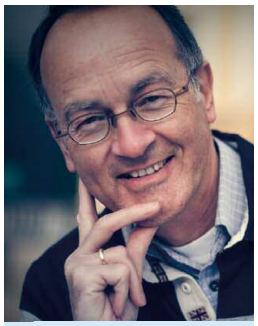
Directive on Preventive Restructuring Frameworks:
Political compromise in the trilogue talks and imminent adoption

Prof. Reinhard Bork summarises the compromises agreed ahead of the adoption of the new directive



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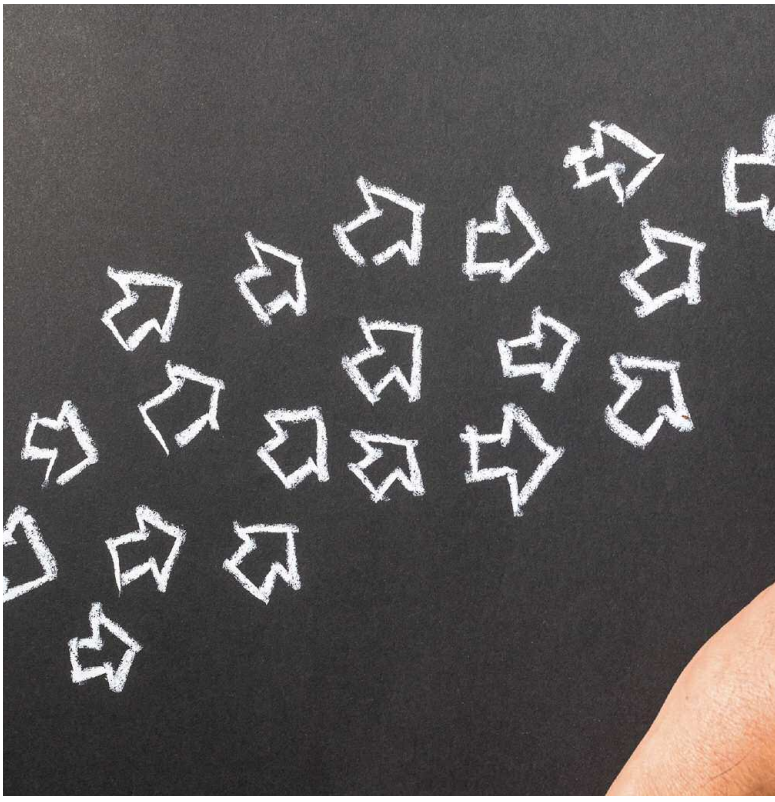
After more than two years of intensive discussions in politics and science, the adoption of the Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30 shortly lies ahead.

The negotiations on the directive have gained significant momentum during the past few months and could finally be concluded in the trilogue talks in mid-December 2018. The agreement reached has made some concessions to the European Parliament in order to find a final compromise, but, in the end, largely respects the principles that Member States have agreed upon in the General Approach of the Council. The compromise text has already been approved by the Committee on Legal Affairs of the European Parliament and should now be ready for its scheduled adoption by the plenary sitting of the Parliament on first lecture on 26 of March 2019.[1] After that, the two-year implementation phase can begin.

The Directive follows on from the recent restructuring trend in Europe and, in the course of this, commits itself to a Europe-wide introduction and harmonisation of efficient preventive restructuring procedures. The now presented compromise essentially retains all the elements of the original Commission proposal but tries to give the Member States sufficient leeway in the concrete implementation of the rules in order to be able to achieve the objectives set in accordance with their existing national framework. Thus, the only binding requirement is that Member States must provide a pre-insolvency restructuring framework with certain instruments; the concrete form of these instruments and of the whole procedure is subject to individual decisions of the national legislators.

However, according to the institutions the compromise text shall be seen as a package of rules aiming to establish a well-balanced regime that takes into account the interests of the debtor, creditors and other interested parties alike. The Directive therefore now comprises the following provisions.

> **THE DIRECTIVE FOLLOWS ON FROM THE RECENT RESTRUCTURING TREND IN EUROPE**

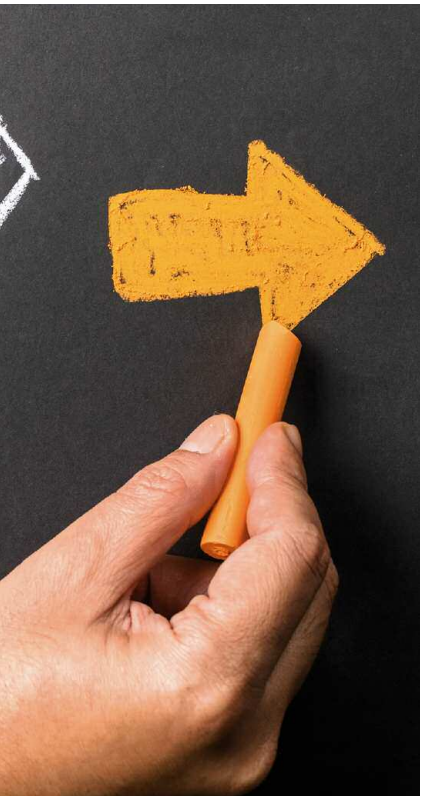


Access to a preventive restructuring framework

Operationally viable, but financially distressed debtors shall, where there is likelihood of insolvency, have access to a preventive restructuring framework that enables them to restructure, with a view to prevent insolvency and ensure their viability (Art. 4 par. 1). The framework exists independently and without prejudice to any other restructuring frameworks under national law (Art. 4 par. 2). It shall be available on application by the debtor but may be extended to requests of other stakeholders such as creditors or workers' representatives, subject to the agreement of the debtor (Art. 4 par. 4a). During the procedure, the debtor in possession generally remains in control of his assets and the day-to-day-operation of the business (Art. 5 par. 1).

Appointed practitioner

Yet the range of this principle proved to be particularly problematic during the negotiations and suitable to prevent a political agreement until the very end of the trilogue. The



institutions specifically argued about whether and in what cases a practitioner should be appointed to monitor and assist the debtor. On the one hand, the European Parliament pleaded for a mandatory appointment at least in some clearly stated cases, where it seems necessary to safeguard the rights of the affected parties.

From the Parliament's point of view, this at least included the cases where the debtor is granted a stay of 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 it is requested by the debtor or a majority of the creditors. The Council, on the other hand, argued, that the appointment of a practitioner would interfere with the preventive character of the framework and particularly would increase the costs of the procedure constituting a considerable burden for the debtor. The engagement of a practitioner should be limited to unspecified individual cases, where an appointment is deemed necessary by a judicial or administrative authority.

Finally, the Parliament prevailed and the parties have agreed on the few cases mentioned above, in which a practitioner should act in a supportive manner. However, these cases are drafted in a way which gives Member States the greatest flexibility possible regarding the transposition and certain safeguards were built in to avoid that the procedure becomes costly and burdensome for the debtor (if the appointment is requested by a majority of the creditors, it is the creditors to bear the cost of the practitioner).

Stay of individual enforcement actions

As the debtor is granted a stay of individual enforcement actions, he initially falls under the protection of Art. 6 and 7 for a maximum of four months. Following the Council's position, the duration of the stay may be extended on request of the debtor, a creditor or, where applicable, a practitioner up to a maximum of twelve months. During the stay, all creditors of the debtor – except for the workers – may no longer enforce their claims. They further can no longer refuse to provide services necessary for the debtor's business based on outstanding claims or any contractual clauses or withdraw from such contracts to the detriment of the debtor.

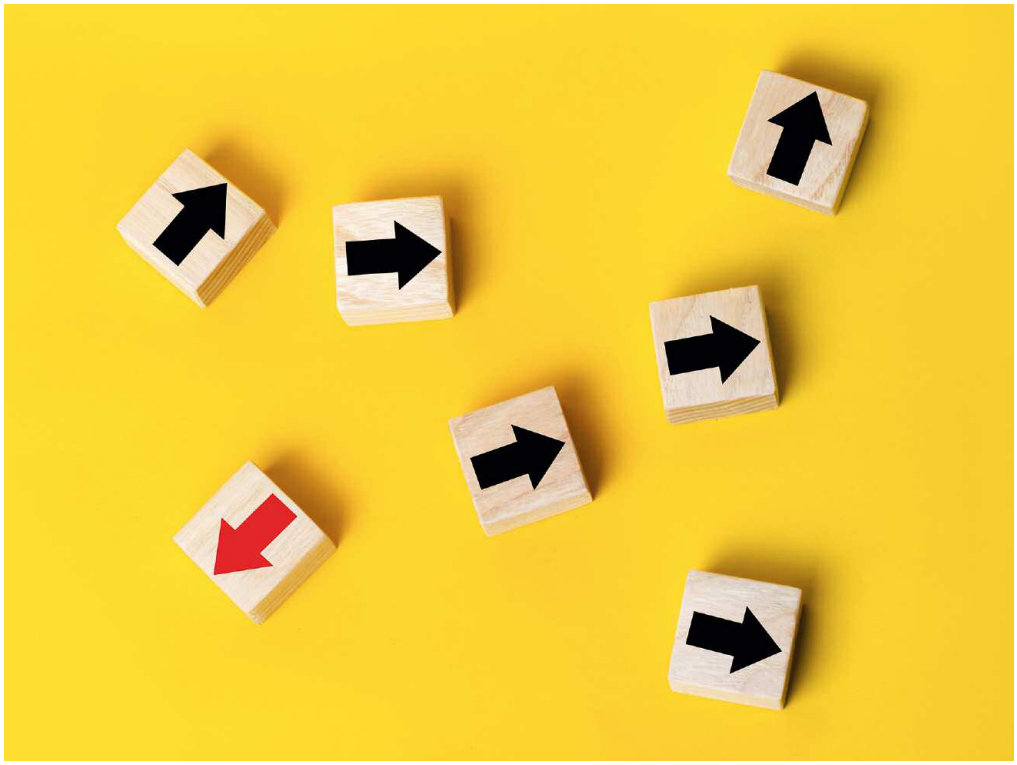
On the other side, the debtor's obligation to file for the opening of insolvency proceedings, which can end in the liquidation of the debtor, shall generally be suspended during the stay. By granting the stay with all its consequences, the Directive enables the debtor to continue his business operations as well as preserve the value of his undertaking during the pending negotiations on a restructuring plan.

Adoption of the restructuring plan

Later on, this restructuring plan needs to be adopted by the creditors and in some cases be confirmed by a judicial or administrative authority entailing a few controversial issues. While the Council had made some concessions regarding the appointment of a practitioner, it decisively insisted on its position when it comes to the adoption of the plan. However, the Parliament respected the Council's desire for greater flexibility and agreed to the corresponding adjustments of the Directive.

Hence, it is no longer mandatory to achieve a double majority in the amount of claims and the number of creditors for a plan to be adopted, though the Member States may require a double majority in each class (Art. 9 par. 4). Furthermore, the Parliament has accepted the Council's approach towards a cross-class cram-down allowing a judicial or administrative authority to confirm a plan under certain circumstances, although it has not been approved by the affected parties in every voting class (Art. 11).

FINALLY, THE PARLIAMENT PREVAILED AND THE PARTIES HAVE AGREED ON THE FEW CASES IN WHICH A PRACTITIONER SHOULD ACT IN A SUPPORTIVE MANNER



> IT IS TO BE FEARED THAT THE FLEXIBILITY OF THE DIRECTIVE ENFORCED BY THE COUNCIL WILL LEAD TO VERY DIVERGENT PROCEDURES IN THE INDIVIDUAL MEMBER STATES

Relative Priority Rule

This instrument was unknown to a number of Member States and raised some concerns again about a possibly more burdensome and costlier framework. However, these concerns have been dispelled by giving the Member States – among others – the option to introduce a "Relative Priority Rule" that ensures dissenting voting classes to be treated at least as favourably as any other class of the same rank and more favourably than any junior class. Finally, the structure of the cram-down-Article 11 has been modified in the talks, but the substance of the Article remained the same as before in the Council's General Approach.

Worker protection

Another controversial point concerned the issue of worker protection in the Directive. In contrast to the Commission's proposal and the Parliament's position, the protection of workers only played a subordinate role in the Council's General Approach.

In the end, the institutions agreed on a no longer mandatory classification of the workers as a separate class in the frame of Art. 9 par. 2. In return a new Art. 12a has been introduced on workers' rights, which indeed does not create any new rights for the workers and seems to be more or less declarative. As regards the protection of new and interim financing in a subsequent insolvency of the debtor, the final compromise is largely equivalent to the text of the Council's General Approach.

Compared to the Commission's proposal the Council decided to reduce the protection scope of Art. 16 and 17, so that most of the national avoidance laws will probably not be affected by this rule. Restructuring consultants and other parties involved in a preventive restructuring procedure must therefore not rely on special protection in the future and should continue to keep an eye on the applicable national regulations on transactions in precedence of an insolvency of the debtor.

On the other side, the Parliament imposed Art. 18, which regards to the duties of directors and was firstly deleted in the Council's General Approach. However, it is difficult to discern a deeper meaning in the re-introduction of Art. 18 as it simply refers to well-known duties such as taking into account the interests of creditors and other stakeholders as well as taking steps to avoid insolvency. Regarding Titles III, IV and V dealing with the discharge of debt as well as measures to increase the efficiency of corresponding procedures and their monitoring, the Parliament largely kept the Council's Approach from May 2018; only little amendments had to be made.

Expectations

What can one expect from the Directive now? It certainly achieves its goal to establish preventive restructuring frameworks throughout Europe. Especially Member States like Germany that so far deliberately refrained from a preventive restructuring procedure will be under pressure to take action. At the same time, however, it is to be feared that the flexibility of the directive enforced by the Council will lead to very divergent procedures in the individual Member States. Finally, the opportunity and advantages of a harmonised procedure throughout Europe might be missed. ■

Footnotes:

1 The compromise text is part of the note that has been published by the presidency of the Council on 17/12/2018 and can be accessed at: https://data.consilium.europa.eu/doc/document/ST-15556-2018-INIT/en/pdf