Luther.

EFET Legal Committee: EU Insolvency Law Harmonisation

Gerd Stuhlmacher | 22 September 2023

unyer GLOBAL ADVISORS

EU Insolvency Law Harmonisation – Background and Objectives

Background:

- *The lack of harmonised insolvency regimes has been identified as one of the key obstacles to the freedom of capital movement in the EU and to greater integration of the EU’s capital markets.*
- *Insolvency rules are fragmented along national lines. As a result, they deliver different outcomes across Member States, and in particular they have different degrees of efficiency in terms of the time it takes to liquidate a company and the value that can eventually be recovered*
- *The ongoing **energy crisis** and the limited fiscal space for public subsidies may result in an increase in business exits in the future. More companies may experience conditions where their debt level turns out to be unsustainable*
- *This EU action therefore addresses a **genuine legislative gap**.*
- *This proposal targets the three key dimensions of insolvency law: (i) the recovery of assets from the liquidated insolvency estate; (ii) the efficiency of proceedings; and (iii) the predictable and fair distribution of recovered value among creditors.*

Current status:

- Draft proposal for a Directive of the European Parliament and of the council harmonising certain aspects of insolvency law

(Doc COM 2022 702 final EUR-Lex - 52022PC0702 - EN - EUR-Lex (europa.eu))

- Proposal prompted lots of criticism and will be subject to changes in the legislative process – process to be observed, still room for EFET to raise suggestions and concerns

EU Insolvency Law Harmonisation – Main content *Avoidance Actions*

Harmonisation of Avoidance Actions:

- *The proposed Directive would require Member States to ensure that preferences, transactions for inadequate consideration and acts intentionally detrimental to creditors can be set aside if they take place within* ***prescribed periods prior to the opening of insolvency proceedings.*** *Member States would be able to adopt or maintain additional provisions relating to the voidness, voidability or unenforceability of legal acts detrimental to the general body of creditors in the context of insolvency proceedings where such provisions provide a greater protection of the general body of creditors.*

  - *Draft contains minimum standards; most jurisdictions already foresee even stronger protection of general body of creditors*
  - *However, netting clauses, in particular such outside the scope of the Financial Collateral Directive should be explicitly protected against avoidance actions*

EU Insolvency Law Harmonisation – Main content *Pre-pack proceedings*

Pre-pack proceedings:

Introduction of pre-pack proceedings in which the sale of the debtor's business is negotiated ***before the opening of insolvency proceedings*** *and the sale executed shortly after the opening of such proceedings. Key features:*

- *Secured creditors permitted to participate but limitations on secured creditors' ability to credit bid,*
- *the need for a court to authorise the pre-pack sale, and*
- ***the fact that necessary ongoing contracts would generally be assigned to the purchaser, even without the consent of the contractual counterparty/ies***

➢ *such pre-pack proceedings should not overwrite* ***contractual assignment clauses*** *and* ***material termination events****. Netting needs to be protected and uphold.*

EU Insolvency Law Harmonisation – Protection of close-out provisions

Areas of concern:

- *No protection of material termination rights and netting provisions in the proposed Directive*

Currently, the proposed Directive does not include a general provision ensuring that, in the first place, the SFD, FCD and EMIR apply notwithstanding the provisions of the proposed Directive. In addition, the proposed Directive only provides limited protection for set-off and netting provisions not covered by the FCD.

Provisions of the FCD do not, for example, protect close-out netting provisions in EFET GAs where both counterparties do not belong to the categories specified in the FCD as applied in the relevant Member State.

- *such close-out netting provisions should also be protected in the same way as close-out netting provisions that fall under the FCD*

EU Insolvency Law Harmonisation – Assignment of contracts in pre-pack proceedings

Areas of concern:

➢ Assignment of contracts without counterparty consent

- The proposed Directive would require Member States to ensure that the acquirer of the debtor's business or part thereof in a pre-pack sale is assigned the **executory contracts which are necessary for the continuation of the debtor's business** and the suspension of which would lead to a business standstill (Article 27(1)). The proposed Directive would require Member States to override any restrictions on assignment in the EFET-GA requiring consent of the debtor's counterparty or counterparties. There would only be a limited exception if the acquirer of the debtor's business or part thereof is a competitor to the debtor's counterparty or counterparties.
- The proposed Directive could conflict with the protection counterparties provided for in the EFET-GA. It could, for example, potentially allow the transfer of individual transactions that are part of a single netting or hedging set, adversely affecting the rights of the parties under collateral arrangements or netting and set-off arrangements.
- In addition, it prohibits the other party from refusing a transfer to a party, which has not the required creditworthiness or is not compliant with internal onboarding requirements.

EU Insolvency Law Harmonisation – Proposed Amendments and next steps EFET

➢ Protection of close-out netting provisions, draft ISDA proposal

The proposed Directive should be amended to include a provision ensuring that other close-out netting provisions (i.e., close-out netting provisions under contracts that are not close-out netting provisions as defined in the FCD) are enforceable in accordance with their terms, notwithstanding the provisions of the proposed Directive, where such other close-out netting provisions would otherwise be enforceable in accordance with national insolvency law, e.g.:

- *Member States shall ensure that other close-out netting provisions are enforceable in accordance with their terms notwithstanding the national measures implementing the provisions of this Directive where those other close-out netting provisions would otherwise be enforceable in accordance with national insolvency law*

➢ Next steps

- Proceed with developing and aligning association position
- Determine key areas of concern of the member firms and develop amendment proposals
- Align with ISDA and other stakeholders