

30 September 2015

**EVALUATION OF THE IMPLEMENTATION OF THE COMMISSION
RECOMMENDATION**

of 12.3.2014

ON A NEW APPROACH TO BUSINESS FAILURE AND INSOLVENCY

The Member States were invited to implement the principles set out in Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency¹ by 14 March 2015 and to communicate to the Commission, on a yearly basis, data concerning the insolvency procedures. The Commission services sent a questionnaire on the review of the Recommendation to the Member States to enquire about its implementation. To date, 24 Member States have sent their contributions to the Commission explaining how they have implemented the Recommendation². The Commission undertook to assess the implementation of the Recommendation in the Member States by September 2015. No reaction has been received yet from four Member States³.

1. Reform processes in the Member States undertaken since the adoption of the Recommendation

According to the responses received, a few Member States have undertaken reforms which, in some cases, resulted in legislation implementing the Commission's Recommendation (legislation was passed in SI introducing a preventive restructuring procedure, ES, HU and RO have improved their personal insolvency regime, HR in both personal and corporate restructuring regimes, new PL is also due to pass legislation soon in the area of corporate restructuring). Such legislation in most cases implements only partially the Commission Recommendation: for example, SI has implemented a preventive restructuring procedure which is limited to debtors which are medium and large companies, but excludes from its scope small enterprises, and to financial creditors only; ES has implemented a personal insolvency procedure, but did not follow the Commission's recommendation on limiting the discharge period for honest debtors to three years, instead limiting it to five years.

In NL a reform process which aims at improving the existing preventive restructuring procedures which does not seem to function properly is still on-going, in LT improvements to the personal insolvency laws are being discussed, while in others Member States consideration is still being given to whether any specific action is necessary following the adoption of the Commission Recommendation (for example in Sweden a special committee was appointed to look at the need to adapt national legislation in the light of the Recommendation and the results are expected in October 2016; in the UK a public consultation has recently been carried out).

¹ COM (2014) 1500 final.

² Austria, Belgium, Bulgaria, Croatia, Czech Republic, Estonia, Finland, France, Germany, Greece, Hungary, Italy, Latvia, Lithuania, Luxembourg, The Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the UK.

³ Cyprus, Denmark, Ireland and Malta.

2. The situation on 12 March 2015

One year after the adoption of the Commission Recommendation, on the basis of the responses of the Member States, the main elements of the Recommendation are implemented in different ways in the Member States.

2.1. Preventive restructuring procedures

Enterprises do not have the same opportunities to deal with their financial difficulties everywhere in the Union. In some Member States businesses in financial difficulties have more opportunities than in others of restructuring their debts by having access to efficient, fast and low cost procedures. In several Member States, flexibility is also built into the legal framework, in that debtors can choose between several such procedures according to their needs (such as the need to restructure only certain of their debts, e.g. financial debts; or the need to obtain a stay), or can combine several such procedures as negotiations on a restructuring plan evolve (for example where a stay becomes necessary only at a later stage).

Several conditions may contribute to the efficiency of restructuring procedures, but six in particular seem to stand out. The Recommendation has focused on these six conditions which, in order to increase the efficiency of restructuring procedures, should be met cumulatively.

a) The possibility to file early with the objective of avoiding insolvency

The later a business initiates restructuring proceedings, the higher the costs of restructuring and the lower the management powers and success rate. Debtors in financial difficulties should have the possibility to restructure their debts before they are insolvent, when the risk of insolvency is however apparent for example because the debtor is unlikely to be able to repay his debts as they fall due in the foreseeable future.

Member States' procedures fall in several categories. In BG, HU, SK and HR debtors do not have access to any type of structured procedure to restructure their debts with their creditors before they are actually insolvent or are already late with re-payments. AT, DE, IT and PT offer debtors the possibility to restructure before they are insolvent, but under very strict access conditions (e.g. an expert certificate must be filed or proof of a high majority of creditors already supporting the plan is required). Finally, BE, CZ, EE, FI, FR, EL, ES, LV, LT, LU, NL, PL, RO, SE and UK offer the debtor in financial difficulties the possibility to restructure at an early stage when there is a likelihood of insolvency in the future, without strict conditions being attached.

b) The position of the debtor

In order to encourage debtors to address their financial difficulties at an early stage, they should be left in principle in control of the day-to-day operation of their business. This would also ensure that the least disruption to the activity of the enterprise. Where necessary, a mediator or a supervisor should be appointed by the court. Debtors should be left in principle in control of the day-to-day operation of their business.

In FR and NL the debtor may lose certain powers of control over the business during preventive restructuring procedures. In AT, CZ, EE, FI, DE, LV, LT, LU, PL, RO, SK, SI, SE, UK and HR the debtor is left in possession, but an insolvency practitioner is also appointed (AT, DE, EE, FI, FR) or the court itself supervises the debtor (BE). Finally, in EL,

IT, PT and ES there is no obligation for a court to appoint insolvency practitioner or such a practitioner can be appointed out-of-court, while in FI an insolvency practitioner is not required in a simplified restructuring procedure.

c) The possibility of a stay on individual enforcement actions

During negotiations on a restructuring plan, the debtor should be able to apply to a court for suspension of individual enforcement actions which could otherwise jeopardise the success of the restructuring process. The stay could be requested against any type of creditor, but at the same time safeguards should be put in place in order to ensure that it is used strictly for the purposes of facilitating negotiations on a restructuring plan. The first such safeguard is the duration of the stay, which should be calibrated to the complexity of the case and not exceed four months; only in more complex cases should the court be able to prolong the initial duration of the stay upon proof of progress in the negotiations. The second safeguard is the possibility to have the stay lifted when it is clear that it is no longer needed to attain the objective of the procedure.

In AT there is no possibility to obtain a stay of individual enforcement actions in such preventive restructuring procedures. In many Member States the stay period is limited in time and can be extended in more complex cases or upon evidence of progress in negotiations (CZ, FR, IT, LV, LT, NL, PT, SE, SI, and UK), while in some it cannot be extended (DE, ES, EL, PL). Where there are several procedures in place, the length of the stay usually varies from one procedure to another. In BE, EE, FI, LU, RO the stay is for an indefinite period, until the restructuring plan is adopted or rejected. In BE, DE, EL, SE the stay may be lifted by the court before the expiry of the stay period if the objectives of the stay can no longer be achieved or there is evidence of abuse. Most often the stay also means that insolvency procedures cannot be open against the debtor. In some Member States some actions cannot be stayed (e.g. in BE and SE in respect of specific secured transactions; in EE in respect of employment claims).

d) Adoption of the restructuring plans by creditors

The Recommendation provides for the adoption of restructuring plans by creditors representing the majority stipulated under national law. It also requests that creditors should vote in classes constituted according to their interests, but that as a minimum secured and unsecured creditors should be treated in different classes for the purposes of adopting restructuring plans. Furthermore, the majority should be weighted depending not merely on the number of creditors, but on the amount of their claims. For the success of restructuring plans, it is necessary to involve those creditors likely to be affected by the plan. While formal voting is not absolutely necessary, when it is foreseen in national law, creditors should whenever possible be allowed to vote by distance means of communication. This will increase creditor participation by lowering their ancillary costs.

In AT and LT there is no possibility of binding dissenting creditors by majority voting. In CZ, EE, EL, ES, HR, IT, LV, LU, NL, PL, PT, SI and the UK binding dissenting creditors is in principle possible, but certain categories of creditors are exempted (e.g. public creditors, employees, secured creditors, commercial creditors). BE, DE and RO offer the possibility of binding dissenting creditors, but they require that all creditors are involved, even those whose rights are not affected. Finally, FI, FR and SI give the possibility that only certain categories of creditors which are affected by the plan are involved (e.g. financial creditors).

e) The protection for new finance granted in restructuring procedures

Encouraging new financing is necessary to ensure the success of a restructuring plan. As a minimum, the most effective means of protecting new financing which was agreed on in the context of a restructuring plan are first to exempt it from avoidance actions and second to exempt providers of such new financing from civil and criminal liability, where it exists. Furthermore, no protection should be granted where fraud was established.

In most MS new finance during restructuring proceedings is allowed (albeit debt-equity swaps are permitted to a lesser extent), however in EE, HR, LT, LU, PL and SE it does not seem to be protected in subsequent insolvency proceedings in any special way. In AT, EL, ES, FR, IT, NL, PT, SI and the UK new finance is protected from avoidance actions while in BE, CZ, FI, FR, IT, DE, EL, LV SI, SK, RO and the UK it receives super-priority or a special status in subsequent insolvency proceedings.

f) The involvement of courts when third party rights could be affected

The Recommendation encourages certain limits to the extent of court involvement. Certain steps in a restructuring process require court involvement. This is the case where the rights of dissenting creditors are affected, either at the stage of imposing or subsequently lifting a stay of individual enforcement actions, or at the stage of validating a restructuring plan which affects such creditors or which provides for new financing directly or indirectly affecting the rights of certain creditors. However, most other steps in the restructuring process do not need to take place in court. For example, when formal voting is required in national laws this could take place out-of-court.

In BE, FI and NL early restructuring procedures require full court involvement, from starting negotiations, and including the appointment of an insolvency practitioner and voting on a plan. In CZ, EE, FR, DE, LV, LT, LU, PL, RO, SE, SI and the UK, while a court must be involved early at the beginning of the process, negotiations between debtor and creditors and voting take place outside court. Finally, in AT, EL, IT, PT and ES the court is involved only to approve a stay or to confirm a restructuring plan.

2.2. Second chance provisions

a) Discharge of debt to allow second chance for entrepreneurs

The Commission Recommendation urges Member States to provide for a reasonable discharge period of maximum three years from the opening of liquidation of assets proceedings or, in cases where a repayment plan has been approved, from the moment the plan is put into application. The provision also contains exemptions which are aimed either at discouraging dishonest entrepreneurs from thinking they can benefit from a quick discharge, or to safeguard the livelihood of the debtor, for example.

In DE, IE, LV, FI, FR, NL, SK, UK discharge periods are largely complying with the Recommendation, although in some cases there are strict conditions attached (e.g. in DE the need for the repayment of 35% of debt). Gaps still remain: there is no possibility of discharge in BG and HU, while in HR, LU and PL there is no definite discharge period and the discharge is left to the discretion of the judge. Discharge periods are still too long in CZ, EE, ES, LT, PT, SI, SE (5 years), AT and BE (7 years), and EL (10 years).

3. Initial impact of reforms implementing the Recommendation

As a general rule, it can be noticed in Member States with weak preventive restructuring frameworks the number of restructurings is low or very low.

As for the recent reforms, although it is still too early to make a comprehensive assessment of their impact, the initial results in the Member States are already visible. For example, in Member States which have introduced a preventive restructuring procedure for the first time, the number of restructurings has increased significantly while the amount of debt-overhang has decreased.

4. Conclusion resulting from the implementation of the Recommendation

In conclusion, it can be seen that among the Member States who replied, several Member States consider that they already largely comply with the Recommendation, and that a significant number of those which do not comply have not launched any reforms to date.

While it is clear that the Recommendation has provided useful focus for those Member States undertaking reforms in the area of insolvency, it has not succeeded in having the desired impact in facilitating the rescue of businesses in financial difficulty and in giving a second chance to entrepreneurs because of its only partial implementation in a significant number of Member States, including those having launched reforms. These differences in the implementation of the Commission Recommendation mean continuing legal uncertainty and additional costs for investors in assessing their risks and continuing barriers to the efficient restructuring of viable companies in the EU, including cross-border enterprise groups.