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# A NEW EU LANDSCAPE FOR RESTRUCTURING: HAVING YOUR CAKE AND EATING IT TOO?

The landscape for out-of-court restructurings in Europe is set for significant changes, which may come much earlier than expected. The purpose of this briefing is to explain the key elements of the future EU Restructuring Directive, its transpositions into national laws and practical consequences.

Today the European Justice and Home Affairs Council announced its approval for the Restructuring Directive. Subsequently, it is expected to be rapidly approved by the European Parliament without any substantial changes. Member States will be under an obligation to transpose it within three years, but it is very likely that the key jurisdictions will do so in 2019.

For example, the French Parliament is currently discussing a bill empowering the Government to transpose the Restructuring Directive as soon as it is approved by the EU institutions. The Dutch government is also very likely to enact the new restructuring law in early 2019. Likewise, the UK government has just proposed a reform of the corporate insolvency (see link), although it will leave the European Union before the Restructuring Directive is to be transposed.

Clearly, the Restructuring Directive will give rise to a more level playing field amongst the different Member States. Although the main principles are mandatory, Member States still have a significant degree of flexibility in the implementation. This will trigger legislative competition, even though the intended aim is to ensure a more harmonised approach to restructuring across the European Union.

Looking into the crystal ball, set forth below are the cornerstones of the future European restructuring market.

Three main elements are to be explained, as follows: (i) the conditions for opening preventive proceedings and their legal effects on the creditors; (ii) the new cram-down mechanism, which will facilitate the adoption of restructuring plans, overcoming the resistance of minority creditors or even shareholders; and (iii) the new safe harbour provided for new and interim financing.

## THE TWO PROPOSED RESTRUCTURING MODELS

The Restructuring Directive is based on a single procedure, inspired by the US Chapter 11 model, which is opened for the benefit of solvent debtors at an early stage, in case of financial difficulties. The debtors will remain in

**Key issues**

- EU landscape for restructuring set for significant change
- Draft Restructuring Directive aims for a more level playing field
- Key elements:
  - access to preventive proceedings including a stay on creditor action
  - cross-class cram-down mechanism to be available in restructurings
  - Safe harbour provisions for new and interim finance

possession and the appointment of insolvency practitioners is optional for Member States.

The Restructuring Directive refers to the triggering event of likelihood of insolvency, as defined under national laws, and allows Member States to provide for a viability test to deny access to debtors without any prospect of successfully overcoming their difficulties.

Thus, the Restructuring Directive implicitly takes the position that the opening of these single proceedings necessarily triggers a general stay of individual enforcement actions, which affects creditors' rights. It provides for a rather short stay of up to 4 months, which can be renewed twice, under precise conditions, for a maximum total duration of 12 months (subject to limited exceptions).

The problem with this approach is that these single proceedings are public and are likely to affect the debtor's business. Moreover, the 4-month period appears to be insufficient to negotiate the main terms and conditions of a viable restructuring plan in complex cases. Indeed, in many cases the debtor may have to establish a business plan and creditors need to get organized in steering committees. Furthermore, financial and business experts may be appointed to provide independent reviews.

This is the reason why the Restructuring Directive does not prohibit but rather complements another model, inspired by the French two-steps approach. In this model, in a preliminary first phase, the debtor engages in a confidential negotiation with its main creditors (*mandat ad-hoc*, *conciliation* proceedings). During this phase, there is no general stay of enforcement actions, but only a voluntary moratorium agreed upon with the main financial creditors. In order to support the negotiation of the plan, an individual stay granted on a case-by-case basis by the supervising judicial or administrative authority is possible. This neutralises potential hold-ups from minority creditors.

Consequently, the restructuring landscape in Europe will be divided between these two models. The advantage of the French-inspired model is the possibility to open the negotiations at a very early stage without interfering with creditors' rights. The general stay of enforcement actions concerning all creditors, or some classes of creditors is limited to a later stage and is subject to strict conditions, i.e. the likelihood of a viable restructuring being approved by the creditors.

Both approaches provide for an exemption for the debtor from its obligation (contained in national insolvency laws) to file for the opening of insolvency proceedings. Moreover, the ongoing contracts shall be maintained, and creditors are prohibited from withholding the performance of their own obligations (ipso facto clauses are therefore neutralised). However, the debtor must be able to pay its current debts when they fall due after the opening of preventive proceedings.

## THE APPROVAL OF RESTRUCTURING PLANS

### The introduction of classes of creditors

The Restructuring Directive provides for the introduction of classes of creditors regrouping affected creditors with a sufficient commonality of interests, who are to vote on the proposed plan. These classes are to reflect the rights and seniority of the affected claims and interests or, more generally, the objective difference of situations of creditors. The Restructuring Directive provides for a

great deal of flexibility, subject to subsequent judicial control. These provisions are inspired by the US Chapter 11, the UK scheme of arrangement and the German insolvency plan.

Member States may provide for an exemption for SMEs, who can be allowed to have a single class of creditors.

## The approval of the restructuring plan

The majority rules for each class of affected creditors will be set by Member States, who cannot require a majority higher than 75% of the amount of the claims but can require an additional majority by head count.

A restructuring plan will be accepted if all the classes of affected creditors approved it and it respects the so-called best interest of creditors test.

The latter condition means that no dissenting creditor would be worse off under the plan than in case of either (i) the debtor being liquidated (sale of its business as a going concern, or piecemeal, and money being distributed according to the normal ranking under national law) or (ii) under the next best alternative scenario if there is no plan. In most cases, there is no practical difference between the two scenarios.

## Cross-class cram-down

The plan can also be confirmed by the supervising authority even where some classes of voting creditors are dissenting, if the cumulative conditions set out below for cross-class cram-down are met.

### Debtor's agreement

The debtor should express its agreement, but Member States may limit this rule to SMEs.

### Approval by one or several classes of creditors

The Restructuring Directive provides for two alternative cross-class cram-down mechanisms, but Member States may also choose to transpose both of them:

- Following the US Chapter 11 model, a plan has to be approved by at least one class of affected voting parties other than the class of equity-holders or any class of creditors who, upon a valuation of the debtor's assets as a going concern, would not receive any payment in case of liquidation proceedings. This rule seeks to make sure that the plan is approved by at least one class of creditors who is "in the money". This valuation as a going concern may give rise to expert disputes and is likely to be expensive and time consuming.
- Following the German model, the Restructuring Directive provides for a simpler alternative, i.e. that the plan be approved by a majority of voting classes of affected creditors, provided that at least one of them is a class of senior (secured) creditors.

In both cases, the plan must comply with the priority rule. In this respect, Member States may choose between two alternatives:

A dissenting voting class should be satisfied in full by the same or alternative means if a junior class of creditors receives any distribution or keeps any interest under the restructuring plan (absolute priority rule). The Restructuring Directive provides however for a certain flexibility. For instance, a junior class

may receive a payment if the senior class is well secured. Moreover, Member States may provide for derogations where necessary to achieve the aims of the restructuring plan, if they do not unfairly prejudice the affected parties. This mirrors the UK concept, currently applied in the scheme of arrangement, of the approval being "just and equitable in the circumstances".

The Restructuring Directive also provides for an alternative relative priority rule, pursuant to which dissenting voting classes are to be treated at least as favorably as any other class of the same rank, as determined by national insolvency laws, and more favorably than any junior class. In this case, the supervising authority has more flexibility to approve restructuring plans.

### Position of equity holders

The position of equity holders is ambiguous. From a financial point of view, they have to accept a cram-down if they are "out of the money". However, they have voting powers and could refuse the implementation of debt equity swaps according to the restructuring plan. The Restructuring Directive is designed to avoid such abuses.

Equity holders will form a class of creditors of their own and be potentially subject to the cross-class cram-down mechanism, with the possibility for the Member States to provide that their consent is not necessary if they are "out of the money".

Alternatively, they will be subject to other mechanisms, as provided by national laws, ensuring that they cannot unreasonably prevent the confirmation of restructuring plans, where they are not worse off under the plan than without it.

## SAFE HARBOUR FOR NEW AND INTERIM FINANCING AGREEMENTS

The Restructuring Directive follows the safe harbour model, already adopted in France, Spain, Italy and Germany, to encourage new financing, and extends it to interim financing.

The idea is to ensure that those creditors who provide new financial assistance necessary for the debtor to implement the restructuring plan, or financial assistance reasonably necessary to preserve or enhance the value of the business during the stay of individual enforcement actions, are not impacted by the eventual subsequent opening of insolvency proceedings.

In this case, such creditors will be exempted from any kind of liability and the financing shall not be declared void or unenforceable.

Member States could also provide for a priority ranking for such creditors in case of a subsequent liquidation, as is currently the case in France.

## OUTLOOK

The Restructuring Directive provides for a more level playing field in the European restructuring market. It is expected that each Member State will try to promote the most efficient and attractive restructuring framework, which needs to be coordinated with the European Insolvency Regulation.

In this respect, in can be anticipated that preliminary confidential proceedings which do not provide for a general stay of enforcement actions (conciliation and scheme of arrangement type of proceedings) will continue being excluded

from Annex A of the Insolvency Regulation. This allows Member States to liberally retain their jurisdiction, not being constrained by the COMI approach.

The reverse of the coin is that the resulting agreements will not benefit from the automatic recognition under the Insolvency Regulation and will be subject to private international law rules.

If automatic recognition is required, the preventive restructuring proceedings must be part of Annex A. This is the reason why it is expected that Member States will follow either the two-steps approach or create two different types of proceedings able to match both goals.

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