Harmonisation in Europe

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Alberto Núñez-Lagos presents his proposal for the harmonisation of the European Preventive Restructuring Framework, to which we welcome feedback from our readers

> INSOL EUROPE HAS BEEN, AND CONTINUES TO BE, READY TO CONTINUE CONTRIBUTING ANY TECHNICAL AND PROFESSIONAL KNOWLEDGE TO THOSE WHO HAVE TO TAKE THE POLITICAL DECISIONS

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The European Commission has the intention to issue a legislative initiative during 2016 on insolvency reform with the purpose to harmonise the insolvency regimes of the Member States.

The task is huge. It would probably make sense to have the insolvency regimes harmonised in several stages. Not everything or every situation in an insolvency regime has the same importance and effects. Also, there are parts of the insolvency regimes which are so different in each Member State (mainly due to historic reasons) that their harmonisation is very difficult to be accepted and thus has to be imposed and previously intensively negotiated. What is certain is that businesses across Member States have the same characteristics and that businesses operating across borders would like to enjoy the same rules in each Member State. Thus the problem is not a business problem but rather a political one which would probably need a political solution.

INSOL Europe has been, and continues to be, ready to continue contributing any technical and professional knowledge to those who have to take the political decisions. Our contribution to this ongoing process through INSOL Europe's (2010) "*Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provisions and practices*" (commissioned by the Directorate-General Justice of the European Commission, October-December 2013) shows that a technical approach is possible.

The proposal I will be making is very simple: first focus on the harmonisation of the preventive restructuring framework, either out of court or with very limited court intervention, or the "PRF" (as named by the Commission Recommendation of 12.3.2014 on approach to business failure and insolvency, paragraph 6.) while continuing negotiating in parallel the harmonisation of the in-court classical insolvency systems.

This proposed solution leads to several questions. The first question is: can a PRF be harmonised without harmonising the rest of the insolvency regime? The answer is yes, if the PRF can be structured as a stand-alone framework. This leads to the second question: what characteristics should a stand-alone PRF have?

Full, temporary and automatic stay

The preventive restructuring and the consequential stay can be requested by the debtor unilaterally in any distressed situation, but not necessarily when the debtor is insolvent. If the debtor is too aggressive and requests the stay only for the purpose of renegotiating existing terms without being in a distressed situation, the debtor risks reaching no agreement with the relevant majority of creditors. Due to the stay, this situation would normally lead to a breach of agreement with the creditors and thus, because of the absence of a creditors' agreement for restructuring, to insolvency.

By filing for a preventive restructuring ("PR") the debtor would obtain:

i. a stay in respect to all legal situations (a full stay) which could jeopardise a negotiation with the creditors;
ii. suspension (a temporary stay) of the directors with the obligation to file for in-court insolvency and suspension of the creditors' right to file for in-court insolvency of the debtor; and
iii. suspension of the enforcement of claims, security and assimilated actions or situations such as set off, acceleration of claims, and any provision or clauses by contract or law. This situation of non-payment, or of becoming the debtor who negotiates with the creditors in order to reorganise the debt, can be invoked for the application of this kind of suspension (including swaps).

The stay is granted to the debtor without any investigation by the court and without any evidence of the existence of negotiations or future negotiations with the creditors. Experience shows that debtors try to negotiate on a confidential basis with key creditors, who normally are sophisticated and have restructuring technology (e.g. banks, hedge funds). Such creditors are willing to participate and monitor the process confidentially in order not to destroy any working capital credit the debtor still has in the market while negotiations take place.

Such a confidential scenario is extremely effective and productive. Only when the restructuring agreement has been reached with such key creditors a PR protection

would be filed in order to achieve (in addition to the referred stay):

i. additional votes/support to the pre-agreed restructuring agreement with such key creditors and eventually the cram-down of dissenting creditors; and
ii. the safe harbour protection of such a restructuring agreement for the transactions contemplated thereunder against future claw back or challenge in the event the borrower finally becomes insolvent (new money, new security, assets disposals, etc.).

In order to avoid fraud, there are two mechanisms:

i. The stay is temporary, e.g. four months extendible for two additional months in given circumstances (complexity of the restructuring, coordination issues with foreign PR or even insolvency proceedings) and if a restructuring agreement with a very significant amount of creditors in each class is not reached in court, insolvency would be mandatory.
ii. If a blocking majority of creditors agree that negotiation on a creditors' agreement will not start or has been cancelled, the court shall automatically end the stay.

Universal

The stay should be applied to the claims the debtor chooses. It can be universal but does not have to. Thus the stay is for the benefit of the debtor. No *pari passu* rule should be applied during the stay if the debtor does not intent to include in the restructuring agreement a specific type of claims (e.g. financial debt is stayed but not the revolving facilities which provide for bonds and guarantees to third party contractors).

Flexible creditors' agreement

The sole aim of a PRF is to enable the debtor to avoid insolvency or if already insolvent, to exit insolvency. Paragraph 6(a) of the Recommendation phrases this situation differently, namely "*the debtor should be able to restructure at an early stage, as soon as it is apparent that there is a likelihood of insolvency*". No matter if it is one way or the other the only important element is that the debtor should have total and absolute freedom to convince or agree with a very relevant majority of creditors, any restructuring including not only a financial restructuring (haircuts and deferrals with or without new money), but also other agreed solutions such as asset disposals, entire business unit disposals, mergers, asset hive downs, debt for asset, debt for equity, etc.

Therefore, I disagree with the Recommendation that a Restructuring Plan, be it formal, structured and probably validated by an expert as described in the Recommendation (see paragraph 8 and following) is the expected product of a PRF. The flexible, informal and consensual Restructuring Agreement I propose will enable debtors and creditors to adapt to any type of restructuring needs and circumstances with the necessary flexibility which will lead to high efficiency. The mechanisms to avoid fraud and abuse are:

i. A high majority of creditors (calculated by classes, basically secured creditors, trade creditors, financial creditor and employees), tax authorities and Social Security should not be classed separately.
ii. A voting power by secured creditors based on the market value of their security in order to avoid under-secured creditors voting for the face value of their claims.
iii. The court control of any formal (i.e. majority requirements), the *pari passu* rules (among classes) and the conflict of interest situations (i.e. a creditor should vote based on an objective and standard interest and not taking into account other interests in other deals (basically the objective test will be to compare the recovery within the Restructuring Agreement with a liquidation within in-court insolvency proceedings).

Court intervention

Court intervention should only be sought for the purposes described above in iii (and indeed for the registration and cancellation of any stay filings) and such sanctioning of a Restructuring Agreement should have the effect of safe-harbour as regards to claw back actions in relation with any agreements reached in the Restructuring Agreement. Appeals should be limited to the same court in order to avoid lengthy processes like in in-court proceedings. Recognition should be automatic. Having these proceedings harmonised would avoid forum shopping and make it very easy to restructure European corporates across Europe with cross border affiliates.

Conclusion

PRF should be easy to harmonise due to the reasons explained. PRF would basically act as an opportunity to restructure by suspending any in-court insolvency proceedings rules which if unsuccessful would lead to insolvency. For the EU, a harmonisation of a piece of the insolvency framework during 2016 or early 2017 would be a tremendous success. ■

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