The EU Directive on Restructuring and Insolvency and the Strengthening of the Creditor's Role in the Course of Restructuring Procedures

On 20 June 2019, the European Parliament and the Council approved the Directive on restructuring and insolvency[1], aimed at reaching a minimal and harmonized preventive restructuring framework within the European Union. The State members have until 17 July 2021 to transpose this directive into their own national legal system[2].

In France, the PACTE law dated 22 May 2019 has entitled the government to transpose the Directive through governmental ordinance at the latest on 22 May 2021[3]. In this regard, the French Ministry of Justice has launched two public consultations, between 2019 and 2021. The publication of the ordinance is expected very shortly.

The new Directive emphasises the European legislators' determination to establish, within all State members, preventive restructuring procedures for companies facing financial struggles without being insolvent, and thus hopes to reinforce the culture of anticipation and prevention of insolvency (**I.**). Simultaneously, the Directive undertakes to rebalance bankruptcy laws in favour of creditors (**II.**).

I. Priority given to prevention *via* restructuring procedures

Inspired notably by the French and German existing frameworks, the Directive aims at setting a preventive restructuring framework enabling the debtor to act « *at an early stage* »[4], in order to avoid liquidation.

The Directive indicates that these preventive procedures should enable companies facing financial difficulties to pursue their business by « *changing the composition, conditions or structure of their assets and their liabilities or any other part of their capital structure – including by sales of assets or parts of the business or, where so provided under national law, the business as a whole – as well as by carrying out operational changes* »[5].

In so doing, the Directive strengthens the involvement of creditors in the rescuing process of the debtor. In this respect, the Directive encourages State members to authorize operations facilitating investments and takeovers within the framework of the restructuring plan, in particular through the restructuring plan, including operations of:

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[1] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).
[2] Directive (EU) 2019/1023, op. cit., article 34.
[3] L. No. 2019-486 of 22 May 2019 on the growth and transformation of companies, JORF No. 0119 of 23 May 2019, Article 196.
[4] Directive (EU) 2019/1023, op. cit., whereas 2.
[5] Ibid.

- "New money" by giving, to existing or new creditors providing financial assistance to the debtor, a privileged status in the case of hypothetical future insolvency proceedings [6];

- Debt-to-equity swaps operations aiming at the conversion of the creditors' debts into equity holding in the company facing financial difficulties[7].

II. The strengthening of the creditor's role in the course of restructuring proceedings

While the Directive intends to facilitate the dialogue between stakeholders [8], the protection of the interests of principal creditors has been made a priority.

Indeed, the Directive provides for new mechanisms with regard to French law which transposition should increase the role of the majority's creditors in the preparation and the negotiation of the restructuring plan. Notably:

- The distribution of creditors into several classes, based on different criteria from the "creditor committees" [9]. The Directive imposes that at least two separate classes are created : one gathering creditors with secured claims, and another one gathering creditors with unsecured claims. In addition, a class of employees could also be set up, as well as a class of shareholders of the debtor company.
  Each class of creditors will vote on the restructuring propositions. The plan will be adopted as soon as the majority is reached in each class[10]. The majority will be calculated by taking into account the amount of claims or interests of the creditors , and its legal limit will not exceed 75%[11] , and when;

- A *cross-class cram-down* mechanism[12] allows for the imposition, under certain conditions, of a restructuring plan upon all the affected parties, even if the plan has not been approved by the majorities required by law. This mechanism may be enforced where the restructuring plan has been approved by at least : (i) one of the classes of secured creditors or having a senior rank with regard to the ordinary unsecured creditors class, or, if that is not the case (ii) one of the voting classes, other than an equity holders class or any other class which could be reasonably

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[6] Directive (EU) 2019/1023, op. cit., article 17. Also, these operations are already covered by French bankruptcy laws (article L.611-11 of the French Code of commerce).
[7] Ibid.
[8] Directive (EU) 2019/1023, op. cit., whereas 10.
[9] In France, the creation of *comités de créanciers* are compulsory if the debtor has 150 employees and/or a turnover of more than € 20 million without tax. There are two types of *comités* : one gathering credit institutions *comité*, and another one with the principle suppliers (article L. 626-30 of the French Code of commerce) and, when required, a third *comité* gathering the bondholders. Thus, French law will have to give up its classification based on the status of the creditors, and adopt a classification based on the nature of the claims from the standpoint of the commonality of economic interest.
[10] Directive (EU) 2019/1023, op. cit., article 9.
[11] We can reasonably assume that the current 2/3 majority required by French law will be maintained in the future reform to come (Article L.626-30-2 of the French Code of commerce).
[12] Directive (EU) 2019/1023, op. cit. article 11.

presumed not to receive any payment or keep any interest if the normal ranking of liquidation priorities were applied.

- The cross-class cram-down principle should ensure the adoption of the restructuring plan by overriding the dissenting minority creditors[13].

- *A priori*, such a mechanism should favour a swift and simplified adoption of the restructuring plan. However, it should be noted that France plans to make its application subject to the prior agreement of the debtor[14].

- Lastly, the Directive requires State members to take any necessary measures aiming at ensuring that the debtor and the equity-holders would not interfere "unreasonably" in the adoption of the restructuring plans[15]. For this purpose, the State members are free to remove the equity holders' voting rights in the adoption of the plan[16].

Furthermore, the new priority given to creditors can also be seen in the limited control granted to the judicial authority on the plan adopted through the cross-class cram-down mechanism. In this respect, the Directive considers that the Court shall not supersede the negotiations driven by the creditors, by modifying the plan [17]. Therefore, the Court's control over the plan shall be limited, except on the grounds of fraud. In this case, the following two criteria shall be examined:

- The *best interest rule* which aims at ensuring that no dissident creditor is worse off under a restructuring plan than they would be in the case of liquidation [18].

- The best interest rule test should be examined by the Court only if the restructuring plan is challenged on this ground [19].

- The *absolute priority rule* which aims at protecting a dissenting class of affected creditors by ensuring that it is treated at least as favourably as any other class of the same rank, and more favourably than any more junior class [20].

If a certain flexibility is granted to State members in the establishment of the above-mentioned mechanisms and rules, the intent of the Directive is to facilitate and speed up restructuring procedures, and to promote their efficiency by placing the creditors as leaders within the adoption of the restructuring plans.

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[13] Directive (EU) 2019/1023, op. cit., article 11.
[14] The proposed new article L. 626-32 of the French Commercial Code provides that only the debtor or the court-appointed administrator, with the agreement of the debtor, may request the court to adopt a plan in accordance with the inter-class forced application.
[15] Directive (EU) 2019/1023, op. cit., whereas 57.
[16] Directive (EU) 2019/1023, op. cit., articles 9.2. et 12.
[17] Directive (EU) 2019/1023, op. cit., article 4.
[18] Directive (EU) 2019/1023, op. cit., whereas 52, article 10.
[19] Directive (EU) 2019/1023, op. cit., whereas 50, articles 2.d. et 10.
[20] Directive (EU) 2019/1023, op.cit., whereas 55.

As mentioned, a reform of French bankruptcy laws is expected by 22 May 2021 to satisfy the transposition requirement of the Directive.
Even though some of the mechanisms provided for in the Directive are already enshrined in the French restructuring and insolvency law, the introduction of those aiming to reinforce the position of creditors within the safeguard proceedings should lead to rebalance these proceedings, that are currently very much in favour of debtors.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

Eric Russo
Email: ericrusso@quinnemanuel.com
Phone: + 33 1 73 09 43 19

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