The Debtor-in-Possession Model in the EU Insolvency and Restructuring Framework – A Domino Effect?

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Abstract

This article analyses the concept of the debtor-in-possession model in EU insolvency and restructuring law, its evolution and the latest iteration under Article 5 of Directive 2019/0123/EU. It also explores whether the DIP model would be a perfect fit for the EU and a missed opportunity for the UK following Brexit.

Introduction

One of the key criticisms of the European Union (EU) corporate insolvency and restructuring laws and procedures has been the lack of a "debtor in possession" (DIP) model, like the one under Chapter 11 of the US Bankruptcy Code, under which the debtor (usually the current management/directors) are left in control of the debtor's business during insolvency restructuring proceedings.[1] However, the passage of Directive 2019/1023/EU on preventive restructuring frameworks (PRD)[2] as a measure to enhance the rescue culture within the EU, has introduced a broader scope of the DIP model that may instigate a paradigm shift in the role and participation of the debtor in insolvency and restructuring proceedings across the EU.

The PRD was approved by the European Parliament on 28 March 2019 and by the Council of Ministers on 6 June 2019 and published in the official journal of the European Union on 26 June 2019 officially becoming law. The overall objective of the PRD is to provide the basis for a new harmonised culture of a preventive restructuring framework for viable businesses in financial difficulties across the EU. This is facilitated by providing avenues for debtors to have

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[1] H. Eidenmuller, "The Rise and Fall of Regulatory Competition in Corporate Insolvency Law in the European Union" (2019) 20 *E.B.O.L.R*, 547-566.

[2] 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, [2019] OJ L 172/18-55.(*Hereafter*, PRD).

access to early warning signs to detect financial difficulties at an early stage to enable prompt intervention.[3]

Article 5 of the PRD provides for the debtor to remain totally, or at least, partially in possession of the financially struggling business and assets, and day-to-day running of the business during insolvency restructuring. This provision also affords the debtor flexibility to commence restructuring proceedings with minimal court and practitioner "practitioner in the field of restructuring" (PIFOR) involvement.[4] In essence, the PRD, under Article 5, has broadened the scope for greater involvement of the debtor in its insolvency restructuring processes/proceedings across Member States than previously envisaged in the Recast European Insolvency Regulation (2015).[5] Therefore, the overall premise is for the debtor to remain in control of business assets and management of the business during restructuring proceedings.[6]

This article analyses the concept of the DIP model in EU insolvency and restructuring laws and processes, its evolution and the "broader scope" as envisaged in the PRD and, the potential impact of its harmonisation in EU insolvency and restructuring frameworks. The article examines the potential impact the DIP model would have on the EU insolvency and restructuring landscape and whether it would be a perfect fit for the EU.

The article also offers an analysis as to whether the PRD, and the drive for a harmonised DIP model in the EU, is a missed opportunity for the UK to improve its insolvency and restructuring laws and processes following Brexit. The article concludes by arguing that although the PRD aims to enhance the rescue culture within the EU through convergence of insolvency and restructuring frameworks, the DIP model might not be the perfect panacea to EU's divergent insolvency and restructuring frameworks but it will be a welcome shift toward enhanced debtor involvement in business restructurings across the EU.

The Debtor-in-Possession (DIP) – an overview

The DIP model is traceable to the US bankruptcy reorganisation of the equity railroad receiverships of the 19th and early 20th centuries.[7] The title DIP is created upon the filing of a

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[3] G. McCormack, "The European Restructuring Directive – a General Analysis" (2020) 33(1) *Insolv. Int*. 11 – 22.
[4] PRD, Recital 30.
[5] Regulation 2015/848/EU of the European Parliament and the Council of 20 May 2015 on insolvency proceedings (recast), [2015] OJ L 141/19 (*Hereafter*, Recast EIR 2015).
[6] PRD, Art. 5.
[7] Peter Tufano, "Business Failure, Judicial Innovation, and Financial Innovation: Restructuring U.S. Railroads in the Nineteenth Century" (1997) 71 *Bus. Hist. Rev*. 1; David A. Skeel, Jr., "The Past, Present, and Future of Debtor-in-Possession Financing" (2004) 25 *Cardozo L. Rev*. 1905.

bankruptcy case under Chapter 11 of the US Bankruptcy Code[8] and it is defined as the "same" person as a pre-petition debtor unless a trustee is appointed.[9] Therefore, the DIP is the existing management/directors of the debtor before filing for bankruptcy/insolvency proceeding but legally "baptised" with the new title of the debtor-in-possession.[10]

The DIP model has several benefits. Key amongst these is the contention that where invoked, the debtor's existing management remain in control and running of the business. This comes with the benefit that existing directors' knowledge, expertise and network of business contacts concerning the debtor's business and financial affairs can continue without interruptions. This may mean that directors may undertake timely and voluntary initiation of restructuring proceedings, which may be beneficial to the debtor's rescue prospects.[11]

Moreover, the DIP is empowered under Chapter 11 reorganisation proceedings to undertake business actions, such as obtaining post-petition financing and rejection of executory contracts in the ordinary course of business, to facilitate the reorganisation plan.[12] This is an example of the benefits (power and involvement) that the US DIP model affords a debtor during Chapter 11 bankruptcy reorganisations, which the PRD seeks to implement across the EU insolvency and restructuring landscape under Article 5.

The DIP Model in EU insolvency and restructuring law

Unlike the US, the concept of the debtor-in-possession is a relatively new phenomenon in EU insolvency and restructuring law. The original European Insolvency Regulation (EIR 2000)[13] did not consider the issue of the debtor-in-possession norm. The main scope of the Regulations was on collective insolvency proceedings that provided for partial or total divestment of a debtor and the appointment of a liquidator.[14] The main basis for initiating insolvency

[8] 11 U.S.C. ss. 101 – 1330 (2012) Enacted by the Bankruptcy Reform Act 1978 (Pub. L. No.95 – 598, 92 Stat. 2549).
[9] 11 U.S.C. s.1101(1).
[10] On this aspect, see further; Thomas G. Kelch, "The Phantom Fiduciary: The Debtor in Possession in Chapter 11" (1991) 38 *Wayne L. Rev*. 1323; G. Triantis," A Theory of the Regulation of Debtor-in-Possession Financing" (1993) 46 *Vand. L. Rev*. 901.
[11] Jennifer Payne, "Debt Restructuring in English Law: Lessons from the United States and the Need for Reform" (2014) 130 *LQR* 282; Kristin Van Zwieten, "Disciplining the Directors of an Insolvent Company" (2020) 33(1) *Insolv. Int*. 2 – 10.
[12] See for example, 11 USC, ss.365 and 1113.
[13] Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160 of 30 June 2000. (*Hereafter*, EIR 2000).
[14] EIR 2000, Art. 1(1).

proceedings was the debtor's insolvency, not other grounds such as preventive insolvency initiatives.

This highlighted the narrow scope of the EIR 2000 and the concern that the EIR was largely a conflict of laws rather than a substantive law instrument like the PRD. This led to recommendations for its reform to adopt a more inclusive and a broader scope in EU insolvency and restructuring laws that included *inter alia*, improved debtor involvement in business restructuring proceedings.[15] These factors dominated the European Commission's proposal for a Regulation amending the EIR 2000 published in December 2012,[16] that resulted in the enactment of the European Insolvency Regulation 2015 (Recast)[17] which came into effect on 26 June 2017.

In the Recast EIR 2015, the EU's insolvency regulations were given a broader scope to cover *inter alia*, (i) proceedings that provide for the restructuring of a debtor at a stage where there is only a likelihood of insolvency, and (ii) proceedings that leave the debtor, fully or partially, in control of its assets and business affairs.[18] Article 1(1) of the Recast EIR 2015 therefore, shifted the focus from the debtor's "insolvency" to "likelihood" of insolvency with the purpose being the avoidance of the debtor's insolvency or the cessation of the debtor's business activities.[19]

The Recast EIR 2015 also gave the first definition of the concept of a Debtor-in-Possession in EU insolvency and restructuring law by defining it as:

> "… [a] debtor in respect of which insolvency proceedings have been opened which do not necessarily involve the appointment of an insolvency practitioner or the complete transfer of the rights and duties to administer the debtor's assets to an insolvency practitioner and where, therefore, the debtor remains totally or at least partially in control of its assets and affairs."[20]

[15] P. J. Omar, "Upstreaming Rescue: Pre-insolvency Proceedings and the European Insolvency Regulation" (2014) 25(1) *I..CC.L.R*, 19–25; H. Eidenmüller and K. van Zwieten "Restructuring the European Business Enterprise: the EU Commission Recommendation on a New Approach to Business Failure and Insolvency" (2015) 16 *E.B.O.R*, 625–667.
[16] European Commission, Proposal for a Regulation of the European Parliament and of the Council Amending Council Regulation (EC) No 1346/2000 on Insolvency Proceedings, COM (2012) 744 final.
[17] Recast EIR 2015 (n 5).
[18] Recast EIR 2015, Recital 10.
[19] Recast EIR 2015, Art. 1(1).
[20] Recast EIR 2015, Art. 2(3). Further iterations on the DIP are Articles; 6(2), 28, 29, 38(1) and (3), 55(5) and 79.

Further references to the DIP norm in EU insolvency and restructuring laws were made in the Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency.[21] The Commission refers to the DIP norm as being:

> "To promote efficiency and reduce delays and costs, national preventive restructuring frameworks should include flexible procedures limiting court formalities to where they are necessary and proportionate …. to avoid unnecessary costs and reflect the early nature of the procedure, debtors should in principle be left in control of their assets and the appointment of a mediator or a supervisor should not be compulsory, but made on a case by-case basis."[22]

This Recommendation also urged Member States to establish, within their respective domestic insolvency legislation, a preventive insolvency framework that provided for *inter alia*, a debtor-in-possession model that facilitated minimal disruptions to the debtor's business due to financial difficulties, and also, provided for the debtor to remain, at least partially in control and the day-to-day running of the business as restructuring attempts were being undertaken.[23]

Members States harmonisation efforts [of DIP model]

Following the passage of the Recast EIR 2015, some EU Member States have taken initiatives to transpose the DIP norm/model in their national insolvency and restructuring laws. However, in a majority of these Member States' legislative provisions on the DIP model, the powers of the debtor-in-possession are limited or/ subject to cooperation with an officer of the court or supervision by a professional insolvency practitioner (IP).[24]

In Germany, for example, insolvency laws prescribe a unified insolvency model that provides for a DIP model in procedures, such as self-administration.[25] This procedure is debtor led as the debtor makes the application to the court and once approved, the debtor's management retains control and continues to operate the business.[26]

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[21] Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency C(2014) 1500 final. (Commission Recommendation 2014).

[22] Commission Recommendation 2014, Recital 17.

[23] Bob Wessels, "Rescue on the Rise" (2014) *Eurofenix*, (Autumn), 12-15; Stephan Madaus, "The EU Recommendation on Business Rescue – Only Another Statement or a Cause for Legislative Action Across Europe?" (2014) 27 (6) *Insolvency Intelligence*, 81.

[24] On this aspect, see broadly, Stephan Madaus and Bob Wessels "Realising the effectiveness of the Insolvency Regulation (Recast)" (2018) 31(4), *Insol. Int*. 105-107.

[25] Insolvenzordnung (*InsO*), s.270. (Insolvency Statute of 5 October 1994 (Federal Law Gazette – Index 311).

[26] Insolvenzordnung (*InsO*), s.270(1)+(2).

The DIP then manages the day-to-day business affairs of the company with the inherent advantage of managerial experience, market knowledge and greater insight into the company's financial difficulties. However, the debtor does this under the supervision of a custodian/administrator.[27] Therefore, the debtor's ability to enter into certain business/contractual liabilities during the self-administration procedure, other than in the ordinary course of business, have to be approved by the custodian/administrator.[28]

In France, insolvency law and restructuring processes, such as the safeguard procedure (with its two variants - the accelerated financial safeguard (*sauvegarde financière accélérée*)[29] and the accelerated safeguard (*sauvegarde accélérée*)),[30] the ad hoc mandate (*mandat ad hoc*)[31] and the conciliation (*conciliation*)[32] embody a debtor-in-possession norm. The *conciliation* and *mandat ad hoc* procedures provide for the debtor to remain in possession and control of the assets and the day-to-day running of the business during restructuring proceedings. These procedures also provide for the debtor to appoint a *conciliateur*, who does not necessarily have to be an insolvency practitioner, to assist the debtor in negotiations with creditors to reach an agreement on the debtor's financial difficulties.[33]

The *conciliateur* does not interfere with debtor-in-possession's management of the company business during the course of the restructuring proceedings, which gives the debtor a chance to execute the restructuring plan, but s/he has to keep the President of the Court appraised of the state of affairs regularly on a confidential basis.[34] However, under the *sauvegarde* procedures, although the debtor remains in possession, the administrator is appointed to supervise and assist the management in preparation of the plan.[35]

In the Netherlands, domestic insolvency laws also prescribe debtor-in-possession mechanisms to be utilised by the debtor undergoing insolvency restructuring proceedings. For example, under the suspension of payment procedure,[36] the debtor remains in possession of the business assets and the day-to-day running of the business but the debtor's authority is limited to a certain extent in relation to certain business dealings/activities. For instance, the debtor must

[27] Insolvenzordnung (*InsO*), s.270(c).
[28] Insolvenzordnung (*InsO*), s.275(1).
[29] Law No 2010-1249 of 22 October 2010.
[30] Ordinance No 2014-326 of 12 March 2014.
[31] Commercial Code, Articles L611-1 to L611-16.
[32] Ibid.
[33] Commercial Code, Article L611-7.
[34] Ibid.
[35] Commercial Code, L622-1.
[36] Dutch Bankruptcy Act 1893 (DBA 1893), Articles 214 to 283.

cooperate with and/or seek permission from the court-appointed administrator[37] before undertaking decisions, such as disposing of company business assets.[38] In addition, where the suspension of payment procedure transcends into bankruptcy liquidation proceedings, the debtor loses the right to dispose of and to administer the assets of the business[39] to the insolvency practitioner (liquidator), who leads the administration and winding up of the debtor's estate.[40]

In the UK,[41] there are provisions in the Insolvency Act 1986 (IA 1986) that provide for the debtor to remain in possession of the business during corporate rescue processes, such as a scheme of arrangement[42] and company voluntary agreements (CVAs).[43] However, during administration proceedings,[44] the debtor does not remain in possession as an external insolvency practitioner, such as an administrator, is appointed to replace the current management to oversee the management of the company's business and affairs. There are other provisions in the recently enacted Corporate Insolvency and Governance Act 2020 (CIGA 2020)[45] that provide for a DIP norm. (These are discussed below under the section on whether the PRD is a missed opportunity for the UK following Brexit).

However, while such measures have been taken by Member States to transpose the DIP norm in their domestic laws, these measures were deemed not dispositive enough to implement a harmonised DIP model in EU insolvency and restructuring laws.[46] For instance, in its Evaluation Report on the implementation of the 2014 Recommendations, the Commission reiterated that Member States had been selective in implementing these recommendations into their respective domestic legislation, which impacted the Commission's intended

[37] DBA 1893, Article 215.
[38] DBA 1893, Article 228.
[39] DBA 1893, Article 23.
[40] DBA 1893, Article 68.
[41] Please note that the UK left the EU on 31 December 2020.
[42] CA 2006, Part 26. A scheme of arrangement is a compromise between a company and its creditors or members or any class to the composition of the debtor's debts.
[43] A company voluntary arrangement is a form of compromise between the debtor and its creditors for a composition in satisfaction of its debts or a scheme of arrangement of its affairs but different from a scheme of arrangement (under Part 26 CA 2006). In a company voluntary arrangement, secured and preferential creditors are not bound by the compromise or arrangement whereas in Part 26 scheme of arrangement they are.
[44] IA 1986, Sch. B1, Para.59. See further; V. Finch, "Control and Co-ordination in Corporate Rescue' (2005) 25 *Legal Studies* 374.
[45] Corporate Insolvency and Governance Act 2020 (CIGA), c.12.
[46] Alan Bennett, "To Harmonise or Not to Harmonise, that's the Question" (2015) 8 *Corporate Rescue and Insolvency,* 98; G. McCormack, "Business Restructuring Law in Europe: Making a Fresh Start" (2017) 17 *Journal of Corporate Law Studies* 1.

harmonisation plans.[47] This might have been attributed to Member States' residual diversity in their domestic insolvency and restructuring frameworks which meant that harmonisation efforts remained at a relatively low level,[48] and initiatives were taken to address these in the PRD.

The DIP norm in the Preventive Restructuring Directive

On 22 November 2016, the EU Commission published a proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU.[49] After adoption by European Parliament and the Council, the Directive became law on 26 June 2019 when it was published in the official journal of the European Union. EU Member States have two years to transpose the Directive into corresponding domestic laws, with a potential extension of one year to Member States that encounter transposition challenges within the two-year period.

Following from earlier unsuccessful initiatives to establish a coherent insolvency framework across the EU to guide and regulate business failures and insolvency restructuring among Member States, The EU Commission spearheaded the passage of the PRD.[50] The 2014 EU Recommendation on a new approach to business failure and insolvency[51] had been partially adopted and implemented by Member States.[52] The 2015 Recast EIR[53] was still in its early

[47] See, Directorate-General Justice and Consumers of the European Commission, "Evaluation of the implementation of the Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency", (30 September 2015). See also, Alan Bennett, "To Harmonise or Not to Harmonise, that's the Question" (2015) 8 *Corporate Rescue and Insolvency*, 98.
[48] On this aspect, see, H. Eidenmueller, "A New Framework for Business Restructuring in Europe: The EU Commission's Proposals for a Reform of the European Insolvency Regulation and Beyond" ECGI - Law Working Paper No. 199/2013, Available at SSRN:< https://ssrn.com/abstract=2230690> [accessed 13 November 2020].

[49] European Commission, *Proposal for a Directive on Preventive Restructuring Frameworks, Second Chance and Measures to increase the Efficiency of Restructuring, Insolvency and Discharge Procedures and amending Directive 2012/30/EU*. (Com (2016) 723/0359) final.
[50] H. Eidenmuller and K. van Zweiten, "Restructuring the European Business Enterprise: The EU Commission Recommendation on a New Approach to Business Failure and Insolvency" (2015) 16 *E.B.O.R*. 625; G. McCormack, "Business Restructuring Law in Europe: Making a Fresh Start" (2017) 17 *Journal of Corporate Law Studies* 1.
[51] EU Commission, Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency, C(2014) 1500 final.
[52] See, COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT, *Accompanying document, Proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Framework*, SWD(2016) 357 final.
[53] European Union, Regulation 2015/848/EU of the European Parliament and of the Council of 20 May 2015 on Insolvency Proceedings (Recast) L141/19.

years of implementation and its full impact was yet to be witnessed.[54] Therefore, the Commission sought a more harmonised approach to corporate insolvency and restructuring across the EU in the form of the PRD as the 2014 Recommendation and the Recast EIR 2015 no longer represented harmonised, efficient and adequate tools to address new challenges arising out of the EU's economic landscape.[55]

Challenges such as the need to have pre-insolvency proceedings aimed at preventing avoidable liquidations by giving the debtor power to file for restructuring proceedings at the earliest opportunity, and provisions for the debtor to remain in control of its business upon opening restructuring proceedings (DIP mechanisms) were among other factors that instigated calls for substantive reforms.[56] Therefore, the PRD's key objective is to reduce the most significant barriers to the free flow of capital stemming from differences in Member States' restructuring and insolvency frameworks.

Under Article 5(1), the PRD provides that "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".[57] This provision may be interpreted as providing for the harmonisation of the DIP model within the EU insolvency and restructuring landscape similar to that adopted in the US by debtors undergoing bankruptcy reorganisation proceedings under Chapter 11 of the US Bankruptcy Code.[58]

Effectively, the PRD prescribes three avenues through which Member States can implement Article 5 provisions in their national laws. The first avenue is where a Member State can adopt a partial debtor-in-possession[59] system where the debtor (directors) work alongside a PIFOR to negotiate and implement a restructuring plan. The second avenue is for a Member State to provide for the appointment of the PIFOR by the judicial or administrative authority on a case-by-case basis.[60] The third avenue is for a Member State to provide for mandatory PIFOR

[54] On this aspect see for instance: G. McCormack, "Corporate Restructuring Law – a Missed Chance for Europe?" (2017) 42(4) *Eur. Law. Rev*. 532 – 561; N.W.A Tollenaar, "The European Commission Proposal for a Directive on Preventive Restructuring Proceedings" (2017) 30(5) *Insol. Int*. 65 – 81.
[55] Eidenmuller, (n 1).
[56] P. Manganelli, "The Modernization of European Insolvency Law: An Ongoing Process" (2016) 11(2) *J. Bus. & Tech. L*. 153, 161.
[57] PRD, Art. 5(1).
[58] G. McCormack, "Corporate Restructuring Law – A Second Chance for Europe?" (2017) 42 (4) *European Law Review* 532 – 561.
[59] PRD, Art. 5(1).
[60] PRD, Art.5(2).

appointment in every restructuring case where it considers the PIFOR appointment necessary to safeguard party interests.[61]

It may be contended that these implementation avenues are too flexible and provide a wider margin for Member States to adopt and implement the DIP model in their national laws and that this presents a harmonisation challenge. However, on analysis, the implication of Article 5 is that the debtor remains at least, partially, in control and day-to-day running of the business. The PIFOR appointment does not lead to management/director displacement with the external Insolvency Practitioner as is the case with other Member States' corporate rescue mechanisms.[62] Even where a mandatory PIFOR appointment is required by a given a Member State, the role of the PIFOR would be limited to assisting the debtor (directors) and creditors in negotiating, drafting and implementing a restructuring plan.[63] However, it is arguable whether, the DIP model would be a perfect fit for the EU.

DIP Model - a perfect fit for Europe?

For decades, within the EU, it has been an established practice that debtor companies experiencing financial difficulties (may) acquire the services of a professional IP, who upon appointment, assumes control of the debtor's assets and the day-to-day management of the business by replacing the current management of the debtor.[64] This practice is procedurally and substantively different from that in the US bankruptcy reorganisation under Chapter 11 where, upon filing for bankruptcy reorganisation proceedings, the debtor remains in control of its assets and day-to-day running of the business.

Barely a year into its passage, the PRD was being "dubbed" the "EU's Chapter 11 model" and it was said that it was inspired by Chapter 11 of the US Bankruptcy Code.[65] However, due to divergences in corporate structures and differences in institutional and operational attitudes between the US and EU insolvency and restructuring structures, questions are raised as to

[61] PRD, Art. 5(3); See also, Recital 30.
[62] F.Mucciarelli, "Not Just Efficiency: Insolvency Law in the EU and its Political Dimensions" (2013) 14 *E.B.O.R* 175; R. de Weijs, "Harmonization of European Insolvency Law: Preventing Insolvency Law from Turning against Creditors by Upholding the Debt–Equity Divide" (2018) 15 *European Company and Financial Law Review* 403–444.
[63] See further, G. McCormack, "The European Restructuring Directive – a General Analysis" (2020) 33(1) *Insolv. Int*. 11 – 22.
[64] J. Armour, B.R Cheffins, and D.A Skeel Jr, "Corporate Ownership Structure and the Evolution of Bankruptcy Law: Lessons from the United Kingdom' (2002) 55 *Vand. L. Rev*. 1699; V. Finch, "Control and Co-ordination in Corporate Rescue' (2005) 25 *Legal Studies* 374.
[65] B. Becker, "The EU's Insolvency Reform: Right Direction, not Enough, and Important Issues left Unaddressed" *VOX, CEPR Policy Portal* (27 June 2019) < https://voxeu.org/article/eu-s-insolvency-reform> [accessed 13 December 2020].

whether, indeed, the DIP model, as articulated in Article 5 would be a perfect fit for Europe. These perspectives are explored below.

Differences in institutional and operational attitude

It has been contended that the DIP model is more suitable for handling very large and complex multi-national corporate debtors with large creditor claims like those under the US DIP model under Chapter 11 restructurings.[66] Notable among such cases are the recent restructurings of American Airlines in 2011[67] and Pacific Gas and Electric Company in 2019.[68] With this in mind, there are concerns, whether indeed, the DIP Model would suit the EU corporate market structure with a high concentration of SMEs. However, the counter argument to this contention is the notion that under SMEs restructurings, the directors are usually the engine behind the restructuring exercise and whose engagement is critical for its success.[69] This would arguably, make the DIP mode a perfect fit for the EU.

In the US, business failure is primarily attributed to external factors such as poor economic climate and not to managerial failings. This is a form of social cohesion that creates a bond of trust and commitment of affording the current management a chance to steer the company back to solvency.[70] There is belief that the current management is well appraised of the debtor's business from past dealings, and therefore, best positioned to implement successful reorganisation plans.[71] This is unlike the position within the EU where the price for management failings is replacement with external IPs rather than assuming more risks with the failed management.[72] In fact, leaving the failed management in control of the restructuring process was likened to leaving an alcoholic in charge of a pub.[73]

The general consensus in the EU, therefore, is that the company becomes insolvent because of management failures. The failed management are replaced with an external professional, such

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[66] Ivashina, et al, "The Ownership and Trading of Debt Claims in Chapter 11 Restructurings"(2016) 119(2) *J. Fin. Econ*. 316 – 355.
[67] Michael J. De La Merced, "American Airlines Parent Files for Bankruptcy" *The New York Times*, (New York, 29 November 2011) < https://dealbook.nytimes.com/2011/11/29/american-airlines-parent-files-for-bankruptcy/> [accessed 26 December 2020].
[68] Zach Wichter, "California's Largest Utility Says its Bankruptcy: Here's What you Need to Know" *The New York Times*, (New York, 29 January 2019) < https://www.nytimes.com/2019/01/29/business/pge-bankruptcy.html> [accessed 26 December 2020].
[69] Ivashina, et al, "The Ownership and Trading of Debt Claims in Chapter 11 Restructurings"(2016) 119(2) *J. Fin. Econ*. 316 – 355; G. McCormack, "Corporate Restructuring Law – A Second Chance for Europe?" (2017) 42 (4) *European Law Review* 532 – 561.
[70] B. A . Henoch, "Post-Petition Financing: Is There Life After Debt?" (1991) 8 *Bank. Dev. J*. 575, 577.
[71] G. McCormack, "Business Restructuring Law in Europe: Making a Fresh Start" (2017) 17 *J.C.L.S*. 1.
[72] G. McCormack, "Control and Corporate Rescue – an Anglo-American Evaluation" (2007) 56 *I.C.L.Q*. 515.
[73] G. Moss, "Chapter 11: An English Lawyer's Critique" (1998) 11 *Insol. Intel*. 17, 18 – 19.

as an IP to oversee the rescue operations of the company business.[74] This is the position that the PRD, under Article 5 would address by affording the debtor a chance to remain (at least, partially) in control of the restructuring process.

Divergence in corporate structures

In the US, there is strong consensus within the bankruptcy and business communities that the DIP is better positioned to manage and execute reorganisation operations successfully than outside professionals brought in following the debtor's financial misfortunes.[75] This notion has not been a widely accepted norm within the EU until the adoption of the PRD. For example, in the US, the DIP is equipped with powers to exercise discretion on how best to implement the reorganisation plan successfully. This may include *inter alia*, power to acquire post-petition financing,[76] or making modifications or rejections to executory contracts,[77] where doing so would lead to successful reorganisation/restructuring.

Under the PRD, there are parallel provisions that empower the DIP to acquire post-petition financing with some protection,[78] like it is the case under the US DIP Model. However, the power to obtain financing and the protection thereof, is not absolute. The PRD provides that post-petition financing (new or interim) may not be protected unless the restructuring plan has been confirmed by a judicial or administrative authority.[79] This is a point of concern that may present a challenge to the DIP within Member States in the quest for post-petition financing as a catalyst for a going concern restructuring process.

Moreover, the power granted by Chapter 11 to a debtor to undertake business decisions such as modifying or rejecting executory contracts,[80] has been one of the most contestable and debatable areas for reform to the US Bankruptcy law for varied reasons.[81] While some academics and commentators consider the debtor's ability and freedom to reject or modify executory contracts in order to augment the debtor's restructuring chances as an important

[74] See, R. Goode, *Principles of Corporate Insolvency Law* (4th ed., London, Sweet & Maxwell, 2011) 39.
[75] D. Skeel Jr, "The Past, Present and Future of Debtor-in- Possession Financing" (2004) *Cardozo Law Review* 101; D. Baird, "The New Face of Chapter 11" (2004) 12 *American Bankruptcy Institute Law Review* 69; B. Adler, V. Capkun and L. Weiss, "Value Destruction in the New Era of Chapter 11" (2013) 29 *Journal of Law, Economics, and Organization* 461.
[76] See, particularly; 11, USC, s.364 (a) – (d).
[77] 11 USC, s.365 and 11 USC s.1113.
[78] Directive 2019/1023/EU, Art. 17(1).
[79] Ibid, Art. 17(2) – (4).
[80] 11 USC, s.365 and 11 USC s.1113.
[81] Barry Adler, "Finance's Theoretical Divide and the Proper Role of Insolvency Rules" (1994) 67 *S. Cal. L. Rev*. 1107: E. Warren, "Bankruptcy Policy Making in an Imperfect World" (1993) 92 *Mich. L. Rev*. 336.

aspect of a perfect insolvency model,[82] others consider it a creditor value maximisation fundamentalism and question the fairness and integrity of the DIP model.[83] Therefore, these are some of the potential knock-on effects that the DIP model may present to the EU's insolvency framework that ought to be given utmost consideration in assessing whether the DIP Model would be a perfect fit for the EU.

The PRD – a missed opportunity for the UK following Brexit?

On 31 December 2020, the UK left the EU and therefore, is no longer a EU Member State and thus does not benefit from the reforms introduced by the PRD. However, prior to the outbreak of the COVID19 pandemic in early 2020, the UK government had undertaken two consultations, in 2016[84] and 2018,[85] in a bid to reform its insolvency laws and processes. This was because many of its basic insolvency laws and procedures had remained unchanged since 2004 and through the global financial crisis of 2007/2008. This presented an opportunity to assess whether these laws and processes were still fit for purpose and in line with international trends.[86]

These consultations were fast-tracked by the UK government and debated by parliament in the wake of the global COVID19 pandemic in a bid to foster legislative changes to guide and support businesses during the COVID19 crisis.[87] Following several parliamentary debates, the UK government on 20 May 2020 published the Corporate Insolvency and Governance Bill (the Bill)[88] with provisions intended to provide businesses with increased flexibility and opportunities to continue trading during the COVID19 period. This Bill was granted royal assent and enacted into the Corporate Insolvency and Governance Act 2020 (CIGA 2020)[89] on

[82] Thomas Jackson, "On the Nature of Bankruptcy Law: An Essay on Bankruptcy Sharing and the Creditors' Bargain" (1989) 75 *Va. L. Rev*. 155; Alan Schwartz, "A Contract Theory Approach to Business Bankruptcy" (1998) 107 *Yale L. J*. 1807.
[83] Harvey R. Miller, "The Changing Face of Chapter 11: A Re-emergence of the Bankruptcy Judge as the Producer, Director, and Sometimes Star of the Reorganization Passion Play" (1995) 69 *Am. Bankr. L. J*. 431; Hamiisi J. Nsubuga, "Corporate Insolvency and Employment Protection: A Theoretical Perspective" (2016) 4(1) *NIBLeJ* 4.
[84] Insolvency Service, *A Review of the Corporate Insolvency Framework: A Consultation on the Options for Reform* (May 2016) (Hereafter, *Government Consultation*).
[85] "Insolvency and Corporate Governance" (Department for Business, Energy and Industrial Strategy, (March 2018).
[86] Per Sajid Javid, *Government Consultation*, Executive Summary, para. 24.
[87] See for example, the press release to this effect by the UK Business Secretary Alok Sharma announced on 28 March 2020 at <https://www.gov.uk/government/news/regulations-temporarily-suspended-to-fast-track-supplies-of-ppe-to-nhs-staff-and-protect-companies-hit-by-covid-19 (accesses 20 November 2020).
[88] Corporate Insolvency and Governance HC Bill (2019-21) <https://services.parliament.uk/Bills/2019-21/corporateinsolvencyandgovernance/documents.html> [accessed 28 November 2020].
[89] Corporate Insolvency and Governance Act 2020, c.12 <https://www.legislation.gov.uk/ukpga/2020/12/pdfs/ukpga_20200012_en.pdf> [accessed 7 October 2020].

25 June 2020, implementing key insolvency and business measures to support and steer businesses and the economy through the COVID19 emergency period.

CIGA 2020 made both temporary (time-limited) changes as a response to COVID19, which include for example, the suspension and/or relaxation of wrongful trading liability for company directors and restrictions on winding up petitions between 1 March 2020 to 30 September 2020. Three permanent changes to UK insolvency and restructuring laws and processes were also introduced which include: (i) a new "standalone" moratorium on creditor enforcement of claims against a company, (ii) a new flexible "restructuring plan" procedure and (iii) new restrictions on (*Ipso facto*) termination clauses on supply contracts. These are analysed below with the exception of (iii) - *Ipso facto* termination clauses as this is outside the scope of this article.

(i) A new "standalone" moratorium

CIGA 2020 introduced a new stand-alone moratorium procedure to be utilised by companies in financial distress with the aim of attempting the rescue of the company as a going concern.[90] This new procedure embodies a debtor-in-possession norm in that it is initiated by the current management/directors who, upon approval, remain in control and run the business with the moratorium offering protection from creditor enforcement actions.[91]

Therefore, provided the company experiencing financial difficulties is an eligible one,[92] directors can apply to utilise a moratorium[93] for an initial period of 20 business days,[94] during which, they remain in charge and control of the business.[95] However, they have to work alongside a 'monitor' – a licensed IP, who also serves as an officer of the court.[96] S/he monitors the company's affairs for the purpose of forming a view as to whether, it remains likely that the moratorium will result in the rescue of the company as a going concern.[97] The monitor can also seek directions from court on issues, such as bringing the moratorium to an end once

[90] Generally, see, CIGA 2020, ss A3(2) and A6 on the required documentation for obtain the moratorium.
[91] CIGA 2020, s. A3(2).
[92] On eligibility criteria for the moratorium, see, CIGA 2020, s.A2 and Sch. ZA1. See also s.A5 on eligibility for overseas companies to obtain the moratorium.
[93] Directors can do this by applying or lodging required documents with the court. See, CIGA 2020, s.A3 and s.A6 for the required documents.
[94] CIGA 2020, s A9(2).
[95] CIGA 2020, ss.A3(2), (3) and A4.
[96] CIGA, s.A34.
[97] CIGA 2020, s.A35(1).

convinced that the moratorium is no longer likely to result in the rescue of the company as a going concern or, where the objectives of rescue have been achieved.[98]

The advantage of the stand-alone moratorium is that it is a director-led process and the initial period of 20 business days covered by it can be extended by directors for a further 20 business days with or without any creditor consent.[99] It can also be extended for longer (up to 12 months) with consent of pre-moratorium creditors or the court after the first 15 business days.[100] Directors will have to file with the court: (a) a notice that they wish to extend the moratorium; (b) a statement that the moratorium debts, and the pre-moratorium debts for which the company does not have a payment holiday, have been paid or discharged; (c) a statement confirming that the company is, or is likely to become, unable to pay its pre-moratorium debts; and (d) a statement from the monitor that in his or her opinion it remains likely that the moratorium will result in the rescue of the company as a going concern.[101]

Therefore, although the provisions on the new stand-alone moratorium do not specifically state they are the new "debtor-in-possession" model *per se*, they however, provide for the debtor to remain in control and in charge of the financially struggling company as rescue and restructuring attempts are undertaken by the debtor. This, it may be argued, mirrors the provisions in Article 5(3) of the PRD, that provide for the DIP mechanisms within EU insolvency and restructuring framework that the PRD seeks to implement across the EU.

(ii) A new restructuring plan

In addition to a stand-alone moratorium, CIGA 2020 also introduced a so-called "new restructuring plan" under Part 26A of the Companies Act 2006,[102] available to companies that have encountered or are likely to encounter financial difficulties that affect their ability to continue trading as a going concern. The new Part 26A restructuring plan is somewhat similar to the already existing scheme of arrangement procedure under Part 26.[103] However, the two most notable differences between these two procedures are that, first, under the new Part 26A procedure, there is no requirement on the debtor to demonstrate insolvency, but it does require evidence of actual or likely financial difficulties. Second, the new Part 26A procedure comes

[98] CIGA 2020, ss.A37, A38.
[99] CIGA 2020, ss.A10 and A11.
[100] CIGA 2020, s.A13.
[101] CIGA 2020, s.A10(1)(a)-(d).
[102] CIGA 2020, s.7 and Sch. 9 and CA 2006, Part 26A, s.901A.
[103] On the old scheme of arrangement procedures, see generally, J. Payne, *Schemes of Arrangement; Theory, Structure and Operation* (Cambridge, CUP 2014); C. Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd ed, Sweet & Maxwell 2017).

with new provisions on creditor "cross-class cram-down" which wasn't available to debtors under the old Part 26 procedure.[104]

The inherent advantage of the provisions on creditor cross-class cram-down is that the debtor is afforded an opportunity to address "hold-out" problems that may slow, if not, totally halt the debtor's restructuring plan. The debtor is also afforded a chance to convince the court to sanction the approval of the proposed restructuring plan even where 75 percent of a voting creditor class has not voted in favour of the plan[105] provided:

i- The court is satisfied that if the plan was to be approved, none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative.

ii- The plan has been agreed by at least 75 percent in value of a class who would receive a payment, or have a genuine economic interest in the company, if the relevant alternative were to occur.[106]

In addition, the new Part 26A restructuring plan can be combined with the new stand-alone moratorium (discussed above) to afford the company some breathing space as it implements its rescue plan. Therefore, as the new restructuring plan is debtor led, directors may propose a restructuring plan they think would enable to compromise creditor and/or members' claims to achieve their intended restructuring plan. This further affords directors' involvement and/or participation and control in the company's restructuring process, which may be seen as a big step towards a debtor-in-possession model integration into the UK insolvency and restructuring landscape.

It may be argued that the provisions under the new Part 26A procedure and on creditor cross-class cram-down measures mirror the provisions instigated by the PRD across EU Member States. Under Article 4, the PRD requires Member States to ensure that, where there is a likelihood of insolvency, debtors have access to a preventive restructuring framework that would enable them to restructure their businesses with a view to preventing insolvency.[107] The

[104] See, CA 2006, Part 26A, ss.901F – 901G; Robin Dicker QC and Adam Al-Attar, "Cross-Class Cram Downs Under Part 26A Companies Act 2006, Corporate Insolvency and Governance Act 2020, Schedule 9" *South Square Digest* (June 2020) at p.34-54.
[105] But subject to the provisions under CA 2006, Part 26A, ss. 901H.2 and 901H.5
[106] CA 2006, Part 26A, s.901F.
[107] PRD, Art. 4(1).

PRD also provides for debtors to adopt cross-class cram-down measures in their proposed restructuring plans.[108]

Provided the proposed plan complies with the "best interest of creditors" test,[109] regardless of whether the class of creditors as a whole is prepared to accept the plan, a judicial or administrative authority may approve such a plan and, thus, it becomes binding upon dissenting voting classes.[110] However, Member States have to ensure that dissenting creditors are not worse off under the proposed plan than they would be in the next best alternative scenario if the plan was not confirmed. In other words, Member States have to ensure that dissenting class creditors are fairly protected and not unfairly prejudiced under the proposed plans.[111]

Therefore, it may be submitted that reforms and changes to UK insolvency and restructuring laws and processes introduced by the CIGA 2020, as discussed above, are in line with the changes introduced by PRD to be transposed across EU Member States. Key features of the PRD such as new moratoria protection (Articles 6 and 7), the introduction of new restructuring plan (Articles 8, 9, and 10) with cross-class cram-down mechanism (Article 11) among other changes have also been mirrored by the reforms in the CIGA 2020. Thus, against the backdrop of Brexit, legislative response in the CIGA 2020 underpins the UK's commitment to remain competitive and in line with the EU's corporate insolvency and restructuring framework.

Conclusion

One of the key concerns over the EU and UK's insolvency model has been the reliance on the so-called "practitioner-in-possession" model – where the current management is replaced by an IP in a formal insolvency setting. Yet once appointed, the IP, as an outsider, needs time to get acquainted with the debtor's business operations and state of affairs before making meaningful decisions. Decisions such as to what the best rescue procedure suited to the debtor's restructuring needs is or, whether other rescue processes may be initiated alongside each other as viable exit routes, may take time to formulate which may lead to unnecessary costs and liquidations. This is one of the concerns that the PRD under Article 5(2) seeks to address by giving the debtor, under a so-called "debtor-in-possession" model, a chance to continue running the business as rescue attempts are undertaken.

[108] PRD, Art. 11.
[109] PRD, Arts 10(2)(d) and 2(6).
[110] PRD, Art. 10.
[111] PRD, Art. 11(1)(c) and Recital 55.

This is a form of a second chance for debtors to prevent, through restructuring, avoidable liquidations by leaving them in control of their assets and day-to-day running of their businesses. This notion has been envisaged by the PRD by putting much emphasis on "pre-insolvency proceedings" and restructuring frameworks as a measure to give the debtor ability to file for insolvency restructuring at an early stage to avoid insolvency. It is envisaged that this approach may increase predictability of corporate insolvency to guard against avoidable liquidations under debtors' control.