

Rescue of Business in Insolvency Law



ELI

EUROPEAN
LAW
INSTITUTE

Projects Conference

Thursday 25 September 2014

Zagreb, Croatia

Professor Bob Wessels

EU Insolvency Law: where do we stand? (i)

- Early period till 2002: ad hoc, e.g.
 - Dir. 77/187 Safeguarding Employees' Rights in case of Transfer of Undertakings
 - Dir. 90/314 re Insolvency of Tour Operator
- 2002 EU Insolvency Regulation 1346/2000
Conflict of law system in x-border insolvency matters:
 - The requirement of fulfilling **international jurisdiction** (COMI, establishment)
 - The principle of **applying the *lex concursus*** of the MS in which insolvency proceedings have been opened, to the rest of the EU (except Denmark)
 - The principle of **automatic recognition** of certain insolvency (related) judgments in other EU MSs, and
 - The duty for **cross-border cooperation** between insolvency office holders ('liquidators') when two or more insolvency proceedings in MSs are pending

EIR - Basis in Art. 81 TFEU (promoting judicial cooperation)

- Hardly contains ‘harmonisation’

Recital 11:

‘(11) This Regulation acknowledges the fact that **as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope in the entire Community**. The application without exception of the law of the State of opening of proceedings would, against this background, frequently lead to difficulties. This applies, for example, to the widely differing laws on security interests to be found in the Community. Furthermore, the preferential rights enjoyed by some creditors in the insolvency proceedings are, in some cases, completely different ...’

Guide to Enactment UNCITRAL Model Law on Cross-Border Insolvency (1997, nr. 13):

All national insolvency systems having so many differences, these ‘... **hamper the rescue of financially troubled businesses**, are not conducive to a fair and efficient administration of cross-border insolvencies, impede the protection of the assets of the insolvent debtor against dissipation and hinder maximization of the value of those assets. Moreover, the absence of predictability in the handling of cross-border insolvency cases impedes capital flow and is a disincentive to cross-border investment ...’

EU Insolvency Law: where do we stand? (iv)

- **Since 2011** in EU: Third phase: harmonisation of insolvency law
- **Late 2011** EP asked EC for legislative proposals
‘... relating to an EU corporate insolvency framework, following the detailed recommendations set out in the Annex hereto, in order to ensure a level playing field, based on a profound analysis of all viable alternatives.’
- **12 December 2012** EC policy ‘A new approach to business failure and insolvency’ aiming to harmonise national insolvency and company laws in various matters
- **July 2013** Consultation
- **March 2014** EC’s Recommendation

Legislative Landscape in EU 2012

In a 2012 study Univ. of Heidelberg prof. Andreas Pieckenbrock compared insolvency laws of England, Italy, France, Belgium, Germany and Austria, concluding that there are several common tendencies in the approach to rescue:

1. **Early recourse** – Sometimes there is an earlier moment of starting a rescue process, for instance in the French *Sauvegarde*: the debtor must encounter problems that he can not solve, which is earlier than the traditional moment that the debtor can not pay its financial obligations when they are due
2. **Debtor in possession** – The board is not fully replaced by the insolvency administrator; in certain proceedings the board stays in control of the business
3. **Stay** – In these countries one finds a moratorium or a stay either automatic like in the *Sauvegarde* or at request (for instance the *concordato preventivo* or *réorganisation judiciaire*)
4. **Protecting fresh money** – There are special provisions to protect fresh money available for the company while trying to work itself out of its misery
5. **Debt for equity swap** – Possibilities of a debt for equity swap, i.e. the conversion of a creditors claim into shares in the capital of the company
6. **Reorg. plans** with mechanism to bind disapproving creditors ('cram-down')

Main Objects of EC's Recommendation (i)

Two main objects of EC's Recommendation of 12 March 2014:

1. To '... ensure that viable enterprises in financial difficulties, wherever they are located in the Union, **have access to national insolvency frameworks which enable them to restructure at an early stage with a view to preventing their insolvency, and therefore maximise the total value** to creditors, employees, owners and the economy as a whole. The Recommendation also aims at giving honest bankrupt entrepreneurs a second chance across the Union.' (*recital (1)*)

Main Objects of EC's Recommendation (ii)

2. In order to achieve these aims, the Commission deemed it necessary to:
'... encourage greater coherence between the national insolvency frameworks in order to reduce divergences and inefficiencies which hamper the early restructuring of viable companies in financial difficulties and the possibility of a second chance for honest entrepreneurs, and thereby lower the cost of restructuring for both debtors and creditors. Greater coherence and increased efficiency in those national insolvency rules would maximise the returns to all types of creditors and investors and encourage cross-border investment. Greater coherence would also facilitate the restructuring of groups of companies irrespective of where the members of the group are located in the Union.'
(recital (11))

Heart of the Recommendation's System

- ‘Minimum standards’ for ‘preventive restructuring frameworks’
- Van Zwieten: Six Core Principles:
 1. Early recourse to framework for debtor in ‘likelihood of insolvency’
 2. Minimised court involvement
 3. Debtor in possession
 4. Court-ordered stay
 5. Ability to bind dissenting creditors to a restr. plan
 6. Protection for new finance



- National insolvency laws reflect tendencies of the Recommendation
- National preventive restructuring framework will likely fall within the new broadened scope on the Insolvency Regulation
- Recommendation (non-binding) invites MSs to take or continue legislative action. Within 12 months (so before April 2015) EU Member States are invited to implement the Recommendation's 'principles' (R34). The endgame is that 18 months after adoption of the Recommendation (so in October 2015) the Commission will assess the state of play, based on the yearly reports of the Member States to evaluate whether further measures are necessary to strengthen the European approach (R36)
- In its substance the Recommendation is modest. It only presents a 'minimum standard'. May MSs add e.g. that the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared to a certain reference date?
- Will the new Commission (mr. Juncker) share same policies on 'insolvency'?

In 2012 ABI has established the ABI Commission to Study the Reform of Chapter 11

The ambition of the Commission is:

‘... the study of the need for comprehensive chapter 11 reform, by which we mean consideration of starting from scratch and re-inventing the statute’

ABI’s report is expected December 2014



- **Business has changed** – Large domestic manufacturers with many hard assets – dependency on contracts and intellectual property rights
- **Companies themselves have changed**
 - Businesses are much more multinational companies, with the means of production and other operations offshore, constituting choice of law implications
 - Today's financial distressed debtor is likely to be a group of related, often interdependent, entities
- **Availability of capital has changed** – Companies had assets, which were an object of security. With the slowing down of providing credit or when credit becomes more expensive, however, debt and capital structures of most debtor companies are more complex, with multiple levels of secured and unsecured debt, many times governed by equally complex inter-creditor agreements or – in Europe – with funding from private (hedge fund, family or crowd fund) investors
- **Creditors have changed** – Growth of distressed debt markets and claims trading introducing creditors with other interests in mind, such as focusing on longer term investment instead of demanding short term liquidity
- **Business environment has changed** – Growing importance of transparent rules for corporate governance, with a greater conscience for climate change, increased emphasis on human rights and desired compliance with environmental and social requirements

Topics of ABI Study on Chapter 11

1. Financing Chapter 11
2. Governance and Supervision of Chapter 11 Cases and Companies
3. Multiple Enterprise Cases/Issues
4. Financial Contracts, Derivatives and Safe Harbours
5. Executory Contracts and Leases
6. Administrative Claim Expansion, Critical Vendors and Other Pressures on Liquidity; Creation and/or Preservation of Reorganization Capital
7. Labor and Benefit Issues
8. Avoidance Powers
9. Sales of Substantially All of the Debtor's Assets, Including Going-Concern Sales
10. Plan Issues: Procedure and Structure
11. Plan Issues: Distributional Issues
12. Bankruptcy Remote Entities, Bankruptcy-Proofing and Public Policy
13. The Role of Valuation in Chapter 11

Business Rescue in Insolvency Law

- Q1/2014 – Q3/2016
- Aim: to design a set of norms and requirements that will enable the further development of coherent and functional rules for business rescue in the EU ('ELI Legislative Guide')

- Reporters
- National Correspondents (NCs)
- Advisory Committee (AC)
- Members Consultative Committee (MCC)

ELI Project Reporters



Prof. Bob Wessels
(Leiden Law School)



Prof. Stephan Madaus
(Martin Luther University Halle-Wittenberg)



Ass. Prof. Kristin van Zwieten
(University of Oxford)

Involvement:

- Draft Inventory reports of national law based on ten queries in the Questionnaire
- Draft/present Normative reports with desiderata/views
- 19/20 March 2015 – Vienna Conference

Headings Questionnaire

1. **Governance and Supervision** of a rescue in court and out-of-court
 - Conditions for out-of-court workouts, conditions for opening of such ‘proceedings’, conditions for opening formal pre-insolvency and insolvency proceedings
 - Role of a court, a supervisory judge or other state agency
 - Status, powers and supervision of insolvency practitioners; duties and liabilities of directors
 - How are unsuccessful rescue attempts in pre-/insolvency procedures terminated or converted into other procedures?
2. **Financing a rescue**, including critical vendors and other pressures on liquidity; the stay
3. **Executory contracts**, including leases, IP-licensing contracts; termination and modification of contracts; transfer of contracts
4. **Ranking of creditor claims**; governance role of creditors
5. **Labour**, benefit and pension issues
6. **Avoidance powers**, including safe harbour for failed rescue efforts in a later bankruptcy, and avoidance powers in pre-insolvency procedures and out-of-court workouts
7. **Sales** of substantially all **of the debtor’s assets** on a going-concern basis
8. **Rescue plan issues**: procedure and structure; distributional issues
9. **Multiple enterprise/corporate group issues**
10. **Special arrangements for small and medium-sized enterprises (SMEs)** including natural persons (but not consumers)

From the Questionnaire the following topics do not seem to be addressed in the Recommendation:

- 3 ('Executory contracts, including leases, IP-licensing contracts; termination and modification of contracts; transfer of contracts')
- 5 ('Labour, benefit and pension issues'),
- 6 ('Avoidance powers, including safe harbour for failed rescue efforts in a later bankruptcy, and avoidance powers in pre-insolvency procedures and out-of-court workouts'),
- 7 ('Sales of substantially all of the debtor's assets on a going-concern basis'),
- 9 ('Multiple enterprise/corporate group issues', although there are some references to groups in the recitals of the Recommendation), and
- 10 ('Special arrangements for small and medium-sized enterprises (SMEs) including natural persons (but not consumers)')

Comparing ELI Project and Recommendation (ii)

- From the Questionnaire indeed topic 1 ('Governance and Supervision of a rescue in court and out-of-court'), 2 ('Financing a rescue, including critical vendors and other pressures on liquidity; the stay'), 4 ('Ranking of creditor claims; governance role of creditors') and 8 ('Rescue plan issues: procedure and structure; distributional issues') are (partly) addressed
- Recommendation also covers consumer bankruptcies, a topic that falls outside the scope of the ELI study

Involvement:

- To act generally as a sounding board on substantive matters
- To assist (based on the submitted inventory reports and the associated papers of the NCs) in selecting best practices or to submit their own ideas
- To review draft texts of the project outcomes and advise on their compatibility with matters of substantial law

Mihaela Carpus-Carcea, Legislative officer DG Justice European Commission acts as an 'observer' to the project, in a similar role as the members of the Advisory Committee

Involvement:

- To allow open-minded debate to ensure that aspects of the project which may provide difficulties of transposition into the legal culture of a Member State can be addressed
- To provides certain contacts to European/national representatives in the insolvency field
- Provide comment on reporters' draft texts
- Alert Reporters to national or regional (scientific) events in which ELI Business Rescue project can be discussed and be available as a speaker

ELI Members are still welcome to register for the MCC

Register via: businessrescue@europeanlawinstitute.eu

Till 3Q/2016 opportunities for discussion:

- American Bankruptcy Institute
- American College of Bankruptcy
- INSOL Europe*
- INSOL Europe Academic Forum*
- INSOL International*
- International Bar Association*
- International Insolvency Institute*
- Turnaround Management Association Europe*

* Already contacted parties

- International Inventory report of Gert-Jan Boon (comparing soft law solutions, such as World Bank 2011 Principles for Effective Insolvency and Creditor/Debtor Regimes and UNCITRAL Legislative Guide)
- Reports of EC re Recommendation's 'implementation'
- Certain EU MS's country analysis'
- ABI report (end 2014)

Project Outcomes: 4 Reports

1. **Inventory report on national insolvency laws**, in particular rescue-related tools, including empirical evidence and the underlying policy choices from 13 selected MSs
2. **Inventory report on international recommendations** from standard-setting organisations re 10 topics of Questionnaire
3. **Legislative aide/guide**, possibly model rules, based on transparent and reasoned policy choices and comprising a catalogue of identified best practice models which support and facilitate the rescue of business while striking a fair balance with creditors' interests and other recognized interests
4. **(if justified) Legislative proposal** (probably: Directive) addressed to the EU legislator, aiming at targeted harmonization of national insolvency laws in order to create a level playing field of balanced rescue solutions in Europe

Our Challenges

1. Continuity of the project
2. Guarantee a sufficient debate with participants
3. Assess the willingness among NCs and members of the AC for approximation of Insolvency Laws
4. Keeping up to date with legislation in a rapidly changing legal environment
5. Assess the willingness within EU and MS to further harmonise substantial rescue related (insolvency) law

Questions

www.europeanlawinstitute.eu

businessrescue@europeanlawinstitute.eu

www.tri-leiden.eu/projects/businessrescue