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Bulgaria - Preventive Restructuring Report : Technical Note

Technical Note

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GLOSSARY

AML	Anti-Money Laundering
B2B	Business to Business
CA	Commercial Act
COVID-19	Coronavirus Disease 19
DBA	Danish Business Authority
DIP	Debtor-in-Possession
DG REFORM	Directorate General for Structural Reform Support
EC	European Commission
EIR	European Insolvency Regulation
ERM II	Exchange Rate Mechanism
EU	European Union
EWT	Early Warning Tool
IP	Insolvency Practitioner (in Restructuring)
MoJ	Ministry of Justice
MSME	Micro, Small, and Medium Enterprise
NPL	Nonperforming Loan
OCW	Out-of-court workout
ROSC	Report on the Observance of Standards and Codes
SOE	State-Owned Enterprise
SME	Small and Medium Enterprise
WBG	World Bank Group

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The objective of the Report is to assist the Bulgarian authorities in the design of a Preventive Restructuring framework to identify and assist debtors in potential financial distress, in line with the recommendations, the EU Directive 2019/1023 of the European Parliament and Council “On preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt” (2019) (hereinafter, the “Directive”²).

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² See EU Directive 2019/1023, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019L1023>

INTRODUCTION

1. In the last years, Bulgaria has transitioned from high economic volatility to a stable economy with a strong performance in the recent history of enduring external and domestic shocks. However, convergence to average EU incomes has been slower than for other Central and Eastern European countries³.
2. In the process of joining the Exchange Rate Mechanism II (ERM II) and introducing the Euro (under the proviso of fulfilling the convergence criteria under Article 140 TFEU), Bulgaria has confirmed its commitment to implement a number of policy measures in reform areas of high relevance. For this reason, Bulgaria has carried out an impressive range of reforms, including measures to strengthen financial sector supervision and to improve the legal frameworks for State-Owned Enterprises (“SOE”) governance and anti-money laundering (“AML”). In this context, regarding the field of insolvency law that matters here, Bulgaria has undertaken to fully transpose the Directive.
3. In Bulgaria, the insolvency regime is encompassed within the Commercial Act (“CA”) and it comprises of two procedures: i) formal insolvency proceedings with liquidation purposes and ii) a preventive restructuring procedure applicable to merchants and corporate debtors exercising a business activity (the “**stabilization procedure**”). The latter was introduced in July 2017 - under the aegis of the EU Commission and the Council - with the view of overcoming the excessive length of insolvency procedures and the low rates of creditors’ recovery under the national system. While the current provisions dealing with the stabilization procedure (Articles 761-797 CA) form a suitable basis for implementing the Directive, substantial amendments are nevertheless needed.
4. The system, in fact, faces some important challenges that should be addressed in the short and medium-term to ensure its continued successful evolution. Some stakeholders complain that the restructuring regime is not operating as efficiently as it should: both take-up rates and outcomes are allegedly poor, and the procedure has been virtually unused by debtors. These criticisms are present in many jurisdictions, even ones with the most advanced restructuring regimes⁴. Insofar as these challenges deal with the current system, they could be addressed with the Recommendations which appear in bold in Part One of this Report.
5. Following some general suggestions, this Report will approach the implementation of the Directive by examining the relevant Articles of the Directive and considering in which ways the existing provisions of the CA might be deleted, amended, or supplemented to comply with the mandatory provisions of the Directive. Where it is considered appropriate also to consider adding an “optional” provision, the reasons for this will be explained.

³ According to the OECD, other Central and Eastern European countries such as Poland, Romania, Slovakia, Latvia, Estonia and Lithuania grew faster than Bulgaria (<https://www.oecd-ilibrary.org/sites/751fe311-en/index.html?itemId=/content/component/751fe311-en#section-d1e7251>)

⁴ The American Bankruptcy Institute Commission to Study the Reform of Chapter was inspired by an awareness that most financially troubled SMEs simply avoid Chapter 11 altogether. In the case of Estonia, they seem to be borne out by statistics from the OECD which, in its 2016 indicator for insolvency regimes, placed Estonia last among 34 OECD member countries.

PART 1: Reforms Not Required by the EU DIRECTIVE

1.1. Challenges faced by the current system

1. On paper, the stabilization procedure was conceived as a workable restructuring procedure accessible by debtors whose financial condition is in substance the same (the debtor is in “**imminent danger of insolvency**”) as that of the category of debtors targeted by the Directive (the debtor faces a “**likelihood of insolvency**”). Nevertheless, if one measure of the success of any in-court restructuring regime is the take-up rate by debtors of the procedure, it cannot be said that the present restructuring regime in Bulgaria has achieved relevant results. Statistics on the use of stabilization proceedings for the period 2017-2019 taken from the website of the Supreme Judicial Council⁵ illustrate that the procedure has been virtually unused by debtors: there appears to have been no accepted application over the period, and a total of only nine attempts to open a case. It is understood that among the reasons for this are the fact that:
 - traders invoke the procedure too late (when insolvency has already occurred);
 - opening a procedure takes too long;⁶
 - the formalities are too onerous; and
 - post-commencement finance is too difficult to obtain.

Other issues of concern in the broader Bulgarian restructuring and insolvency regime have been well-documented elsewhere and remain to be resolved.⁷ Of particular importance is the presence of fraud and other illegal activities as well as procedural abuses.⁸

2. The government has identified gaps in the insolvency framework and come up with a timeline for implementing changes. Bulgaria’s Council of Ministers adopted a road map for legislative and procedural reform to make the bankruptcy and rehabilitation framework more effective in July 2019.
3. Legislative changes include ongoing implementation support including capacity building for the judiciary and other involved professionals, enhancement of the judicial infrastructure and upgrading of electronic communication and data collection systems.
4. Pushing forward insolvency reforms will be important to support the recovery from the COVID-19 crisis, particularly the reallocation away from activities that are less viable in the medium term. Indeed, following the debt overhang due to COVID-19, a priority is to rapidly legislate to put in place measures that enable the rehabilitation of viable enterprises in financial difficulties through preventative restructuring or pre-insolvency framework. Moreover, given the relatively high rate of NPLs in Bulgaria (partly due to the deficiencies in the country’s insolvency and legal framework), reforms would increase creditor recovery of losses, thereby supporting the growth of credit markets.

⁵ Available here <http://www.vss.justice.bg/page/view/1082> (last access 26 October 2021).

⁶ Compare the US model, for example, where a debtor opens a Chapter 11 proceeding with no court involvement at all and obtains the benefit of an immediate stay against all creditor action.

⁷ See “Report on the Observance of Standards and Codes,” Bulgaria, World Bank Group, June 2016, the “ROSC”) and “Specific Recommendations tackling the impediments of the Bulgarian Insolvency and Restructuring Framework,” EY, May 2019.

⁸ See the discussion under Principle D6 of the ROSC.

The government adopted the roadmap to address the gaps in the insolvency framework and transpose the Directive. Wide consultations have been undertaken in the past months with representatives of government agencies, the judiciary, the legal professions and experts/academics.

The main areas of interventions are illustrated below:

Improving access to insolvency. The legislative changes aim at easing and making faster access to insolvency proceedings and stabilization proceedings, including shortening procedural deadlines. This includes having a single process for processing applications within the same insolvency proceedings; reforming the submission and acceptance phase; establishing accelerated procedures for small businesses; setting out objective grounds for initiating proceedings; increasing efficiency of property liquidation; and compulsory imposition of an insolvency plan between classes of creditors.

Workout and rehabilitation. Planned actions include the establishment of an early warning system with the aim of getting debtors to take action to avoid insolvency, as well as debt discharge procedures. The reforms also will put in place a comprehensive overhaul of pre-insolvency rehabilitation proceedings and introduce new mechanisms to protect new and interim funding.

Enhancing governance and capacity building. Rules on corporate governance are to be improved through putting in place a comprehensive framework on the duties and responsibilities of directors, better regulation of the profession of trustees and officials in the bankruptcy arena, and additional safeguards to prevent bad faith of parties involved in insolvency and stabilization proceedings. The capacity of the regulator is to be enhanced through the provision of the human and financial resources needed for effective regulation.

Judicial infrastructure. Improved judicial infrastructure is critical for the success of the reform. The reform involves changing the rules governing local jurisdiction, regulating the role of experts, creating special procedural rules for appeals, and providing the opportunity for judges to delegate administrative tasks to assistants. Bankruptcy and stabilization proceedings are due to be made smoother through the promotion of the use of electronic communication throughout the process. A code of ethics and professional standards is to be prepared for professionals involved in proceedings.

Training and communication. An updated training needs assessment is being carried out. The aim is to provide specialized training for bankruptcy and stabilization judges and legal personnel, including trustees, on the amended legal framework and new processes. A handbook is to be prepared on bankruptcy and stabilization procedures including templates for reporting activities. Systems are to be put in place to implement electronic means of communication for insolvency and stabilization proceedings, and to improve the quality and availability of statistical data.

Sources: <https://www.minfin.bg/upload/41380/CoM%20%20Roadmap%20on%20Insolvency%20Framework%20Reform%20in%20BG.pdf> and <https://www.oecd-ilibrary.org/sites/751fe311-en/index.html?itemId=/content/component/751fe311-en#section-d1e7251>

5. The above observations represent part of the essential background to the present exercise. As such, they ought to inform the approach taken by those ultimately responsible for implementing the Directive.

1.2. Confidentiality and informality: enhancing Out-of-Court Workouts

1. Although it is understood that the present stabilization procedure is administered largely in private (in the sense that the proceedings are only open to participants, not the public), it is an illusion to think that the financial problems of a debtor applicant are in any meaningful sense kept “private”. Indeed, as soon as the opening of a reorganization procedure is approved, the moratorium on creditors’ enforcement actions becomes effective, which in practice has a strong adverse effect on the business reputation of the debtor.
2. Maintaining confidentiality and allowing restructurings to take place in a private and informal manner should therefore be one of the main objectives of any potential insolvency reform. As observed in other jurisdictions, however, the problem of the stigma associated with admitted financial failure will most likely ease over time, provided that the reorganization regime can gain greater acceptance as a legitimate means of preserving business value with minimum disruption to commercial operations.
3. In other jurisdictions, restructuring techniques do exist which aim to ensure that the debtor’s financial problems remain confidential, at least until such time as a restructuring plan has been agreed. For example, in France, the *mandat ad hoc* procedure permits a judge to appoint an insolvency practitioner (“IP”) to assist management of the debtor to negotiate an amicable restructuring with all or some of its creditors, suppliers and possible sources of fresh financing. The scope of the *mandat* is determined by the court in each case, without a statutory limit in duration. The role of the *mandataire* is only to make suggestions and to persuade creditors of the merits of achieving a compromise. There is no stay of creditor action.
4. Given the stage of development of the IP profession in Bulgaria, it is not felt to be appropriate to recommend that this approach now be taken. Further, to add such a procedure to the stabilization restructuring regime in Bulgaria would not constitute an act of “compliance” with the EU Directive, because even though the *mandat ad hoc* procedure does not give rise to a stay of enforcement actions, it nevertheless requires the appointment of an IP (which is something the EU Directive seeks to make non-mandatory in many cases).
5. In recent years, with the cooperation of the World Bank and the IMF, a set of guidelines known as the INSOL Principles (the “Principles”) have become known and accepted as a guide for financial creditors in coordinating and managing credit issues in larger cases.⁹ The second edition of the Principles was published in May 2017. The Principles embody three concepts that are fundamental to any out-of-court restructuring: first, that creditors should refrain from taking any action which would reduce their exposure; second, that debtors should not take any action that would adversely affect the position of creditors as compared with their position as of the standstill date; and third, that new money is to have priority.
6. The Principles could usefully have the express endorsement of the Central Bank even though they have no binding nature.¹⁰ It may be worth noting that the adoption of the Principles would be consistent

⁹ EU Member States which have adopted the Principles include Austria, Croatia, Serbia and Romania.

¹⁰ Such support was not part of the implementation process in Hungary, and this may have contributed to the lack of success of the Principles in that jurisdiction.

with Article 4(5) of the EU Directive, which contemplates the possible adoption of out-of-court procedures as part of an overall preventive restructuring framework. As an alternative, Latvia published some useful guidelines for Out-of-Court Debt Restructuring some years earlier. These were re-approved by the Latvian Insolvency Issues Committee in February 2018. The Latvian guidelines bear many of the hallmarks of the INSOL Principles. There are many other examples.¹¹

7. Accepting the view of many interlocutors that virtually all Bulgarian corporate debtors should be viewed as SMEs, it would be helpful to provide to the public a range of restructuring “tools” to assist debtors who are, or should be, reorganizing. These tools could be publicized electronically so that any fear of stigma or loss of confidentiality which might otherwise inhibit a debtor from asking for assistance is eliminated. Assistance of this sort could take many forms. One example is attached to this report as Schedule 1. It is a Debtor’s Checklist intended to assist a debtor to approach a reorganization in an organized manner. This document is in most respects particularly suited to smaller companies. There are many other possible forms of assistance which could be made available in this way.

Recommendation 1 – Consider the adoption of a set of informal out-of-court restructuring guidelines. Those guidelines could include a draft sample standstill agreement, accession agreement, and checklists for participants. At the same time, consider making available to debtors and their advisers a range of tools, such as checklists for debtors and templates of reorganization plans, to assist debtors in analyzing their financial position and preparing a reorganization plan. It is noteworthy that the scope for these tools may be both general and sector-based (e.g., tourism).

1.3. A case for a special regime for SME insolvency? Where would it fit?

1. Consideration should be also given to the more general question of imposing shorter time limits for certain steps to be taken in the case of SMEs.¹² Special, less-complicated, regimes of that sort are increasingly found in other jurisdictions. In France, for instance, there is a fast-track liquidation procedure for small businesses, and the *mandataire ad hoc* and *conciliation* pre-bankruptcy procedures are useful for small businesses. The USA has fast-tracked special provisions for small business restructurings under Ch. 11 and Ch. 15 of the US Bankruptcy Code. In Japan, the Civil Rehabilitation Act has been used to target small business reorganizations by making use of variable stays of proceedings designed on a case-by-case basis. In the Czech Republic, the insolvency court may opt for a shortened and simplified bankruptcy proceedings for debtors that are natural or legal persons whose turnover for the last accounting period preceding the declaration of insolvency does not exceed CZK 2,000,000 (approx. EUR 77,500) and has no more than 50 creditors. And in the UK, there is a small business moratorium to permit the debtor to develop a plan (known as a Company Voluntary Arrangement) as an alternative to the much more complex procedure known as administration.¹³ Such regimes typically come into effect as an exception to the “usual” procedures, and almost always include shorter timeframes, less oversight and monitoring by IPs, and reduced court involvement.

¹¹ For instance, Slovenia published a set of principles specifically tailored to the restructuring of SMEs in 2015.

¹² “SME” is a term which, to have any meaning, requires a definition. This is usually done with reference to any one or more of the following attributes: number of employees, number of creditors, amount of unsecured debt and annual turnover.

¹³ Other examples include India and Slovenia (expedited procedure for debtors having the status of ‘micro company’ under the Companies Act). Many jurisdictions have simpler procedures in place to deal with consumer bankruptcies.

2. As opposed to the experiences observed in these countries, there does not seem to exist a need in Bulgaria for any such special procedures because the vast majority of corporate debtors could properly be viewed as SMEs in any event. As a result, rather than viewing SMEs (and MSMEs) as the exception, they should be viewed as the norm. All of the procedures in the current CA should be examined from that perspective.
3. However, the task of reforming the CA to meet the needs of SMEs more efficiently is far from simple. This is because very little of the present CA was drafted with the limitations of SMEs in mind. This could – at least in part – explain why for many of the smaller debtors experiencing difficulties, the CA procedures are simply too costly, too lengthy, and too complex.
4. There is therefore an argument that the coming into force of the EU Directive is an opportune moment to examine how the Bulgarian restructuring regime could be made more accessible to SMEs. In doing so, Bulgaria must make a policy choice between (i) designing a procedure for all incorporated entities and making the necessary changes to accommodate the needs of SMEs within that procedure; or (ii) treating SMEs as a different version of commercial legal entities and designing a special procedure in a new law that would deal with both legal and natural persons. The EU Directive allows both approaches¹⁴, although it is expected that most Member States will prefer to follow the second approach and make amendments to their existing bankruptcy laws, which in most countries apply to both legal and natural persons.¹⁵
5. Such approach implies acknowledging that the best way to deal with the insolvency of small businesses is using a liquidation/discharge regime for natural persons and, for viable businesses, a simplified restructuring regime applicable to both natural and legal persons. Indeed, an examination of the regimes which have embraced this approach shows that the special proceedings for small businesses are essentially modified versions of arrangement proceedings for individual entrepreneurs. This approach recognizes that the financial architecture and creditor profile of small businesses tend to resemble those of individuals, rather than larger corporates (for example, multiple layers of debt, complicated operational structures and a web of contractual arrangements are rare).
6. Therefore, it may be more appropriate to follow the second approach. The CA should then be supplemented with additional provisions that regulate the possibility of fast-track insolvency proceedings accessible to small- and medium-sized companies and entrepreneurs.

A fast-track procedure should foresee the application of shortened procedural terms for parties within insolvency (e.g., shorter deadlines for submission of claims/pleadings) and for the court (shortened deadlines to issue a declaration of insolvency, review pleadings, issue decisions and/or rulings). The access to such proceedings should be based on unified criteria allowing for a clear distinction from the regular proceedings. It is recommended that the fast-track proceedings are based on economic criteria (e.g., annual turnover of the debtor). It could be stipulated that debtors with annual turnover of less than EUR 50,000.00 and fewer than 20 creditors can benefit from shortened procedural deadlines (incl. review of the petition, submission, and acceptance of claims, lodging of appeals, etc.).

Recommendation 2 – Consider going through the legislative process to supplement the CA with additional provisions regulating the fast-track proceedings that will allow small- and

¹⁴ Article 1(4) allows Member States to restrict the application of its preventive restructuring provisions to legal persons.

¹⁵ An example of this is the proposed Dutch amendments to the Dutch Bankruptcy Act, due to come into force (if passed into law) in 2020. These amendments are intended to be fully compliant with the EU Directive.

medium-sized companies and sole proprietors fast access to insolvency proceedings.

PART 2: Implementation of Directive

2.1. Introduction

1. From a descriptive standpoint, the Directive consists of an Introduction, 101 Recitals and 36 Articles. It pursues three main objectives, namely, to ensure that: a) the insolvency laws across EU member States - albeit profoundly different – provide for preventive restructuring framework, which includes a restructuring plan; b) entrepreneurs are granted a second chance through an effective discharge mechanism; and c) EU member States put in place other measures aimed at enhancing the efficiency of restructuring, insolvency, and discharge procedures more widely.¹⁶
2. The Directive has three main aims:
 1. To ensure that member states have a preventive restructuring framework, which includes a restructuring plan;
 2. To ensure that entrepreneurs have a second chance through an effective discharge mechanism; and
 3. To ensure that member states put in place measures to raise the efficiency of restructuring, insolvency, and discharge procedures more widely.

The objectives are to contribute to the proper functioning of the internal market and to remove obstacles to the exercise of fundamental freedoms.

3. In pursuit of these objectives, the Directive requires that viable enterprises have access to effective national restructuring regimes which enable them to continue operating.¹⁷ It is crucial to point out that the Directive does not seek to impose an EU-wide restructuring regime but rather to achieve coherence between Member States' regimes, which should in future be based on shared principles. Consistent with this approach, there is also a great deal of 'optionality' in the Directive: many provisions are not mandatory (the word "shall" is the operative word in English) but optional (the word "may" denotes this). Indeed, the Directive leaves "*sufficient flexibility for Member States to choose their approach of implementing those principles.*"¹⁸ A list of "discretionary areas" includes the following:
 - The degree of control which the debtor's management should retain while subject to the preventive restructuring procedure;
 - The duration of the stay;

¹⁶ Recital 1.

¹⁷ The impact of enhanced reorganization procedures was clearly shown in Poland, where the number of restructuring cases following implementation of substantial reforms in 2017 was far higher than in any previous year. This was accompanied by a sharp fall in the number of liquidations. See *Emerging Markets Journal*, Issue No.4, Fall 2017.

¹⁸ "Restructuring and Insolvency in Europe: Policy Options in the Implementation of the EU Directive," a blog dated 30 July from authors from the IMF stated: "[Its] harmonization effect is likely to be limited, given the many options for implementation: 143 different options, in fact;"; See also Recital 16: "This Directive should allow Member States flexibility to apply common principles while respecting national legal systems. Member States should be able to maintain or introduce in their national legal systems preventive restructuring frameworks other than those provided for by this Directive."

- Whether the restriction on terminating executory contracts should be limited to “essential contracts”;
 - The required majority for the approval of a plan;
 - The decision whether or not to have a legislative provision permitting the cram-down of shareholder claims; and
 - How employees should be treated for voting purposes.
4. The EU Directive does not, therefore, intend to impose an EU-wide restructuring and insolvency regime but seeks to ensure coherence between Member States’ regimes, which should in future be based on shared principles.¹⁹
 5. Some EU jurisdictions already have or will shortly have domestic legislation which takes account of the changes proposed in the EU Directive, for example, Greece and the Netherlands. In other jurisdictions, for example, Spain, Croatia, Poland, Slovenia, and Bulgaria, although some changes to domestic laws will be required to achieve compliance, these will not be major. Bulgaria is in the same category, as it already has, in the CA, a preventive restructuring law, but this will need to be amended to achieve compliance.
 6. To the extent that the EU Directive deals with corporate debtors, after some general comments this Report will cover relevant Articles of the EU Directive in order. Consistent with the scope of this project, no consideration will be given to those Articles of the EU Directive which deal with individual entrepreneurs, or with the ways in which the EU Directive requires Member States to collect data.

2.2. General Recommendations on Implementation

1. This Report aims to assist the Working Group in considering the specific amendments needed to be made to comply with the Directive. It also mentions that the challenges which will inevitably be encountered in the operation of the Directive in Bulgaria once its provisions have been implemented should not be underestimated. This is because the Directive adds a process which depends for its success on the existence of practices and procedures which are either absent or not yet deeply established in Bulgaria. Based on the following examples, there seems to be a need for institutional reforms to ensure the effectiveness of the structural reforms in question:
 - immediate access to the court;
 - acceptance by judges of a low level of intervention in the process of restructuring as well as a capacity and willingness to make immediate decisions when necessary;
 - IPs²⁰ with a new range of skills;
 - and a relatively high level of trust between and among stakeholders.
2. All of these features are usually created over many years by a combination of favourable experience of traditional in-court restructurings and the existence of clear and enforced sanctions to promote good

¹⁹ The EU Directive may have the potential to work more effectively than the US Chapter 11 which inspired it, especially for SMEs. The costs of a Chapter 11 can be very substantial, as many US commentators have recently noted. See the ABI Report, at note 40, below.

²⁰ The term “IP” will be used throughout this Report to mean “practitioner in the field of restructuring” (or “insolvency practitioner”), as that term is defined in Article 2(1)12 of the Directive.

debtor behaviour.²¹ The requirement to implement the Directive represents an opportunity to take legislative steps to improve the behaviour of debtors, creditors, and Insolvency Practitioner (Ips). Over time, with sustained enforcement of those behaviours, trust in the broader system of restructuring and insolvency among stakeholders in Bulgaria will increase, as has happened in other countries such as Germany, France and the UK.

3. Fortunately, the authors of the Directive were sensitive to these challenges. Although the Directive does harmonize some important principles, it deliberately leaves “*sufficient flexibility for Member States to choose their approach of implementing those principles.*”²² These explicit limits to the ambition of the Directive are welcome and important. They allow the drafters of the necessary new provisions to remain mindful of the current state of development of the Bulgarian regime (including the supporting institutional infrastructure) and thus to make realistic choices of how best to implement the Directive in the specific context of Bulgaria. In effect, they make the task of making the necessary amendments and additions to the present regime less daunting by permitting the drafters to take what one might call a minimalist approach to the changes they make.
4. In future, and with experience of the preventive restructuring regime in practice, the optional provisions of the Directive may be looked at again and incorporated by further amendments if appropriate. But at this time, it is recommended that the changes to Bulgarian law focus on the mandatory provisions of the Directive wherever possible.
5. This Report does not include an article-by-article examination of the provisions of the CA, and any related laws, to see if any such provisions can or should be deleted because they are inconsistent with the philosophy of the Directive, or superfluous. One example of this might be to remove the out-of-court settlement in Chapter 48 CA because it does not include sufficient protection for creditors and is out of step with the sorts of best practices being encouraged by the Directive. Another might be to harmonize the practices and procedures in Ch. 44 for approving an administrative plan in a bankruptcy proceeding so that the requirements in a preventive restructuring and in bankruptcy are as similar as possible. This is a painstaking editorial task and is best done working from the original Bulgarian text of both the CA and the Directive. If the Working Group undertakes this task and would like to discuss any particular aspect of it, then this would of course be welcome.

Section 1: Subject Matter and scope

Article 1 - Subject matter and scope

“1. This Directive lays down rules on:

(a) preventive restructuring frameworks available for debtors in financial difficulties when there is a likelihood of insolvency, with a view to preventing the insolvency and ensuring the viability of

²¹ Many other EU Member States are at a similar stage in the development of a strong culture of restructuring e.g., Slovenia, Spain and the Baltic States. And Germany must make even greater legislative changes than Bulgaria as it has not until recently had any pre-insolvency processes available to debtors.

²² “Restructuring and Insolvency in Europe: Policy Options in the Implementation of the EU Directive,” a blog dated 30 July from authors from the IMF stated: “[Its] harmonization effect is likely to be limited, given the many options for implementation: 143 different options, in fact;” See also Recital 16: “This Directive should allow Member States flexibility to apply common principles while respecting national legal systems. Member States should be able to maintain or introduce in their national legal systems preventive restructuring frameworks other than those provided for by this Directive.”

the debtor;

(b) procedures leading to a discharge of debt incurred by insolvent entrepreneurs; and

(c) measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt.

2. This Directive does not apply to procedures referred to in paragraph 1 of this Article that concern debtors that are:

(a) insurance undertakings or reinsurance undertakings as defined in points (1) and (4) of Article 13 of Directive 2009/138/EC;

(b) credit institutions as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013;

(c) investment firms or collective investment undertakings as defined in points (2) and (7) of Article 4(1) of Regulation (EU) No 575/2013;

(d) central counter parties as defined in point (1) of Article 2 of Regulation (EU) No 648/2012;

(e) central securities depositories as defined in point (1) of Article 2(1) of Regulation (EU) No 909/2014;

(f) other financial institutions and entities listed in the first subparagraph of Article 1(1) of Directive 2014/59/EU;

(g) public bodies under national law; and

(h) natural persons who are not entrepreneurs.

3. Member States may exclude from the scope of these Directive procedures referred to in paragraph 1 that concern debtors which are financial entities, other than those referred to in paragraph 2, providing financial services which are subject to special arrangements under which the national supervisory or resolution authorities have wide-ranging powers of intervention comparable to those laid down in Union and national law in relation to the financial entities referred to in paragraph 2. Member States shall communicate those special arrangements to the Commission.

4. Member States may extend the application of the procedures referred to in point (b) of paragraph 1 to insolvent natural persons who are not entrepreneurs. Member States may restrict the application of point (a) of paragraph 1 to legal persons.

5. Member States may provide that the following claims are excluded from, or are not affected by, preventive restructuring frameworks referred to in point (a) of paragraph 1:

(a) existing and future claims of existing or former workers;

(b) maintenance claims arising from a family relationship, parentage, marriage or affinity; or

(c) claims that arise from tortious liability of the debtor.

6. Member States shall ensure that preventive restructuring frameworks have no impact on accrued occupational pension entitlements.”

Clarifying the scope of the new preventive insolvency framework

1. Under the system currently in force in Bulgaria, restructuring proceedings (*i.e.*, stabilization proceedings) are dealt with under Part Five of CA, entitled “Merchant Restructuring Proceedings.” At the outset, it is suggested that the Chapter be re-named “Preventive Restructuring Proceedings.” This change would highlight more clearly the philosophy behind the Directive, and also give due prominence to the new provisions. It is also suggested that the focus should be on economic activity rather than on the form of business organization. The scope of application of the Directive, in fact, encompasses not only companies and other legal persons (irrespective of the regime of limited or unlimited liability), but it applies also to “entrepreneurs” as defined in Article 2.1(9). In addition to natural persons exercising trade, business or craft, this definition includes professions such as accountants and lawyers.²³ In this respect, hence, it is advisable that the use of the term “merchant” in the heading of Part Five of the CA is closely reconsidered²⁴. Indeed, this terminology could appear overly restrictive, and it may lead to interpretation carving out from the scope of application of preventive restructuring proceedings “entrepreneurs”, in the sense explained above.
2. The use of the term “restructuring” should be changed to read “preventive restructuring” wherever appropriate throughout CA Part Five.
3. The current version of Article 764 CA carves out from the scope of application of restructuring proceedings “*public-enterprise, merchant, exercising a State monopoly or created by a special law, as well as for a bank or an insurer*”. Although the debtors currently listed in the provision at stake already echoes partially Articles 1.2 and 1.3 of the Directive, it would be appropriate that the categories of debtors to whom CA Part Five is not intended to apply be closely considered and, if need be, Article 764 CA be amended to be fully compliant with the list of debtors to whom the Directive is not intended to apply in Articles 1.2 and 1.3.
4. In this respect, note that under Article 1.4 (second sentence), the Directive permits to restrict the application of the Directive’s provisions on preventive restructuring frameworks to legal persons. This would be a narrower application of the new regime than that currently provided by the CA, but in some jurisdictions, the restructuring regime which applies to corporate entities is separate from that which applies to other forms of business organisations (such as sole entrepreneurs).
5. Importantly, whatever possible, the language used in the amended CA must be consistent with, and echo the language used, by the Directive. For instance, the present text of CA Chapter Five uses the terms “merchant” or “banks”. It is recommended that Bulgaria follows closely the wording of the Directive. With respect to the example of the exclusion of certain categories of debtors from the scope of the new provisions on preventive restructuring, the language used should be identical to the language

²³ Although not mandatory, Recital 21 states that it would be “advisable” for Member States to apply the provisions relating to discharge of debt to consumers (*i.e.*, natural persons who are not entrepreneurs) “at the earliest opportunity.”

²⁴ According to Article 1 CA “*Merchants are: 1. the commercial companies; 2. the cooperatives, except housing cooperatives. (3) Any person, who has established an enterprise, which, in accordance with its purpose and volume, requires that its business be conducted on a commercial basis, [...] shall also be considered a merchant*”.

Moreover, under Article 2 CA persons who are not merchants are defined as “*1. natural persons engaged in farming; 2. artisans, persons providing services through their own labor or freelancing, except where their business may be defined as an enterprise within the meaning of Article 1, Paragraph 3; 3. persons providing hotel services by letting rooms in housing units occupied thereby*”.

used in Articles 1.2 and 1.3 Directive (e.g., “bank” is used in the English translation of the CA whereas the Directive uses the expression “credit institution”).

6. It is recommended that the CA strikes a careful balance between the reformed regime on preventive restructuring proceedings and bankruptcy procedures, by allowing the smooth transition and easy conversion of proceedings from one procedure to another.²⁵ It is indeed advantageous – also in terms of procedural efficiency – that, for instance, where a bankruptcy petition has been filed by a creditor, the debtor is allowed to apply to convert the bankruptcy proceeding (possibly with liquidation outcome) into a preventive restructuring procedure if its financial condition supports such application. The ability to move from one type of proceeding to another should be referred to expressly in the legislation. To do so will help reduce one source of delay in the Bulgarian system. If a preventive restructuring proceeding is clearly not going to gain the approval of the requisite majority of creditors, or the creditors vote down a plan²⁶, it should be possible with minimal formalities for the proceeding to be converted to a liquidation. This could be done by the court at the “sanction” stage, or earlier if the directors or any IP appointed to assist them to realise that any applicable test requiring the opening of a bankruptcy proceeding has in fact been triggered (as required by Article 626 CA).
7. It is not necessary (and in the light of § 6 above it is even not desirable) that, further to what is already set forth under Article 762 CA, that the law expressly specifies that the debtor in a state of material insolvency as defined under the CA²⁷ (and subject to bankruptcy proceeding) is excluded from the scope of application of the preventive restructuring regime. Article 761 CA makes it clear that preventive proceedings are intended to avoid “initiation of bankruptcy proceedings.” It must, therefore, follow that a debtor in bankruptcy cannot meet that condition of entry relating to preventive restructuring proceedings unless its financial condition has changed during the course of the bankruptcy proceeding and the proceedings have been converted to a preventive restructuring proceeding.
8. Articles 763²⁸ and 768(2)(4)²⁹ CA should be deleted.
9. It may be necessary to amend any other laws which might restrict the availability of preventive restructuring proceedings. It has been pointed out that Article 14(4) of the Non-Profit Legal Entities Act³⁰ requires amendment for this reason. All other relevant laws should be examined in the same way.
10. Should a policy decision be taken to provide a list of claims which are not affected by the preventive restructuring framework (as permitted by Article 1(5) of the Directive), then it should be noted that workers’ claims protected in this way in existing insolvency regimes in other EU countries are usually

²⁵ See World Bank Principles C1.

²⁶ See in this respect Articles 795 and 796 CA.

²⁷ See *infra* Section 2, §2.

²⁸ The current version of Article 763 CA reads “*Restructuring proceedings for general partners shall be considered initiated simultaneously with the initiated restructuring proceedings for the company*”.

²⁹ Article 768(2)(4) CA reads “*In addition to the rules set forth in this Part, the following special procedural rules shall apply within the restructuring proceedings: 4. the restructuring proceedings may not be terminated, except upon death of the applicant, if they are a sole trader or general partner*”.

³⁰ Article 14 Non-Profit Legal Entities Act, (bearing title “Liquidation”) provides that “(1) *The dissolution of non-profit legal entity shall involve procedure for liquidation. (2) The liquidation shall be conducted by the managing body or a person assigned thereby. (3) Where no liquidator has been assigned pursuant to paragraph (2), as well as under the circumstances of Article 13, paragraph (1), sub-paragraph 2, such person shall be assigned by the district court by domicile of the non-profit legal entity. (4) The relevant provisions of the Commerce Act shall apply to insolvency, bankruptcy, the liquidation procedure and the authority of the liquidator, respectively. The acts of the court of insolvency that shall be entered in the entrepreneur court registry, relevant to non-profit legal entities, shall be entered in the court registry of non-profit legal entities and shall be promulgated in the State Gazette, and the acts that are promulgated in the entrepreneur court registry shall be promulgated in the State Gazette*”.

limited or “capped” in amount and/or protected by a fund applicable to such claims. In Germany, the cap is three months of wages prior to the opening of proceedings. In France, employee claims in a restructuring are guaranteed by a national fund called the Association for the management of employee claims (AGS), which is funded by employers. The effective limit on the amount of wages for which AGS is responsible is for the 60 days of work preceding the commencement of restructuring proceedings. In practice, since the basis of the preventive regime is that it should apply *before* insolvency has occurred, it is likely that in most cases, wages will have been paid on a current basis, as otherwise, most businesses would be insolvent and/or unable to continue.

11. As the very useful paper prepared by the Working Group (the “**Working Group Paper**”) points out,³¹ if the other categories of claims referred to in Article 1(5)(b) and (c) of the Directive are also to be excluded from the scope of the preventive regime, then consequential amendments will be needed to other laws.

Section 2: Definitions

Article 2 - Definitions

“For the purposes of this Directive, the following definitions apply:

- (1) ‘restructuring’ means measures aimed at restructuring the debtor’s business that includes changing the composition, conditions or structure of a debtor’s assets and liabilities or any other part of the debtor’s capital structure, such as sales of assets or parts of the business and, where so provided under national law, the sale of the business as a going concern, as well as any necessary operational changes, or a combination of those elements;*
- (2) ‘affected parties’ means creditors, including, where applicable under national law, workers, or classes of creditors and, where applicable, under national law, equity holders, whose claims or interests, respectively, are directly affected by a restructuring plan;*
- (3) ‘equity holder’ means a person that has an ownership interest in a debtor or a debtor’s business, including a shareholder, in so far as that person is not a creditor;*
- (4) ‘stay of individual enforcement actions’ means a temporary suspension, granted by a judicial or administrative authority or applied by operation of law, of the right of a creditor to enforce a claim against a debtor and, where so provided for by national law, against a third-party security provider, in the context of a judicial, administrative or other procedure, or of the right to seize or realise out of court the assets or business of the debtor;*
- (5) ‘executory contract’ means a contract between a debtor and one or more creditors under which the parties still have obligations to perform at the time the stay of individual enforcement actions is granted or applied;*
- (6) ‘best-interest-of-creditors test’ means a test that is satisfied if no dissenting creditor would be worse off under a restructuring plan than such a creditor would be if the normal ranking of liquidation priorities under national law were applied, either in the event of liquidation, whether piecemeal or by sale as a going concern, or in the event of the next-best-alternative scenario if the*

³¹ “Transposition of the Directive on Restructuring and Insolvency in Preventive Restructuring Proceedings,” undated, 13 pages.

restructuring plan were not confirmed;

(7) ‘new financing’ means any new financial assistance provided by an existing or a new creditor in order to implement a restructuring plan and that is included in that restructuring plan;

(8) ‘interim financing’ means any new financial assistance, provided by an existing or a new creditor, that includes, as a minimum, financial assistance during the stay of individual enforcement actions, and that is reasonable and immediately necessary for the debtor's business to continue operating or to preserve or enhance the value of that business;

(9) ‘entrepreneur’ means a natural person exercising a trade, business, craft or profession;

(10) ‘full discharge of debt’ means that enforcement against entrepreneurs of their outstanding dischargeable debts is precluded or that outstanding dischargeable debts as such are cancelled, as part of a procedure which could include a realisation of assets or a repayment plan or both;

(11) ‘repayment plan’ means a programme of payments of specified amounts on specified dates by an insolvent entrepreneur to creditors, or a periodic transfer to creditors of a certain part of entrepreneur's disposable income during the discharge period;

(12) ‘practitioner in the field of restructuring’ means any person or body appointed by a judicial or administrative authority to carry out, in particular, one or more of the following tasks: (a) assisting the debtor or the creditors in drafting or negotiating a restructuring plan; (b) supervising the activity of the debtor during the negotiations on a restructuring plan, and reporting to a judicial or administrative authority; (c) taking partial control over the assets or affairs of the debtor during negotiations. 2. For the purposes of this Directive, the following concepts are to be understood as defined by national law: (a) insolvency; (b) likelihood of insolvency; (c) micro, small and medium-sized enterprises (“SMEs”).”

Introduction of key definitions in the CA

1. The CA does not contain a separate Chapter of definitions. It is recommended that consideration be given to including an Article in the CA containing definitions of key terms and principles at least relating to Part Five CA. If either now or in future, more sweeping changes to CA are desired, or if it is considered helpful even at this stage, these new definitions could be drafted so as to be of more general application throughout the CA.
2. Article 2(2) of the Directive leaves the definition of the notions “insolvency” and “likelihood of insolvency” to national law. It is therefore crucial that the meaning of the term “insolvency” be as clear as possible. For “merchant” debtors, Bulgaria uses the cashflow test (Article 609 CA), and, in the case of companies, the balance sheet test (Article 742 CA). The present definition of “insolvent” is provided in Article 608 CA, which is applicable to “merchants”³². That definition could be simplified by adopting one or both of the tests in wide use around the world.

³² Article 608 CA provides as follows: “insolvent shall be any merchant, unable to meet any due: 1. payable obligation arising out of, or related to a commercial transaction, including its validity, performance, non-performance, termination, invalidation or cancellation, or the consequences from its termination; or 2. public-law obligation to the state or municipalities related to the merchant's business; or 3. obligation under a private state receivable; or 4. obligation to pay wages to at least one third of the workers and employees, which has not been discharged for more than two months.

The Directive does not formulate any test for determining insolvency. Two commencement tests are generally recognized as international good practices³³.

The “cash flow” test allows proceedings to begin if a debtor is unable to pay its debts as they become due, and it is the most widely used test around the world. The so-called “balance sheet” test, in turn, allows proceedings to begin upon showing that the value of the debtor’s assets is below that of its liabilities.

For instance, **France** adopts a pure cash-flow test. Under Article L.631-1 *Code de Commerce*, a debtor is deemed insolvent (“*en cessation des paiements*”) when it is unable to meet its due debts out of its available assets (*i.e.*, those in the form of cash or those that can be quickly turned into cash), taking into account undrawn committed facilities and other credit reserves and moratoria or standstills accepted by creditors.

The **German** *Insolvenzordnung* (“InsO”) uses both the cashflow test (*Zahlungsunfähigkeit*, the debtor is illiquid, *i.e.* unable to pay its debts when they fall due, § 17(2) InsO) and the balance sheet test (*Überschuldung*, the debtor is over-indebted, in the event that the debtor is a legal entity which does not have at least one natural person who is personally liable without limitation, *i.e.* if the debtor’s assets do not cover its liabilities, § 19 InsO). The InsO envisages also the likelihood of insolvency (*drohende Zahlungsunfähigkeit*, which allows the debtor to voluntarily file a petition on the grounds that it is likely that the debtor will become unable to meet its payment obligations when they fall due in the future (§ 18 InsO).

In **Spain**, the repealed Article 2 of the *Ley Concursal*³⁴ provides that any debtor that is (or foreseeably will be in the immediate future) unable to meet its payment obligations on a regular basis is considered to be insolvent (cash-flow test). Case law clarifies, though, that inability to meet regular obligations occurs when the debtor fails to pay its debts to at least 15% of two different types of creditors (classified for these purposes as financial, commercial, or public creditors).

In **Greece**, Article 77 of the recently enacted Law on “Regulation of debts and provision of a second chance” Law³⁵, states that a debtor who fails to fulfill overdue financial obligations in a general and permanent manner is declared bankrupt. Thus, the cash-flow test is a ground for commencing proceedings.

If these tests are to be used throughout the insolvency and restructuring regime in Bulgaria, including the new preventive insolvency procedures, there does not appear to be a justifiable policy reason to restrict the application of the balance sheet test to corporate entities. Further, CA Article 608(1) sets

(2) it shall be assumed that the merchant is unable to meet any due obligation under paragraph 1, if, prior to filing of the application for initiation of the bankruptcy proceedings, the merchant has not applied for announcement in the commercial register of the merchant’s annual financial statements for the past three years.

(3) insolvency shall be presumed when the debtor has stopped paying. paying shall be considered to be stopped also in the cases, when the debtor has paid, in part or in full, some receivables of some creditors.

(4) insolvency shall be presumed, if, under enforcement proceedings, initiated to enforce an effective claim of the creditor, who has filed an application under article 625, the receivable has remained partially or fully outstanding within 6 months after the reception of the voluntary payment notice”.

³³ See Recommendation 15, UNCITRAL Legislative Guide on Insolvency Law.

³⁴ The Spanish *Ley Concursal* was recently modified by Royal Legislative Decree 1/2020, of May 5, published in the Official Gazette “BOE” no. 127 of 05/07/2020

³⁵ Law No. 4738/2020 on “Regulation of debts and provision of a second chance” Law was adopted in Greece on October 26, 2020.

out three different examples of obligations which, if they cannot be met, will mean that a debtor is insolvent on a cash flow basis. A more modern way of expressing the test could simply refer to an inability to pay debts as they fall due without identifying any particular categories of debts. In addition, in order to facilitate proving the insolvency of a debtor by a creditor, examples of debtor behaviour which could allow a court to presume a debtor's insolvency could be added in a separate subsection, as Article 608(2) CA now seeks to do.

3. The simplification of the definition of “insolvent” will require consequential changes to CA Article 762(2), which could probably be deleted.
4. The word “bankrupt” in Article 762(1) CA should be changed to “insolvent.” Bankruptcy is a legal status deriving from a court order opening a judicial procedure; insolvency is a financial condition.

Section 3: Availability of preventive restructuring frameworks

Article 4 - Availability of preventive restructuring frameworks

“1. Member States shall ensure that, where there is a likelihood of insolvency, debtors have access to a preventive restructuring framework that enables them to restructure, with a view to preventing insolvency and ensuring their viability, without prejudice to other solutions for avoiding insolvency, thereby protecting jobs and maintaining business activity.

2. Member States may provide those debtors that have been sentenced for serious breaches of accounting or bookkeeping obligations under national law are allowed to access a preventive restructuring framework only after those debtors have taken adequate measures to remedy the issues that gave rise to the sentence, with a view to providing creditors with the necessary information to enable them to take a decision during restructuring negotiations.

3. Member States may maintain or introduce a viability test under national law, provided that such a test has the purpose of excluding debtors that do not have a prospect of viability, and that it can be carried out without detriment to the debtors' assets.

4. Member States may limit the number of times within a certain period a debtor can access a preventive restructuring framework as provided for under this Directive.

5. The preventive restructuring framework provided for under this Directive may consist of one or more procedures, measures or provisions, some of which may take place out of court, without prejudice to any other restructuring frameworks under national law.

Member States shall ensure that such restructuring framework affords debtors and affected parties the rights and safeguards provided for in this Title in a coherent manner.

6. Member States may put in place provisions limiting the involvement of a judicial or administrative authority in a preventive restructuring framework to where it is necessary and proportionate while ensuring that rights of any affected parties and relevant stakeholders are safeguarded.

7. Preventive restructuring frameworks provided for under this Directive shall be available on application by debtors.

8. Member States may also provide that preventive restructuring frameworks provided for under this Directive are available at the request of creditors and employees' representatives, subject to the agreement of the debtor. Member States may limit that requirement to obtain the debtor's agreement to cases where debtors are SMEs.”

Broadening the scope of the CA restructuring framework

1. The language of Article 4 of the Directive is much broader than the language of Article 761 CA which simply refers to a restructuring achieved by way of an agreement settling the debtor's payables. In order to comply with the Directive, Article 761 CA should be amended by closely following the broader language used by the Directive. This will make it clear that the purpose of preventive restructuring proceedings is to enable debtors to restructure the business in any manner which achieves the objective of preventing insolvency and ensuring viability. A broader language would also make it clear that the restructuring can encompass both financial and operational restructurings. This approach should also be reflected in the re-drafting of Article 770 CA (to be discussed below): the terms of any possible restructuring need to allow for a wide range of different approaches to resolving the debtor's difficulties, whether they are described as financial, non-financial or operational.
2. The question of **limiting access** to the preventive insolvency regime in ways that encourage good debtor behaviour can be addressed in several different ways, as follows:³⁶
 - a. Limiting access due to the **debtor's creditor profile** – As recommended in the Working Group Paper, Article 762(3)4 CA³⁷ should be deleted. The rights of related parties are best considered in the context of voting rights. While it may be the case that a debtor with a large proportion of connected-party creditors is not the sort of “honest” and “viable” debtor which the Directive aims to support, this should not be an assumption at early stage in the process.
 - b. Limiting access due to **unacceptable behaviour by the debtor prior to any application to open a preventive restructuring procedure** – In paragraph III 2.2, the Working Group Paper raises for discussion the possibility that a failure by the debtor to observe book-keeping obligations should not, of itself, disqualify a debtor from accessing the new procedure, because the business of such a debtor might nevertheless be viable. It must be considered that the main objective of a swift recovery through preventive debt restructuring benefits not only the debtor (by providing a mechanism that aims at preventing the opening of insolvency proceedings, and possibly the exit of the business from the market). Preventive restructuring preserves viable companies and allows to keep them in business, reducing economic losses suffered by creditors due to the cessation of the debtor's operation and eventually it could also contribute to limiting costs to the financial sector and ultimately public budgets. In this constellation, the decision to preclude the debtor from access to preventive restructuring proceedings is not entirely satisfactory, for the rescue of viable companies benefits the entire market and cannot be used as a sanction against the debtor. As an alternative to the present position, Article. 762(3)1 CA could be deleted in favour of a new

³⁶ Note that any changes to CA Article 763(3) will require changes to CA Article 771(2).

³⁷ Article 762(3)4 CA reads “Restructuring proceedings may not be initiated for: when more than one fifth of the merchant's payables are to related parties and parties, which have acquired, over the past three years, receivables from related parties to the merchant”.

formulation which focusses on whether or not the records of the debtor are adequate to ascertain the debtor's business and financial position. That may be an acceptable compromise solution, but it may be preferable to maintain a strict requirement that annual accounts be properly filed and published as a condition of eligibility to open the proceedings in order to promote the high standards of debtor behaviour needed if the new preventive regime is to gain the trust and confidence of participants. In considering this policy issue, it could be that a distinction could be drawn between the reporting requirements which apply to an SME and those which apply to larger businesses. If, after consideration, Article 762(3)1 CA is to be amended or deleted, then Article 608(2) CA³⁸ will need similar attention.

- c. Limiting access due to **repeated applications** for preventive restructuring proceedings by the same debtor – Article 4(4) of the Directive allows Member States to limit the number of times within a certain period a debtor can access a preventive procedure. It is noted that this optional provision is part of the existing regime in Bulgaria (CA Article 762(3)2). Nevertheless, the history of previous proceedings is a policy matter, and the present prohibition on any application if made within 3 years of a previous filing may be unduly harsh. An alternative approach would be to require the court hearing a second or indeed any later application to dismiss it, unless the court is satisfied that the later application is being brought in good faith and due to circumstances beyond the control of the debtor. This requirement would in effect require the debtor to explain in detail, and to the satisfaction of the court, the reasons for the later application. It is for discussion whether this may be a more effective way to limit abuse than a time limit, which could work an injustice if the business of an honest debtor is badly damaged by, for example, an unexpected change in market forces. This suggestion would effectively give the court a discretion to approve the opening of proceedings in such circumstances. If the courts are not willing to accept such discretion, however, it may be limited by appropriate language, then a fixed time period within which repeated applications cannot be made remains an acceptable alternative.

In **Estonia**, an application to open a reorganisation proceeding cannot be accepted if made less than two years after the closing of any previous proceeding.

Chapter 11 of the **US Bankruptcy Code** is often spoken of as a model of the “early stage” restructuring procedure envisaged by the EU instruments and, hence, it is often called for comparisons with the Directive.

Regarding the access to the restructuring procedure, the approach taken overseas seems slightly different. At the outset, it must be noted that under the US Code there are no limits placed on the number of times debtors can file an application for Chapter 11 relief. Nevertheless, applications must be made “in good faith”, meaning that they must be filed to achieve corporate restructuring (or to bring about a liquidation or sale of the company). If this is not the case, creditors may request the court to dismiss the Chapter 11 petition³⁹.

³⁸ Article 608(2) CA reads “It shall be assumed that the merchant is unable to meet any due obligation under Paragraph 1, if, prior to filing of the application for initiation of the bankruptcy proceedings, the merchant has not applied for announcement in the Commercial Register of the merchant’s annual financial statements for the past three years”.

³⁹ See, for instance, *SGL Carbon Corporation* (1999) 200 F 3d 154, where the petition was dismissed because the debtor failed to demonstrate a genuine reorganization purpose.

According to the ABI Chapter 11 Commission “*companies do not undertake a chapter 11 filing lightly. A company’s management is commonly concerned about the public nature of a chapter 11 case and the potential distraction to the business caused by enhanced oversight from the court, the US Trustee, creditors and other parties in interest*”.⁴⁰

3. Limiting access because of an application to commence a bankruptcy proceeding against the debtor, as provided in Article 762(3)3 C, is not a valid reason to prohibit an application to commence a preventive restructuring proceeding. It is clear that the *rationale* underpinning such provision is to avoid those debtors whose business has no prospect of being restructured may abusively access the preventive restructuring mechanisms to further delay their exit from the market (one may refer, for instance, to the so-called zombie firms, *i.e.*, companies that operate just enough to continue surviving but are unable to pay off their debt. Such companies, given that they just scrape by meeting overheads (wages, rent, interest payments on debt, for example), have no excess capital to invest to spur growth). Nevertheless, the mere *filing* of an insolvency application does not entail that it has been already heard and, hence, adjudicated. Against this background, Article 762(3)3 CA should therefore be deleted.
4. Article 770 CA requires the debtor to provide a great deal of information and gives the court a significant oversight role at the time of the application to open the proceedings. These features are inconsistent with the introduction of a new regime based on the US Ch.11 model of debtor-in-possession (“**DIP**”). Changes are therefore needed if the new procedure is to be successful. The problems which should be addressed in the amendments include:
 - a. Article 770 CA contains a list of all the materials required to be included in an application to open a restructuring proceeding. The list of procedural prerequisites needs to be dramatically shortened to ease the burden on debtors. This applies with special force to SMEs, which typically will not have the resources to comply with such onerous requirements. It is clear from the decided cases that compliance by debtors is one of the main reasons why the present regime is not working.⁴¹ The Directive states simply that the materials filed concerning the financial difficulties of the debtor “*should indicate a likelihood of insolvency*” (Recital n. 24), and thus the Directive leaves it entirely to Member States to decide on the level of detail needed to support the admission by the debtor that such is its financial position.⁴² The materials filed in support of the application to open the proceeding should therefore be required to establish only two things: first, that the debtor has a viable business, and, secondly, that the business is likely to become insolvent if steps are not taken to deal with its financial or operational problems. Any additional requirements should be kept to the minimum necessary for the court to understand the scale of the debtor’s operations (e.g., turnover, total assets, number of employees). Each requirement of Article 770 CA should therefore be reviewed with the idea of facilitating access to an honest debtor with a viable business in mind.

⁴⁰ See <http://commission.abi.org/full-report> (last access September 2021).

⁴¹ See, for example, Case No. 492/2018, Plovdiv Court of Appeal, and Court Ruling No. 298/2017, Burgas Court of Appeal from case no. 2016/2017.

⁴² The present position is one in which the courts consider their role to be akin to that of a gatekeeper: “*the laws require strictly formally that list to be prepared and presented by the applicant and the function of the court is, on the basis of that list, to assess whether there is an imminent threat of insolvency as per the statutory definition....*” Court ruling No.492/2018, Plovdiv Court of Appeal, case No. 682/2018.

b. In any event, all of the matters in Articles 770(1)9-13⁴³ and 770(3)-(7) CA⁴⁴ pertain to the restructuring plan itself, which is not something which the debtor needs to have already prepared at the time of this application. These matters should be addressed in a different part of the amended preventive restructuring regime (see discussion under Article 8 of the Directive, below) and should be deleted from Article 770 CA. It is only if the debtor proposes, at the time of the application to open the proceeding, the expedited approval of a previously negotiated plan, that the content of the plan should be relevant at that stage of the process (see discussion in paragraph 7 under this Article, below).

c. The role of the court needs to be one of facilitating the opening of a proceeding by honest debtors with viable businesses rather than, as at present, protecting creditors and presumably the public from debtors who do not comply with the onerous threshold procedural requirements in Article 770 CA. Against this background, each of the grounds for rejecting the application in Article 773 CA, needs to be reviewed. Once the application of the debtor has been filed, the role of the court should be limited to checking if the formal requirements under the CA have been met. In its present form, Articles 773(1) 4-7 and 773(2) 2 CA empower the court to investigate matters which are, at this stage, not appropriate, and should be deleted.⁴⁵

d. Inherent in this change must be an acceptance by the courts of another of the basic principles of all DIP restructuring regimes *viz.* that, since decisions on the merits of the debtor's eventual restructuring plans will be largely in the hands of affected creditors, it should be left to them, acting in their own best interests, to do so. Experience shows that creditors can be trusted to do this. It may be only a slight over-simplification to suggest that the role of the courts after the Directive is fully implemented should shift from that of "gatekeeper" to that of "facilitator." This major cultural shift needs to be accompanied by extraordinary efforts to speed up access to the courts themselves. Restructurings rarely succeed unless participants can access the court quickly in case of need.

5. Article 4(3) of the Directive allows for a "viability test" for the limited purpose of excluding debtors

⁴³ Those paragraphs, specifically, require the insolvency application to include "9. a specific proposal by the merchant on the method, time limits and terms, under which it will pay its payables to its creditors; 10. the extent of satisfaction received by each class of creditors compared to what it would have received upon liquidation of the property under the procedure provided for by the law; 11. any and all guarantees and securities, which the merchant is ready to provide to each class of creditors under the restructuring plan; 12. any management, organisation, legal, financial and other actions to implement the restructuring plan; 13. any other circumstances relevant to the proposed restructuring plan, at merchant's discretion, including appointment of a supervisory body".

⁴⁴ The referred paragraphs of Article 770 CA read "(3) When the restructuring plan provides for a partial discharge of the merchant's payables, the plan shall provide for satisfaction of at least 50 percent of each creditor's receivables, except the creditors, which are related parties to the merchant, for which satisfaction to a smaller extent may be provided for.

(4) When the restructuring plan provides for a partial discharge of the merchant's payables, for the secured creditors, the plan shall provide for satisfaction in the amount of the arm's length price of their established securities and at least 50 percent of their receivables. In this case, an arm's length evaluation of all securities established by the merchant shall also be attached to the restructuring application.

(5) When the restructuring plan provides for a deferred payment of the payables, the time limit for the payment to all creditors may not be longer than three years after the date of termination of the restructuring proceedings.

(6) When the restructuring plan provides for a sale of the whole enterprise, self-contained parts thereof or separate property rights, an arm's length evaluation of the respective property, subject to the transaction, and a draft contract for sale, signed by the buyer, shall also be attached to the application.

(7) When the restructuring plan provides for a debt-for-equity swap, an arm's length evaluation of the receivable and the preliminary consent of the creditor to subscribe to shares against its receivable, shall also be attached to the application. Article 700, Paragraph 6 shall be applied accordingly."

⁴⁵ These comments echo those contained in the "Technical Comments" dated January 11, 2016.

that do not have a prospect of viability. The Directive also provides, curiously, that any such test should be done “*without detriment to the debtor’s assets,*” which one assumes is meant “as economically as possible.” In the context of Bulgaria, there could be many cases in which the court hearing the application to open the proceedings might want to obtain reassurance from an independent source (for example an IP, or an external auditor examining the financial statements of the debtor) that the debtor’s business is fundamentally viable. It is therefore recommended that this optional provision be considered for inclusion in the amended CA. Once the amended CA is published it will almost certainly become the practice in larger cases for debtors to obtain a viability report in advance so that the report could form part of the materials filed in support of the application. Although the Directive (correctly) does not make the provision of such a report mandatory, to encourage the practice (particularly in larger cases) the amending legislation should expressly permit the debtor to include a viability report along with the other required materials at the time of filing, and further provide that, if this is not done, the court can require that one be provided. Since most restructurings are time-critical, in the larger cases it is likely that a practice will develop of providing such reports at the outset.

6. Paragraph X 5 of the Working Group Paper suggests that Article 773(2)2 CA should be deleted⁴⁶. This is appropriate provided that other amendments to the CA leave it open to the court to reject an application to open a preventive restructuring proceeding where the court is not satisfied that the debtor’s business is viable.⁴⁷ More generally, the basis on which a court would be justified in refusing to open the new procedure is part of the very important issue “access” to the procedure. The Directive is dedicated to ensuring that “viable” enterprises run by “honest” debtors have access to the procedure. If the debtor’s business is not viable, or there is strong evidence of dishonest conduct on the part of the debtor, an immediate liquidation is in the best interests of creditors and society as a whole. The obvious difficulty confronting a judge hearing the initial application to open the proceeding is the absence of detailed knowledge of the business and of the prospects for a successful restructuring **at the time that the application is dealt with**. At that time, Article 4(1) of the Directive requires that debtors “*have access to a preventive restructuring framework that enables them to restructure*” (emphasis added). This implies a less onerous test for access than proof that a restructuring will “definitely” be possible. Nevertheless, where the materials filed in support of the application to open the proceeding fall short of demonstrating to the satisfaction of the court that the business is “viable,” or the court concludes that the debtor is already insolvent, the court must remain able to reject the application in order to prevent the abuse of it. There is therefore a difficult balance to be struck between allowing access to businesses which might not succeed in restructuring and denying access without sufficient justification to businesses which could be successfully restructured. And overlaying this challenge may be many cultural “barriers to trust.”
7. Article 4(5) of the Directive provides that preventive restructuring frameworks “*may consist of one or more procedures...some of which may take place out of court....*” In the sequence of additions to the legal toolkit available to assist in the restructuring of viable debtors, if a jurisdiction does not already have a fully-functioning in-court restructuring regime the logical first step is to introduce some form

⁴⁶ Article 773(2)2 CA reads “*The court may reject the application on initiation of restructuring proceedings, by decision, when the court finds that: [...] 2. no conditions and opportunities exist for the merchant’s business to continue after endorsement of the restructuring plan*”.

⁴⁷ And later, following the opening of a proceeding and the development of a plan which has been approved by creditors, it may be the case that the financial position of the debtor has continued to deteriorate, and the court, at this stage, might again be perfectly justified in deciding not to approve the plan for the reason stated in Article 10(3).

of non-binding out-of-court workout (“OCW”) guidelines, with the support of the central bank. In the case of Bulgaria, a set of informal out-of-court restructuring guidelines would form a useful addition to the range of measures available to participants. A copy of the well-known INSOL Principles for Out-of-Court-Restructurings is attached as Schedule One. These principles were developed by INSOL with the cooperation of the World Bank and the IMF and have become known and accepted as a guide for financial creditors in coordinating the managing credit issues in larger cases.^{48 49}

9. Among the procedures which could be considered for inclusion in Bulgaria there are “pre-packaged plan” (or “pre-pack”)⁵⁰. A pre-pack is a restructuring plan which has been agreed with all affected creditors before an application to open the restructuring proceeding is made.⁵¹

The Polish simplified restructuring proceedings

Under its so-called Shield Law 4.0. Poland has recently adopted a new, simplified restructuring proceeding. It is a powerful proceeding and has proven to be popular with debtors in Poland. It provides a 3-month delay in meeting payment obligations and a 4-month moratorium on enforcement action without the need for any judicial involvement.⁵² Secured claims can be restructured provided that new payment terms provide for 100% payment of obligations at some future date. Further, secured claims could potentially be crammed down if secured creditors do not accept revised payment terms, as long as those terms are equivalent to what the secured creditor could have obtained through enforcement.⁵³ The role of the court is limited to dealing with applications to lift the automatic moratorium for cause, approving the plan following a favourable vote by creditors and dismissing the proceeding should 4 months have elapsed without a plan being approved. The proceeding is run by a licensed restructuring advisor who is appointed by the debtor. Although initially intended as a temporary measure (in part a response to Covid-19), it is believed that the Polish Government may consider extending its application. The measures are not, however, without downside risks, including the following: (a) The possibility of collusion among creditors and the debtor; (b) The limited liability of the debtor for opening such a procedure, and the risk that this might be done in bad faith; (c) The limited responsibility of the “arrangement administrator” for the failure of the proceedings as a result of improper supervision of the debtor’s activity; (d) The vulnerability of foreign creditors to a lack of awareness of events “on the ground” and reduced capacity to comply with announcements made in the Gazette absent continuous access to the database.

⁴⁸ EU Member States which have adopted the Principles are: Austria, Croatia, Serbia and Hungary.

⁴⁹ Latvia introduced a set of its own guidelines in February 2018. They resemble the INSOL Principles. There are many other examples.

⁵⁰ A. Gurrea-Martínez, “The rise of Pre-Pack as restructuring tool: Theory, Evidence and Policy”, 2021, available at <https://papers.ssrn.com>

⁵¹ There are two types of pre-packs. The US type consists of a pre-agreed plan, along with the necessary levels of creditor support and disclosure of relevant information. The UK/Netherlands/Poland type is in effect a pre-agreed sale of all or part of the business of the debtor (and, in fact, they are sometimes referred to as ‘business transfer schemes’, where all preparatory work takes place before the appointment of an IP and the sale is concluded immediately following his or her appointment. Each jurisdiction can adapt formal requirements to suit local needs. In all cases, much time and costs are saved as the court procedure is invoked only for the limited purpose of completing the deal rather than as a procedural framework for the development and approval of a plan.

⁵² The moratorium is triggered by a publication in the Polish Official Gazette.

⁵³ The effect of this is to allow debtors a very real opportunity to extend payment of secured debt, especially where the market for the assets which are subject to the security is weak.

10. In both bankruptcy proceedings (see Article 628(4) CA⁵⁴) and the present restructuring regime (Article 770 CA), Bulgarian law permits or requires plans to be submitted to the court along with an application to open proceedings, but the essential feature of a pre-pack – prior creditor approval – is missing. This gap in the regime was pointed out in a World Bank paper commenting on the Merchant Restructuring Proceedings added to the CA on 1 July 2017.⁵⁵ The typical pre-pack procedure provides for an abbreviated procedure to approve in-court a plan which has been approved by the required majorities of creditors before the proceeding was opened. Creditors who do not approve of the plan will have the ability to object to it before the court, and in this way their rights are protected. This process is a valuable addition to any restructuring regime.
10. The main advantages of this approach in the context of implementing the Directive include the following:
 - It permits the development of a confidential out of court solution which the court can endorse;
 - The time constraints imposed by the formal process do not apply during the negotiations;
 - The preventive restructuring framework outlined in Articles. 4 and 5(2) specifically contemplates cases where an IP will **not** be appointed when the proceeding is opened. In many pre-pack situations, no IP will need to be appointed because no stay will be needed, and the plan will not include cross-class cramdown (see Article 5(3) of the Directive). In this way, the introduction of an explicit permission to file an agreed plan along with the other necessary element of an application to open a preventive restructuring proceeding would constitute a positive step in the compliance exercise;
 - Equally, an express provision for agreed plans to be filed along with the petition to open the proceedings would be a “measure or provision” under Article 4(5) of the Directive as it would be part of the (potentially multiple) preventive restructuring proceedings which takes place out-of-court.
11. In order to adopt this suggestion, a number of amendments to the CA are needed. In the interests of clarity, these should be included in a new Article.
12. Those amendments could also include the possible appointment by the debtor, acting without any involvement of the court, of a “facilitator” to assist the debtor with the negotiations of the plan with the creditors. The possibility of making such an appointment would enable the debtor to remain in control of its business, and thus form a visible part of the compliance exercise under Article 5 of the Directive.⁵⁶ Further, if the debtor does open a restructuring proceeding, the court could make such an appointment. Under Article 5 of the Directive, the court could also appoint such an expert to assist the debtor with the structure, negotiation and filing of the restructuring plan. Clearly, the effectiveness of these suggestions in practice depends on the existence of a cadre of trusted professionals to assume these roles.

⁵⁴ Article 628(4) CA reads “*With their application, the debtor or creditor may also propose a plan under Article 696, as well as specify a person meeting the requirements under Article 655, Paragraph 2, whom the court shall appoint as a temporary trustee in bankruptcy, if bankruptcy proceedings are initiated*”.

⁵⁵ At page 8.

⁵⁶ Such an appointment should also be possible by the Court.

Section 4: Debtor in Possession

Article 5 - Debtor in possession

“1. Member States shall ensure that debtors accessing preventive restructuring procedures remain totally, or at least partially, in control of their assets and the day-to-day operation of their business.

2. Where necessary, the appointment by a judicial or administrative authority of a practitioner in the field of restructuring shall be decided on a case-by-case basis, except in certain circumstances where Member States may require the mandatory appointment of such a practitioner in every case.

3. Member States shall provide for the appointment of a practitioner in the field of restructuring, to assist the debtor and creditors in negotiating and drafting the plan, at least in the following cases:

(a) where a general stay of individual enforcement actions, in accordance with Article 6(3), is granted by a judicial or administrative authority, and the judicial or administrative authority decides that such a practitioner is necessary to safeguard the interest of the parties;

(b) where the restructuring plan needs to be confirmed by a judicial or administrative authority by means of a cross-class cram-down, in accordance with Article 11; or

(c) where it is requested by the debtor or by a majority of the creditors, provided that, in the latter case, the cost of the practitioner is borne by the creditors.”

Framing the discretionary power of courts to appoint the IP

1. Under Articles 772 and 774-785 CA, the opening of proceedings has many consequences for the debtor. The Directive requires that many of those consequences be reconsidered or removed from the CA, and each provision should be examined with the following in mind.
2. Article 5(2) of the Directive begins with the confusing words “*Where necessary*”. However, it is clear enough that the intention of this provision is to require that a preventive insolvency process should be available, at least in theory, to debtors without the appointment of a “practitioner in the field of restructuring” (the “**IP**”⁵⁷) in many cases. This appears to be a significant change from the present position in Bulgaria, as Article 772(2) CA requires the court to appoint an IP in every case.

The decision of the EU legislature to make the appointment of the IP optional was based on the **UK** scheme of arrangement procedure, which is not an insolvency procedure (not even EU Regulation 848/2015 on insolvency proceedings (“EIR”)), but in practice proves to be a very powerful tool for both solvent and insolvent entities if the necessary parties and the court approve the terms of the scheme. In that UK procedure, together with the CVA, an insolvency practitioner is not required and

⁵⁷ As noted in footnote 3, above, the term “IP” (or, sometimes “Trustee”) is used in this Report for convenience only. A different term should be used to describe more accurately the role to be performed by such a practitioner in the context of a restructuring. Other terms include: “reorganization adviser,” “restructuring adviser” and “administrator.” Any term which does not convey the message that the debtor is in a state of insolvency could be used.

there is no stay.⁵⁸ There are very few other examples of such procedures elsewhere in the EU. And actually, it may be added that the 2020 UK Corporate Insolvency and Governance Act has introduced, *inter alia*, a new moratorium procedure for companies in financial distress⁵⁹. It is essentially a DIP process with the aim of facilitating the rescue of a company as a going concern. For what matters here, the moratorium is overseen by a monitor who should be a qualified and licensed IP. The monitor, whose task is to provide general oversight during the moratorium process, is an officer of the court and may apply to the court for directions about the carrying out of the monitor's functions. The monitor, however, is chosen directly by the debtor, and settles the remuneration.

In **France**, the two non-collective informal pre-insolvency procedures of the *mandat ad hoc* and *conciliation* procedures, often cited as models of preventive restructuring techniques, are based on what one commentator has described as the “*systematic appointment of an insolvency practitioner by the court*”.⁶⁰ And indeed, they both take place essentially out-of-court and are based on negotiations with the creditors, supported by independent restructuring practitioners within a regulated and protected framework. Such procedures are typically meant to operate -in principle- on a confidential basis, and to be based on individual consent between the debtor and its (main) creditors, with a view to successfully negotiating some kind of settlement, binding only for creditors agreeing with it.

And even the recent **Polish reforms**, which added an “arrangement approval proceeding,” include the appointment by the court of a licensed supervisor, who assists the debtor in a variety of ways, including in the preparation of a restructuring plan.

3. It should be noted that the practical impact of Article 5(1) on the current Bulgarian practice of appointing an IP in every case has been dramatically reduced by the other provisions of Article 5 of the Directive. In making the appointment of an IP not only possible but **mandatory** in those cases described in its Article 5(3)(a)-(c), the Directive stops well short of adopting the essential characteristic of the debtor-in-possession restructuring regime which is at the heart of US Ch. 11.⁶¹ In reality, with the possible exception of pre-packaged restructurings, cases where an IP must be appointed are likely to constitute a large majority of cases, as debtors will usually require a general stay against creditor action in order to negotiate and develop a workable plan.
4. Moreover, Article 5(2) of the Directive permits the appointment of an IP in other cases “on a case-by-case basis”. The addition of other circumstances into the text of the revised CA to guide the courts in deciding whether or not the appointment of an IP is necessary should be considered. In this way, there would be compliance with the Directive but also the possibility of a significant area of control over the actions of the debtor where this is necessary. The circumstances in which the appointment of an IP could be considered “necessary” (this is the word used in Article 5(2) of the Directive) including where there is a possible need for an IP to “supervise the activity of a debtor,” or “to partially take control

⁵⁸ That said, in many cases a scheme if prepared by a debtor which is already an insolvency procedure, and in those cases there will be both a stay and the appointment of an insolvency officeholder to oversee the process.

⁵⁹ The new law on the moratorium is envisaged in section 1(1) of the 2020 Act which inserts new Part A1 before the CVA provisions in Part 1 of the Insolvency Act 1986.

⁶⁰ Technical Report, Eurofenix, Spring 2019, by Emmanuelle Inacio.

⁶¹ Under the US system, the debtor has full DIP access to US reorganization procedures, including a general stay against creditor action, as a starting point in every case.

over the debtor’s daily operations” or “to assist the debtor and creditors in negotiating and drafting the plan”. All of these expressions are used in either the Directive itself or in Recital n. 30, and all of them could thus form a justification to require the appointment of an IP in cases not expressly covered by Article 5(3)(a)-(c) of the Directive.

Section 5: Stay of individual enforcement actions

Article 6 - Stay of individual enforcement actions

“1. Member States shall ensure that debtors can benefit from a stay of individual enforcement actions to support the negotiations of a restructuring plan in a preventive restructuring framework. Member States may provide that judicial or administrative authorities can refuse to grant a stay of individual enforcement actions where such a stay is not necessary or where it would not achieve the objective set out in the first subparagraph.

2. Without prejudice to paragraphs 4 and 5, Member States shall ensure that a stay of individual enforcement actions can cover all types of claims, including secured claims and preferential claims.

3. Member States may provide that a stay of individual enforcement actions can be general, covering all creditors, or can be limited, covering one or more individual creditors or categories of creditors. Where a stay is limited, the stay shall only apply to creditors that have been informed, in accordance with national law, of negotiations as referred to in paragraph 1 on the restructuring plan or of the stay.

4. Member States may exclude certain claims or categories of claims from the scope of the stay of individual enforcement actions, in well-defined circumstances, where such an exclusion is duly justified and where: (a) enforcement is not likely to jeopardise the restructuring of the business; or (b) the stay would unfairly prejudice the creditors of those claims.

5. Paragraph 2 shall not apply to workers' claims. By way of derogation from the first subparagraph, Member States may apply paragraph 2 to workers' claims if, and to the extent that, Member States ensure that the payment of such claims is guaranteed in preventive restructuring frameworks at a similar level of protection.

6. The initial duration of a stay of individual enforcement actions shall be limited to a maximum period of no more than four months.

7. Notwithstanding paragraph 6, Member States may enable judicial or administrative authorities to extend the duration of a stay of individual enforcement actions or to grant a new stay of individual enforcement actions, at the request of the debtor, a creditor or, where applicable, a practitioner in the field of restructuring. Such extension or new stay of individual enforcement actions shall be granted only if well-defined circumstances show that such extension or new stay is duly justified, such as:

(a) relevant progress has been made in the negotiations on the restructuring plan;

(b) the continuation of the stay of individual enforcement actions does not unfairly prejudice the rights or interests of any affected parties; or

(c) insolvency proceedings which could end in the liquidation of the debtor under national law

have not yet been opened in respect of the debtor.

8. The total duration of the stay of individual enforcement actions, including extensions and renewals, shall not exceed 12 months. Where Member States choose to implement this Directive by means of one or more procedures or measures which do not fulfil the conditions for notification under Annex A to Regulation (EU) 2015/848, the total duration of the stay under such procedures shall be limited to no more than four months if the centre of main interests of the debtor has been transferred from another Member State within a three-month period prior to the filing of a request for the opening of preventive restructuring proceedings.

9. Member States shall ensure that judicial or administrative authorities can lift a stay of individual enforcement actions in the following cases:

(a) the stay no longer fulfils the objective of supporting the negotiations on the restructuring plan, for example if it becomes apparent that a proportion of creditors which, under national law, could prevent the adoption of the restructuring plan do not support the continuation of the negotiations;

(b) at the request of the debtor or the practitioner in the field of restructuring;

(c) where so provided for in national law, if one or more creditors or one or more classes of creditors are, or would be, unfairly prejudiced by a stay of individual enforcement actions; or

(d) where so provided for in national law, if the stay gives rise to the insolvency of a creditor.

Member States may limit the power, under the first subparagraph, to lift the stay of individual enforcement actions to situations where creditors had not had the opportunity to be heard before the stay came into force or before an extension of the period was granted by a judicial or administrative authority.

Member States may provide for a minimum period, which does not exceed the period referred to in paragraph 6, during which a stay of individual enforcement actions cannot be lifted.”

Article 7 - Consequences of the stay of individual enforcement actions

“1. Where an obligation on a debtor, provided for under national law, to file for the opening of insolvency proceedings which could end in the liquidation of the debtor, arises during a stay of individual enforcement actions, that obligation shall be suspended for the duration of that stay.

2. A stay of individual enforcement actions in accordance with Article 6 shall suspend, for the duration of the stay, the opening, at the request of one or more creditors, of insolvency proceedings which could end in the liquidation of the debtor.

3. Member States may derogate from paragraphs 1 and 2 in situations where a debtor is unable to pay its debts as they fall due. In such cases, Member States shall ensure that a judicial or administrative authority can decide to keep in place the benefit of the stay of individual enforcement actions, if, taking into account the circumstances of the case, the opening of insolvency proceedings which could end in the liquidation of the debtor would not be in the general interest of creditors.

4. Member States shall provide for rules preventing creditors to which the stay applies from withholding performance or terminating, accelerating or, in any other way, modifying essential

executory contracts to the detriment of the debtor, for debts that came into existence prior to the stay, solely by virtue of the fact that they were not paid by the debtor. 'Essential executory contracts' shall be understood to mean executory contracts which are necessary for the continuation of the day-to-day operations of the business, including contracts concerning supplies, the suspension of which would lead to the debtor's activities coming to a standstill. The first subparagraph shall not preclude Member States from affording such creditors appropriate safeguards with a view to preventing unfair prejudice being caused to such creditors as a result of that subparagraph. Member States may provide that this paragraph also applies to non-essential executory contracts. 5. Member States shall ensure that creditors are not allowed to withhold performance or terminate, accelerate or, in any other way, modify executory contracts to the detriment of the debtor by virtue of a contractual clause providing for such measures, solely by reason of:

- (a) a request for the opening of preventive restructuring proceedings;*
- (b) a request for a stay of individual enforcement actions;*
- (c) the opening of preventive restructuring proceedings; or*
- (d) the granting of a stay of individual enforcement actions as such.*

6. Member States may provide that a stay of individual enforcement actions does not apply to netting arrangements, including close-out netting arrangements, on financial markets, energy markets and commodity markets, even in circumstances where Article 31(1) does not apply, if such arrangements are enforceable under national insolvency law. The stay shall, however, apply to the enforcement by a creditor of a claim against a debtor arising as a result of the operation of a netting arrangement.

The first subparagraph shall not apply to contracts for the supply of goods, services or energy necessary for the operation of the debtor's business, unless such contracts take the form of a position traded on an exchange or other market, such that it can be substituted at any time at current market value.

7. Member States shall ensure that the expiry of a stay of individual enforcement actions without the adoption of a restructuring plan does not, of itself, give rise to the opening of an insolvency procedure which could end in the liquidation of the debtor, unless the other conditions for such opening laid down by national law are fulfilled.”

Amending the stay provisions contained in the CA

1. Article 780 CA⁶² will need to be substantially rewritten to comply with Article 6 of the Directive. For

⁶² Article 780 CA reads “(1) After initiation of the restructuring proceedings, no enforcement proceedings against the merchant and no enforcement action under the procedure of the Registered Pledges Act against any property of the merchant shall be admissible.

(2) As of the initiation of the restructuring proceedings, any and all enforcement proceedings against the merchant and any enforcement action under the procedure of the Registered Pledges Act against any property of the merchant shall be stayed. Security measures may be imposed under the stayed enforcement proceedings against the merchant.

(3) Any enforcement action prior to the stay shall remain in effect. After the stay, the private or public enforcement agent may not take any new enforcement action, but may take action to secure the receivable. Interest shall be assessed for the duration of the stay.

ease of reference, all of the stay provisions should – if possible – be encompassed into one single provision of the CA, including the special treatment given to workers’ claims (which might otherwise have been inserted as an amendment to Article 776(1) CA).⁶³ It is recommended that the wording of mandatory provisions of the Directive be followed as closely as possible.

2. The Working Group Paper quite rightly identifies consequential amendments to other provisions of the CA, such as the amendment needed to Article 626(1) CA⁶⁴ to suspend the debtor’s obligation to file for bankruptcy during the period of any stay granted under Article 7 of the Directive.
3. In order to be consistent with practices in most other jurisdictions, Article 780(3) CA should only permit **completed** enforcement actions to remain in effect once the stay comes into force. The second and the third sentences of Article 780(3) CA should be deleted, in part because the court does not directly supervise enforcement agents in the same way as it can supervise the conduct of the debtor and the IP.
4. To provide for a fair balance between the rights of the debtor and those of creditors, the Directive provides for i) a limitation of the duration of the stay up to 4 months (Article 6(6) Directive); ii) the possibility that the granting of the stay may be refused “where it is not necessary” (Article 6(1) Directive; and iii) that the stay be lifted where it no longer fulfills the “*objective of supporting the negotiations on a restructuring plan*” (Article 6(9)(a) Directive). The final sentence of Article 6(9) of the Directive, if adopted, would enable the amended CA to specify a period during which the stay could not be lifted. Notwithstanding the view expressed in the Working Group Paper, it is not recommended that this optional provision be included. An affected creditor should **at any time** be able to seek relief from the stay on the grounds stated in Article 6(9) of the Directive, and even to challenge the granting of the stay in the first place, on the basis stated in Article 6(1) of the Directive (for instance, Recital n. 34, mentions the “unfair prejudice” caused by uncompensated loss or depreciation of collateral). In this way, the new preventive regime could accommodate unexpected developments. The expression “unfair prejudice” appears several times in Article 6 of the Directive. Primarily because secured creditors will expect it, this Report recommends that any creditor affected by the stay be given an express permission to apply to have the stay lifted or varied at any time on the basis that the stay is causing them “unfair prejudice.” This is specifically permitted in Article 6(9)(c), but it must be provided in national law.

In the Directive, the possibility that the creditor obtains a lift of the stay seems to be all subsumed under the concept of “unfair prejudice”. And this concept does not seem to apply exclusively to secured creditors, but also to unsecured creditors, as the Directive does not make distinctions. In other words, creditors, and not just secured creditors, seem to be entitled to apply to the judicial or

(4) *The stay of enforcement proceedings and enforcement action under the procedure of the Registered Pledges Act shall remain in effect until termination of the restructuring proceedings.*

(5) *Upon endorsement of a restructuring plan, the stay under Paragraphs 2 - 4 shall be replaced by the effect of the decision on endorsement of the restructuring plan.*

(6) *When the restructuring proceedings are terminated without endorsement of a restructuring plan, any stayed enforcement proceedings and satisfaction actions taken under the procedure of the Registered Pledges Act shall be resumed immediately”*

⁶³ Article 776(1) CA reads “*As of the initiation of the restructuring proceedings, the merchant may not make any payments on any payables, arising prior to the date of the application on initiation of the proceedings and remaining outstanding on their respective due dates, with the exception of transfers of amounts to settle public receivables such as value-added tax, excise, taxes or mandatory social security contributions on behalf of a worker, employee or other person, from whose remuneration the respective public receivable is being withheld*”. In paragraph VII.1 the Working Group Paper suggests amending CA Article 776(1) itself, but, on balance, it would be easier for future users of the CA if all provision relating to the stay, and exceptions to it, were in one place.

⁶⁴ Article 626(1) CA states that “*Any debtor, who becomes insolvent or over-indebted, shall apply for initiation of bankruptcy proceedings within 30 days*”.

administrative authority to have a stay lifted on the ground that it causes “unfair prejudice”.

As suggested by an author, “*it may be that the concept of ‘unfair prejudice’ is being asked too much*”⁶⁵. Indeed, such a broad option could affect negatively the course of negotiations and discourage debtors to open restructuring proceedings if certainty and predictability regarding the stay is not granted.

The **US Bankruptcy Code** takes a somewhat different approach. Under Section 362, relief may be granted against a stay relating to acts against property where i) the debtor does not have any equity remaining in the collateral and ii) the property is not necessary for an effective reorganisation. If the debtor fails to demonstrate that the property is necessary or that a successful organisation is a realistic possibility, then the secured creditor should be given permission to enforce the security and lift the stay.

Another approach could be drawn by the **UK** experience associated with the administration procedure. As suggested by the case-law, a more particular and comprehensive guidance on when the stay should be lifted may represent a viable solution⁶⁶.

5. Article 7(4) of the Directive is mandatory. It will require Article 777 CA to be redrafted⁶⁷. Examples of “essential contracts” (which is defined in Article 7(4) of the Directive as “*executory contracts which are necessary for the continuation of the day-to-day operations of the business, including contracts concerning supplies, the suspension of which would lead to the debtor's activities coming to a standstill*”), are contained in Recital n. 41. Note that it is permitted to provide safeguards to avoid unfair prejudice to counterparties affected by the stay on terminating essential contracts.⁶⁸
6. The amendments should allow any creditor to agree to waive any security or priority rights. Article 766(4) CA should therefore be deleted.

Section 6: Content of restructuring plans

Article 8 - Content of restructuring plans

“1. Member States shall require that restructuring plans submitted for adoption in accordance with Article 9, or for confirmation by a judicial or administrative authority in accordance with Article 10, contain at least the following information:

(a) the identity of the debtor;

(b) the debtor's assets and liabilities at the time of submission of the restructuring plan, including a value for the assets, a description of the economic situation of the debtor and the position of

⁶⁵ G. McCormack, *The European Restructuring Directive*, 2021, p. 132.

⁶⁶ See *Re Atlantic Computers plc*, [1992], Ch 5050, at 541-541.

⁶⁷ Article 777 CA reads “(1) Upon request by any party, the court may allow any bilateral contract, to which the merchant is party, to be terminated, if the contract has not been performed in full or in part at the time of initiation of the restructuring proceedings. (2) The court shall allow the termination of the contract under Paragraph 1 only if the court finds that the performance of the contract will impede the performance of the merchant's obligations, provided for in the restructuring plan, and that the non-performance of the contract will not cause more than the usual damages to the other party. (3) Upon termination of the contract, the other party shall be entitled to damages”.

⁶⁸ See second subparagraph of Article 7(4).

workers, and a description of the causes and the extent of the difficulties of the debtor;

(c) the affected parties, whether named individually or described by categories of debt in accordance with national law, as well as their claims or interests covered by the restructuring plan;

(d) where applicable, the classes into which the affected parties have been grouped, for the purpose of adopting the restructuring plan, and the respective values of claims and interests in each class;

(e) where applicable, the parties, whether named individually or described by categories of debt in accordance with national law, which are not affected by the restructuring plan, together with a description of the reasons why it is proposed not to affect them;

(f) where applicable, the identity of the practitioner in the field of restructuring;

(g) the terms of the restructuring plan, including, in particular: (i) any proposed restructuring measures as referred to in point (1) of Article 2(1); (ii) where applicable, the proposed duration of any proposed restructuring measures; (iii) the arrangements with regard to informing and consulting the employees' representatives in accordance with Union and national law; (iv) where applicable, overall consequences as regards employment such as dismissals, short-time working arrangements or similar; (v) the estimated financial flows of the debtor, if provided for by national law; and (vi) any new financing anticipated as part of the restructuring plan, and the reasons why the new financing is necessary to implement that plan;

(h) a statement of reasons which explains why the restructuring plan has a reasonable prospect of preventing the insolvency of the debtor and ensuring the viability of the business, including the necessary pre-conditions for the success of the plan. Member States may require that that statement of reasons be made or validated either by an external expert or by the practitioner in the field of restructuring if such a practitioner is appointed.

2. Member States shall make available online a comprehensive checklist for restructuring plans, adapted to the needs of SMEs. The checklist shall include practical guidelines on how the restructuring plan has to be drafted under national law. The checklist shall be made available in the official language or languages of the Member State. Member States shall consider making the check-list available in at least one other language, in particular in a language used in international business.”

Clarifying the content of a restructuring plan

1. As previously mentioned, Article 770 CA needs to be separated into two different provisions, one dealing with the contents of an application to open a preventive proceeding, and the other listing the information and topics to be included in the restructuring plan itself.
2. To comply with Article 8(1) of the Directive, it is recommended, first of all, that the contents of the Directive be adopted as directly as possible. Note that the list of items to be included in a plan required by the Directive is only a minimum and focuses on the key objectives of the plan and procedures for implementation. This is different from the much more detailed approach taken in Article 770 CA. If the approach of Article 770 CA is to be continued, it is suggested that the opportunity be taken to redraft and reorganise the present list in that article, in order to avoid duplication and increase clarity. It may

also be desirable to include entirely new items with a view to assisting debtors and their advisers in drafting a plan suited to the circumstances of any particular case. A “catchall” provision could also be added to end of any list intended to encourage the debtor to include anything not mentioned in the list but which “assists affected creditors and the court in making an informed decision on the merits of the plan.”

3. In cases where an IP has been appointed to assist the debtor, it is recommended that a declaration from the IP validating the statement that the plan has a reasonable prospect of preventing the insolvency of the debtor be required, as contemplated by Article 8(1) (h).
4. Certain provisions in CA Article 770 could perhaps be deleted. Creditors themselves should be able to decide what proportion of the amount they are owed they will accept, and over what time period (Articles 770(3) and (4)), and it is arbitrary to require that a certain proportion of debts of a particular type must be paid in any plan (Article 770(5)). A decision on the matters covered in Article 770(6) and (7) CA could be left to the debtor. If creditors are not content with what is proposed they can be relied upon to object or to withhold their approval at the voting stage. What the debtor must disclose is sufficient reliable information to enable creditors to make an informed decision on whether or not to accept the terms set out in the plan⁶⁹. It would also be appropriate for the IP, with the approval of the debtor, to be able to respond directly to reasonable requests for information from creditors, given the obligation of the IP to “assist the debtor and creditors in negotiating and drafting the plan” under Article 5(3) of the Directive.⁷⁰ In those (hopefully rare) cases where a debtor and the IP might disagree on whether or not certain information sought by creditors should be disclosed, a court direction could be sought.⁷¹
5. One of the key features of any restructuring plan is to identify clearly which creditors are to be involved in the proceedings (i.e., the “affected creditors”). CA Article 766 provides that “all” creditors “shall be involved in the restructuring proceedings.” This is true only to the extent that a stay which applies to all creditors is granted. Article 766 should therefore be amended or deleted.
6. Article 8(2) of the Directive requires that a comprehensive checklist for restructuring plans be made available, adapted to the needs of SMEs. This Report does not address this requirement. Although not a substitute for the checklist required by Article 8(1) of the Directive, Schedule Two to this Report is a comprehensive checklist intended for use by SMEs to assist them to prepare for restructuring discussions with creditors. This tool, like the OCW guidelines, could assist in agreeing a restructuring plan completely out of court, or in preparing a plan for submission to the court as a pre-packaged plan, as discussed under Article 4 of the Directive, above.

Section 7: Adoption of a Restructuring Plan

Article 9 - Adoption of restructuring plans

⁶⁹ In this respect it must be considered that under Article 700 CA “*The supervisory body may, at any time, require the debtor to present information on a report on any matter concerning the business of the debtor and the implementation of the administration plan*”.

⁷⁰ Although that obligation appears in the context of situations where the appointment of an IP is mandatory, it is to be assumed that such a function is part of the duties of an IP in every case where one is appointed.

⁷¹ Such a proposal is consistent with World Bank Principle C14.1, which provides that a restructuring system should “provide a structure that encourages fair negotiation of a commercial plan.”

“1. Member States shall ensure that, irrespective of who applies for a preventive restructuring procedure in accordance with Article 4, debtors have the right to submit restructuring plans for adoption by the affected parties. Member States may also provide that creditors and practitioner in the field of restructuring have the right to submit restructuring plans and provide for conditions under which they may do so.

2. Member States shall ensure that affected parties have a right to vote on the adoption of a restructuring plan. Parties that are not affected by a restructuring plan shall not have voting rights in the adoption of that plan.

3. Notwithstanding paragraph 2, Member States may exclude from the right to vote the following:

(a) equity holders;

(b) creditors whose claims rank below the claims of ordinary unsecured creditors in the normal ranking of liquidation priorities; or

(c) any related party of the debtor or the debtor's business, with a conflict of interest under national law.

4. Member States shall ensure that affected parties are treated in separate classes which reflect sufficient commonality of interest based on verifiable criteria, in accordance with national law. As a minimum, creditors of secured and unsecured claims shall be treated in separate classes for the purposes of adopting a restructuring plan. Member States may also provide that workers' claims are treated in a separate class of their own. Member States may provide that debtors that are SMEs can opt not to treat affected parties in separate classes. Member States shall put in place appropriate measures to ensure that class formation is done with a particular view to protecting vulnerable creditors such as small suppliers.

5. Voting rights and the formation of classes shall be examined by a judicial or administrative authority when a request for confirmation of the restructuring plan is submitted. Member States may require a judicial or administrative authority to examine and confirm the voting rights and formation of classes at an earlier stage than that referred to in the first subparagraph.

6. A restructuring plan shall be adopted by affected parties, provided that a majority in the amount of their claims or interests is obtained in each class. Member States may, in addition, require that a majority in the number of affected parties is obtained in each class. Member States shall lay down the majorities required for the adoption of a restructuring plan. Those majorities shall not be higher than 75 % of the amount of claims or interests in each class or, where applicable, of the number of affected parties in each class.

7. Notwithstanding paragraphs 2 to 6, Member States may provide that a formal vote on the adoption of a restructuring plan can be replaced by an agreement with the requisite majority.”

Avenues to provide flexibility in the creation of creditor classes

1. The creation of classes is one of the most important topics in many restructurings. From the debtor’s perspective, the number of classes should be kept as low as possible, as it increases the likelihood that the required majorities will be achieved by reducing the number of possible groups with recognised divergent interests. From the point of view of creditors (particularly in higher value cases), a larger

number of classes provides more leverage, as the threat of not obtaining the required level of support tends to make debtors more receptive to changes in the plan of particular value to certain groups. Although, in a few jurisdictions (e.g., France), classes containing individual creditors are not formed, and no distinction is drawn between secured and unsecured creditors,⁷² in most jurisdictions this is not the approach taken.⁷³ The Directive recognises this in Article 9(4), which requires every Member State to ensure that affected parties are treated in separate classes “*which reflect sufficient commonality of interest based on verifiable criteria.*”

2. Recital n. 44 of the Directive makes it clear that many of the decisions regarding classes can be made under national law. Apart from treating secured and unsecured creditors in different classes (which the Directive states should “always” be done), the Directive leaves it to each Member State to make its own policy decisions. This Report recommends that the approach to classes in implementing the Directive be kept as simple as possible but include an element of flexibility.⁷⁴
4. Consideration could be given to amending Article 789 CA to reduce the number of classes. There seems to be no reason for unsecured claims to be divided into separate classes by reason of the identity of the creditor. Article 789(1)3 CA could be deleted. Since it is also recommended that parties related to the debtor should have no right to vote on the plan, Article 789(1)5 CA could also be deleted.
5. To provide a degree of flexibility in the creation of classes, the revised CA could also permit additional classes to be formed wherever a group of creditors constitutes (to quote from the Directive) “sufficient commonality of interest-based on verifiable criteria” to justify forming a class. In considering this possibility, it should be remembered that the class issue can be central to gaining the approval of creditors to a plan, and that in jurisdictions (e.g., the UK, other Commonwealth countries and the USA), disputes over class formation arise frequently.
6. It will be very rare that there are any workers’ claims for unpaid wages in a preventive restructuring proceeding. If wages cannot be paid, it is far more likely that the debtor will already be insolvent, and thus no longer eligible to open a preventive proceeding. The Working Group Paper (IX 1.1) makes a set of detailed recommendations concerning employees who are also related to the debtor. It is for discussion whether one way of dealing with this issue would be to delete Article 1(1)2 from the definition of “Related Parties” in the Supplementary Provisions of the CA so that employers and employees are no longer defined as “related persons”.
7. Creditors which are “related parties” may (but not “must”) be excluded from voting on the plan, if they have a “conflict of interest under national law.” This difficult question is therefore to be decided on a case-by-case basis if this optional provision in the Directive is adopted. Whatever the policy decision on that issue, the recommendation of the Working Group that the substance of Articles 766 (5) and 790(2)6 CA be deleted should be accepted. Such acceptance does not imply, however, that there may not be good reasons to challenge the validity of a claim being brought by a related party under other provisions of the CA.
8. Contested creditor claims can become a major problem if they cannot be resolved quickly. This is particularly true if fraudulent claims are submitted by creditors (or debtors). Rights of appeal to the courts from a decision on a disputed claim made by the IP assisting the debtor in court-supervised restructurings can lead to delays which can have disastrous consequences for the entire restructuring

⁷² Instead, voting rights are allocated to committees of creditors and other groups of affected parties by the judicial administrator.

⁷³ Examples of jurisdictions in which classes are formed prior to voting on a restructuring plan include Germany, Greece, Hungary, Italy, the Netherlands, the UK and Portugal, Canada, Australia and the USA.

⁷⁴ Revisions to voting rights contained in CA Part 5 Chapter 53 may logically require revisions to other provisions of the CA regarding voting rights in other contexts, for example CA Article 703.

exercise. Recital n. 46 allows Member States to deal with this on a national level. In a bankruptcy proceeding, Article 673(2) CA provides that only creditors with admitted claims have a right to vote at the creditors' meeting, and disputes of all kinds relating to claims are to be referred to the court under procedures set out in Chapter 43 CA. Even observing the time limits in that Chapter, it is obvious that the resolution of a disputed claim could take weeks. The present merchant restructuring provisions state that the list of creditors submitted by the debtor as part of the application to open the restructuring proceeding is to be reviewed by the IP under Article 783(1)1 CA and then submitted to the court for finalisation under Article 786. Again, even observing the time limits in Article 786 CA, it could take many weeks to resolve disputed claims, and there appears to be no discretion given to the IP to put a value on a claim "for voting purposes" in case of need. As a result, a single disputed claim could cause inordinate and damaging delays to the process, and, potentially, loss of value to all stakeholders. It is therefore suggested that the time limits in Article 786 CA be examined to see if they could be reduced. Further, if there are any appeal rights from a decision of the court made under CA Article 786(3), then these could be eliminated.

9. A contingent claim is a debt whose existence depends on uncertain future developments. Recital 46 strongly suggests that Member States have in place a mechanism for valuing contingent claims. The acceleration mechanism which appears to apply in a bankruptcy context in CA Article 617 should be examined to see if, in practice, it has performed this function adequately. If so, it could also apply to contingent claims submitted by creditors in the context of a preventive restructuring.
10. The mandatory provisions of Article 9(6) of the Directive concerning majorities will require amendments to CA Article 789, as the Working Group Paper points out.
11. Although not a mandatory provision, the suggestion in the Directive in the third paragraph of Article 9(4) that SMEs debtors should be permitted not to treat creditors in separate classes (apart from secured and unsecured creditors) may be appropriate in the context of Bulgaria.
12. In contrast, there is a requirement, in the fourth paragraph of Article 9(4), to adopt appropriate measures to ensure that class formation is done with a view to protecting the interests of "vulnerable creditors such as small suppliers." One such appropriate measure would be to allow for payment in full of the claims of unsecured creditors below a certain monetary amount in a plan. This would both protect the smaller creditors and improve the prospects of obtaining their approval of the plan. Note that this provision is intended to benefit the debtor in obtaining approval of a plan and does not guarantee any new rights for creditors.⁷⁵

Section 8: Confirmation of the Plan by the Court

Article 10 - Confirmation of restructuring plans

"1. Member States shall ensure that at least the following restructuring plans are binding on the parties only if they are confirmed by a judicial or administrative authority:

(a) restructuring plans which affect the claims or interests of dissenting affected parties;

(b) restructuring plans which provide for new financing;

(c) restructuring plans which involve the loss of more than 25 % of the workforce, if such loss is

⁷⁵ See Recital 43.

permitted under national law.

2. Member States shall ensure that the conditions under which a restructuring plan can be confirmed by a judicial or administrative authority are clearly specified and include at least the following:

(a) the restructuring plan has been adopted in accordance with Article 9;

(b) creditors with sufficient commonality of interest in the same class are treated equally, and in a manner proportionate to their claim;

(c) notification of the restructuring plan has been given in accordance with national law to all affected parties;

(d) where there are dissenting creditors, the restructuring plan satisfies the best-interest-of-creditors test;

(e) where applicable, any new financing is necessary to implement the restructuring plan and does not unfairly prejudice the interests of creditors. Compliance with point (d) of the first subparagraph shall be examined by a judicial or administrative authority only if the restructuring plan is challenged on that ground.

3. Member States shall ensure that judicial or administrative authorities are able to refuse to confirm a restructuring plan where that plan would not have a reasonable prospect of preventing the insolvency of the debtor or ensuring the viability of the business.

4. Member States shall ensure that where a judicial or administrative authority is required to confirm a restructuring plan in order for it to become binding, the decision is taken in an efficient manner with a view to expeditious treatment of the matter.”

Electronic approval of the Plan by the Court

1. Article 10(1) of the Directive can be correctly implemented by adding a requirement that all plans approved by creditors in a preventive procedure must be confirmed by the court under an amended version of CA Article 790.
2. The Working Group may wish to consider whether to use electronic means of notification of the plan under Article 10(2)(c), as contemplated by Article 28 of the Directive.
3. Since the “best interests of creditors test” is defined in Article 2(1)(6) of the Directive, this definition should (if not already appearing in an Article containing other definitions) be reproduced in the CA in order to guide the court in confirming (subject to the final paragraph of Article 10(2)) that the test is satisfied in the plan, as required by Article 10(2)(d). The same comment applies to the definition of “new financing” and “interim financing,” in the context of complying with Article 10(2)(e).
4. The extent to which (if at all) CA Article 768 should continue to apply to a preventive insolvency proceeding should be considered. DIP restructurings should, to the maximum extent possible, be driven by debtors and creditors and their advisers, with the court playing a supportive role, rather like a referee. A reinforced *ex officio* procedure, in contrast, gives the court an investigative role. If that role is to be preserved, it should not be allowed to interfere with the decisions of the participants in the absence of specific statutory provision. Paragraph X 4 of the Working Group Paper mentions a possible

amendment to CA Article 768(2)1, which would have the effect of limiting the ability of the court to play such a role. But the larger question to consider is whether Articles 768(2)1 and 768(2)2 have any place at all in the new regime.

Section 9: Cross-Class Cramdown

Article 11 - Cross-class cram-down

“1. Member States shall ensure that a restructuring plan which is not approved by affected parties, as provided for in Article 9(6), in every voting class, may be confirmed by a judicial or administrative authority upon the proposal of a debtor or with the debtor's agreement, and become binding upon dissenting voting classes where the restructuring plan fulfills at least the following conditions:

(a) it complies with Article 10(2) and (3);

(b) it has been approved by: (i) a majority of the voting classes of affected parties, provided that at least one of those classes is a secured creditors class or is senior to the ordinary unsecured creditors class; or, failing that, (ii) at least one of the voting classes of affected parties or where so provided under national law, impaired parties, other than an equity-holders class or any other class which, upon a valuation of the debtor as a going concern, would not receive any payment or keep any interest, or, where so provided under national law, which could be reasonably presumed not to receive any payment or keep any interest, if the normal ranking of liquidation priorities were applied under national law;

(c) it ensures that dissenting voting classes of affected creditors are treated at least as favourably as any other class of the same rank and more favourably than any junior class; and

(d) no class of affected parties can, under the restructuring plan, receive or keep more than the full amount of its claims or interests. By way of derogation from the first subparagraph, Member States may limit the requirement to obtain the debtor's agreement to cases where debtors are SMEs. Member States may increase the minimum number of classes of affected parties or, where so provided under national law, impaired parties, required to approve the plan as laid down in point (b)(ii) of the first subparagraph.

2. By way of derogation from point (c) of paragraph 1, Member States may provide that the claims of affected creditors in a dissenting voting class are satisfied in full by the same or equivalent means where a more junior class is to receive any payment or keep any interest under the restructuring plan.

Member States may maintain or introduce provisions derogating from the first subparagraph where they are necessary in order to achieve the aims of the restructuring plan and where the restructuring plan does not unfairly prejudice the rights or interests of any affected parties.”

Drawing the essential features of a cramdown provisions

1. The Directive introduces the concept of cross-class cramdown. It is inspired by US Ch. 11. The objective of this device is to limit the influence on the outcome of a restructuring which can be exerted

by “out of the money” creditors. Put bluntly, there is often a temptation among dissenting creditors to seek to derail the restructuring if they are not going to benefit from it by arguing that they form a separate class of creditors and then voting against the plan. In this way, they can force the debtor to try to find a way of getting their support by making payments which are unjustified on any commercial basis.

2. The drafting of Article 11 of the Directive is difficult to follow. For convenience, the essential features of a cramdown provision are set out below:

“Where some classes have not approved the plan with the requisite majorities the court can still confirm the plan where:

- *The plan meets the ‘best interests of creditors’ test; and*
- *Dissenting creditors are treated at least as favourably as any other class of the same rank and more favourable than any junior class; and*
- *No class receives more than the full amount of its claim; and*
- *The plan has been approved by either:*
 - *A majority of classes of affected creditors provided that at least one of those parties is either a secured creditor or is senior to unsecured creditors; or*
 - *At least one class of affected or impaired creditors (not being shareholders or anyone who, on a going concern value of the debtor, would not receive anything in the liquidation priorities order)”.*

3. The fundamental decision to be made in drafting the new provisions of the CA required by Article 11 is whether to adopt an “absolute priority principle” or a “relative priority principle” approach to payment of creditors under a plan. The absolute priority principle requires that senior classes of creditors must be paid in full before junior classes or shareholders receive or retain any value at all. The relative priority principle, in contrast, allows a plan to be approved if a senior class is treated more favourably than a junior class even though the senior class is not paid in full. Article 11(1)(c) adopts the relative priority rule as a starting point, but it should be noted that the Directive does not require a Member State to adopt one principle as opposed to the other: the Directive specifically permits the adoption of the absolute priority rule in Article 11(2).
4. There is much debate over the relative merits of each approach. There are policies for and against each choice. However, one argument against the acceptance of the relative priority rule may be particularly relevant in the context of Bulgaria, namely: that the relative priority rule does not respect the usual order of distribution of payments in a liquidation scenario. This could add another layer of complexity in the negotiation of a plan. It would allow, for example, a plan to give value to unsecured creditors or shareholders without preferential or secured creditors being paid in full.
5. Practically speaking, it may be desirable in this instance to adopt the absolute priority rule (this is permitted in the first subparagraph of Article 11(2)) and, at the same time, allow a plan in any given case to derogate from that principle *“in order to achieve the aims of the restructuring plan and where the restructuring plan does not unfairly prejudice the rights or interests of any affected parties,”* as provided in the second subparagraph of Article 11(2).

Section 10: Equity Holders

Article 12 - Equity holders

“1. Where Member States exclude equity holders from the application of Articles 9 to 11, they shall ensure by other means that those equity holders are not allowed to unreasonably prevent or create obstacles to the adoption and confirmation of a restructuring plan.

2. Member States shall also ensure that equity holders are not allowed to unreasonably prevent or create obstacles to the implementation of a restructuring plan.

3. Member States may adapt what it means to unreasonably prevent or create obstacles under this Article to take into account, inter alia: whether the debtor is an SME or a large enterprise; the proposed restructuring measures touching upon the rights of equity holders; the type of equity holder; whether the debtor is a legal or a natural person; or whether partners in a company have limited or unlimited liability.”

Identifying the meaning of misconduct in the reorganisation process

1. Where shareholders are excluded from voting on a plan there must also be a provision which prohibits shareholders from “unreasonably” preventing or creating obstacles to the adoption and confirmation of a plan. Clearly, this mandatory provision confers a discretion on the court to decide what “unreasonably prevent” or “create obstacles” means, and it would be helpful for examples of the meaning of what might constitute unreasonable conduct of that sort to be included in a new provision. Given the difficulty of identifying and listing all possible forms of such conduct, consideration could perhaps be given to including in any such list a general form of words such as: *“any conduct which unfairly interferes with the interests of the debtor or affected creditors under this Chapter, or which can or might create obstacles to the adoption or confirmation of a restructuring plan,”* or words to similar effect. The court should also be able to consider the views of any IP appointed in the particular case. Needless to say that such kind of evaluation requires that judicial are equipped with a specific set of expertise and skills in the area of insolvency law.

Section 11: Workers

Article 13 - Workers

“1. Members States shall ensure that individual and collective workers' rights, under Union and national labour law, such as the following, are not affected by the preventive restructuring framework:

(a) the right to collective bargaining and industrial action; and

(b) the right to information and consultation in accordance with Directive 2002/14/EC and Directive 2009/38/EC, in particular:

(i) information to employees' representatives about the recent and probable development of the undertaking's or the establishment's activities and economic situation, enabling them to communicate to the debtor concerns about the situation of the business and as regards the need to consider restructuring mechanisms;

(ii) information to employees' representatives about any preventive restructuring procedure which could have an impact on employment, such as on the ability of workers to recover their wages and any future payments, including occupational pensions;

(iii) information to and consultation of employees' representatives about restructuring plans before they are submitted for adoption in accordance with Article 9, or for confirmation by a judicial or administrative authority in accordance with Article 10;

(c) the rights guaranteed by Directives 98/59/EC, 2001/23/EC and 2008/94/EC.

2. Where the restructuring plan includes measures leading to changes in the work organisation or in contractual relations with workers, those measures shall be approved by those workers, if national law or collective agreements provide for such approval in such cases.”

Preserving the rights of workers during the preventive restructuring framework

1. Union and national labour law need to be examined to ensure that the categories of workers' rights set out in Article 13(1) are not going to be affected by the new regime.
2. In order to implement Article 13(2), it is recommended that this condition be included among the list of factors on which the court must be satisfied when it is called upon to confirm a plan under Article 10.

Section 12: Valuation

Article 14 - Valuation by the judicial or administrative authority

“1. The judicial or administrative authority shall take a decision on the valuation of the debtor's business only where a restructuring plan is challenged by a dissenting affected party on the grounds of either:

(a) an alleged failure to satisfy the best-interest-of-creditors test under point (6) of Article 2(1); or

(b) an alleged breach of the conditions for a cross-class cram-down under point (ii) of Article 11(1)(b).

2. Member States shall ensure that, for the purpose of taking a decision on a valuation in accordance with paragraph 1, judicial or administrative authorities may appoint or hear properly qualified experts.

3. For the purposes of paragraph 1, Member States shall ensure that a dissenting affected party may lodge a challenge with the judicial or administrative authority called upon to confirm the restructuring plan. Member States may provide that such a challenge can be lodged in the context of an appeal against a decision on the confirmation of a restructuring plan.”

Provisions for a quick and efficient valuation

1. In the limited circumstances in which this Article would apply (see Article 14(1)(a)-(b)), the necessary additions to the CA should also impose strict time limits for the completion of the valuation exercise, or, at a minimum, words requiring the valuation to be done “as quickly and efficiently as possible”. The same comment applies to the decision by the court on the value-based challenge to the plan once the valuation has been done. There should be no appeal from the decision.

Section 13: Effects of the Restructuring Plan

Article 15 - Effects of restructuring plans

“1. Member States shall ensure that restructuring plans that are confirmed by a judicial or administrative authority are binding upon all affected parties named or described in accordance with point (c) of Article 8(1).

2. Member States shall ensure that creditors that are not involved in the adoption of a restructuring plan under national law are not affected by the plan.”

Compliance with the terms of the approved restructuring plan Compliance with the terms of the approved restructuring plan

1. As a general comment, amendments to CA Chapter 57 should allow for the terms of the approved restructuring plan to speak for themselves as far as the timing and method of implementing the plan are concerned. CA Article 792, for example, does not do this, as it prescribes an arbitrary time limit for concluding a going concern sale of the business. The time to consider the timeframe for concluding a sale is at the stage before a plan is voted on by creditors. At that stage, it could be that although the time for concluding a sale is more than one month later, it is nevertheless reasonable under the circumstances.
2. CA Article 791 requires amendment to make it clear that only affected creditors are bound by the plan.
3. The English version of CA Article 795 is not clear. If a creditor wishes to challenge a plan on the basis that it was approved on the basis of threats or fraud then the appropriate time to raise this issue is at the time of the vote or – at the latest – at the time that confirmation by the court is requested. If the threat or (more likely) fraud is discovered during the implementation of the plan, then any order invalidating the plan should apply to all those bound by the plan rather than just to the creditor who applied for the invalidation order. CA Article 795(2) should be amended to reflect this.
4. CA Article 796(2) will require amendment to take account of the time periods of the stay (if granted) under Article 6.

Section 14: Appeals

Article 16 - Appeals

“1. Member States shall ensure that any appeal provided for under national law against a decision to confirm or reject a restructuring plan taken by a judicial authority is brought before a higher judicial authority. Member States shall ensure that an appeal against a decision to confirm or reject a restructuring plan taken by an administrative authority is brought before a judicial authority.

2. Appeals shall be resolved in an efficient manner with a view to expeditious treatment.

3. An appeal against a decision confirming a restructuring plan shall have no suspensive effects on the execution of that plan. By way of derogation from the first subparagraph, Member States may provide that judicial authorities can suspend the execution of the restructuring plan or particles thereof where necessary and appropriate to safeguard the interests of a party.

4. Member States shall ensure that, where an appeal pursuant to paragraph 3 is upheld, the

judicial authority may either: (a) set aside the restructuring plan; or (b) confirm the restructuring plan, either with amendments, where so provided under national law, or without amendments. Member States may provide that, where a plan is confirmed under point (b) of the first subparagraph, compensation is granted to any party that incurred monetary losses and whose appeal is upheld”.

Limiting the power of the courts to confirm an amended plan

1. It may be necessary to provide additional powers to any relevant court to give effect to the second paragraph of Article 16(3) of the Directive.
2. In a case where an appeal is successful, the Directive requires that the appellate court be given the power to set aside or to confirm the plan (without amendments) *or*, “*when so provided under national law*” to confirm the plan with amendments. There is a policy decision to be made in deciding whether or not, and to what extent, the court should be able to confirm a plan “*with amendments*” without requiring the plan to be put to another vote by creditors in the amended form. It is suggested that, in order to avoid substituting the judgement of the court for that of the creditors, any power to confirm a plan “*with amendments*” should be limited to amendments that do not materially alter the value of distributions to affected creditors under the plan as approved by them. If amendments of a more substantial nature follow from the decision of the appellate court, then the plan as amended should be put to another vote of affected creditors.

Section 15: Protection for new finance

Article 17 - Protection for new financing and interim financing

“1. Member States shall ensure that new financing and interim financing are adequately protected. As a minimum, in the case of any subsequent insolvency of the debtor: (a) new financing and interim financing shall not be declared void, voidable or unenforceable; and (b) the grantors of such financing shall not incur civil, administrative or criminal liability, on the ground that such financing is detrimental to the general body of creditors, unless other additional grounds laid down by national law are present.

2. Member States may provide that paragraph 1 shall only apply to new financing if the restructuring plan has been confirmed by a judicial or administrative authority, and to interim financing which has been subject to ex ante control.

3. Member States may exclude from the application of paragraph 1 interim financing which is granted after the debtor has become unable to pay its debts as they fall due.

4. Member States may provide that grantors of new or interim financing are entitled to receive payment with priority in the context of subsequent insolvency procedures in relation to other creditors that would otherwise have superior or equal claims.”

Providing adequate protection for providers of new financing

1. New finance is needed in virtually every successful restructuring. Providing “adequate protection” for

the providers of new financing is also essential.

2. As one might expect, what is known as “post-petition financing” in the USA is subject to a highly developed set of rules, all of which are intended to encourage the provision of new money to a debtor in a Ch. 11 proceeding. Among these are:
 - A DIP may obtain unsecured post-petition credit in the ordinary course of business without court approval;
 - The court may authorise post-petition credit as an administrative expense;
 - The court may grant to a post-petition lender a ‘super priority’ over all other administrative and unsecured claims;
 - A DIP may also obtain secured credit, and the court may grant various different levels of priority over existing security rights over the debtor’s property, including (where the debtor can demonstrate that it cannot obtain credit otherwise) a level of priority equal or superior to existing lien rights.⁷⁶
3. The Directive does not directly address the most important question regarding interim financing, which is not that it should not be open to challenge as avoidable transactions in the event that the debtor becomes insolvent, but what priority needs to be given to this form of financial support in order to encourage arm’s length providers to make it available to debtors in financial difficulty. The possibility that priority to providers of such finance could be given in a subsequent insolvency of the debtor is mentioned in Article 17(4), but the Directive provides no further guidance on this crucial question.
4. The first question is, therefore: **what level of priority** is going to be given under Bulgarian law to the providers of such finance? This requires an examination of Article 722 CA with a view to adding interim finance to the order of priority in the most appropriate place.

Looking at other jurisdictions for guidance, it will be seen that a variety of priority treatments are possible.

In **Spain**, new money provided by an unrelated party can receive priority as an administrative expense (ranking alongside the IP’s fees) to the extent of 50% of the amount of new money, with the balance ranking as generally privileged.

In **Germany** and the **UK**, loans to assist the debtor in carrying on business taken out by the insolvency administrator are paid before unsecured claims but after claims relating to the costs of the proceedings and secured claims.

In **France**, in a safeguard proceeding (a proceeding in which the debtor is presumed to be solvent), a debtor may obtain new finance with court consent, and its priority depends on whether a liquidation or reorganisation plan is confirmed by the court at the end of the observation period.

It can readily be seen that the treatment for priority purposes of new or interim financing varies a great deal within the EU. That said, in all jurisdictions which have addressed this issue one thing is clear: some sort of special priority is granted to interim financing provided to a debtor in a court-supervised restructuring proceeding.⁷⁷ This is for discussion by the Working Group.

⁷⁶ Subject always to the debtor being able to provide “adequate protection” to existing lienholders (which in most cases is difficult to do).

⁷⁷ Further, many jurisdictions will need to make changes to their existing post-filing finance provisions in order to comply with

5. The second question is what sort of **conditions (if any)** should be put on the granting of the priority provided in the amended CA to new or interim financing. As mentioned above, in some jurisdictions there will be no priority unless a plan is subsequently approved by the court. However, there is a strong argument that potential providers of new finance will not be willing to make finance available if the priority is only to be given if a plan is subsequently approved by the creditors and confirmed by the court. This is because, as Recital n. 68 states, at the time that interim financing is needed, it will not be known whether or not any plan will come into effect. Although it is for discussion, it is not recommended that the drafters make the confirmation of a plan a condition precedent to giving priority to new finance, as suggested by the Working Group Paper in paragraph XIII (4) and (5). An alternative – and the preferred – approach (also endorsed by the Working Group Paper) to this very real challenge is to require, as a condition of receiving the priority in the Directive, court approval for the interim financing. It should be noted that in order for this suggestion to work in practice it is essential that the debtor have access to the relevant court very quickly to obtain the necessary approval.
6. To protect further against possible abuses, the amendments to the CA should include the definition of interim financing contained in Article 2(1)8 of the Directive⁷⁸. If the financing on offer from an arm's length provider of finance meets that definition, the court should be very reluctant not to approve it when the debtor requests it, especially where that request is also endorsed by the IP.
7. It is for discussion if further protection for possible abuses of the granting of priority to interim finance might be needed. One possibility would be to use language going beyond that of the definition of interim finance in the Directive, and to incorporate language similar to that in the third sentence of Recital 68. Another might be, as suggested by the Working Group Paper (para. XIII (4)) to set out a list of the categories of purposes for which interim finance will be applied in order for it to qualify for any enhanced priority over that of unsecured creditors.

Section 16: Protection for Other Restructuring Claims

Article 18 - Protection for other restructuring related transactions

“1. Without prejudice to Article 17, Member States shall ensure that, in the event of any subsequent insolvency of a debtor, transactions that are reasonable and immediately necessary for the negotiation of a restructuring plan are not declared void, voidable or unenforceable on the ground that such transactions are detrimental to the general body of creditors, unless other additional grounds laid down by national law are present.

2. Member States may provide that paragraph 1 only applies where the plan is confirmed by a judicial or administrative authority or where such transactions were subject to ex ante control.

3. Member States may exclude from the application of paragraph 1 transactions that are carried out after the debtor has become unable to pay its debts as they fall due.

4. Transactions referred to in paragraph 1 shall include, as a minimum: (a) the payment of fees for and costs of negotiating, adopting or confirming a restructuring plan; (b) the payment of fees for

Article 17, and so the present position in many EU Member States could change.

⁷⁸ Under the Directive, interim finance is defined as “any new financial assistance, provided by an existing or a new creditor, that includes, as a minimum, financial assistance during the stay of individual enforcement actions, and that is reasonable and immediately necessary for the debtor's business to continue operating, or to preserve or enhance the value of that business”.

and costs of seeking professional advice closely connected with the restructuring; (c) the payment of workers' wages for work already carried out without prejudice to other protection provided in Union or national law; (d) any payments and disbursements made in the ordinary course of business other than those referred to in points (a) to (c).

5. Without prejudice to Article 17, Member States shall ensure that, in the event of any subsequent insolvency of the debtor, transactions that are reasonable and immediately necessary for the implementation of a restructuring plan, and that are carried out in accordance with the restructuring plan confirmed by a judicial or administrative authority, are not declared void, voidable or unenforceable on the ground that such transactions are detrimental to the general body of creditors, unless other additional grounds laid down by national law are present ”.

Protection of transactions necessary for the negotiation of a restructuring plan from subsequent challenge

The Directive requires that certain payments relating to the (failed) preventive restructuring of the debtor made after a preventive proceeding has been opened be protected from subsequent challenge in the event of the subsequent insolvency of the debtor (e.g., claw-back actions). If the recommendation of this Report regarding the incorporation of an explicit permission for a debtor to present a pre-packaged plan for confirmation by the court at the time a preventive proceeding is adopted, then the additions to the CA required by Article 18 of the Directive should make it clear that such costs relating to the negotiations of pre-packs should not be open to challenge even if they were incurred before the insolvency proceeding was opened.

Section 17: Duties of Directors

Article 19 - Duties of directors where there is a likelihood of insolvency

“Member States shall ensure that, where there is a likelihood of insolvency, directors, have due regard, as a minimum, to the following:

(a) the interests of creditors, equity holders and other stakeholders;

(b) the need to take steps to avoid insolvency; and

(c) the need to avoid deliberate or grossly negligent conduct that threatens the viability of the business.”

Balancing the duties of directors with reasonable commercial risk-taking

1. Article 19 of the Directive imposes new duties on directors which appear to have no counterpart in any area of Bulgarian law.⁷⁹ Penalties for failing to observe the duty to file (as provided under Article 627 CA⁸⁰), disqualifications from being eligible to act as a managing director of a company (Article

⁷⁹ The provisions of the CA, the Commercial Register of Non-Profit Legal Entities Act and the Tax and Social Insurance Code reveal no similar provisions.

⁸⁰ Article

141(8) CA⁸¹), and sanctions under the Criminal Code (Article 227(b) – (f), in the section regarding the “Crimes against Creditors”) are intended to ensure compliance with a duty to put an insolvent company into a bankruptcy proceeding⁸².

2. The new duty is completely different. It requires directors to examine their decisions in a new way when there is a likelihood of insolvency and the business continues to trade⁸³.
3. Any new law which requires directors to “have due regard” to the interests of a range of interests other than those of the company itself (and its shareholders) will tend to increase the risk that, in order to avoid personal liability, the directors might decide to cease trading prematurely and refrain from pursuing in a committed way either trading out of the difficulties or attempting a restructuring. If this sort of behaviour were widespread, the damage to the economic wellbeing of the nation would be significant. It is worth keeping in mind that personal liability of directors is a modern feature of the “business judgement rule.” That rule seeks to promote the reasonable but free exercise by directors of their managerial functions, and to protect their decisions from review (and liability) even if their decisions turn out to have been mistaken and even if they lead to the insolvency of the company⁸⁴. The Directive also recognises the risk to the existence of a strong corporate enterprise culture posed by a provision such as Article 19. Recital 70 states in relevant part: “...it is important to ensure that directors are not dissuaded from reasonable business judgment or taking reasonable commercial risks, particularly where to do so would improve the chances of a restructuring of potentially viable businesses.”
4. Turning to the drafting exercise of a new regime of Directors’ duties on the verge of insolvency, this could logically be done in 3 steps.⁸⁵

(i) First, it is strongly recommended that provisions be added to Bulgarian corporate law which set out a range of duties to be observed by directors when a company is trading normally. This set of duties are aimed at protecting the company, its shareholders and other stakeholders against mismanagement and misconduct. A range of the sorts of duties which are commonly found in other jurisdictions⁸⁶ include the following:

- To act in good faith;
- To act according to the constitution of the company;

⁸¹

⁸² Since 1996, the Bulgarian Criminal Code includes a special section (“Crimes against Creditors”, whereby it is envisaged that a trader who becomes insolvent and within 30 days following suspension of payments fails to notify its situation to the court shall be punished by imprisonment up to three years or by a fine in the amount of up to BGN 5,000. Such a penalty shall also be inflicted on persons managing or representing a company if within 30 days following suspension of payments they have failed to request the court to initiate insolvency proceedings.

⁸³ Like Bulgaria, many EU jurisdictions already impose a duty on directors to file for bankruptcy within a specified time if the company is insolvent.

⁸⁴ The World Bank Principle B2⁸⁴ describes the balance to be struck in the following way: “Laws governing directors’ obligations in the period approaching insolvency should promote responsible corporate behavior while fostering reasonable risk taking and encouraging business reorganization”.

⁸⁵ It should be noted that within the EU a variety of approaches to this exercise has been taken. In some jurisdictions (such as the Netherlands and Portugal), the interest of creditors is to be taken into account even when the company is trading normally. The requirement to implement the Directive, however, justifies an approach which sees a clearer “division” between duties which exist in normal circumstances and those which come into play when a company is in financial difficulties but not yet in a position where an obligation to file for bankruptcy is appropriate (See UNCITRAL *Legislative Guide on Insolvency Law* (2013)).

⁸⁶ The list was compiled by looking at the directors’ duties which apply in Belgium, the Czech Republic, France, Germany, Italy, Poland, the Slovak Republic, Spain and England and Wales.

- To act in the best interests of the company (*i.e.*, fiduciary duty);
- To promote the success of the company for the benefit of its members;
- To exercise independent judgment;
- To exercise reasonable care, skill and diligence, taking into account their specific competences;
- To act as prudent managers (*i.e.*, duty of care);
- To establish and maintain organisational, accounting and administrative measures appropriate for the nature and size of the business of the company;
- To avoid situations in which the director might have a personal interest that conflicts with the interests of the company;
- Not to accept a benefit from a third party by virtue of being a director or for doing (or not doing) anything as a director;
- To declare any personal interest in a transaction or arrangement with the company to other directors before the transaction is entered into.

Breaches of duties such as these should attract consequences such as compensation to the company for the damages and the loss suffered and even disqualification. Language appropriate to Bulgaria imposing similar duties and enforceable consequences should be added to the Bulgarian corporate law, and which all directors should be urged to become familiar with.

(ii) Once an explicit set of duties in normal circumstances is part of Bulgarian general corporate law, the second step will be to insert *additional duties* (probably into the CA) which will be triggered when a company faces a “likelihood of insolvency.” The reason underpinning such additional provisions is the shift of financial risk once a business entity is hit by insolvency. Indeed, when a debtor becomes insolvent, the financial stakeholders bearing the risk of any loss suffered by the business are the creditors (instead of the shareholders). In this constellation, the conduct of the business management must shift the focus from maximizing the profits and the return on the shareholder investment to the protection of the creditors and the preservation of the debtor’s assets, which will serve for the (collective) satisfaction of the creditor’s claims. Hence, the conservation of the estate requires, comprehensive measures to protect the estate from the actions of creditors and the debtor.

Compliance with the Directive requires that this be done, and this will oblige many Member States to supplement their present provisions on directors’ duties in some way.⁸⁷ For the avoidance of doubt, these new duties are to be imposed in the period *before* the obligation to file for bankruptcy under Article 626 CA has arisen.

The liability regime of Directors (in the verge of insolvency) may vary to a significant extend across Member States⁸⁸.

For instance, in some jurisdictions the insolvency of the company debtor is characterised as either fortuitous or culpable. In **Spain** where the material insolvency of the debtor was caused by gross negligence or wilful conduct (also) of directors, they may be held liable wholly or partially for the

⁸⁷ In the past, in most Member States there has been no change in the nature of a director’s duties either when a company was nearing insolvency or when it was in fact insolvent. Exceptions to this have been in the UK, Ireland, Malta and Cyprus, where a shift in duties to take account of the interests of creditors has been required – in the UK for the past 40 years.

⁸⁸ For a study on this topic, see Gerner-Beuerle, Carsten, Paech, Philipp and Schuster, Edmund-Philipp, *Study on directors’ duties and liability*, Study on directors’ duties and liability, LSE London 2013.

claims of the creditors (See Articles 172 and ff. *Ley Concursal*).

In **Germany**, in addition to the actions relating to the breach of the duty to file the insolvency petition, Article 64 GmbHG provides that the IP may bring on behalf of the divested debtor proceedings against directors who have made payments out of company money after the point where they should have filed for insolvency proceedings.

In the **Netherlands**, the case-law has created a specific atypical remedy, which aims at the reinstatement of the insolvency state through, that vests the IP (exclusively) with the *locus standi* to bring action for damages, according to the common rules of tort law, against a third party whose conduct, before the opening of the procedure, has violated the right of the body of creditors (the so-called *Peeters Gatzel action*)⁸⁹.

As has been the case in those jurisdictions which have recognised a shift in duties in the past, the imposition of this duty does not imply a need to prescribe any specific preventive action: the appropriate action will depend solely on the circumstances of the company concerned. Of critical importance will be the seriousness of the company's financial circumstances and the commercial context in which it operates.

In at least two respects, Article 19 of the Directive is not well drafted, and its wording can probably be ignored without a risk of non-compliance. First, the suggestion in Article 19(a) that a duty should be owed to "other stakeholders" is not only vague but also a source of possible confusion for drafters⁹⁰. Fortunately, Recital n. 71 states that the Directive is not intended to establish any hierarchy of parties whose interests need to be considered, leaving it to Member States "*to decide on establishing such a hierarchy*". It is so difficult to consider the operation of such a hierarchy in practice that it is recommended that no such attempt be made, and that the requirement be that the directors simply be required to "have due regard to the interests of creditors" when there is a likelihood of insolvency.

The second way in which Article 19 of the Directive is poorly drafted appears in its paragraph (c). Conduct such as that described therein would be a breach of the regular duty of care vested with directors in normal times of business operation. It is therefore entirely unnecessary to mention such a "duty" as something arising where there is a likelihood of insolvency. The duty applies to *all* actions of directors.

(iii) In order to encourage compliance with this new duty, the third step of the legislative exercise is to insert new and enforceable sanctions for breach of the new duties to be imposed on directors as a result of the implementation of Article 19 of the Directive. Indeed, a new set of obligations imposed on Directors will hardly be of effect where it is not combined with enforceable (and enforced) sanctions for the failure to comply. It must be mentioned at the outset, that mindful of the discussion in paragraphs 3-4, above, it is clearly not the intention of the Directive to force (or even frighten) directors into what might be a premature bankruptcy filing.

Nevertheless, as also illustrated by Principle B2 of the World Bank Principles, in the period approaching insolvency, the law "*should provide appropriate remedies for breach of directors' obligations, which may be enforced after insolvency proceedings have commenced*". In most Member

⁸⁹ The original judgement giving rise to this action is HR, 14 January 1983, in *NJ*, 1983, p. 597.

⁹⁰ It may often be the case, for example, that what the financial creditors consider to be in their interests will be in contradiction to what the employees consider to be in their interests and thus a duty owed to both constituencies could not possibly be observed.

States, it is the IP in the eventual bankruptcy of the debtor who is vested with the legal standing to bring claims on behalf of all creditors against the directors for having breached applicable duties. If there are insufficient funds available to make such claims, the IP could be empowered to assign such a claim to a creditor who is willing to take action.⁹¹

In some jurisdictions with highly evolved insolvency systems, the IP can also file a report with a government agency with the power to take steps to impose sanctions such as disqualification. It is for discussion whether the court or a regulatory agency should have this power in Bulgaria.⁹² The inclusion of provisions of this kind requires close consideration in respect to the (wide range of) material and procedural aspects that the liability of directors breaching their duties entails, notably: i) who are the addressees of the duty to file; ii) the nature of the liability; iii) to whom the duty to file is owed and the standing to sue; iv) the extent of the damage; v) possible limitations of directors' liability.

Breach of those duties could attract not only personal liability on the part of the director(s) concerned but also disqualification from being eligible to act as a director of any Bulgarian company for a period of time. On paper, Bulgaria has the most rigorous disqualification regime as the period of suspension can be indefinite. It may be appropriate to modify that position to a fixed period of years, depending on the gravity of the breach.⁹³

Section 18: The judiciary and practitioners in the field of restructuring

Article 25 - Judicial and administrative authorities

“1. Without prejudice to judicial independence and to any differences in the organisation of the judiciary across the Union, Member States shall ensure that:

(a) members of the judicial and administrative authorities dealing with procedures concerning restructuring, insolvency and discharge of debt receive suitable training and have the necessary expertise for their responsibilities; and

(b) procedures concerning restructuring, insolvency and discharge of debt are dealt with in an efficient manner, with a view to the expeditious treatment of procedures.”

Article 26 - Practitioners in procedures concerning restructuring, insolvency and discharge of debt

“1. Member States shall ensure that:

(a) practitioners appointed by a judicial or administrative authority in procedures concerning restructuring, insolvency and discharge of debt ('practitioners') receive suitable training and have the necessary expertise for their responsibilities;

⁹¹ In broad terms, such an assignment could be on the basis that those creditors who are providing the funding receive the full value of their claims and their costs from the proceeds of any litigation, with any balance to be distributed according to the usual order in a liquidation, or an outright “sale” of the claim to the creditors concerned. There are other alternatives possible within this framework.

⁹² In many Member States (e.g., Belgium, the Netherlands, Latvia and Portugal), it is also possible for a creditor to sue directors in tort where the company has entered into a contract when the directors knew or should have known that the company would not be able to meet its obligations to the creditor and nor would there be sufficient assets to discharge the obligation to the creditor.

⁹³ Within the EU, the range of disqualification is from 1 year to 20 years, but most provide a range of periods, depending on the gravity of the breach (say, from 2-15 years).

(b) the conditions for eligibility, as well as the process for the appointment, removal and resignation of practitioners are clear, transparent and fair;

(c) in appointing a practitioner for a particular case, including cases with cross-border elements, due consideration is given to the practitioner's experience and expertise, and to the specific features of the case; and

(d) in order to avoid any conflict of interest, debtors and creditors have the opportunity to either object to the selection or appointment of a practitioner or request the replacement of the practitioner.

2. The Commission shall facilitate the sharing of best practices between Member States with a view to improving the quality of training across the Union, including by means of the exchange of experiences and capacity building tools.”

Article 27 - Supervision and remuneration of practitioners

“1. Member States shall put in place appropriate oversight and regulatory mechanisms to ensure that the work of practitioners is effectively supervised, with a view to ensuring that their services are provided in an effective and competent way, and, in relation to the parties involved, are provided impartially and independently. Those mechanisms shall also include measures for the accountability of practitioners who have failed in their duties.

2. Member States shall ensure that information about the authorities or bodies exercising oversight over practitioners is publicly available.

3. Member States may encourage the development of and adherence to codes of conduct by practitioners.

4. Member States shall ensure that the remuneration of practitioners is governed by rules that are consistent with the objective of an efficient resolution of procedures. Member States shall ensure that appropriate procedures are in place to resolve any disputes over remuneration.”

Capacity building solutions and training of judges as well as insolvency practitioners

1. The changes required by the Directive will have profound consequences for the judiciary and also for the IP who are called upon to assist the debtor and/or the creditors in the ways required by the Directive.⁹⁴
2. As noted in the Introduction, very few (if any) IPs qualified under Ordinance No. 3 of 27 June 2005 (the “**Ordinance**”) will possess the necessary background and formal training to play the important role required of them under the Directive. Restructurings are very different from liquidations and entail different skills. In those EU jurisdictions with fully elaborated restructuring and insolvency regimes, it is often the case that the cadre of IPs who do restructuring work is different from those who do liquidations.
3. Given the present state of development of the restructuring culture in Bulgaria, it would be unrealistic

⁹⁴ See Articles 2(1) 12 and 5(3).

to impose any training framework aimed specifically at those who wish to qualify into a new profession restricted to restructuring cases (as opposed to liquidation cases). It is therefore recommended that the present training programme required to be followed by potential IPs be expanded to include topics and experience of more direct relevance to restructurings. As Article 16(2) of the Ordinance gives the responsibility for organising and conducting the qualification of IPs to the MoJ, it is recommended that the MOJ consider and implement the changes necessary to the current training and monitoring programme.

4. Articles 783 and 783 CA⁹⁵ need to be amended to be consistent with the requirements of the Ordinance and with the Directive. Article 782(4) CA, for example, should require the IP to enter office immediately rather than within 3 days after being appointed by the court. The list of IPs' powers under Article 783 CA could be re-worded to emphasize the supporting role of the IP rather than the oversight function.
5. Members of the judiciary might benefit from additional training (in addition to direct experience) in restructuring topics. It is easy, but unrealistic, to recommend that judges with specific expertise always be assigned to restructuring cases: the flow of cases would be insufficient to make this a practical suggestion at this time. That said, the extent of the DIP "philosophy" of the Directive is an entirely new concept, and exposure to the experience of other jurisdictions, in particular, could be useful. Again, it is suggested that the additional training and support for judges who might be called upon to administer the new provisions could usefully form a separate workstream in the MOJ. Other possible measures, such as creating new territory-wide jurisdictions for restructuring cases, to help ensure that a cadre of judges does indeed develop over time, are beyond the scope of this paper.

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APPENDIX 1 (Legislation and regulatory acts consulted)

- Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency)
- Commercial Act, in *State Gazette* No. 48/18.06.199 (Amended issue 64 of 18.07.2020, in force from 21.08.2020)
- Not-for-Profit Legal Entities Act, in *State Gazette* No 81/06. 10. 2000 (Amend SG No105/22.12.2006)
- Criminal Code, in *State Gazette* No. 26/2.04.1968
- Ordinance on the procedure for selection, qualification and control over Insolvency Administrators, No. 3 of 27 June 2005
- UNCITRAL Legislative Guide on Insolvency Law
- Spanish *Ley Concursal* as modified by Royal Legislative Decree 1/2020, of May 5, in "BOE" no. 127 of 05/07/2020.
- Law No. 4738/2020 on "Regulation of debts and provision of a second chance" adopted in Greece on October 26, 2020.

APPENDIX 2 (The INSOL Principles for Out of Court Restructurings)

FIRST PRINCIPLE: Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to co-operate with each other to give sufficient (though limited) time (a “**Standstill Period**”) to the debtor for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor’s financial difficulties to be formulated and assessed, unless such a course is inappropriate in a particular case.

Commentary:

1. No business has a “right” to conduct an out-of-court workout: the granting of a Standstill Period is a concession by creditors and not a right of the debtor. The debtor (and, if applicable, the debtor’s advisers) therefore needs to assess whether there is a realistic possibility that financial difficulties can be resolved, and the business’s long-term viability restored. If a possibility does not exist, alternative remedies should be considered, including liquidation of the company through formal bankruptcy proceedings.⁹⁶
2. The purpose of the Standstill Period is to give the debtor time to prepare a restructuring plan. The plan must show that the business is capable of operating profitably and the extent to which the debtor will be able to repay its debts. There is no prescribed minimum to the contents of a restructuring plan, but it is imperative for the debtor to show in the plan that there is a reasonable prospect that the business will be viable within the foreseeable future. Matters usually found in a restructuring plan include the following:
 - Projected trading profit/loss for future years;
 - Cash flow forecasts;
 - Sources of additional capital;
 - Any proposed modifications of creditors’ rights by deferral, variation or debt forgiveness;
 - Material changes in management or ownership.
3. The reference to “all relevant creditors” refers to all creditors whose rights will be affected by the proposed restructuring.
4. The unanimous support of all relevant creditors is essential to the restructuring’s success. As a result, the number of participating creditors should be kept as low as possible to minimize the complexity of the negotiations. If there is not enough creditor support for granting the debtor a reprieve to find a solution for its financial difficulties, the restructuring cannot proceed, since the lack of court intervention means that there is no way to force opposing creditors to come to terms against their will.⁹⁷ That said, the way in which the Principle is expressed makes it plain that what

⁹⁶ For example, a formal insolvency procedure such as an in-court restructuring (if available under local law) or liquidation.

⁹⁷ However, expedited restructuring mechanisms can provide a way to come to an agreement among a requisite number of creditors

it is hoped will develop, over time, is a willingness of creditors to participate in the process unless such participation is “inappropriate” in a given situation. Expressed differently, as examples of successful out of court workouts multiply, the “norm” will become an increasing willingness of creditors to take part in the out of court workout process rather than insisting on the exercise of what may be strict legal rights as creditors before the debtor has had a chance to present other, possibly more attractive, alternatives.

5. The Standstill Period should be limited to the time required to produce a restructuring plan, or to establish that such a plan cannot be produced within an acceptable time. It would be unusual for the initial Standstill Period to be longer than a few weeks, although this will vary from case to case.⁹⁸
6. During the Standstill Period, it is essential that creditors receive sufficient reliable information to enable them to assess the debtor’s financial position, to understand the causes of the financial problems, and evaluate any solutions proposed. At the end of the process, creditors will be asked to approve of the solution proposed. Without adequate information, they will not be able to do so.
7. An ever-present challenge for the debtor is the natural tendency of many creditors to adopt an “each creditor for itself” approach and to pressure the debtor for payment on an individual basis. The effectiveness of such a strategy will depend in part on the provisions of local bankruptcy law dealing with transactions undertaken on the eve of a debtor’s insolvency. For example, in some jurisdictions, the application of such pressure can be a defense to a claim brought by a subsequent liquidator to challenge the validity of the transaction as a preference. The prospects of success of the out of court workout are diminished as the commercial significance of such transactions increases.

SECOND PRINCIPLE: During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced.

Commentary:

1. The objective is to achieve stability and to maintain the pre-standstill status quo among existing relevant creditors.⁹⁹
2. The attractiveness of the workout process can be enhanced by the involvement of qualified professional advisers or government agencies that have moral authority and/or can earn the respect of the creditors.

and then apply to a court to enforce that agreement against dissenting creditors. *See* ____.

⁹⁸ Note that the reference is to an “initial” Standstill Period. It is very common for the Standstill Period to be extended. Indeed, one of the advantages of the out of court approach to workouts is that they enable the debtor to avoid the time limits (which are often unrealistic) imposed by laws governing the conduct of restructurings conducted within the context of a formal court proceeding.

⁹⁹ In some jurisdictions, there is legislative provision for a statutory form of moratorium on creditor claims.

3. However, if it is achieved, all creditors must be confident that, in deciding not to pursue their individual remedies, they will not be prejudiced vis a vis other creditors should a consensual way forward for the debtor not be found. Each creditor's relative ranking must neither be worsened nor improved during the workout process.
4. In those cases where there is a written Standstill Agreement, it will be necessary for the creditors signing up to the Agreement to agree, during the Standstill Period:
 - a. not to try to improve their positions relative to other creditors;
 - b. not to insist on payment of amounts owed to them; and
 - c. not to initiate collection, security enforcement or winding up proceedings;
 - d. To allow existing credit lines and facilities to be used.
5. A written agreement is not always necessary, however, as there can be an informal understanding among the most important creditors that they will work together towards a solution.

THIRD PRINCIPLE: During the standstill period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the Standstill Commencement Date.

Commentary:

1. If the creditors are expressly or tacitly to agree that they shall not take any steps intended to enable one (or one group of them) to gain an advantage over other creditors, it must follow that the debtor must also agree not to undertake any activities or transactions which would be detrimental to the interests of any creditor or class of creditors, or alter their respective priority positions.
2. One important exception to this principle must be the ability of the debtor to continue to make payments in what is commonly referred to as "the ordinary course of business", as otherwise the debtor would not be able to continue to trade while attempts are made to agree the terms of a workout. What must be avoided, therefore, are transactions which are not for full value, the making of preferential payments, the granting of security for past debts or incurring new borrowings without creditor consent.

FOURTH PRINCIPLE: The interests of relevant creditors are best served by coordinating their response to a debtor in financial difficulties. Such co-ordination will be facilitated by the selection of one or more representative co-ordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.

Commentary:

1. All negotiations between the debtor and relevant creditors must be conducted in good faith, in an atmosphere of honesty and frankness, and with the objective of finding a constructive solution. If

any parties lose confidence that their counterparts are negotiating in good faith, the negotiations are likely to fail, with the consequence that creditors will fall back on their legal remedies and enforcement proceedings and/or insolvency proceedings are likely to begin.

2. Unless the negotiations can be conducted on a bilateral basis, the number of constituencies that could be involved in a corporate workout, and their different priority positions in the event of liquidation, means that it is often advisable for committees to be formed and for professional advisers to play their part in achieving a consensus.
3. Relevant creditors or any co-ordination committee may wish to consider appointing one person (for example, the creditor with the greatest exposure, or with experience in managing workout negotiations or an independent person) to lead negotiations on their behalf with the debtor.
4. Where the creditors are experiencing difficulties in reaching an agreement, it is appropriate to consider whether or not mediation could be used as a workout tool. Any agreement reached between or among certain creditor groups on this basis can be conditioned on an overall workout plan being agreed which includes them.
5. It may be appropriate for the costs of outside advisers (perhaps within specified limits, or “caps”) to be paid by the debtor.

FIFTH PRINCIPLE: During the Standstill Period, the debtor should provide, and allow relevant creditors and/or their professional adviser’s reasonable and timely access to, all relevant information relating to its assets, liabilities, business and prospects, in order to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.

Commentary:

1. The integrity of the process depends on the quality of the information in the possession of creditors being asked to compromise, in some way, their debts. Although time will in most cases be “of the essence” – and indeed the tension of deadlines serves a valuable purpose in reaching an agreement - the Standstill Period must be sufficiently long to enable the necessary information to be gathered, disseminated and understood.
2. The debtor must have strict disclosure obligations. At the very least, this information will include full particulars of the debtor’s assets and liabilities and of the future business prospects of the debtor. In order to produce this information, the debtor may need to produce forecasts and projections that are more detailed than those it would normally prepare.
3. The creditors must also have sufficient time to consider the details of the workout solution being proposed.

SIXTH PRINCIPLE: Proposals for resolving the financial difficulties to the debtor and, so far as practicable, arrangements between relevant creditors relating to any standstill, should reflect applicable law and the relative positions of relevant creditors at the Standstill commencement Date.

Commentary:

1. Absent special circumstances, creditors will wish to be assured that the debtor will treat like creditors alike both throughout the workout process and also in any proposed plan.
2. The provisions of local bankruptcy law should serve as the guide to the relative priority position of creditors. For example, unless local bankruptcy law specifically so provides, it will generally be unacceptable if deferred creditors or shareholders are to benefit to any extent while unsecured or secured creditors are not being paid in full.
3. Creditors will analyze their position under different scenarios (e.g. in a liquidation or in a court-supervised reorganization) in order to decide what their view of any proposed restructuring plan should be. Having said that, creditors may appreciate that it may be necessary for minor trade creditors to be paid in full to achieve greater consensus and also to permit the debtor's business to continue.

SEVENTH PRINCIPLE: Information obtained for the purposes of the process concerning the assets, liabilities and business of the debtor and any proposals for resolving its difficulties should be made available to all relevant creditors and should, unless already publicly available, be treated as confidential.

Commentary:

1. Ideally, all relevant creditors should be provided with the same information and it should be as detailed as the circumstances of the case require. It must in any event be sufficiently detailed to permit creditors to form their own view of the merits of the proposal being put forward by the debtor.
2. If, in any given case, information is price-sensitive or in some way the subject of legitimate confidentiality concerns, then confidentiality agreements are commonly required before the information is made available.
3. Where the relevant creditors are only the debtor's banks, in most instances they can be relied upon to treat any information concerning the debtor in confidence.
4. In very complex cases, the issue of debt trading may arise. This raises complex issues and special conditions may be needed where creditors intend to trade their debt.

EIGHTH PRINCIPLE: If additional funding is provided during the Standstill Period or under any rescue of restructuring proposals, the repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.

Commentary:

1. The ability of the debtor to continue in business during any period of negotiations is central to the notion of an out of court workout. While some debtors do not depend on third party finance to operate, many do. In that event, or if additional funding is required for other justifiable reasons

during the workout discussions, the sources are typically the proceeds of sale of non-core assets, new investment from shareholders or additional lending from existing creditors (including banks).¹⁰⁰

2. Unless a certain degree of priority is accorded to any additional lending, it is highly unlikely that money will be made available, and the workout may fail to survive long enough to permit a workout plan to be fully developed and considered by creditors.
3. The priority treatment which is generally sought and made available for additional finance provided during a workout is often described as a “super priority” because the provider of such finance is entitled to be paid in priority to the claims of pre-existing creditors, even if the workout fails and a formal insolvency follows. Because of this priority, it is often the case that existing creditors are willing to provide this form of finance.

¹⁰⁰ The debtor must appreciate that in the event that there are no assets capable of being offered as security for additional funding, the creditors are unlikely to be willing to provide it. In these circumstances, it may be necessary for the debtor’s shareholders to introduce additional equity, provide personal guarantees or similar security.

APPENDIX 3 (Preparing for a restructuring: Checklist for debtors)

NOTE: This Checklist is intended to assist a debtor (a micro, small or medium-sized business) in financial difficulties to prepare for restructuring discussions with creditors, with a view to achieving a restructuring of the business and finances of the debtor so that its business can continue.

Although not all of the questions raised will be relevant in all circumstances, it is hoped that financially troubled debtors of all types, including companies, partnerships, and sole traders, will benefit from using it on a selective basis. The aim is to help debtors of all types to be well-prepared for discussions, and to assist them in developing a credible plan which will win the support of creditors and, if need be, the court.

1. The Debtor

1.1 Place of incorporation.

1.2 Verify all shareholdings.

1.3 Establish identity of any controlling shareholders, or of identifiable groups of shareholders (e.g. family members)

1.4 Establish if there are any associated or related companies or individuals under local law and consider the consequences of this for any future restructuring process.

1.5 Obtain up to date search information from all public registers.

1.6 Obtain copy of constitution of debtor (if a company).

2. Business and Assets

2.1 Briefly describe the business activities of the debtor.

2.2 Briefly describe the recent trading history of the debtor, including major changes in the business, acquisitions or disposals.

2.3 Prepare a list of assets which are owned outright, and a separate list of all assets which are charged, leased, hired, licensed, held on trust or subject to retention of title or otherwise not available to pay the claims of unsecured creditors.

2.4 Obtain copies of any property, plant or other asset registers of title.

2.5 Consider obtaining independent valuations of key assets likely to be essential to enable the business to continue or likely to need to be sold to raise finance.

2.6 As soon as it is apparent that it may be necessary to apply to the court to open a preventive restructuring proceeding (for example if a stay against creditor action or enforcement proceedings is needed), consider obtaining a brief and inexpensive viability report from a qualified IP to show to the court.

3. Management

3.1 Identify current directors.

- 3.2 Identify key managers and employees who are not directors.
- 3.3 Identify connections, if any, between management and shareholders, including family connections.
- 3.4 If remuneration of management is linked to performance, set out the details of the arrangement.

4. Financial Information and Confidentiality

- 4.1 Obtain copies of latest management accounts.
- 4.2 Obtain copies of recent audited accounts.
- 4.3 Obtain/produce up-to-date cash flow statements and forecasts.
- 4.4 Obtain/produce budgets, forecasts and other future financial planning information.
- 4.6 Consider need for confidentiality agreement for recipients of commercially sensitive information and form of any such agreement.

5. Cash flows

- 5.1 Identify all bank accounts including bank, location, currency, purpose and current balances.
- 5.2 Describe cash flow patterns.
- 5.3 Identify key cash flow dates, such as: paying wages, rent and other periodic mandatory payments.

6. Key Contracts Review

- 6.1 Locate all key contracts. If they are not in writing then draft a description of their essential terms.
- 6.2 Establish whether valuable contracts may be terminated by counterparty or might automatically be terminated on an “insolvency.” Determine whether “insolvency” includes “restructuring” and if so whether it might make a difference if the “restructuring” is completely informal or involves the court.
- 6.3 Establish the consequences of termination by the debtor of key contracts. Damages or contingent liabilities.
- 6.4 Examine contracts with customers and suppliers, service providers, IT and IP licences, property and other operating leases, and assess the consequences of a restructuring on these.

7. Financing

- 7.1 Identify all sources of financing.
- 7.2 Obtain copies of all bank loan documentation and identify, where applicable:
 - The amount and type of facility;
 - Current level of drawdown;
 - Repayment profile;

- Interest rates and margins, both normal and default;
- Fees and expenses;
- Events of default and potential events of default;
- Termination rights, including acceleration;
- Financial and other covenants;
- Negative pledges;
- Governing law.

7.3 Establish if there are any existing defaults. Have any default notices been served, or rights reserved? Are there any letters extending or varying facilities?

7.4 Obtain copies of documents relating to all other bank facilities, such as:

- Overdrafts;
- Letters of credit;
- Bonding;
- Acceptance credits;
- Bills of Exchange;
- Currency facilities;

7.5 Identify any foreign exchange contracts, swaps, options or other derivative contracts, and obtain copies of relevant ISDA Master Agreements and Schedules. Establish termination provisions, close-out exposures and current mark-to-market values.

7.6 Identify all bonds, notes and other debt instruments issued by the company, and obtain copies. Review these documents as loans.

7.7 Identify all finance leases and obtain copies. Review as loans.

8. Security and Guarantees

8.1 Identify all guarantees given by or to the debtor and note the following in each case:

- Identity of guarantor;
- Beneficiary of guarantee;
- Persons/entities guaranteed;

- Is any guarantee secured over any assets of the debtor or shareholder?
- Purpose/benefit to guarantor in providing the guarantee;
- Consider the enforceability of the guarantee under its governing law;
- Assess the risk that payment under the guarantee will be required.

8.2 Identify all security given, including the following:

- Mortgages on land;
- Debentures;
- Charges or Pledges over shares;
- Charges by deposit of title deeds;
- Charges on bank accounts;
- Charges over movable/personal property e.g. equipment, ships, aircraft;
- Cash held as collateral, and where;
- Other collateral, type and location.

8.3 Identify all creditors who may be able to assert liens, retention of title claims, trusts or other proprietary (*in rem*) or security rights.

8.4 Check that all security requiring to be registered has been registered and assess the consequences of failing to do so.

9. Litigation and Litigation Risk

9.1 Obtain details of all material litigation against the company, including:

- Parties;
- Nature and amount of claim;
- Lawyers acting;
- Stage reached in the proceedings;
- Advice received on likely outcome;
- Insurance cover;
- Settlement prospects.

9.2 Obtain details of any claims or threats of litigation.

9.3 Establish if any significant arrears owed to suppliers, tax or government creditors. Has any enforcement action been threatened or commenced?

10. Regulation

10.1 Are the activities of the debtor subject to regulation in any way? If so, by whom?

10.2 Does the debtor hold licences which permit its activities? Could these licences be affected by a restructuring or insolvency?

10.3 Are there obligations to disclose restructuring or insolvency events to regulators? Consider how this obligation is to be discharged, and when this must/should be done;

10.4 Are any public announcements required, e.g. through a stock exchange?

11. Advisers

11.1 Identify and list contact details for:

- Legal advisers;
- Auditors;
- Financial advisers;
- Valuations experts;
- Any relevant technical advisers.

11.2 Identify and list contact details for the legal, financial and other advisers to the financial creditors.

