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


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)

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
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

 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