BUSINESSEUROPE

Comments

27 February 2017

Proposal on EU insolvency and second chance

Context

On 22 November 2016, the Commission put forward a proposal on EU business insolvency including early restructuring of companies in difficulties and giving a "second chance" to entrepreneurs. The purpose is to ensure more efficiency of insolvency frameworks across EU Member States which promotes investors' trust, a better debt recovery rate and ultimately induces a change of mentality in Europe regarding business failure and business recovery.

BusinessEurope issued a press release on the day of the proposal supporting the approach taken. However, BusinessEurope also alerted to the need of reaching a good balance between creditors and debtor's interests (with small and medium-sized companies often finding themselves on both sides of the spectrum).

Below some **key facts** on EU insolvencies:

- **200 000 companies** go bankrupt every year in the EU;
- **50% of businesses** do not survive the **first 5 years**;
- Insolvencies cost **1.7 million in job losses** a year in the EU;
- It can take an average of **6 months to 4 years to resolve an insolvency case** in national courts in the EU;
- **¼ of insolvencies have a cross-border nature**;
- **Recovery is higher in restructuring procedures** (83% of claims) compared to liquidation procedures (57% of claims).

This position paper comments on the approach taken by the Commission in this initiative as well as on some of the specific articles of the proposal.

Main messages

- BUSINESSEUROPE is **generally supportive of a restructuring approach** to insolvency in Europe **and of a second chance**.
- This proposal could pave the way to a **change of mindset** in Europe by **eliminating the stigma of failure**.
- It is however essential that this objective is balanced against the **interests of creditors**.

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- It is also important to **set different levels of safeguards during pre-insolvency proceedings** in order to avoid abuses.
- Facilitating access to restructuring procedures is particularly important for **small and medium-sized companies (SMEs)** as they are less resourceful when it comes to meeting restructuring costs and dealing with insolvency procedures.
- Given how insolvency is strongly intertwined with many areas of law and with national legal traditions we welcome the **minimum standards** approach chosen. This will allow Member States to keep efficient well-established features of their system.
- It is important that the legal framework now proposed is **without prejudice to other existing recovery procedures of diverse nature** (e.g. contractual nature) which can be found in Member States.
- It is important to keep the scope limited **to pre-liquidation procedures**.
- There should be **no attempt to harmonise classes and ranking of creditors**. This would be a too difficult task at European level. Nevertheless, a **debate is needed on whether or not public creditors** and their role/privileges during restructuring procedures should be taken into consideration by this proposal.
- Minimum requirements on **second chance (discharge) are important** but they need to be **balanced with enough safeguards**.
- To successfully recover struggling businesses, **we also need to guarantee that the right incentives are in place**:
    - Incentives **for managers** – to turn to early warning systems; to define credible restructuring plans; to look for assistance;
    - Incentives **for creditors** – to feel reassured that enough safeguards are in place; to be able to count on efficient and quick procedures;
    - Incentives **for new capital** – to feel motivated to invest in companies in difficult situations.

Specific comments on the proposal

Article 1 – Subject matter and scope

BusinessEurope supports the focus of the proposal on the pre-insolvency phase**.** A wider scope (e.g. liquidation) would risk undesirable interference with national legal systems with less clear benefits.

It should be made clear that the proposal is without prejudice to alternative preventive restructuring procedures (e.g. of contractual nature) that might exist at Member State level.

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Inducing a cultural change in Europe towards restructuring does not depend on legislative measures alone. A holistic approach is necessary which will require the involvement of the EU, Member States and public and private entities (e.g. business organisations/chambers of commerce, where relevant) in order to be successful.

- **Article 3 – Early warning**

BusinessEurope welcomes the attempt to grant widespread access across the EU to early warning tools for debtors and entrepreneurs. These systems can be of different nature, configuration or funding-model.

- **Article 4 – Preventive restructuring frameworks**

BusinessEurope welcomes the extension of preventive restructuring procedures across the EU.

Mainstreaming these procedures will imply significant changes in the way Member States' systems operate in an area which is deep-rooted in national legal traditions. In order to have a smoother implementation it is advisable that the proposal grants Member States some degree of flexibility regarding safeguards for the opening of such procedures.

- **Article 5, Article 7(6) and Recital 18 – Debtor in possession**

BusinessEurope agrees with the principle that the debtor should in general be left in control of the assets and day-to-day operation of their business which allows for flexibility in implementing and executing the restructuring plan.

Nevertheless, this prerogative of the debtor must not be absolute. There should be an underpinning obligation to run the business in the best interest of the restructuring plan, safeguarding the interests of the creditors. Also, to avoid abuses it should be assessed whether to:

- Recommend the appointment of a practitioner in more situations, although BusinessEurope agrees that such appointment should not be mandatory in all cases.
- Consider the possibility for Member States to require some form of oversight of the management by officially appointed administrators in cases which would ensure that creditors are well-informed and fairly treated throughout a transparent restructuring process. For example:
    - When a stay of enforcement actions is granted in the absence of a consensus between debtor and affected creditors.
    - When a restructuring plan is adopted in the absence of a consensus between debtor and affected creditors.
    - When the obligation of the debtor to file for insolvency arises during the period of the stay.

- **Article 6 – Stay of individual proceedings**

The stay of proceedings should be reflective of the period necessary to turn around the business upon implementation of the restructuring plan. Regardless whether the proposed periods are adequate or not, it is important to consider introducing warning markers (equivalent to those identified by the Directive to establish the likelihood of success of the restructuring plan) as early as possible. Otherwise, dragging the process is likely to lead to a situation where the creditors are worse off given that the assets of the business would have been eaten out by the time the stay period expires.

It should be clarified whether interim judicial precautionary measures would also be covered by the stay. If not, it would be important to open a discussion on such a possibility.

Paragraph 8 of this article grants the possibility for creditors to lift the stay. This is not a generalized feature across all Member States' legal systems due to different approaches taken. Therefore, this suspension should preferably become an option for Member States rather than a default rule.

- **Article 7 – Consequences of the stay**

A stay has important consequences (e.g. suspension of the debtor's obligation to file for insolvency) for creditors, therefore safeguards need to be in place to avoid abuses.

A major consequence is the suspension of the debtor's obligation to file for insolvency under national law (paragraph 1). BusinessEurope questions whether any exceptions to this suspension could be considered beyond the ones foreseen in paragraph 3.

Transparency throughout the duration of the stay is important to allow creditors to be enabled to act during the restructuring process.

Although there are limitations to what suppliers/creditors can do to the contractual relation with the debtor during the stay, termination on other grounds (not related to insolvency/opening of restructuring procedures) should be admissible this way preserving contractual freedom. Instead of an option to Member States, the contractual limitations during the stay period foreseen in paragraphs 4 and 5 of Article 7 should be limited to essential contracts which are necessary for the continuation of the day-to-day operation of the business.

- **Article 8 – Content of the restructuring plans**

BusinessEurope agrees with establishing minimum standards for a 'credible' restructuring plan.

- **Articles 9, 10 and 11 – Restructuring plans procedures and duration**

The draft directive does not contain provisions on the maximum duration of the restructuring. In BusinessEurope's view, it should be reflected whether to introduce safeguards/check-points to avoid that the restructuring process drags on for too long which would defeat the objectives pursued by the proposed directive.

BusinessEurope agrees with establishing minimum requirements on cross-class cram-down. Involvement by courts in this process is an important guarantee for creditors. Especially if the concept of different classes of creditors is to be retained (according to Article 9), this provision may prove an adequate fail safe option to proceed with a restructuring plan.

- **Article 15 – Appeals**

BusinessEurope agrees with the principle that appeals shall be resolved in an expedited manner.

- **Article 16 – Protection of new financing and interim financing**

BusinessEurope broadly welcomes minimum requirements on the protection of new and interim finance.

- **Article 18 – Duties of directors**

BusinessEurope welcomes the establishing of general duties of the directors of companies in connection with the negotiations on a preventive restructuring plan.

Involvement of a practitioner could be promoted to help fulfillment of these fiduciary obligations

However, it should be clarified that the violation of such duties should not lead to an automatic disqualification of directors. Consequences of these breaches should be analyzed on a case-by-case basis.

- **Article 20 and 21 – Discharge and disqualification periods**

BusinessEurope welcomes the fact that the proposal seeks to provide coherence between discharge and disqualification periods.

Independently of the merits of the specific maximum discharge period proposed (3 years) it is fundamental that the necessary safeguards are in place to avoid abuses.

The proposal already provides some important exclusions/limitations to discharge periods (e.g. dishonest/bad faith behavior, abusive or recurrent use of discharge), nevertheless it is advisable to assess carefully whether other requirements could be proposed. For example, a reflection is needed on the possibility to introduce a minimum quantitative threshold of paid debt to obtain discharge. This is a requirement that can be found in some national insolvency systems.

- **Article 24 – Judicial and administrative authorities training and specialisation**

BusinesEurope strongly welcomes this provision.

Article 25 and 26 – Insolvency practitioners

BusinessEurope agrees with the minimum requirements regarding insolvency practitioners which we believe could help increasing the efficiency and effectiveness of insolvency proceedings.

Article 28 – Digitalisation

BusinessEurope welcomes the fact that this proposal embraces digitalisation in the field of pre-insolvency. Other possible uses of digital tools could be looked at, for example, regarding meetings with creditors and shareholders or digital access to relevant information during the restructuring process.

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