Rescue on the rise

Bob Wessels looks at how the European Commission wishes to develop a rescue and recovery culture across the Member States

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In a 2012 study, University of Heidelberg professor Andreas Pieckenbrock compared rescue measures in insolvency laws of England, Italy, France, Belgium, Germany and Austria. He concludes that there are five common tendencies in these rescue proceedings.

1. Early recourse

Sometimes there is an earlier moment of starting a rescue process, for instance in the French *Sauvegarde*: the debtor must encounter problems that he can not solve earlier than the traditional moment that the debtor can not pay its financial obligations when they are due;

2. Debtor in possession

The board is not fully replaced by the insolvency administrator; in certain proceedings the board stays in control of the business. This is what we call 'debtor-in-possession';

3. Stay

In these countries one finds a moratorium or a stay either automatic like in the *Sauvegarde* or at request (for instance *the concordato preventivo* or *réorganisation judiciare*);

4. Protecting fresh money

There are special provisions to protect fresh money available for the company while trying to work itself out of its misery;

5. Debt for equity swap

The possibility of a debt for equity swap, i.e. the conversion of a creditors claim into shares in the capital of the company.

6. Binding disapproving creditors

Generally, as Pieckenbrock explains, such a rescue is based on the principle of a composition or an arrangement concluded between the insolvent debtor and his creditors. Such a rescue plan is binding for those creditors who voted in favour of the plan, but is also binding upon a (given percentage) of a dissenting minority of creditors (sometimes referred to as 'cram-down') or a watering down ('bail-in') for altgesellschafter (ie. existing shareholders).[1]

In the study by INSOL Europe on a new approach to business failure and insolvency, published in April 2014, the reporters (University of Milan professor Stefania Bariatti and Robert van Galen) have studied 28 EU Member States. It is interesting to note that generally professor Piekenbrock's characteristics are available in new or renewed recovery proceedings in nearly all member states.[2]

EU's policy: A new approach to business failure and insolvency

In 2013 the European Commission expressed its policy, named 'A new European approach to business failure and insolvency' and it wished to identify the issues on which the new European approach should focus '… so as to develop a rescue and recovery culture across the Member States'. It is stated that many European restructuring frameworks '… are still inflexible, costly and value destructive'.[3] Using the outcomes of a public consultation in 2013, the European Commission presented on 12 March 2014 its Recommendation on a new approach to business failure and insolvency.[4] The Recommendation has two major objects. First of all to:

'… ensure that viable enterprises in financial difficulty, wherever they are located in the Union, have access to national insolvency frameworks which enable them to restructure at an early stage with a view to preventing their insolvency, and therefore maximise the total value to creditors, employees, owners and the economy as a whole. The Recommendation also aims at giving honest bankrupt entrepreneurs a second chance across the Union.' (recital (1))

In order to achieve these aims, the Commission deemed it necessary to:

'… encourage greater coherence between the national insolvency frameworks in order to reduce divergences and inefficiencies which hamper the early restructuring of viable companies in financial difficulty and the possibility of a second chance for honest entrepreneurs, and thereby lower the cost of restructuring for both debtors and creditors. Greater coherence and increased efficiency in those national insolvency rules would maximise the returns to all types of creditors and investors and encourage cross-border investment. Greater coherence would also facilitate the restructuring of groups of companies irrespective of where the members of the group are located in the Union.' (recital (11))

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Introducing minimum standards on preventative restructuring frameworks

The Recommendation seeks to reach these goals by encouraging Member States to put in place '… a framework that enables the efficient restructuring of viable enterprises in financial difficulty and give honest entrepreneurs a second chance' (R1).[5] The Recommendation provides for 'minimum standards' on 'preventative restructuring frameworks' (R3(a)) to be implemented in all Member States. Through promoting adherence to these standards throughout the Union, the Commission hopes are three of a kind:

- *for national insolvency systems* - to improve the existing means for resolving distress in viable enterprises (R5) and encourage coherence in initiatives or reviews of 'corporate rescue framework' in all Member States (R10),

- *for businesses* - to improve access to credit (R4), encourage investment (R8) and to smoothen '… the adjustment for over-indebted firms, minimizing the economic and social costs involved in their deleveraging process' (R12), and

- *for creditors* - to improve mechanisms for resolving financial distress efficiently, with reduced delays and costs and limited court formalities ('… to where they are necessary and proportionate in order to safeguard the interests of creditors and other interested parties likely to be affected') (R17).

Six core principles

Oxford associate professor Van Zwieten has analysed the Recommendation in greater detail with as a result that she concludes that there are six core principles on which the minimum standards of the Commission's recommendations for a preventative restructuring framework are based.[6] I will follow her analysis below. These principles apply to any debtor ('… any natural or legal person in financial difficulty when there is a likelihood of insolvency'; R5(a)), excluding financial institutions.[7] The scope of these core principles is 'restructuring', which means '… changing the composition, conditions, or structure of assets and liabilities of debtors, or a combination of those elements, with the objective of enabling the continuation, in whole or in part, of the debtors' activity' (R5(b)).

1. Early recourse

A debtor should be able to have recourse to the restructuring framework at an early stage (R6(a)). The framework is only open to a debtor that is already in 'financial difficulty' (R1), such that there is a '… likelihood of insolvency'(R6(a)).

2. Minimised court involvement

A debtor should have recourse to the restructuring framework without the need to formally open court proceedings (R8). More generally, a restructuring procedure should not be lengthy and costly and court involvement should be limited to circumstances where necessary and proportionate to safeguard the rights of creditors and others affected by a proposed restructuring plan (R7). On the other hand involvement of a court

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in some other circumstances may be necessary, including the granting of a stay.

3. Debtor in possession

A debtor '… should keep control over the day-to-day operation of his or her business' while the restructuring framework is used (R6(b)).[8] This principle provides an incentive for a debtor to use the procedure early, ensures minimum disruption to the operations of the debtor and allows him to carry on his day-to-day operations.[9] Restructuring is a management tool, rather then a signal of failure.[10]

4. Court-ordered stay

A debtor should be empowered to seek a temporary stay of individual creditor enforcement actions (including those by secured and preferential creditors), by application to a court (R6(b) and R10). From a debtor's perspective a stay is designed to enable the assets of the business to be kept together, preventing their piecemeal dismemberment by creditors. A stay improves the chances of negotiations by the debtor, but it should be balanced by the need to adequately protect secured creditors' interests, by allowing these creditors to request a relief from the stay under certain specified conditions. The Recommendation proposes a set of safeguards, including time limits (initial stay of up to four months, subject to renewal up to a maximum duration of 12 months; R13), and an obligation to lift the stay when no longer necessary in order to facilitate the adoption of a restructuring plan (R14). In Member States which make the granting of the stay subject to certain conditions, a debtor should be able to be granted a stay in all circumstances where: (a) creditors representing a 'significant amount' of the claims likely to be affected by the restructuring plan support the negotiations on the adoption of a restructuring plan; and (b) the restructuring plan has a reasonable prospect of being implemented and of preventing the insolvency of the debtor (R11).

5. Ability to bind dissenting creditors to a restructuring plan

A Member States' preventive restructuring framework should provide for a plan to be negotiated between debtor and creditors (secured and unsecured), and – where approved by the requisite majority of creditors in affected classes, as described by the national law – sanctioned by a court, with the effect that dissenting creditors are bound by it (R6(d), 16, 20, 21, 26). Secured creditors are to be treated as a separate class from unsecured creditors (R17). When a restructuring plan is adopted unanimously by affected creditors it should be binding on 'all those affected creditors', which seems to provide support for a fully out-of-court contractual restructuring, also for those creditors that did not participate in the adoption process itself.

A framework should also allow for the sanctioning of a plan approved by some classes but not others, with the result that it would be possible for a majority of classes to bind dissenting classes (i.e. for those classes to be 'crammed down'). The conditions under which a restructuring plan can be confirmed by a court should be clearly specified and should include at least that the restructuring plan (a) has been adopted in conditions which ensure the protection of the legitimate interests of creditors, (b) has been notified to all creditors likely to be affected by it, and (c) does not reduce the rights of dissenting creditors below what they would reasonably be expected to receive in the absence of the restructuring, if the debtor's business was liquidated or sold as a going concern, as the case may be (the HLR-test, the hypothesis liquidation result-test). In addition (d) any new financing foreseen in the restructuring plan is necessary to implement the plan and does not unfairly prejudice the interests of dissenting creditors (R22). Procedural requirements should safeguard the rights of the creditors to ensure that all creditors are notified about the plan, can object to it, and can appeal against it, except that an appeal should '… not, in principle, suspend the implementation of the restructuring plan' (R24).

6. Protection for new finance

Those parties who provide new finance to a debtor in accordance with the terms of a court-sanctioned restructuring plan should be shielded from the operation of avoidance provisions, paulian actions etc. in national insolvency law (R6(e) and 27), as well as from 'civil and criminal liability relating to the restructuring process' (R28) except in the case of fraud (R29).

What's next?

Within twelve months (so before April 2015) EU Member States are invited to implement the Recommendation's 'principles' (R34). The endgame is that 18 months after adoption of the Recommendation (October 2015) the Commission will assess the state of play, based on the yearly reports of the Member States to evaluate whether further measures are necessary to strengthen the European approach (R36). If all goes well the outcome of the Recommendation will dovetail with the (amendments to the) European Insolvency Regulation, whilst the regulation most probably will also include debtor-in-possession and pre-insolvency procedures. Proceedings based on the 'preventive restructuring framework', drafted in national insolvency systems will potentially benefit from the system of the Regulation.

Conclusion

The Recommendation, formally, reflects a soft approach. It invites Member States to take or continue action. Substantially it only presents a 'minimum standard', allowing Member States to add specific conditions and components to have the preventive restructuring framework operate within the legal context and economic environment of their national market. It is the bare minimum, as there is no clear principle about the debtor not taking any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) by a certain reference date, or that the debtor should provide, and allow relevant creditors and/or their professional advisers reasonable and timely access to all relevant information relating to his or her assets, liabilities, business and prospects, in order to enable proper evaluation to be made of his or her financial position and any proposals to be made to relevant creditors.[11] A solid, comparative analysis during 2015 will be necessary to assess whether other binding measures are appropriate in order to reach the Commission's policy goals. If the new Commission, under the leadership of Jean-Claude Junker, maintains this policy (which I would endorse), we will hear from the Commission, as most probably in many states the process of legislating takes many years. However, legislation in Germany, Spain, France and proposals in the Netherlands has used quite the same paint as can be seen in the Recommendation. ■

> A SOLID COMPARATIVE ANALYSIS DURING 2015 WILL BE NECESSARY TO ASSESS WHETHER OTHER BINDING MEASURES ARE APPROPRIATE IN ORDER TO REACH THE COMMISSION'S POLICY GOALS

Footnotes:

1 Andreas Pieckenbrock, *Das ESUG – fit für Europa?*, NZI 22/2012, 906ff. By the same author the theme has been presented in a broader context with focus on Germany, as a continuous work in progress, see Andreas Pieckenbrock, *Das Insolvenzrecht zu Beginn des 21. Jahrhunderts: ein Dauerbaustelle*, in: Werner Ebke, Christopher Seagon, Michael Blatz (eds.), Solvenz – Insolvenz – Resolvenz, Baden-Baden: Nomos 2013, 79ff.

2 For instance: debtor in possession proceedings (in certain cases supervised by an insolvency practitioner appointed by the court), a rescue plan in which creditors, sometimes even secured creditors, can be crammed down provided a certain qualified majority is reached, the ability to order a stay of the enforcement of claims, the possibility of attracting new loans, although these reporters have generally found that no super-priority was granted to new financing. For an eyewitness account of the machinations behind tendering for and successfully delivering a report to the European Commission: Michael Tierhoff, Love me tender: How a project rocked INSOL Europe, eurofenix Spring 2014, 16ff.

3 See Impact Assessment ('Impact Assessment 2014' or 'IA 2014') accompanying the document Commission Recommendation on a New Approach to Business Failure and Insolvency', 12.3.2014, SWD(2014) 61 final, 2.

4 For the text, see http://ec.europa.eu/justice/newsroom/civil/news/140312_en.htm. For an overview, see Stephan Madaus, The EU Recommendation on Business Rescue – Only Another Statement or a Cause for Legislative Action Across Europe?, in: 27 Insolvency Intelligence 2014, no. 6, 81ff.

5 Recommendations 30-33 relate to a second chance for honest entrepreneurs. These are not discussed here. 'R' stands for Recommendation.

6 Kristin van Zwieten, Restructuring law: recommendations from the European Commission, in: Law in Transition (EBRD publication) 2015 (forthcoming).

7 Recital 15: 'It is appropriate to exclude from the scope of this Recommendation insurance undertakings, credit institutions, investment firms and collective investment undertakings, central counter parties, central securities depositories and other financial institutions which are subject to special recovery and resolution frameworks where national supervisory authorities have wide-ranging powers of intervention …'.

8 The Recommendation does however contemplate (not compulsory, but on a case by case basis) the appointment by a court of a 'supervisor' to oversee debtor activity and safeguard creditor interests: R9(b).

9 IA 2104, 10.

10 See Madaus, o.c., 82.

11 See the Third and Fifth principle in the INSOL International Statement of Principles for A Global Approach To Multi-Creditor Workouts (published October 2000). The publication demonstrates that these Principles are endorsed by the World Bank, the Bank of England and the British Bankers Association. See Bob Wessels, International Insolvency Law, 3rd ed. 2012, par. 10107.