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Living in a Debtor's Paradise? The New EU Directive on Restructuring and Insolvency

Getting a second chance and bringing a business back to life with the help of effective restructuring procedures seems uncontroversial throughout the EU. However, there was until recently no EU-wide legal framework for such procedures. After more than two years of negotiations, the EU Directive on Restructuring and Insolvency was finally adopted on 20 June 2019. There are major concerns that it will be too favourable to debtors. One thing, however, is clear: during the implementation process to be completed by 17 July 2021, lots of other issues and details will have to be brought to the table.

Aims of the Directive

What the EU legislator had in mind during the adoption process seems obvious: everyone involved benefits from restructuring a business and keeping the know-how, jobs and general structure alive rather than liquidating the business's assets. A European-wide harmonization of these procedures not only provides legal certainty for cross-border investments but also prevents forum shopping for jurisdictions with more efficient procedures that provide a truly fresh start for entrepreneurs. Through all this, the directive's aim is to ensure the proper functioning of the internal market.

When does it all start?

Entities wishing to benefit from these new procedures if they are in financial difficulties still have to be viable and cannot be insolvent. In fact, in order to be able to initiate a procedure, there must be a likelihood of insolvency. When exactly this is the case has to be defined by the national legislator. In the Austrian legal system, there are already certain criteria which lead to different legal consequences. The most prominent examples include the duty to file for insolvency under the insolvency code (*Insolvenzordnung*) in case of impending insolvency (*drohende Zahlungsunfähigkeit*) and the need for reorganisation under the Business Restructuring Act (*Unternehmensreorganisationsgesetz*) where the equity ratio deteriorates materially and on a lasting basis. However, it is still unclear how the definition of the likelihood of insolvency will relate to these statutory facts.

A chance to improve current legislation?

The latter reorganisation procedure is hardly ever used in practice, since it does not seem to provide enough benefits for the debtor. There is, for example, no moratorium on the enforcement of creditors' claims during the restructuring period, whereas under the directive the debtor can apply to the court to obtain one. During this period, mandatory insolvency filing rules for directors will be suspended as well. What is more, this comes with a more general protection against the enforcement of *ipso facto* clauses, meaning that suppliers with contractual rights to terminate the supply contract solely based on the insolvency will not be able to invoke these rights. Therefore, it remains to be seen whether amendments of national laws will be necessary in Austria.

The restructuring plan

The debtor, and – if national legislation so determines – creditors and the restructuring administrator, can submit a restructuring plan. Voting is open to affected parties, i.e. creditors but also

workers and equity holders whose interests are directly affected by the restructuring plan.

A major difference to Austrian law is the mandatory division of creditors into classes according to their commonality of interest; for example, the division into secured and unsecured creditors. There is also no minimum quota that has to be guaranteed in the plan. This ultimately represents the second chance and a fresh start for the debtor. However, currently, under the Austrian insolvency code, a quota is necessary and usually amounts to 20%, rising to 30% for a reorganisation in self-administration. This no quota requirement is balanced out by the seemingly high threshold for consent to the restructuring plan, which can be set by each Member State at up to 75% of votes. Generally speaking, the consent of all classes is needed, except when a cross-class cram-down takes place.

Various outcomes for the restructuring plan

If the restructuring plan is not approved in every voting class, it may under certain circumstances be confirmed by a judicial or administrative authority upon the proposal of a debtor or with the debtor's consent, and become binding upon dissenting voting classes. This can ensure that promising restructuring processes are not torpedoed by particular creditors. There is even the possibility for Member States to allow a debt-to-equity-swap, which could ultimately entail the takeover of the company against the will of shareholders, to be included into the plan.

Of course, the court can also decline to confirm the restructuring plan if there is no reasonable prospect for the future viability or the prevention of insolvency of the business.

But what about the creditors' interest?

As a counterpart to many provisions ensuring the benefits for the debtor and the efficiency of the whole procedure, there is the guiding principle that all restructuring measures have to comply with the *best-interest-of-creditors test*. The test is only passed and the plan confirmed by the court if no dissenting creditor would be worse off under the plan than in a normal ranking of liquidation priorities in national insolvency or restructuring proceedings.

We will have to see what the future brings.

Author

Dr. Thomas Trettnak

For more information

Dr. Thomas Trettnak, LL.M./CM
Partner Austria
Thomas.trettnak@cerhahempel.com
Tel: +431 514 35 531

Media owner and publisher: **CERHA HEMPEL Rechtsanwälte GmbH**, Parkring 2, A-1010 Vienna | Tel: +43 1 514 350 Fax: +43 1 514 35 35 | email: office@cerhahempel.com | Although this newsletter was created with the greatest of care, we nevertheless do not accept any responsibility whatsoever for its content being correct, complete or up to date **| Visit us at www.cerhahempel.com |**
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