Restructuring law: recommendations from the European Commission

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In March 2014, the European Commission published its “Recommendation on a new approach to business failure and insolvency” (the Recommendation).¹ The Recommendation is addressed to European Union (EU) Member States, 11 of which are countries where the EBRD invests.² The primary subject of the Recommendation is the legal treatment of distressed but viable businesses. Its main objective is to ensure that all Member States have in place a procedure that enables such businesses to “restructure at an early stage with a view to preventing their insolvency”.³ With the exception of one section (which is concerned with personal bankruptcy law),⁴ the Recommendation is devoted to setting out what the Commission describes as “minimum standards” for these restructuring procedures in Member States. This article focuses on the restructuring components of the Recommendation.

The Commission defines restructuring as a process by which the “composition, conditions, or structure” of a debtor’s assets and liabilities are changed, “with the objective of enabling the continuation, in whole or in part” of its business activities.⁵ As noted below,⁶ the Commission has expressed concern at reports that distressed but viable businesses are being channelled into liquidation proceedings in some Member States. The result may be the break-up of business assets to be sold on a piecemeal basis, even though the business is worth more to creditors (and to other classes of stakeholders, such as employees) when preserved on a going concern basis. A restructuring is one way to preserve the value of such a business. A restructuring of liabilities (for example, through the write-down of debt or, in the case of a company, the conversion of debt to equity) could be used to restore the debtor to solvency so that it can continue to trade. Achieving this will require negotiation with affected creditors to procure their consent to compromise or otherwise alter their rights against the debtor. A restructuring procedure provided by law can, however, offer tools to facilitate reaching agreement – for example, by providing that in certain circumstances the decision of a prescribed majority of creditors to accept a restructuring plan can also bind dissenting creditors to the plan. Such tools can be provided within an insolvency code (for example, as part of a corporate rescue or reorganisation procedure),⁷ or outside it – as in the case of the English scheme of arrangement.⁸

The Commission’s Recommendation is primarily focused on this type of restructuring tool – that provided by law to facilitate the negotiation of a binding restructuring agreement. It should be emphasised at the outset that it is perfectly possible to achieve such an agreement without recourse to a restructuring or insolvency procedure provided by law. Creditors can negotiate informally with a debtor to achieve a restructuring by consensus. Creditors with sufficiently similar interests and incentives (such as banks) may also develop their own restructuring processes, for use where a debtor with exposure to multiple creditors of that class becomes distressed.⁹ More formally, creditors or classes of
creditors (such as bondholders) may commit themselves, before distress, to a restructuring process in a contract. These solutions may be more desirable than recourse to a formal procedure provided by law, not least because they may be less costly to achieve – recourse to formal restructuring or insolvency procedures can involve significant direct and indirect costs. Achieving such a solution may, however, be easier in the presence of a legal procedure that parties can “bargain in the shadow of”, knowing that if they fail to cooperate, formal (public and costly) proceedings may have to be commenced. In addition, there will be some circumstances in which informal, industry or contractual solutions to distress are inappropriate (for example, because creditor interests and incentives are too diverse to permit effective coordination), and then the presence of a restructuring procedure provided by law may be of direct utility to stakeholders.

There is one other point that should also be emphasised at the outset, which is that a restructuring is not the only means of achieving the Commission’s objective of preserving the value of a distressed but viable business. Another route to preserving the value of such a business, that need not necessarily involve restructuring, is the sale of the business on a going concern basis. Such a sale may be achieved outside or within a formal insolvency or receivership procedure. There is also a hybrid approach, in which a sale is negotiated in anticipation of an insolvency procedure and takes effect immediately on its commencement, with the proceeds of sale distributed to creditors in accordance with the priority rules provided by insolvency law. Such an approach (a “pre-packaged” sale) can avoid some of the loss to business goodwill that is associated with the commencement of formal insolvency proceedings. Whichever approach is used, a sale on a going concern basis may be the most effective way of maximising the value of a distressed debtor’s business. By comparison, a restructuring may be more costly to achieve, since it requires bargaining with creditors to procure their consent to alter or compromise the debtor’s liabilities. There may however be some cases where value can only be maximised by keeping the business with the debtor (for example, because its assets are not transferable or not readily transferable), and then a restructuring of the kind envisaged by the Commission may be necessary.

The background to the release of the Recommendation

Interest by European policy-makers in the subject of business rescue and restructuring is not new – the rise of a “rescue culture” in Europe over the last two decades has been well documented. It is clear, however, that the global financial crisis (and an associated rise in business insolvencies) has sharpened the focus of policy-makers on the subject. In late 2011, the European Parliament adopted a resolution on insolvency proceedings. The resolution exhorted the value of insolvency laws as a “tool for the rescue of companies at Union level”. It identified a trend towards greater convergence in the domestic insolvency laws of Member States, and urged further harmonisation of domestic law in several areas – including some aspects of the design of restructuring procedures. Differences in domestic laws across states were identified as a potential barrier to restructuring in cross-border insolvency cases, and a desire was expressed to ensure a “level playing field” across the EU.

The European Commission was tasked with considering Parliament’s recommendations, and submitting proposals for law reform. The reform agenda was ambitious, not least because the Parliament’s recommendations were directed not only to the harmonisation of aspects of domestic insolvency and bankruptcy laws, but also to the topic of cross-border insolvency in the EU (including the revision of the European Insolvency Regulation). Since 2011, the Commission has done a considerable amount of work on business insolvency at both the domestic and cross-border level. This includes commissioning multiple studies (including an in-depth study of restructuring mechanisms currently available to distressed businesses in Member States), the release of Commission communications and public consultations. Some of the themes that emerge from this body of work include: (i) a stated desire to enable the survival of viable businesses and a conviction that law has a role to play in facilitating this; (ii) concern that differences in the laws of Member States mean that some businesses have a better chance than others of restructuring at an early stage; and, relatedly (iii) concern that some restructuring procedures are so costly or otherwise unworkable that they cannot be used to resolve financial distress, with the result that some viable but distressed debtors
are unnecessarily wound up. The overall conclusion of the Commission is that “many European restructuring frameworks are still inflexible, costly and value destructive”. The Recommendation is the Commission’s response.

The core features of the Recommendation

Although the recent work of the Commission in the field of business rescue has been extraordinarily wide-ranging, the Recommendation has a much narrower scope. It focuses primarily on restructuring, and particularly on the design of procedures provided by law for the early restructuring of distressed business debtors. The Recommendation aims 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 seeks to achieve this by encouraging the availability of a “preventative restructuring framework” in all Member States, and by setting out “minimum standards” for what this framework ought to offer distressed enterprises. By promoting adherence to these standards across the EU, the Commission hopes to improve existing means for resolving distress in viable enterprises, and through this to improve access to finance for businesses ex ante (that is, in the period before any distress) as creditors adjust to the availability of improved tools for resolving financial distress that avoid the need for recourse to value-destroying insolvency procedures.

There are six core principles emphasised in the Commission’s recommendations for a “preventative restructuring framework” in each Member State. These principles are complementary and as such should be analysed together, rather than in isolation. The six principles are:

1) **Early recourse**: the Commission recommends that a debtor be able to have recourse to the restructuring framework at an early stage, before factual insolvency. In Member States where restructuring tools are presently contained within insolvency procedures that can only be commenced after a debtor is insolvent, adherence to this principle would require a change in the law to make such tools available earlier, without recourse to the full insolvency procedure. The Commission does not, however, recommend unrestricted access to its restructuring framework. To prevent misuse of the procedure by solvent companies (for example, as a device to coerce a compromise where the debtor is fully capable of fulfilling its existing obligations), the Commission recommends restricting the availability of the framework to debtors already in “financial difficulties”, such that there is a “likelihood of insolvency”.

2) **Minimised court involvement**: the Commission recommends permitting a debtor to have recourse to the restructuring framework without the need to formally open court proceedings. More generally, it emphasises the need for a swift and inexpensive procedure, and as such recommends restricting court involvement to circumstances where necessary and proportionate to safeguard the rights of creditors and others affected by a proposed restructuring plan (see principle 5 below). The Commission does contemplate the involvement of a court in some other limited circumstances (including where the debtor seeks a stay of creditor enforcement action; see principle 4 below), but its overall emphasis is on minimising the need to have recourse to a court. Conformity with this principle could require significant change in jurisdictions that presently require courts to undertake a wider range of tasks in a restructuring process (for example, holding meetings for creditors to vote on a plan).

3) **Debtor-in-possession**: the Commission recommends that the debtor “keep control over the day-to-day operation of its business” while the restructuring framework is used. This principle is designed to ensure that the business can continue to be run while the possibility of restructuring is explored, with minimal disruption to ordinary operations. Leaving the debtor in control of the business may also help to incentivise early entry into the framework, consistent with principle 1. The principle of leaving managers in control might be regarded as controversial in jurisdictions that presently require the relinquishing of control in insolvency processes, but there is no necessary inconsistency. The Recommendation focuses on legal tools to enable restructuring, and not on the broader question of the design of insolvency procedures (which
typically involve a much wider range of activities, such as investigations into managerial conduct, and the avoidance of pre-insolvency transactions).\textsuperscript{40}

4) \textit{Court-ordered stay}: the Commission recommends that the debtor be empowered to seek a stay of individual creditor enforcement action (including by secured creditors), by application to a court.\textsuperscript{42} The stay is designed to enable the assets of the business to be kept together, preventing their piecemeal dismemberment by creditors. Since a stay impinges on the ordinary rights of creditors to enforce on default, its availability might in some circumstances be predicted to increase rather than decrease the cost of credit \textit{ex ante}. For this reason,\textsuperscript{43} the Commission recommends a series of safeguards, including time limits (initial stay of up to four months, subject to renewal up to a maximum duration of 12 months),\textsuperscript{44} and an obligation to lift the stay when no longer necessary to facilitate the adoption of a restructuring plan.\textsuperscript{45} The Commission also contemplates Member States imposing other conditions on the availability of the stay. States might, for example, require evidence of the viability of a debtor’s business, so as to exclude use of the procedure by non-viable businesses (that is, those whose assets are not worth more kept together than broken up in a piecemeal sale). The Commission does however recommend that the stay be granted where creditors with a “significant” amount of claims support the negotiation of a restructuring plan, and the plan has a reasonable prospect of being implemented and of preventing the debtor’s insolvency.\textsuperscript{46}

5) \textit{Ability to bind dissenting creditors to a restructuring plan}: the Commission recommends that the restructuring framework provide for a plan to be negotiated between debtor and creditors (secured or unsecured), and – where approved by the requisite majority\textsuperscript{47} of creditors in affected classes – sanctioned by a court, with the effect that dissenting creditors are bound by it.\textsuperscript{48} The Commission also recommends power to sanction a plan approved by some classes but not others, with the result that it would be possible for a majority of classes to bind dissenting classes (that is, for those classes to be “crammed down”).\textsuperscript{49} Various safeguards are called for, including a requirement that the plan does not reduce the rights of dissenting creditors below that which they might reasonably be expected to have received if the debtor’s business had instead been liquidated or sold on a going concern basis, as the case may be.\textsuperscript{50} Procedural requirements are also stipulated to ensure creditors are notified of the plan, can object to it, and can appeal against it.\textsuperscript{51} As others have noted,\textsuperscript{52} aspects of the Commission’s proposals for restructuring plans appear to borrow from the English scheme of arrangement procedure, which enables a court to sanction a binding scheme that has the consent of the prescribed majority of creditors (or of creditors in an affected class), subject to a range of substantive and procedural safeguards. It is important to acknowledge that the administration of this scheme procedure with due safeguards has required significant judicial input and expertise (for example, to develop principles for the proper constitution of classes).\textsuperscript{53}

6) \textit{Protection for new finance}: the Commission recommends that those who provide new finance to a debtor in accordance with the terms of a court-sanctioned restructuring plan be shielded from the operation of avoidance provisions in insolvency law,\textsuperscript{54} and from “civil and criminal liability relating to the restructuring process”,\textsuperscript{55} except in the case of fraud.\textsuperscript{56}

While developing its Recommendation, the Commission has also been working on the reform of the European Insolvency Regulation. The connection between these two projects should be briefly noted. One of the proposed amendments to the European Insolvency Regulation is the widening of its scope, to include certain debtor-in-possession and pre-insolvency procedures.\textsuperscript{57} If this amendment is made, then the kind of restructuring procedure contemplated in the Commission’s Recommendation could potentially come within the scope of the European Insolvency Regulation.\textsuperscript{58} This would mean that the rules of the Regulation governing jurisdiction to open proceedings, and the effect of proceedings once opened (including obligations of recognition and cooperation by other Member States), could apply to these restructuring procedures. The cumulative impact of domestic reforms to give effect to the Recommendation, and the amendment of the European Insolvency Regulation, could therefore be highly significant.
Next steps

The Recommendation is not binding, but the Commission invites Member States to implement its core principles within 12 months (that is, by 12 March 2015). The Commission proposes to conduct an overall assessment of compliance with the Recommendation after 18 months (in September 2015). At the same time, the Commission also invites Member States to collect “reliable annual statistics on the number of preventative restructuring procedures opened, the length of procedures and information about the size of the debtors involved and the outcome of the procedures opened”, and to communicate this annually to the Commission (beginning in March 2015). This invitation reflects the paucity of reliable information in many Member States (and in many other jurisdictions around the world) about the rate of recourse to formal restructuring and insolvency procedures, and the cost, duration and outcome of such proceedings once opened. As such, the Commission’s invitation to improve data collection and reporting is a positive step.

The Commission’s 12 month timetable for reforms to ensure compliance with its core restructuring principles is extremely short. There may be good reason for a Member State to proceed somewhat more cautiously, so as to better ensure the efficacy of reforms. The swift introduction of a new restructuring procedure might appear attractive but be ultimately counterproductive – for example, because it does not include adequate safeguards to ensure that viable businesses are filtered from non-viable businesses and that only the former are eligible to have recourse to the procedure. Such a result could actually add to the costs associated with enterprise distress, and as a consequence could have a negative impact on the cost and availability of credit ex ante – contrary to the Commission’s overarching objectives.

In many cases, it will be more sensible to begin by gathering much more detailed information at country level on what works, and what does not work, in existing law. This should include data of the kind called for by the Commission (that is, information on the use of any existing restructuring procedures), but is clearly not limited to this. Some important research has already been done (including in the studies commissioned by the European Commission), and other research is ongoing (such as the study commissioned by the European Law Institute). However, these studies should be complemented by further research and stakeholder consultation at country level in those jurisdictions contemplating reform. Given the discussion in the introduction to this article, some questions that might usefully be explored in these jurisdictions include:

- What kind of business enterprises might need to have recourse to a restructuring procedure provided by law, and what are their typical features (such as their capital structure)?
- Where such procedures are already provided by law, what are their deficiencies, not only in the law “on the books”, but also as it is interpreted and applied in practice?
- Are there legal or other institutional barriers to the use of informal, industry or contractual restructuring solutions to distress, and if so should more be done to dismantle these?
- Are there legal or other institutional barriers to achieving the sale of a business on a going concern basis (as a possible alternative to restructuring), and if so should more be done to dismantle these?

Exploring the first two questions should enable a tailoring of reform to meet stakeholder demand, and help to reduce the risk that any new procedure will be rendered too costly or otherwise unworkable by the same implementation problems that have impaired existing procedures. The latter two questions go beyond the scope of the Commission’s Recommendation, but are clearly complementary to it. If there are other less costly means of achieving a restructuring, or if there are other (non-restructuring) means of preserving the value of a distressed debtor’s business, then these should be explored, if the objective of maximising value ex post to improve the cost and availability of capital ex ante is to be taken seriously.
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2 Bulgaria, Croatia, Cyprus, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.
3 Recommendation (n 1) Recital (1).
4 Ibid. Part IV, which recommends a discharge from debts for bankrupt but “honest” entrepreneurs after no more than three years.
5 Ibid. Article 5(b).
6 See text to n 27.
7 Though this does not mean that the debtor must necessarily be factually insolvent to use the procedure. Different jurisdictions take different approaches to this question.
8 Which appears in the English company law code (the Companies Act 2006, Pt 26), and may be used by a solvent or insolvent company: for an overview, see J. Payne (2014), Schemes of Arrangement: Theory, Structure and Operation, Cambridge University Press, Chapter 1.
9 Such processes have been developed in many jurisdictions for commercial banks, often under the leadership of central banks. Many have been modelled on the “London Approach”, as to which see J. Armour and S. Deakin (2001), “Norms in private insolvency: The ‘London Approach’ to the resolution of financial distress”, Journal of Corporate Law Studies, pp. 21-51.
11 See further Garrido ibid. 24-25.
12 These two routes to preserving value are not necessarily mutually exclusive – a restructuring could be carried out with a view to effecting a sale of the business on a going concern basis. See Payne (n 8) pp. 187-191.
15 Or at least the consent of the requisite majority, as prescribed (in the case of a formal restructuring procedure) by law.
17 See further ibid. Part IV.
19 Ibid. Recital J.
20 Ibid. Recitals D and C. The specific proposals for harmonisation are set out in the Annex to the Resolution. They were developed with reference to a report commissioned by the Legal

Resolution (n 18) Recital A. This recital also raises the issue of “forum shopping”, a phenomenon which European policy-makers have long been interested in.

Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings. The Regulation provides rules on the opening, recognition and effect of insolvency proceedings throughout Member States, where a debtor has its centre of main interests in a Member State (Recital 14). It was scheduled for review by 1 June 2012 (see Article 46 of the Regulation).


Ibid. Section 1.

Ibid. Section 3.3. See also “Impact Assessment accompanying the document Commission Recommendation on a New Approach to Business Failure and Insolvency” (12 March 2014), European Commission, SWD 61, p. 2 and Section 3.2.

Recommendation (n 1) Recital (1).

Ibid. Part I. See also Recitals (4), (8) and (11).

Ibid. Article 6(a).

For jurisdictional examples, see Impact Assessment (n 27) 11-12.

Recommendation (n 1) Article 6(a), and the definition of “debtor” in Article 5(a). See also Impact Assessment (n 27) Section 7.2.1.

Recommendation (n 1) Article 8.

Ibid. Article 7. See also Impact Assessment (n 27) Section 7.2.6.

See further Impact Assessment (n 27) 14-15.

Recommendation (n 1) Article 6(b). The Recommendation does however contemplate the appointment by a court of a “supervisor” to oversee debtor activity and safeguard creditor interests: Article 9(b).

Impact Assessment (n 27) Section 7.2.3.


See further Payne (n 8) [5.6.2.1] “A scheme is not an insolvency procedure”.

Recommendation (n 1) Articles 5(c), 6(c) and 10.

See Impact Assessment (n 27) Section 7.2.2.

Recommendation (n 1) Article 13.

Ibid. Article 14.

Ibid. Article 11.

As prescribed by national law. Ibid. Article 18.

Ibid. Articles 6(d), 16, 17 (providing for secured creditors to be treated as a separate class to unsecured creditors), 20-21, 26. Article 25 provides that a plan adopted unanimously by affected creditors should be binding on them, which appears to provide support for out-of-court contractual restructurings (discussed in the introduction to this article).

Ibid. Article 18. For further discussion of the class cramdown tool, see Payne (n 8), Chapter 5, particularly pp. 239-242.

Ibid. Article 22(c).

Ibid. Article 24, except that an appeal should “not in principle suspend the implementation of the restructuring plan”.


See further Payne (n 8) Section 5.5.2.1.

Recommendation (n 1) Articles 6(e) and 27.

Ibid. Article 28.

Ibid. Article 29.


As is explicitly acknowledged in the Impact Assessment that accompanies the Recommendation (n 27) Section 2.5.

Recommendation (n 1) Article 34.
59 Ibid. Article 36.
60 Ibid. Article 35.