provide that workers are treated in a separate class of their own.

The formation of classes shall be examined by a judicial or administrative authority when a request for confirmation of the restructuring plan is submitted. The EU co-legislators agree that Member States may provide for a judicial or administrative authority to examine and confirm the formation of classes at an earlier stage.

A restructuring plan shall be adopted by affected parties, provided that a majority in the amount of their claims or interests is obtained in each class. Member States may, in addition, require that a majority in the number of affected parties is obtained in each class.

Member States shall lay down the majorities required for the adoption of a restructuring plan. Those majorities shall not be higher than 75% in the amount of claims or interests in each class.

6. CONFIRMATION OF PLAN

At least the following restructuring plans are to be binding on the parties only if they are confirmed by a judicial or administrative authority:

restructuring plans which affect the interests of dissenting affected parties; and

restructuring plans which provide for new financing.

The conditions under which a restructuring plan can be confirmed by a judicial or administrative authority must be clearly specified and include at least the following:

the restructuring plan has been adopted;

the restructuring plan complies with the best-interest-of-creditors test;

any new financing is necessary to implement the restructuring plan and does not unfairly prejudice the interests of creditors.

Judicial or administrative authorities must be able to refuse to confirm a restructuring plan where that plan would not have a reasonable prospect of preventing the insolvency of the debtor or ensuring the viability of the business.

7. CROSS CLASS CRAM DOWN

A restructuring plan which is not approved by all voting classes of affected parties, may be confirmed by a judicial or administrative authority upon the proposal of a debtor or with the debtor's agreement, and become binding upon dissenting voting classes where the restructuring plan fulfils certain conditions, including that:

it has been approved by at least one class of affected creditors other than equity-holders *and* any other class which would not receive any payment or other consideration; and

it complies with the absolute priority rule.

The Parliament broadly agrees with the original text, but suggests that the restructuring plan should be approved by *the majority* of classes (other than equity-holders *or* any other class which would not receive any consideration). The Council proposes to significantly amend the original text, introducing the requirement that no class of affected parties can receive or keep more than the full amount of its claims or interests and the possibility that the requirement for the debtor's agreement may be limited to cases where debtors are small and medium sized enterprises.

Moreover, according to the Council's position, in order for the restructuring plan to be confirmed, it must be approved by either:

at least one voting class of affected parties, or, where so provided under national law, impaired parties, other than an equity-holders class or any other class which, upon a valuation of the debtor as a going concern, would not receive any payment or keep any interest, or, where so provided under national law, can be reasonably presumed not to receive any payment or keep any interest, if the normal ranking of liquidation priorities were applied under national law; or a majority of voting classes of affected parties, provided that at least one of those classes is a secured creditor class or is senior to the ordinary unsecured creditors' class.

8. PROTECTION FOR NEW AND INTERIM FINANCING AND OTHER RESTRUCTURING RELATED TRANSACTIONS

New financing and interim financing must be adequately protected. In particular, new financing and interim financing shall not be declared void, voidable or unenforceable unless such transactions have been carried out fraudulently or in bad faith.

The Council would also require that the grantors of such financing shall not incur civil, administrative or criminal liability on the sole ground that such financing is detrimental to the general body of creditors.

Furthermore, in the Council's opinion, Member States may provide that, in the case of any subsequent insolvency of the debtor, grantors of new or interim financing are entitled to receive payment with priority in relation to other creditors that would otherwise have superior or equal claims.

In the case of any subsequent insolvency of the debtor, transactions that are reasonable and immediately necessary for the negotiation of a restructuring plan must not be declared void, voidable or unenforceable on the sole grounds that they are detrimental to the general body of creditors. This scope may be limited to cases where the plan is confirmed by a judicial or administrative authority or where such transactions were subject to control based on forecasts not results.

Transactions may be excluded if they are concluded after the debtor has become unable to pay their debts as they fall due.

In the case of any subsequent insolvency of the debtor, any transaction which is reasonable and immediately necessary for the implementation of a restructuring plan and is carried out in accordance with the restructuring plan confirmed by a judicial or administrative authority must not be declared void, voidable or unenforceable on the sole ground that such transaction is detrimental to the general body of creditors.

9. ACCESS TO DISCHARGE FOR INSOLVENT ENTREPRENEURS

Insolvent entrepreneurs must have access to at least one procedure that can lead to a full discharge of debt. If a full discharge of debt is conditional on a partial repayment of debt by the entrepreneur, the related repayment obligation must be based on the individual situation of the entrepreneur and, in particular, is proportionate to the entrepreneur's seizable or disposable income and assets during the discharge period.

In this context, the Council would set the maximum period after which insolvent entrepreneurs are able to be fully discharged of debt at three years. Those who have complied with their obligations, where such obligations exist under national law, shall be discharged of their debt on expiry of the discharge period without the need to apply to a judicial or administrative authority to open any additional procedure.

If an insolvent entrepreneur obtains a discharge of debt in accordance with the Directive, any disqualifications from taking up or pursuing a trade, business, craft or profession on the sole ground that the entrepreneur is insolvent, shall cease to have effect, at the latest, at the end of the discharge period.

However, provisions denying, restricting or revoking access to discharge of debt or providing for longer periods for obtaining a full discharge of debt or longer disqualification periods may be introduced in certain well-defined circumstances and where such derogations are duly justified, such as:

where the insolvent entrepreneur acted towards the creditors or other stakeholders dishonestly or in bad faith according to national law when becoming indebted, during the insolvency procedure or during the payment of the debt;

where the insolvent entrepreneur does not adhere to a repayment plan or to any other legal obligation aimed at safeguarding the interests of creditors, including an obligation to maximize returns to creditors;

where the insolvent entrepreneur fails to comply with information or cooperation obligations under national law;

in the case of abusive applications for a discharge;

in the case of a new application for a discharge within a certain period after the insolvent entrepreneur has been granted a full discharge of debt or has been denied a full discharge of debt due to a serious violation of information or cooperation obligations;

where the cost of the procedure leading to the discharge of debt is not covered; or

where a derogation is necessary to guarantee the balance between the rights of the debtor and the rights of one or more creditors.

Specific categories of debt may be excluded, such as:

secured debts;

debts arising out of or in connection with criminal penalties;

debts arising out of tortious liability;

debts regarding maintenance obligations arising from a family relationship, parentage, marriage or affinity;

debts incurred after the application for or opening of the procedure leading to a discharge of debt; and

debts arising out of the obligation to pay the cost of the procedure leading to a discharge of debt, from discharge of debt, or restrict access to discharge of debt or lay down a longer discharge period where such exclusions, restrictions or longer periods are duly justified.

There may be longer or indefinite disqualification periods where the insolvent entrepreneur is a member of a profession to which specific ethical rules or specific rules on reputation or expertise apply or a profession dealing with the management of the property of others, or where an insolvent entrepreneur intends to gain access to such a profession.

10. EFFICIENCY MEASURES

Without prejudice to judicial independence and to any differences in the organisation of the judiciary across the EU:

the members of the judicial and administrative authorities dealing with procedures concerning restructuring, insolvency and discharge of debt must receive suitable training and have the necessary expertise for their responsibilities; and procedures concerning restructuring, insolvency and discharge of debt must be dealt with in an efficient manner.

As regards practitioners in this field, the Parliament fully agrees with the original proposal by the Commission. The Council takes a limited principle-based approach requiring practitioners appointed by a judicial or administrative authority in procedures concerning restructuring, insolvency and discharge of debt to receive suitable training and have the necessary expertise for their responsibilities. The conditions for eligibility, as well as the process for the appointment, removal and resignation of practitioners, must be clear, transparent and fair. In appointing a practitioner for a particular case, including cases with cross-border elements, due consideration must be given to the practitioner's experience and expertise, taking into account the specific features of the case. In order to avoid any conflict of interest, debtors and creditors must have the possibility to either object to the selection or appointment or request the replacement of the practitioner.

11. ROUTE AND TIMETABLE TO IMPLEMENTATION

The harmonisation process of business insolvency rules is of course accompanied by disputes and fierce lobbying by all sides. Importantly, the Parliament's legislative report on the proposal lacked the support of one of the most important political groups and, as we could see later once the Council adopted its own position, Member States often disagreed with Parliament on key issues within the proposal.

Banking associations were among the first to take action, warning that the maximum duration of the stay period (four months, extendible up to ten or twelve months) affects the rights of creditors and/or banks to enforce their repayment claims. Moreover, they argue that such a period is not consistent with the Capital Requirements Regulation under which a bank has to consider a repayment claim as in default if the debtor is overdue on a payment for more than 90 days.

Following the adoption of a common position by the Council, the institutions can now launch a series of 'trilogues' in order to resolve controversial issues and prepare the ground for an agreement on a common text. The declared objective of the co-legislators is to finalise the legislative path of the Directive before the 2019 European elections, towards the end of May 2019. The Council, on the one side, and the Parliament, on the other, will have to iron out certain differences on important issues within the proposal, such as the cross class cram down mechanism and the degree of flexibility granted to Member States.

After the Directive enters into force, Member States would have to transpose almost all new rules into domestic legislation within two years (according to the Parliament and the Commission), or three years (according to the Council). This indicates that, under present conditions regarding the potential Brexit transition period, the government of the United Kingdom will be free to consider whether and how to implement these rules.

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