Restructuring insolvent business - a view from a contract lawyer.

Intervention by prof. Matthias E. Storme,
ELI conference Ferrara September 2016

I was invited mainly as a contract lawyer and I will try to make some remarks from that point of view, but start with a more general remark.

I.

1. What we are seeing in insolvency law in the last two decades let's say - but it's a more general tendency in some other parts of the law which has advantages and disadvantages - is a shift from rules to actors, a shift from clear rules to *outsourcing* questions, to mediations, negotiation, etc. This evidently has advantages and disadvantages, as every solution. There is a young colleague of mine who made his PhD on these developments and he says we are now in the age of therapeutic law[1]. We are no longer in the age of classical law and the age of the rule of law; we are in the age of law as therapy. And now it is difficult with such developments, I will not say impossible, but it is difficult to combine that with the big principles that we have advanced and that were advanced also by my colleague Bob Wessels here today: equality before the law, legal certainty, legal transparency. We have to try to combine these advantages of this shift with these important principles, or to say it very shortly, with the rule of law, maintaining the rule of law.

2. One of the main reasons for this shift - at least that's the argument that is very often advanced and we have heard it today - is to gain time. And then the question is: in which circumstances do you gain time by not having clear rules and leaving it to negotiated settlements and in which cases are you precisely losing time by not having clear rules because people are negotiating in the shadow of the law? And the clearer the law is, the quicker negotiations will take place and lead to results. Also there, the fact that you shift to mediation/negotiation, does not dispense us of the need to think for which cases we need clear rules and for which cases we can leave it to let's say vague rules. That's the more general idea.

3. Secondly under the rule of law it is possible to some extent to outsource, as we are doing, typical judicial tasks and guarantees to other professions, but only to a limited extent. And certain tasks can be outsourced rather easily without too many problems under the rule of law. I think in my country and in some other countries we have rather good experiences with outsourcing

[1] Ph. THION, *Wetgeving en alternatieven. Van staatssoevereiniteit tot normaliteitsbeheersing* (Brussels: Larcier 2011).

certain judicial tasks to notary-publics for example. But it's a well-established profession in most of Continental Europe; they have fixed tariffs in most countries, which is an important element for legal certainty; and are a well-organized corps. I'm not sure that outsourcing judicial tasks to other types of profession offers the same guarantees even if it's sometimes necessary. So it will require a little bit more judicial control than is required over public notaries for example.

II.

4. Let's turn to the collective settlements with creditors. As has been said at this conference already, sometimes we have real agreements and sometimes we have an obligation to settle etc. We thereby have to distinguish between at least three cases, apart from the fact that it is very difficult to speak about insolvency in general between very big companies and the micro ones (which was an important element already of the lectures we've had).

5. First of all there is the real agreement, where there is an agreement with creditors. That's the easy case. Probably the only problem that has to be tackled is in how far do we offer these real agreements, where there is a consent of creditors, a kind of safe haven in case of subsequent bankruptcy. Do they fall under the avoidance rules or should we make an exception to the avoidance rules and under which conditions? I think that's the main question that arises with the real agreement.

Now "real agreement" is a little bit wider than only present consent, because a real agreement can also be based on a consent given in advance: the collective action clause is the consent given in advance that you will follow the majority of creditors. I don't think there is something very special to add to that. This is thus the easy case.

6. The second, the more difficult case, is the imposed agreement. Now for a contract lawyer it's already strange to call that an agreement and to recognise "an obligation to consent", whereas it is basically an arrangement which is imposed by the law and usually by the court if certain conditions are met, like a certain type of majority of creditors.

7. It is difficult to evaluate this in such general terms and I think we should at least start with the following distinction which could simplify things, namely a distinction - and I cite from one of the slides that was projected - "the case where you have a majority of equally impaired creditors". That's still a rather easy case. We're dealing with a consortium of funders, banks, and they are basically in the same position: they have the same security rights, or no security rights at all, and

they get an equal treatment in the plan which is approved by the majority but not by the holdouts. There are very good arguments to impose, on the minority shareholders, such a plan with only a limited judicial control, what we call a marginal control. The creditors are in the same position, they receive the same treatment and in fact they did the same thing. And so there are quite good arguments to do that with only a marginal control by the court.

8. There is also a second possibility in case of a certain type of holdouts that are now called vulture funds, a solution that may help to negotiate in the shadow of the law. We have a new statute in Belgium since last summer[2] and this in a certain sense was nothing new: it revived the old *lex anastasiana* which is at least fifteen hundred years old and which we still have in our civil code (art. 1699 CC) in a number of situations, but it did not apply to the typical situation of the vulture funds; it means that they simply cannot get more than what they've paid. Under this statute, if you buy distressed debt, outside the negotiated agreement, you will never receive more than what you've paid yourself. I think it's a quite effective rule to oblige them to negotiate, because in a negotiated settlement they will probably get more than what they've paid. I do believe it's an effective means and I am in favour of reviving the *anastasiana.*

9. The situation is quite different if you are dealing with different types of creditors, if you are comparing banks with suppliers of material, with tort creditors etc. And it becomes difficult to justify rules which simply do not distinguish and say "well, we have a sufficient majority of creditors of all types and they can decide for all the other ones." To do that without judicial intervention is quite difficult I think under the rule of law.

There must be some possibility indeed to impose an arrangement also in these cases, but there are two - from my point of view I would say constitutional - principles that in principle should be respected even if in practice it's not always easy to know how to apply them. We do find them also in many of the documents that pretend to set out the principles.

10. The first principle, which is easy to understand but very difficult to apply, is evidently "no creditor worse off". It's perfectly legitimate to impose a cramdown on a creditor as long as the creditor receives at least what he would receive in liquidation. And that he does not receive his full share of the value that is saved, that is something we should be able to overrule as long as he

[2] Loi du 12 juillet 2015 relative à la lutte contre les activités des fonds vautours, www.ejustice.just.fgov.be/cgi/article_body.pl?language=fr&pub_date=2015-09-11&numac=2015003318&caller=summary

receives at least what he would receive in liquidation. This minimum is a principle we deduce simply from the constitutional protection of ownership, from the First Protocol to the European Convention Human Rights etc. It's a principle which also governs the Belgian ideas in theory, but in practice it is not respected, also because it's very difficult to prove that you would have obtained more in case of liquidation. So there we have some practical difficulties: how are we going to draft the rules taking into account this principle on the one hand and making it workable on the other hand.

11. The second question is evidently: if you are dealing with different categories of creditors, how are you organizing it that these creditors are to some extent treated equally? Again probably the only way is to compare it with the result in case of liquidation. So maybe the second principle is in most cases equal to the first principle, but it gives us a different flavor because the danger that we see in practice is that there really is a danger of insider trading: that the nice parts go to the friends and that the other creditors are sent away with just the minimum that they can afford to get through a court that is not looking very well at the case because it has no time and is not sufficiently specialized.