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New EU proposal for a preventive restructuring framework

Proposal for a 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

On November 22, 2016, the European Commission issued a proposal ("Proposal") for a new directive which aims to introduce effective preventive restructuring frameworks across Europe, to ensure that honest entrepreneurs are given a second chance, and to make insolvency proceedings more efficient. After implementation into German law, it will be the first time that Germany will have a preventive restructuring framework outside the existing insolvency regime.

1. Preventive restructuring framework

The core element of the Proposal is the introduction of effective preventive restructuring frameworks in the Member States. The aim of providing such frameworks is to encourage timely restructurings in order to maximize the value to the involved stakeholders. For this purpose, debtors shall be encouraged and enabled to implement early restructurings to avoid insolvency and restore long-term viability of their businesses. The Proposal contemplates the following key features:

Early access to preventive restructuring: The preventive restructuring framework shall require a certain "likelihood of insolvency". The preventive restructuring framework can be applied for either by the debtor or with the debtor's consent by the creditor.

Debtor in Possession: During the restructuring, the management of the debtor shall remain in control of the assets and the day-to-day operation of the business. The competent court or authority may under certain circumstances appoint a supervisor, in particular where the debtor is granted an automatic stay of individual enforcement actions or where the debtor's restructuring plan requires a cram-down of one or more creditor classes.

Automatic Stay; suspension of insolvency proceedings; executory contracts: During the negotiations of a restructuring plan, the debtor may benefit from a **general or partial stay of individual enforcement** of up to **four months**, and under specific circumstances of up to **twelve months**. During the period of the stay, obligations to file for insolvency shall be suspended. Where a general stay is ordered, creditors cannot file for insolvency during the stay. Member States may provide for exceptions in case the debtor becomes illiquid during the period of the stay, provided that even in such case the restructuring process shall in principle continue. **Executory contracts** that are essential to the debtor's business may not be terminated by creditors, nor shall the creditors have the right to withhold performance purely because of the stay or for debts that came into existence prior to the stay. Clauses in contracts allowing the creditor the termination or refusal of performance upon restructuring negotiations or request for a stay shall be unenforceable.

Restructuring Plans: By a restructuring plan, a debtor shall be enabled to propose a restructuring of its liabilities and/or equity, and the debtor's access to new financing shall be improved. **Key elements** of a restructuring plan shall be

- a valuation of the debtor's business,
- identification and classing of affected parties (creditors or equity holders), and
- the terms of the proposed restructuring, which may include a rescheduling, waiver, or conversion of debt, as well as
- new financing, and the restructuring of the debtor's equity.

To **adopt the restructuring plan**, in each and all classes of affected parties, a sufficient majority must vote in favor of the plan. The required majority shall be determined by the Member States, provided that it may not exceed 75% in the amount of claims or interests in each class. **Approval** of the plan by an authority shall be required if the plan affects the interests of dissenting affected parties or provides for new financing to be granted in connection with the restructuring. When deciding on the approval of a plan, the authority shall review compliance with the requirements for the adoption of the plan and that the plan is in the best interest of creditors. Upon approval by the competent judicial or administrative authority (to be chosen by the Member States), the plan shall become binding on all involved parties. Where the sufficient majorities are not reached in all classes, a **cross-class cram-down** of the dissenting class shall under certain conditions be possible by decision of the authority, which shall take into account and safeguard the legitimate interest of dissenting stakeholders. Notably, the cross-class cram-down mechanism shall be available to overcome an unreasonable blockade by equity holders if the plan processes a restructuring of the equity.

Safe harbor: The Proposal provides for a safe harbor for transactions which are made in connection with the restructuring and are not carried out fraudulently or in bad faith. Protection is awarded in particular to **interim financing** and **new financing** that is granted in connection with a restructuring process. The grantors of such financing shall be protected from avoidance action, as well as criminal or civil law liability, to which they could be exposed under the laws of certain Member States like Germany. To encourage the granting of financing in connection with the restructuring, the Member States may afford **super-priority** to the grantors of such financing. In addition to interim and new financing granted in connection with the restructuring, a broad range of transactions closely connected with the negotiation of a restructuring plan or made to further the implementation of an approved plan, as well as payments in the ordinary course of business shall benefit from the safe harbor rules.

Directors' Duties: The rescue approach of the Proposal is stressed by the requirement for the Member States to lay down rules on director duties. Where there is a likelihood of insolvency, these rules shall make directors focus on the restructuring, thereby preserving the value of the business and minimizing losses, in the interest of creditors, workers, shareholders and other stakeholders.

2. Second chance

Offering in every member state a true second chance to honest entrepreneurs to restart business activities shall encourage entrepreneurial activity. At the same time, costly COMI shifting activities shall be prevented. Therefore, over-indebted entrepreneurs shall have access to an automatic full **discharge** of their debts after a period of **three years** starting from the opening decision on a liquidation procedure or the start of a repayment plan. If discharge is obtained, the entrepreneur is no longer prevented from taking up or pursuing businesses. Exemptions restricting access to discharge or providing for a longer discharge period can be provided *inter alia* for dishonestly or in bad faith or abusively acting entrepreneurs, those not adhering to legal obligations like a repayment plan or those repeatedly using discharge procedures as well as for specific debt (e.g. secured debt, criminal fines).

3. Measures to increase the efficiency of restructuring, insolvency and second chance

Minimum standards for appointing, supervising and remunerating practitioners in the field of restructuring, insolvency and second chance are proposed in order to enable the practitioners to take quick decisions and to shorten the length of procedures by professional acting. In particular, Member States shall ensure
(i) practitioners obtaining necessary training, (ii) clear and transparent conditions for eligibility and (iii) proper supervision and appropriate sanctions in case of failure. Electronical filing, notification and voting shall be possible nationally and cross border to further increase efficiency of the procedures.

4. Outlook

To become a binding directive the Proposal will need to be approved by the European Council following hearings before the European Council and the European Parliament. The Member States will then have to implement the framework into local law and provide for a respective preventive restructuring framework within two years. Overall, we are expecting the implementation in local law to take two or three years from now in Member States which, like e. g. Germany, do not yet have a preventive restructuring framework in place.

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