The impact of the Directive on shareholders, companies' directors and workers

Catarina Serra looks at the proposed Directive on pre-insolvency proceedings from another angle

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As widely announced, the so-called "Proposal for a Directive on pre-insolvency proceedings" was made public before 2016 ended (on 22 November)[1].

With a view to a minimum harmonisation of substantive insolvency law, the future Directive aims to put in place common principles and rules to improve the efficiency of the Member States' restructuring and insolvency laws[2], particularly in respect to preventive restructuring frameworks.

It is hardly noticeable at first sight but the amendments put forward in the Proposal go far beyond the borders of insolvency or pre-insolvency law. They cross over to the fields of company law and even labour law, affecting not only the usual players (debtor and creditors) but also the other companies' stakeholders, namely the shareholders, the companies' directors, and the workers.

When enacted and transposed into the national laws, the Directive will have an impact on the legal status of these individuals, as a result of several measures, especially the possibility of derogating the requirement for a shareholders' meeting and the shareholders' pre-emption right to new shares in capital increases, a wrongful trading rule for directors and the special treatment of workers. All for the sake of restructuring.

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Undermining shareholders' rights

One of the most impressive measures of the Directive is the possibility of derogating some of the rules consecrated in the so-called "Second Company Law Directive (Recast)" (also known as "Directive on shareholders' rights")[3].

Pursuant to Article 32[4], a paragraph is added to Article 45 of the Second Company Law Directive, determining that Member States shall derogate from Article 19 (1), Article 29, Article 33, Article 34, Article 35, Article 40 (1) (b), Article 41 (1) and Article 42 to the extent and for the period that such derogations are necessary for the establishment of the preventive restructuring framework provided for in the future Directive on pre-insolvency proceedings.

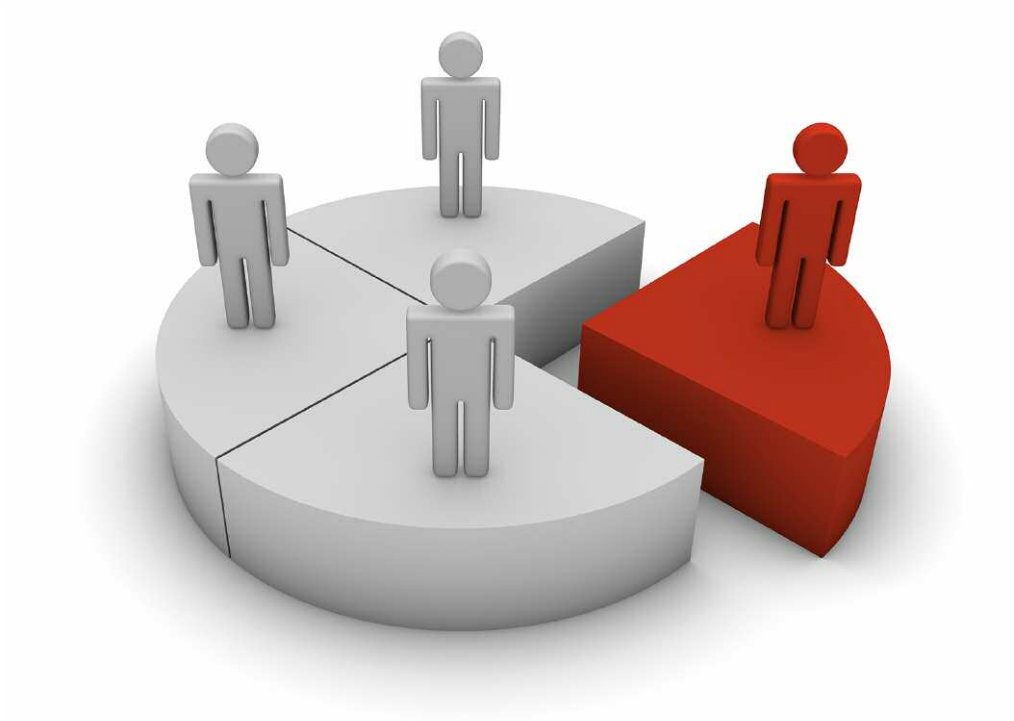
The above mentioned provisions require that a general meeting of shareholders takes place in certain situations (serious loss of the subscribed capital, increase in capital and reduction of the subscribed capital when there are several classes of shares, when there is a compulsory withdrawal of shares and when there is a withdrawal of shares acquired by the company itself or by a person acting in his own name but on behalf of the company) and that, when capital is increased by consideration in cash, the shares are offered on a pre-emptive basis to shareholders in proportion to the capital represented by their shares.

The goal pursued by the European legislator is easy to grasp: prevent shareholders from jeopardising the restructuring effort[5]. Let us bear in mind, though, that the derogations touch sensitive matters of company law and, more importantly, their accommodation in the legal systems of Member States will trigger the need for a careful coordination between insolvency law and company law frameworks. This will make it quite a challenging task for domestic legislators.

Placing (more) responsibility on directors

Article 18 lays down a rule on directors' duties in the vicinity of insolvency. According to this provision, Member States shall establish rules to ensure that, where there is a likelihood of insolvency, directors have the following obligations:

(a) to take immediate steps to minimise the loss for creditors, workers, shareholders and other stakeholders;
(b) to have due regard to the interests of creditors and other stakeholders;
(c) to take reasonable steps to avoid insolvency; and
(d) to avoid deliberate or grossly negligent conduct that threatens the viability of the business.



> IN ACCORDANCE WITH ARTICLE 9 (2), "MEMBER STATES MAY ALSO PROVIDE THAT WORKERS ARE TREATED IN A SEPARATE CLASS OF THEIR OWN"

The link between this provision and Section 214 of the English Insolvency Act (wrongful trading)[6] immediately stands out. Resorting to the legislator's own words, directors are expected "to take every step with a view to minimising the potential loss to the company's creditors"; otherwise, they will be held liable.

The accommodation of such a regime in the national laws of certain Member States may give rise to concern for it represents the adoption of criteria which are, at the same time, broader and more imprecise than the ones used in a significant part of European jurisdictions[7]. It is undisputed that the regime places (more) responsibility on directors, imposing on them a set of serious duties. But the results of an extended application are unpredictable: only where national courts feel confident in applying vague legal concepts may the broadness of the regime translate into an increase in the number of cases that end up with the liability of directors. And even if this is the case, not all is perfect. In fear of being held liable, directors will be risk-averse and, what is more, will demand higher remunerations.

Enhancing the protection of workers

The preferential treatment granted to workers under the Directive may be viewed as threefold and lies on:

(1) the workers' possibility to form a separate class of their own;
(2) the exemption from stay of individual enforcement actions for workers; and
(3) the enhanced protection for work already carried out.

In accordance with Article 9 (2), "Member States may *also* provide that workers are treated in a separate class of their own". The Proposal provides, in general, for the treatment of affected parties in separate classes for the purpose of voting on the adoption of the restructuring plan, the class formation criterium being the similarity of claims or *interests* likely to justify a homogenous group with commonality of interest. The reference to the similarity of *interests* (not just claims) and the word "also" in the part of the provision referring to the possible formation of a separate class for workers suggest that the workers may present themselves as a class *even when they do not hold claims or irrespective of that capacity*.

Under Article 6 (3), Member States shall ensure that the workers' outstanding claims are spared the effects of the stay of individual enforcement actions to the extent that Member States do not provide for an appropriate protection by other means or, more precisely, if they do not ensure that the payment of such claims is guaranteed at a level of protection at least equivalent to that provided for under the relevant national law transposing Directive 2008/94/EC[8]. This means that the workers may continue to bring enforcement actions against the debtor with a view to obtaining the payment of their outstanding claims. The possibility is in accordance with the rule, laid down in Article 6 (2), that the stay may be general, covering all creditors, or limited, covering one or more individual creditors. Even so, it should be noted that the only exception expressly provided for in the Proposal regards the workers' claims.

Finally, pursuant to Article 17 (1) and (2) (c), Member States shall ensure that the payment of worker wages for work already carried out is not declared void, voidable or unenforceable as acts

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detrimental to the general body of creditors in the context of subsequent insolvency procedures, unless such transactions have been carried out fraudulently or in bad faith. There is a presumption that this work is carried out to further the negotiation of a restructuring plan confirmed by a judicial or administrative authority or closely connected with such negotiations.

Final remarks

Some tend to underestimate the anticipated changes based on the (little) value of the Proposal, which, to be sure, is deprived of legal force. Furthermore, it is not certain that the Directive will be approved in the terms laid down in the Proposal, or at all. Should the latter be the case, we would just be waiting for Godot…

Nonetheless, it is not wise to ignore the Proposal. In the worst-case scenario, the Proposal unveils the current trends of insolvency law and this alone makes it worth considering. At best, the Directive will be approved as usual and will confirm the amendments put forward by the Proposal.

As discussed above, some of the amendments will be surprising for those who remain unaware of the connecting links between the insolvency law and the other legal branches[9]. The truth is that the recent (re)focus of the insolvency law on business/corporate restructuring[10], with the subsequent need for it to address the companies' everyday problems (pre-insolvency and other distress situations), is leading to an extension of its scope and of the universe of affected parties. Today, insolvency law may indeed be envisaged as "corporate governance under financial distress"[11]. This is one thing that was made quite clear by the Proposal. ■

Footnotes:

1 The Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU. (available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016PC0723&from=EN).
2 See Emmanuelle Inacio, "The European Commission's Directive Proposal for common principles and rules on preventive restructuring frameworks, insolvency and second chance", Eurofenix, Winter 2016/2017, 66, 12-13.
3 Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012.
4 All Articles without references regard the Proposal.
5 See Explanatory Memorandum and Recital 44.
6 Also worth mentioning is Section 172, Subsection 3, of the English Companies Act.
7 See, for instance, in Germany, *Insolvenzverschleppungshaftung*.
8 Directive 2008/94/EC of the European Parliament and of the Council of 22 October 2008 on the protection of employees in the event of the insolvency of their employer.
9 On the subject see Karsten Schmidt, "Interaction of Corporate Law and Insolvency Law: German Experience and International Background", Rebecca Parry / *Paul Omar (Eds.), International Insolvency Law – Future Perspectives – The Edwin Coe Lectures delivered at the INSOL Europe Academic Forum Annual Conferences 2008-2014*, 2015, 125 ff.
10 Historically speaking, insolvency is an instrument designed for the world of commerce. For a long time, it was exclusively applied to merchants and companies.
11 See Horst Eidenmüller, "Comparative Corporate Insolvency Law", European Corporate Governance Institute (ECGI) – Law Working Paper n.º 319/2016, at 2 (available at https://ssrn.com/abstract=2799863).