# Comments

Proposal of the European Commission
for preventive restructuring frameworks
COM(2016) 723 final dated 22 November 2016

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The German Banking Industry Committee is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 1,700 banks.

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Opinion on the Proposal of the European Commission for a
Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of insolvency procedures, COM (2016) 723 final dated 22 November 2016


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## I. Introductory comments

The leading banking-sector associations of the banks and savings banks, which are grouped together in the German Banking Industry Committee (GBIC), support the aim of the proposed Directive to facilitate and promote the restructuring and rescue of companies in economic difficulties. However, they are sceptical about the EU-wide harmonisation of pre-insolvency restructuring procedures for companies and debt relief regulations (second chance) for honest entrepreneurs in the form currently proposed by the European Commission.

The rules envisaged in the draft Directive are unbalanced and create disproportionate/unreasonable burdens on creditors, in particular the secured creditors. Moreover, the proposed regulations to some extent fail to comply with the regulatory requirements of the Capital Requirements Regulation (CRR)[1].

The GBIC is concerned about a debasement of loan collateral and the resulting higher loss rates, which would further increase the pressure on regulatory capital and could affect the supply of credit to small and medium-sized enterprises.

The German Banking Industry Committee questions whether the harmonized procedure must necessarily be a pre-insolvency procedure. It believes it is worth considering whether Member States should be given the freedom to offer either a restructuring framework before insolvency or one within the context of insolvency, pointing to German insolvency law which is favourable to rescues.

This opinion’s main points of criticism of the Commission's proposal can be summarised as follows:

- The proposal is unbalanced because it essentially imposes burdens on creditors and curtails their rights but hardly provides for the duties and obligations of debtors.
- The proposed duration of a stay (moratorium) is much too long, in particular because it contradicts banking supervisory law; it should be limited to a maximum of four weeks. (Nos. II.3.3.4 and II.3.3.5).
- The EU Commission’s proposal quite rightly does not envisage restricting the pre-insolvency restructuring procedure to a financial restructuring or to financial creditors; and such considerations should not be taken up in the draft Directive either (No. II.3.1.3).
- Any interference in the rights of creditors must be tied to the condition that the Court positively assess the chances of the success of the restructuring plan presented by the debtor, the interference is fair and that the rights of the parties concerned are not unduly affected (Nos. II.3.1.1 and II.3.1.2).
- A procedure should only be initiated if the debtor does not present grounds for insolvency (No. II.3.1.4). The duty to file for insolvency may not be suspended during the stay (No. II.3.4).
- The stay should be restricted to dissenting creditors (No. II.3.3.6). Articles 7 (4) and 7 (5) should be deleted; alternatively, financial creditors should be exempted (No. II.3.3.2). If Articles 7 (4) and 7 (5) were to be retained – despite considerable doubts – an exception for netting agreements (No. II.3.3.3) would be needed.

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[1] Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

- The Court must have the ability to set a stay aside of its own motion; creditors should also be able to terminate the restructuring procedure – and thus also the effect of the stay – at any time (Nos. II.3.3.7 and II.3.5).
- The quorum majorities for the votes on the restructuring plan envisaged in the proposal are too narrow, they must be set at least 90% of the amount of the claims (No. II.4.1.2). A 'cross-class cram-down' is to be rejected in a pre-insolvency procedure and is at best conceivable at the expense of the partner, equity holder and equity holder-like creditor group (No. II.4.1.3).
- An interference in the rights of a dissenting creditor should normally only be possible if the restructuring plan does not lead to any deterioration of the creditor's interests, measured at the going concern value. The measurement of the creditor's interest at break-up value, as envisaged by the present draft, is inappropriate (No. II.4.1.4).
- The blanket privileged treatment of restructuring financing in a subsequent insolvency as presently envisaged is to be limited to cases in which the debtor can point to a viable business model which is convincing to the creditors of the restructuring financing, so as to avoid detriment to existing claims (in particular loans already granted) (No. II.4.2).
- The maximum period of three years for the residual debt discharge envisaged in the proposal is to be rejected. It is too short and does not provide any incentives for the debtor to satisfy the creditor. The three-year period should be included in the Directive as a minimum (No. II.5).

## II. Comments in detail

### 1 Subsidiarity

The Commission proposal is essentially based on Article 114 of the Treaty on the Functioning of the European Union, which makes the establishment and functioning of the single market the subject of European legislation. It is thus stated in the explanatory memorandum to the proposal for a Directive that the main objective is *"to reduce the most significant barriers to the free flow of capital stemming from differences in Member States' restructuring and insolvency frameworks"*. Such an argumentation, which is far too generally couched, would justify the harmonisation of the entire civil, criminal and administrative law on the basis of the fundamental freedoms. The argument that the free movement of capital is hindered by differently organised or partially non-existent pre-insolvency restructuring procedures is not convincing.

There is considerable doubt as to whether the differences between Member States' insolvency laws actually have an influence on the decisions made by entrepreneurs and investors with regard to cross-border activities and thus have any relevance for the single market (thus also the motion before the Bavarian State Parliament, publication 17/15252 and the subsequent decision of the Bavarian State Parliament, publication 17/15362 and the recommendation of the Committees of German Federal Council(Bundesrat) , publication 1/1/17).

Moreover, the EU does not have comprehensive legislative and harmonisation competence in the area of insolvency law. The EU Commission is trying to create new competencies by referring to an alleged restriction of fundamental freedoms.

Against this background, any problems in the individual Member States identified by the EU Commission should be remedied at the national level and are not the responsibility of the European Union, owing to the absence of relevance for the single market.

**2 Early Warning Tools (Article 3)**

Creditors should not be obliged to point out to debtors their own economic situation or to draw attention to the urgency of the need for action.

The proposed Directive requires Member States to ensure that debtors and entrepreneurs have access to an "early warning tool" (Article 3 (1)).

Overall, it is unclear what is meant by access to "early warning tools". It is unclear whether the debtor has to take action him- or herself or whether third parties – from tax advisors and auditors to authorities to creditors – should warn the debtor.

It would in any event be inappropriate to oblige creditors to point out to the debtor their own economic situation and to signal the need to act as a matter of urgency within the meaning of Article 3 (1). All creditors will be interested in the development of their debtor's economic situation in their own interests. However, imposing duties on them to protect the interests of the debtor by means of warnings is inappropriate because infringements of these obligations could possibly result in unfavourable legal consequences, such as, for example, claims for damages. The lender would then not only have to suffer a default of payment owing to the insolvency of the debtor, but also have to bear disadvantageous legal consequences because they did not draw the debtor's attention to the urgency of the situation, or be exposed, on account of this warning, to instinctive insolvency challenges, in particular pursuant to sec. 133 German Insolvency Code (InsO), in subsequent normal insolvency proceedings. This not only contradicts the objective of the proposed draft Directive – to increase the lending capacity of credit institutions by reducing the number of non-performing loans –, but also ignores the individual responsibility of every economic actor.

**3 Preventive restructuring frameworks**

The European Commission's proposal provides explicitly for the introduction of a preventive restructuring framework, in other words a set of rules that are applicable at a point at which the debtor company is not yet insolvent (see Article 4 (1)). At the same time it is proposed to permit – under certain conditions – interfering with the rights of creditors.

In derogation from the present proposal, we believe it is worth considering whether Member States should be free to offer a restructuring framework either before insolvency or during insolvency. Thus in Germany, for example, there is a rescue procedure embedded in insolvency proceedings. Using this procedure, debtors are able to negotiate a rescue plan with their creditors. Interference with the rights of creditors within this procedure is just as possible as the replacement of the consent of those creditors who refuse to agree to the rescue plan. In our view, Member States that already have a functioning restructuring framework for rescue procedures should not be required to introduce an additional, explicitly pre-insolvency restructuring framework.

In our Opinion we nevertheless assume that the regulations proposed by the European Commission relate to pre-insolvency rescue procedures.

**3.1 Prerequisites for the use of a preventive restructuring framework**

3.1.1 Application on interference in the rights of creditors (Article 4)

An application to and a decision by a court are only necessary if the rights of creditors are to be interfered with.

According to the European Commission's proposal, an application by the debtor or an application by the creditor with the agreement of the debtor is required for the use of the restructuring framework (Article 4 (4)). In view of the fact that at the same time the participation of a judicial or administrative authority should be restricted (Article 4 (3)), the question arises as to whether an application should really be necessary in order for debtors and creditors to negotiate with each other about a restructuring, or whether what is really meant is that a court can restrict the rights of creditors only on application by the debtor. The provision in Article 4 (4) should be clarified accordingly. At the same time, the provision in Article 4 (3) should also be clarified in such a way as to require the participation of the judiciary whenever creditor rights are to be interfered with.

3.1.2 The restructuring's chances of success / profitability

An interference with the creditor's rights must be made dependent on the fact that the proposed restructuring has chances of success.

Access to the procedure may only be granted to debtors with a viable business model. The chances of success of the proposed restructuring must be examined by a court. The court may, if necessary, consult an expert such as a lawyer, an independent tax consultant, an auditor or a person with comparable qualifications. The examination must take place before any interference in the creditor's rights takes place. Only then can an interference be justified at all.

In this context, the special importance of bookkeeping and accounting obligations must be observed. In the case of a debtor who does not meet these obligations adequately in the period which is relevant for the assessment, the chances of success of the restructuring attempt will not normally be identifiable.

3.1.3 Scope

The EU Commission's proposal quite rightly does not provide for a restriction of the pre-insolvency restructuring procedure to a financial restructuring or to financial creditors.

The EU Commission's proposal – quite rightly – does not provide for a limitation of the scope of a preventive restructuring framework. However, limiting such a framework to financial restructuring or even exclusively to financial creditors is sometimes discussed in specialist circles. Quite apart from the associated demarcation difficulties, the German Banking Industry does not see any need for a limitation on the scope of application; such a restriction is rather to be rejected.

Insofar as the advocates of restricting the procedure to financial creditors make the point that extending the scope to all creditors is problematic because the EU Commission then necessarily interferes in other

legal areas in which it has no jurisdiction, it is not clear why this assessment might be changed solely due to the limitation to financial creditors.

Moreover, restriction of the scope of application to financial creditors would also considerably reduce the chances of rescue for debtor companies, especially if another group, e.g. the suppliers, are the main creditors of the company, or an operational restructuring is needed. We are unable to recognise any convincing reason why a pre-insolvency restructuring procedure should not be available in such cases.

It is therefore only then appropriate if the debtor themselves define the specific scope of application by formulating a restructuring plan. They themselves must identify the causes of the crisis (see also Article 8 (1b)) and make proposals for the elimination of the causes and thereby decide which creditors can and must contribute to the elimination of the crisis and the lasting rescue of the enterprise. Whether they restrict their restructuring plan to financial restructuring or involve other creditors must be left to them.

#### 3.1.4 Absence of grounds for insolvency

A restructuring procedure may only be admissible if there are no grounds for insolvency in the person of the debtor yet.

The Directive must be supplemented to state that a restructuring procedure may only be initiated if there are no insolvency grounds in the person of the debtor under the insolvency law of the Member State concerned, in particular no (impending) insolvency. There is otherwise a risk that debtors will circumvent insolvency proceedings with the help of the restructuring procedure, and that remaining assets will be removed or lost at the expense of creditors, in particular suppliers and credit institutions.

#### 3.1.5 Proportionality of the interference with creditor rights

Interference with creditors' rights must be proportionate and may not unduly affect the rights of the creditors concerned. This must be examined by a court.

Interference with the rights of individual creditors within the framework of restructuring procedures represents a special sacrifice, must as such be proportionate and must not unduly affect the rights of the creditors concerned. The debtor should therefore always have to demonstrate why the creditors can reasonably be expected to suffer the interference, for example – in the case of a stay – because although they will not be able to execute for a certain period they are protected against a possible loss in the value of their collateral. The remarks in Recital 20 on "unfair prejudice" are in this respect inadequate and far too much oriented towards the debtor's interest. A distinctly stronger orientation towards creditor interests is necessary here.

### 3.2 Debtor in possession (Article 5)

In order to simplify the procedure and to increase acceptance among debtors, we propose to do away with the possibility of appointing an administrator.

In the procedure proposed by the EU Commission, the debtor in principle is permitted to continue his own business. This is a sensible regulation. Otherwise, it could hardly be expected that debtors would make use of the possibility of such a procedure outside insolvency. After all, the procedure runs even without an application (see our opinion under No. II. 3.1.1), which raises the question of how a court could deprive a debtor of management authorisation in the absence of an application to initiate the procedure.

The EU Commission's proposal leaves the Member States free to appoint, in certain cases, some kind of practitioner in the field of restructuring. We suggest doing away with naming a practitioner completely, especially for monitoring the implementation of the restructuring plan. The aim of the procedure is a consensual agreement between the creditor and the debtor with the slightest possible involvement of the Court. The designation of a practitioner – even if the designation is only optional – presupposes the decision of a court. The possibility that a practitioner might be engaged is not likely to increase the debtor's willingness voluntarily to initiate such a procedure. Finally, it is to be expected that the restructuring plans will typically contain clauses which would render the whole plan invalid if the debtor fails to meet his obligations vis-à-vis one of the creditors included in the plan, or fails to meet them on time. For this reason, too, a practitioner is not needed.

### 3.3 Stay of individual enforcement actions (Article 6)

Under Article 6 of the draft Directive, a court may grant a debtor who is negotiating a restructuring plan a stay of individual enforcement actions by creditors if and to the extent such a stay is necessary to support the negotiations of a restructuring plan. The stay of individual enforcement actions is defined in Article 2 (4) and is a measure which burdens both secured and unsecured creditors (Article 6 (2)).

The Commission's proposals on the details of this stay are to be criticized, and in part to be rejected, as explained below. It may be added that these rules interfere with contract and property law, trade and company law, and the law of collateral security, and thus profound consequences are to be feared in legal areas in which the Union has no jurisdiction.

#### 3.3.1 Enforcement and out-of-court negotiations

The stay of individual enforcement actions should be restricted to such enforcement actions as are initiated after the commencement of out-of-court negotiations. If several creditors indicate that the negotiations have no prospect of success – for example by initiating enforcement actions after the commencement of out-of-court negotiations – the stay must be lifted.

A debtor who does not commence out-of-court negotiations until creditors are already enforcing and who is no longer economically in a position to terminate the enforcement immediately would probably have long since had to file for insolvency. In any case, they have missed the moment for out-of-court negotiations. In our opinion, there can be no court-ordered stay of enforcement actions already commenced before the start of the out-of-court negotiation.

Prevention of the initiation of enforcement actions in the period after the start of out-of-court negotiations for a maximum of four weeks (see II.3.3.4 below) by court order might be considered. However, this can only apply if obligations arising from long-term commitments are being serviced.

In any event, if several creditors indicate – by initiating of enforcement actions after the start of out-of-court negotiations or in another manner – that they see no prospects of success for the out-of-court negotiations and that they will not give their consent thereto, the creditors may not be prevented from asserting their rights by way of enforcement. The stay must be limited to dissenters (for details see No. II.3.3.6 below).

### 3.3.2 Effects on executory contracts (Article 7 (4) and (5))

Article 7, clauses 4 and 5 should be deleted. In any case, financial creditors should be exempted. Should Article 7 (4) nevertheless be retained, it should at least be made clear that in the case of loans, new drawdowns are possible only with the consent of the lender. The suspension of termination rights or other stipulations may not result in the creditor losing its collateral right without being able to obtain replacement for it or to increase it accordingly. It must be made possible for creditors to acquire incontestable collateral for new receivables or collateral items.

According to the EU Commission's proposal, a contract between the debtor and one or more creditors under which both parties still have unfulfilled obligations (an executory contract, Article 2 no. 5) at the time of granting the stay of enforcement, may not, during the stay period, be terminated by the creditor or in any other way modified to the detriment of the debtor on account of financial liabilities of the debtor that came into existence prior to the stay (Article 7 (4)).

This arrangement places the interests of debtors in the foreground without taking into account those of creditors. In any event, such a regulation is not needed if the debtor complies with the contract. In this case, the possibilities for the creditor concerned to terminate or modify a contract are governed by the rules agreed to by the contracting parties. On the one hand, an immediate termination of or unilateral change in the contractual relationship will not normally be possible – at any rate not an extraordinary termination without notice. Thus, it also cannot lead to a disturbance of the negotiations on the out-of-court restructuring. On the other hand, a debtor who does not comply with the contract does not appear to be worthy of protection. A debtor who does not comply (no longer complies) with the contract has probably passed the stage of a likelihood of insolvency and can no longer benefit from a pre-insolvency restructuring procedure anyway.

Alternatively, an exemption must be provided for financial creditors, for whom this arrangement is neither designed nor appropriate.

The term "executory contracts" is not clearly defined. In particular, it is unclear what effects Article 7 (4) has on credit lines, loan collateral and revolving loan collateral such as global warehouse assignments and global receivables assignments (of current and future obligations). Therefore, if Article 7 (4) is to be retained despite the objections raised here, and remain extended to financial creditors, it must at least be clarified that in the case of existing loans, new drawdowns are only possible with the consent of the lender. This must apply irrespective of whether or not recourse has been had before initiation of the procedure. If there is a risk that the loan receivable might increase during the procedure without the consent of the creditor, this would significantly affect the willingness of the banking industry to provide credit lines to economically weak small and medium-sized enterprises. As a result, their financial difficulties would probably not be diminished, contrary to the EU Commission's objective. Furthermore, the suspension of termination rights or other stipulations may not result in the creditor losing its collateral right without being able to obtain replacement for it or to increase it accordingly.

It must be ensured that, in the case of revolving loan collateral such as global receivables assignments and global warehouse assignments, new receivables or goods covered by the global receivables assignment or global warehouse assignments also become incontestable collateral during the restructuring procedure.

The considerations set out with regard to Article 7 (4) are, accordingly, also applicable to Article 7 (5), which should also be deleted.

#### 3.3.3 Exceptions and specific safeguards for financial transactions (netting agreements) (executory contracts) (Article 7 (4))

In view of the specific function of netting agreements and, in order to avoid that counterparties are exposed to disproportionate and incalculable risks, there is a need for exceptions or, at the very least clearly defined safeguard provisions protecting these agreements (limitation of the suspension to a maximum of 48 hours /clarification that termination rights remain unaffected in the event of a failure to fulfil material contractual obligations, in particular the obligation to post collateral, as well as the performance of delivery and payment obligations under the agreements in question). Such exceptions or appropriate safeguards would not obstruct any rescue efforts: On the contrary, they also protect the company to be restructured from incalculable risks. In this context, it must be taken into account that (i) in the event of a termination of these agreements (close-out) both parties will be able to enter into new transactions replacing the terminated transactions and (ii) that the economic risks emanating from the transactions (caused by the volatility inherent to these transactions) following a stay are equally unpredictable and incalculable for both parties.

The insolvency framework of both the EU and EU Member States provide for specific legal provisions and safeguards for financial transactions (derivatives and securities financing transactions or financial services within the meaning of § 104 InsO). Key element of these safeguards and special provisions is the protection of the contractual close-out netting mechanism in the event of a default of one of the parties or a breach of material contractual obligations (also known as netting agreements). The purpose of netting agreements is an appropriate and effective of the risks of a counterparty’s default. In particular, they ensure that the counterparty to the defaulting party is not exposed to unpredictable risks over an uncertain period of time caused by the unavoidable fluctuations in value of the transactions covered by the netting agreement. Hereby, netting agreements also protect the financial system against systemic risks since they prevent a contagion of the counterparty. At the same time, they also ensure that the defaulting counterparty is not forced to speculate on the future development of the value of the relevant transactions in question. Thus, they also protect the assets in the event of an insolvency. The restrictions this may impose on an insolvency administrator are justified especially because the relevant transactions can be replaced by replacement transactions in event replacement transactions are actually needed for ensuring business continuity. Consequently, financial transactions cannot be compared to and treated as agreements or transactions which cannot be replaced in the course of a recovery attempt.

Netting agreements can, only perform their key function if they permit the counterparties to terminate the agreement in accordance with the contractually agreed close-out netting mechanism upon any event which indicates an impending default – which may occur before the formal opening of insolvency proceedings, for example upon the filing of the application or where there are other material grounds which would allow such filing of insolvency proceedings. The latter is also an express prerequisite under the existing capital requirements regime of the CRR.

In view of the above described importance of netting agreements as an instrument for mitigating counterparty risks and also systemic risks, the Financial Collateral Directive provides for a protection of contractual netting agreements. Likewise, the bank recovery and resolution regime of the BRRD also relies on functioning netting agreements as an important tool for an effective resolution, in particular in the case of a bail-in or a transfer of assets and liabilities to another legal entity. The BRRD further provides for a temporary stay of the termination rights, but only for a very short period of a maximum of 48 hours or two days. Moreover, the BRRD calls for the special safeguards in order to further protect

netting agreements. This demonstrates that netting agreements not only do not obstruct a recovery or resolution attempt but on the contrary, are instrumental to it.

The provisions for the stay so far do not contain any specific exceptions or safeguard provisions protecting financial transactions or netting agreements. Consequently, these agreements could presumably subjected to a stay. The contracting party would consequently be prevented from terminating the contract for the duration of the stay, even in the event of default or where there to be other material grounds. Considering the specific function of netting agreements described above, this would have far-reaching and disproportionate consequences for the other counterparty. From the beginning of the stay until its end or until the eventual opening of insolvency proceedings, they would be exposed to the risks arising from the transactions, a risk exposure that would almost be impossible to calculate or mitigate.

Such a one-sided allocation of the risks at the expense of the other contracting party cannot be justified by with the interest of the company to be rescued: The company to be rescued has the possibility of entering into replacement transactions. The fact that these may not always be concluded on the exact same terms as before is not a sufficient reason for imposing significant additional risks on the other contracting party. In this respect, the situation differs substantially from other contracts for which there is a continuation interest in the case of a rescue attempt: In the case of other contracts such as a rental agreement regarding essential facilities, the risks of the counterparty resulting from agreements subject to the stay essentially correspond to the previously existing economic risk. In the case of financial transactions or other transactions, which are subject to comparable fluctuations in value, the economic risk exposure of the counterparty from the relevant agreement will change considerably over time and especially following a stay. Such an uneven, one-sided and unpredictable risk transfer would be clearly disproportionate and can therefore not be justified. It would also be difficult to understand why the recovery regime for companies should allow far more intrusive interference with creditor's rights than the recovery and resolution regime for credit institutions.

In order to prevent such clearly disproportionate and unacceptable consequences for the other counterparty, financial transactions or netting agreements should therefore be exempted from the consequences of a stay.

At the very least, there is a need for specific safeguard provisions that should at a minimum correspond to those in the BRRD. In particular, the suspension period in respect of the termination rights for financial transactions or netting agreements by the stay would have limited to a maximum period of 48 hours. In addition, it would have to be expressly clarified that that any right to terminate the agreement remains unaffected, irrespective of the suspension or the stay, in the event of breaches of material contractual obligations during the suspension or stay, in particular any payment, delivery obligations and an obligation to post collateral.

Contractual netting agreements are routinely used by credit institutions, as well as by other market participants, including industrial companies as well as small and medium-sized companies, as a means to mitigate the risks arising from financial transactions, in particular from derivatives and securities financing transactions (securities repo transactions and securities loans). They constitute the basis for the inter alia for the calculation of the capital requirements and as well as for the regulatory mandatory collateralisation of financial transactions under the new regulatory framework for OTC derivatives (OTC Derivatives Regulation (EU) No. 648/2012, central counterparties and trade repositories – EMIR). Their validity and enforceability are also assumed by many other European supervisory regulations, including the bank recovery and resolution regime of the BRRD.

#### 3.3.4 Duration of the stay

The stay must be limited to a maximum of four weeks.

Even apart from special banking supervisory features, to which we will refer separately, a four-month period for a stay of execution outside insolvency proceedings is far too long. In view of the considerable interference with creditor rights which a stay represents and of the objective of supporting a rescue plan already drawn up by the debtor, a maximum period of four weeks is sufficient and appropriate.

According to Article 6 (1), a stay may be granted by the Court only if and to the extent that such a stay is necessary to support the negotiation of a restructuring plan. A plan must therefore already be available; the stay is not intended to give the debtor time to prepare the plan. If the negotiations are not successfully concluded within a few weeks, they must in any case be considered to have failed.

For example, the German insolvency plan procedure provides for the Court to review the plan and, after conclusion of the examination, that the creditors shall have no longer than two weeks to comment on the plan (sec. 232 (3) German Insolvency Code (InsO)) and that the vote of the creditors on the plan shall take place within one month of the conclusion of the Court's examination (sec. 235 (1) German Insolvency Code (InsO)).

The excessive duration of the stay proposed by the EU Commission is also a cause for concern because at the same time – as is also to be rejected – it is proposed that the duty to file for insolvency should be suspended for the duration of the stay (Article 7 (1)). This entails the risk of misuse of the scheme and of a "legalised delay in filing for insolvency". The debtor receives an unreasonable leverage vis-à-vis creditors, who have to fear a one-year standstill as well as regulatory consequences (see our opinion under No. II.3.4).

A protracted stay also entails the risk that collateral can in future no longer be recognised as risk-mitigating under European banking supervisory law (see, among other things, Article 194 (4) CRR), since recognition requires that the credit institution has the right to "liquidate …, in a timely manner, the assets from which the protection derives".

We therefore consider a stay of a maximum of four weeks to be appropriate.

If making a protracted stay possible is nevertheless insisted on, secured creditors – alone due to the banking regulations named – must be exempted from the effects of the stay.

#### 3.3.5 Conflict between a stay and banking supervisory regulations

For reasons of banking supervisory law, any stay must be significantly shorter than three months in order to avoid the receivable being rated as a default within the meaning of banking supervisory law.

It is envisaged that the stay can last up to four months or, if extended, up to twelve months (Article 6 (4) to (7)). A stay of up to four months is already incompatible with European banking supervisory law. According to Art. 178 CRR[2], a receivable must be regarded as in default if the obligor is more than 90 days past due. Therefore, in the light of this the duration of the stay must be set shorter and may on no account last more than three months owing to the above-mentioned banking supervisory regulations. We believe, however, that a stay must be limited to four weeks.

[2] Capital Requirement Regulation: Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

#### 3.3.6 Enforcement protection limited to dissenters

A stay should not be granted in general but only at the expense of individual creditors. In doing so, unreasonable discrimination against these creditors must be avoided, even in the event of the failure of the restructuring and the opening of insolvency proceedings. We recommend rules on retroactive invalidity of enforcement actions.

A temporary stay of individual enforcement measures should only be allowed if such measures could affect negotiations and reduce the prospects for restructuring the debtor's enterprise. The stay of individual enforcement measures may only be used to keep the enterprise safe from the hazards of dissenters and their disruptive potential. This narrow scope of application must be formalised in the Directive. If several creditors reveal by their behaviour that they are not willing to negotiate on the basis of the plan submitted, the Court may not grant a stay.

The stay must also comply with the principles of proportionality and must not unduly disadvantage individual creditors.

The suspension of individual enforcement measures does not serve the purpose of the general creation of liquidity. Therefore, the suspension of individual enforcement measures can only be sought against individual creditors.

As the suspension of enforcement measures is restricted to individual creditors, it should be ensured that this does not unduly restrict the principle of the equal treatment of creditors. If the restructuring attempt fails, it may happen under the current version of Article 7 (6) that the creditors who were forbidden to enforce their rights are left wholly or partially empty-handed in a subsequent insolvency, while the creditors who are not affected by the suspension were able to obtain satisfaction. An equilibrium must be created here in the Directive, e.g. by means of retroactive invalidity of enforcement measures on the opening of proceedings or simplified contestation.

In addition, preparatory enforcement actions (for example, giving and serving notice) should remain permissible during the stay in order to avoid a loss of time after the end of the stay (see also 2.3.2 above on the deletion of Article 7 (4)).

A restructuring framework cannot provide for a comprehensive stay to the detriment of all creditors. This is available – for example in Germany – within the framework of the already existing regulations for insolvency proceedings which are favourable to rescue. Companies that need extensive enforcement protection (and not just protection against individual dissenters) are factually insolvent and cannot have access to a restructuring framework.

The pre-conditions for a stay must be examined by a court.

#### 3.3.7 Reasons for lifting a stay pursuant to Article 6 (8)

The Court must be given the opportunity to lift a stay of its own motion. Creditors should be given the opportunity to terminate the restructuring procedure (and thus the effect of the stay) at any time.

The grounds for lifting a stay envisaged by Article 6 (8) are inadequate. In particular, provision should also be made for the Court to lift the stay if it no longer considers the conditions for its grant to be met. This lifting should also be possible ex officio. Due to the risk of misuse, it should also be ensured that in cases where for example a debtor does not provide contractually agreed information to creditors affected by the stay, to which the creditors are entitled, the Court may lift the stay.

Furthermore, creditors should have the option, at every stage in the procedure, of terminating the proceedings as a whole (see in detail below, No. II.3.5), with the result that the stay automatically ends.

### 3.4 Obligation to file for insolvency (Article 7 (1) to (3))

A suspension of the obligation to file for insolvency during the stay is to be rejected.

The draft Directive provides, in Article 7 (1) to (3), for a suspension of the obligation to file for insolvency during the stay. This is not appropriate. On the contrary, the debtor's obligation to file for insolvency should remain in place even during the stay. If a ground for insolvency is present, then the restructuring procedure should be converted into proper insolvency proceedings. Any other approach would be contrary to the character of the procedure, since, in particular, the stage of the likelihood of insolvency within the meaning of Article 4 (1) would have been passed.

Insolvency proceedings and the duty of the debtor to apply for such proceedings are primarily intended to protect the rights of creditors. If the obligation to file for insolvency were suspended, creditors would be denied protection of their financial interests. This is all the less justifiable since the debtor, apart from negotiating with his or her creditors – which is also to be rejected – does not have to fulfil any conditions for a stay of execution. He or she can continue his or her loss-making enterprise without limit – according to the European Commission's proposal for months (see Article 6 clause 4 et seq.) – and can deplete the subsequent assets in the insolvency at the expense of the creditors. In such a situation, creditors are not even to be allowed to initiate the opening of insolvency proceedings themselves (Article 7 (2)). This is obviously inappropriate.

A suspension of the obligation to file for insolvency may also result in a restructuring procedure being improperly initiated or its initiation being "threatened" merely in order to delay proper insolvency proceedings, either to dispose of company assets or to harm creditors.

The opening of insolvency proceedings does not mean that the debtor company could no longer be rescued and also does not mean that a restructuring plan (in the form of an insolvency plan) could not be implemented. The obligation to file for insolvency would, however, ensure that a court and (normally) an insolvency administrator would safeguard the rights of all creditors – and not only the creditors affected by the restructuring plan. This protection does not need to be dispensed with in order to encourage the rescue of the debtor. Ensuring protection, however, increases creditors' confidence in the rescue efforts. Finally, an incentive for the debtor to rescue his or her company quickly and comprehensively might be expected to be associated therewith, if he or she wants to avoid the frequently cited "stigma of insolvency".

### 3.5 Termination of the procedure on the initiative of the creditors

A majority of the creditors affected by the restructuring plan must have the opportunity to bring about the termination of the restructuring procedure.

The pre-insolvency restructuring procedure serves to restructure the debtor company before insolvency occurs, and thus preserve the common interests of the debtor and the majority of the creditors. To this end, they are given the opportunity of preventing individual creditors from disturbing the negotiations over the plan or the implementation of the plan. If, however, a majority of the creditors affected by the restructuring plan (by number or by sum total) is not interested in the procedure, for example because they do not believe in its success, carrying out the procedure neither appears to be meaningful nor is the

interference in creditor rights justified. Provision should therefore be made for the procedure to be terminated at the initiative of the creditors at any time, if a simple majority of the creditors are opposed to the continuation of the proceedings.

## 4 Restructuring plans

### 4.1 Acceptance and confirmation of the restructuring plan

#### 4.1.1 Explicit refusal by creditors (Article 10 (1a))

The lack of comment on the restructuring plan by a creditor should not be considered as consent.

Under the present proposal, restructuring plans generally do not require judicial confirmation. Judicial confirmation should be envisaged, inter alia, if the restructuring plan also affects the interests of creditors who have rejected the plan (Article 10 (1a)). It seems, therefore, clearly necessary that a creditor explicitly disagree with the plan.

In view of the fact that an out-of-court procedure is involved, the initiation and implementation of which is not tied to any pre-requisites to be examined by a court or other authority, it appears inappropriate to consider a creditor's lack of comment as consent. Rather, it should be required that a plan may only bind the creditors if all creditors have explicitly agreed. In Article 10 (1a) it should therefore read "non-consenting affected parties" instead of "dissenting affected parties".

#### 4.1.2 Majority of votes in the case of judicial confirmation (Article 9 (4), (5))

The sum total majority pursuant to Article 9 (4) must amount to at least 90 per cent.

The EU Commission's proposal provides that a restructuring plan can be confirmed by the Court and made binding for all creditors if, among other things, certain voting majorities are given. For the adoption of the restructuring plan, a sum total majority (based on the amount of the claims or interests) must be achieved in each creditor class and, if applicable, in the equity holder class. For this, a simple majority (more than half) should suffice (Article 9 (4), first sentence). Under Article 9 (4), second sentence, Member States may, within the framework of implementation, lay down the majorities necessary for the adoption, but not more than 75 %.

These requirements for the majority ratios are not acceptable.

The Commission itself remarks that the voting behaviour of the creditors is also a vote on whether the debtor enterprise is viable (Recital 17). Only if a large majority (i.e. at least 90 %) agree to the rescue plan does it have sufficient creditor support for a rescue. To this extent it must also be taken into account that as long as the insolvency is only probable, but has not yet occurred, even higher requirements must apply in order to justify inroads into the rights and assets of creditors who do not voluntarily agree to these inroads.

The "best interest of creditors test" (Article 10 (2b); (Article 2 (9)) does not replace the high requirements for the voting majority. While this test is suitable in an insolvency plan procedure to ensure the protection of non-consenting creditors, this test alone is not sufficient in the case of the preventive restructuring procedure presented here. Unlike insolvency plans following the opening of insolvency proceedings, with a restructuring plan in a preventive restructuring framework it is by no means certain that the rights of the creditors will be curtailed at all (in later insolvency proceedings). Only the voting

majorities being discussed here open the possibility of also curtailing the rights of non-consenting creditors.

The sum total majority pursuant to Article 9 (4) must amount to at least 90 per cent (and not only at least 50 per cent and at most 75 per cent). In any event, the Member States may not be denied the imposition of such higher requirements on the voting majorities.

#### 4.1.3 Cross-Class Cram-Down (Article 11)

| A cross-class cram-down is to be rejected. |
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The Commission's proposal provides that in certain circumstances the Court can replace the lack of consent by creditor groups (cross-class cram-down). The provision of a cross-class cram-down is to be rejected in pre-insolvency proceedings. The substantial interference in the rights of the creditors involved with this provision is not justified. In addition, the procedure for confirming the restructuring plan (Article 10) is marginalised: once the consent of the creditors has been reached in only one creditor group, the debtor no longer has to carry out the procedure for confirming the restructuring plan.

An exception should be provided only with regard to the equity holder group and, if appropriate, the equity holder-like creditor group (those holding a position similar to an equity holder due to a subordination or extensive co-decision rights, e.g. mezzanine creditors). Only these groups should be overridden if necessary. They are particularly close to the debtor company and profit in a special manner from the economic success of the company after a successful rescue. It may be assumed that there is an overriding interest in carrying out a rescue even against the will of these creditor groups, on the basis of a plan proposed by the debtor company itself, if all other creditor groups have consented and are prepared to contribute to the rescue.

However, if an extensive cross-class cram-down regulation were nevertheless to be introduced with the Directive, then the secured creditors would have to be excluded from the possibility of the cross-class cram-down or from the application of the restructuring plan. For this would entail a depreciation of their loan collateral that would not be compatible with banking supervisory law.

#### 4.1.4 Valuation (Article 13)

| The reference for the valuation of the creditor interests should be the going concern value and not the break-up value, as envisaged in the proposed Directive. |
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The measurement of the creditors’ interest at break-up value, as envisaged by the present draft, is inappropriate. The benchmark for assessing the creditor's interests should generally be the going concern value, with special consideration for collateral, but not as now – under the so-called "best interest of creditors test" pursuant to Article 2 (9) – the break-up value.

The valuation for affected equity holders relates to the going concern value of the company, whereas the "best interest of creditors test" pursuant to Article 2 (9), which is the benchmark for the creditors concerned, is based on the break-up of the company. This reference is very unfavourable for the creditors concerned. For it carries the risk that, in the context of the preventive restructuring procedure, the company will be restructured in favour of the shareholders, but to the detriment of the creditors. Since the procedure may be initiated before the debtor is insolvent, it is to be assumed that any plan submitted will provide for a more favourable satisfaction quota than the quota in insolvency proceedings, and that the requirements of the "best interest of creditors test" will therefore virtually always be fulfilled.

However, the test does not ensure a balanced comparison, since it does not take into account the fact that the creditor would legally have had the option of enforcing his or her claim early on, prior to the insolvency. This circumstance will not encourage the acceptance of preventive restructuring procedures among creditors. If the credit institutions' satisfaction quota were to decrease as a result of an imbalanced "best interest of creditors test", the credit institutions' default rate calculations would have to be adjusted accordingly, which would entail further pressure on the regulatory capital requirements for EU banks and consequences for the financing of new companies.

It is therefore necessary, from the point of view of the German banking industry, to revise the "best interest of creditors test" pursuant to Article 2 (9). According to the draft Directive, the test is based on the break-up value – whether this is the break-up or the sale of the company as a whole. Instead, it should adduce as the benchmark the figure the creditor would have obtained if he or she had enforced as early as possible and realised the collateral.

### 4.2 Protection of rescue loans (Article 16)

In Article 16 (1), second sentence, privileged treatment should also be excluded if the lender has not previously convinced themselves that granting the loan as part of a restructuring plan is likely to lead to the rescue of the company.
The same conditions should apply to the possibility of granting lenders the right to preferential satisfaction in a subsequent insolvency proceedings (Article 16 (2)).
The privileged treatment of restructuring loans should be restricted to external borrowers.

The proposed Directive provides for the special protection of rescue loans in possible subsequent insolvency proceedings. Under this proposal, Member States must adequately encourage and protect the company's new financing.

(Loan) contracts for new financing for the company may only be declared void or unenforceable in subsequent insolvency proceedings if they have been carried out fraudulently or in bad faith (Article 16 (1) sentence 2). To our understanding, this basic rule corresponds to the current legal situation in Germany. Accordingly, the financing of a company in crisis is regarded as being in bad faith in the sense of a disadvantage for other creditors if the lender has not previously convinced themselves of the prospects of success of the restructuring plan and has comprehensibly come to the conclusion that a rescue of the company is likely through implementing the plan. However, we suggest clarification of this rule.

It is necessary to prevent lenders from lending in a company crisis for the sole reason that they will be privileged vis-à-vis other creditors in subsequent insolvency proceedings. In the spirit of the EU Commission, on the other hand, Member States should encourage the granting of restructuring loans if this new financing contributes to the rescue of the company. In order to clarify this objective, Article 16 (1), second sentence, should exclude privileged treatment not only in general in the case of fraud or bad faith, but also explicitly where the lender has not previously convinced themselves that the loan, as a component of a restructuring plan, will probably lead to the rescue of the company.

The same conditions should apply to the possibility of according the grantors of new or interim financing the right to preferential satisfaction in subsequent insolvency proceedings (Article 16 (2)).

In the opinion of the German banking industry, the privileged treatment of restructuring loans should be restricted to external borrowers. If equity holders grant loans in this phase, the general rules for equity

holder loans should apply. There is no justification for favouring equity holders who decide to give loans rather than equity capital.

Finally, it must be ensured that the privileged treatment of rescue loans does not disadvantage existing creditors, especially as this could jeopardise collateral pool eligibility in the case of mortgage collateral.

### 4.3 Protection of the costs of restructuring and of restructuring advice (Article 17)

The privileged treatment of advisory fees is to be rejected.

We acknowledge that not all payments relating to the restructuring are to be protected by the arrangement in Article 17, and that the preference should apply in particular only to plans approved by a court (Clause 1) and also only for reasonable payments (Clause 2a). Nonetheless, such comprehensive protection of advisory fees is to be rejected. On the contrary, advisory fees and other transactions aimed at promoting negotiations on the restructuring plan should be dealt with as would any other receivable by creditors. That those who provide advisory services should be in a better position than both those who provide new loans for the rescue of the company and those who are already creditors of the debtor company is also to be rejected. Finally, it is counterproductive to grant privileged treatment only in the case of judicially confirmed plans, because this creates a false incentive for consultants to always seek court confirmation. This would run counter to the aim of the EU Commission to create a procedure with the least possible involvement of the courts.

## 5 Duration of the Discharge Period (Articles 19, 20)

The short duration of the discharge period is to be rejected. At best, it would be conceivable to grant a reduction to three years if the debtor provides a sufficient quota. Moreover, the Directive should not specify a maximum duration, but a minimum duration of the discharge period (of at least three years).

Article 20 of the draft directive provides that a discharge automatically occurs within a maximum of three years. There are no requirements such as a proportional satisfaction of the creditors (Article 20 para. 1) to be satisfied for this.

This short duration of the discharge period is to be rejected. It does not provide any incentive for the satisfaction of creditors. Experience in Germany has shown that debtors are often able to make partial contributions to the repayment of insolvency claims only after three years. An unconditional short discharge period (of a maximum of three years) would therefore lead to creditors having to face a significantly poorer or even no quota.

The aim of insolvency proceedings and a discharge procedure is the equal satisfaction, but also the highest possible satisfaction of the creditors on the one hand and the complete discharge of the debtor from his or her obligations on the other. Both objectives must be reconciled. The creditor's interest in the highest possible rate of satisfaction is countered by the debtor's interest in as fast a discharge as possible. While the debtor is debt-free after the grant of the discharge, the creditors must bear the (economic and legal) damage incurred by them due to the discharge.

A short three-year discharge period must therefore be made dependent on the debtor contributing not merely negligibly to limiting the damage to his or her creditors. To this extent, it would be conceivable, in line with the German model, to grant a reduction to three years if the debtor is able to pay at least 35 % of the debts.

Furthermore, the draft Directive does not provide for a minimum level on the duration of the discharge procedure. In order to ensure a level playing field within the European Union and to curb the "insolvency tourism" the EU Commission complains of (see Recital 4), the Directive should set not a maximum, but a minimum discharge period (at least three years).

## 6 No change in the COMI during a restructuring procedure

The Directive should be supplemented by a provision to the effect that the debtor is not allowed to change his or her Centre Of Main Interests (COMI) within the meaning of Article 3 European Insolvency Regulation as long as a restructuring procedure continues. The acceptance of preventive restructuring procedures among creditors would suffer significantly if debtors were given the opportunity to abuse restructuring procedures to “buy time” by removing their COMI to another jurisdiction.

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