European Association of Certified Turnaround Professionals

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European Commission
Directorate-general Justice
Unit A 1 Civil Justice Policy - Secretariat
Rue Montoyer 59, 2/74
1049 BRUSSELS, Belgium

Dear Sir/Madam

RE: CONSULTATION ON INSOLVENCY II
Focus: "Early Restructuring Procedure"

With reference to your aforementioned project and the letter of my predecessor as President of the European Association of Certified Turnaround Professionals (EACTP), Mr. Tyrone Courtman, as of 17 March 2015 regarding the previous consultation, I would, in the name of EACTP, make the following comments:

1. **Summary**
   EACTP strongly supports the EU-Commission's recommendations as contained in its paper issued on 12 March 2014 ("on a new approach to business failure and insolvency") and would only recommend to add some clarifications and minor adjustments in order to differentiate the envisaged "Preventive restructuring framework" from "insolvency proceedings" of any kind.

2. **Background of EACTP**
   EACTP is an independent organisation, which has established the first European-wide accreditation programme for all turnaround professionals to provide an industry standard of quality in the practice of turnaround and restructuring. We currently have certified members from Eire, Denmark, Finland, France, Germany, Greece, Italy, The Netherlands, Poland, Romania, Serbia, Spain, Sweden, Switzerland and the UK.

3. **Focus of this recommendation – "pre-insolvency restructuring mechanism"**
   Within this letter, I am going to focus on the core competence of our organisation – the operational turnaround which looks at the distressed business holistically to identify the cause of the problem and the challenges facing the business, including, but not limited to, operating model, organization and culture, process, strategy, customers, suppliers, pricing, skills. Although insolvency procedures are necessary in a free market economy and might even lead to the turnaround of companies, we think that insolvency is rather a means to allow for companies unfit for the market to leave it within an orderly framework than a tool for restructuring. Albeit there are examples of (especially large) businesses being rescued in insolvency procedures, most businesses going into insolvency end there being liquidated. Despite these facts, our impression is that during the last years, the focus of most reforms has been to improve insolvency proceedings as a means to turnaround companies rather than to ask whether insolvency procedures as such are the right "tools" to turn around a company. Real turnaround to our utmost conviction, however, always involves and evolves around the operational restructuring of a business, not merely its financial restructuring. This may be achieved in and out of insolvency, however, after many years of experimenting with

insolvency procedures it is apparent to us, that it did not really improve the figures of rescued businesses.

Therefore, we assume that any additional formal "early restructuring procedure" should have the aim to present a framework for operational restructurings. Accordingly, we will concentrate our recommendation on the shortcomings of the procedures currently in place with regard to operational turnarounds and comment on the cornerstones of a procedure allowing to turn around a business with operational means.

4. Shortfalls of the current regime

a) Insolvency Procedures are not a "turnaround" procedure per se

Insolvency is often praised as a "turnaround tool", however, actual figures in the EU-member states do not support this opinion. Even if – especially in larger cases – a turnaround is effectuated through an insolvency procedure, experience shows that this "turnaround" is seldom accompanied by an operational restructuring, but most of the time it is rather only a "financial restructuring".

Currently there is EU-wide no harmonised framework in place to deal with out-of-court / pre-insolvency restructurings. The current "regime" – especially regarding SME's – more often than not consists of two steps: the attempt of a debtor to negotiate a deal, often followed by an (ill-prepared) insolvency procedure in which – depending on the personality of the insolvency administrator as the designed "strong man" – a haircut might be executed through whatever plan-mechanism being in place in the respective state, which is then sold as turnaround to the public.

Quite often in these cases, the short period of time in which the "turnaround" was achieved within insolvency is stressed as additional success. However, this proclaimed swiftness is at odds with our observation that operational restructuring needs time to be effective, a minimum of 6 months. This is all the more true if old habits and culture within the business have to be exchanged for new ones and/or alternative measures and strategies that needs executing such diversification or innovation. Accordingly, our experience is that most of the "turnarounds" in insolvency-procedures only really manage to stabilise the respective business while hoping that certain measures introduced will become effective before the company falls back into a crisis.

On the other hand, especially in large cases, involving the financial restructuring of a leveraged buy-out (LBO), the all-comprising effects of an insolvency are not adequate – but rather intrusive – to deal with financial issues arising only between a relatively small and professional group of financial investors / banks and the business. Therefore, most investors try to avoid insolvency if at all possible knowing that it would additionally destroy value. However, other "investors" try to use this fact as leverage – and threat with insolvency. "Solutions" in these cases often rather resemble a ransom and frequently seem to be more to the benefit to the hold-out creditor and to the detriment of the company.

b) Out-of-court restructurings require unanimous support

In out-of-court restructurings money and thus time is often running out faster than it is possible to seriously assess the chances of a survival of the company. Quite frequently, banks and other institutional creditors go down on an ailing business using their advanced knowledge of the company's financial situation – and also being forced to by current banking regulation (Bale III). Hence a crisis situation might lead to the sudden "death" of the enterprise after a certain tipping point has been passed. The problem is that nobody is really able to foresee this tipping point after which the situation deteriorates very fast. Hence, a certain "stop"-mechanism like a formal "out-of-court" procedure might give a breathing space in which to assess the company's viability.

Also, as already stated above for LBO-restructurings, the threat of insolvency presents a leverage for free-riders to assert a full payment of their own claim (which in some cases has been bought at a discount from the original creditor). It is not unusual to pay 100% of the amount originally due to such creditors (so-called "nuisance fee") while forcing a "haircut" to all other creditors. This

unpopular "deal-making" is due to the fact that outside of insolvency creditors may always request a 100%-payment of their claim which is a constitutional right derived from the Roman *pacta sunt servanda*.

This two typical examples for the problems of unanimous support show the (legal) boundaries which might hinder successful out-of-court restructurings. A formal set of rules blocking (for a certain time-period) such hindrances could indeed lead to more successful operational restructurings.

5. Commenting on the Commission's Proposal

a) With regard to pre-insolvency restructuring mechanisms, the EU-Commission in its current consultation takes up its previous recommendation as of 12 March 2014 (C(2014) 1500 final) on a new approach to business failure and insolvency. Under point III. "Preventive restructuring framework" of the said recommendation, the Commission states that:

"6. Debtors should have access to a framework which allows them to restructure their business with the objective of preventing insolvency. The framework should contain the following elements:

(a) the debtor should be able to restructure at an early stage, as soon as it is apparent that here is a likelihood of insolvency;
(b) the debtor should keep control over the day-to-day operation of its business;
(c) the debtor should be able to request a temporary stay of individual enforcement actions;
(d) a restructuring plan adopted by the majority prescribed by national law should be binding on all creditors provided that the plan is confirmed by a court;
(e) new financing which is necessary for the implementation of a restructuring plan should not be declared void, voidable or unenforceable as an act detrimental to the general body of creditors.

7. The restructuring procedure should not be lengthy and costly and it should be flexible so that more steps can be taken out-of-court. The involvement of the court should be limited to where it is necessary and proportionate with a view to safeguarding the rights of creditors and other interested parties affected by the restructuring plan."

Also, the EU-Commission recommends to establish the possibility to appoint a *mediator* or a *supervisor*.

b) EACTP strongly supports this proposal and would like to make the following additional recommendations:

- The overall aim of a preventive restructuring framework should be to FULLY turnaround the business and consequently allow for an operational restructuring to take place.

- In order to avoid a distortion of competition through the excessive use of restructuring mechanisms ("over-restructuring") which could be observed in the USA with aviation companies entering Chapter 11 procedures with the aim to improve their business stance, the "early stage" allowing a debtor (and the debtor only!) to enter into such a procedure should be rather narrowly defined. This could either be the threat of imminent creditor action or independent business reviews (IBR) stating the imminent insolvency of the business.

- The EACTP believes that Directors and business owners should be incentivised and encouraged to take appropriate preventive measures if their businesses are in distress but not yet insolvent. An educational/informative programme and strategies needs to be implemented within the Preventative Restructuring Framework to cascade or make

information available to business owners and directors of companies to help them at an early stage to understand what restructuring is, the process and what can achieve.

- Even a temporary stay of enforcement will from a constitutional law viewpoint always require a court involvement – as would be any cram-down by a majority of the creditors. However, the designated court should in any case NOT be the insolvency court but a different one in order to keep the two procedures strictly separated. Otherwise any "preventive restructuring framework" will be regarded as an "additional" insolvency proceeding – with the consequences to turnarounds as described under point 4 above. We would recommend conferring the competence for such a procedure to a chamber of the court-system specialising in commercial matters.

- The threshold for a majority decisions should be set between the (sometimes low) majority requirements for a restructuring plan in insolvency (e.g. Germany with 50% of the claims in amount and heads) and 100% - to get a high-acceptance rate: We would recommend something between 2/3 and 80% in claims and would allow for the different treatment of creditor-groups as is the case e.g. in English "*schemes of arrangement*"-procedures. There in trade-creditors usually are paid in full (to keep the business alive) while the financial creditors usually take the "haircut".

- Also, in order to allow institutional creditors, like banks, to act differently under a preventive restructuring framework, than they would under insolvency, there is a need for a "synchronisation" of these institutions' regulations (such as Bale III) with the proposed framework.

- EACTP would also strongly support the recommendation to establish the functions of a *mediator* and *supervisor* in the framework basically on a voluntary basis. The function of the mediator will be twofold; firstly of assessment and secondly of steering. Again, as already pointed out in relation to the court-involvement, we would also with regard to the appointment of such persons recommend that it should be a) an individual person, not a corporation, b) in the case of a *mediator* not an insolvency practitioner, whereas in the case of a *supervisor* it might well be one and c) being someone who has proved his / her adherence to certain professional standards, as to business behaviour, insurance, etc. In the case of a moratorium, the court shall authorise a supervisor to issue appropriate reports to the court in order to safeguard the interests of those creditors whose claims are momentarily not executable under a moratorium.

- In addition to the foreseen protection to "new financing" as foreseen in lit D. of the Commission's recommendation, EACTP would advise to include so-called "bridge financing" into the scope of the framework. Bridge loans are usually granted for the sole purpose to allow the survival of the business BEFORE a decision on the restructuring has been taken. As pointed out before, especially SME's typically run out of money once the tipping point is passed. The protection of bridge finance (which is already routine in many member states) would allow for additional finance to be allocated under strict circumstances.

We hope you find these comments useful, and would be very happy to discuss them in more detail or to give you more information on issues raised in this letter or about our association.

Jukka-Pekka Joensuu

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President