AECM position on the harmonisation of certain aspects of insolvency law

Guarantee institutions play a crucial role in the promotion of small and medium-sized enterprises' (SMEs') access to finance. As they are partially guaranteeing banks' exposures, they are one of the first in line to be affected by the insolvency of a beneficiary SME. The insolvency framework is therefore strongly influencing their activity. That is why the current Commission proposal is of high relevance for AECM members which is the reason why we would like to submit the following comments.

Definitions

The definition of the 'best-interest-of-creditors test' in **Article 2.h** is based on a comparison of the proceeds achieved in the sale by way of the pre-pack procedure with the proceeds achieved in the liquidation procedure by applying the distribution sequence "in the event of a piecemeal liquidation". The comparison needs to take into account a - possibly more advantageous - sale of a continued business in the regular insolvency proceedings as well as a procedure without a sale. This is in order to exclude that those possibilities are disregarded abusively and to the detriment of the creditors. The Restructuring Directive (Directive (EU) 2019/1023, Article 2.1 No. 6) already foresees a definition for the 'best-interest-of-creditors test'. In order to preserve legal uniformity, we strongly advise not to set up a different – more debtor-friendly - definition of the very same concept.

Pre-pack procedure

We support the pre-pack procedure in principle for the absence of publicity of the debtor's discontinuity allows for a reasonable price to be kept for the sale of the assets. The pre-pack procedure is furthermore a procedure that is conducive to innovative restructuring techniques, i.e. it allows innovative takeovers that would probably not be possible under the classic insolvency regime. Nonetheless, it needs to be designed in a way that makes it unsusceptible to abuses. It is therefore primordial to strengthen the rights of creditors to control the proper implementation of the operations. That is why we suggest the following modifications to the provisions regarding the pre-pack procedure.

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Article 22.1 regulates the appointment of the monitor. We advocate that creditors should be involved in the selection of the monitor or should at least have the right to veto the appointment of a monitor if they fear that it would not allow for a conduct of the proceedings in accordance with the interests of the parties. **Article 22.2** sets out a list of provisions for the monitor to comply with. For the sake of transparency, we suggest to add the requirement for the monitor to list the affected creditors as well as the creditors with securities.

The presumption that in case of only one binding offer, this offer shall reflect the market price in the sale process as foreseen in **article 24.2** is detrimental to the rights of creditors and open to abuse. At the very least, there should be an objective assessment of the value of the company as an indicator, even in the presence of only one single offer.

Article 26.1 foresees that the debtor's business is sold to the acquirer proposed by the monitor. It is important that member states offer a mechanism that allows creditors as well as other potential acquirers to contest the choice of the monitor. This is in order to avoid abuse and to maximise recoverable assets.

Article 27.2 states the conditions under which the court may decide to terminate executory contracts when the debtor's business or part thereof is acquired. The sole condition that such termination is "in the interest of the company" seems insufficient. It should, moreover, be provided that if terminating these contracts triggers a fine, this should be borne by the acquirer, at least partially.

With regard to **article 28** of the proposal, we would like to emphasise that particular attention must be paid to respecting the rights of creditors who grant releases to debtors so that the asset transferred is free and clear to the purchaser. We suggest the following modification of the formulation:

"Member States shall ensure that the acquirer acquires the debtor's business or part thereof free of debts and liabilities, ***without prejudice to the rights of creditors over the assets of the company,*** *unless the acquirer expressly consents to bear the debts and the liabilities of the business or part thereof."*

Article 32 concerns bids for acquisition by a closely related party. In order to avoid the possibility of asset dilapidation, it should be specified in this article that in the event that an offer is made by persons who exercise or have exercised control over the company for six months prior to the commencement of the proceedings and at the same time directly or indirectly exercise control over rights necessary for the

continuation of the company's business, such offer may only be taken into consideration under the condition that such rights are accessible under the same conditions to the other bidders[1].

Article 34 is supposed to protect the interests of creditors. Nonetheless, two of its paragraphs are jeopardising this protection. Paragraph 2 restricts the right of creditors to be heard. It would from our point of view be important to precise that the competence to determine whether a creditor will not be reimbursed ex officio and therefore not heard must be conferred to a curator or a consular judge for example, but in no case to the debtor. Paragraph 4 allows for the waiver of the requirement of consent by secured creditors in winding-up proceedings for the release of security interests. This provision is likely to have a direct impact on guarantee institutions as they often have security interests in assets necessary for the continuity of the business (goodwill, intellectual property). We therefore oppose the current wording of this provision. In order to better protect the creditors' legitimate interest, we suggest that such a waiver may need to be requested by the debtor or the potential purchaser to the court (in an urgent procedure) justifying the request. The burden of proof of the satisfaction of the best-interest-of-creditors test which is condition for the mentioned waiver would need to lie with the applicant and not with the creditor. This reformulation is necessary in order not to discourage guarantee institutions to participate in the financing of a company, as this would potentially have as a consequence that a financing does not take place.

Directors' duty to request the opening of insolvency proceedings

The time limit of three months for directors to submit a request for the opening of insolvency proceedings mentioned in **article 36** is much too long. Such a long time limit poses substantial risks of abuse and is prone to jeopardise the recoverable insolvency mass. We therefore advocate a time limit of maximum 30 days after the directors became aware or can reasonably be expected to have been aware that the legal entity is insolvent or 30 days from the date of cessation of payments. The latter criterion is preferable as it is more objective and easier to determine.

Winding-up of insolvent microenterprises

Title VI, which deals with the possibility for micro-enterprises to benefit from a deficit liquidation, is likely to cause practical difficulties because of the possibility for the

[1] Such a provision is for example enshrined in Belgian economic law. Positive experiences with this provision have been reported.

enterprise not to have an insolvency practitioner. Our experience, however, shows that the company often needs assistance by an expert in this complex area. Furthermore, the treatment of (partially) secured creditors, subordinated creditors and employees requires the neutral instance of an insolvency administrator. Creditors can apply for an insolvency administrator, but must bear his costs. This is not reasonable for creditors are already exposed to a (partial) loss of claims. We would like to suggest to follow the example of Belgian law which foresees the automatic appointment of a trustee who is paid a fixed fee in the event of insufficient assets. This means that even the smallest company can have a practitioner to wind up its business. This is crucial in order to protect the reconciliation of interests. Otherwise, there is a risk that creditors' interests will be harmed, criminal activity will not be discovered, and additional asset waste or shifting will not be stopped. The liquidation in a single act (i.e. without a liquidator) is questionable in the event of a loss-making liquidation and in any case requires the agreement of the creditors concerned. It therefore seems that the "simplifications" brought about by Title VI actually lead to a weakening of the control that is necessary for this type of procedure.

Article 56 allows for discharge for entrepreneur debtors, as well as for those founders, owners or members of an unlimited liability microenterprise debtor who are personally liable for the debts of the microenterprise. The notion of entrepreneur debtor being very vague, we request to explicitly allow access to discharge only to natural persons, but not to legal persons. Furthermore, discharge shall be granted only if the debtor requests the competent authority to release its debts. The creditors must of course be informed in good time. It is, moreover, important to provide for the possibility for stakeholders to contest this request on the basis of serious misconduct that contributed to the loss-making liquidation.

Further, the proposed **article 57** deals with the coordination of the procedure initiated by a possible creditor against a personal guarantee (linked to the company in deficit liquidation) with the liquidation procedure. This article seems complicated to put into practice because, on the one hand, if a creditor pursues a personal guarantee, it is generally for his own benefit and not for the benefit of the estate (not the same parties) and, on the other hand, it is not always the same competent authorities that are involved[2]. This coordination may be beneficial for the speed of payment to the creditor but, in practice, the intrinsic difference between the two procedures may be detrimental to the rights of creditors who have a guarantee 'on the side'.

[2] In Belgium, for example, the pursuit of a guarantee does not even necessarily fall within the competence of the court of the company.

Creditors' Committee

As regards the creditors' committee, **article 61** limits the number of its members to a maximum of seven. We have a critical eye on this limitation as it jeopardises the sufficient representation of the interests of all creditor categories.

Article 63.1 stipulates the requirement for the creditors' committee to lay down a protocol of working methods within 15 working days. This time limit appears too short. In order to ensure a diligent setup of the protocol, we recommend to fix a deadline after 30 days. Paragraph 2 of the same article lists the matters that shall be at least addressed in the protocol. In our view, this list should be extended to the appointment a spokesperson for each creditor group who should be remunerated as such.

In order to improve the representation of creditors, we suggest to extend the list of rights and duties of the creditors' committee in **article 64.1** by the right to be heard by the insolvency practitioner, who must respond in good faith and within a reasonable timeframe to requests from the committee.

Article 65 provides for the possibility that the expenses of the creditors' committee might not be borne by the estate. We would like to caution that the possibility that the committee may be remunerated in a way other than via the estate risks creating possible conflicts of interest in the context of the discontinuation procedure. That is why we recommend to clarify that expenses may only be covered by the estate or in case of insufficiency via a lump sum borne by the State.

Final remarks

In more general terms, we plead for an insolvency framework that strikes the right balance. On the one hand, between harmonising rules and procedures and allowing to take national specificities into account. On the other hand, between simple procedures for small enterprises that also allow for a discharge under strict conditions as well as a second chance, and respecting the rights of creditors without the confidence of whom no financings would take place. It is, furthermore, important to emphasise that the proposed directive shall constitute a minimum standard that allows well-established and well-functioning national rules and procedures to persist.

We would kindly like to ask co-legislators to take our points into account in the preparation of their respective positions.

Brussels, March 2023

About us

The 46 members of the **European Association of Guarantee Institutions (AECM)** are operating in 31 countries in Europe. They are either private/mutual sector guarantee schemes or public promotional institutions or banks. Their mission is to support SMEs in getting access to finance. They provide guarantees to SMEs that have an economically sound project but do not dispose of sufficient bankable collateral. This so-called SME financing gap is recognised as market failure. By guaranteeing for these enterprises, guarantee institutions help to address this market failure and facilitate SMEs' access to finance. The broader social and economic impact of this activity includes the following:

- Job creation and preservation of jobs by guaranteed companies
- Innovation and competition: crowding-in of new ideas leading to healthy competition with established market participants
- Structure and risk diversification of the European economy
- Regional development since many rural projects are supported
- Counter-cyclical role during crises

SME guarantees generally pursue a long-term objective and our members, if public, private, mutual or with mixed ownership structure, have a promotional mission.

AECM's members operate with counter-guarantees from regional, national and European level. As of end-2021, AECM's members had about bEUR 312 of guarantee volume in portfolio, thereby granting guarantees to around 5.9 million SMEs. AECM's members are by far the most important counterparts of the EIF concerning EU counter-guarantees, handling EU guarantees from the very beginning in 1998.

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