A closer look at...

The General Approach of the Council on the European Commission's Proposal Directive on Preventive Restructuring Frameworks

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> IF A CERTAIN DEGREE OF FLEXIBILITY IS NECESSARY TO ENHANCE HARMONISATION, THE EFFECTIVENESS AND CONSISTENCY OF A RESCUE CULTURE IN THE EUROPEAN UNION SHOULD HOWEVER NOT BE SACRIFICED ON THE ALTAR OF FLEXIBILITY

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On 11 October 2018, the (Justice and Home Affairs) Council agreed upon its position on the compromise text concerning the European Commission's Directive Proposal on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU of 1 October 2018[1].

Legislative procedure

As a reminder, on 21 August 2018, the Committee on Legal Affairs of the European Parliament adopted Angelika Niebler's Report[2] on the European Commission's Directive Proposal and recommended that the European Parliament's position adopted at first reading under the ordinary legislative procedure should amend the Commission's proposal[3]. The Committee also decided to enter into inter-institutional negotiations ahead of Parliament's first reading. The Report was endorsed by the plenary meeting of the European Parliament and the decision to enter into inter-institutional negotiations was confirmed on 12 September 2018, meaning that the trilogue would start as soon as the Council had adopted its position.

By its general approach, the Council gives the Parliament an idea of its position on the Commission's legislative proposal, in order to help reaching a compromise between the Parliament and the Council. Moreover, informal inter-institutional meetings will be organised by the Council, the Parliament and the Commission to help them reach an agreement on the legislative amendments in early 2019.

Content of the Council's General Approach

The position of the Council keeps all the main elements of the European Commission's Proposal but provides a high degree of flexibility to Member States to adapt the new legislation to their existing frameworks[4]. If a certain degree of flexibility is necessary to enhance harmonisation, the effectiveness and consistency of a rescue culture in the European Union should however not be sacrificed on the altar of flexibility.

Access to preventive restructuring frameworks

The Council notes that there is a wide consensus on the principle laid down by the European Commission's Proposal, according to which Members States shall ensure that effective preventive restructuring frameworks are available for debtors in financial difficulty when there is a likelihood of insolvency. However, a fear lingers that debtors with no prospect of viability will largely apply for these tools, which would cause unnecessary delays in the opening of an insolvency procedure, and would risk decreasing the value of the estate[5].

Thus, the Council proposes to allow the Member States which deem it necessary, to introduce a viability test as a condition for access to preventive restructuring frameworks, provided that this test is carried out without any detriment to the debtor's assets[6]. The absence of detriment does not exclude, however, the possibility to require debtors to prove their viability at their own costs[7].

The compromise text also provides the Member States with the possibility of making this framework available not only upon the debtor's request, but also upon the creditors' request on an optional basis[8]. Moreover, the concept of "likelihood of insolvency" is to be understood as defined by the national law, according to the General Approach.

Appointment of the practitioner in the field of restructuring

Regarding the role of the practitioner in the field of restructuring, the Proposal states that the appointment by a judicial or administrative authority of a practitioner in the field of restructuring shall not be mandatory in every case, but may be required where the debtor is granted a general stay of individual enforcement actions or where the restructuring plan needs to be confirmed by a judicial or administrative authority by means of a cross-class cram-down in order to avoid unnecessary costs and incentivise debtors to apply for the preventive restructuring at an early stage of financial difficulties.

The Council notes that if the Member States agree that the preventive restructuring procedure should be a debtor-in-possession procedure, meaning

that the debtor should be left in - at least partial – control of the assets and the day-to-day operation of the business, some Member States however consider that the presence of a practitioner in the field of restructuring can increase the efficiency of the procedure and can ensure that the interests of all parties are taken into account.

The compromise thus lays down the general principle that the appointment of such a practitioner shall be decided on a case-by-case basis, depending on the circumstances of the case or on the debtor's specific needs, except in certain cases, where the national law may require such a mandatory appointment[9]. According to Recitals 18a, the Member States could decide that the appointment of a practitioner in the field of restructuring is always necessary in certain circumstances, including such as where the debtor benefits from a general stay of individual enforcement actions, where the restructuring plan needs to be confirmed by a judicial or administrative authority by means of a cross-class cram-down or where the restructuring plan includes measures affecting the rights of workers, when the debtor or its management have acted in a fraudulent, criminal or detrimental way in business relations, or when the appointment is made with the sole purpose of assisting in drafting or negotiating the restructuring plan.

Stay of individual enforcement actions

Regarding the question of the maximum duration of the stay, the Proposal requires the Member States to allow the debtor to apply for a general or limited stay of individual enforcement actions, in order to support the negotiations of a restructuring plan limited to 4 months, and that the total duration of the stay of individual enforcement actions, including extensions and renewals, shall not exceed twelve months. The compromise keeps this duration[10,11] in order to reach a compromise between the rights of the debtor and of the creditors.

However, the General Approach introduces a derogation from the twelve-month period, where, according to national law, the restructuring plan is to be submitted within eight months from the start of the initial stay of individual enforcement actions to a judicial or administrative authority for confirmation, Member States have the possibility to provide that the stay is extended until the plan is confirmed[12].

Moreover, the compromise includes the possibility for the Member States to lift the stay of individual enforcement actions where the stay no longer fulfils the objective of supporting the negotiations of a restructuring plan or, where, provided by the national law, it creates unfair prejudice to creditors.

But the compromise also allows Member States to introduce a minimum period during which the stay cannot be lifted, as well as to limit the possibility of requesting the lifting of a stay to where creditors did not get an opportunity to be heard before the stay came into force or before an extension of the period was granted by a judicial or administrative authority. The Member States may provide for a minimum period during which the stay of individual enforcement actions cannot be lifted within the time limit of the initial duration of the stay of individual enforcement actions, up to four months[12].

Cross-class cram-down mechanism

The Proposal includes a cross-class cram-down mechanism to be used if the restructuring plan is not supported by the required majority in each class of affected parties, leading to a dissenting voting class.

The proposal required Member States to make a valuation of the debtor in order to determine which classes of creditors would be "out of the money", and therefore not able to carry the plan by their support in a cross-class cram-down vote and introduced an absolute priority rule according to which a dissenting class of creditors must be satisfied in full if a more junior class could receive any distribution or keep any interest under the plan.

Some Member States considered that these requirements would make the procedure more burdensome and costly and would render the preventive restructuring more restrictive, if not impossible.

The first problem has been addressed in the compromise text by introducing an alternative option by which Member States can avoid the requirement that only classes of creditors "in the money" can carry the plan, namely where a majority of classes of creditors votes in favour of the plan of which at least one class is a secured class of creditors or a class senior to the ordinary unsecured creditors[14].

The second problem has been addressed in the compromise text by providing another alternative option for the Member States, namely to introduce a different benchmark, which is a "relative priority rule", in order to protect dissenting creditor classes when using a cross-class cram-down mechanism. This alternative option requires that dissenting voting classes are treated at least as favourably as any other class of the same rank, if the normal ranking of liquidation priorities under national law were applied, and more favourably than any junior class[15].

To be continued… ■

Footnotes:

1 http://data.consilium.europa.eu/doc/document/ST-12536-2018-INIT/en/pdf
2 http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&mode=XML&reference=A8-2018-0269&language=EN#title5
3 *Eurofenix*, 2018 Autumn edition
4 https://www.consilium.europa.eu/en/press/press-releases/2018/10/11/directive-on-business-insolvency-council-agrees-its-position/
5 Page 3.
6 Article 4, 1a.
7 Recital 17a.
8 Article 4, 4.
9 Article 5, 2.
10 Article 6, 4.
11 Article 6, 7.
12 Article 6, 7a.
13 Article 6, 8.
14 Article 11, 2b.
15 Article 11, 2a.

MEMBER STATES, HOWEVER, CONSIDER THAT THE PRESENCE OF A PRACTITIONER IN THE FIELD OF RESTRUCTURING CAN INCREASE THE EFFICIENCY OF THE PROCEDURE AND CAN ENSURE THAT THE INTERESTS OF ALL PARTIES ARE TAKEN INTO ACCOUNT