BRIEFING

EU Legislation in Progress

New EU insolvency rules give troubled businesses a chance to start anew

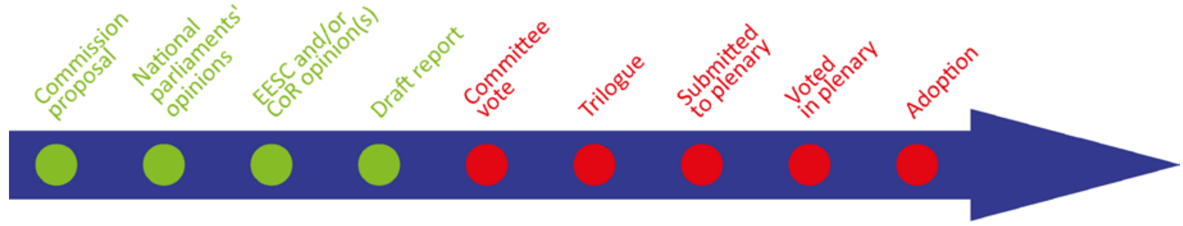
OVERVIEW

In 2012, the Commission proposed to recast the 2000 Insolvency Regulation in order to address the cross-border aspects of insolvency in the EU. Adopted in 2015, the recast regulation introduced clear rules on the jurisdiction and law applicable to a debtor's insolvency proceedings and made mandatory the recognition of those proceedings in other EU Member States. Its remit was expanded to include not only bankruptcy but also hybrid and pre-insolvency proceedings, as well as debt discharges and debt adjustments for natural persons (consumers and sole traders).

In late 2016, as a further step and a follow up to the Insolvency Recommendation of 2014, the Commission proposed to adopt a directive on business restructuring, which would provide new legal tools to rescue viable businesses in distress and give honest but bankrupt entrepreneurs a second chance. The proposal focuses on three key elements: common principles on early restructuring tools, which would help companies to continue operating and preserve jobs; rules to allow entrepreneurs to benefit from a second chance through a discharge of debt; and targeted measures allowing Member States to increase the efficiency of insolvency, restructuring and discharge procedures. The initiative is a key deliverable under the capital markets union action plan. It will also contribute substantially to addressing the high levels of non-performing loans in banks' balance sheets. The draft report was presented to the Parliament's Committee on Legal Affairs (JURI) in September 2017. In May 2018 the Council reached agreement on part of the proposal.

Proposal for a directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU

Committee responsible:	Legal Affairs (JURI)	COM(2016) 723 22.11.2016
Rapporteur:	Angelika Niebler (EPP, Germany)	2016/0359(COD)
Shadow rapporteurs:	Sergio Gaetano Cofferati (S&D, Italy); Kosma Złotowski (ECR, Poland); António Marinho E Pinto (ALDE, Portugal); Jiří Maštálka (GUE/NGL, Czech Republic); Joëlle Bergeron (EFDD, France)	Ordinary legislative procedure (COD) (Parliament and Council on equal footing – formerly 'co-decision')
Next steps expected:	Vote in committee on the draft report	



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Introduction

Insolvency rules involve a wide variety of measures, ranging from early intervention before a company finds itself in serious difficulty, to restructuring, aimed at saving vital economic parts, to liquidation of assets, where a company cannot otherwise be saved. A well-functioning insolvency framework covering all these measures is an essential part of a good business environment. It supports commerce and investment, helps to create and preserve jobs and facilitates absorption of economic shocks that may increase the level of non-performing loans and unemployment.

The cross-border features of insolvency have grown increasingly in number in recent years. In an ever-expanding and interconnected single market, many companies have cross-border interests when it comes to their clients, supply chains, scope of activity, and investor and capital base. According to the impact assessment accompanying the Insolvency Recommendation of 2014 (see 'Preparation of the proposal'), about 25 % of bankruptcies in the EU involve creditors and debtors in more than one Member State, while more than a million SMEs in Europe are active abroad. Insolvency rules also influence cross-border expansion and investment: for instance, the variety of national insolvency laws makes it difficult for investors to assess credit risks for cross-border transactions. In addition, insolvency proceedings in a cross-border context are often inefficient, complex and expensive, especially for SMEs. Therefore, a higher degree of harmonisation in insolvency law is essential for a well-functioning single market and capital markets union.

The first common framework for cross-border insolvency proceedings in the EU was set out by the Council in 2000, and was subsequentlly updated and streamlined in 2015 (see 'Existing situation'). The new rules shifted the focus away from liquidation and now cover not only bankruptcy proceedings but also hybrid and pre-insolvency proceedings, as well as debt discharges and debt adjustments for natural persons (consumers and sole traders). As a further step in this direction, in November 2016 the European Commission proposed a directive on preventive restructuring frameworks and second chance, that would allow viable businesses in distress to be rescued, and honest but bankrupt entrepreneurs to be given a second chance through a discharge of their debt.

Context

Across the globe, procedures to restructure financially distressed businesses are increasing in importance, among other things because they enable such businesses to address their financial difficulties at an early stage, when their insolvency could be prevented and the continuation of their activities assured. Viable businesses, whose rehabilitated assets may be worth more than in a liquidation scenario, can potentially start producing returns for shareholders and making reimbursements to creditors again, while guaranteeing jobs. Hence, the approach of rescuing distressed viable businesses instead of liquidating them, maximises the total value to creditors, employees, owners and the economy as a whole.

As pointed out in a Commission expert group report of January 2011, business entry and business exit are natural processes that are inherent to economic life. However, business closure is not yet seen as an opportunity for more reinvigorated entrepreneurial and business activity. As a matter of fact, many honest bankrupt entrepreneurs feel discouraged to restart a business due to the stigma, difficulties or discrimination they faced after their bankruptcy. In addition, bankruptcy has an important secondary effect on entrepreneurship: many would-be entrepreneurs do not start a new business because of their fear of the consequences of failure.

Data show that bankruptcies around the globe grew dramatically at the end of the past decade. Every year in the EU, 200 000 firms go bankrupt, as a result of which over 1.7 million people lose their jobs. Research reveals that businesses set up by restarters grow faster than those set up by first-timers in terms of turnover and jobs created. Hence, a second-chance policy enabling formerly bankrupt entrepreneurs to take up business anew, may have a positive impact on company creation and job growth. An effective second-chance policy has been acknowledged as fundamental in sending a message that entrepreneurship does not necessarily have to turn into a 'life sentence', in case things go wrong.

Existing situation

In 2012, the Commission proposed a recast of the Insolvency Regulation, in order to address the cross-border aspects of insolvency in the EU. The main purpose of the reform was to provide clear rules that would a) help identify the competent jurisdiction and applicable law for a debtor's insolvency proceedings; and b) make the recognition of those proceedings in other EU Member States mandatory. Regulation (EU) 2015/848 ('the 2015 recast regulation') was adopted in 2015.

Similar to its predecessor, the 2015 recast regulation set out rules on the opening of 'insolvency proceedings' against debtors who have their 'centre of main interest' (COMI) in a Member State (whether or not the debtor has assets and creditors in more than one Member State), and rules on the effects of insolvency proceedings on such debtors. The regulation does not apply to debtors from the excluded categories (credit institutions, insurance undertakings, specific forms of investment firms and undertakings), for which special rules apply, and to non-excluded debtors who have their COMI in a third country. It further introduced a new, more precise definition of COMI, codifying the methodology developed in the case law of the Court of Justice and adding new presumptions of COMI for individuals.

The 2015 recast regulation broadened the range of insolvency proceedings to cover not only bankruptcy but also hybrid and pre-insolvency proceedings aimed at avoiding liquidation, as well as debt discharges and debt adjustments for natural persons (consumers and sole traders).[1]

It also addressed the issue of publicity and transparency by requiring Member States to establish insolvency registers, interconnected via the European e-Justice portal, and to publish relevant court decisions. That way foreign courts, creditors and insolvency praticitioners could obtain information about the start of parallel insolvency proceedings. New, detailed rules obliged courts and insolvency praticitioners (including liquidators) from different Member States to communicate and cooperate closely, in order to coordinate main and secondary insolvency proceedings in different countries.

The 2015 recast regulation empowered the insolvency praticitioners in main proceedings to request a stay of the opening of secondary proceedings, in order to facilitate negotiations on the restructuring of the business involved. Moreover, the 2015 recast regulation abolished the requirement that whenever secondary proceedings are opened, they must also be winding-up proceedings, as was the case under the 2000 regulation.

Finally, the 2015 recast regulation included an entirely new chapter addressing the issue of insolvency of a company belonging to a group of companies. The chapter includes provisions on cooperation and communication between courts, between insolvency praticitioners and between courts and insolvency praticitioners, similar to those governing the relationship between main and secondary proceedings. More ambitiously, the 2015 recast regulation set out a framework enabling a coordinator to develop a non-binding restructuring plan for the entire group.

The 2015 recast regulation does not envisage harmonisation of national insolvency proceedings, but in an accompanying communication the Commission announced that it would analyse the impact of divergences between national insolvency laws.[2]

Comparative elements

Many EU Member States are experimenting with new rescue procedures to save profitable yet financially distressed businesses. Unlike classical insolvency proceedings, restructuring proceedings usually begin before insolvency, are conducted by the debtor without the appointment of an insolvency praticitioner, feature only minimal court involvement, and often only affect certain creditors or groups of creditors.

A 2016 study commissioned by the Commission's Directorate-General for Justice and Consumers, compared substantive insolvency law throughout the EU. The study provided a horizontal cross-cutting analysis of the data identifying areas where disparities in national law create problems that have impacts outside national boundaries. Those areas are: directors' duties, liabilities and disqualifications; rules on the ranking of claims/order of priorities and the conditions under which certain detrimental acts can be avoided; conditions for the opening of insolvency proceedings and fast-track or standardised procedures for SMEs; procedures available to overindebted consumers and explaining how over-indebtedness is dealt with in the Member States, including the conditions and timeframe for debt reduction and discharge; connected matters such as length of the procedures, involvement of creditors, publicity and cost. The study also examined the extent to which the Commission's Recommendation on a new approach to business failure and insolvency and the provision of second chance for entrepreneurs (see section on 'Preparation of the proposal') is reflected in national frameworks. The report's findings and analysis were based on data on various insolvency law matters provided by national reporters from all EU Member States and two comparator countries, the United States and Norway.

The Commission's November 2016 proposal on business restructuring and second chance ('the proposed directive') is supported by country-specific factsheets providing figures, broken down by Member State, on the effectiveness and average length of insolvency proceedings, and the recovery rate for secured creditors following insolvency proceedings. All figures are laid out according to the World Bank report, Doing Business 2017. The Doing Business project ranks countries according to a number of criteria, among which the efficiency of their insolvency frameworks on a scale of 0-16. The EU average is 11.6, which is 5 % below the OECD average for high-income countries. The efficiency of insolvency frameworks varies widely across EU Member States.

As summarised in a Q&A document accompanying the proposal, 'World Bank indicators suggest that recovery rates vary between 30 % and 90 % in the EU. Recovery rates are higher in economies where restructuring is the most common insolvency proceeding: in such economies creditors can expect to recover 83 % of their claims, against an average of 57 % in liquidation procedures. The length of insolvency proceedings ranges from a few months to four years, with 14 Member States having procedures which last for two or more years. Currently, in four Member States there is no possibility to access any type of defined procedure to restructure debts with creditors before their companies are actually insolvent or are already late with payments. In five other Member States there is the possibility to restructure before becoming insolvent, but under very strict access conditions. Discharge periods for entrepreneurs in Member States range from 1 to 10 years, they are longer than 5 years in a substantial number, and in a few Member States it is still impossible to obtain discharge at all. Discharge periods also often require repayment of a certain percentage of debts which makes the debt discharge impossible for many entrepreneurs who cannot ensure this partial repayment'. However, as pointed out in an article by G. McCormack (a member of the team that carried out the abovementioned 2016 study), these data must be considered in the light of the possibility that the way in which the World Bank Doing Business project rankings are compiled may encourage countries to 'game' the system, for example by moving resources and effort away from some important but unmeasurable dimensions to the narrower tasks that are tracked and measured. Therefore it may not necessarily reflect what happens in practice in a particular country.

The proposed directive bears some similarities to Chapter 11 (on reorganisation) of the US Bankruptcy Code. Critics of Chapter 11 have claimed that it is too easily available, that it allows debtors too much control, and that it is characterised by a relatively low success rate and endless delay. However, as suggested by Professors Warren and Westbrook, the data from large samples of Chapter 11 cases filed in 1994 and 2002 demonstrate that this characterisation is wrong and reveal that Chapter 11 offers realistic hope for troubled businesses to turn around their operations and rebuild their financial structures. On the contrary, the authors argue that the amendments to Chapter 11 introduced in 2005 as a follow-up to the mentioned criticisms, have led to modest reductions of delay at the price of blocking many reorganisations of small businesses.

As acknowledged by McCormack (see above), similarities certainly exist between the proposed directive on business restructuring and Chapter 11, in particular when it comes to the provisions on the debtor in possession; the provision on the stay on claims against the debtor to facilitate the restructuring process; the treatment of executory contracts; and the conditions for having a restructuring plan approved and for receiving protection for new financing. Nevertheless, there are also strong differences on the level of details between the proposal and Chapter 11 in each of these areas. For instance, while Chapter 11 envisages a stay as an automatic effect of restructuring proceedengs, the stay provided for in the EU proposed directive is discretionary.[3] Chapter 11 also contains a much broader regime for new financing than that set out under the proposed directive.

Parliament's starting position

The Commission's initiative should be seen in the context of a Parliament own-initiative resolution from 2011, in which it pointed out the importance of removing disparities between national insolvency laws to reduce obstacles for companies with cross-border activities and highlighted that insolvency law should be a tool for the rescue of companies. The Parliament also recognised that, despite there being no legal basis for full harmonisation, there are areas of insolvency law where more convergence is achievable and worthwhile, including from an employment law perspective.

It is for this reason that Members called on the Commission to submit, on the basis of Article 50, Article 81(2) or Article 114 of the Treaty on the Functioning of the European Union, one or more legislative proposals relating to an EU corporate insolvency framework, following the detailed recommendations set out in the annex to the resolution, in order to ensure a level playing field, based on an in-depth analysis of all viable alternatives.

Many of the recommendations were addressed in the context of the revision of the 2000 Insolvency Regulation (see 'Existing situation'). The Commission's proposed directive is a response, inter alia, to the request for harmonising some aspects of the restructuring plans.

In its 2017 own-initiative resolution on the banking union, the Parliament restated the need to improve and harmonise the early restructuring and insolvency framework, including through work on the Commission's proposal on early restructuring and second chance, and with a view to safeguarding the most vulnerable debtors such as SMEs and households.

Council starting position

In its conclusions of November 2015 on the capital markets union action plan, the Council referred to the insolvency initiative and invited the Commission to consult the Member States in order to identify business insolvency law-related barriers to the development of a single market for capital. It also welcomed the Commission's commitment to submit, 'on the basis of those consultations and having due regard to the complexity of the involved subject matters and the resulting need for taking a balanced approach, a proposal aiming to ensure, in full respect of the principles of subsidiarity and proportionality, that the main business insolvency-related obstacles identified are tackled, drawing on best practices and well-performing national frameworks'.

In its conclusions of 5 December 2016 on tackling bottlenecks to investment, the Council (Ecofin) recognised that well-functioning insolvency frameworks support economic growth and financial stability. It also stated that clear rules for cross-border proceedings and reduced differences in insolvency systems across countries are beneficial for cross-border investment. On the contrary, inefficient insolvency frameworks create important bottlenecks which may consist of low recovery rates for claimholders, including secured creditors, and a lack of effective and efficient restructuring procedures. Finally, it acknowledged that adequate insolvency frameworks may have a positive impact on the resolution of non-performing loans.

Preparation of the proposal

In December 2012, the Commission adopted a communication highlighting certain areas where differences between domestic insolvency laws could hinder the efficiency of the internal market. Those differences concern the principle of free movement, in particular of capital, but also competitiveness and economic stability as a whole. It indicated a gradual approach starting with the modernisation of the 2000 Insolvency Regulation accomplished by the adoption of the 2015 recast regulation (see 'Existing situation') and reflecting on the ways to be followed to address the disparities between substantive insolvency laws.

In this perspective, in March 2014 the Commission adopted a recommendation (the Insolvency Recommendation) on a new approach to business failure and insolvency, encouraging Member States to implement early restructuring procedures and allowing bankrupt entrepreneurs a 'second chance'. The recommendation set out EU-level minimum standards for 1) preventive restructuring procedures enabling debtors in financial distress to reorganise their business with the objective of avoiding insolvency, and 2) discharge periods for honest bankrupt entrepreneurs, which would give them a second chance. It also included measures aimed at reducing the length and cost of proceedings for SMEs. The recommendation suggested that its main principles could also be applied to consumer insolvency. Member States were supposed to implement the Insolvency Recommendation by March 2015. However, while it is clear that the recommendation has provided a useful focus for Member States undertaking reforms in the area of insolvency, an assessment carried out by the Commission as part of the economic analysis accompanying the capital markets union action plan of September 2015, has shown that the Insolvency Recommendation has only partially been taken up by some Member States, including by those receiving insolvency-related recommendations in the context of the European Semester exercise addressing macro-economic imbalances. Even those Member States that implemented the Insolvency Recommendation, did so in a selective manner, meaning that differences remain. Several Member States do not provide the possibility to restructure a business before it has become insolvent. As regards second chance, important discrepancies have remained as to the duration of the discharge period.

In this context, the capital markets union action plan announced a legislative initiative on business insolvency, including early restructuring and second chance, intended to address the most important barriers to the free flow of capital and to build on national regimes that work well.

Another step illustrating the Commission's support for legislation that creates a regulatory environment capable of addressing bankrupcy without dissuading entrepreneurs from starting a new business again was the Single Market Strategy presented on 28 October 2015.

The Commission's communication of 24 November 2015 on the completion of the banking union confirmed that i) there is a need for greater convergence in insolvency law and restructuring proceedings across Member States; ii) the inefficiency and divergence of insolvency laws make it harder to assess and manage credit risk; and that iii) enhancing legal certainty and encouraging the timely restructuring of borrowers in financial distress is particularly relevant for the success of strategies to address the problem of non-performing loans in some Member States.

The June 2015 Five Presidents' Report on 'Completing Europe's Economic and Monetary Union' flagged the area of insolvency law among the most important bottlenecks preventing the integration of capital markets in the euro area and beyond.

Against this background, the Commission published a proposal for a directive on business restructuring and second chance on 21 November 2016 ('the proposed directive'), which aims to provide new legal tools for viable businesses in distress and honest, but bankrupt individuals.

The Commission impact assessment (IA) of the proposal is based on a wealth of information drawing on both research and consultation. It envisages a broad range of options and tries to estimate the territorial impacts of the initiative, by providing, for example, a legal analysis of the most important issues for most Member States. However, as pointed out in the initial appraisal of the IA carried out by EPRS, it also presents some weakenesses, when it comes to the analysis of social and employment outcomes, the lack of binding timeframes to achieve the numerous objectives identified and the monitoring costs that Member States would possibly incur.

The changes the proposal would bring

The stated key objective of the proposed directive is 'to reduce the most significant barriers to the free flow of capital stemming from differences in Member States' restructuring and insolvency frameworks'. The proposal pursues this aim by focussing on three key areas: common principles on early restructuring tools, which would help companies continue their activity and preserve jobs (Title II); rules to allow entrepreneurs to benefit from a second chance through debt discharge (Title III); targeted measures for Member States to increase the efficiency of the insolvency, restructuring and discharge procedures (Title IV). It also includes horizontal provisions (Titles I, IV, V and VI).

Preventive restructuring frameworks

Title II lays down common, core elements for preventive restructuring frameworks to be set out by Member States. The aim is to give debtors in financial distress, whether legal or natural persons, effective access to procedures facilitating early negotiation of restructuring plans, and their adoption by creditors and possible confirmation by a judicial or administrative authority. A role is recognised for practitioners in the field of restructuring, but their appointment should not be mandatory (Article 5).

Currently, individual creditors can hinder a restructuring procedure by seizing the debtor's assets as soon as the debtor is in financial distress ('race to grab').[4] That leads to cumulative increased expenses and lower recovery for other creditors, and reduces the prospects for successful restructuring. With the proposed new rules, the debtor would benefit from a stay of individual enforcement actions and a suspension of insolvency proceedings. Specific provisions on the maximum duration of the stay (four months), the conditions for its renewal and the conditions for lifting the stay are set out, to address the concerns that creditors might be negatively affected by the stay. Workers' outstanding claims are exempted from the stay in case Member States do not provide for appropriate protection by other means. For the period of the stay, the opening of other types of insolvency procedures, in particular liquidation procedures, should not be allowed, so that the debtor is able to continue operating its business (Articles 6 and 7).

The proposed directive also sets out provisions relating to the content, adoption and (eventual) court confirmation of restructuring plans. More specifically, it lays down the minimum mandatory information that should be included in the restructuring plans. Member States may require additional mandatory information, provided this does not put a disproportionate burden on debtors. Member States are also required to develop online models of restructuring plans and provide practical information on how proposer of a plan can use such models (Article 8). Restructuring plans should be approved by the creditors or classes of creditors concerned. Where creditors with different interests are involved, they should be considered in separate classes. As a minimum, secured and unsecured creditors should always be treated separately. Member States may also provide that workers are treated in a class separate from other creditors (Article 9). Under the current legal framework, dissenting minorities of creditors can hamper the restructuring process (a 'hold-out'). Instead, the proposed directive sets out the conditions to be met to ensure that a restructuring plan can still be confirmed by a judicial or administrative authority even if it is not supported by one or more classes of creditors ('cross-class cram-down') (Article 11). It also states that shareholders and other equity holders should not be allowed to obstruct the adoption of the restructuring plan for a viable business, provided that their legitimate interests are protected (Article 12).

Access to fresh money is vital for the success of the restructuring procedure and the prosecution of a business; however, new financing for companies going through early restructuring is currently not sufficiently encouraged or protected in most EU countries. The proposed directive thus lays down rules to protect new and interim financing as well as other restructuring-related transactions, asking Member States to ensure that they cannot be declared void, voidable or unenforceable as an act detrimental to the general body of creditors in the context of eventual subsequent insolvency procedures. The possibility for Member States to provide grantors of new or interim financing with the right to receive payment with priority in the context of subsequent liquidation procedures is also envisaged. In addition, the grantors of new and interim financing would be exempted from civil, administrative and criminal liability in possible subsequent insolvency of the debtor, unless such financing has been granted fraudulently or in bad faith (Articles 16 and 17).

Second chance for entrepreneurs

Title III lays down minimum provisions on the release of over-indebted entrepreneurs from liability for certain unsecured debt obligations resulting from a court order or an agreement with creditors ('debt discharge'), such release being considered the basic condition for granting entrepreneurs a second chance. Member States can go beyond these minimum requirements by including more friendly treatment of entrepreneurs (such as rules on access to finance for second starters) in national frameworks. Although these provisions are restricted to entrepreneurs, Member States may extend them to all natural persons, to ensure consistent treatment of personal debt.

Under the rules currently in force in Member States, discharge periods range from one to 10 years. These rules often require debtors to partially repay their debt, which makes it impossible to apply the debt discharge to those who cannot afford to pay. Under the proposed new rules, honest bankrupt entrepreneurs would be entitled to a full discharge of their debt after a maximum of three years, without having to reapply to a judicial or administrative authority. Adequate safeguards would be put in place to prevent abuse (Article 20). The proposed directive gives Member States a large margin of discretion in setting limitations on access to discharge and on discharge periods, provided that such limitations are clearly specified and are needed to safeguard a general interest (Article 22).

In some countries, merely discharging debt may not be sufficient to allow bankrupt entrepreneurs to start a new business, for instance, where bankruptcy is accompanied by a disqualification order with a longer duration. To give honest entrepreneurs an effective second chance, the proposed directive envisages that disqualifications linked to over-indebtedness should be time-limited, so that they would cease to have effect at the latest at the end of the discharge period (Article 21).

Efficiency of insolvency, restructuring and discharge procedures

Court proceedings in many Member States are lengthy, complex and costly. The excessive length of restructuring, insolvency and discharge procedures is yet another main factor contributing to low recovery rates and discouraging investors from doing business in certain jurisdictions. Title IV, which applies not only to preventive restructuring and discharge procedures but also to insolvency procedures, aims to address these weaknesses.

Measures to increase the effectiveness of restructuring, insolvency and second chance frameworks would contribute to efficient management of defaulting loans and reduce the accumulation of non-performing loans on bank balance sheets. They would also contribute to improving the residual value that can be expected by creditors by allowing an earlier and swifter restructuring or resolution for debtors facing financial difficulties.

In this field, the Commission's proposed directive introduces provisions related to the specialisation of the courts, as well as the qualifications, supervision and remuneration of insolvency practitioners (Articles 24–26), which are expected to improve the efficiency of insolvency procedures and reduce their cost and length. The use of purpose-built technology is also encouraged to this end (Article 27).

Horizontal provisions

The proposed directive includes minimum rules on the monitoring of restructuring, insolvency and discharge procedures (Title V). In particular, it sets out rules on the collection of data by Member States and the communication of such data to the Commission using a standardised data communication template. In its concluding paragraphs, the directive gives some provisions on its relationship with other EU instruments, on the review of its application, on the adoption of standard forms, and on its entry into force and into application (Title VI).

Even if the proposal does not harmonise core aspects of insolvency – such as rules on the conditions for opening insolvency proceedings, a common definition of insolvency, a ranking of claims and avoidance actions – the proposed new rules would be useful for achieving full cross-border legal certainty, as confirmed by many stakeholders in the public consultation.

Advisory committees

The European Economic and Social Committee (EESC) adopted its opinion on this proposal on 29 March 2017.

National parliaments

The legislative proposal has been transmitted to the national parliaments. The deadline for the submission of reasoned opinion on the grounds of subsidiarity was 8 March 2017. One chamber submitted a reasoned opinion and three chambers opened political dialogue with the Commission.

Stakeholders' views[5]

The European Parliamentary Financial Services Forum (EPFSF) held a discussion on the Commission's proposed directive in January 2017. In its preparatory briefing for the event, the EPFSF acknowledged that the proposed directive addresses many of the concerns linked to the negative effects resulting from the differences in the European insolvency regimes. However, there are a few areas where further clarity is needed, for example, with regard to provisions requiring that a subjective decision be made, without indicating who is responsible for making it. This is the case for the provisions concerning the stay of individual enforcement action, the suspension of insolvency proceedings and court confirmation of the restructuring plan. Further clarity would also be required for situations where Member States are expected to take action or to grant certain protections, yet the directive does not provide for any concrete enforcement measures. The same goes for the (eventual) rights of creditors to propose a restructuring plan and for the obligation of certain third parties (such as accountants, tax and social security authorities) to report negative company developments. The note also pointed out the unintended consequences that the proposal might have on banks' balance sheets, if the position of secured creditors (such as banks) is alterated or the protection of their collateral diluted. Finally, the EPFSF pointed out the beneficial effect of giving Member States the flexibility to achieve the objectives of the proposal by applying the principles and targeted rules in a way that is suitable in their national contexts.

In their comments of 27 February 2017, BusinessEurope were generally supportive of a restructuring and second-chance approach in the European insolvency framework. While acknowledging that the proposed directive could help change mindsets by eliminating the stigma of failure for honest bankrupt entrepreneurs, they also insisted on striking a balance between this goal and the interests of creditors. BusinessEurope highlighted the importance of facilitating access to restructuring procedures for SMEs, which dispose of fewer means to meet the relevant costs or to face insolvency proceedings. Preserving Member States' existing recovery procedures of a diverse nature (e.g. contractual nature) was also underlined as important, as was the move to limit the scope of the proposal to pre-liquidation procedures. Even if harmonising the classes and the ranking of creditors would be a daunting task, BusinessEurope pointed out that a debate should nevertheless be held on whether the proposed directive should offer rules on public creditors and their role/privileges during restructuring procedures. Furthermore, the organisation underlined that minimum requirements on debt discharge are important but they need to be balanced with adequate safeguards. Finally, they stressed that to successfully rescue distressed businesses, the right incentives need to be in place for managers, for creditors and for fresh capital.

In a position paper of February 2017, the European Banking Federation (EBF) expressed concerns about unintended effects stemming from the proposal. In particular, the EBF warned that, if the economic interest of secured creditors such as banks is altered, the cost of future loans might increase. Furthermore, the EBF feared that the eventual decrease of recovery rates for banks would push up further the already high rate of non-performing loans. The EBF expressed particular concern about the length of the stay of individual enforcement actions, which would affect the rights of banks to enforce their repayment claims or collateral. The federation also pointed out the need to clarify that restructuring proceedings can only be initiated if the debtor is not illiquid under the national law. The EBF strongly upheld the position that netting arrangements (in particular, early termination clauses in such netting arrangements) and security arrangements should not be affected by the stay or at least be subject to special safeguards and exception. The federation also suggested including safeguards and limitations in line with those foreseen under the Banking Recovery and Resolution Directive (BRRD), in order to avoid unfair and imbalanced effects on the solvent counterparties. Finally, the EBF also proposed to amend the cross-class cram-down mechanism and the 'best interest of creditors test' set out in Article 2(9) of the proposed directive.

On 7 June 2017, the European Central Bank (ECB) issued an opinion on the proposed directive. As a general remark, the ECB welcomed the key objectives of the proposal and aknowledged that it introduces many highly relevant minimum harmonisation measures for the existing restructuring frameworks. However, the ECB wished that a holistic approach pursuing comprehensive harmonisation of national insolvency laws had been taken with regard to both restructuring and liquidation. That would provide predictable insolvency procedures facilitating transactions in a cross-border context and help fostering distressed loans markets across the EU. The ECB added, among other things, that a well-designed insolvency framework should create the right incentives for all stakeholders. Such an approach may also support and promote financial stability. In addition to legislative reforms, a code of best practice or principles could be introduced to foster convergence; in particular the adoption by Members States of the Model Law on Cross-Border Insolvency of the UN Commission on International Trade Law (UNCITRAL) could help to achieve this. The opinion noted that, even if a stay of individual enforcement actions would limit the immediate exercise of creditors' rights, creditors may nevertheless benefit from lower costs of workouts, earlier and easier access to collateral, and hence higher collateral values, as well as enhanced markets for distressed loans. Finally, the ECB called for a more nuanced consideration of the legal relationship between the proposed directive and key provisions of the EU's inancial regulatory framework, so as to avoid any unintended consequences for financial institutions that may stem from the impact of the proposed directive on financial contracts with their commercial counterparties. These general remarks were then translated into some specific observations and concrete proposals for amendments of the Commission's text.

Legislative process

The **European Parliament's Committee on Legal Affairs** (JURI) appointed Angelika Niebler (EPP, Germany) as rapporteur for this file. She presented her draft report on 25 September 2017.

Some amendments she put forward aim to streamline the early warning mechanisms that Member States should develop to detect a deteriorating business before it transits to insolvency. Other amendments grant Member States the right to limit access to restructuring proceedings to enterprises and entrepreneurs that comply with legal accounting and book-keeping obligations.

The draft report leaves Member States more room for manoeuvre on the possible involvement of a judicial or administrative authority in a restructuring procedure. It also states that restructuring frameworks should be available at the request of affected creditors, with the agreement of the debtor. In order to increase the effectiveness of the restructuring procedure, Member States can provide for the mandatory involvement of a practitioner in the field of preventive restructuring. The debtor's employees' rights to information are enhanced. Workers should also be granted full labour law protection throughout the course of preventive restructuring procedures.

Furthermore, the proposed amendments allow debtors negotiating a restructuring plan to benefit from a stay of individual enforcement actions only if the obligation to file for insolvency under national law has not yet arisen. The length of the stay is reduced to two months, with the possibility of extending it to a maximum of six. At the same time, the obligation of creditors not to modify existing contracts during the stay period ('delivery obligation') is restricted to contracts that are necessary for the continuation of the day-to-day operation of the business ('essential contracts'). The draft report allows Member States to provide that equity holders, just like workers, are treated as a separate class of creditors. It also mitigates the cross-class cram-down by stating that a restructuring plan not supported by all classes of creditors can still be confirmed by a judicial or administrative authority, provided that it gets the approval of the majority of classes. Finally, in order to prevent abusive debt discharge, the draft report sets out more stringent safeguards. Amendments to the draft report were tabled in November 2017 and work on it is ongoing within the committee.

In the **Council**, the file is still being discussed at working-party level. The objectives of the proposal received, in principle, broad support from ministers on 27 January 2017 during the informal Justice and Home Affairs meeting (the 'Council'). The Council held a first policy debate on the proposed directive on 8 and 9 June 2017 and, on that occasion, endorsed a set of principles on some key issues for future work. A second policy debate was held in December 2017. Several compromise texts were put forward between December 2017 (Estonian Presidency) and April 2018 (Bulgarian Presidency). On 15 May 2018, the ministers reached an agreement on the text of the articles of Titles III, IV and V and a number of recitals of the proposed directive ('partial general approach').

The compromise package agreed within the Council provides that at least one procedure leading to the discharge of debts for an insolvent entrepreneur be set out by the Member States. Member States would remain able to interpret the concept of 'insolvency' (which might include over-indebtedness) under their national law. Member States would also be allowed to require that the activity to which the debts are related has ceased. The compromise text confirms the general rule that the discharge period should be no longer than three years, yet provides broad possibilities for Member States to define situations in their national law where limitations to access discharge or longer periods would apply before a debtor is fully discharged. The agreed text allows Member States to choose freely among different alternatives (a repayment plan, a realisation of assets or a combination of both) when implementing the provisions on the start of the discharge period.

Considering that the organisation of the judiciary is part of the procedural autonomy granted to Member States, the compromise text adopts a principle-based approach, requiring that members of judicial and administrative authorities dealing with insolvency, restructuring and discharge of debt-procedures are suitably trained and in hold of the necessary expertise. It also requires that the procedure should be carried out in an efficient manner, but leaves a broad margin of interpretation for Member States as to how they should implement these provisions. The compromise text also introduces a number of general principles that Member States have to follow in their national legal systems regarding the appointment, selection, supervision and remuneration of practitioners, as well as a requirement for Member States to supervise their practitioners. While preserving the provision requiring Member States to make it possible to undertake certain procedural steps by digital means, the compromise text limits it to procedural actions that can reasonably be achieved within a certain time frame. The text also extends the implementation period for this provision from three to five years in general and to seven years for eventual contestations and appeals.

Finally, the compromise text streamlines the provisions concerning the amount of data to be provided by Member States to monitor the effectiveness of national insolvency and restructuring procedures, and limits it to what Member States consider achievable. The remaining Titles (I, II and VI) and remaining recitals will be subject to further discussions at a later stage.

EP SUPPORTING ANALYSIS

Preventive restructuring, second chance and efficient restructuring, insolvency and discharge procedures, Initial Appraisal of the Commission Impact Assessment, EPRS, May 2017.

The Impact on SMEs of the Proposal of Preventive Restructuring, Second Chance and Improvement Measures, Policy Department for Citizens' Rights and Constitutional Affairs, European Parliament, May 2017.

Finalising reform of cross-border insolvency rules, EPRS, May 2015.

Reform of the EU Insolvency Regulation, EPRS, January 2014.

Cross-border insolvency law in the EU, European Parliament Library Briefing, February 2013.

Harmonising insolvency laws in the Euro area: rationale, stock-taking and challenges. What role for the Eurogroup?, Economic Governance Support Unit, European Parliament, July 2016.

Harmonisation of insolvency law at EU level, Policy Department for Citizens' Rights and Constitutional Affairs, European Parliament, 2010.

OTHER SOURCES

Preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures, European Parliament, Legislative Observatory (OEIL).

ENDNOTES

1 According to Article 2 of Regulation 848/2015, 'insolvency proceedings' mean the collective proceedings referred to in Article 1(1), which are listed in Annex A.

2 For an in-depth analysis of the European insolvency regulation currently in place, see Bork, Reinhard and Zwieten, Kristin van, *Commentary on the European insolvency regulation*, Oxford University Press, 2016.

3 See Articles 6 and 7 of COM (2016) 723 final.

4 The 'race to grab' configures the situation where each creditor may anticipate the difficulties of negotiations and may plan to defect before other creditors do. That leads individual creditors to bear higher costs than they would bear if creditors acted collectively (for further elements on the effects of the creditors' coordination see Bhandari, Jagdeep S. and Weiss, Lawrence A., *Corporate Bankrupcy, Economic and legal perspectives*, Cambridge University Press, 1996).

5 This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under 'EP supporting analysis'.

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