The position of secured creditors according to the draft EU Directive on Preventive Restructuring Frameworks

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EU Directive on Preventive Restructuring Frameworks, etc. (D. on restructuring & insolvency)

- Proposal by the Commission: 22 November 2016
  - based on the project of a Capital Market Union (CMU)
  - to increase cross-border investments

- Adoption by the EU Parliament: 27 March 2019
  - with significant amendments and changes
  - mostly: more discretion for Member States in transposition

- Pending adoption by the Council of the EU
  - Justice and Home Affairs Council – was expected for 6/7 June 2019
  - culmination of Romanian presidency
  - however: does not seem to be on current schedule (?)

- Period for transposition by Member States: 2 years

EU Directive on Preventive Restructuring Frameworks, etc. (D. on restructuring & insolvency)

three pillars:

- Preventive Restructuring Framework (PRF)

- Discharge of debt

- Measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt

Scope of the PRF – "likelihood of insolvency"

Art. 4 (1):
*Member States shall ensure that, where there is a **likelihood of insolvency**, debtors have access to a preventive restructuring framework that enables them to restructure, with a view to preventing insolvency and ensuring their viability, without prejudice to other solutions for avoiding insolvency, thereby protecting jobs and maintaining business activity.*

Art. 2 (2):
*For the purposes of this Directive, the following concepts are to be understood **as defined by national law**:*
(a) insolvency;
(b) likelihood of insolvency;
(c) micro, small and medium-sized enterprises ('SMEs').

In general: lots of flexibility for Member States

Stay of individual enforcement actions, art. 6

1. *Member States shall ensure that **debtors can benefit from a stay of individual enforcement actions to support the negotiations of a restructuring plan** in a preventive restructuring framework.*
   Member States may provide that judicial or administrative authorities can refuse to grant a stay of individual enforcement actions where such a stay is not necessary or where it would not achieve the objective set out in the first subparagraph.
2. *Without prejudice to paragraphs 4 and 5, Member States shall ensure that a stay of individual enforcement actions **can cover all types of claims, including secured claims** and preferential claims.*
3. *Member States may provide that a stay of individual enforcement actions can be general, covering all creditors, or **can be limited**, covering one or more individual creditors or categories of creditors.*
   Where a stay is limited, the stay shall only apply to creditors that have been informed, in accordance with national law, of negotiations as referred to in paragraph 1 on the restructuring plan or of the stay.

Stay of individual enforcement actions, art. 6

4. *Member States **may exclude certain claims or categories of claims** from the scope of the stay of individual enforcement actions, **in well-defined circumstances**, where such an exclusion is duly justified and where:*
   *(a) enforcement is **not likely to jeopardise the restructuring** of the business; or*
   (b) the stay would unfairly prejudice the creditors of those claims.
5. *- 9. (…) [workers' claims; initial duration [up to 4 months]; extension; maximum duration [up to 1 year]; lifting the stay]*

In summary:

- Stay can affect secured creditors.
- Options for Member States:
  - Stay can be limited to unsecured creditors, or all or certain secured creditors can be excluded, esp. where the collateral is not operation-critical or where the depreciation would render it unfair.
  - Stay can also be lifted if it would be unfair.
  - Compensation? (see rec. 37: "does not cover … compensation")

Effect of stay on contracts, art. 7 (4) and (5)

4. *Member States shall provide for rules* ***preventing creditors*** *to which the stay applies* ***from withholding performance or terminating, accelerating or, in any other way, modifying essential executory contracts*** *to the detriment of the debtor,* ***for debts that came into existence prior to the stay****, solely by virtue of the fact that they were not paid by the debtor.*
'Essential executory contracts' shall be understood to mean executory contracts which are necessary for the continuation of the day-to-day operations of the business, including contracts concerning supplies, the suspension of which would lead to the debtor's activities coming to a standstill.
The first subparagraph shall not preclude Member States from affording such creditors ***appropriate safeguards with a view to preventing unfair prejudice*** *being caused to such creditors as a result of that subparagraph.*
Member States may provide that this paragraph also applies to non-essential executory contracts.

Effect of stay on contracts, art. 7 (4) and (5)

5. *Member States shall ensure that creditors are **not allowed to withhold performance or terminate, accelerate or, in any other way, modify executory contracts** to the detriment of the debtor by virtue of a **contractual clause** providing for such measures, **solely by reason of**:*
   *(a) a request for the opening of **preventive restructuring proceedings**;*
   *(b) a request for a **stay of individual enforcement actions**;*
   (c) the opening of preventive restructuring proceedings; or
   (d) the granting of a stay of individual enforcement actions as such.

In summary:

- no *ipso-facto* clauses
- relevance of art. 7 (4) for loan agreements (etc.) unclear:
  – essential executory contracts? rec. 41 mentions payment services, maybe also open line of credit (?) → potentially dangerous
  – debts that came into existence before the stay? rec. 41 mentions due date
  – allows for safeguards instituted by Member States

Restructuring plan & its adoption

Art. 9 (4) subpara. 1:
*Member States shall ensure that affected parties are **treated in separate classes**, which reflect sufficient commonality of interest based on verifiable criteria, in accordance with national law. As a minimum, **creditors of secured and unsecured claims shall be treated in separate classes** for the purposes of adopting a restructuring plan.*

Art. 9 (6):
*A restructuring plan shall be adopted by affected parties, provided that a **majority in the amount of their claims or interests is obtained in each class**.*
Member States may, in addition, require that a majority in the number of affected parties is obtained in each class.
*Member States shall lay down the majorities required for the adoption of a restructuring plan. Those majorities **shall not be higher than 75%** of the amount of claims or interests in each class or, where applicable, of the number of affected parties in each class.*

Restructuring plan & its adoption

Art. 10 (2) :

Member States shall ensure that the conditions under which a restructuring plan can be ***confirmed*** *by a judicial or administrative authority are clearly specified and include at least the following:*

(a) the restructuring plan has been adopted in accordance with Article 9;

(b) creditors with sufficient commonality of interest in the same class are treated equally, and in a manner proportionate to their claim;

(c) notification of the restructuring plan has been given in accordance with national law to all affected parties;

(d) where there are dissenting creditors, the restructuring plan satisfies the ***best-interest-of-creditors test****;*

(e) where applicable, any new financing is necessary to implement the restructuring plan and does not unfairly prejudice the interests of creditors.

Compliance with point (d) of the first subparagraph shall be examined by a judicial or administrative authority only if the restructuring plan is ***challenged*** *on that ground.*

Restructuring plan & its adoption

Art. 2 (1):
[…]
(6) 'best -interest -of -creditors test' means a test that is satisfied if ***no dissenting creditor would be worse off under a restructuring plan*** *than such a creditor would be if the normal ranking of liquidation priorities under national law were applied, either in the event of liquidation, whether piecemeal or by sale as a going-concern, or in the event of the next-best-alternative scenario if the restructuring plan were not confirmed;*
[…]

In summary:

- separate classes unsecured ⇔ secured (possible exception SMEs), however not too small classes ("communality" not "identity" of interests)
- at this stage, only secured creditors can outvote other secured creditors
- basic and important protection: best-interest-of-creditors test

Restructuring plan & its adoption

Art. 11 (1):
Member States shall ensure that a restructuring plan which is ***not approved*** *by affected parties, as provided for in Article 9 (6),* ***in every voting class****, may be confirmed by a judicial or administrative authority upon the proposal of a debtor or with the debtor's agreement, and become binding upon dissenting voting classes where the restructuring plan fulfils at least the following conditions:*
(a) it complies with Article 10 (2) and (3);
(b) it has been approved by: [… certain classes];
(c) it ensures that dissenting voting classes of affected creditors are ***treated at least as favourably as any other class of the same rank and more favourably than any junior class****; and*
(d) no class of affected parties can, under the restructuring plan, receive or keep more than the full amount of its claims or interests.
[…]

Restructuring plan & its adoption

Art. 11 (2):

(2) By way of derogation from point (c) of paragraph 1, Member States may provide that the claims of affected creditors in a dissenting voting class are ***satisfied in full by the same or equivalent means where a more junior class is to receive any payment or keep any interest under the restructuring plan****. Member States may maintain or introduce provisions derogating from the first subparagraph where they are necessary in order to achieve the aims of the restructuring plan and where the restructuring plan does not unfairly prejudice the rights or interests of any affected parties.*

In summary:

- cross-class cram-down possible, but only
  - if certain classes agree (Member States can determine, minimum: one class “in the money”; maximum: majority and one w/ preference)
  - if best-interest-of-creditors test is observed
  - if RPR or APR is observed

New financing, art. 17

Art. 17 (4):
Member States may provide that grantors of new or interim financing are entitled to ***receive payment with priority*** *in the context of subsequent insolvency procedures* ***in relation to other creditors that would otherwise have superior or equal claims****.*

In summary:
Danger to secured creditors only if "super-super-priority" which Member States should not allow.

Fears of secured creditors? The debate in Germany

- Germany: no preventive restructuring proceeding, only formal insolvency proceedings with liquidation as the rule (incl. going concern sale), “insolvency plan” as an option
- Insolvency proceedings can be initiated early by the debtor (“imminent insolvency” / “threat of insolvency”)
- “Underwhelming” results of average insolvencies – typically the worst case scenario, also for (partially) secured creditors
- Alternative: Simple contractual work-out – negotiations with immense hold-out potential for shareholders and creditors

Fears of secured creditors? The debate in Germany

➔ Banks as typically secured creditors *welcome* a preventive restructuring proceeding in principle

- additional tool in the tool box
- allows to deal with hold-out creditors and shareholders: outvoting them and/or “cramming them down”
- (more or less) avoids the “stigma of insolvency”
- opponents are mostly insolvency practitioners fearing for their *de facto* monopoly

Thank you very much!

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