**Insolvency Proceedings and Preventive Frameworks**

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I. Preliminary Remarks: Co-existence of Formal and Informal Restructuring Schemes

Most existing insolvency systems allow not only for liquidation but also for rehabilitation of the debtor enterprise. Liquidation may include the market sale of the debtor’s business as a going concern – and a reorganization plan, in some systems, such as the U.S. and the German systems, may also be a liquidating plan. Recent legislation, for example, in Spain, has facilitated going concern sales by providing for the transfer of permits, licenses, and essential contracts to a purchaser of all or essential business assets.

Following the financial crisis some countries, such as France and Spain, and recently the EU Commission with a Proposal for a Directive on preventive restructuring frameworks, COM(2016) 723 final,\(^1\) perceived a need to introduce preventive restructuring tools for deleveraging businesses (*i.e.*, in this context, the existing debtor entity) on a large scale from financial debt outside formal insolvency proceedings with a minimal degree of court and professional involvement. It is hoped that such schemes will quickly reduce the levels of non-performing loans, protect employment, favor growth, and facilitate the establishment of a capital markets union. Typically, the failure of a restructuring attempt under such debtor-driven schemes does not lead automatically to formal insolvency proceedings, and a sale of the business or its major assets (*i.e.*, a change of ownership and/or control) is either not

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\( ^* \) This paper is a slightly revised version of a note presented to, and distributed at, an international workshop organized by the Joint Vienna Institute (JVI) and the IMF Legal Department (LEG) on “European Corporate and Household Insolvency” in Vienna on May 10-11, 2017. It expresses the personal views of the author and not those of any organization he is, or was, associated with. It was not commissioned or solicited by the organizers of the workshop.


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https://doi.org/10.5771/9783845287256-71

Generiert durch IP '54.70.40.11', am 18.07.2021, 10:43:18.

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provided for or, in any event, highly unlikely. The U.K. with its scheme of arrangement (since the Company Act 1986) has the longest experience with such a preventive scheme. Some of the most developed EU Member States (e.g., Germany) apparently perceive no need for a preventive restructuring framework.

The most important policy issues for the design of preventive restructuring schemes are:

- Which, if any, of the elements of formal insolvency rehabilitation proceedings can, or should usefully, be translated into preventive frameworks,
- what measure of added moral hazard and misuse risk can be tolerated in exchange for the reduced court and professional involvement in, and the expected greater speed of, restructurings within such frameworks,
- what is, on the macro-economic policy level, the right measure of debtor protection (often euphemistically named “rescue culture”) in various economies given their differing degrees of market orientation and economic well-being, as well as political and cultural differences regarding the desirable rate of structural change versus the protection of existing employment, industry structures, and firm sizes.

II. Some Complex Issues

The co-existence of preventive and formal restructuring procedures obviously gives rise to a number of complex issues.

1. When Is Restructuring Desirable?

The classical formula is that financially distressed but viable firms should be rescued, and non-viable ones should quickly exit the market by liquidation, including, where appropriate, by a sale of the business as a going concern. In market conform insolvency systems, such as the U.S., the U.K. and the German systems, rescue worthiness (“viability”) is viewed as an

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excess of going concern over liquidation value of the firm as perceived by parties-in-interest, with decisive say rights of creditors. Other systems (e.g., in some countries of Western and Southern Europe) include externalities, \textit{i.e.}, non-financial “stakes” such as macro-economic or political factors, in the rescue-worthiness decision such as continued employment by the firm or regional or structural importance of the debtor business. These factors may be reflected in the design of proceedings, for instance, by limits to the say rights of creditors, by procedural rights of labor and other “stakeholders”, in a rescue bias of judges and also, in a subtler way, in public opinion calling for ever more “rescue culture”.

In any event, the “viability” balance of factors produces positive or negative externalities. An excessive rescue bias in a system may have negative macro-economic consequences for desirable structural change and modernization, the mobilization of labor and other productive factors, the creation of efficient firm sizes and industry structures etc. If, as is quite common, a minimum sustainable (positive) cash flow of $> 0$ after restructuring is viewed as the criterion of viability, this will manifestly not induce the most efficient (re-)allocation of productive resources for more profitable uses in a functioning market economy. On the other hand, an inherent liquidation bias or inefficiency of insolvency systems and their administration may destroy value and may discourage entrepreneurial risk taking in perspective. The continued effects of the financial crisis, a large volume of systemic insolvencies (e.g., up to 40+ percent of SMEs in Greece) and a large overhang of non-performing loans in some Member States of the EU, appear to call for a stronger rescue bias and for substantial simplification and de-sophistication of deleveraging procedures, at least for a certain period of systemic recovery, in these countries. The traditional variance of economic policies and legal traditions, and the differing stages of development among EU Member States will inevitably continue to influence insolvency policies; in the mid-term, they will be a barrier to European harmonization of insolvency laws. The Draft EU Directive COM(2016) 723 final (the “Draft Directive”)\textsuperscript{4} attempts to accommodate such variances by offering national legislatures a menu of policy options on many issues – but with a disturbing tendency and mindset to produce permanently more “rescue culture” even in countries that managed the financial crisis successfully.

\textsuperscript{4} Supra note 1. See also Madaus, Europäische Ideen für einen präventiven Restrukturierungsrahmen und Handlungsspielräume für das deutsche Recht, in this volume, supra at pp. 43 et seq.; Seagon/Scheel, Die Stellung des Arbeitnehmers im Richtlinienentwurf der Kommission über präventive Restrukturierungsverfahren (COM[2016] 723 final), in this volume, infra at pp. 99 et seq.
2. Who Should Determine “Viability”?  

Market conform systems such as the U.S. or the German systems, but also the English scheme of arrangement, leave it up entirely to creditors to assess the merits of a restructuring plan, following detailed disclosure of the planned measures prior to their votes, and without reliance on a normative concept of “viability”. Judges in the USA and Germany may only reject a plan which is not “feasible”, i.e., manifestly without a chance for sufficient creditor acceptance. Other systems require a “viability” opinion by an independent expert or accountant, provided either by the plan initiator (i.e., in most cases, the debtor or its chosen advisors) or a professional commissioned by the court. Systems which include external (non-financial) factors and “stakeholder” interests in the rescue decision obviously cannot rely merely on the self-interest of creditors for an assessment of rescue worthiness. In such systems, affected creditors are made to bear a share of the distressed debtor’s troubles, even if they may, as in many systems, ultimately reject a proposed plan by majority vote. Such “pain sharing” or “sacrifice” by creditors may include, for example, a moratorium causing them a “time-value-of-money” loss, including possible depreciation of collateral, acceleration of their claims or a bar to interest accrual, and extra expenses for participation in a procedure. They operate a wealth transfer over time from creditors to the debtor which often will motivate them to agree to an early debt settlement.

The Draft Directive attempts to accommodate a normative prognosis of “long-term viability” with the decisive say rights of creditors whose majority consent is eventually needed for a restructuring plan. In any event, creditors must face the risk of four months of an uncompensated stay. Even if it is manifest that a relevant portion of creditors does not support continued negotiations, the stay “may” (not “shall”) be lifted in the discretion of the judge, or else it may last up to 12 months.

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5 See Art. 8(1)(g) of the Draft Directive, whatever this term may mean. The imperfect official German translation speaks misleadingly of “profitability” (Rentabilität). The person responsible for proposing the plan (it may be a member of management or an advisor chosen by it) must deliver an opinion both on the actual “viability” of the business and the “restoration” of its “long-term-viability” – implying it ever existed – which will avoid insolvency if the plan were implemented. Note that the detailed plan must not be presented at the beginning of negotiations but only for judicial plan confirmation which is not needed for a consensual plan.

6 Art. 6(8) of the Draft Directive.
3. Preventive Restructuring Versus Insolvency Rescue Schemes: Triggers

Formal insolvency proceedings use as a trigger the presence of “insolvency” or “imminent insolvency”, referring either to the – actual or foreseeable – inability to pay, or cessation of paying debts as they mature (the “illiquidity” test) or the excess of liabilities over assets (the “balance sheet” test), based on asset valuation in light of a prognosis of likely liquidation or survival of the debtor. In preventive restructuring schemes, sometimes softer triggers such as financial difficulty are used. The Draft Directive uses a rather vague likelihood of insolvency as a condition for access to preventive restructuring, apparently without requiring a liquidity plan for a defined period.7 Other systems such as the formal U.S. chapter 11 or the English scheme of arrangement do not require a showing of insolvency or other financial distress at all but rely on creditors’ self-interest in embarking on negotiations and deciding on plan acceptance. In the U.S. system which (unlike the existing English scheme) operates an automatic stay on all debt enforcement immediately upon a debtor filing, the court has equitable powers immediately to dismiss cases brought in “bad faith” or frivolously.

Experience has shown that all trigger criteria, but especially those based on actual or future illiquidity, can be manipulated easily not only by lenders but also by related parties, e.g., by shareholders and other insiders who may cancel their loans. Therefore, it should be considered to follow the U.S. and English example and allow for maximum speed of access to restructuring by introducing immediate commencement of proceedings upon a debtor filing (“voluntary cases”) without a showing of financial distress or likelihood of insolvency. This should be combined with strict deadlines and flexible use of the stay on creditor action, adequate protection of secured creditors, and with judicial or administrative monitoring of manifest misuse of process by debtors.

Automatic commencement of voluntary cases brought by debtors, viz. requiring for the opening of proceedings merely a showing of some early signs of financial distress or applying the traditional illiquidity/insolvency test for access, do not usefully distinguish, in light of the U.S. experience, “formal” insolvency from preventive restructuring proceedings. The U.S. Bankruptcy Code’s chapter 11 can be, and most often is, used by debtors well before illiquidity/insolvency and is, thus, perhaps the most successful
preventive scheme world-wide, although it has all elements and legal safeguards of the most sophisticated “formal” insolvency proceedings.

We find a more meaningful differentiator in the right of a non-insolvent debtor to withdraw at will its petition for relief, or simply to break off negotiations, and return to “square zero”, and possibly file subsequent restructuring requests any time later, or embark upon new restructuring discussions. The Draft Directive allows a debtor to withdraw its opening move at any time (it is silent about repeated restructuring attempts), and so do, for instance, the English scheme of arrangement and the German Schutzschirmverfahren or umbrella proceeding.8 In a U.S. voluntary case, on the other hand, the debtor may obtain a discretionary judicial dismissal of its petition only after “notice to and a hearing of” all creditors. The debtor is, therefore, always at risk of losing control (and the right to operate its business as debtor-in-possession) and experiencing the appointment of a trustee or an examiner, or suffer the judicial conversion of the case to a chapter 7 liquidation.9 It is easy to enter U.S. bankruptcy – but hard to get out.

Accordingly, in the following chapter, irrespective of whether a financial trigger criterion is applied and, if so, which one, proceedings will be named insolvency proceedings if a debtor’s restructuring petition exposes the latter to the risk of involuntary liquidation (Type A), and preventive restructuring frameworks if the non-insolvent debtor may exit/break off negotiations and exit proceedings at will (Type B). Typically, Type A proceedings are “formal” proceedings under continuous monitoring by a court and/or insolvency professional, and Type B proceedings or frameworks are more or less “informal” with reduced judicial and/or professional involvement.

III. Procedural Links Between Type A and Type B Proceedings

In countries like the USA and Germany that do not follow an essentially unitary approach to both imminent and actual insolvency, the co-existence of Type A and Type B proceedings leads to a number of fresh complexities. These include but are not limited to the following:

(1) Should a pending Type B proceeding bar the opening of a Type A, following a petition by creditors? Or a debtor petition? In the latter case,

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8 § 270a, § 13(2) InsO.
9 11 U.S.C. § 1112; Bankruptcy Rules, 1017, 1019, 2002. Moreover, creditors may file and process a reorganization plan (which may be a liquidating plan), if the debtor does not file a plan within 120 days or if the debtor plan is not accepted within 180 days: 11 U.S.C. § 1121 (c).
who should have a right/a duty to file (each management member, a quorum of members, or the management board)?

(2) Should elements of a failed Type B (with no accepted plan) survive into a subsequent Type A, for example, a negotiated but not accepted plan (as a “pre-pack”), votes cast by participating creditors, or the classification of affected claims?

(3) Should fresh money loans given during a Type B without plan confirmation (including novated or prolonged loans by former lenders, rescheduling of such loans, including with redistribution or pooling of collateral) enjoy some priority in a subsequent Type A? How about a case of a confirmed Type B plan which fails to prevent a later Type A insolvency? Should the interval between Type B plan acceptance and the subsequent Type A matter? Should the causes of insolvency matter?

(4) Should interim financial measures such as asset disposals by the debtor taken during an unsuccessful Type B (without an accepted plan) be exempt from avoidance scrutiny in a subsequent Type A? How should one handle cases of an accepted Type B plan which fails to prevent a subsequent Type A? Should the duration of the interim before the opening of the Type B matter? How about civil and criminal liability for the debtor management and/or controlling shareholders in these situations?

IV. Elements of Restructuring Schemes

In the following chapter, we shall examine which elements from developed formal insolvency systems (Type A) can or should usefully be extended into preventive restructuring frameworks (Type B). As will be seen, many of these elements depend, for their function and justification, on the common pool problem characteristic of traditional bankruptcy based on proven or assumed insolvency. 10

1. Freezing Proportion of Claims at Commencement of Case

In Type A systems, proportions among claims of multiple creditors are frozen by the opening of proceedings, irrespective of the varying pre-insolvency net present value per each dollar of nominal claims, for voting, distribution or priorities, by (i) a bar to interest accrual (post-petition or post-____________________

opening interest becoming either a non-allowable, or a subordinated claim),
(ii) acceleration (maturing) of all debt, (iii) translation of foreign currency
claims into the national currency of the forum, and (iv) considering condi-
tional and contingent claims with a statutory discount. The freeze facilitates
restructuring negotiations and voting because the “bargaining chips” of
players do not vary over time.

In Type B schemes of the out-of-court type there is no opening decision
triggering a formal proceeding under continued judicial monitoring. Under
the Draft Directive, the involvement of a court is necessary only in case of
a petition for a partial or general stay of individual debt enforcement or in
case creditor dissent needs to be overridden by the majority rule or by cross-
class-cram-down which will often show only quite late in negotiations. The
result of an accepted plan is not a binding and directly enforceable judicial
decision but a mere contract binding affected parties-in-interest. Non-affect-
ected creditors and their claims remain outside the proceedings (with the
apparent and quite puzzling exception of a stay of individual enforcement),
and an accepted or confirmed plan. Consequently, existing Type B systems
(e.g., the English scheme of arrangement or the procedure leading to a Span-
ish acuerdo de refinanciación) and also the Draft Directive do not operate
an automatic freeze of proportions among creditors. For a limited number
of, say, financial creditors a concerted contractual temporary freeze (“stand-
still”) may sometimes be achievable. Otherwise the positive effect of such
a freeze for the negotiation dynamics is lost in Type B proceedings.

2. Inclusion of All Debt in Restructuring Versus Partial Restructuring

Type A proceedings generally involve all creditors in the restructuring pro-
cess and its decision-making mechanisms whereas the most developed mar-
ket conform systems (e.g., USA, U.K., and Germany) include equity hold-
ers (shareholders) as well. Involvement of all creditors is inevitable in pro-
cedings that may end in an involuntary liquidation where obviously all
debt needs to be taken into account. Involvement of all financiers, including
equity holders, allows for a complete overhaul of the debtor business’s fi-
nance structure. Another advantage of complete debt restructuring is that it
allows a clear-cut separation of pre-petition/opening and later restructured
debt from fresh debt incurred during proceedings and after plan confirma-
tion. This separation permits including in the restructuring trade debt from
past periods without losing the trading relationship (under the rules on ex-
ecutory contracts discussed below). Clear-cut separation is helpful also for
future participation of the debtor enterprise in financial markets, and it allows granting, in a transparent and plausible fashion, future priority to fresh money loans taken in the course of proceedings, or later under a confirmed plan. Involvement of all debt does not necessarily mean, as the Draft Directive appears to suggest, that complex “supply chains” will be interrupted and “ripple effect” insolvencies will likely ensue. Nor does it mean that all involved creditors will necessarily be affected by the restructuring and invited to vote on a plan. The debtor may choose to assume pending contracts on their existing terms on Day One, and a plan may provide that classes of creditors or equity holders will not be impaired and then be deemed to have accepted the plan without a vote.11

Existing Type B frameworks and the Draft Directive allow the debtor to limit its restructuring plan to certain categories of debt, for example, loans granted by financial institutions and/or arisen from bond issuances. Allowing such partial restructuring is intended to permit a maximum of confidentiality and speed of the restructuring process with generally savvy creditors, and to avoid disturbing existing business and trading relationships. Among existing Type B systems, only the U.K. scheme12 allows for technical inclusion of shareholders (of U.K. companies) in the restructuring process and its decision-making rules. The Draft Directive provides for such inclusion of shareholders as an option for Member States.13

Partial restructuring does not provide the aforementioned benefits of a Type A. If misused, partial restructuring may deplete, for the benefit of included (“affected”) creditors, the pool of assets or reduce future income streams available for non-included (non-“affected”) and future creditors in a subsequent insolvency.

3. Stay of Creditor Enforcement Action

In Type A proceedings, enforcement and debt collection by all creditors is stayed at the commencement of a case. In the USA, the stay is automatic at the moment of a debtor’s filing; in systems which require the showing of a trigger criterion (such as insolvency) and a formal opening decision, judges may, and usually will, order a stay for the interim between a filing and the opening decision.

11 11 U.S.C. §§ 1024, 1029(b); § 237(2) InsO.
12 Provided for in the Company Act and applicable only to “companies” – a quaint limitation for lawyers trained in the Roman law tradition.
13 Art. 12(2) of the Draft Directive.
Existing Type B preventive frameworks (e.g., the English scheme of arrangement as presently in force, the French conciliation and sauvegarde/sauvegarde accelerée or the Spanish acuerdo) do not provide for a stay. The Draft Directive, by contrast, provides for a stay of up to 12 months if the court or administrative body deems it necessary to support negotiations of a restructuring plan. The stay may be ordered against all classes of creditors except labor, including secured and priority creditors. The stay may be partial or include “all creditors”. As stated before, it is not clear whether only affected creditors (whose claims are to be restructured by the plan) or also non-affected creditors may be included in a stay; the latter appears to be the case from the language of the Draft Directive. If all creditors are included in the stay, EU Member States may require the appointment of a professional. The Draft Directive is silent, however, on whether not only the debtor but also creditors may petition for a general stay, for instance, in order to obtain appointment of a professional. In light of the spirit of the Draft Directive, the answer is likely to be negative.

As initiation of negotiations by the debtor within a Type B framework does not accelerate its debt contractual maturities remain in place. One can hardly imagine a situation in which all liabilities mature on the same date. Thus, under liquidity aspects, there will hardly ever be a need for “a general stay covering all creditors”. Usually, the debtor’s interests are served fully by a stay of those claims or security interests that are, or will, mature and are, or could be, adjudicated and enforced during the Type B process (i.e., at most during 12 months). A selective stay only against a creditor with a mature and immediately enforceable (e.g., a finally adjudicated claim) will, so one should think, always cause such a claim to be “substantially worse off … than if the stay was not granted”. But quite obviously, under the Draft Directive, the selective stay is intended to stop precisely such creditors.

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14 Art. 6 of the Draft Directive has all details on the scope and effects of a stay.
15 Art. 5(3)(a) of the Draft Directive. The other situation where such appointment may be required is when the plan needs to be confirmed by an inter-class-cram-down against one or several creditor or (as the case may be) shareholder classes, Art. 5(3)(b) of the Draft Directive. This is a rather puzzling provision since the need for inter-class-cram-down will usually show only after lengthy discussions. Its chief function, therefore, will be deterring creditor classes from dissent by a threat of extra costs for a professional and added delay.
16 Cf. “whereas” clause n° 22 of the Draft Directive where this language is used to explain when a creditor is “prejudiced unfairly”.

https://doi.org/10.5771/9783845287256-71

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If, pending discussions of a preventive restructuring plan, the debtor becomes insolvent, an existing duty of the debtor to file for insolvency shall be, or may be, suspended for the duration of any stay (even a stay ordered only against one individual creditor) who might be a friend of the debtor.\(^{17}\)

A general stay shall bar, in addition, the opening of Type A proceedings upon a creditor petition.\(^{18}\) Perhaps this will be the main motive for debtors to request a general stay although a professional may then be appointed. For other purposes, a general stay is not needed against creditors whose claims are not mature; and debtors will usually not be interested in seeing a professional appointed and involved in their business affairs. For purposes of due process of the law, it is quite doubtful whether a discretionary general stay order should have such far-reaching impact on creditors’ rights.

Another unusual effect of a stay under the Draft Directive, which is unrelated to the classical function of barring debt enforcement by creditors, is preventing the modification (e.g., acceleration or termination) of contracts; we shall discuss this below in the context of “executory contracts”.

For an out-of-court process initiated by the debtor without any proof of imminent insolvency and without mandatory professional monitoring, the maximum duration of a stay (\textit{i.e.}, 12 months) is far too long. If negotiations eventually fail, the “stayed” creditors are not compensated adequately if debt enforcement is unsuccessful or if insolvency is later declared. The provisions of the Draft Directive, especially on discretionary partial stays of creditor action outside formal proceedings, leave wide room for strategic maneuvering (moral hazard) for debtors and for friendly or related creditors wishing to delay formal proceedings, escape from equal treatment of creditors by preferences for some, and avoid professional monitoring. Should they be enacted, constitutional challenges are likely and promising, for example, in Germany.

4. Classification of Claims, Requisite Majorities, Avoiding Gerrymandering (Engineering Majorities)

a) Classification of Claims

In Type A proceedings, in order not to add up apples and oranges for voting, it is best practice to allow forming separate voting classes for parties-in-

\(^{17}\) Art. 7(1) and (3) of the Draft Directive.

\(^{18}\) Art. 7(2) of the Draft Directive.
interest with diverse but *substantially similar interests*. For members of a class it is best practice to require equal treatment based on the amounts of claims. Generally, separate classification of secured and unsecured creditors is mandatory, and many systems require separate classification of creditors with priorities – or subordination – in liquidation.\textsuperscript{19} Secured creditor status in this context is not based, in good practice, on the formal existence of a security interest but on a valuation of the collateral and the measure of recovery provided by it in a hypothetical bankruptcy liquidation (its liquidation value). Thus, for example, a mortgagee’s claim will often be a “secured claim” only in part and, for the remainder, an unsecured claim.

Regarding claims with equal liquidation rank (priority), some systems (e.g., the U.S. and German systems) allow for separate classification of *pari passu* creditors with typically diverse real life interests, such as liquidity preferences, for example, of tort creditors or labor as against trade creditors or financiers, or owners of liquid versus contingent claims (e.g., arising from future physical harm).\textsuperscript{20} The rationale for such classification is to best approximate Pareto optimality in negotiations and thus secure maximum acceptance of a plan by claimants.

Some Type B systems apply analogous classification rules, based on secured versus unsecured status and on liquidation priorities (e.g., the English scheme of arrangement), but only for voting. The Draft Directive proposes

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\textsuperscript{19} This is the case for systems that are based on “absolute priority”. Obviously, numerous priorities may complicate negotiations and voting considerably. Jurisdictions like Germany (since 1999) which abolished priorities for pre-insolvency claims avoid this complication. Unfortunately, the Draft Directive does not even address priorities, one of the causes why future preventive frameworks of EU Member States will not be functionally equivalent. The complications caused by traditional “cascading” priorities (the lexical ordering of classes of claims), would be avoided by expressing the perceived different social worthiness of entitlements by “weighted multipliers” which would allow for grouping pre-insolvency unsecured claims of all claimants in a single class; cf. Balz, Simplifying Bankruptcy, in: Basedow/Drobnyg/Ellger/Hopt/Kötz/Kulms/Mestmäcker (eds.), Aufbruch nach Europa, 75 Jahre Max-Planck-Institut für Privatrecht, 2001, pp. 317, 330-336.

\textsuperscript{20} Such systems require, in addition to absolute priority, non-discrimination among different pari passu classes in terms of the net present value of the different technical treatment they receive; cf. § 245(1)(3) InsO.
a similar system,21 but with effects not only for voting but additionally for enforcing absolute priority against dissenting classes by cross-class-cram-down. This function of classification is not self-evident for a Type B scheme, because secured, priority and subordinate claims are liabilities all alike on a distressed but solvent entity’s balance sheet, they must all be paid upon maturity, and liquidation is not the inevitable only alternative to restructuring. Rather than exclusively applying hypothetical liquidation rank (priority) for claims, the relative likelihood of timely full payment (i.e., maturity and rights of acceleration, the existence of judgment claims, initiated enforcement etc.) and typically varying liquidity preferences should be considered for the formation of voting classes. The natural interest of self-organizing creditor groups in confidential out-of-court negotiations will often lead to respecting such differences in the formation of negotiating and voting groups. Such flexible classification is, however, obviously not suited as a basis for cross-class-cram-down in a Type B framework as will be explained in more detail below.

Regarding the valuation of collateral, the market value at the maturity date should be used instead of liquidation value (see, for example, the Spanish acuerdo).

b) Requisite Majorities

Majority rule in collective proceedings to break the veto of “holdout” claimants is not based on an analogy to political democracy (“one man – one vote”) but on the presumption that majority consent based on claimants’ relative financial stakes in a restructuring decision expresses economic reason. In Type A proceedings with elaborate substantive standards for fair treatment and with substantial judicial scrutiny, majority thresholds may be

21 The Draft Directive allows separate classification of labor law claims irrespective of any priority status; thus, it indirectly recognizes that pari passu claims may be classified separately. It is not clear why earned employee claims should be classified at all because they are not subject to a stay and must be paid as they mature (i.e., usually on a weekly or monthly basis), see Art. 6(3) of the Draft Directive. In practice, therefore, outstanding employee claims will at most be minimally affected at the plan confirmation stage. Formation of a separate employee class which will usually consent to any rescue plan then has the only function of allowing plan confirmation against dissenting classes by cross-class-cram-down.
low.\textsuperscript{22} In Type B systems with little or no judicial control they must be higher. For the English scheme of arrangement, they are 75 percent by amount, and the Draft Directive rightly permits such a super-majority requirement.

Certain modern Type A laws, like the U.S. and German laws, require a \textit{per capita} majority of creditors (by “number”) – in addition to the majority by amounts. This may sometimes complicate restructurings and also give small creditors some leverage to negotiate for benefits or for the status as a non-impaired class. Existing Type B frameworks, except the English scheme,\textsuperscript{23} appear to be satisfied with majorities by amount only, and the Draft Directive follows this path. The \textit{per capita} requirement should not be seen as a sprinkling of political democracy in the restructuring process. Its function is to curb (to some extent) distortions of decision making through strategic trades in distressed debt in the advent of financial crisis and during negotiations, \textit{e.g.}, for purposes of control (“loan to own”) or for refusing restructurings in order to drive a competitor into bankruptcy and eventually out of business. Under this aspect, the \textit{per capita} vote requirement may be yet more useful in Type B frameworks where there are fewer possibilities to monitor and curb strategic (non-monetary) behavior by creditors than in court-controlled Type A proceedings. The risk of complicating negotiations will generally be controlled in Type B frameworks by treating small creditors as unaffected, and not involving them in the negotiations. Very rarely will they be financial creditors.

c) Engineering Majorities

Classification, especially when it is based on “real-life” diversity of interests, can be misused for fabricating “false” majorities both in Type A and Type B procedures. The propriety of classification and the “good faith” of the plan proponent must be subject to some measure of judicial/official review for the latest at the plan confirmation/homologation stage, either \textit{ex officio} or upon motion by an affected party-in-interest. Requiring a \textit{per capita} majority is helpful for preventing misuses of classification.

\textsuperscript{22} 1/2 plus one vote both in amounts and by creditor numbers/heads (per capita count) in Germany (cf. § 244 InsO); 2/3 by amounts and 1/2 plus one vote by numbers in the USA (cf. 11 U.S.C. § 1124(c)).

\textsuperscript{23} Sec. 899 (1) Company Act 2006 (50+ percent of creditors by number).
5. Minimum Standard for Dissenting Individuals: Best-Interest Test

In Type A proceedings of the past (composition/arrangement), judicial confirmation typically hinged on whether the judge felt a restructuring plan to be in the “common interest of creditors”. Modern reorganization proceedings like in the USA and Germany are not concerned with consenting claimants and do not require that consenting parties fare better than without the plan; they apply the so-called “best-interest test” only to dissenting individuals. Because involuntary liquidation is always looming in Type A proceedings, the best-interest test is understood as guaranteeing dissenting parties the liquidation value of their entitlements.

For Type B frameworks, the Draft Directive borrows this principle from Type A by providing\(^{24}\) that no dissenting creditor shall be worse off than in bankruptcy liquidation.\(^{25}\) This is not convincing both in principle and for practical reasons. By definition, a failing preventive restructuring attempt by a solvent debtor leads by no means automatically to liquidation of its business. Other than returning to square zero, the debtor may find other roads to rescue outside insolvency, for example, a sale of the company or its assets on the market, a merger or a capital increase. It is not logical in this situation to use liquidation as a foil for minority protection, and it is not economically efficient because it scares creditors into consent to a plan. In practical terms, determining the liquidation value of a claim under the Draft Directive can merely be guesswork because, on the liabilities side, (i) the relative amounts of claims (proportions) are not frozen by a formal opening decision like in Type A proceedings and, thus, vary over time due to differing maturities, interest rates, and currencies, because (ii) affected claims may be specious and are not formally validated/verified by a trustee or by the court, and because (iii), in the likely partial restructurings, claims of non-affected creditors are not even known with any degree of certainty. On the asset side, where no estate is formed and inventoried and where possible avoidance actions, fraud, and directors’ or shareholders’ liabilities are not investigated, determining the liquidation value of debtor’s assets would be burdened with undue uncertainty and costs, and cause significant delay.

In existing Type B frameworks (e.g., of the U.K., France, and Spain), we do not find the best-interest test. In order to secure some minimum protec-


\(^{25}\) Strangely, in the wording of the Draft Directive, this principle is not extended to shareholders.
tion for creditors, some systems limit the scope of restructuring to, for example, a maximum of $x$ percent debt forgiveness, or a maximum extension of maturities by $y$ months, with $x$ and $y$ sometimes being a function of the majority consent level (50+, 66+, or 75%) achieved by willing creditors. Such obviously arbitrary limits to the scope of negotiations are dysfunctional insofar as they exclude restructurings which would be efficient, i.e., in the common interest of reasonable creditors and the debtor alike. The time-proven English scheme of arrangement relies exclusively on supermajority (75%) votes by amounts and a majority by number of creditors viz. shareholders in each class and, thus, avoids both the complexity of a “best-interest test” and the inefficiency of arbitrary restructuring boundaries.

6. Cram-Down Against Dissenting Classes: Absolute Priority

The principle of absolute priority is linked inextricably with the idea of a “cross-class-cram-down”. Such cram-down is tantamount to the enforcement of absolute priority against dissenting classes. Some modern market conform Type A insolvency systems, such as the U.S. or the German systems, apply absolute priority. The notion is that, absent consent by all impaired classes to the contrary, the relative rank (priority) of claims that would be applicable in liquidation should also be applied in reorganization. In other words, the “reorganization pie” should be distributed among claimants in the same proportions as the alternative “liquidation pie”. The economic rationale for absolute priority is that parties-in-interest should choose under identical distribution rules (i.e., with maximum market conformity) between liquidation and reorganization. This choice (i.e., every financier’s individual unfettered investment decision either to disinvest or reinvest its financial stake in the debtor’s business) should not be slanted towards rescue for hoped-for positive externalities such as social or macro-economic effects. This explains why absolute priority is generally not in favor, even for Type A proceedings, for instance, with France and some Southern European EU Member States where the protection of existing employment and a slow-down of structural economic change are traditionally felt to be socially desirable.

The U.S. and German systems, by contrast, apply absolute priority to secured as well as to all classes of unsecured claims, whether they be priority (privileged), ordinary, or subordinate, and also to equity (shareholders). Dissent by a creditor or shareholder class may only be disregarded if such
class is treated “fairly and equitably” and receives a fair share of the reorganization “bonus”. In its essence, under absolute priority, this standard means that a class’ dissent may only be overruled by a plan accepted by other classes if no senior class receives more value than 100 percent of its allowed claims, and no junior class receives any value at all. In actual insolvency, creditors thus have a right, in principle, to “wipe out” equity.

This right is mitigated in practice by two factors: (1) Both the U.S. and the German systems grant the non-insolvent debtor a head start of several months for a plan proposal. Only thereafter creditors (U.S.) or the trustee (Germany) may propose a competing plan, always causing some costly delay; debtors will generally not propose the wiping-out of equity. (2) In closely-held companies, especially when able management holds equity, it is often in the interest of creditors not to eliminate shareholders.

If absolute priority is assured, a plan accepted by at least one (U.S.), or several, or by a majority (Germany) of, impaired class(es) may be “crammed-down” upon, and confirmed against the dissent of, one or several impaired dissenting classes.

The Draft Directive requires a plan to comply with both the best-interest test and with the absolute priority rule for judicial or administrative confirmation,\(^{26}\) translating the U.S. and German principles into the pre-insolvency stage. Consequently, it mandates the introduction of a cross-class-cram-down against one or more dissenting classes if at least one affected class of creditors accepted the plan which would receive a payment or other consideration in case of a liquidation.\(^{27}\) Member States may require a larger minimum number of acceptances by classes. The Draft Directive requires a costly and time-consuming – and yet necessarily dubious – enterprise valuation at bankruptcy liquidation values.

It is highly doubtful whether these provisions are appropriate. They cause the same logical and practical concerns as the application of the best-interest test. In case of a solvent debtor, the bankruptcy liquidation hypothesis is obviously not a necessary and convincing assumption. Where involuntary

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\(^{26}\) Art. 10(2) of the Draft Directive and Art. 11(1) of the Draft Directive.

\(^{27}\) Art. 11(1)(b) of the Draft Directive. As was seen in the context of the best-interest test, this latter condition may require a number of complex guesses about the true (contested or uncontested) volume of all other claims at the uncertain time of a hypothetical bankruptcy liquidation and the likely assets, including inflows from avoidance and liability actions that would be available at an uncertain future date minus the extra cost of auctions, etc. If labor claims form a special class, often with priority status, they will usually most easily fulfill the minimum acceptance condition of the Draft Directive.
liquidation is not an imminent risk for debtors, it does not seem right to enforce the liquidation type distribution order in informal restructurings. It, moreover, appears unfair and inappropriate to allocate the entire reorganization “bonus” achieved by restructuring merely to participating (“affected”) parties-in-interest in cases where only a sub-set of creditors participates in the restructuring. It is submitted, therefore, that absolute priority and cross-class-cram-down are not suitable for Type B proceedings and do not warrant the cost and delay for determining (in necessary vague fashion) the liquidation value of a debtor business and the – yet more complex – liquidation value of a consenting class’ claims. The experience with the U.K. scheme of arrangement shows that outside actual, or manifestly imminent, insolvency, the proper basis for Type B schemes is a bare supermajority vote in each affected class without substantive checks and limits on the content of a plan other than manifest misuse in “bad faith”.

7. Treatment of Equity/Shareholders and Subordinate Claims

a) Equity/Shareholders

In Type A proceedings which apply the absolute priority rule (e.g., USA and Germany), shareholders are involved in the insolvency process and decision-making mechanisms (i.e., classification, voting, and eventual cram-down). Unless creditors opt otherwise, equity will be wiped out. Inter alia, a complete debt-for-equity swap may be enforced against shareholders.

In Type B proceedings, this effect of absolute priority can rarely come into play because only the debtor, its management as controlled by shareholders, and/or a supervisory body, may initiate proceedings and end them at will, without immediate insolvency looming. In special situations, a debtor filing might be used (or rather misused) to reorganize the governance of the company to the detriment of a minority shareholder.28 The Draft Directive which espouses absolute priority in principle is inconsistent in its treatment of equity. It offers both full absolute priority with the complete procedural involvement of shareholders in the restructuring process,29 and

28 Germany has seen a case (in re Suhrkamp) where management controlled by shareholder A triggered imminent insolvency based, inter alia, on accelerating shareholder loans, for an “umbrella” proceeding, in order to change the company structure and to eliminate pre-existing special governance rights of shareholder B.
29 Art. 12(2) of the Draft Directive.
a mere – conditional and quite vague – obligation for equity holders not unreasonably to obstruct a promising plan,\(^\text{30}\) a duty to be enforced outside the restructuring process under applicable adjustments of the domestic company laws. The latter approach is found in some existing Type B proceedings, for example, the Spanish *acuerdo de refinanciación*. Obviously, it would be unrealistic to hope to motivate debtors to initiate early preventive negotiations with creditors if controlling shareholders were at a practical risk of losing their shareholdings. The framework created by the Draft Directive will function, despite the invocation of absolute priority, essentially as a debtor protective mere deleveraging tool for enterprises without major changes of ownership, control, and corporate structure.

Under the constitutional laws of some EU Member States, the membership rights of shareholders in a non-insolvent corporation are treated as property rights, irrespective of their present financial value. This will be a bar to applying absolute priority in its full, and practically and politically crucial, meaning – against equity – outside Type A proceedings. Moreover, the Second EU Directive on company law (2012/30/EU) on capital measures and the competence of the shareholders’ general meeting (and likewise the Third Directive on mergers) have so far been read by Member States and the European Court of Justice as applying without exemptions to non-insolvent companies. The Draft Directive wishes to exempt in future such Type B proceedings from the prior Directives which implement class voting for shareholders under Art. 12(2). It is assumed that this will cause, on the national and on the EU levels, both constitutional and EU institutional litigation.

b) Subordination

Contractual, statutory, and – in some systems like the U.S. system – judicial (“equitable”) subordination (e.g., of certain claims of shareholders or other related parties/insiders) is usually enforced in Type A proceedings based on absolute priority.\(^\text{31}\) Unless impaired senior classes (who take a loss) choose otherwise, subordinate debt is usually “wiped out”.

\(^{30}\) Art. 12(1) of the Draft Directive.

In Type B proceedings, a similar treatment of subordination is not self-evident. Extending subordination (a negative “priority”) into the solvent life of a debtor is as problematic as enforcing positive priorities via cross-class-cram-down, and particularly so if absolute priority is not applied against equity/shareholders.

The Spanish Type B scheme (*acuerdo de refinanciación*), following the rules on *convenio* in Spanish Insolvency Law, does not apply absolute priority, including to shareholders. It accords subordinate claims the same restructuring treatment as ordinary unsecured claims but with the proviso that they may only be paid and enforced after restructured ordinary claims.

8. Treatment of Secured Creditors

In modern Type A proceedings:

- Secured creditors are included in the stay.
- The stay may be lifted, if, for example, the collateral is inconsequential for the continuation of the business and the implementation of a plan or the legitimate interests of the creditor prevail.
- Creditors are entitled to “adequate protection”, for example, against wear and tear of collateral and, where applicable, for the costs of insurance and maintenance, for instance, in cash or by an exchange of collateral.32
- The secured portion of a nominally “secured” claim is based on a valuation of the collateral under the premise of hypothetical liquidation (“liquidation value”); more sophisticated U.S. rules allow for valuation in light of each proposed plan (which will often lead to going-concern valuation of collateral).
- “Over-secured” creditors with an “equity cushion”, *i.e.*, where the value of collateral exceeds the amount of the claim, receive post-petition interest up to the excess value for the time of the stay.
- German law33 additionally provides for regular cash payments of contractual interest on the secured portion of all claims, starting three months after the beginning of the stay on enforcement, no matter whether the stay was ordered as a provisional measure in the opening or “umbrella” stage or followed from the opening decision. This is a

32 The U.S. Bankruptcy Code has the most sophisticated rules, see 11 U.S.C. §§ 361, § 363(e).
33 § 169 InsO.
very efficient means for avoiding delay by debtors (“playing with their creditors’ money”) and a strong incentive for debtors to review continuously the necessity of the stay, and to de-freeze collateral whenever possible.

Inasmuch as the Draft Directive provides in Art. 6 for a stay in Type B proceedings, up to four months will be the rule without consideration of the creditors’ interest and without guarantees of adequate protection. An extension of the stay may be granted up to a total of 12 months, if negotiations have made “relevant progress” and the extended stay does “not unfairly prejudice” affected parties. Otherwise, or when it becomes apparent that a sufficient portion of creditors who could block plan acceptance wishes to break off negotiations, the stay expires after four months \textit{viz.} may be lifted. Generally, the Draft does not “price delay”, and it invites debtors instead to play with creditors’ money and to enjoy a cost-free breathing spell for up to 12 months without a tangible risk of liquidation. When a plan eventually fails and is not confirmed, there is no compensation for the possible loss of creditors.

As was explained, the Draft Directive does not say how the secured portion of a claim should be determined for voting and value distribution among creditors. In a Type B proceeding, where liquidation is not an imminent threat, applying liquidation value is not appropriate. Nor is liquidation value appropriate as minimum protection for dissenting secured creditors under the best-interest-test.

9. Executory Contracts, Early Termination/Curing of Default, \textit{Ipso-Facto} Clauses

a) Executory Contracts

In modern Type A systems (\textit{e.g.}, USA and Germany), the debtor-in-possession, or, as the case may be, the trustee may reject or assume “executory contracts”. This term denotes pending contracts where both parties have not yet fully executed their respective obligations. If a contract is assumed, the debtor’s estate will have to pay the other party’s consideration in full as an administrative expense. If the contract is rejected, the estate gets rid of a burdensome obligation, and the counterclaim of the other party for damages is an ordinary unsecured and non-priority claim. This time-honored principle is essential both for protecting the estate for liquidation and for restoring the financial health of debtors in reorganization.
Existing Type B systems and the Draft Directive do not provide the debtor who enters into restructuring discussions with the right to reject burdensome contracts, and rightly so. Such interference with contractual property rights, if permitted in an informal, out-of-court and pre-insolvency framework, would appear to be a violation of the EU Charter of fundamental rights, and of the constitutions of most EU Member States.

b) Early Termination/Curing of Default

Some Type A proceedings (e.g., the U.S. system) provide that the commencement of a case cures past default of the debtor and invalidates cancellation or acceleration rights of the other party. In case of utility services (e.g., electricity, telecommunications), continued service to the debtor is mandatory, even if the supply contract was validly terminated before; fresh services must then be paid on a regular basis, and enjoy “administrative priority”.

The Draft Directive attempts to produce similar effects for Type B proceedings. The absence of a formal opening decision creates extra complexity. The separation of “old” from “fresh” tranches of debt is based on the dates of each relevant order of a stay against any creditor. This use of the concept of stay is dysfunctional, outside its classical function of barring debt enforcement.

This raises several questions:

- Debtors may grant a preference to supplier A by ordering the stay against it earlier than against B; then the relative proportions of stayed “old” and privileged “new” debt vary for A and B. A receives guaranteed (priority) regular full payment earlier than B. Should the stay be denied against B for “unfair prejudice”? B would then not obtain priority status at all even for future tranches of trade debt. Or should the stay against A be lifted? Will we see a race of diligence among creditors asking the debtor to request an early stay?

- Interest accrual is not barred at the beginning of negotiations. How is interest on “old” tranches of debt treated? Should it be paid post-stay on a regular basis? Or should it be stayed also? If so, should post-stay interest on “old” portions of debt be a subordinate claim?

- Should the stay have retroactive effect, if a supplier validly terminated its contract pre-stay, and re-instate the debtor to the status quo ante?

34 Art. 7(4) of the Draft Directive.
• Should fresh debt tranches be paid before plan confirmation? Or would they have administrative priority in a subsequent Type A insolvency proceedings (one occurring any time – or within x years)? How if negotiations end without a confirmed plan?

c) *Ipso-Facto* Clauses

In Type A proceedings, it is best practice to invalidate “*ipso-facto clauses*” which lead to the acceleration or termination of a contract when the debtor files a petition for insolvency. The Draft Directive extends this principle to Type B proceedings, no matter whether the other party is an “affected” creditor. This appears inevitable for rescues within a Type B framework but constitutes another problematic inroad on the freedom and sanctity of contracts.

10. Fresh Money Financing (Interim and New Financing)

a) Interim Financing/DIP Finance

In Type A proceedings, the debtor-in-possession or the trustee may obtain fresh unsecured and, if collateral is (or is judicially made) available, secured credit to cover operating costs in the ordinary course of business during proceedings. If proceedings end in liquidation, claims from interim loans have administrative priority and must be paid before all ordinary unsecured creditors. In reorganization, administrative expense claims must generally be paid no later than on the effective date of the plan. Thus, priority status generally helps debtors in insolvency to obtain working capital and to bridge the restructuring phase.

However, creating new liabilities with super-priority risks harming existing creditors unless “fresh money” creates value in at least identical amount. Therefore, in the USA, fresh money loans outside the ordinary course of business require court approval after “notice and a hearing” of creditors. In Germany, the trustee will usually involve the creditors’ committee (*Gläubigerausschuss*) in order to avoid personal liability to creditors.

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35 The most elaborate and efficient rules on “fresh money”/DIP financing are in the U.S. Bankruptcy Code, see 11 U.S.C. § 364.
In the opening “umbrella” stage of formal proceedings under German law, a debtor-in-possession may create administrative expenses with priority for fresh money only with the approval of the court for each loan.\textsuperscript{36}

Existing preventive frameworks, such as the English scheme of arrangement, do not deal with the status of fresh money in a future insolvency proceeding. Sometimes creditors define such status among themselves and with a fresh lender in an inter-creditor agreement which is obviously not binding on other, especially future, creditors.

The Draft Directive allows EU Member States to create an administrative super-priority for \textit{interim financing}\textsuperscript{37} in any “subsequent liquidation”\textsuperscript{38} over “creditors that would otherwise have superior or equal claims”. If a Member State introduces such a priority, fresh money loans must be ranked at least senior to ordinary unsecured claims. The Draft Directive does not provide for prior analysis of the economic sense of such borrowing by the court or by an independent expert, not even for approval by a body of affected creditors. This exposes affected, unaffected and future (post-confirmation) creditors to substantial risk, and the debtor to serious moral hazard.

The Draft Directive gives rise to a number of questions, for example:

- Why does a solvent debtor who pays all its debts as they mature need a special priority for fresh money loans in the ordinary course of business?
- Why can we not rely in informal proceedings on interested affected creditors making inter-creditor agreements on ranking with a lender of fresh money?
- Why should non-affected and non-participating creditors suffer from expenses for an abortive restructuring attempt in a later liquidation?
- Why should fresh creditors whose claims arose post-confirmation of a plan which later fails suffer from priority expenses caused in the abortive preventive restructuring?
- What is meant by “subsequent” liquidation? Should this mean liquidation which occurs any time after a proposed plan is not accepted? Or a liquidation that follows a confirmed plan which does not prevent insolvency any time later? Should there be time barriers? Should it matter

\begin{itemize}
\item \textsuperscript{36} § 270b(3) InsO. The priority is, moreover, only applicable if the “umbrella” stage (the opening stage of formal insolvency) leads directly to the opening of a formal proceeding which involves all creditors. It is not applicable, if the debtor withdraws its petition and thus ends the umbrella stage without approval of a plan, and if later formal proceedings are opened following a fresh petition.
\item \textsuperscript{37} Defined in Art. 2(12) of the Draft Directive.
\item \textsuperscript{38} Art. 16(2) of the Draft Directive.
\end{itemize}

https://doi.org/10.5771/9783845287256-71

Generiert durch IP '54.70.40.11', am 18.07.2021, 10:43:18.

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whether the disclosed causes (as against new causes) of financial distress lead to later insolvency?

- Why should priority be applicable only in liquidation and not also in a later Type A reorganization? Why not in a subsequent (repeated) Type B preventive restructuring attempt?
- How should a priority carry-forward from the earlier preventive restructuring be ranked in relation to administrative expenses in a subsequent Type A proceeding? How in relation to interim and new money financing in a subsequent Type B preventive restructuring?

Granting a priority for fresh money loans granted in a Type B restructuring for future Type A proceedings goes beyond good practice and violates the almost world-wide principle that bankruptcy priorities cannot be created by contract at the expense of unwilling future parties.

b) New Financing

The German Type A insolvency law\(^{39}\) allows to authorize the reorganized debtor to create new post-confirmation debt or to let priority interim finance survive into the post-confirmation stage (i) if formal supervision of plan execution (and continued jurisdiction of the insolvency court) is provided for in the plan, which is possible for no more than three years, and if (ii) the plan provides for a post-confirmation special credit facility of a certain amount.

The maximum volume of such facility is controlled by the judge. During plan supervision, the trustee and a creditors' committee continue to monitor the reorganized debtors’ financial behavior as before, and it is for the trustee to contract with third parties.

In a fresh Type A proceeding opened during the period of supervised plan execution,

- creditors who participated in the first proceedings, and are included in the confirmed plan, but also
- new creditors who contracted voluntarily, within the planned credit facility, with the trustee during the period of supervision (but not creditors with tort claims or other statutory claims such as tax claims)

will be subordinated to grantors of new financing within the defined credit facility. If this harms creditors (new and old alike), the trustee is, in principle, personally liable. This – quite unusual and rarely used – set of rules

\(^{39}\) Cf. §§ 260-268, in particular §§ 264-266 InsO.
obviously complicates a subsequent Type A proceeding, for example, regarding classification.

Can this be translated to a Plan B framework? Without formal publicity of the financing facility, (e.g., in a commercial register), judicial and/or trustee supervision, involvement of all pre-confirmation creditors, and precise limits on the volume and duration of priority for new financing the German system is not a suitable model for Type B frameworks.

In its Art. 16, the Draft Directive provides for none of these checks. However, a fresh money priority surviving the failure of a restructuring attempt should, at most, have effect against creditors in a later Type A proceeding (reorganization or liquidation) who were involved in the making of a confirmed plan which did not avoid formal insolvency for a defined period (of, say, a maximum of three years). If, as will be the rule, the uncompleted or failed Type B proceeding affected a subset of creditors, we shall see relative priorities in a subsequent Type A unduly complicating negotiations, classification and voting on a reorganization or liquidating plan.

11. Immunity of a Plan Against Avoidance and as Basis for Liability

Following Type A proceedings, the content of a confirmed plan and the decisions taken by the competent bodies and persons during proceedings cannot be challenged outside, or in, a later Type B proceeding. With the exception of trustees and members of creditors’ committees, individuals involved in insolvency related procedural decisions are generally not liable for the court confirmed outcome of Type A proceedings.

In Type B proceedings without continuous court supervision and the possible complete non-involvement of a professional, granting immunity from avoidance and liability can harm non-participating and future creditors. To limit such possible harm, the Spanish legislature (acuerdo de refinanciación) considered a set of restructuring “quality indicators” for immunizing plans against later avoidance actions, i.e., an improved asset/liability ratio, the presence of post-restructuring assets at least equal to existing liabilities, maximum encumbrance of collateral pledged to affected creditors of no more value than 90 percent of restructured debt, an upper limit to the interest rate for restructured debt of no more than 1/3 above the rate for pre-restructuring debt. While such criteria may help limit moral hazard, they are evidently arbitrary and inefficient from an economic perspective.

The Draft Directive grants unconditional and unlimited protection from avoidance or cancellation to confirmed plans and measures connected with...
negotiations unless fraud or bad faith can be shown, with special mention of “reasonable” costs and fees for professionals.\textsuperscript{40} For measures outside the ordinary course of business, EU Member States may require prior approval of such measures by a professional or by the judge.

12. International Jurisdiction and Recognition

The Draft Directive is silent on the international aspects of Type B proceedings. However, Regulation (EU) 2015/848 on Insolvency Proceedings, as recast in 2015, includes in its Annex A two Type B proceedings, namely, the French \textit{Sauvegarde financière accélérée} and the Spanish \textit{Homologación de acuerdos de refinanciación}. The U.K. moved to exclude the scheme of arrangement from Annex A, in order to uphold opportunistically the very broad and extravagant English jurisdiction for such schemes not based on COMI in the U.K.

If the Draft Directive were adopted and implemented one would expect that

1. the Insolvency Regulation will, in future, be recast so as to apply to all Member States’ Type B proceedings, regarding jurisdiction based on COMI and mutual recognition of confirmed\textsuperscript{41} plans, and
2. the English Type B scheme will not, and should not, be recognized (before or post Brexit) in EU Member States unless English jurisdiction was based on COMI.\textsuperscript{42}

It warrants discussion, however, if the Regulation needs to be applied with all its chapters to Type B proceedings, including the automatic opening of secondary proceedings and the mandatory coordination within groups of companies. For Type B proceedings, arguably only chapters 1 and 2 of the Regulation (on recognition and on applicable law) should be mandatory,

\textsuperscript{40} Art. 17 of the Draft Directive.
\textsuperscript{42} U.S. courts recognize the English scheme, if based on U.K. COMI, as a “foreign proceeding” for purposes of chapter 15 (implementing the UNCITRAL Model Law on cross-border insolvency). I am grateful to Professor \textit{Horst Eidenmüller}, Oxford University, for this information.
and such proceedings should be included in a new Annex C to the Regulation which would then render the Regulation applicable to preventive restructuring frameworks only with limited scope.