Restructuring across Europe – a new era?

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All three institutions of the European Union have now approved the EU Preventive Restructuring Framework Directive. This is the EU's first attempt to "harmonise" insolvency laws across the Member States, that have disparate existing legislation. What does the Directive do and what will be its effect in practice?

The Directive

The Preventive Restructuring Framework Directive[1] (the "Directive") has now been approved by the European Parliament as well as the Council of the EU. Those two bodies, together with the European Commission (which proposed the legislation), are now agreeing the final changes to be made to the Directive before its publication in the Official Journal. The draft was first published in November 2016, and while the different institutions have had divergent views on some of the wording, there is agreement to proceed to the Directive becoming binding.

To date, EU insolvency law has focused on cross-border cooperation and conflicts of laws issues – understandably, given the very different local insolvency laws and procedures that exist throughout the EU. As a directive, each Member State will have two years from the date of publication of the Directive in the Official Journal, to enact it into its own laws. Inevitably, that will result in slightly different versions of the Directive being enacted across Europe.

As at the date of publication, it remains to be seen whether the UK will, in fact, leave the EU on 30 March 2019 (or on some later date). However, we will briefly consider below the changes that would be required to English law to give effect to the Directive, as well as its likely impact on the laws of some other Member States.

Key aims

The Directive has three key aims:

- That every Member State should have a preventive restructuring framework available to debtors where there is a likelihood of insolvency, involving certain common principles
- That entrepreneurs should benefit from a "second chance", thereby imposing a maximum of 3 years for a bankrupt to be discharged from their debts
- To increase the efficiency of insolvency, restructuring and discharge procedures across the EU

1 Full title: 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/EU (2016/0359).

As regards English law, the second and third points above will have less impact. Bankrupts in England are usually released from bankruptcy after 12 months unless certain circumstances apply (*e.g.* the bankrupt has refused to cooperate with the bankruptcy trustee). Similarly, the cost and length of insolvency procedures in England compare relatively favourably with a number of other Member States.

Preventive restructuring framework

The focus of this article is therefore on the preventive restructuring framework and its likely effect across Member States.

The Directive requires that the "preventive restructuring framework" in each jurisdiction should achieve the following:

- Make early restructuring possible (*i.e.* be available prior to insolvency)
- Allow debtors to be able to continue to run their businesses during the restructuring[2]
- Provide for an optional moratorium against enforcement, to be granted by judicial or administrative authority for a maximum of 4 months (with the potential to extend to up to a total maximum of 12 months)
- Make use of the moratorium to facilitate negotiations on preventive restructuring plans (on which, see further below)
- Prevent dissenting minority creditors and shareholders from jeopardising the restructuring, while still having their legitimate interests protected
- Provide protection[3] for new financing injected as part of the restructuring

Restructuring plans

The Directive also provides some minimum provisions that must be included in the restructuring plans available in each Member State. A number of these concepts are already familiar to practitioners in England, both from the existing scheme of arrangement process, and the "restructuring plan" that was detailed in August 2018 by the Government as part of its proposed insolvency law reform.[4]

When approving a restructuring plan, all affected parties must vote in "classes" that reflect commonality of interest. As a minimum, secured and unsecured creditors are required to be placed in separate classes.

Member States are permitted to set their own majorities for approval of restructuring plans, including a numerosity test (requiring a majority in number of creditors to approve, as well as a percentage of the debt held), if so desired. However, the maximum permitted majority is 75% of claims in each class. There must also be some judicial or administrative approval of a plan which affects the interests of dissenting parties and/or provides for new financing.

The Directive also requires that restructuring plans permit cross-class cramdown. The final version of the Directive gives more discretion to Member States as regards cross-class cramdown than was originally proposed by the Commission, and, as a result, is somewhat convoluted. In overview, any cramdown plan must (i) be approved by at least one impaired class of creditors who are not "out of the money" (or by a majority of classes including at least one senior/secured class) and (ii) be subject to a judicially approved fairness test.

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2 Although the initial proposal was that insolvency practitioners ("IPs") should not be appointed as a matter of course, this has, as a practical matter, been watered down during the approval process. Member States can require IPs to be appointed where a moratorium applies and/or where a restructuring plan needs to be confirmed by cross-class cramdown. Accordingly, we would still expect to see IP involvement in most, if not all, cases.

3 Note that protection connotes protection from being subsequently set aside; not priority for new financing (akin to the US concept of debtor-in-possession ("DIP") financing). Protection for new money already exists in some jurisdictions: *e.g.* it is one of the reasons why a debtor in France would apply for conciliation after reaching agreement pursuant to the pre-insolvency *mandat ad hoc* process.

4 The UK Government's proposed new "restructuring plan" is discussed in more detail below (under "Restructuring across Member States"). However, with Brexit still on foot (at the time of publication), and a traditional absence of time in the Parliamentary calendar for insolvency law changes, it is difficult to predict when the proposals may translate into legislation.

Subject to these parameters, there is scope for individual Member States to tailor their restructuring regimes to best suit the local business climate and existing legislation.

Impact on Member States

It is common knowledge that the insolvency regimes of Member States across the EU vary dramatically, and in a number of respects. Some, such as England and Wales, are considered more creditor-friendly; others, such as France, have traditionally been considered more debtor-friendly. The eventual impact of the Directive will inevitably depend on the individual enactment into each country's local laws. However, we endeavour to provide a snapshot here of some key European jurisdictions and the Directive's likely effect:

- England and Wales: The standalone moratorium proposed by the Directive does not currently exist, nor does the concept of cross-class cramdown in a restructuring plan. However, the proposed insolvency law reform released by the Government in August 2018[5] does put forward a standalone moratorium and a restructuring plan which contains features of the existing scheme of arrangement mechanism, but with cross-class cramdown. In summary, should the UK remain part of the EU and be required to implement the Directive, this could be achieved by legislation incorporating the Government's existing law reform, with some minor tweaks.

- France: The major change required by the Directive will be the introduction of more extensive rules on classes of creditors. At present, only two creditors' committees exist in France (in addition to the bondholders' assembly, if applicable) in the context of safeguard and recovery proceedings but not in pre-insolvency procedures. The possibility to use cross-class cramdown will also be a completely new and positive development. While France does have very effective pre-insolvency processes (such as *mandat ad hoc*) these do not provide for a standalone moratorium, which is only currently available with a *sauvegarde* filing. Although the Directive was keen to avoid the mandatory appointment of an IP, as highlighted above, we would expect that to continue to occur in most cases. The French Parliament is in the process of adopting a law (*loi Pacte*) allowing a very quick enactment of the Directive into its domestic law.

- Germany: The flexible preventive restructuring framework will be a new concept in German law. The new framework will provide for the possibility to compromise dissenting creditors (and potentially shareholders) in a pre-insolvency restructuring procedure. Currently in Germany, out-of-court restructurings other than the restructuring of German law-governed bonds require unanimous approval. Existing in-court procedures are only available in case of insolvency, and there is substantial court involvement. Although the new framework will require involvement of the courts and under, certain circumstances, the appointment of a restructuring practitioner, we would expect there to be less judicial involvement as a result of the Directive. Another key change is that it will be possible to effect a restructuring with respect to only certain (groups of) creditors – *e.g.* solely financial creditors – rather than collective proceedings with all creditors, as is currently the case.

- Italy: The Directive is intended to improve efficiency of insolvency proceedings, reducing their length. It is hoped that this will assist in Italy, with specialised training for insolvency practitioners and the use of electronic means of communication. In addition, the separation of creditors into classes is not currently mandatory in Italy. It is intended that the class regime will ensure that creditors with similar rights will be treated equitably, and as such, the changes required by the Directive will be an opportunity to improve on the existing processes. The Italian bankruptcy regime is currently in the midst of fundamental reform and it is expected that the principles set out in the Directive are likely to be incorporated as part of that process.

- Spain: In a similar vein to the impact on Italy, it is intended that the specialised training for insolvency practitioners and the use of electronic means of communication introduced by the Directive will improve efficiency of insolvency procedures and reduce their cost and length. The Directive will also make it substantially easier and quicker for honest insolvent entrepreneurs to access a full discharge of their debt within a shorter period and with repayment of an amount of debt that is adapted to each entrepreneur.

[5] A full copy of the proposals and response to consultation is available at: https://www.gov.uk/government/consultations/insolvency-and-corporate-governance.

Conclusion

It is worth reiterating that the value of any EU directive is always dependent on the way it is enacted into the national laws of each Member State. However, there is clear value in the Directive and its attempt to introduce some minimum standards for preventive insolvency proceedings across the EU.

Sensibly, the EU has not sought to "harmonise" the distinct national insolvency laws that currently exist; instead focusing on some key changes that should be welcomed both by creditors and debtors across the Member States.

Legislative change has been attempted, with varying degrees of success, by the majority of EU Member States over recent years, but if the new Directive is successful, it could mean that local processes will increasingly become viable restructuring options for distressed businesses on the continent. Whether this will mean that historically prevalent regimes such as English schemes and US chapter 11 will diminish remains to be seen: those processes are well-tested and have the benefit of highly experienced judiciary systems and judges to support them, so it may be some time before newly inked regimes under the Directive displace them as first choice for companies and creditors in large-scale restructurings.

Nevertheless, the Directive has fired the starting gun for increased legislative change across the EU, and restructuring professionals and stakeholders will be watching closely to see how these principles are put into practice in the coming months and years.

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