

The European Commission's Directive Proposal for common principles and rules on preventive restructuring frameworks, insolvency and second chance



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Emmanuelle Inacio takes a closer look at the new EC directive...

On 22 November 2016, the European Commission presented the long-awaited proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU¹.

The European Commission Directive (the Proposal) is part of the Capital Markets Union Action Plan and the Single Market Strategy that announced a legislative initiative on business insolvency, including early restructuring and second chance which aims at removing key barriers to the development of capital markets in the EU by providing legal certainty to cross-border investors and companies operating across the EU.

Indeed, reviews of the implementation of the 2014 Commission's non-binding recommendation on restructuring and second chance² showed that, despite reforms in the area of insolvency, rules still diverge and remain inefficient in some countries, which means continuing legal uncertainty, additional costs for investors in assessing their risks, less developed capital markets and persisting barriers to the efficient restructuring of viable companies in the EU, including cross-border groups of companies.

Furthermore, even if the new European Insolvency Regulation of 20 May 2015 (EIR Recast), replacing the EIR of 29 May 2000 and applying to insolvency

proceedings which will be opened after 26 June 2017 extends the scope of the EIR to preventive procedures which promote the rescue of an economically viable debtor and give a second chance to entrepreneurs, it is not an instrument harmonising Member States' substantive insolvency laws but a private international law tool. Indeed, the new EIR does not tackle the discrepancies between these procedures.

The aim of the Proposal is above all to enhance the rescue culture in the EU by establishing a common EU-wide framework able to ensure effective restructuring, second chance and efficient procedures both at national and cross-border level.

The Proposal does not harmonise core aspects of insolvency proceedings but gives Member States the flexibility to achieve the objectives by applying the key principles and targeted rules in a way that is suitable to their national contexts. This is particularly important since some Member States already have elements of well-functioning frameworks in place.

The Proposal consists of 47 recitals and 36 Articles and aims to introduce in the Member States the common principles on the use of preventive restructuring frameworks (Title II), rules to provide a second chance for entrepreneurs (Title III) and targeted measures for the Member States to increase the efficiency of restructuring, insolvency and second chance (Title IV and V).

Common principles on the use of preventive restructuring frameworks

The Proposal aims to put in place common, core elements for preventive restructuring frameworks to give debtors in financial difficulty, be they legal or natural persons, effective access to procedures facilitating restructuring plans' early negotiation, adoption by creditors and possible confirmation by a judicial or administrative authority in order to reduce the number of formal insolvency filings in the EU and thereby maximize the value to the involved stakeholders.

For this purpose, the Proposal requires the Member States to:

- ensure that the debtor remains totally or at least partially in control of its assets and affairs;
- limit the circumstances in which a practitioner in the field of restructuring may be appointed;
- allow the debtor to apply for a general or limited stay of individual enforcement actions to support the negotiations of a restructuring plan of up to four months, which can be extended or renewed for up to 12 months by the judicial or administrative authorities, precluding the opening of insolvency proceedings, security enforcement, and any contractual rights of termination or acceleration;
- include minimum mandatory information in restructuring plans submitted for confirmation by a judicial or



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- administrative authority;
- provide for a restructuring plan to be adopted by the necessary majority of affected creditors voting in classes;
- allow a cross-class cram-down mechanism if the restructuring plan is not supported by all classes of creditors;
- ensure that the restructuring plan is approved by a judicial or administrative authority if the plan affects the interests of dissenting affected parties or provides for new financing to make it binding;
- ensure that when deciding on the approval of a plan, the authority reviews its compliance with the requirements for the adoption of the plan and that the plan is in the best interest of creditors;
- protect new and interim financing by ranking such financing at least senior to the claims of ordinary unsecured creditors and other restructuring related transactions against avoidance; and
- impose specific duties where there is a likelihood of insolvency, to ensure that directors pursue early restructuring when the business is viable.

Rules to provide a second chance for entrepreneurs

The Proposal sets up minimum provisions on discharge of debt for over-indebted entrepreneurs as the basic conditions for ensuring entrepreneurs a second chance in order to boost entrepreneurship and prevent costly forum shopping.

The Member States are required to ensure that honest over-indebted entrepreneurs may be fully discharged from their debts after maximum three years and have the benefit of short disqualification orders without the need to re-apply to a judicial or administrative authority. Where personal and professional debts are intertwined, the Proposal

states that the Member States should try to consolidate the separate procedures.

Targeted measures for Member States to increase the efficiency of restructuring, insolvency and second chance

The Proposal also contains provisions to improve the efficiency of the Member States' restructuring and insolvency laws in order to reduce the excessive length and costs of procedures in many Member States, which results in legal uncertainty for creditors and investors and low recovery rates of unpaid debts.

To that purpose, Member States are required to ensure that members of the judiciary and administrative authorities are properly trained and specialised in restructuring, insolvency and second chance matters and that these matters are dealt with in an efficient manner which ensures expeditious treatment of the procedures.

In addition, the Member States are required to ensure that insolvency practitioners receive adequate training, so that their services are provided in an effective, impartial, independent and competent way in relation to the parties. To that end, codes of conduct are encouraged by the Proposal.

Regarding the appointment, removal and resignation of practitioners, a clear, predictable and fair process is required in all Member States. In particular, the criteria concerning the manner in which the judicial or administrative authority selects such a practitioner must be clear and transparent and the Member States must give consideration to the practitioner's experience and expertise. In cross-border situations, the practitioner's ability to communicate and cooperate with foreign insolvency practitioners and authorities and the human and administrative resources must be taken into account. Moreover, the debtors and creditors shall be consulted in the selection of the practitioners.

Lastly, the Proposal requires that their work be subject to appropriate supervision, regulatory structures and an effective regime of sanctions and that their fees be governed by rules which incentivise timely and efficient resolution.

The Proposed Directive adopts many of the recommendations for minimum standards presented by INSOL Europe's Insolvency Office Holders, which were presented to the European Commission, DG Justice in July 2016³.

Next Steps

To be enacted as a binding European directive, the Proposal will need to be approved by the European Council following hearings before the European Council and the European Parliament. The Proposal will probably undergo some changes in the upcoming EU legislative process.

The Member States will then be required to transpose the directive's provisions into their respective legal systems within two years of its entering into force at the EU level and within three years from such date for its provisions on increasing the efficiency of restructuring, insolvency and second chance.

Against this background, the INSOL Europe Turnaround Wing has launched a new project during the Annual Congress in Cascais, under the co-chair of Alberto Núñez-Lagos, outgoing President of INSOL Europe, on the legal implementation of the preventive restructuring frameworks regulated in Title II of the future Directive.

The first outcomes of the Turnaround Wing's project will be presented during the Annual Congress in Warsaw which will be held on 5-8 October 2017. ■

Footnotes:

- http://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=50043.
- C(2014) 1500 final, 12 March 2014.
- www.insol-europe.org/ioh-forum-news



THE PROPOSED DIRECTIVE ADOPTS MANY OF THE RECOMMENDATIONS FOR MINIMUM STANDARDS PRESENTED TO THE EUROPEAN COMMISSION BY INSOL EUROPE'S INSOLVENCY OFFICE HOLDERS



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