



Bundesministerium
der Justiz und
für Verbraucherschutz

The Debate over Priority Rules Read Through the Lense of National Lawmakers

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EU-RPR – what is it about?

Doomsday Prophecy

Relative priority as a “hidden ... piece of dynamite” or “explosive device” having the potential to

- not only blow up the foundations of insolvency and corporate law (*Brinkmann*)
- but also alter “the entire legal system and with it the basic fabric of our European society [!]” (*de Weijs/Jonkers/Malakotipour*)

Promise of the Holy Land

“Einsteinian revolution” transforming established thinking that once helped achieving progress, but has meanwhile to be acknowledged to hamper progress” and apt to “mark a milestone in the advance of civilization[!]” (*Mokal/Tirado*)



Is the EU-RPR actually a rule?

- **Legislative History**
 - “more favorable treatment” as a last minute stopgap solution
 - intendend not as a ready-to-apply rule, but merely to provide for more flexibility
- **No Denotation, Lots of Connotations**
- **Operationalizing “Relative Priority”: Two Levels of Operation**
 - Determining the cap/ceiling for the treatment of junior classes
 - Making a choice from the range of possibilities between such ceiling/cap and APR
- **Factors Relevant when Comparing the Treatment of Classes**
 - Allocated value
 - Dilution/haircut ratio
 - Relative priorities
 - Recognizing option values



Comparing the Treatment of Classes

- **Allocated Value**

Junior class to receive less in value than dissenting senior class.

If junior class receives \mathbf{x} , the senior class would have to receive a position worth $\mathbf{x} + \varepsilon$ ($\varepsilon > 0$)

- May ε actually be infinitesimally greater than 0 – or would it have to be substantially greater?
- Does ranking of the position(s) matter?
- Does it matter how much the senior class has to sacrifice (in relation to what the juniors have to sacrifice or will retain)?

- **Haircut/Dilution Ratio**

Juniors to be impaired by at least the same ratio by which seniors are subjected to a haircut

- Application to shareholders → translate haircut into dilution. Shareholders to retain no more than $\frac{C-H}{C}$ of share capital, where \mathbf{C} is the creditors' original claim and \mathbf{H} the haircut
- $C - H + \frac{H}{C}E$
- $\lim_{n \rightarrow \infty} \frac{a_n}{C} H$ where $a_0 = \frac{C-H}{C} H$



Comparing the Treatment of Classes

- **Preserving Relative Priorities**

No class to be placed in a class (post-reorganization) that ranks below a class, to which the class ranked equal or with priority

- *SWAINE*, 27 Columbia Law Review 901 (1927); 28 Columbia Law Review 29 (1928) (approving of early 20th century practice of railroad restructuring)
- *BONBRIGHT/BERGERMAN*, 28 Columbia Law Review 127 (1928)

- **Recognizing juniors' option value**

- ABI Chapter 11 Commission
- *BAIRD*, 165 University of Pennsylvania Law Review 785 (2017)



Making the Choice from a Broad Range of Solutions

- **The Range**

- EU RPR would be permissive in respect of all solution between the treatment under APR and the ceiling to be determined under the “more favorable treatment”-test
- In order to become operational, a choice must be made between the many possible solutions

- **How to Make the Choice?**

- National legislators would have to either provide for a methodology for determining the appropriate treatment or to allocate the right of choice
- EU RPR is completely silent of the methods and standards as well as the aspects relevant when making that choice

- **Uncertainties in respect of creditors’ treatment are inevitable**

- **Impact on *ex ante*-assessment of Credit Risk**

- Determining LGD for purposes of banking regulation
- Distinguishing between non-subordinated and subordinated titles (see, e.g., § 64 ECB Guideline (ECB/2014/60))



Outlook

“It may be that a formula can be evolved which secures the desired compromise between the absolute priority doctrine and the relative position doctrine but which at the same time leaves the position of each security holder less ambiguous and less subject to the arbitrary or self-interested decisions of those parties who are able to dominate the reorganization policy. Unless and until this is done, the prevailing modified relative position doctrine will remain, as it is today, a dangerous doctrine; for its ambiguity and vagueness leaves the security holders and the courts with no definite standard by which they can decide whether a proposed reorganization plan complies with the priority rights of the different claimants.”

BONBRIGHT/BERGERMAN, 28 Columbia Law Review 127, 164 (1928)