COMMENTS TO THE PROPOSAL FOR DIRECTIVE
[COM(2016) 723 FINAL]

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PART I
SUGGESTED AMENDMENTS

Inclusion of going concern sales in the scope of the Directive

Article 2

Definitions

For the purposes of this Directive, the following definitions shall apply:

(1) (…);

(2) 'restructuring' means changing the composition, conditions, or structure of a debtor's assets and liabilities or any ~~**other**~~ part of the debtor's capital structure, including share capital, or a combination of those elements, including sales of assets ***or the business in whole or in part, with the objective of enabling it to continue as a going concern either with the same or with different owners*** ~~**or parts of the business, with the objective of enabling the enterprise to continue in whole or in part**~~;

(…).

Comment

The vast majority of restructurings in Europe, especially of small and medium enterprises (SMEs), are achieved via a sale of the business as a going concern. The scope of this Directive would be significantly reduced if it did not facilitate such sales by the debtor and its creditors, the parties with the best information about the debtor's business and its prospects and a direct stake in maximising the business's value, in a fair and efficient manner.

Crucially, where a proposed restructuring includes sale of the business as a going concern, the law should require adequate market exposure and due creditor scrutiny to ensure a fair valuation of the business and to avoid undervalue sales. This is particularly important when the purchaser is an entity related to the debtor. Empirical data collected as part of our project, especially that from the UK, which has a vast experience with quick going concern sales performed within a restructuring procedure, show that a sale of business to related parties can indeed be used to deleverage the business at the unjustified expenses of junior creditors and to the benefit of the debtor.

We suggest inclusion in the Recitals of the Directive a reference to reasonable market exposure of assets to be sold and the requirement for the proposed sale to obtain prior creditor (and other stakeholder) approval as provided for in this Directive.

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Refinement of "best interest of creditors test". Introduction of the "relative priority rule"

Article 2

Definitions

For the purposes of this Directive, the following definitions shall apply:

(1) (…);

(9) 'best interest of creditors test' means that no dissenting creditor would be worse off under the restructuring plan than they would be ***if the plan were not approved;***

~~**(10) 'absolute priority rule' means that a dissenting class of creditors must be satisfied in full before a more junior class may receive any distribution or keep any interest under the restructuring plan;**~~

(10) ***'relative priority rule' means that a dissenting class of creditors or equity holders is to receive treatment at least as favourable as any other class of the same rank and more favourable than any more junior class and that no more senior class can receive or keep economic values exceeding the full amount of the claims or equity interests of such class, as valued at the time the restructuring plan is confirmed;***

(…).

Article 11

Cross-class cram-down

1. Member States shall ensure that a restructuring plan which is not approved by each and every class of affected parties may be confirmed by a judicial or administrative authority upon the proposal of a debtor or of a creditor ~~with the debtor's agreement~~[1] and become binding upon one or more dissenting classes where the restructuring plan:

(a) fulfils the conditions in Article 10(2);

(b) has been approved by at least one class of affected creditors other than an equity-holder class ~~**and any other class which, upon a valuation of the enterprise, would not receive any payment or other consideration if the normal ranking of liquidation priorities were applied**~~;

(c) complies with the ~~**absolute**~~ ***relative*** priority rule.

2. Member States may vary the minimum number of affected classes required to approve the plan laid down in point (b) of paragraph (1).

[1] See below for a more reasoned discussion on the possibility of creditors to file competing plans.

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Article 13

Valuation by the judicial or administrative authority

~~**1. A 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.**~~ **<u>1.</u>** ~~**An enterprise value**~~ ***<u>In each of the following cases,</u>*** the judicial or administrative authority ***<u>shall determine the value of the enterprise on the basis both that the proposed restructuring plan is implemented and that no such plan is implemented</u>*** ~~**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 grounds of an alleged breach of the ~~**absolute priority rule**~~ ***<u>best interest of creditors test</u>.***

~~**3.**~~ **<u>2.</u>** 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.

~~**4.**~~ **<u>3.</u>** Member States shall ensure that the challenges referred to in paragraphs 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.

<u>Comment</u>

1. ***<u>Refinement of the 'best interest of creditors test'</u>****. The best interest of creditors test serves the (main) purpose of defining a floor for the distributions to creditors, below which any individual creditor can successfully challenge a plan because they would be better off with alternative outcomes they are entitled to. A restructuring affecting creditors' claims is justifiable only if the creditors do not involuntarily suffer an additional loss.*

The Directive Proposal defines the best interest of creditors test only using "liquidation", whether piecemeal or as a going concern, as the comparator scenario; there are cases, however, in which (solvent or insolvent) liquidation is not the only or even likely alternative to the non-adoption of the proposed restructuring plan – there may be the case that the debtor's business is still viable for the time being even without any restructuring plan; this holds particularly true if there is no defined threshold of distress required to access the restructuring proceeding (a choice we support on the basis of evidence from jurisdictions with the most extensive restructuring experience).

Thus, we suggest using the 'no plan scenario' as a comparator, with the resulting most likely outcome, either be it piecemeal liquidation, going concern liquidation or mere continuation of the firm without a plan. This with the purpose of determining the comparator value that sets the floor that shall be met, with respect to each claimant or shareholders, to pass the best interest test (Art. 2

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no. 9). In other words, the creditors are entitled to receive at least what they would receive in the most likely scenario that would follow if the plan were not adopted. It is important to note that the alternative scenario used as a comparator cannot be purely speculative, and cannot be based on other possible restructuring plans that have not been placed before the creditors and other stakeholders.

The refinement of the best interest of creditors test also leads to a change in Article 13, requiring the determination of both the value of enterprise as resulting from the adoption of the restructuring plan and the value of the enterprise in the most likely outcome that would result from a possible non-adoption of the restructuring plan: as the case may be, continuation of the enterprise without any deleveraging, going concern liquidation, piecemeal liquidation).

The values of the enterprise with and without the proposed restructuring are necessary to assess compliance with the best interest of creditors test in case of challenges (based on that issue), or in any case of a cross-class cram down.

*2. **Introduction of the 'relative priority rule'**. The absolute priority rule (APR) as suggested and defined in the Directive Proposal (Art. 2 no. 10) is a concept familiar from many jurisdictions; it is a logical and, at first glance also, obvious test for the fair treatment of classes insofar as ranks in statutory insolvency proceedings usually trigger a waterfall distribution – only once all more senior classes are satisfied in full can a junior class hope for any distribution at all.*

However, when looking at a going concern business and at a negotiated and voted-on restructuring solution, this rigidity of the absolute priority rule can become problematic. On the one hand, it may make particularly difficult restructuring based on plans with more than one class of creditors (which are instead valuable because they allow creditors to vote according to their economic interests). On the other hand, the APR may impede or even condemn, in particular, any attempt to let the current shareholders retain a stake in the restructured business.

The latter concern is of special importance with owner-run/family-run businesses and thus with MSMEs; it is often desirable, though, to incentivise the shareholders/managers to restructure early, to discourage them from holding out of an agreement, to contribute and commit to the restructuring and to apply their knowledge of the business in the interest of the creditors throughout and after restructuring. We have heard evidence of this from several jurisdictions. We are not alone in highlighting these considerations. The American Bankruptcy Institute's report on Chapter 11 reform (2014) devotes a lot of attention to easing the absolute priority rule in different ways (including a specific and very sophisticated approach for MSMEs, see pp. 299-302 of the report, Chapter VII. "Proposed Recommendations: Small and Medium-Sized Enterprise (SME) Cases).

Taking into account the role that business owners of MSMEs, in particular, may be expected to play in the restructuring, the absolute priority rule may even fall short of the fairness it is supposed to ensure for distributions in the first place; we advocate, thus, for a more flexible standard allowing distributions to junior classes (or their retention of interests and economic values) even before all (dissenting) senior classes are satisfied in full.

Basic fairness demands that in treating a dissenting class and its members (a) the best interest of creditors test is met, i.e. *all dissenting creditors receive at least what they would receive in the absence of the plan, (b) no senior class receives more than their claims or stakes in full, (c) no class*

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of the same seniority receives more favourable treatment than the class in question, and (d) all more junior classes receive less favourable treatment. To determine how favourable the treatment of a class is, the distributions, awarded and retained values (in particular shares in the business), are to be valued as of the plan's confirmation. We define criteria (b) to (d) as the new relative priority rule that replaces the absolute priority rule in Art. 2 no. 10.

We have discussed at length whether it would be adequate to require a "gap" or "distance" between the treatments of classes of different ranks, by using vague/open standards such as a treatment of classes "adequate" to their rank or such as a "materially less favourable treatment" as part of criterion (d) above, but we have rejected this approach because it lacks the clarity and ease-of-use of the recommended relative priority rule.

*3. **Other amendments**. Although the most important of the recommended changes to the rule concerning the cross-class cram-down in Art. 11 of the Directive Proposal is the replacement of the absolute priority rule with the relative priority rule, we also recommend two more changes: with a view to allow for competing plans presented by creditors, the requirement of the debtor's agreement has to be deleted (see below a discussion on "Rights of creditors to file a restructuring proposal following the debtor's application for preventive restructuring"), and it should not be a set requirement that the affected creditor class approving the plan according to Article 11 paragraph 1(b) has to be "in the money"; the interests of more senior classes are adequately protected by both the best interest of creditors test and the relative priority rule.*

Prevention of abuses

Article 5A

Prevention of abuses

1. Member States shall ensure that any creditor or group of creditors holding claims of at least 10 percent of the total indebtedness can at any time request the judicial or administrative authority to cease a restructuring procedure or declare that a restructuring measure no longer applies in the following cases:

(a) when the debtor is not in financial distress and is taking undue advantage of the procedure or measure;

(b) when a stay is in place under Article 6, if the plan has no reasonable prospect of being approved or implemented and furthering the procedure or measure would result in a damage to the creditors.

Comment

The provisions of the proposed Directive, making reference to debtors in "financial difficulty" that causes "likelihood of insolvency", do not identify a prerequisite concerning the level of distress of the debtor in order to pursue a preventive restructuring procedure or measure. In other terms, an entrepreneur might further a restructuring either without actually being in a situation of distress (with a view at deleveraging at the expenses of its creditors and, thus, gain an improper

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advantage), or, at the opposite, while being in a situation of irreversible insolvency, where no turnaround of the firm is indeed feasible.

The choice of not providing a judicial or administrative assessment of the level of distress as a condition to enter into preventing restructuring appears, indeed, well-grounded, based on several considerations.

(1) The decision on whether the debtor should be allowed to pursue a preventive restructuring would better rest with the creditors, possibly supported by the qualified judgment of the professional in charge of the verification or examination of the plan. If the creditors are adequately informed, they are certainly best placed to make a correct decision. Giving such power to the creditors is consistent with the well-thought goal of the proposed Directive concerning the limitation of the role of judicial or administrative authorities (Recital No. 18).

(2) It should be noted that the quantitative and qualitative empirical evidence shows that very often entrepreneurs delay starting the restructuring process often to a point when its chances of success are slim. To the contrary, cases in Continental Europe of abusive use of preventive restructuring procedures and measures are very rare. It is thus unlikely that a debtor not in a situation of distress purportedly initiate a restructuring. The persisting stigma associated with restructuring procedures in Continental Europe, the fear to lose control of the business, and the poor experience with existing systems in many jurisdictions (regarded as lengthy and unpredictable) explain the findings. It can be safely stated that, in most cases, regulated restructuring procedures may generate a reputational and operating damage outbalancing the benefits resulting out of a deleveraging. Removing the prerequisite of a judicial or administrative assessment on a minimum level of distress should reduce the stigma associated with preventive restructuring procedures and measures.

Nevertheless, in order to balance the choice of not providing a minimum/maximum distress threshold to access to preventive restructuring, it is prudent and advisable – particularly with regard to the concerns of those jurisdictions that have not yet adopted any out-of-court preventive proceeding – to include in the proposed Directive a more general anti-abuse provision that goes beyond Article 6 paragraph 8. At any moment after the restructuring process is initiated by the debtor, creditors should be entitled to challenge the restructuring on the grounds of its abusive utilization and require the judicial or administrative authority to assess whether the debtor is indeed experiencing financial difficulties or in a situation of irreversible insolvency, where no turnaround of the firm is indeed feasible. In this latter case, the right to require such an assessment by the judicial or administrative authority should be only available when a stay is in place, given that otherwise the creditors are entitled to file for insolvency.

The case of restructuring attempts that have no reasonable prospect of being approved or implemented is practically more relevant. Creditors, if adequately informed, should be able to detect and turn down proposed plans that are not feasible; nevertheless, pending the restructuring attempt, creditors may anyway suffer a damage, particularly when a stay on enforcement actions (Article 6 of the proposed Directive), when new financing is provided under the protective umbrella of non-avoidability (Article 16 of the proposed Directive), and when protection of transactions in case of later insolvency (Article 17 of the proposed Directive) are granted, automatically or upon request to the judicial or administrative authority, as a result of the access to a preventive restructuring procedure or measure.

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*In any case, the assessment made by the judicial or administrative authority is designed as optional, being subject to the request by one or more creditors. Further, only creditors having, individually or on aggregate, a qualified interest in the restructuring (*i.e. *having claims of at least 10% of the total indebtedness) are entitled to require such an assessment. This is important to avoid frivolous challenges, which could otherwise be moved to the sole purpose of hurdling the restructuring process and try to extract some private benefits.*

It is important to point out that the mere existence of such a right to challenge the restructuring attempt on the grounds of its abusiveness, should serve as an ex-ante *incentive to the debtor. Although we might expect a limited number of challenges, the perspective of the relevant risk would probably encourage the debtor to engage in preventive restructuring negotiation only when it is indeed in financial difficulties and such difficulties are so much severe to leave no space for a restructuring.*

Counting votes for approval of plans

Article 9

Adoption of restructuring plans

1. Member States shall ensure that any affected creditors have a right to vote on the adoption of a restructuring plan. Member States may also grant such voting rights to affected equity holders, in accordance with Article 12(2). ***Duly notified creditors that do not exercise the right to vote on the restructuring plan are not counted in ascertaining whether a plan has received support from the majorities required for its adoption. For micro and small enterprises, Member States may treat duly notified creditors that have not voted on the plan as having consented.***

(…)

Comment

The amendment aims at tackling rational creditor passivity, which is a problem especially for micro and small enterprises.

As a general rule, along the lines of the well-established practice of some jurisdictions, we propose not to count, for the determination of the required majorities, those creditors that, although duly informed, decide not to cast their vote. Such a provision would enhance the effectiveness of the voting system: creditors that have an opinion on the restructuring plan are incentivized to cast their votes on pain of being left out of the accounting of the requisite majorities; for the same reason, no effect on the chance of approval is associated with creditors passivity, thus avoiding that uninformed/uninterested creditors may indirectly determine the success or failure of the restructuring attempt. The qualitative and quantitative empirical evidence has shown that creditors' passivity is one of the main threat to reaching an effective restructuring.

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*However, it is important to leave to Member States the possibility of providing a deemed consent mechanism for the adoption of restructuring plans concerning micro and small enterprises. It is widely recognized that the smaller the claim, the lesser the incentive for creditors to cast their vote in the context of a restructuring: creditors weigh up the additional value they estimate they could receive by actively participating to the process against the amount of time and money this effort requires and, when the costs outweigh the return, they do not participate to the process (see UNCITRAL, "*Insolvency of micro, small and medium-sized enterprises*", 10-19 May 2017). This phenomenon is more common, of course, the smaller the firm, due to the usual small median value of claims.*

Clarifying protection for new and interim financing

Article 16

Protection for new financing and interim financing

1. (...).

2. Member States may afford grantors of new or interim financing the right to receive payment with priority in the context of subsequent ~~**liquidation**~~ ***insolvency*** procedures in relation to other creditors that would otherwise have superior or equal claims to money or assets. In such cases, Member States shall rank new financing and interim financing at least senior to the claims of ordinary unsecured creditors.

3. (..).

<u>Comment</u>

*The empirical evidence shows that there is a positive correlation between new and interim financing and the rate of success of restructuring attempts. The pivotal importance of new and interim financing has been pointed out also by the UNCITRAL in its recent publications (see UNCITRAL, "*Insolvency of micro, small and medium-sized enterprises*", 10-19 May 2017). Further, the present Proposal moves from two fundamental assumptions:*

(1) the restructuring of viable businesses is a primary goal for Member States, since it allows to better preserve the value of the distressed business, save jobs, and reduce the risk that loans become non-performing loans in cyclical down turns and/or increase the market value of non-performing loans (see the Explanatory Memorandum attached to the Proposal);

(2) legal uncertainty poses a significant obstacle to investments, inducing investors to restrain from making them or to demand a higher return.

In light of the above, the priority provided for grantors of new or interim financing may not depend on the nature of the insolvency proceeding applied in case of failure of the restructuring attempt. To the contrary, the priority should apply regardless of the type and nature of the restructuring

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procedure so as to provide grantors with an adequate level of certainty about the ranking of their claim. That is pivotal to pose an effective and satisfactory incentive to provide new or interim financing and, ultimately, to make practically possible the restructuring of many viable firms facing a financial distress.

To this purpose, "liquidation" should be replaced by "insolvency" to reassure grantors of new or interim financing that that favourable raking be enforceable regardless of the nature of the specific proceeding applied in case of failure of the restructuring attempt (particularly, the priority should be granted even if a non-liquidation insolvency procedure is applied).

Liability of Directors of companies approaching insolvency

Article 18

Duties of directors

1. Member States shall lay down rules to ensure that, **~~where there is a likelihood of insolvency, directors have the following obligations~~** ***when the debtor is or would imminently become unable to meet its obligations as they fell due, the following obligations arise*****:**

~~(a) to take immediate steps to minimise the loss for creditors, workers, shareholders and other stakeholders;~~

~~(b) to have due regard to the interests of creditors and other stakeholders;~~

~~(c) to take reasonable steps to avoid insolvency;~~

~~(d) to avoid deliberate or grossly negligent conduct that threatens the viability of the business.~~

(a) directors will have due regard to the interests of creditors as a whole and other stakeholders;

(b) directors will immediately take reasonable steps to avoid insolvency or, if unavoidable, to minimize further loss for creditors and other stakeholders.

2. The measures expected from directors under paragraph 1 might include, among others: the commencement of honest negotiations with the relevant stakeholders with a view to reaching an agreement, either by restructuring bilaterally the obligations or by using one of the out-of-court tools or proceedings existing in the jurisdiction; gathering and evaluating the financial situation of the business, including, when necessary and feasible, requesting independent advice; increasing communication amongst directors, and between the former and financial controllers and the auditor of the entity; modifying management practice to take account of the interests of creditors and other relevant stakeholders; adopting measures to protect the value of the key company assets; adopting measures to ensure the continuation of the debtor's business when the

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directors have reasonable grounds for believing that to do so is in the interests of the creditors as a whole; requesting the commencement of formal insolvency proceedings.

3. Member States should establish a liability to compensate the damages caused to creditors by directors who either knew or ought to have known that the debtor was or would imminently become unable to meet its obligations as they fell due and failed to comply with the obligations referred to in paragraphs 1 and 2.

Comment

The previous version of the article seemed to include several repetitions and leave out relevant information.

Firstly, the reference to "likelihood" of insolvency, as a way to define the moment when duties for directors arise, seems unprecise, since, by definition, a "likelihood" of insolvency always exists. It might have been more accurate to refer to the insolvency being more probable than not, but, for obvious reasons, the calculation of probabilities is very difficult to establish.

Secondly, para (a) ("to take immediate steps to minimise the loss for creditors, workers, shareholders and other stakeholders") appears somewhat confusing. It seemed to refer to all the parties mentioned at the same level, when, in insolvency, they are subject to a strict hierarchy. Some of the parties mentioned are - and others may be - in conflict: will a director be complying with the rule when adopting a decision that benefits shareholders and externalizes the cost (or the risk) on creditors? Clearly not. By eliminating the separate reference to different stakeholders, the rule simply refers to the hierarchy envisaged in the general insolvency system, which puts creditors on top. In the proposal, we make reference to creditors "as a whole" precisely to clarify that directors must adopt decisions that maximize the value of the business, benefitting all creditors (and shareholders) as a consequence thereof, independently of the different tiers of creditors (which are inherently in the same type of conflict referred to above concerning shareholders).

Thirdly, letter (b) of the current version Article 18 of the Proposal seems to overlap with (a) and share its main flaw. Hence we propose to eliminate it. As we propose to eliminate (d), since it is also included in the previous letters (how can a director take all immediate steps to minimise damage to creditors if it is observing a "deliberate or grossly negligent conduct that threatens the viability of the business?".

In our proposal, we purport to spell out a comprehensive regulation of the liability of directors, along the lines of UNCITRAL´s legislative Guide, although with some suggested amendments and additions that make it closer to the principles embedded in the Directive.

In summary, we propose to:

(i) firstly, define the moment when the duties of directors are altered;

(ii) such moment is linked with the vicinity of insolvency, understanding insolvency as the inability to pay debts as they mature (a situation that the laws of all Member States consider relevant);

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(iii) a simple definition of the duties is then proposed, in two parts, one where the beneficiaries of the fiduciary duties are determined, and one where the type of actions expected are introduced, based on the degree of distress of the business;

(iv) then we suggest the inclusion of a number of actions that are expected from directors if they want to comply with their new duties; the actions listed are not the only possible actions, but are indeed the most evident ones; this part of the article (paragraph 2) is greatly important, since it provides guidance concerning the expected behaviour of directors and the existing out-of-court and in-court procedures in each jurisdiction;

(v) finally, a general liability rule is established, with two salient elements: on the one hand, the liability is purely compensatory and linked with the damage caused by the breach of the duties spelt out in the article; on the other, the liability is based on willful misconduct and negligence, since directors are expected to compensate damages when they knew or when they ought to have known that the business was in the situation defined in (ii).

Fairness and efficient determination of fees borne by the estate

Article 27

Supervision and remuneration of practitioners *<u>and other professionals</u>* in the field of restructuring, insolvency and second chance

1. Member States shall put in place appropriate oversight and regulatory structures to ensure that the work of practitioners in the field of restructuring, insolvency and second chance is appropriately supervised. This oversight and regulation shall also include an appropriate and effective regime for sanctioning practitioners who have failed in their duties.

2. Member States shall ensure that the fees charged by practitioners in the field of restructuring, insolvency and second chance are governed by rules which incentivise a timely and efficient resolution of procedures with due regard to the complexity of the case. Member States shall ensure that appropriate procedures with built-in safeguards are available to ensure that any disputes over remuneration can be resolved in a timely manner.

<u>3. Paragraph 2 shall apply to the fees charged by professionals advising the parties in connection with any aspect of a restructuring plan, when such fees are borne by the estate and the plan is not adopted with the consent of every affected creditor.</u>

<u>Comment</u>

Restructuring costs are generally perceived as high, especially for small and medium enterprises (see, e.g., Recitals 11 and 13).

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The proposed amendment is in line with the provision of Article 17 paragraph 2 (b), which protects "the payment of reasonable fees and costs in seeking professional advice in connection with any aspect of a restructuring plan". The proposed amendment aims at encouraging fairness and efficient determination of fees when the relevant cost is borne also by non-consenting creditors.

The original text of Article 27 concerns only 'practitioners', who are defined by Article 2(15) as 'any person or body appointed by a judicial or administrative authority' to perform tasks relating to the restructuring.[2] *However, from the perspective of allocation of the relevant costs, there is no difference between practitioners and other professionals advising the parties (debtor or creditors) when their fees are to be paid out of resources that are drawn from the estate.*

An exception can be made only when the plan does not envisage any cram-down (either of dissenting creditors or of one or more entire classes).

* * *

PART II
FURTHER ISSUES FOR DISCUSSION

Right of creditors to file a restructuring proposal following the debtor's application for preventive restructuring

Article 4
Availability of preventive restructuring frameworks

1. (…)

(…)

4. Preventive restructuring frameworks shall be available on the application by debtors, or by creditors **with the agreement of debtors**

Article 11
Cross-class cram-down

1. Member States shall ensure that a restructuring plan which is not approved by each and every class of affected parties may be confirmed by a judicial or administrative authority upon the

[2] We also suggest correcting what, given the definition provided under Article 2(15), appears to be a mistake in Article 26 (Appointment of practitioners in the field of restructuring, insolvency and second chance). Paragraph 3 should be amended as follows: *"3.~~**Where practitioners in the field of restructuring, insolvency and second chance are appointed by the judicial or administrative authority,**~~ Member States shall ensure that the criteria concerning the manner in which the judicial or administrative authority selects such a practitioner are clear and transparent. (...)"*.

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proposal of a debtor or of a creditor **with the debtor's agreement** and become binding upon one or more dissenting classes where the restructuring plan:

(a) fulfils the conditions in Article 10(2);

(b) (…);

(c) (…).

(…)

Comment

Under the Proposal, only the debtor is entitled to

(i) *apply for the restructuring tool (Article 4, par. 4), and*

(ii) *apply for the confirmation of a plan that has not been approved by each and every affected class,* i.e. *apply for a cross-class cram-down (Article 11, par. 1).*

Creditors are entitled to apply for the restructuring tool and apply for a cross-class cram-down solely "with the debtor's agreement".

The result of the above provisions is that only the debtor is entitled to initiate the process and, most commonly, determine the content of the proposal (indeed, creditors may not obtain the confirmation of a plan that has not received the approval of all classes, including shareholders, without the company's consent).

The provision of the debtor's exclusive right to initiate the restructuring process appears well justified, as proved by the following considerations:

(1) providing a creditors' right to initiate the process may pose a negative incentive for the debtors to transparently and truthfully communicate to third parties and, particularly, creditors their actual financial and economic situation, making creditors' monitoring more costly and less effective (this is particularly serious problem for SMEs that usually do not have any internal monitoring mechanism, such as the provision of a statutory auditors committee);

(2) the restructuring tool provided under the Proposal does not require any preventive judicial and/or administrative decision on the existence of a situation of financial and/or economic distress; thus, no one other the debtor itself could be entitled to activate a tool that implies such a situation, such as the restructuring tool at issue.

To the contrary, regarding the right to propose a competing plan, it is advisable to amend the Proposal (particularly, Article 11 concerning the application for cross-class cram-down) in order to ensure that, once the debtor has activated the restructuring procedure, the creditors may formulate a plan and obtain its confirmation through a cross-class cram down. Without a creditors' right to file a competing plan, the debtor could easily impose on creditors terms that are in its own

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best interest, despite not being value maximizing, provided that what offered to creditors is (even marginally) better than what creditors estimate to receive in case of insolvency. In other words, the debtor may exercise its exclusive right to formulate a restructuring plan to extract value from creditors, relying on the fact that creditors cannot file a more convenient restructuring plan and, thus, are bound to take it or leave it.

That solution would be clearly in contrast with the considerations underlying what stated by the Proposal under Article 12, par. 1 ("Member States shall ensure that, where there is a likelihood of insolvency, shareholders and other equity holders with interests in a debtor may not unreasonably prevent the adoption or implementation of a restructuring plan which would restore the viability of the business").

It is strongly advisable to amend the Proposal with a view at entitling creditors to file a competing plan and apply for a cross-class cram-down, if needed to have the plan confirmed.

Confirmation as a stronger safeguard for creditors

Article 10

Confirmation of restructuring plans *and stakeholder protection*

1. Member States shall ensure that the following restructuring plans can become binding on the parties 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 which provide for new financing.

1A. In line with Article 17 paragraph 4, Member States may require the confirmation of a judicial or administrative authority for restructuring plans which are protected from avoidance actions in insolvency proceedings. Should the Member State decide not to make confirmation mandatory, the issuance of an independent expert opinion should be made mandatory. The opinion ought to, at least, include a confirmation of compliance with the legal requirements and the commercial reasonableness of the agreement.

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**;**

(d) the plan does not impose on any creditor a sacrifice that is disproportionate considering what is objectively necessary for the successful implementation of the plan.

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3. Member States shall ensure that judicial or administrative authorities may refuse to confirm a restructuring plan where that plan***, in a manner evident to an expert conducting an objective assessment,*** does not have a reasonable prospect of preventing the insolvency of the debtor and ensuring the viability of the business.

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

Comment

*1. **Confirmation or independent expert's opinion for plans providing exemption from avoidance actions**. Judicial or administrative confirmation of plans is key to add certainty to the procedure and protect minorities and non-participating creditors.*

The confirmation does not come without costs, since it requires time and effort. Because of this, legislators should ensure that confirmation is envisaged when there is a need to protect stakeholders that would otherwise be left out in the cold. Typically, this is the case when dissenting creditors are bound by the terms of the plan, since the majority might abuse the rights of the minority. Similarly, the protection awarded to interim and new finance, if commercially unreasonable, may damage other creditors, including those that are out of the agreement.

For the same reasons, some control ought to be exerted over agreements that are given a safe harbour by the law in a subsequent insolvency. Minority creditors and creditors not bound by the agreement may be prejudiced by a plan that externalizes the risk on them and which can not be avoided ex post. Judicial or administrative confirmation appears an adequate solution and is consistent with letter (b) of paragraph 1 and with Article 17.

If, for the sake of speed and efficiency, the law of a Member State allows protection from avoidance actions even without court/administrative confirmation, then a reasonable compromise seems to require an independent expert's opinion that the legal requirements are met and the plan is commercially reasonable in a manner that facilitates the rescue of the business in the interest of creditors as a whole, not of individual - even if majority - creditors.

*2. **Creditors that have to be notified: clarification**. In letter (a) of paragraph 2, we propose to eliminate the reference to known creditors "likely to be affected" by the plan, which adds uncertainty without a sound justification. Notification should concern all creditors affected.*

*3. **Better defining the powers of the judicial/administrative authority**. The judge or the administrative authority confirming the plan should control all the elements of the plan: compliance with legal formalities, effective approval by the required thresholds, and the material content of the plan. In considering this part, by far the most important and controversial, the following points should be kept in mind.*

(a) An out-of-court restructuring is a collective procedure, where unanimous consent is replaced by a system of majorities. Dissenting and affected-but-absent creditors must be bound by the decision

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of the majority. But like with insolvency law, pre-insolvency proceedings belong in the realm of exceptional legislation: the rules generally applicable in a situation of financial normality cease to apply for the sake of a greater good. Precisely because it is exceptional, it should be confined strictly within its boundaries. The sacrifice imposed on minority/non-participating creditors should be tied to what is strictly necessary for the rescue attempt to thrive; but not more. Creditors should not be imposed a bigger sacrifice than what is needed for the viability of the business in the mid-term. Naturally, the judge/agency does not need to second-guess and make a revaluation of the plan. The exclusion of certain creditors from the agreement would only happen when it is evident and clear that the said creditors are being asked for a sacrifice that is unnecessary. Hence, we propose the inclusion of letter (d) in the second paragraph of Article 10.

(b) The confirming authority should not be allowed to replace the will of the vast majority of creditors based on the apparent "non-feasibility" of a plan, unless it is absolutely evident to an expert (which will not always be the judge) that the plan has objectively no prospect of being successfully implemented. The addition of language to paragraph 3 of Article 10 tries to ensure that only in very clear cases the confirming authority will overrule the decision of the vast majority of creditors to assume a new risk.

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