Position Paper

of the German Bar Association by the Committee on Insolvency Law in collaboration with the European section on Insolvency & Restructuring Law

on the Proposal for a Directive COM(2016) 723 on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU

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- Rechtsanwalt Peter Hoegen, Frankfurt/M.

Responsible DAV-Director

- Rechtsanwalt Udo Henke

Contact in Brussels:

- Rechtsanwältin Eva Schriever, LL.M.

Deutscher Anwaltverein
Littenstraße 11, 10179 Berlin
Tel.: +49 30 726152-0
Fax: +49 30 726152-190
E-Mail: dav@anwaltverein.de

Büro Brüssel
Rue Joseph II 40, Boîte 7B
1000 Brüssel, Belgien
Tel.: +32 2 28028-12
Fax: +32 2 28028-13
E-Mail: bruessel@eu.anwaltverein.de
Transparency Register identification number: 87980341522-66

www.anwaltverein.de

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The German Bar Association (Deutscher Anwaltverein – DAV) is the professional body comprising more than 66.000 German lawyers. Being politically independent the DAV represents and promotes the professional and economic interests of the German legal profession.

The DAV also supports the European Commission's new approach to business failure. In particular, the DAV supports the concept of introducing restructuring plans to prevent insolvency without the courts having to become involved in the drawing-up of such plans or having to employ, with however much latitude, an independent, court-confirmed restructuring expert. The matter concerns restructuring plans that are not part of insolvency proceedings that make unnecessary actually initiating such proceedings ('social stigma'), and, with them, court proceedings. Extending this to national and EU group level restructuring would be desirable.

Preface

It is the opinion of the DAV that the following reasons in particular also support the need for such a process, which is described in detail in the context for the proposal (draft directive):

Restructuring early helps avoiding losses that must be borne by other stakeholders if a business fails. Businesses used to be financed by classic equity capital and debt capital provided by banks. In recent years, new structures and products as well as new financial service providers have sometimes resulted in complex structures that are also characterised by financial service providers having sometimes different interests with financial investing. This has led to new constellations for out-of-court restructuring.

Out-of-court restructuring is occasionally hindered or thwarted by individual creditors who utilise security potential or, as the case may be, **disruptive potential** they have obtained in order to gain special advantages during an out-of-court restructuring. This behaviour, which serves neither creditors' interests nor economic interests, demands a more comprehensive preventive restructuring framework.

In particular:

On Article 3 – Early warning

As part of an early warning system that should generally be set up, the management (independent of the enterprise's legal form) should be required to **continuously conduct internal audits** of the business. If weak earnings or financial difficulties loom, a vulnerability assessment should be conducted, restructuring measures reviewed and the necessary steps taken. The preventive restructuring framework should allow companies to take the necessary **restructuring steps early** without being hindered by irrelevant self-interests.

On Article 4 – Availability of preventive restructuring frameworks

It is advisable to establish a **restructuring framework** (Union-wide scheme) for restructuring loans and financial liabilities (including securities, etc.) that is not connected with insolvency (to be distinguished from pre-insolvency advice).

DAV recommendation for Article 4 para. 2:

The preventive restructuring framework should be used to **restructure the liabilities side** of the balance sheet, including capital structure and equity capital. The following should be added to the beginning of Article 4 para. 2 as new sentences 1 and 2:
'The preventive restructuring framework is established for restructuring loans and financial liabilities, as well as liabilities similar to financial liabilities and liabilities whose general, statutory ***payment terms*** *have been* ***extended*** *by the parties concerned through* ***legal transaction****. This shall not include pension obligations.'*

The company is required to keep its distance to obligations to file for insolvency (so-called '**distance rule**'). This means the restructuring framework is only available if the enterprise, when requesting permission to restructure, can demonstrate sufficient working capital over the next six months given the likely course of business, and that the enterprise can turn an operating profit or compensate for any incurred losses. In addition, promising negotiations over a restructuring plan would by themselves support a positive going concern prognosis.

An **exception** to this would only be made if a creditor suddenly and unexpectedly withdraws from the initiated restructuring step or negotiations in order to gain selfish advantages despite the fact that the restructuring steps/negotiations were verifiably initiated promptly.

If the distance rule is not observed as per Article 4 para. 1 of the draft directive, the request is invalid. Announcements/requests are not rejected for being premature as per no. 3. The company is obligated to promptly negotiate economically viable restructuring steps with its stakeholders.

DAV recommendation for Article 4 para. 4:
The following should be added as sentence 2 of Article 4 para. 4:
'The debtor shall provide proof of sufficient operative liquidity for the next six months when requesting a restructuring measure.'

DAV recommendation for a new Article 4 para. 5:
A new para. 5 should be added to Article 4 as follows:
'Insofar as legally relevant, the Member States shall ensure that promising negotiations under the restructuring framework shall constitute sufficient grounds a positive going concern prognosis.'

The draft directive does not provide a connecting factor regarding **international jurisdiction**, specifically whether the jurisdiction in which preventive restructuring proceedings have been started must be the same as the debtor's general jurisdiction or COMI, or whether other bases should be acceptable, such as the creditor's place of business or law selected by majority. The Member States should have their national versions of the restructuring framework included in Annex A of the Council regulation on insolvency proceedings. The Council regulation on insolvency proceedings would then be authoritative for questions of jurisdiction and recognition.

DAV recommendation for a new Article 4 para. 6:
A new para. 6 should be added to Article 4 as follows:

‘The Member States may request that the procedures and steps for the preventive restructuring framework specified in the implementation of this Directive be included in Annex A of the Council regulation on insolvency proceedings.’

On Article 5 – Debtor in possession and the role of practitioners in the field of restructuring

The draft directive wisely suggests the inclusion of a **moderator** and of restructuring experts during pre-insolvency proceedings. While Recital 18 introduces the concept of a moderator it does not address the matter further. Recital 18 reads:

‘To avoid unnecessary costs and reflect the early nature of the procedure, debtors should in principle be left in control of their assets and the day-to-day operation of their business. The appointment of a restructuring practitioner, whether a mediator supporting the negotiations of a restructuring plan or an insolvency practitioner supervising the actions of the debtor, should not be mandatory in every case, but made on a case-by-case basis depending on the circumstances of the case or on the debtor’s specific needs.’

Article 2 no. 15 of the draft directive is more specific:

‘‘practitioner in the field of restructuring’ means any person or body appointed by a judicial or administrative authority to carry out one or more of the following tasks:

(a) to assist the debtor or the creditors in drafting or negotiating a restructuring plan;

(b) to supervise the activity of the debtor during the negotiations on a restructuring plan and report to a judicial or administrative authority;

(c) to take partial control over the assets or affairs of the debtor during negotiations.’

It should be noted that Article 13 para. 3 additionally introduces the concept of experts:

‘Member States shall ensure that properly qualified experts are appointed to assist the judicial or administrative authority, when necessary and appropriate, for the purposes of the valuation, including where a creditor challenges the value of the collateral.’

To this extent, the statement made by the Recital that forgoing an expert to assist and monitor the debtor apparently generates unnecessary costs is neither empirically validated in the documents submitted by the Commission nor accurate in absolute terms. The oft-heard refrain that consultant’s or administrator’s fees are excessive is

more often asserted than actually proved. Especially in complicated cases, a moderator can create trust, fairness and transparency. This can reduce friction costs and, when the process is guided by experience and skill, result in cost efficiency. Of course, this requires the ‘moderator’ to be neutral and independent.

In the German version, the independent practitioner in the field of restructuring may also take on the role of an expert as established in Article 13 of the draft directive. Giving this task to the practitioner in the field of restructuring, who is already involved, increases efficiency and saves money.

That the term ‘practitioner in the field of restructuring’ is translated into German as meaning ‘restructuring administrator‘ is therefore likely due to the fact that an ‘insolvency practitioner‘ and an insolvency administrator rightly share the same job description. However, pre-insolvency proceedings do not require any administration. They are not a ‘light version’ of insolvency proceedings.

The DAV suggests correcting the aforementioned provisions as follows:

DAV recommendation for Recital 18:
‘To reflect the early nature of the procedure, debtors should in principle be left in control of their assets and the day-to-day operations of their business. The appointment of an independent restructuring practitioner supporting the negotiations of a restructuring plan or supervising the actions of the debtor should not be mandatory in every case, but made on an case-by-case basis depending on the circumstances of the case or on the debtor’s specific needs, and to promote transparency, fairness and efficacy in the proceedings.’

DAV recommendation for Article 2 para. 15:
‘‘practitioner in the field of restructuring’ means any independent, neutral person or body suitable for the case at hand and appointed by a judicial or administrative authority to carry out one or more of the following tasks:

(a) to assist the debtor or the creditors in drafting or negotiating a restructuring plan;

(b) to supervise the activity of the debtor during the negotiations on a restructuring plan and report to a judicial or administrative authority;

(c) to take partial control over the assets or affairs of the debtor during negotiations.'

DAV recommendation for Article 13 para. 3:
'Member States shall ensure that properly qualified experts are appointed to assist the judicial or administrative authority, when necessary and appropriate, for the purposes of the valuation, including where a creditor challenges the value of the collateral. <u>The Member States shall be free to allow this task to be delegated to the practitioner in the field of restructuring.</u>'

On Article 6 – Stay of individual enforcement actions
A temporary **stay (moratorium) on individual enforcement activities** for claims incurred and due before the stay is granted should be possible if these activities could impact negotiations and reduce the probability of the debtor's enterprise being restructured. The stay serves only to protect the enterprise from those interfering parties who recklessly pursue their own interest and make usage of their disruptive potential. The stay is not used to generate liquidity in general. This is why the stay can only be requested against affected creditors who will later as a member of a creditors' class vote on the restructuring plan; the stay is to be conjoined with a cram-down request.

Article 6 para. 1 of the draft directive does not provide for whether the **stay** should be ordered **only when requested** or, possibly, ex officio. However, since Article 4 para. 3 of the draft directive intends to have as little involvement as possible from the courts, the stay should only be able to be ordered when requested. In this case, Article 4 para. 4 of the draft directive suggests that both the debtor and a creditor (with the debtor's consent) may request such a stay. In practice, any security provided by a member of a group (so called **group security)** and the associated risk of a domino effect also pose a considerable risk and obstacle to restructuring. It should therefore also be possible to request a stay against affected creditors who have received securities for the debtor's liabilities from companies affiliated with the debtor.

DAV recommendation for Article 6:

For this reason, Article 6 para. 1 should be formulated as follows:

'The Member States shall ensure that debtors who are negotiating a restructuring plan with their creditors may request a stay of individual enforcement actions against the affected creditors and, if required by law, shareholders, as well as the companies affiliated with the debtor, as far as these companies have granted the affected creditors securities, if and to the extent that such a stay is necessary to support the negotiations of a restructuring plan.'

Individual creditor groups should **not** incur any **extraordinary charges**. It is reasonable to temporarily prohibit creditors from termination, as well as revoking the entitlement to collect assigned receivables and to dispose over pledged current goods. However, this should not result in creditors losing their security interest without compensation. Therefore creditors should be allowed to acquire securities on new receivables or goods, which is prohibited under current jurisprudence due to avoidance rights[1].

If the stay on enforcement activities were limited to individual (affected) creditors, it should be ensured that the stay does not unduly limit ***par condicio creditorum***. If attempts at restructuring fail, the current version of Article 7 para. 6 of the draft directive does not protect creditors who were prohibited from exercising their rights from coming away partially or completely empty-handed from a subsequent insolvency, while the creditors not affected by the stay are able to obtain satisfaction. The Directive or the implementation into national law must create an offset, e.g. with an expanded ex lege invalidity or simplified avoidance actions.

DAV recommendation on Article 2 and Article 6:

We therefore suggest that Articles 2 and 6 define the affected creditors as only participants of the restructuring plan or that these Articles allow specific stays to be requested only against creditors who are subject to the plan. The ordinary legal transactions conducted as part of a going concern should not be hindered (e.g. by

[1] German Federal Civil Court (BGH) Judgment of 29/11/2007 – IX ZR 30/07, ZIP – Zeitschrift für Wirtschaftsrecht (Journal for Economic Law) 2008, p. 183; BGH of 29/11/2007 – IX ZR 165/05, ZIP 2008, p. 372; BGH of 26/06/2008 – IX ZR 47/05, ZInsO – Zeitschrift für das gesamte Insolvenzrecht (Insolvency Law Journal) 2008, p. 803.

avoidance rights). For example, continued delivery without situational special advantages should not disadvantage those third parties.

The affected parties' **right to terminate** may be suspended. However, an announcement to the court that negotiations have begun has the effect of preventing stakeholders from terminating for this reason (commencing restructuring talks). To this extent, clauses that trigger **automatic maturity** when the debtor's economic circumstances worsen must be invalidated. Excepted from this provision would be withdrawals, rights of retention, or automatic maturities that serve to protect solvent partners from being obliged to increase their risk by continuing business with the debtor. These provisions (i.e. prohibitions on withdrawal and ex lege invalidities) deeply affect the concept of **international** particularly English, **financing agreements**. In order to implement this, the EU Member States must act in unity, which would limit the latitude of national legislatures.

DAV recommendation for Article 6 para. 2:
For this reason, Article 6 para. 2 should be formulated as follows:
'The Member States shall ensure that a stay of individual enforcement actions may be ordered in respect of affected creditors, including secured and preferential creditors. The stay may be general, covering all affected creditors, or limited, covering one or more individual creditors, in accordance with national law. Termination, even by unaffected creditors, based solely on the circumstance of negotiations over restructuring or a request for restructuring pursuant to Article 6, shall be invalid.'

DAV recommendation for Article 6 paras. 4–7:
Article 6 paras. 4–7 should set forth a maximum stay of three months, such that no non-performing loans (NPLs) are produced by the stay itself. National legislatures should limit the option of **extending the stay** to a total duration of four months. Brief periods, e.g. three weeks to file for insolvency, have indisputably been proved effective. Longer negotiations typically do not produce better results, merely higher costs. A stay should not result in securities no longer being recognised as risk-reducing by regulatory authorities (e.g. Article 194 para. 4 CRR). In order to avoid requalification as an NPL as a result of utilising the preventive restructuring framework, the provisions of European

banking regulation law, whose Article 178 CRR[2] states that receivables should be considered defaulted if the debtor is late by 90 days or more, should also be amended.

Since a stay or suspension of rights of withdrawal, as well as any legal extensions or other measures taken by the parties to avoid insolvency, can negatively affect the rights of the affected parties and of non-involved third parties (e.g. employees, service providers, suppliers, subcontractors), measures related to the stay should not mandatorily, but regularly be monitored by a — as the draft directive puts it — **'practitioner in the field of restructuring'**.

DAV recommendation for Article 5:

To this extent, we recommend amending Article 5 para. 3 of the draft directive (debtors in possession) as follows:

'The Member States should require the appointment of an independent practitioner in the field of restructuring recommended by both the debtor and the creditors in the following cases:

a) where the debtor is granted a general stay of individual enforcement actions in accordance to Article 6;

b) where the restructuring plan needs to be confirmed by a judicial or administrative authority by means of a cross-class cram-down, in accordance with Article 11.

Such an appointment shall only be prescinded if the cost of 'his involvement is not reasonably proportional to the debtor's assets and the activity (or activities) affected by the stay.'

DAV recommendation for Article 7:

The provisions of Article 7 should be amended accordingly to reflect our recommendation for Article 6 that the stay of enforcement activities be limited to affected creditors.

[2] Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 646/2012.

On Article 8 – Content of restructuring plans

The centre of the preventive restructuring framework is the **restructuring plan**, on the basis of which debtors should restructure their liabilities. It needs to be accepted by the creditors and, if required by national law, shareholders it affects, and then has to be confirmed by the court (provided it was not resolved unanimously). The actual steps of the restructuring plan are rightly left unspecified, however there is no guideline stating that everything involved in the restructuring (cf. Article 2 no. 2 of the draft directive and its wide definition) must be included in the restructuring plan. This would apply in particular if the intention is to alter the capital structure by a ***debt-to-equity swap***. For this case, it should also be made clear that any provision permitted by **company law** may be included in the restructuring plan. In substance, the restructuring plan should not only include provisions on restructuring loans and financial liabilities, but also provisions on restructuring claims and rights arising from such borrowings and financings (both in rem claims and securities). In practice, **group securities** and the associated risk of a domino effect also pose a considerable risk and obstacle to restructuring. This is why the restructuring plan should also include securities provided for the debtor's liabilities by companies affiliated with the debtor.

DAV recommendation for Article 8 para. 1 letter f):

Article 8 para. 1 letter f) should be recast as follows:
'The Member States shall require restructuring plans submitted to a judicial or administrative authority to contain at least the following information:

f) All essential measures for restructuring, in particular the substantive provisions on restructuring loans and financial liabilities, as well as corresponding claims by affected creditors, including, inter alia, if required, recommendations regarding the following:
- *i) its proposed duration*
- *ii) any proposal by which debts are rescheduled or waived or converted into other forms of obligation;*
- *iii) conversion of receivables by affected creditors into shares or membership rights of the debtor and any other measure permitted by company law;*

iv) release of securities provided to the affected creditors by the debtor or the companies affiliated with the debtor;
v) reorganisation under company law, in particular the transfer and contribution of subsidiaries or other debtor assets;
vi) any new financing as part of the restructuring plan;'

The **profitability statement** (Article 8 para. 1 letter g) of the draft directive) is supposed to be prepared by the person responsible for submitting the restructuring plan; in the opinion of the Commission, this should be the debtor. However, since the statement describes and tests the economic suitability of the recommended restructuring activities, and should permit at least a summary review by the judicial and administrative authority during the approval process, it should be submitted by an **independent restructuring expert** or at least approved by such an expert.

The **content** of the statement should allow the affected creditors to review the **'profitability' of the enterprise** before they vote to adjust their claims. The requirements for this statement should be more specific: taking into account any existing risks, it should illustrate whether and to what extent the enterprise can be continued and restructured and the steps described in the restructuring plan are appropriate and necessary to avoid insolvency and re-establish the debtor's sustained ability to operate as a going concern, including the conditions required to achieve ongoing profitability. In cases of majority votes and, in particular, a cross-class cram-down, the statement should also include an **evaluation of the company by going concern and liquidation value** (including financial planning).

DAV recommendation for Article 8 para. 1 letter g):

Article 8 para. 1 letter g) should be reformulated as follows:

'(1) The Member States shall require restructuring plans submitted for confirmation by a judicial or administrative authority to contain at least the following information:

g) an opinion or reasoned statement or confirmation submitted or approved by an independent restructuring expert that the business can be maintained as a going concern and rescued, explains why the business is viable, how implementing the proposed plan is likely to result in the debtor avoiding insolvency and restore its long-term viability, and states any anticipated

necessary pre-condition for its success; <u>in cases of a majority vote and, in particular, a cross-class cram-down, the statement should also contain an appraisal of the business by going concern and liquidation value (including financial planning); the statement must be submitted promptly to the affected creditors before the vote is held.</u>'

The Member States are asked to provide an **online sample restructuring plan** that is in accordance with national law, at least in regard to minimum content (Article 8 para. 2 sentence 1 of the draft directive). However, it is down to the parties whether to use this sample plan (Article 8 para. 3 of the draft directive). The question is generally whether a sample can be a suitable instrument in this case. It is our opinion that it should not be more than an overview of the minimum material requirements for a restructuring plan that is flexible enough to allow for the content to be adapted to suit the case at hand in accordance with national law.

DAV recommendation for Article 8 para. 2:
Article 8 para. 2 should be amended as follows:

'(2) The Member States shall make a model for restructuring plan available online. That model shall contain an <u>overview</u> of the <u>minimum requirements</u> under national law and shall provide general but practical information on how the model is to be used. The model shall be made available in the official language or languages of the Member State. Member States shall endeavour to make the model available in other languages, in particular in languages used in international business. It shall be designed in such a way that it can be adapted to the needs and circumstances of every case.'

On Article 9 – Adoption of restructuring plans

The creditors affected by the restructuring plan and, if required by national law, shareholders (cf. Article 2 no. 3 of the draft directive) should have the right to vote on whether to accept the restructuring plan. Conversely, unaffected parties have no such right. The restructuring plan requires a sum majority from the creditor classes that have to be formed. The draft directive does not address **voting procedure**, specifically determining voting rights, notice periods, chairmanship, dealing with claims, potential

claims, claims not yet due and contingent claims, as well as conflicts. Instead of a formal voting procedure, the Member States are able to require that the vote takes place in the form of consulting and obtaining the consent of each creditor class (Article 9 para. 5 of the draft directive). At least if a majority vote or cross-class cram-down is expected, the independent practitioner in the field of restructuring, as a neutral third party experienced in restructuring, should **determine voting rights**. It should also be made clear what is meant by '**consultation**'. Due to the vagueness and potential for misuse associated with the consultation procedure, a foregoing of the consultation procedure and a vote by circulation in writing or an online vote should be considered.

The draft directive requires that the affected creditors, who are organised into **different classes** in the restructuring plan, accept the plan. The classes are formed so each class contains claims or interests with rights that are similar enough to justify considering the members of the class a homogeneous group with the same interests (Article 9 para. 2 sentence 2 of the draft directive). Class formation is based on different rights, not similar economic interests. At minimum, secured and unsecured claims (Article 9 para. 2 sentence 3 of the draft directive), and, if required by national law, shareholders form their own groups. Furthermore, it is up to national law to require a separate class for employees (Article 9 para. 2 sentence 4 of the draft directive). It should be made clear that the classes can be formed based on comparable rights as well as on fundamentally similar economic interests or creditor characteristics, such as suppliers or banks, otherwise there will be definition issues and risks of misuse. It should also be made clear that a separate **class for employees** may **only** be formed if the restructuring plan infringes on their rights. It should be possible for the court to conduct an early review of these classes at the debtor's request (cf. Recital 25).

The restructuring plan is accepted by the parties affected if the **majority**, formed by a simple majority of the amount invested (and not also a majority of those present), of each class accepts the plan (Article 9 para. 4 of the draft directive). However, the Member States are free to set the acceptance threshold between 50.1% and 75% (Article 9 para. 5 of the draft directive). In order to avoid a race amongst national legislatures (where the debtor chooses the jurisdiction with the lowest acceptance threshold), a mandatory **majority of 75% per class** should be required. For a **cross-**

class cram-down, a **majority of groups** (of 50%) should also be required (see below on Article 11) to avoid allowing only one class to pass the restructuring plan.

DAV recommendation for Article 9:

Article 9 paras. 1–6 should be expanded accordingly and reformulated as follows:

‘(1) *The Member States shall ensure that any affected creditors have a right to vote on the adoption of a restructuring plan. If a majority vote or a cross-class cram-down is expected, the practitioner in the field of restructuring shall determine voting rights. Member States may also grant such voting rights to affected equity holders, in accordance with Article 12 para. 2.*

(2) *Member States shall ensure that affected parties are treated in separate classes which reflect the class formation criteria. Classes shall be formed in such a way that each class comprises claims or interests with rights as well as substantially similar interests or creditor characteristics that are sufficiently similar to justify considering the members of the class a homogeneous group with commonality of interest. As a minimum, secured and unsecured claims shall be treated in separate classes for the purposes of adopting a restructuring plan. Member State may also provide that workers are treated in a separate class of their own, but only if the restructuring plan infringes on their rights.*

(3) *Class formation shall be examined by the judicial or administrative authority when a request is filed for confirmation of the restructuring plan. At the debtor’s request the court may conduct a preliminary review of class formation.*

(4) *A restructuring plan shall be deemed to be adopted by affected parties, provided that a majority of 75% in the amount of their claims or interests is obtained in each and every class.’*

(5) *Member States may stipulate that a vote on the adoption of a restructuring plan takes the form of a circulation procedure in writing or an online vote of a requisite majority of affected parties in each class.*

(6) *Where the necessary majority is not reached in one or more dissenting voting classes, the plan may still be confirmed if it complies with the cross-class cram-down set out in Article 11.’*

On Article 10 – Confirmation of restructuring plans

The draft directive requires that the plan is confirmed by a judicial or administrative authority if it has not been accepted by all of the affected creditors or if new financing is intended (Article 10 para. 1 of the draft directive). Conversely, if all of the affected creditors accepted the restructuring plan and no new financing is intended, confirmation of a judicial or administrative authority is not required. At minimum, the judicial or administrative authority has to review whether the requirements specified in Article 10 para. 2 of the draft directive (i.e. the plan has been submitted to all creditors likely to be affected, conforms with the best interest of creditors test, and addresses any need for new financing) have been met and, if necessary, to reject the restructuring plan if there is no justified prospect of avoiding insolvency and ensuring the profitability of the debtor's business. However, the draft directive does not address the scope (legality and/or practicality, legal and/or economic information and assumptions in the plan) or the depth (full review, review of conclusiveness or plausibility, random or summary review) of the review by the judicial or administrative authority.

Scope and depth of review have a reciprocal effect on each other: the judicial or administrative authority should fully review **compliance with legal requirements** (formal and material), including whether or not all essential documents have been submitted. A review of the plausibility of the **economic principles and content of the plan**, and, in particular, the **comparative analysis** that must be conducted (as part of a review on discrimination) should be required, but also be sufficient if the statement required pursuant to Article 8 para. 1 letter g) of the draft directive were submitted or approved by an independent restructuring expert (see 'On Article 8' above). Otherwise the judicial or administrative authority would first have to obtain an appropriate expert opinion.

The plan should only be confirmed if the **debtor has accepted** the restructuring plan; this acceptance should be expressly stated (even though it is implied when the debtor requests plan confirmation).

Second opinions should only be obtained when reasonable. This is in line with the purpose of the restructuring plans to provide an effective, efficient procedure for SMEs (small and medium-sized enterprises) as well (cf. Recital 13).

The **comparative analysis** should be based on market value according to the type of transaction and not generally on liquidation value (in contrast to Article 2 no. 9 of the draft directive). The debtor should also be free to have a **consensual restructuring plan** (100% acceptance) **confirmed by the court** with the result that the provisions for a court-confirmed plan apply. This would make it easier for the plan to be recognised at home (and in the rest of Europe).

The debtor should bear the **burden of proof** that the requirements have been met and that the business is likely to continue.

The ambitious **30-day period for plan confirmation** (Article 10 para. 4 of the draft directive) should be retained due to the typically urgent nature of restructuring, however it should be possible for the judicial or administrative authority to make a prompt decision while the plan is being drafted (or after it is completed) or, at the latest, when it is sent to the creditors. This kind of provision conforms to the possibility of having class formation reviewed in advance that is already envisaged in Recital 25.

The debtor should bear the **court costs** for plan confirmation.

DAV recommendation for Article 10:

Article 10 should be expanded accordingly and recast as follows:

'(1) Member States shall ensure that the following restructuring plans can become binding on the parties with the consent of the debtor only if they are confirmed by a judicial or administrative authority:

a) restructuring plans which affect the interests of dissenting affected parties;

b) restructuring plans accepted by all affected parties, but only at the request of the debtor or an affected creditor with the consent of the debtor, with the result that the provisions for confirmed restructuring plans apply;

c) restructuring plans which provide for new financing.

(2) Member States shall ensure that the conditions under which a restructuring plan can be confirmed by a judicial or administrative authority are clearly specified and include at least the following:

a) the restructuring plan has been adopted in accordance with Article 9 and has been notified to all known creditors likely to be affected by it;

b) the restructuring plan complies with the best interest of creditors test;

c) any new financing is necessary to implement the restructuring plan and does not unfairly prejudice the interests of creditors.

(3) Member States shall ensure that the judicial or administrative authority:

a) reviews the compliance with (formal and material) legal requirements and the completeness of documents, and conducts a plausibility review regarding the economic content of the plan and upon submission, the comparative analysis; and

b) may refuse to confirm a restructuring plan where that plan does not have a reasonable prospect of preventing the insolvency of the debtor and ensuring the viability of the business; the debtor shall bear the burden of proof.

(4) Member States shall ensure that where a judicial or administrative authority is required to confirm the restructuring plan in order for it to become binding:

a) the debtor submits a copy of the voting documents to the judicial or administrative authority at the latest when such documents are submitted to the affected creditors.

b) a decision is taken without undue delay after the request for confirmation has been filed and in any case no later than 30 days after the request is filed.

(5) The debtor shall bear the court costs for the confirmation of the plan.'

On Article 11 – Cross-class cram-down

According to the draft directive, the restructuring plan becomes binding to one or more classes in a cross-class cram-down if, inter alia, it is accepted by at least one class of affected creditors (Article 11 para. 1 letter b) of the draft directive). National legislatures can change the minimum number in the accepting class (Article 11 para. 2 of the draft directive). In order to avoid a race within the EU, the minimum quota of classes agreeing to the plan should be uniformly required to be a simple majority (50 %).

DAV recommendation for Article 11:

Article 11 para. 2 should be deleted. Instead of *'by at least one class'*, Article 11 para. 1b) should read *'by a majority of the classes or at least half of the classes'*.

On Article 12 – Equity holders

The inclusion of equity holders (Article 12 of the draft directive) is welcomed, since it prevents arguments that the Second Company Law Directive does not permit infringement on their shares.

However, stating that equity holders and other shareholders may not prevent the acceptance or implementation of a restructuring plan 'unreasonably' seems too weak; a reason can always be found. They should only be allowed to obstruct the plan if they were to receive less under the plan than from liquidation; this should be based on liquidation value, not share price.

Recommendation: Article 12 para. 1 should be amended accordingly.

On Article 13 – Valuation by the judicial or administrative authority

If a restructuring plan is contested by an affected creditor because it allegedly **breaches the best interest of creditors test**, the judicial or administrative authority determines the liquidation value (Article 13 para. 1 of the draft directive). The **comparative value** is the value the creditor would have received if the business had filed for insolvency upon the first termination. However, this does not always have to be the liquidation value, rather the market value depending on the type of transaction, which could be either the going concern value or a partial divestiture and/or liquidation value (see above under Article 10 of the draft directive). This should be clarified in Article 13 (as well as in Article 2 no. 9 – *best interest of creditors test*). Furthermore, the judicial or administrative authority should generally only obtain an expert opinion if the statement has not been prepared by an independent restructuring expert. The reference to the value of the security in Article 13 para. 3 of the draft directive should be removed because securities are always based on the underlying value of the collateral.

DAV recommendation for Article 13:

Article 13 para. 1 and 3 should be amended accordingly and recast as follows:

‘(1) A market value depending on the type of transaction, which may either be the going concern value, or a partial divestiture and/or liquidation value, shall be determined by the judicial or administrative authority where a restructuring plan is challenged on the grounds of an alleged breach of the best interest of creditors test.

(2) An enterprise value shall be determined by the judicial or administrative authority on the basis of the value of the enterprise as a going concern in the following cases:

a) where a cross-class cram-down application is necessary for the adoption of the restructuring plan;

b) where a restructuring plan is challenged on the ground of an alleged breach of the absolute priority rule.

(3) Member States shall ensure, in the event no statement or confirmation has been submitted by an independent restructuring expert pursuant to Article 8 para. 1 letter g), that properly qualified experts are appointed, when deemed necessary and appropriate by the judicial or administrative authority, to assist in appraisal or, in exceptional instances, when a statement or confirmation pursuant to Article 8 para. 1 letter g) has been submitted and the cost is reasonable, to provide a second expert opinion.

(4) Member States shall ensure that the challenges referred to in paras. 1, 2 and 3 can be lodged with the judicial or administrative authority called upon to confirm the restructuring plan or in the context of an appeal against a decision on the confirmation of a restructuring plan.’

On Article 14 – Effects of restructuring plans

Restructuring plans confirmed by a judicial or administrative authority are binding for all of the parties named in the plan (Article 14 para. 1 of the draft directive). Creditors who have not participated in a voting class and thus not accepted the restructuring plan shall not be affected (Article 14 para. 2 of the draft directive). There are no provisions regarding the reinstatement of claims in the event that debtors fall behind with creditors who have deferred or partially waived their claims, nor are there provisions regarding any kind of monitoring of the plan. At minimum, it should be clarified that the effects of

the plan are binding for the debtor and the ‘affected parties’ included in the plan (cf. Article 2 no. 3 of the draft directive) once the plan is confirmed. The term ‘each party’ is ambiguous. Para. 2 should be reworded because it is too vague.

DAV recommendation for Article 14:

Article 14 should be expanded accordingly as follows:

‘(1) Member States shall ensure that restructuring plans which are confirmed by a judicial or administrative authority are binding upon all affected parties identified in the plan.

(2) Creditors who did not participate in the vote on the restructuring plan shall not be affected by the plan.’

On Article 15 – Appeals

The draft directive allows for appeal of the judicial or administrative body’s decision to confirm the plan without suspensive effect (Article 15 paras. 1 and 3 of the draft directive) and with the option to seek damages (Article 15 para. 4 letter c); similar to Articles 253 and 251 para. 3 German Insolvency Act); however, it does not require any admissibility criteria. Appeals should only be admitted if the affected party objects in writing at the time of the vote, votes against the restructuring plan and provides prima facie evidence for a breach of the best interest of creditors test. In German practice, this has been proved to make the procedure more effective and efficient. A confirmation should also be possible if the dissenting creditor can be compensated using funds provided in the restructuring plan for this purpose.

DAV recommendation for Article 15:

Article 15 paras. 1 and 2 should be expanded accordingly:

‘(1) Member States shall ensure that a decision on the confirmation of a restructuring plan taken by a judicial authority may be appealed before a higher judicial

authority and that a decision on the confirmation of a restructuring plan taken by an administrative authority may be appealed before a judicial authority. Such appeal shall only be admitted if the affected party:

a) objected in writing at the time of voting,

b) voted against the restructuring plan and

c) has furnished prima facie evidence that it will be placed in a worse position than before the plan and that this disadvantage cannot be offset by payment using funds provided in the restructuring for this purpose.

(2) Appeals shall be resolved in an expedited manner.

(3) An appeal against a decision confirming a restructuring plan shall have no suspensive effects on the execution of that plan.

(4) Member States shall ensure that, where an appeal pursuant to paragraph 3 is upheld, the judicial authority may either:

a) set aside the restructuring plan; or

b) confirm the plan and grant monetary compensation to the dissenting creditors, payable by the debtor or by the creditors who voted in favour of the plan or using funds provided in the restructuring plan for this purpose.'

On Article 18 – Duties of directors

Obligations to file for insolvency are not affected by the preventive restructuring framework.

The restructuring framework is supposed to enable timely restructuring of an enterprise. It would be expected that the management reasonably prepares managerial decisions according to the circumstances and their significance, considers managerial decisions and their implementation within the bounds of firm knowledge and established entrepreneurial conduct, and exercises proper control. It would also be expected to retain the necessary capital by applying a minimum standard of due diligence. It should be noted that any managerial steps are based on the management having sufficient information. When preserving 'generally accepted management principles', the management is routinely able to recognise looming crises in a timely manner and take the necessary steps. To this extent, promising negotiations within the restructuring framework would indicate the probability of a positive going concern prognosis as defined in Article 19 para. 2 sentence 1 German Insolvency Act.

The business can continue properly during preventive restructuring, since it is turning an operating profit or has the liquidity to offset losses. The temporary stay (moratorium) on individual enforcement activities would mean liabilities do not have to be included in the liquidity status for the duration of the stay as long as the business can assume the restructuring plan is in the general interest of its creditors.

As a result of the independent practitioner in the field of restructuring's compliance with the distance rule (which is subject to review), companies utilise the preventive restructuring framework in a timely manner, and it prevents them from electing to request measures purely for the tactical purpose of hiding an impending insolvency and avoiding any civil and/or criminal claims. This would also save the restructuring tool from being compromised.

There would be no need to suspend obligations to file for insolvency. The restructuring framework would be available to companies that (a) turn an operating profit or can provide adequate liquidity to offset loss, (b) have sufficient working capital for the next six months and (c) are reasonably likely to be successfully restructured. If these requirements are met, the management would be able to assume the probability of a positive going concern prognosis, which would suspend the obligation to file for insolvency due to over-indebtedness.

The Commission should also provide a conflict clause for situations in which the management and the shareholders disagree on when to initiate the restructuring process or which measures to take within the preventive restructuring framework.

On Articles 25 and 26 – Practitioners in the field of restructuring, insolvency and second chance

Articles 25 and 26 of the draft directive are intended to contribute to the **professionalisation** of practitioners in all restructuring and insolvency proceedings. The DAV fully supports this approach. It only recommends the following self-explanatory amendment:

DAV recommendation for Article 26 para. 1 and 2:

‘(1) Member States shall ensure that the process for the appointment, professional liability insurance, dismissal, resignation, and liability of insolvency administrators and practitioners in the field of restructuring, insolvency and second chances is clear, predictable and fair and fulfils, in particular, the requirements set out in paragraphs. 2, 3 and 4.

(2) Member States shall ensure that the condition for eligibility requirements and the grounds upon which an insolvency administrator or practitioner in the field of restructuring may be ineligible for appointment are clear and transparent. Clear provisions on adequate professional liability insurance shall also be set forth.’