Annex 1: Additional Submissions Contributing to the Exposition of the Preventive Restructuring Directive

The following are submissions from various groups and committees which contribute to the rich conversation about the PRD; however, when these contributions were included in Chapter 5 itself, it was felt that they compromised its flow and clarity. As such, they have been included here in Annex 1 for readers who wish to delve further into the development of the PRD.

10.1.1 The Experts Group on Restructuring and Insolvency Law (2016)

Following on from the lack of reaction to its Recommendation, the Commission established the Expert Group on Restructuring and Insolvency Law – hereafter 'the Expert Group' or 'the Group'– which met a number of times throughout 2016. It was comprised of over 20 leading academics and practitioners from 12 EU countries and its function was to discuss various aspects of insolvency law and more specifically, to focus on how the Commission Recommendation may be amended, thereby making it more effective across the EU and leading to more legal certainty.[1]

The first meeting of the Expert Group took place on 14th January 2016, at which the members discussed the need for a definition of insolvency, the early warning system and directors' liability and disqualification. Much of the material discussed at that meeting was outside the scope of this particular report; interestingly, however, on the issue of a common definition of insolvency, the Expert Group did not view the matter in the same way as the European Central Bank, as discussed previously, in that there was no consensus amongst the members as to the need for a common definition.[2]

Amongst other matters, the issues of protection for new financing and the stay of individual enforcement actions were considered at the second meeting of the Expert Group. There was no consensus amongst the members as to the extent to which new financing should be protected, however concern was expressed that secured creditors may be prejudiced by the preferential treatment of new financiers in subsequent insolvency proceedings. One interesting point to note was the contention that the protection of new financing should have a time limit, after which such finance would not receive preferential treatment if new insolvency proceedings were commenced. On the issue of the stay, the Group emphasized the importance of the restructuring plan having a "reasonable prospect of the success", stating that this should be the test used by the courts in considering the application. On other aspects, such as whether the stay should be automatically ordered or on specific request of the debtor, there was a lack of consensus amongst the participants.

A more comprehensive discussion relating to the stay took place at the third meeting of the Group; the experts were of the view that a debtor should be able to request a stay where individual enforcement actions would negatively impact on the restructuring process, however it was thought by some members that the stay should only be granted in circumstances where the negotiations have a reasonable prospect

[1] Minutes Expert Group Meeting – 14/01/2016 p.3; "[t]he view shared by the majority of the experts is to focus on how the Insolvency Recommendation may be improved as to provide more legal certainty and more binding force in Member States."

[2] Those who were in favour of a common definition were of the view that it would increase legal predictability and consistency in early restructuring across Member States. Those opposed to a common definition viewed it as unnecessary for accessing early restructuring, instead many viewed consistency in the elements which trigger restructuring as the best way forward.

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of success and do not unfairly prejudice creditor's interests.[3] Interestingly, on the matter of the duration of the stay, the Group disagreed with the Recommendation – and consequently, the eventual text of the Directive – on the duration of the stay, as members advocated for a duration of two months instead of four. In terms of lifting the stay, the Group was of the view that the stay could be lifted at the request of a majority of the creditors involved in the restructuring process or by a single (class of) creditor(s) if it was unfairly prejudicial. The issue of decreased court involvement / greater flexibility within the restructuring process was also discussed with a majority of the Group opining that debtors should be able to begin restructuring without the need to immediately open court proceedings, but with the appointment of a "competent and well-trained" mediator or supervisor.

At the fourth meeting of the Expert Group, the members discussed a number of key points including cram-down and protection of new finance.[4] It is worth noting at this point that it was unclear if the Group reached a consensus on many of the issues discussed, as the report often refers to "some members" as opposed to "the experts", "the majority of members" or "the Group". On the issue of cram-down, the Group were in favour of a provision which would allow Member States to avoid "a hold out from 'out-of-the-money' shareholders"; as such, the members discussed 'cross-class cram-down' with "appropriate safeguards" as one mechanism of avoiding such a 'hold out'.[5] The Group appeared to have quite a comprehensive discussion on the matter of protection for new financing. They discussed granting super-priority status to new financing subject to court confirmation and while some members were in favour of this approach, there was a divergence of views regarding how this should be reflected in the law;

> "some members of the group expressed … that the new instrument should not entail too many details on this issue, just providing for a general rule on protection of new finance in case of liquidation...others were in favour of providing for more details, in order for the [Member State] to be able to implement correctly the legislation."[6]

The experts advocated for a distinction to be made between 'new financing' and 'interim financing', however, they stopped short of agreeing definitions of new and interim finance. Instead, some of the members opined that interim finance should be understood as "the money necessary to enable the debtor to negotiate a plan with its creditors". Some members of the group went on to suggest that interim financing should receive some protection, just not super-priority status. The Expert Group then proceeded to identify some key questions related to new and interim financing:

- When should protection be granted for interim financing; should it be the date of the hearing for granting the stay, or when a mediator has been appointed by a court, or any step which indicates clearly that the debtor has entered into a restructuring process?
- Should protection be granted for 'new equity money'?
- Should the protection of new financing be granted for a limited period?

Little of the content of meetings 5 and 6 of the Group is relevant for the purposes of this report, however the stay was discussed once again.[7] The majority of the Group advocated for a stay of short duration,

[3] The use of the word "only" is added by the author, as it seems to be implied in the meeting minutes but not expressly stated.
[4] The matters of the stay and judicial involvement were also discussed but former discussion was limited to whether the stay should only apply to past unpaid claims or to both unpaid claims and current obligations and the latter to judicial involvement in the context of the confirmation of a restructuring plan, where it appeared to be the view of the experts that court confirmation was necessary is all cases where there was interference with the rights of dissenting creditors.
[5] The Group also proposed an alternative solution; a provision "by which the liability of directors and/or shareholders may be sought in subsequent insolvency proceedings if there is an attempt to reach an agreement bearing in mind that in preventive restructuring it remains difficult to assess whether shareholders would be out-of-the money in case of liquidation(as the debtor should not be insolvent to enter into a preventive restructuring process under the scope of the future instrument)."
[6] Expert Group Meeting 4, 4
[7] The conversation regarding whether future EU restructuring matters could come within the scope of the recast insolvency regulation was interesting, as the Group noted the requirement within the recast EIR that proceedings be public. The Group expressed concern that this requirement that the restructuring procedure be conducted in "public" could undermine one of key factors which determines the success of a

which would not exceed 4 months save in exceptional circumstances, where there would be a possibility of extension. It is interesting to note that the Group theorised that longer time periods "would just create unwanted incentives for debtors without raising the chances of agreement in practice".

Meeting 7 saw the Group revisit the issues of the stay, cram-down and protection for new finance, amongst a number of other matters. The experts, once again, reaffirmed their position that the stay should be short – an initial period of three months[8] – and extended in the case of complex restructurings. As outlined earlier, it was interesting to note the "strong concerns" of certain experts that the stay would be open to abuse and their reference to the "moral hazard problem".[9] There was divergence between the experts as to whether the stay should be automatic and general. The same experts who expressed concerned regarding abuse also stated that the stay should be neither automatic nor general, whereas other members were of the view that the stay should be automatic at first, otherwise it would be "cumbersome for a court to determine if there are reasonable prospects of success of the restructuring". The Group also unanimously agreed that nothing should prevent the debtor from paying his creditors during the stay period.

Cram-down was discussed as one possible mechanism of ensuring that the adoption of a restructuring plan would not be unreasonably prevented by certain parties in the context of the treatment of out of money shareholders in the restructuring process.[10] From the perspective of this report, it was interesting to see that some of the Group were hesitant to make cramming down in such cases mandatory and noted constitutional issues such as "infringement of property rights" as potential conflict. On the issue of priority of the financier, the Group agreed that new and interim finance should be encouraged via provisions to exempt them from avoidance actions in subsequent insolvency proceedings and from civil and criminal liability in subsequent insolvency, unless there was fraud. There was, however, no consensus on whether the regulation needed more specifics regarding the ranking of new financiers in subsequent insolvency proceedings, e.g. they should be ranked senior to unsecured creditors, they should receive priority status, etc.[11]

At the 9th and final meeting of the Expert Group,[12] the issues of the stay and cram-down were revisited.[13] On the matter of the stay, the position of the Group appeared to be largely the same as it had been in previous meetings.[14] They reiterated their concerns on the link between the "moral hazard problem" and the length of the (extension of the) stay and advocated, once again, for the duration of the stay to be of a limited period and that any extension would be "granted under stricter conditions". On the issue of cross-class cram-down, the Group definitively summarised its position as one of being in favour of cramming down on dissenting creditors "as long as the best interest of creditors test is respected" and in favour of cross-class cram-down "as long as at least one class of creditors votes for the plan and the absolute priority rule is respected". The experts also, once again, raised the issue of the protection of property rights in relation to shareholders, however, where the shareholders form a class for the purposes of voting, they should be subject to cross-class cram-down rules.

preventive restructuring process namely the confidentiality of the negotiations. The importance of preventing debtors and certain creditors from forum shopping was also highlighted.

[8] This duration was most desirable according to the majority.

[9] Broadly speaking, moral hazard occurs when a party takes increased risks because they are aware that another party will bears the cost of those risks.

[10] Other mechanisms included shareholders' liability in cases where they reject the restructuring plan frivolously and preventing the out of money shareholders from voting.

[11] Some of the experts viewed better protection for new financing to be necessary to ensure the success of a restructuring plan. Others were hesitant to mandate more increased protection for new finance because of "potential repercussion to securities, credit markets and capital requirements for banks".

[12] At meeting 8, the Expert Group discussed rules for group companies, 'safe harbour' provisions relating to avoidance actions and new rules on second chance, however, none of these issues are directly linked to the specific focus of this report.

[13] Protection for interim financing was also briefly discussed, as well as a number of other issues not directly relevant to this report such as, Ipso Facto clauses, third party releases and minimum standards for Insolvency Practitioners.

[14] With that said, comments from individual experts were minuted. One expert was of the view that protection from avoidance actions for interim financing should only be given when the negotiations yield a court confirmed plan. This view did not appear to be popular with other members.

Lastly, the Group, once again, discussed the matter of confidentiality in the negotiation process. There was no consensus amongst the experts as to whether confidentiality should be mandatory in the process. Some experts viewed confidentiality in the negotiation of restructuring plans as essential to ensuring that the success of the restructuring plan was not compromised. As such, it was their view that confidentiality should be guaranteed.[15] Interestingly, other members opined that once there is court involvement, there would be publicity/opening of proceedings for the purposes of Insolvency Regulation and as such, confidentiality should not always be applicable. Furthermore, they added that a requirement for confidentiality may conflict with other laws, for example where the debtor is subject to laws for listed companies.[16]

10.1.2 National Parliament Submissions to the European Parliament

The first opinion on the Commission proposal to be received by the European Parliament came from Dáil Éireann, the Irish Parliament, via article 6 of Protocol (No. 2), which states:

> "Any national Parliament …may …within eight weeks from the date of transmission of a draft legislative act …send to the Presidents of the European Parliament, the Council and the Commission a reasoned opinion stating why it considers that the draft …does not comply with the principle of subsidiarity."[17]

In line with the internal workings of the Dáil, a Joint Committee was created to consider if the proposed directive complied with the principles of subsidiarity and proportionality.[18] It found that the proposed directive was in conflict with the aforementioned principles on a number of grounds. At 3.2, the Committee opined that the proposal breached the principle of subsidiarity in seeking to harmonise the substantive law of Member States and specifically referenced what it described as the "prescriptive approach on both substantive and procedural aspects" of insolvency law. The Committee referenced the requirement that Member States provide for preventive restructuring frameworks contained in article 4, the "detailed conditions for Member States to fix a stay on enforcement actions pending restructuring" contained in article 6 and the minimum conditions for cross-class cram-down contained in article 11. The Committee acknowledged that although Irish law already had many of the features contained in the proposed directive, its approach was quite different on some of the more prescriptive provisions; as such, the Committee opined that the proposal may affect the delicately-struck balance between debtors and creditors, which individual Member States strike with "reference to specific cultural, social and economic factors".

At 3.4 the Committee expressed concern about the goal of the proposed directive to limit the involvement of the courts in insolvency matters. First, it expressed its unease at the use of the words "necessary" and "proportionate", opining that these words are open to a range of interpretations. Arguably, however, this flexibility of interpretation by the individual Member State contradicts the concern relating to the "prescriptive approach" taken by the proposal, which the Committee expressed earlier in the submission. Consistent with the concerns expressed by the Expert Group, the Committee noted the impact that the insolvency process can have on the property rights of creditors which, without a high level of judicial oversight, may raise questions as to consistency of the proposal with Bunreacht na hEireann (the Irish Constitution).[19]

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[15] It is worth noting that the "problematic issue of the relationship of this legislative instrument with EIR" was also highlighted in the context of this discussion.

[16] It is worth noting that some experts differentiated between the adoption of a restructuring plan and the contents of that plan for the purposes of confidentiality.

[17] Consolidated version of the Treaty on the Functioning of the European Union - PROTOCOLS - Protocol (No 2) on the application of the principles of subsidiarity and proportionality

[18] The Joint Committee is comprised of members of the Dáil (Parliament) and the Seanad (Senate).

[19] The Irish Constitution explicitly safeguards property rights; see arts 40.3.2 & 43. Citing the distinguishing of business and personal debts in relation to sole traders, the Committee also noted the potential for the property rights of lending institutions to be affected if they no longer have full recourse against both the entrepreneurial and non-entrepreneurial assets of a sole trader. In view of the concern expressed for the rights of lending institutions, it is somewhat ironic that Irish law provides for the displacement of a receiver – generally appointed by a financial institution – if examinership proceedings are commenced within a designated timeframe, thereby denying the financial institution full recourse.

Interestingly, at 3.7, the Committee expressed concern that the independence of the judiciary, provided for by the Irish Constitution, may be compromised by the requirements for specialised training of judges and for Member States to ensure that proceedings are dealt with in an efficient manner.[20] One could argue, however, that the qualification contained in article 25, namely "[w]ithout prejudice to judicial independence", should alleviate any related concerns. The Committee also viewed the requirement to collect data on the relevant procedures, contained in article 29, to be unduly arduous, as "a significant number of informal arrangements are made …between debtors and creditors, no details of which are maintained".

In total, national submissions were received from Germany, Spain, Portugal, Italy and the Czech Republic. Germany, through the Bundesrat, issued a lengthy opinion.[21]

10.1.3 EMPL – Workers' Rights

As outlined earlier in Chapter 5, the EMPL Committee proposed multiple amendments with a view to strengthening the position of workers. For example, the EMPL Committee advocated for a specific reference to "workers representatives" in Recitals 13[22] and 16[23] and for a specific reference to the right of workers in Recital 2.[24] The Committee also sought to create new recitals such as:

> "(1) All workers should have the right to protection of their claims in the event of the insolvency of their employer, as set out in the European Social Charter."
>
> "(3a) The Member States should examine the possibility of devising mechanisms to prevent excessive or abusive recourse by employees to experts at the expense of an undertaking, since such recourse would ultimately have a negative impact on the financial situation of the undertaking."
>
> "(3c) Special treatment should be accorded to retired workers whose pensions depend, entirely or in part, on company pension plans, and who might be harmed by early restructuring"

Interestingly, when amending Recital 35 – rights of workers where a restructuring plan entails a transfer of part of undertaking or business – the Committee advocated for specific account to be taken of "the rulings handed down by the Court of Justice, as Advocate-General Mengozzi recently pointed out in his conclusions in Case C126/16" i.e. the Estro case.

The Committee proposed amending article 3 to include "workers and their representatives" in the parties that should have access to early warning tools and argued for the inclusion of two new paragraphs within that article, which would guarantee access to information for employees' representatives and the ability of employees to communicate concerns.[25] Article 8(1), which governs the content of restructuring plans,

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In that way, Irish law already quite substantially affects the rights of financial institutions. Also, it is worth noting that the link made between constitutional property rights and financial institutions is quite tenuous, as Irish constitutional rights do not attach to an entity, only to an individual.

[20] The Committee contended this on the basis that Irish law does not dictate how the courts operate.

[21] The Bundesrat is the legislative forum comprised of the 16 Federal States.

[22] "Small and medium enterprises, especially when facing financial difficulties, **as well as workers representatives**, often do not have the resources to hire professional advice, therefore early warning tools should be put in place to alert debtors to the urgency to act."

[23] "The earlier the debtors or **the workers' representatives** can communicate concerns about an undertaking's worrying situation or financial difficulties and can take appropriate action, the higher the probability of avoiding an impending insolvency or, in case of a business whose viability is permanently impaired, the more orderly and efficient the winding-up process. Clear information on the available preventive restructuring procedures as well as early warning tools should therefore be put in place to incentivise debtors who start to experience financial problems to take early action **and to empower the workers concerned so that they are able to take an active role in the restructuring process**."

[24] "In the restructuring process the rights of all parties involved should be protected, including **those of workers**."

[25] Art 3(2a); "Member States shall ensure that employees' representatives have full access to information and are consulted if action needs to be taken" and art 3(3a):

> "Member States shall ensure that workers' representatives are able to communicate concerns to debtors and entrepreneurs about the difficulties the undertaking is in and the urgent nature of those difficulties; Member States shall ensure that workers' representatives are in a position to have recourse to an independent expert of their choice in accordance with national law and practices, giving an access to relevant, up-to-date, clear, concise and user-friendly information regarding the financial situation of the business and the different restructuring strategies being envisaged, including transfer to worker ownership; Member States shall also ensure that the tax, social

was amended by the Committee to mandate the inclusion of the impact of the restructuring plan on all types of pensions of retired and current workers, on the working conditions and remuneration of workers and on subsidiaries and subcontractors. The insertion of a new article, 8(1a) was also proposed, which sought to consider employees a preferential class:

> "Workers' claims or other rights shall not be affected by restructuring plans and the workers class shall take priority. Exceptionally, contractual conditions may be renegotiated in early restructuring processes at company level between the management and the workers' representatives if this serves the normal continuation of business activity and maintenance of jobs."[26]

10.1.4 ECON – Article 7

Amendments 57 – 61 of the report from the Economic and Monetary Affairs Committee pertained to article 7 of the Commission proposal[27]; the Committee attempted to rewrite article 7(2)[28] to confine "all creditors" to those "involved in the negotiation of the restructuring plan" and to add "with the exception of workers, in accordance with article 6(3)" to the end of the article. Similar to the proposed amendment to article 6(9), ECON attempted to strengthen the position of creditors in article 7(3)[29] and 7(4) by inserting the condition of not causing "severe financial difficulties to creditors"[30] to (i) the stay, or suspension of the opening of insolvency proceedings and (ii) the prevention of the modification (including withholding performance, termination or acceleration) by creditors of executory contracts.[31] The Committee attempted to soften the requirement on Member States to prevent creditors from modifying executory contracts via a contractual clause[32] by changing the wording form "shall ensure" to "may require". None of the changes proposed by ECON were adopted in the final text, thus the protection afforded to creditors remained largely as it was before.

The Report proposed only one change to article 17, the replacement of the word "may" with "shall" in article 17(3);

> "Member States shall require the transactions referred to in point (e) of paragraph 2 to be approved by a practitioner in the field of restructuring or by a judicial or administrative authority in order to benefit from the protection referred to in paragraph 1."[33]

Point (e) was removed from the final text, thus the amendment was rendered moot.

Similar to EMPL, ECON proposed no amendments to article 11, but did propose five to article 9. Generally speaking, these amendments attempted to strengthen to position of workers and vulnerable

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security, competition and audit authorities are able under national law to be able to flag any worrying financial developments as soon as possible."

[26] The amended art 9(2) also refers to employees as preferential creditors.

[27] Amendment 61 was to the original art 7(6), which was subsequently from the final text, so just Amendments 57 - 60 will be considered

[28] Pertains to the prevention of the opening of insolvency proceedings during the stay by creditors.

[29] The derogation from art 7(1); "Where the obligation of the debtor to file for insolvency under national law arises during the period of the stay of individual enforcement actions, that obligation shall be suspended for the duration of the stay"

[30] ECON Report 35:

"Member States may derogate from paragraph 1 where the debtor becomes illiquid and therefore unable to pay his debts as they fall due during the stay period. In that event, a judicial or administrative authority shall have the power to defer the opening of the insolvency procedure and to keep in place the benefit of the stay of individual enforcement actions, on condition that it does not cause severe financial difficulties to creditors, in order to examine the prospects for achieving an agreement on a successful restructuring plan or an economically viable business transfer, within the period of the stay."

[31] The Committee further amended art 7(4) to include "any supplies where a suspension of deliveries would lead to the company's activities coming to a standstill" as the definition or meaning of an executory contract.

[32] "…that creditors may not withhold performance or terminate, accelerate or in any other way modify executory contracts to the detriment of the debtor by virtue of a contractual clause providing for such measures, solely by reason of the debtor's entry into restructuring negotiations, a requested for a stay of individual enforcement actions, the ordering of the stay as such or any similar event connected to the stay."

[33] ECON Report p. 44. For clarity, "point (e)" is one of the "[t]ransactions enjoying the protection referred to in paragraph 1" per art 17(2); "transactions such as new credit, financial contributions or partial asset transfers outside the ordinary course of business made in contemplation of and closely connected with negotiations for a restructuring plan".

creditors.[34] The Report proposed specifying "workers" in the types of creditors who should have a right to vote on a restructuring plan and added that creditors should have "full knowledge of the consequences" of the restructuring plan.[35] ECON also amended article 9(2) to provide that Member States "shall" provide that workers are treated in a class of their own, as opposed to that they "may" do so, as per the original proposal and inserted a reference to "specific rules supporting separate class formation for vulnerable creditors, such as small suppliers and micro and small enterprises" at the end.[36] Few of the amendments proposed were accepted in the final text, however, given that article 9(4) requires now Member States to put appropriate measures in place "to ensure that class formation is done with a particular view to protecting vulnerable creditors such as small suppliers", it appears that the Committee may have had success on that particular point.[37]

10.1.5 Committee of the Regions

In October 2017, the Committee of the Regions expressed its opinion on the proposal and drafted seven amendments to the proposed directive. Generally speaking, these amendments pertained to the rights of workers or their involvement in the insolvency process. The COR also made a number of policy recommendations, many of which were quite general in nature such as "creating new opportunities" i.e. facilitating start-ups and "access to finance" for start-ups. The COR did, however, express specific concern about what it considered to be the "current inability to harmonise Member States' legal systems relating to insolvency proceedings; it was the view of the Committee that the directive would not "make a meaningful contribution to increasing the number of start-ups remaining on the market for longer than two to three years".[38]

[34] For example, ECON added the following to att 9(6); "Member States shall guarantee that in the case of lack of collaboration of other creditors, the workers' restructuring plan may be presented to the competent administration or court and adopted without the consent of non-cooperative creditors."
[35] ECON Report, 39.
[36] ECON Report, 39.
[37] Art 9(4); Member States shall put in place appropriate measures to ensure that class formation is done with a particular view to protecting vulnerable creditors such as small suppliers.
[38] Opinion COR – 12/10/2017 – 342/47.