



Plan content and allocation of value

APR vs EU RPR

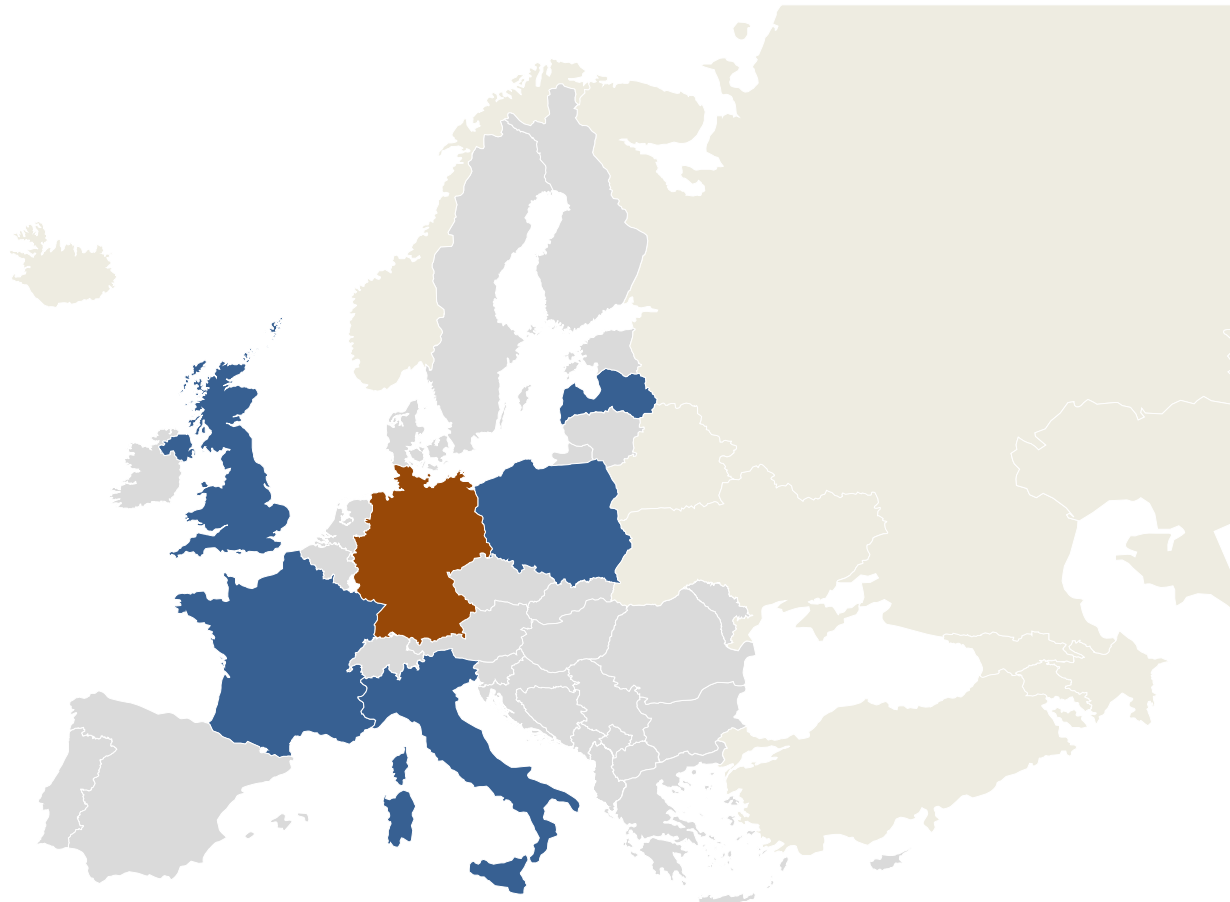
Deviating from Absolute Priority

Amsterdam

24 February 2020



Economies without APR are EU reality



- Classification of creditors (and shareholders)
- APR
- If at all, a veto of a class may be ignored if:
 - a qualified majority of creditors votes to accept (PL/DE),
 - the class has 'no economic interest' (BIT) (UK), or
 - APR and no discrimination of dissenting class (DE).
- Actual consent is usually key
 - Trust in the plan and the debtor (management)
 - Plan is a negotiated solution = cooperation



Best interest of creditors test

Originated in **US law**: s 5103 A of the US Bankruptcy Act of 1874 – today: 11 USC 1129(a)(7)

EU: **'no creditor worse off'** principle (see e.g. art. 36(8), 74 BRRD)

- Guaranty of the **'liquidation' value** in insolvency proceedings
(where liquidation is the only alternative to the plan; see UNCITRAL Legislative Guide, 2004, rec. 152)
- Value generated in case of the (individual) enforcement of a claim without the plan
- Current economic value of a claim/share affected by the plan
 - In some Member states protected constitutional guarantee for property
 - Includes protection of fully secured claims [100 in liquidation = no worse off under the plan]
 - Includes protection by priority in distribution of liquidation proceeds [100 in liquidation = no worse off under the plan]
- Restructuring surplus is not covered (not individually available/enforceable, but product of cooperation)

[for more, see Jacoby/Janger, *Tracing Equity: Realizing and Allocating Value in Chapter 11*, Texas Law Review 96:673 (2018)
(https://scholarship.law.unc.edu/cgi/viewcontent.cgi?article=1425&context=faculty_publications)]



Unease with a (strict) APR in Europe

APR: no junior class receives ANY value before more senior dissenting class is paid in full

Small and medium-size businesses

2018: 25.000.000 SME in EU-28 (93% Micro)
(99% of all enterprises; 66% of
employment)

- Simple capital structure
- Little/no market value in distress
- BIT only protects secured/preferred creditors
- If company, entrepreneur is (only) shareholder
= restructuring must allow for equity to stay

➤ **APR gives EVERY creditor class a veto**

Preferential (public) creditors

APR: Preference = senior class

- Payment in full required before ANY junior class (e.g. unsecured creditor class) may receive ANY value under the plan

= Preferred creditors free-ride in any restructuring

APR frustrates any legislative initiative to involve public creditors in burden sharing
(esp. in jurisdictions with complex preference legislation)



European Law Institute – ‘relaxed’ APR

a) MSME problem with APR

- Distinguish financial equity investors from entrepreneurs (‘sweat equity’/‘soft variables contributors’)
 - Cramdown and APR only against financial equity investors
 - No cramdown (APR) against entrepreneur=equity holder (not impaired or must vote to accept plan)
[similar to new rule for small business debtor in 11 USC 1191(c) – disposable income in 3 years = full payment]

b) Preferential creditors and APR

- NO APR protection, only BIT
 - Legislators shall reconsider preferences for public creditors in a bankruptcy liquidation
- Limited or ‘relaxed’ APR

[European Law Institute, *Rescue of Business in Insolvency Law*, 2017

https://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/Instrument_INSOLVENCY.pdf]



CoDiRe – Relative Priority Rule

- a) Actual creditor support principle
- b) BIT for pre-insolvency cases (not yet insolvent debtors)
 - **No** assumption that alternative scenario is a bankruptcy (piecemeal) liquidation
 - A plan proposing a continuation shall calculate with a going-concern value in the BIT.
 - Where a competing plan was accepted and would be confirmed, BIT values are distribution under this plan.
- c) Relative Priority Rule
 - (1) Each dissenting class receives at least the same as equally ranking classes.
 - (2) No junior class receives an equivalent or better treatment.
 - (3) No senior class receives more than the full present economic value of their claims.
 - More flexibility to retain sweat equity
 - No free-ride incentive for (preferred) creditor classes

<https://www.codire.eu/wp-content/uploads/2018/11/Stanghellini-Mokal-Paulus-Tirado-Best-practices-in-European-restructuring.-Contractualised-distress-resolution-in-the-shadow-of-the-law-2018-1.pdf>



Directive (EU) 2017/1132

An approach with (too) many options:

- a) **EU best interest test:** art. 10(2)(d), 2(6) and recital 52 – *next best alternative scenario*
 - b) **RPR** (default rule in art. 11(1)(c), recital 55) or **APR** (option in art. 11(2), recital 55)
 - c) **‘Relaxed’ Absolute Priority Rule:** art. 11(2) subpara. 2, recital 56
 - d) ‘Relaxed’ treatment of equity if not part of the plan: art. 12, recital 57
 - e) **No cramdown/APR for SME with owner=manager structure:** art. 9(4) subpara. 3, recital 58
- *No deviation from basic principles of civil law – rather a modern, more differentiated framework*