Distressed Financing In-Between Regulatory Regimes

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This paper delves into the intricate interplay between two fundamental principles in insolvency and preventive restructuring – equality and the best interests of creditors. While these principles often align harmoniously, there are scenarios where they diverge, such as when prioritizing specific creditors yields an overall net benefit for all stakeholders.

Invariably, successful debtor rehabilitation hinges on securing new financing, particularly when the debtor teeters on the brink of insolvency. Nevertheless, financiers may hesitate to support a financially distressed debtor, particularly if the conditions seem burdensome for the debtor. Bridging the gap between the debtor's exigencies and market realities frequently necessitates regulatory intervention, which may entail affording distressed financiers preferential treatment vis-à-vis other creditors.

Pursuant to Article 17 of the Preventive Restructuring Directive (PRD), Member States are mandated to safeguard interim and new financing provided during preventive restructuring negotiations or implementation. At the very least, such financing should be shielded from transaction avoidance and other liability claims in the event of the debtor's subsequent insolvency. Member States are also encouraged to grant interim and new financiers superpriority status over other creditors.

Yet, the failure of privileged financing to rescue the debtor can leave unsecured creditors worse off than they were before, raising concerns about moral hazard. Given that the debtor initiates preventive restructuring and retains control, it could selectively privilege certain financiers, potentially even colluding with them. Conversely, financiers might opt to withhold support until the distressed debtor enters preventive restructuring, thereby securing a preferential position.

This paper examines two contrasting approaches to address these challenges. The first, the inclusive approach, advocates extending PRD protection to all financiers or creditors, regardless of when they offer financial support. This approach aligns with PRD's broad definition of interim financing and promotes a gradual transition toward preventive restructuring. However, the issue of superpriority remains contentious.

In contrast, the exclusive approach starkly distinguishes earlier financing from preventive restructuring financing. To mitigate inequality among creditors, robust ex ante control mechanisms are crucial, often involving court intervention and creditor approval. While this approach may be less agile and grant the debtor less autonomy, it may warrant Member States introducing superpriority provisions.

This paper provides a comparative analysis of these two approaches, shedding light on their implications for equality, the best interests of creditors, and the overall effectiveness of preventive restructuring frameworks. By exploring these dynamics, it contributes to the ongoing discourse on the evolving landscape of insolvency and preventive restructuring law in Europe.