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Flexibility vs. Certainty Evaluating the Impact of the Relative Priority Rule (RPR) under the European Directive on Preventive Restructuring and Insolvency

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1. Abstract

The thesis explores the Relative Priority Rule (RPR) within the European Union's Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 (Preventive Restructuring Directive), examining its impact on creditor protection and its potential to foster opportunistic behavior. Through a comparative analysis, the thesis contrasts the newly implemented EU RPR with the U.S. Absolute Priority Rule (APR), highlighting the EU RPR's flexibility which allows dissenting creditors to be treated more favorably compared to junior classes creditors, like out-of-money shareholders, without requiring full satisfaction of their claims, unlike the APR, which requires full satisfaction of dissenting creditor classes claims before junior classes can retain value.

However, this flexibility may come at the cost of legal certainty. The flexibility introduced by the RPR, which allows for deviations from traditional priority rules (where creditors are paid strictly based on the seniority of their claims), could result in unpredictable outcomes. This unpredictability can reduce legal certainty because creditors may not be sure of their position and expected recoveries in a restructuring scenario. Consequently legal certainty is crucial in insolvency and restructuring contexts as it provides predictability and stability in the financial system.

Moreover, the thesis argues that the flexibility provided by the RPR might result in unpredictability and inconsistent results, making it difficult for creditors to foresee restructuring outcomes and possibly leading to increased costs or decreased willingness to extend credit. For instance, junior creditors or out-of-the-money shareholders might be encouraged to engage in holdout behavior, delaying restructuring processes in hopes of negotiating better terms. This can increase the costs and time involved in restructuring, potentially leading to suboptimal outcomes for all parties. Additionally, the bargaining power of unsecured creditors may be diminished under the RPR, as these creditors often lack collateral to back their claims and might find themselves deprioritized in restructuring plans that favor other stakeholders. This shift could significantly impact the dynamics of creditor negotiations, potentially leading to unfair distributions and complications in achieving consensual restructuring solutions.

Therefore, the thesis advocates for a tailored approach to priority rules that aligns with fundamental insolvency law objectives to maximize value distribution and minimize systemic risks, recommending that Member States consider the nuances of both rules while transponding

the Directive into their legislative frameworks, thus avoiding unintended consequences in insolvency proceedings.

Furthermore, equally important, this work contains a substantive comprehensive comparison of three domestic jurisdictions (Austria, the Netherlands and Bulgaria) and an analysis on the manner of transposing the preventive restructuring frameworks, focusing correspondingly on the RPR or APR.

Keywords Preventive Restructuring Directive; Relative Priority Rule (RPR); Absolute Priority Rule (APR); Pros and Cons of the European Union RPR; Tailor-Made Version of the APR and RPR; Transposition by Member States;

2. Introduction

2.1. Overview of Directive 2019/1023 and the New Priority Rule

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), commonly referred to as the Preventing Restructuring Directive(PRD)[1], was adopted on 20 June 2019, had been published on June 26, 2019 and entered into force on July 16, 2019. The Directive introduced significant changes aimed at harmonizing and improving the frameworks for preventive restructuring, insolvency, and second chance across the Member States. This established a minimum standard among EU Member States for preventative restructuring frameworks available to debtors in financial difficulty and for providing measures to increase the efficiency of restructuring procedures.

The Directive offers a valuable set of tools for debtors in financial difficulties to restructure their business.[2] It includes features like an early initiation point, the debtor-in-possession approach, a flexible stay, the ability to adopt restructuring plans out-of-court, and the implementation of a cross-class cram-down, which shall be focused on in the present research paper.

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[1] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, second chance, and measures to increase the efficiency of restructuring, insolvency and discharge procedures, and amending Directive (EU) 2017/1132 [2019] OJ L172/18.

[2] Directive 2019/1023, rec 4.

The PRD includes provisions such as debt relief for deeply indebted entrepreneurs and improvements to the processes of restructuring, insolvency, and discharge. A vital aspect of the Directive is the introduction of preventive restructuring frameworks, which are intended to enable businesses facing financial challenges to restructure their capital structures at an early stage, maintain their operations and avoid insolvency, thus limiting the unnecessary liquidation of viable enterprises [3].
What is more, this Directive is a key component of the EU's efforts to create a more effective and cohesive approach to handling business distress and insolvency, with an emphasis on increasing the efficiency of restructuring processes, giving debtors a second chance, and improving the overall environment for investment in Europe. In addition, the Preventive Restructuring Directive aims to facilitate the cross-border recognition of restructuring procedures and the recognition and enforceability of judgments emanating from such procedures.
Unlike EU Regulations, the Directives do not have automatic effect and so Member States had to transpond the PRD into national law by 17 July 2021, subject to a one year extension which could be requested from the European Commission.[4]

2.2. Summary of Key Objectives

In a nutshell and for easier reference, the key objectives of Directive 2019/1023 are as follows:

1. Preventive restructuring frameworks: The Directive promotes preventive restructuring frameworks that enable companies experiencing financial difficulties to continue operating. This preventive approach allows companies to restructure early to avoid insolvency and ensure their viability, thereby safeguarding jobs and maintaining value for creditors.[5]

2. Second chance for entrepreneurs: The Directive in Recital 5 discusses the challenges faced by honest but insolvent entrepreneurs in obtaining a timely debt discharge. In many Member States, this process can exceed three years, prompting entrepreneurs to relocate to jurisdictions with faster procedures. This situation not only incurs significant costs but also hampers

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[3] Directive 2019/1023, rec 2.
[4] Directive 2019/1023, art 34(2) .
[5] Directive 2019/1023, rec 2.

entrepreneurial activities due to lengthy disqualification periods associated with debt discharge.[6]

3. Measures to increase efficiency: It introduces measures to streamline and digitize insolvency procedures, making processes more efficient and reducing unnecessary burdens and costs.[7] The Directive emphasizes the importance of professional qualifications for practitioners and promotes a more integrated approach to insolvency proceedings across the EU.

4. Protection of creditors and minority shareholders: The Directive ensures that the rights of creditors and minority shareholders are protected during the restructuring process. It provides for clear rules on staying enforcement actions and on the approval of restructuring plans, which must be fair and equitable to different classes of creditors.[8]

5. Cross-border insolvency proceedings: The Directive also includes provisions to improve the handling of cross-border insolvency cases, enhancing the recognition of restructuring decisions across EU borders and ensuring substantive minimum standards for preventing restructuring procedures as well as for closer coordination among Member States in handling insolvencies involving multiple countries.[9]

6. "Best -interest- of -creditors test"[10]: The best- interest- of- creditors test is a fundamental safeguard within restructuring frameworks, designed to protect dissenting creditors from receiving less than they would under the most advantageous alternative scenario. This test is pivotal in maintaining fairness and ensuring that the restructuring plan does not unduly prejudice any creditor's rights. Therefore it prevents a scenario where a restructuring plan could be approved that benefits some creditors at the expense of others.

7. Cross-class cram-down: The Directive outlines that Member States should have provisions for cross-class cram-down, which namely shall be in the focus of the present thesis. This process allows a restructuring plan to be confirmed even if not all creditor classes agree but it is supported by at least one impaired class of creditors. This mechanism can reflect principles of both RPR and APR depending on national implementations, as some examples from

[6] Directive 2019/1023, rec 5.
[7] Directive 2019/1023, rec 6.
[8] Directive 2019/1023, art 10(2) and art 11
[9] Directive 2019/1023, rec 12.
[10] Directive 2019/1023, art. 10 (2)(d) and art. 2 (1)(6)

Member States in this respect shall be reviewed further in the present work. In the context of cross-class cram-downs, the Absolute Priority Rule (APR) mandates that senior creditors must be fully satisfied before junior creditors can receive any value. Conversely, under adjustments similar to the Relative Priority Rule (RPR), restructuring plans can modify the typical hierarchy of creditor claims, potentially allowing deviations from the standard priority order.[11] As these rules are the focus of this paper, they will be examined further in greater detail.

8. Treatment of secured and unsecured creditors: The Directive discusses the formation of classes of creditors, distinguishing between secured and unsecured creditors, which is relevant to priority rules. These classifications are crucial when plans involve cross-class cram-downs, potentially applying APR principles to ensure that secured creditors are treated according to their priority status compared to unsecured creditors.[12]

9. Flexibility in restructuring plans: While not explicitly naming RPR, the Directive allows for significant flexibility in how restructuring plans are formulated and confirmed, including provisions for how affected parties (including all classes of creditors) are to be treated. This flexibility can include departures from strict priority adherence, which is a hallmark of RPR, where the overall goal is to achieve a viable restructuring that maximizes value for all parties.

These last two points specifically addresses issues relevant to creditor priority and restructuring mechanisms that can be associated with either RPR or APR, showing the Directive's balance between preserving traditional priority structures and allowing modifications to facilitate restructuring and economic recovery.[13]

For these reasons, by means of focusing on early restructuring and improving the chances of recovery for businesses in distress, the EU aims to bolster economic stability, maintain high levels of employment, and improve outcomes for creditors and investors. The Directive is a step towards a more uniform legal framework for insolvency in Europe, aiming to reduce discrepancies in insolvency outcomes among Member States and to foster a more predictable and secure investment environment by introducing a uniform restructuring tool across the EU to prevent insolvencies. This directive addresses the need to harmonize national laws and procedures related to preventive restructuring, insolvency, debt discharge, and

[11] Directive 2019/1023, art 11.
[12] Directive 2019/1023, art 9(4),(6).
[13] Directive 2019/1023, art 11(1)(c) and art. 2

disqualifications, as these legal frameworks significantly influence business location decisions within the internal market and for foreign investors.

All things considered, the Restructuring Directive offers various options for Member States to enhance or establish pre-insolvency restructuring frameworks and tailor them according to their legal tradition and current business needs.

3. Preventive Restructuring Procedure as per the Directive

According to the Directive, debtors with viable enterprises facing potential insolvency should have access to a Preventive Restructuring Framework to avert insolvency.[14] The Directive establishes the basic framework but leaves key procedural elements to the Member States' discretion. For example, national legislators must define terms like “insolvency,” “likelihood of insolvency,” and “SMEs,”[15] and introduce a viability test as a prerequisite for accessing the preventive restructuring procedure.[16] Once an enterprise meets the criteria for likelihood of insolvency and passes the viability test, the debtor can choose to enter the Preventive Restructuring Framework and submit a restructuring plan.[17] Article 8 of the Directive outlines a non-exhaustive list of elements that the restructuring plan should address.[18] The plan can include various measures such as extending or reducing debt, debt-for-equity swaps, and the sale of assets or business units. The proposed plan must then be voted on by the affected parties[19]. The Directive mandates that these parties be grouped into separate classes to reflect a commonality of interest.[20] While the criteria for forming these classes are to be determined by national law, the Directive requires that, at a minimum, secured and unsecured creditors be placed in separate classes.[21] Once the required majority vote of affected parties is achieved in each class[22], the consensual plan becomes binding on all affected parties, including dissenting voters, provided it meets several conditions outlined in Article 10(2). One such condition,

[14] Directive 2019/1023 rec. 1 and art. 1(1)
[15] Directive 2019/2013, art. 2(2)
[16] Directive 2019/2013, rec.36
[17] Directive 2019/1023, art. 4 (7)
[18] Directive 2019/1023, art. 8 (1)

[19] As per art. 2(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.

[20] Directive 2019/1023, art. 9 (3)
[21] Directive 2019/1023, art. 4 (4)
[22] Directive 2019/1023, recital 47

which must be verified by a judicial authority upon request of the affected parties, is adherence to the 'best-interest-of-creditors test'. This test ensures that no dissenting creditor receives less value under the plan than they would in a liquidation scenario, whether through piecemeal sale, as a going concern, or under the next best alternative restructuring plan.[23]

To mitigate holdout behaviors, the Directive has introduced a cross-class-cram-down mechanism similar to that found in the US Chapter 11.[24] Under this mechanism, a plan that does not gain the required majority in one or more classes can still become binding if it meets additional criteria: i) it must be accepted by at least one affected class that stands to gain value (in the money)[25], and ii) it must comply with either the EU RPR or APR.[26]

4. RPR and APR- General Overview and Regulation as per the Directive

As it was clarified earlier in this thesis, the Directive on Preventive Restructuring and Second Chance aims to protect viable enterprises and honest entrepreneurs likely to become insolvent from entering formal insolvency procedures. According to the Directive, the starting point in any restructuring process is a restructuring plan, which details strategies for debt restructuring and fund-raising to overcome financial distress. If the plan meets the Directive's conditions and gains the required majority vote in each voting class of affected parties, it becomes enforceable against all affected parties.[27]

A restructuring plan that fails to secure the necessary majority vote in every voting class can still be enforced against dissenting creditors using a cross-class cram-down mechanism, which was explained in 2.2.(7) of this work. What is important to be mentioned again is that this mechanism ensures that the plan can proceed despite opposition from certain creditor classes, thereby preventing hold-out behaviors that could otherwise obstruct the restructuring process. For the cram-down to be applied, the plan must be approved by at least one impaired class and meet certain fairness criteria to protect the interests of dissenting creditors. As a result, this approach balances the need for efficient restructuring with the protection of creditor rights.

[23] Definition of the "best-interest-of-creditors-test" is in the Directive Art. 2(6); also recitals 49 and 50

[24] 11 U.S.C. §§ 1101-1195, available at https://www.law.cornell.edu/uscode/text/11/chapter-11.

[25] According to Article 11(1)(b)(ii) of the Directive, the assessment of whether a class is considered "in the money" is based on the going concern value of the enterprise.

[26] Directive 2019/1023, art. 11 (1) and (2); also recital 55

[27] Directive 2019/1023, art. 9

Furthermore, to ensure adequate protection for dissenting creditors, the Directive requires Member States to implement several conditions for judicial enforcement of a non-consensual plan.[28] One such condition is the distribution of value to dissenting classes of creditors according to a priority rule, namely the Absolute Priority Rule (APR) or the Relative Priority Rule (EU RPR). Member States can choose which priority rule to implement. This paper's core research question is: which priority regime, the APR or the EU RPR, aligns best with basic insolvency law goals?

4.1. Absolute Priority Rule (APR)

Under the APR, claims of creditors in a dissenting class must be fully satisfied before any value can be distributed to junior classes. What is more, in contrast with the RPR, which shall be explained further in this paperwork, the APR adheres to a strict order of priority where all claims of a higher priority class must be fully satisfied before any value can be passed down to junior classes.

The order of priority as per the Absolute Priority Rule derives from Chapter 11 of the US Bankruptcy Code.[29] Chapter 11's Absolute Priority Rule (APR) establishes a strict hierarchy that orders claims from secured creditors at the top to equity holders at the bottom, ensuring each class is fully satisfied before any distribution to junior classes. The hierarchy prioritizes:

1. Secured Creditors**:** At the forefront, those with collateral-backed claims, such as financial institutions and bondholders with secured interests in the company's assets, are guaranteed full satisfaction first.
2. Administrative and Priority Claims**:** This includes costs associated with the bankruptcy process, such as legal and court fees, and certain priority debts like employee wages, benefits, and taxes, essential for maintaining business operations during restructuring.
3. Unsecured Creditors**:** This group, which includes suppliers, bondholders, and other entities with contractual obligations not backed by collateral, follows next. Although lower in priority, their claims often represent a significant portion of the company's liabilities.

[28] Article 11 of the Directive outlines a set of criteria that a non-consensual restructuring plan must meet to be enforceable against dissenting creditors.
[29] 11 U.S.C. §§ 1101-1195, available at https://www.law.cornell.edu/uscode/text/11/chapter-11.

4. Equity Holders: At the bottom, owners or shareholders receive any remaining assets only after all creditor classes have been paid, often resulting in little to no recovery for this group in bankruptcy[30].

This structured approach ensures predictability and fairness in insolvency outcomes by respecting the established hierarchy of claims.

Given these points, this means that under APR, if dissenting creditors belong to a senior class, they must be fully paid off according to their original terms before any assets or payments can be distributed to junior creditors. Therefore APR is more rigid and can potentially make restructuring negotiations more difficult because it leaves less room for compromise and requires full payment to senior creditors, regardless of the overall impact on the company's ability to successfully restructure. In the following sections of this thesis, a more detailed exploration of the Absolute Priority Rule will be provided to enhance understanding and illustrate its key aspects more effectively.

4.2. Relative Priority Rule (RPR)

In October 2018, the European Council introduced via a last-minute change the EU Relative Priority Rule, allowing for the more flexible treatment of dissenting creditors, as long as they are treated more favorably than junior classes.[31] This amendment, supported by the European Parliament[32], aims to avoid the burdensome requirements of the APR[33]. While the APR is seen as a creditor protection measure, the EU RPR offers flexibility, potentially reducing costs and procedural rigidity.

[30] Gilson, Stuart C., Creating Value Through Corporate Restructuring: Case Studies in Bankruptcies, Buyouts, and Breakups, 2nd ed. (John Wiley & Sons, Inc., 2010), p.20-60

[31] Proposal for a Directive from the European Parliament and the Council of Europe dated 16 October 2018, on preventive restructuring frameworks, second chances, and measures to enhance the efficiency of restructuring, insolvency, and discharge procedures, amending Directive 12536/18, 2016/0359 (COD), 'General approach', p.5-6 ('October 2018 Directive').

[32] The European Parliament approved the proposed text from October 2018 on 28 March 2019. Refer to the European Parliament legislative resolution of 28 March 2019 regarding the proposal for a directive on preventive restructuring frameworks, second chances, and measures to improve the efficiency of restructuring, insolvency, and discharge procedures, amending Directive 2012/30/EU (COM (2016) 0723 - C8-0475/2016 - 2016/0359 (COD)).

[33] It appears that the preferred rule is the RPR, as Article 11(1)(c) of the Directive permits the application of the APR as an exception to the RPR.

The new EU RPR introduces a degree of flexibility in how creditors' claims are treated during a restructuring process. Consequently, under RPR, it is permissible for dissenting creditors to receive a more favorable treatment compared to junior creditors, even if their claims are not fully satisfied. This means that dissenting creditors can be offered better terms or partial payments before junior creditors (like shareholders or unsecured creditors lower in the hierarchy) receive any value. Therefore the RPR in the EU's restructuring framework offers a significant shift in how the claims of different classes of creditors are managed during the financial restructuring of a company. Here's a more comprehensive explanation on the context and flexibility nature of RPR.

4.2.1. Mechanism of RPR

The RPR allows for more favorable treatment of dissenting creditors than their rank in the claims hierarchy would typically permit, even if their claims are not fully satisfied. Instead of requiring these dissenting creditors to be fully paid off before any junior creditor can receive payments, RPR allows for partial payments to senior dissenting creditors if it helps facilitate a restructuring agreement that is more likely to save the company. This flexibility is strategic, aiming to enable more practical and mutually agreeable restructuring plans. By not strictly binding the process to fully satisfy dissenting creditors first, RPR allows for a distribution of resources that might better serve the overall goal of keeping the company viable, potentially benefiting all parties in the long term.

4.2.2. Benefits of a Flexible Approach

This flexibility can make it easier for companies to reach an agreement with creditors, as it allows negotiation space to offer dissenting creditors a deal that, while not fully satisfying their claims, might offer them better recovery than in a liquidation scenario. By facilitating these agreements, RPR can help avoid company liquidation, which typically results in lower recoveries for all creditors. It aims to keep the company operating, which might offer better outcomes even for junior creditors who might otherwise receive little to nothing in a strict liquidation process under the Absolute Priority Rule (APR).

4.2.3. Implications

The RPR attempts to balance the immediate financial interests of dissenting creditors with the broader economic interest of keeping the company operational, which can be crucial during economic downturns where salvaging companies can prevent broader economic repercussions. While RPR might be criticized by those who prefer the certainty and strict order of APR, it is supported by others who see value in the flexibility and potential for increased overall recovery rates through continued business operations. The two positions-pro and con- shall be reviewed further in this thesis.

In essence, RPR is about finding a pragmatic middle ground where the interests of dissenting creditors are sufficiently respected without allowing their needs to completely obstruct potentially beneficial restructuring efforts that could save the company and improve recoveries for all involved in the longer term. Similarly, this flexibility aims to facilitate more agreeable and practical restructuring agreements that can help save a distressed company while still providing some protection to dissenting creditors.

The statement illustrates how the Relative Priority Rule (RPR), by offering flexible treatment for dissenting creditors, makes restructuring more adaptable to the needs of various stakeholders compared to the rigid framework of the Absolute Priority Rule (APR). This flexibility is intended to increase the success rate of reorganizations by allowing customized solutions that preserve the distressed company’s value and protect jobs while still respecting the claims hierarchy to a reasonable degree. The RPR is preferred over the APR, as shall be illustrated further in this thesis, in most Member States, because it enhances restructuring efficiency, encouraging consensual agreements between creditors and debtors that can result in distributions different from those under APR. This acknowledges the complexity of modern business distress and the importance of maintaining a going concern’s value, challenging the notion that strict adherence to priority rules always maximizes creditor value. [34] Consequently, the RPR is seen as a flexible tool aimed at balancing diverse stakeholder interests in the restructuring process, reflecting a pragmatic and outcome-focused approach to insolvency proceedings.[35]

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[34] Pottow, John A. E., 'Cross-Border Corporate Insolvency in the Era of Soft(ish) Law' (2018) 18 Journal of Corporate Law Studies p. 305, p. 310

[35] Mark Roe and Frederick Tung, Corporate Restructuring and the Evolution of the Insolvency Framework: A Comparative Analysis (2019) 59 International Review of Law and Economics p. 105, p. 117.

5. Development of Priority Regulations in Bankruptcy Law

In restructuring procedures, the two primary concepts that have sparked significant debate among scholars globally are the relative priority rule (RPR) and the absolute priority rule (APR), which are in the focus also of this thesis. The APR, regarded as "fundamental," has a long-standing history in the operation of the US Bankruptcy Code[36], particularly Chapter 11. Conversely, the RPR has recently been introduced into EU law through the EU Restructuring Directive, reviewed in the first part of the present thesis. Despite its recent implementation in the EU, the notion of relative priority in US law is much older and differs from the European concept, which is considered revolutionary and has faced substantial criticism.[37]

5.1. Review of the RPR and APR in the USA Context

To critically discuss the RPR in light of the EU's innovative rule, which is the objective of the present thesis, one must begin with the basics, examining the APR and its alternative, the RPR, in US restructuring procedures.

Chapter 11 of the US Bankruptcy Code facilitates the debt restructuring of financially troubled companies, enabling them to propose a reorganization plan that allows continued operation while repaying creditors over time.[38] The aim of Chapter 11 is to preserve the company's assets through reorganization rather than selling them for their liquidation value[39] .The reorganization plan must first gain approval from various classes of creditors and shareholders and then be confirmed by the court. The law mandates that the conditions outlined in section 1129 of the US Bankruptcy Code be met before the court can confirm the plan. A notable feature of Chapter 11 is the cramdown provision, which allows the court to confirm the plan even if one or more impaired classes of creditors reject it, provided that at least one impaired class approves it by voting.[40] Chapter 11 includes protections for minority creditors, requiring the plan to pass the "best interest of the creditors" test, ensuring that impaired creditors receive no less than they

[36] 11 U.S.C. §§ 1101-1195, available at https://www.law.cornell.edu/uscode/text/11/chapter-11.

[37] de Weijs RJ, Jonkers AL and Malakotipour M, 'The Imminent Distortion of European Insolvency Law: How the European Union Erodes the Basic Fabric of Private Law by Allowing "Relative Priority" (RPR)' (2019) Amsterdam Law School Research Paper No 2019-10, Centre for the Study of European Contract Law Working Paper No 2019-05 https://ssrn.com/abstract=3350375

[38] Jonathan M. Seymour and Steven L. Schwarcz, 'Corporate Restructuring under Relative and Absolute Priority Default Rules: A Comparative Assessment' (2021) 2021 U Ill L Rev 1, 1-36

[39] Jennifer Payne, 'Creditor schemes of arrangement: debt restructuring', in Schemes of Arrangement: Theory, Structure and Operation (Cambridge University Press 2021) 5.8.1.1

[40] 11 USC § 1129(10)

would in a liquidation scenario. The plan must also ensure fair treatment for each class of creditors and be fair and equitable.[41] Additionally, the plan should adhere to the absolute priority rule, which stipulates that senior class creditors must be fully paid before junior class creditors and that senior creditors cannot receive more than 100% of their claim, while junior creditors receive less than 100%.[42] However, Chapter 11 allows for different allocation rules if the parties agree, making the APR not mandatory[43]

In the United States, the concepts of absolute and relative priority were first compared by James C. Bonbright and Milton M. Bergerman in their 1928 work, "Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization." These ideas were extensively debated throughout the 1930s, but the absolute priority rule ultimately prevailed, despite ongoing criticism.[44] The APR dictates that senior creditors must be paid in full before junior creditors receive any payment, and junior creditors must be satisfied before equity holders receive anything. This means that if the company's assets are insufficient, junior creditors may receive nothing.[45] Conversely, under the RPR, which was popular until the late 1930s in the U.S., the reorganized capital structure includes all parties. Senior investors forgo default in exchange for equity in the reorganized firm, while junior creditors receive a call option, exercisable at a later stage, with the option price equating to the outstanding debt to the senior investor.[46] A few years ago, in 2014,[47] this discussion resurfaced with proposed statutory amendments and a potential return to the concept of relative priority.[48]

The contemporary understanding of priority under Chapter 11 of the U.S. Bankruptcy Code is described by Baird as a hybrid approach, blending elements of both absolute and relative priority, making it more effective than strict adherence to the APR.[49] Baird argued that absolute priority might be more effective in scenarios involving the market sale of a distressed company, where the goal is to maximize value. He identified a challenging fit within Chapter 11 between

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[41] 11 USC § 1129(a)(7), § 1129(b)

[42] Payne, J. (n.7), 5.8.1.1

[43] Seymour JM and Schwarcz SL, (n 6)p. 3

[44] Baird DG, 'Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy' (2017) 165 U Pa L Rev p.786

[45] Ibid, p.790

[46] Ibid, p.793-796

[47] American Bankruptcy Institute (ABI) Commission to Study the Reform of Chapter 11, Full Report (2014), available at: https://commission.abi.org/full-report

[48] Baird DG., (n.12), p.787

[49] Ibid, p.786, 829

the absolute priority framework and the court's valuation process, as opposed to an actual market sale price, suggesting that relative priority would be a more suitable approach.[50]

Despite various criticisms, the absolute priority rule has been affirmed by scholars as a "cornerstone of reorganization practice and theory" and the "most important and famous" rule.[51] Recently, it was reaffirmed as a longstanding fundamental rule in Czyzewski v. Jevic Holding Corp., 580 U.S. (2017). In Jevic, the Supreme Court addressed whether the distribution order could be altered for a perceived greater good without the affected creditors' consent, answering in the negative.[52] Additionally, Jevic highlighted another crucial aspect of priority: it not only requires preserving the order of final rights allocation but also upholding the values of the process itself to ensure "participation, predictability, and procedural integrity." It emphasized that the powers of senior creditors in Chapter 11 must be balanced to avoid undermining these values.[53] The absolute priority rule allows senior creditors to benefit from the entire current value of the going concern, originally introduced to prevent the exclusion of junior creditors by senior creditors and shareholders during the reorganization of railroad companies in the late 19-th century.[54] Similarly, in Bank of America v. 203 North LaSalle Street Partnership,[55] the court held that the absolute priority rule emerged to prevent insiders, whether management or senior creditors, from gaining an unfair advantage in the reorganization process.[56]

5.2. Comparison of RPR and APR in the EU and the USA

The EU Directive on restructuring and insolvency, in a surprising last-minute change, as stated earlier in the present thesis, introduced an alternative to the long-established Absolute priority rule by allowing Member States to adopt the Relative priority rule. This EU RPR, however, differs significantly from the US version. Scholars argue that while the US relative priority rule mainly differs from absolute priority in the timing of rights assessment, the EU relative priority

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[50] Ibid, p.788

[51] Lipson, Jonathan C., The Secret Life of Priority: Corporate Reorganization after Jevic (October 20, 2017). 90 Washington Law Review, 2018, Forthcoming, Temple University Legal Studies Research Paper No. 2018-04, p.646

[52] Ibid., p.636

[53] Lipson, J, (n. 19), p.639

[54] McCormack, G, The European Restructuring Directive (Edward Elgar Publishing Limited 2021) 6.61

[55] Bank of America National Trust and Savings Association v 203 North LaSalle Street Partnership

[56] McCormack G., (n 22), 6.62

rule disregards all priority rights[57], resulting in the "reshuffling and curtailing of pre-existing rights."[58] According to the APR, as already mentioned, dissenting creditors must be fully paid before any value is distributed to a lower-ranking class. The inclusion of the APR as a mandatory criterion when cramming -down a dissenting class represents a balanced approach. While the cross-class cram-down mechanism related to the RPR mitigates potential holdout behaviors and aids in implementing the restructuring plan, the APR safeguards dissenting creditors by ensuring their full payment before junior classes receive any value. This statement shall be explained in more details further down in the present work. However, what is important, this new mechanism has raised numerous concerns and doubts among scholars.

5.3. Critique and Support by European Academics

According to the EU's relative priority rule (RPR), under Article 11 (1)(c) of the Restructuring Directive, dissenting voting classes of affected creditors are treated at least as favorably as any other class of the same rank and more favorably than any junior class. Additionally, shareholders may retain their interests in the company even if senior classes are not fully satisfied. The Directive offers the absolute priority rule as an alternative option-Article 11 (2). Generally, the EU RPR allows for deviation from creditors' pre-agreed contractual priorities when a company faces financial difficulties. Proponents argue that this provides greater flexibility and fairness, while critics contend it reduces predictability and could harm the economy.[59] The risk lays in the fact that “the creditors are left with the liquidation value and the shareholders may try to usurp all or most of the going concern surplus”. The scholars further worry that the EU RPR might undermine fundamental private law principles by permitting wealth transfer from creditors to shareholders under the guise of flexibility, company preservation, and job retention. Also the “best interest of creditors test” under Article 10 (2)(d) of the Directive which seems to be fine at first glance, does not itself protect sufficiently the creditors in case of cross-class cram-down as the creditors are at risk of receiving only the liquidation value and the shareholders an usurp the going concern surplus, as already mentioned.[60] This raises questions about fairness, particularly for creditors, as the EU RPR could subsidize shareholders at creditors' expense, creating perverse incentives and

[57] McCormack, G, The European Restructuring Directive (Edward Elgar Publishing Limited, 2021) 6.61
[58] McCormack G., (n.22), 6.77
[59] De Weijs RJ, Jonkers AL and Malakotipour M, 'The Imminent Distortion of European Insolvency Law: How the European Union Erodes the Basic Fabric of Private Law by Allowing Relative Priority (RPR)' Amsterdam Law School Legal Studies Research Paper 2019-p.10, 5.
[60] Ibid, p.7.

encouraging over-indebtedness and strategic insolvency filings.[61] Comparing creditors' claims with shareholders' interests is inherently challenging, making the relative treatment of different classes difficult to implement. While treating creditors as favorably as other classes sounds appealing, it may lead to uncertainty and arbitrary outcomes rather than genuine flexibility.[62]

The severe criticism by Prof. Weijs has not gone unanswered, as Prof. Bob Wessels provides five reasons in support of the EU RPR in his 'The Full Version of My Reply to Professor De Weijs et al' (2019).[63] He highlights that the EU RPR is distinct from the US relative priority rule and is founded on three main principles: the debtor is not actually insolvent; managers and shareholders are incentivized to engage in the restructuring process; and there is uncertainty in valuation and actual business value.[64]

The first justification is logical because, in the case of actual insolvency, creditors are entitled to the assets upon enforcement, and shareholders would not receive anything due to their subordinate position under liquidation rules. However, if the company is not yet insolvent, it retains some value, shareholders still hold equity, and excluding them would violate property rights. Prof. Wessels contends that applying insolvency rules, including absolute priority, is unjustified as it contradicts the EU Restructuring Directive's objectives, which are to prevent insolvency and promote early-stage restructuring.[65]

The EU directive's provision for Member States to choose between the two priority rules—relative and absolute—offers flexibility, allowing consideration of market specificities and social factors to protect employment and preserve economic activities.[66] This approach requires carefully balancing all stakeholders' interests, thereby serving the broader social interest and the economy itself.[67]

The Relative priority rule in the Directive appears to benefit equity holders and junior creditors more favorably in terms of the proportion between what they are owed and what they ultimately receive. However, the final outcomes are unpredictable and may not meet expectations. Unlike

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[61] Ibid, p.23.
[62] Ibid, p.24.
[63] Available at: https://bobwessels.nl/blog/2019-03-doc10-the-full-version-of-my-reply-to-professor-de-weijs-et-al/
[64] McCormack, G, The European Restructuring Directive (Edward Elgar Publishing Limited 2021) 6.81
[65] McCormack, G, The European Restructuring Directive (Edward Elgar Publishing Limited 2021) 6.83
[66] Wessels B, 'The Full Version of My Reply to Professor De Weijs et al' (2019), (n.32)
[67] McCormack G., (n.22), 6.85

creditors, who receive a fixed return on their debts, shareholders' returns are contingent on the business's success and eventual profits. As McCormack aptly put it, "shareholders get the gains but should also suffer the pains."[68]

Another notable but discussed upon feature of the EU Restructuring Directive is the cross-class cramdown mechanism, which permits a restructuring plan to be enforced on all creditor classes, even those that have not approved it.[69] The Directive mandates that the plan be sanctioned by a majority of the voting classes, as long as at least one is either a secured creditor, senior to an unsecured creditor, distinct from the equity holders, or if the going-concern value indicates it is out of money.[70] Similar to Chapter 11 in the U.S., several conditions must be satisfied for the plan to be confirmed. These include meeting the "best interest of creditors test" and the "fairness test," which comprises three subtests: first, the priority rule, which can be either the absolute priority rule as in U.S. Chapter 11 or the EU Directive's innovative relative priority rule, with Member States choosing between them; second, ensuring that the affected party class does not receive more than it is entitled to; and third, adhering to the "no unfair discrimination principle," ensuring dissenting classes are treated as favorably as other classes of the same rank.[71] The primary distinction between the U.S. Chapter 11 cross-class cramdown mechanisms and those under the EU Directive is the Member States' option to adopt the relative priority rule, along with its associated advantages and disadvantages.

In conclusion, while the relative priority rule introduced by the EU Restructuring Directive has faced significant criticism, it is essential for scholars to follow up the implementation and use by the Member States before dismissing it outright. The harshest critics raise issues regarding fairness and practicality, yet supporters emphasize the importance of considering the broader context of social concern and economic stability. Historical evidence indicates that rigidly adhering to a single priority rule often results in challenges, suggesting that allowing the flexibility to choose between relative and absolute priority could prove to be an effective approach.

[68] Ibid., 6.90
[69] Payne, J. (2021) 'Creditor schemes of arrangement: debt restructuring', in Schemes of Arrangement: Theory, Structure and Operation. Cambridge: Cambridge University Press, 5.8.1.2.
[70] Ibid., 5.8.1.2
[71] Directive 2019/1023, Art. 11(1)(d) and Art. 11(1)(c)

6. Insights from some Member States on Transposition of the Directive (Austria, the Netherlands and Bulgaria)

By June 2022, most European Union (EU) Member States had reached the extended deadline to implement the EU Preventive Restructuring Directive (Directive 2019/1023), marking the EU's initial substantive, though limited, harmonization effort in restructuring and insolvency legislation. Expectations have varied: some anticipate that it will lead to only a minimal level of harmonization[72], while others believe that reforms in national laws could boost the economies of specific jurisdictions, particularly those that lack a preventive restructuring framework[73] (for example Denmark and the Netherlands).

What is more, with the transposition of Directive 2019/1023 into the national laws of most Member States, it is now timely to evaluate its effectiveness and compare the approaches of three Member States in choosing between the Relative Priority Rule (RPR) and the Absolute Priority Rule (APR). Furthermore The Directive was aimed at ambitious goals, notably as part of the effort to create a Capital Markets Union, aiming to diminish legal uncertainties and reduce the costs associated with cross-border investments and create a truly singe market for capital across the European Union. The question remains whether Directive 2019/1023 has met these targets. The PRD 2019 has received mixed reviews: it has been praised as “a milestone in the harmonization movement”[74], criticized as “a radical and substantive reform”[75], and even described as “a refuge for failing firms”[76]. Despite restructuring and insolvency law being considered “one of the last vestiges of a nationalistic, codified approach to private law on the European continent”[77], the PRD 2019 suggests that harmonization is possible. However, this

[72] D.C. Ehmke, J.L.L. Gant, J.M.G.J. Boon, L. Langkjaer & E. Ghio, ‘The European Union preventive restructuring framework: A hole in one?’ (2019) 28(2) International Insolvency Review para 5.

[73] European Bank for Reconstruction and Development, EBRD Insolvency Assessment on Reorganization Procedures, 2022, p.4, 10; R.P. Freitag, ‘General Aspects of the Directive on Restructuring and Insolvency’ (2022)

[74] M. Vanmeenen, ‘Pre-Insolvency Arrangements: The Belgian Experience’, in: R. Parry and P.J. Omar (eds.), Reimaging Rescue (INSOL Europe 2016) p.162.

[75] D.C. Ehmke, J.L.L. Gant, J.M.G.J. Boon, L. Langkjaer & E. Ghio, ‘The European Union preventive restructuring framework: A hole in one?’, International Insolvency Review, 2019, 28(2), para 1.

[76] H. Eidenmüller, ‘The Rise and Fall of Regulatory Competition in Corporate Insolvency Law in the European Union’ (2019/20) European Business Organization Law Review, p. 559.

[77] J.H. Dalhuisen, ‘Harmonization of substantive Insolvency Law in the EU’, Maandblad voor Vermogensrecht, 2021/5, p. 159, who uses this quote to refer to the more recent publication by the European Commission, Proposal for a Directive of the European Parliament and the Council harmonising certain aspects of insolvency law, 7 December 2022, COM(2022) 702 final.

potential depends not only on the directive's adoption but also significantly on its effective transposition, thus creating a harmonized EU legislation.

Although the EU legislator granted considerable leeway to Member States in implementing the Directive, which at first glance is praiseworthy as it allows for adjustments to local conditions, this flexibility also poses challenges to harmonization, permitting countries to craft their unique tailoring that may hinder actual convergence and divert from the initial intention of reaching a maximum harmonization in the preventive restructuring.

This analysis will specifically provide and overview on the reforms in preventive restructuring laws, thus aiming to achieve the objectives of the Directive in harmonization of the European Union legislation, as the focus shall be on the Relative Priority Rule (RPR) and Absolute Priority Rule (APR), alternatively, at the domestic level in three Member States: Austria, the Netherlands and Bulgaria.

6.1. Austria

The Austrian implementation of the Directive was accomplished by introducing a new Restructuring Code ("ReO")(*Restrukturierungsordnung*) in July, 2021[78]. There is significant debate about whether the ReO truly enhances Austria's current restructuring and insolvency framework. However, it may still offer mechanisms and resources that could aid in promoting a culture of preventive restructuring and business rescue.

6.1.1. Historical Development of Preventive Restructuring

However the concept of restructuring is not new to Austria. As early as 1914, and even as far back as 1862, the Austrian legislator enacted the Austrian Settlement Code (Ausgleichsordnung, "AO")[79], which enabled debtors to restructure their debts through collective proceedings by reaching agreements with the majority of their creditors. The AO featured a debtor-in-possession model overseen by a court-appointed administrator, included provisions for a moratorium, and mandated a minimum quota of 40%. Unfortunately, mainly because of this high minimum quota, these proceedings were seldom utilized in practice.

[78] Austrian Restructuring Code (Restrukturierungsordnung), Federal Law Gazette Nr. I 2021/147
15 Austrian Settlement Code (Ausgleichsordnung) National Law Gazette Nr. 1915/337

Later, in 1997, the Austrian legislator introduced the "reorganization proceeding" through the Business Reorganization Act (Unternehmensreorganisationsgesetz, "URG") in 1997.[80] The URG was established to promote timely and well-thought-out reorganization strategies[81] by allowing debtors in need of reorganization to undergo confidential proceedings[82]. Despite the high aspirations of the URG legislators, which align closely with the intentions behind PRD 2019, the reorganization proceedings under URG have not gained practical acceptance. [83] This lack of acceptance is likely due to the high costs involved and the absence of provisions for a moratorium or mechanisms to force and cram-down dissenting creditors into accepting restructuring measures like debt haircuts.[84] Despite its very low practical relevance and widespread expectations that it would be amended or repealed by the implementation of the Preventive Restructuring Directive, the URG remains in effect. However, neither amendment nor repeal has occurred.

Another very important piece of legislation is The Austrian Insolvency Code (Insolvenzordnung, “IO”). It constitutes a comprehensive framework for managing insolvency in Austria. Originating from the Austrian Bankruptcy Code of 1914 (Konkursordnung, “KO”), it has undergone significant updates over the last century, with the most substantial reform in 2010, which consolidated and modernized the KO and AO into the IO.[85] The IO now provides three types of insolvency proceedings for companies: rehabilitation proceedings without self-administration (Sanierungsverfahren ohne Eigenverwaltung), rehabilitation proceedings with self-administration (Sanierungsverfahren mit Eigenverwaltung), and bankruptcy proceedings (Konkursverfahren). These proceedings can be utilized to restructure or liquidate a business, with rehabilitation proceedings also serving as a potential means for winding down

[80] Business Reorganization Act (Unternehmensreorganisationsgesetz) Federal Law Gazette Nr. I 1997/114

[81] See Legislative Materials, Regierungsvorlage 734/XX. 10 June 1997, p.75

[82] Such reorganization need is presumed if certain financial figures are met (Section 22(1) n 1 URG), specifically if the equity ratio according to Section 23 URG is below 8% and the fictional debt repayment period according to Section 24 URG exceeds 15 years

84 See e.g. G Wabl, ‘Preventive Restructuring Mechanisms in Austria: More Flexibility Needed? A Practical Analysis of Existing Tools and Possible International Impacts’ (2017) 14(4) Intl Corp Rescue 249.

[84] These points were already raised in the legislative process preceding the URG (see Legislative Materials, Regierungsvorlage 734/XX. 10 June 1997, 75-76); see also G Wabl, above n 8.

[85] Insolvency Law Amendment Act 2010, Federal Law Gazette Nr. I 2010/29; A. Konecny, ‘Das Verfahrensgebäude der Insolvenzordnung‘, in A. Konecny (ed), *ZIK Spezial: IRÄG 2010* (LexisNexis 2010) 1-21, 5-6 (‘einheitliches Insolvenzverfahren’); see also G. Kodek in C. Koller, E. Lovrek & M. Spitzer (eds), *IO – Insolvenzordnung* (Wien 2019) § 1 para 14-15.

operations.[86] Although bankruptcy proceedings were initially designed to liquidate the debtor's assets to satisfy creditors, the IO now promotes restructuring and rescuing the business, even within the context of bankruptcy proceedings.

6.1.2. New Restructuring Code ("ReO")

Therefore, considering the above, this makes it the opportune moment for a comprehensive reform like the ReO. Such a reform would not have been possible without the external impetus provided by the PRD 2019. The objective of the proceedings under the ReO is to enable companies and entrepreneurs to restructure to prevent illiquidity and ensure business viability (Section 1(1) ReO). The proceedings are available to all companies and entrepreneurs, excluding specific businesses like financial institutions, insurance companies, and non-entrepreneurs (Section 2(1) ReO). Unlike some other EU member states, Austria does not provide specific provisions for enterprise groups, requiring separate restructuring proceedings for each affected group member. The ReO allows debtors to file for regular restructuring proceedings, European restructuring proceedings, or simplified restructuring proceedings, with regular and simplified proceedings being confidential and European proceedings being public.

The ReO in general follows the structure of the PRD 2019 and includes the following roles and positions:

- **The debtor**

  As a general rule, the debtor remains in possession and retains control over the assets and business operations (Section 16(1) ReO).

- **Restructuring expert**

  Restructuring experts must possess substantial experience, including specialized knowledge in restructuring and insolvency laws, business law, and business administration (Section 11(1) ReO). Additionally, restructuring experts must be independent (Section 11(2) ReO). The restructuring court is responsible for selecting

[86] E.g. through a "Liquidationstreuhandschaft" (Section 157m IO), see S. Riel, 'Verfahrensrechtliche Fragen beim Treuhandsanierungsplan', Österreichisches Bankarchiv, 2015, 63(12), 880-889, 881; M. Trenker, *Treuhänderüberwachung der Sanierungsplanerfüllung* (Manz 2017) 219-220.

the experts, with neither the debtor nor creditors having a formal right to influence the selection process. There is also a public registry where restructuring experts can be listed.

- **Restructuring court**

The court handling restructuring proceedings is the same as for insolvency proceedings under the IO (Section 4 ReO in conjunction with Section 63 IO), which is the first instance court where the debtor conducts business at the time of application.

- **Creditors**

Creditors are not entitled to file for restructuring proceedings or present a restructuring plan. This monopoly power belongs to the debtor. [87] Only the debtor can initiate restructuring proceedings. For companies, the authorized representatives (such as directors of a limited liability company) have the right to apply for these proceedings. Creditors, shareholders, or other parties do not have the entitlement to apply for restructuring proceedings.[88]

However, creditors remain integral to the proceedings if impacted by the restructuring plan, allowing them to exercise their voting rights as stipulated in Section 32 (1) ReO. They must be divided into predefined creditor classes:

- **Workers**

Workers' claims are excluded from restructuring proceedings (Section 3 (1) ReO), and their rights under individual or collective labor agreements remain unaffected by the

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[87] The debtor has the monopoly on initiative (Initiativmonopol) (M Trenker, also note 24, ReO § 27 para 6; see further P Fidler in P Fidler, A Konecny, S Riel & M Trenker (eds)

[88] M. Schimka, 'Gesellschaftsrechtliche Überlegungen zur Restrukturierungsordnung', Der Gesellschafter, 2021, 50(6), p. 374-379 (p. 378); M. Trenker in: P. Fidler, A. Konecny, S. Riel & M. Trenker (eds), ReO – Restrukturierungsordnung und die weiteren Bestimmungen des RIRUG, Manz: Wien, 2022, ReO § 27 para 6; see also F. Mohr, 'Einleitung und Ablauf des Restrukturierungsverfahrens', in: A. Konecny (ed), ZIK-Spezial: RIRUG – Neuerungen im Restrukturierungs- und Insolvenzrecht, LexisNexis: Wien, 2021, p. 67-84 (p. 70).

restructuring or plan (Section 43 ReO). However, the debtor must inform employee representatives per Article 13 PRD 2019.

- **Equity holders/shareholders**

  Although equity holders are crucial for the success of restructuring proceedings under the ReO, there are few provisions addressing them.

- **Directors**

  For companies, the ReO outlines specific responsibilities for directors related to the likelihood of insolvency (Section 1 (3) ReO), which largely align with Article 19 of PRD 2019.

As mentioned multiple times beforehand, the objective of this thesis is to explore issues related to creditor priority and restructuring mechanisms, particularly in the context of RPR and APR. Consequently, the further analysis of the ReO will focus primarily on the restructuring plan and its adoption, the classification of creditors, the best interest of creditors test, the cross-class cram-down (fairness test), and finally on the Austrian legislator's preference for adopting the RPR.

The Restructuring Plan

As previously mentioned, only the debtor has the authority to submit a restructuring plan to the restructuring court. This plan can be filed either along with the application for the proceedings or within a deadline of no more than 60 days, as determined by the court (Section 27 (1) in conjunction with Section 8 (2) ReO). The plan must contain a comprehensive list of information, detailed in Section 27 (2) ReO, which closely resembles the requirements outlined in Article 8 (1) PRD 2019.

Creditors Classes Formation

Section 29 ReO provides a mandatory and exhaustive list of classes to be formed,[89] if applicable. These classes include secured creditors, unsecured creditors, bondholders,

[89] Legislative Materials above note 21, p. 17; M. Trenker in P. Fidler, A. Konecny, S. Riel and M. Trenker (eds), above note 24, ReO § 29 para 2, 6; M. Fellner in S. Mock and M. Zoppel (eds)

vulnerable creditors (specifically those with claims of less than EUR 10,000), and subordinated creditors (Section 29 ReO). Shareholders are not included in this list, and their legal position cannot be affected by the plan without their consent.

If creditors belong to multiple classes (e.g., partially secured creditors), they can be assigned to more than one class (Section 29 (2) ReO). Within each class, the principle of equal treatment of creditors must be maintained (Section 34 (1) n 2 ReO). "suppliers"), which limits flexibility and may draw criticism.

Creditor Selection and Pre-review of the Plan

The debtor can select which creditors to include in a restructuring plan, allowing for tailored solutions. This selection must be justified (Section 27 (2) n 6 ReO) and appropriate (Section 30 (1) n 4 ReO). For instance, only financial creditors may be included while suppliers remain unaffected. Afterwards, upon presentation, the court reviews the plan's compliance with statutory requirements, including class formation and creditor selection. If requirements are unmet, the court can set a deadline for improvements (Section 30 (2) ReO). This pre-review aims to resolve issues early.

Adoption of the Plan

Voting on the restructuring plan occurs at a court hearing scheduled 30 to 60 days after the plan is presented by the debtor (Section 31 (1) ReO) and after the plan has passed the pre-review process before this hearing. The debtor is required to send the restructuring plan to the voting creditors no later than two weeks before the hearing.

Only affected creditors can vote at the hearing, with voting rights based on claims included in the restructuring plan plus interest up to the presentation date (Section 32 (1) ReO). Affected creditors can challenge the voting rights of other creditors by contesting their claims (Section 32 (2) ReO). The court will only decide on such challenges if they could affect the voting outcome.

The plan is adopted if, within each creditor class, a simple majority in number and at least 75% in value of the creditors present at the hearing vote in favor (Section 33 (1) ReO). If any creditor class dissents, their consent can still be overridden through a cross-class cram-down.

The plan is confirmed by the court if it correspond to all the statutory requirements, as mentioned in the pre-reviewing phase. However, the extensive list of possible grounds for court refusal in Section 34 ReO may conflict with the efficiency principle intended by PRD, potentially diminishing the practical attractiveness of the ReO.[90]

Best Interest of Creditors Test

The best interest of creditors test is another crucial confirmation requirement, which the court must only examine if a dissenting creditor requests it (Section 33 (2) ReO). This test, closely mirroring the PRD 2019, and explained in details earlier in this thesis, ensures that a dissenting creditor is not treated less favorably than in the next best alternative scenario.

Cross-class cram-down (fairness test)

Section 36 ReO enables a cross-class cram-down if the required majority is not attained in every class. This provision allows a restructuring plan to be confirmed if (i) the majority of classes, including the secured creditors or the majority of the "in the money" classes, approve the plan, and (ii) dissenting creditor classes are treated no worse than those of the same rank and better than subordinated classes. The Austrian legislator has chosen to implement the relative priority rule (RPR) rather than the absolute priority rule (APR), citing that the IO already uses the RPR for dealing with statutorily subordinated creditors. Unlike other jurisdictions that may apply a "relaxed absolute priority rule," the ReO establishes the relative priority rule as the standard practice.

6.1.3. Further Conclusions from the Choice of Relative Priority Rule (RPR) by the Austrian Legislator

- **Flexibility for Restructuring Plans**

  The adoption of the Relative Priority Rule (RPR) allows for greater flexibility in structuring and confirming restructuring plans. By not strictly adhering to the Absolute Priority Rule (APR), which mandates that senior creditors must be paid in full before any value can be allocated to junior creditors, the RPR provides room for more pragmatic and tailored solutions. This flexibility can facilitate agreements that are more

[90] M. Trenker in: P. Fidler, A. Konecny, S. Riel & M. Trenker (eds), above note 24, ReO § 34 para 4.

feasible for distressed businesses, potentially leading to higher chances of successful restructurings and better overall outcomes for all stakeholders involved.

- **Encouragement of Negotiations and Compromises**

  The RPR fosters an environment where negotiations and compromises between different classes of creditors are more likely. Since the rule requires that dissenting classes be treated no worse than those of the same rank and better than subordinated classes, it encourages a more collaborative approach to restructuring. This can lead to more equitable solutions that consider the interests of all parties, rather than a rigid hierarchy that may not always serve the best interests of the company or its creditors.

- **Alignment with Existing Practices and Austrian Legal Tradition**

  Implementing the RPR aligns with the existing practices under the Austrian Insolvency Code (IO), which already incorporates relative priority in dealing with statutorily subordinated creditors. This consistency helps in maintaining a coherent legal framework, reducing confusion and uncertainty among practitioners and stakeholders. It also indicates a continuity in legal principles, which can be beneficial in providing a stable and predictable environment for restructuring and insolvency proceedings.

Implementing the RPR aligns also with Austria's longstanding legal traditions in insolvency and restructuring law. Historically, Austrian insolvency law has incorporated elements of relative priority, as seen in the existing practices under the Austrian Insolvency Code (IO) which already deals with statutorily subordinated creditors on a relative basis. This continuity ensures that the new restructuring frameworks under the Restructuring Code (ReO) are consistent with established legal principles, providing a stable and predictable environment for both practitioners and stakeholders. By maintaining this alignment, Austria upholds its legal traditions while also embracing modern, flexible approaches to business restructuring.

6.2. The Netherlands

The transposition of The Directive in the Netherlands resulted in adoption of Wet homologatie onderhands akkoord (Act on the confirmation of a private restructuring plan, WHOA). The "Wet homologatie onderhands akkoord" (WHOA) was published in the Dutch State Gazette

(Staatsblad) and came into effect on January 1, 2021.[91] The legislation was part of the Dutch legal framework to provide a pre-insolvency restructuring mechanism, allowing companies to restructure their problematic debts with court approval, thereby avoiding bankruptcy. This law was initially adopted by the Dutch House of Representatives (Tweede Kamer) on May 26, 2020, and subsequently approved by the Senate (Eerste Kamer) later that year.

6.2.1. Historical Development of Preventive Restructuring

For a long time, Dutch restructuring and insolvency law has been marked by the lack of an effective preventive restructuring framework. In the Netherlands, restructuring and insolvency issues are primarily governed by the Faillissementswet (Dutch Bankruptcy Act, DBA).[92] The DBA outlines two corporate restructuring and insolvency procedures: bankruptcy, which is liquidation-focused, and suspension of payments (surseance van betaling), which serves as a preventive restructuring mechanism. These procedures complement the limited options previously available under Dutch contract law for binding dissenting creditors in out-of-court debt restructuring before the WHOA was enacted.

Unlike bankruptcy, which focuses on liquidation, suspension of payments acts as a preventive restructuring procedure. These processes, introduced by the DBA, supplemented the limited options under Dutch contract law for binding dissenting creditors in out-of-court debt restructurings before the WHOA was implemented.

The effective changes that WHOA brought, were related to the introduction a flexible framework that allows for the proposal of restructuring or liquidation plans to a portion of the debtor's creditors and shareholders. Once confirmed by the court, these plans become binding on all included creditors and shareholders, including those who were absent or dissented.

6.2.2. Historical Overview of Dutch Plan Proceedings and WHOA

The WHOA was preceded by a long-standing debate about introducing a legal instrument for confirming extra-judicial restructuring plans. Although forbidden in 1540, local statutes

[91] Gewijzigd voorstel van wet, Eerste Kamer der Staten-Generaal (26 May 2020) https://www.eerstekamer.nl/behandeling/20200526/gewijzigd_voorstel_van_wet_3 accessed 5 June 2024.

[92] Article 1 DBA et seq. The DBA is in force since 1 September 1896. Subsequently, various amendments have been included in the DBA, see further: Bob Wessels, Insolventierecht, Faillietverklaring (Deel I), *5th* edition, Deventer: Wolters Kluwer 2019, para 1051-1053c.

evolved to allow restructuring plans.[93] The Desolate Boedelskamers in cities like Amsterdam and Dordrecht enabled debtors to negotiate plans with creditors to avoid bankruptcy.[94] The French Code de Commerce in 1811 and the Dutch Code of Commerce in 1838 later replaced these frameworks.

Discussions on statutory plan proceedings continued through the 19th to the 21st centuries, including before the DBA in 1893.[95]Advocates argued for plan proceedings to prevent bankruptcy and avoid the negative impacts of collective liquidation, while critics highlighted fairness, ownership rights, and legal uncertainty.[96]

In July 2019, the WHOA bill was presented to Parliament following a thorough public consultation process.

During the final drafting stages, Parliament engaged in extensive discussions about the positions of secured and unsecured creditors and the distribution of reorganization value under the plan. Some parliamentarians expressed concerns that under the relaxed Absolute Priority Rule (APR) and the 'cash out option', secured creditors would exert excessive control over the WHOA process, potentially claiming a disproportionately large share of the reorganization value, thereby leaving unsecured creditors with very little.

As a result, amendments were adopted to enhance the protection of unsecured small and medium-sized enterprise creditors, ensuring they receive at least 20% of their claims under the plan, even if higher-ranking creditors are not fully satisfied. Additionally, amendments limited the rights of secured creditors in two significant ways. First, unlike other creditors, certain secured creditors are not entitled to the cash out option, which allows a creditor to demand cash payment of the liquidation value of its claim instead of what is offered under the plan.[97] Second,

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[93] A Mennens, Het dwangakkoord buiten surseance en faillissement, Onderneming en Recht, nr. 118 (diss. Nijmegen), Deventer: Wolters Kluwer 2020, p. 41 and seq.

[94] A Noordam, Schuldsanering en goede trouw (diss. VU Amsterdam, 2007) 131 (fn 92). See for a legal historic analysis of this proceeding: M den Hollander, Stay of Execution. Institutions and Insolvency Legislation in Amsterdam (diss. Tilburg, 2021) chs 3-5. See also B Wessels, Rembrandt's Money: The legal and financial life of an artist-entrepreneur in the 17th century Holland (Deventer: Wolters Kluwer, 2021) 389-390.

[95] NWA Tollenaar, Het pre-insolventieakkoord. Grondslagen en raamwerk (diss. Groningen, Deventer: Wolters Kluwer, 2016) para 1.2;

[96] A Mennens, Het dwangakkoord buiten surseance en faillissement, Onderneming en Recht, nr. 118 (diss. Nijmegen, Deventer: Wolters Kluwer, 2020) p. 43 and seq.

[97]Kamerstukken II 2019/20, 35 249, nr. 24; Article 384(4)(d) DBA.

an amendment introduced the bifurcation of secured creditors' claims, placing them in a class of secured creditors to the extent that their claims are covered by security in liquidation. The remaining portion of their claims is classified as unsecured.[98] The House of Parliament and the Senate adopted the WHOA bill with these amendments, and it entered into force on 1 January 2021 as already mentioned.
The WHOA integrates components from the English Scheme of Arrangements, US Chapter 11, and the EU Restructuring Directive (EU2019/1023). Although the WHOA has been integrated into the DBA, it is not classified as a 'bankruptcy proceeding'. Instead, the WHOA is included under Title IV of the DBA, which is titled 'outside bankruptcy and suspension of payments'.

The WHOA offers a swift and efficient restructuring process outside of formal insolvency, typically completed within a few months. It allows a restructuring plan to bind selected secured, unsecured, and preferential creditors, as well as shareholders, while protecting the interests of dissenting parties.

What is more, the WHOA gives both the debtor and other key stakeholders the chance to avert uncontrolled insolvency early on, preserving the debtor's value outside the public domain. It ensures a high level of deal certainty through various supportive measures, offers flexibility in the restructuring plan's contents, and can be automatically recognized across the EU. By all means, the main objective of the WHOA is to prevent financially troubled debtors from entering bankruptcy due to hold-out creditors blocking successful plans. This can be achieved through either a restructuring or liquidating plan. A restructuring plan aims to ensure the viability of the debtor and their business, while a liquidating plan focuses on winding up unviable businesses, still providing a better outcome for creditors compared to bankruptcy.[99] Despite minimal statutory differences between the two plans, the following analysis will primarily address the WHOA process related to confirming restructuring plans.

As repeatedly emphasized, the aim of this thesis is to examine issues surrounding creditor priority and restructuring mechanisms, specifically focusing on the RPR and APR frameworks. Therefore, as with the Austrian example, the subsequent analysis of the WHOA will concentrate on the participants, restructuring plan and its implementation, the categorization of

[98] Kamerstukken II 2019/20, 35 249, nr. 14; Article 374(3) DBA.
[99] Kamerstukken II 2018/19, 35 249, nr. 3 (Explanatory memorandum to the WHOA), p. 1-2.

creditors, the best interest of creditors test, and finally, the Netherlands legislator's inclination towards adopting the APR.

Following the structure of the PRD 2019, the WHOA includes the following

Roles and Positions

- **Debtors**

  They are both natural and legal persons, regardless of their legal form. However, it excludes natural persons who do not engage in a profession or business, as well as debtors that are banks or insurers. These excluded debtors have access to alternative debt restructuring or rescue mechanisms.[100]

Regarding the material scope of the WHOA, the framework is available to debtors who are in a situation where it can reasonably be assumed they will soon be unable to pay their debts as they become due, a scenario referred to as 'pre-insolvency' or 'light insolvency' test.[101] Debtors can initiate a WHOA process when it is reasonably anticipated that they will soon be unable to pay their debts as they become due. This pre-insolvency test also stipulates that debtors must still be able to meet their current obligations.[102]

- **Restructuring Experts and Observers**

  In WHOA proceedings, courts may appoint a restructuring expert or an observer (Observator) based on the specifics of each case. Restructuring experts can be appointed at the request of individual creditors, shareholders, Works Councils, Employee Representative Bodies, or the debtors themselves. Once appointed, restructuring experts are primarily responsible for drafting and negotiating a restructuring plan.

  An observer can be appointed by the court either at the request of a debtor or on the court's own initiative.[103] However, an observer can only be appointed if a restructuring expert has not been appointed or as long as no restructuring expert is appointed. The

[100] Article 369(1) DBA
[101] Articles 370(1) and 371(3) DBA
[102] Kamerstukken II 2018/19, 35 249, nr. 3 (Explanatory memorandum to the WHOA), p. 33.
[103] Article 380(1) and 379(1) DBA.

observer's role is to oversee the preparation of the restructuring plan and to consider the interests of the creditors.

- **Court**
  The court's involvement is minimal and can be seen as mere facilitating and ensuring a fair restructuring plan when consensus among parties cannot be achieved.[104]

The Restructuring Plan

A plan may focus on restructuring, allowing the legal entity to continue operating, or on liquidation, leading to a controlled winding-up and subsequent dissolution of the legal entity.[105] In addition, the restructuring plan must contain all the necessary details to ensure that affected creditors and shareholders eligible to vote can make an informed decision about the plan.[106]

Adoption and confirmation of the Plan
Class formation

Voting on a restructuring plan occurs within classes of affected creditors and shareholders. Separate classes are created when their current rights in bankruptcy or the rights offered under the restructuring plan significantly differ. This generally includes distinctions among secured creditors, creditors with retention of title, preferential creditors, ordinary unsecured creditors, subordinated creditors, and shareholders. Additionally, variations can exist within the group of ordinary unsecured creditors if the rights offered under the plan are sufficiently distinct. A restructuring plan must specify how the rights of each class of affected creditors and shareholders are modified under the plan.[107]

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[104] Although court involvement is limited, the Dutch Judiciary has established a specialized group of judges and legal assistants from all district courts to handle all WHOA cases exclusively. These cases will be heard by a three-judge panel, forming an essential foundation for the judiciary to build expertise in handling WHOA proceedings (Kamerstukken II 2018/19, 35 249, nr. 3 (Explanatory memorandum to the WHOA) p.20).
[105] Kamerstukken II 2018/19, 35 249, nr. 3 (Explanatory memorandum to the WHOA), p. 2.
[106] Article 381(1) DBA; Kamerstukken II 2018/19, 35 249, nr. 3 (Explanatory memorandum to the WHOA), p. 12.
[107] Article 375(1)(d) DBA.

Adoption of the Plan

All affected creditors and shareholders have the right to vote, which occurs within their respective classes. The proposer of the plan can choose the voting method, which may include a physical meeting, a digital meeting, or a written format.[108] A class of creditors approves a restructuring plan if at least two-thirds of the voting creditors' claims support the plan.[109]

Confirmation of the Plan

The court will approve a restructuring plan unless it identifies reasons for rejection under Article 384 DBA. In addition, and what is important to the present topic of the thesis, other rejection grounds focus on the substantive fairness of a plan and can only be invoked by dissenting creditors and shareholders, sometimes only if they belong to a dissenting class. Firstly, confirmation can be rejected if the plan does not pass the 'best interest test.' The court may reject the plan if it is clearly demonstrated that dissenting creditors or shareholders would be worse off under the restructuring plan than they would be in a liquidation scenario under bankruptcy.[110]

Dissenting creditors and shareholders from a class that rejected a restructuring plan may also contest its confirmation if the reorganization value is distributed unfairly. The WHOA generally follows the Absolute Priority Rule (APR), where the distribution of reorganization value adheres to the ranking of claims in bankruptcy. However, several exceptions exist, effectively creating a more flexible version of the APR. The Dutch legislator mandated that ordinary SME creditors with trade or tort claims must receive at least 20% of their original claim in cash or equivalent value.[111] The court will deny confirmation if they receive less than 20%, unless the debtor or restructuring expert presents compelling reasons for this deviation. Secondly, a plan may deviate from the APR if there is a reasonable justification and the interests of affected creditors or shareholders are not harmed. Lastly, deviation from the APR is allowed when all creditor classes consent to the plan.

Another ground for rejecting confirmation is if dissenting creditors in a dissenting class are not granted the right to receive a cash-out payment from the debtor equivalent to the liquidation

[108] Article 381(6) DBA.
[109] Article 381(7) DBA.
[110] Article 384(3) DBA.
[111] Article 384(4)(a) DBA

value of their claim.[112] However, this does not apply to secured creditors who finance the debtor's business. These creditors do not have a statutory right to a cash-out option. Instead, they can request the court to reject confirmation if their rights are altered or if they are offered shares or depositary receipts under the plan without being given the option to choose an alternative form of distribution. This alternative form may still involve deferred payment, but it does not include a cash-out option.[113]

In the event of lacking grounds for rejection, the court confirms the plan, thus making it binding to all the creditors and shareholders.[114]

6.2.3. Conclusion on the Adoption of the Absolute Priority Rule (APR) by WHOA in the Netherlands

The general adoption of the Absolute Priority Rule (APR) by the WHOA in the Netherlands signifies a deliberate choice to align Dutch restructuring law with established international standards, particularly those of the US Chapter 11 bankruptcy framework, besides the Directive. This decision leads to:

- **Enhanced Creditor Protection**

The APR ensures that senior creditors are paid in full before any value is distributed to junior creditors. This provides a clear and predictable hierarchy of claims, enhancing the protection for senior creditors and potentially increasing their willingness to engage in restructuring negotiations.

- **Increased Legal Certainty**

By adopting the APR, the WHOA offers a structured and transparent framework for debt restructuring. This legal certainty can reduce disputes among creditors and streamline the restructuring process, as all parties have a clear understanding of the priority of claims.

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[112] Article 384(4)(c) DBA.
[113] Article 384(4)(d) DBA.
[114] Article 385 DBA.

- **Alignment with International Practices**

The APR is a well-recognized principle in international restructuring and insolvency law, particularly in the US. By incorporating this rule, the Netherlands aligns its insolvency framework with international best practices, which can facilitate cross-border restructurings and enhance the attractiveness of the Netherlands as a jurisdiction for restructuring.

- **Flexibility with Safeguards**

While the WHOA adopts the APR, it also includes exceptions and modifications to address specific concerns and improve fairness. For instance, SME creditors are ensured a minimum payment, and secured creditors do not automatically receive a cash-out option. These provisions introduce a degree of flexibility while maintaining the core principles of the APR.

- **Balancing Interests**

The adoption of the APR under the WHOA reflects a balance between protecting the rights of senior creditors and providing a viable path for distressed businesses to restructure. By ensuring that higher-priority claims are satisfied first, the rule helps maintain trust in the restructuring process, while exceptions ensure that the needs of other stakeholders, including SMEs, are also considered.

- **Potential Challenges**

Implementing the APR can lead to challenges, particularly in ensuring that all creditors feel fairly treated and that the process does not disproportionately favor secured creditors. The WHOA addresses these challenges by including provisions that allow for deviation from the APR when justified and ensuring a minimum payout for certain creditors.

- **Judicial Oversight and Expertise**

The Dutch Judiciary has established a specialized pool of judges to handle WHOA cases, ensuring that the APR and other aspects of the law are applied consistently and fairly. This specialized judicial oversight is crucial for building expertise and confidence in the new framework.

In conclusion, the adoption of the APR by the WHOA enhances creditor protection, legal certainty, and alignment with international practices while incorporating necessary flexibility to address specific stakeholder concerns. This balanced approach aims to make the Dutch restructuring framework robust, fair, and attractive for both domestic and international stakeholders.

6.3. Bulgaria

6.3.1. Implementation of the Directive into the Commerce Act

Looking at the integration of the RPR in Bulgaria shows how EU directives are influencing existing national restructuring frameworks. This approach balances established creditor hierarchies with the need for flexibility for distressed firms.

Traditionally grounded in the principles of the Commercial Law, Bulgaria's commercial insolvency practices have evolved considerably with the transposition of the EU Restructuring Directive into Bulgarian Commerce Act[115] in August 2023.[116] This significant legislative change aligns Bulgaria with the Directive's vision of providing frameworks for preventive restructuring, enabling early intervention, and potentially allowing deviations from the APR in favor of more pragmatic and flexible solutions offered by the RPR, as discussed earlier in this paper.

The incorporation of the Directive into Bulgarian law signifies a strategic shift towards enhancing the efficiency and accessibility of restructuring processes, aiming to preserve business value and maintain employment while ensuring fair treatment of creditors. This approach aligns with the broader objectives of the Directive, emphasizing a commitment to fostering a restructuring environment that balances the needs of distressed firms with the rights and interests of their creditors.

Since July 2017, Bulgaria has implemented a pre-insolvency restructuring regime within the Commerce Act for corporate entities that are at risk of insolvency but not yet insolvent, allowing them to restructure and continue operating. This regime, referred to as "stabilization" in the Commerce Act[117] but having the same meaning as "restructuring," was not aligned with

[115] Promulgated, Bulgarian State Gazette № 48/18.06.1991, https://lex.bg/laws/ldoc/-14917630
[116] Promulgated, Bulgarian State Gazette, № 66/01.08.2023
[117] Commerce Act, Art. 761

the EU Directive 2019/1023/EC, as the Directive was only in draft form at that time. Therefore, Bulgaria had already established this type of legislation prior to the Directive's introduction. With the recent amendment published on 1 August 2023, Bulgaria has now harmonized its restructuring processes with EU standards, ensuring more efficient and accessible procedures for maintaining business operations and protecting creditor interests.

The most significant amendment related to the Directive transposition concerns the "likelihood of insolvency" criterion as a prerequisite for restructuring applications.[118] This criterion is now defined as the debtor's anticipated inability to make payments based on their maturities over the next 12 months, as opposed to the previous six-month period. The former six-month threshold proved insufficient, as applications were often submitted too late, leading courts to find actual insolvency rather than a "likelihood of insolvency." The management bodies are now advised to have an action plan in place to identify "likelihood of insolvency" in a timely manner and to take the necessary restructuring steps to comply with the new legal requirements.

Roles and Positions

Similar to Austria and the Netherlands, and in accordance with the Directive, the active participants in Bulgaria's restructuring process include **the debtor**, who initiates the stabilization procedure.[119] The debtor must file an application with the competent court[120] and propose a stabilization plan. The **competent court** is the court as per the registered seat of the company.

The **trustee** is a natural person, appointed by the competent court when this is necessary to protect the interests of the parties when the stabilization plan can be confirmed by the court through enforcement between classes of creditors or at the request of the merchant or at the request of the majority of the creditors [121] In addition, the trustee assists the merchant or his creditors in the preparation and negotiation of a stabilization plan and supervises the activity of the trader when this is stipulated by a court act in the stabilization proceedings.[122]

[118] Commerce Act, Art. 762 (1) and (2)
[119] Commerce Act, Art. 769 (1)
[120] Commerce Act, Art. 765
[121] Commerce Act, Art. 772 (2), 1, 2 and 3
[122] Commerce Act, Art. 782 (1)

Another player is **the inspector**, who are also appointed by the competent court and who must be a registered auditor.[123] The inspector prepares a report to the court and creditors on the correspondence between the indicated in the stabilization plan prognoses and the methods for satisfaction of creditors with the financial and property condition of the merchant.[124]

The Stabilization Plan

The stabilization plan must include specific requisites as detailed in Article 770 (1) to enable affected creditors who are eligible to vote to make an informed decision. Key elements include comprehensive information about the trader (debtor), a complete overview of their financial status, details of any ongoing court proceedings against the debtor, a full list of creditor classes, and the anticipated financial improvement of the debtor, among others.[125]

Adoption of the Stabilization Plan

The court confirms the final list of creditors,[126]. In this way this step ensures that all eligible creditors are accurately identified and included in the process.

The creditors, as per the conformed list, vote on the stabilization plan proposed separately according to the classes[127], thus ensuring that each class has the opportunity to approve or reject the plan. The plan is adopted by each class with a majority of half of the receivables in the class and for the plan for this class to be adopted at least two – thirds of the creditors in the class must have voted.[128]

Affirmation of the Stabilization Plan

The court affirms or refuses to affirm with a ruling the adopted plan in a closed hearing.[129] This hearing is not open to the public, providing a confidential environment for discussing the details of the plan. During the closed hearing, the court examines whether all legal requirements have been met. This includes verifying that the plan adheres to the relevant provisions of the Commerce Act and the Preventive Restructuring Directive.

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[123] Commerce Act, Art. 784 (1)
[124] Commerce Act, Art. 784 (2)
[125] Commerce Act, Art. 770 (1)
[126] Commerce Act, Art. 786 (3)
[127] Commerce Act, Art. 789 (1)
[128] Commerce Act, Art. 789 (3)
[129] Commerce Act, Art. 790 (1)

One of the key criteria the court assesses before conformation is the fairness of the plan to dissenting creditors. In the event of creditors who disagree with the plan, the Bulgarian legislator has chosen to follow the Relative Priority Rule-when there are dissenting creditors with the stabilization plan, the latter will not put them in a more unfavorable position than they would be in the case of applying the regular order of claims.[130]

Further, the stabilization plan can be approved by the court also under the condition that dissenting voting creditor classes are affected and treated at least as favorably as any other class of the same rank and more favorably than any lower-ranking class.[131]

Based on its review, the court can either confirm or refuse to confirm the stabilization plan. When all the legal requirements are observed, the court confirms the stabilization plan.[132] If the court confirms the plan, it becomes enforceable against all creditors, including those who dissented. If the court finds that the plan does not meet the necessary legal and fairness criteria, it can refuse to confirm the plan, requiring further modifications or the submission of a new plan.

Therefore the court's role in the confirmation of the stabilization plan is crucial to ensuring the fairness and legality of the restructuring process. What is more, the court's confirmation process for stabilization plans in Bulgaria is designed to ensure that the restructuring process is fair, legal, and in the best interest of all parties involved. By rigorously reviewing the plan and requiring majority approval from creditors, along with ensuring fairness to dissenting creditors, the court plays a pivotal role in balancing the needs of distressed firms with the rights and interests of their creditors.

6.3.2. Challenges Faced by Bulgaria in Implementing the Preventive Restructuring Directive

One of the primary challenges was aligning Bulgaria’s existing insolvency framework with the EU’s Preventive Restructuring Directive. This required substantial amendments to the Commerce Act, thus explaining also the late transposition of the Directive by Bulgaria. This

[130] Commerce Act, Art. 790 (9)
[131] Commerce Act, Art. 790, (3) 2
[132] Commerce Act, Art. 790 (2)

process involved integrating complex legal principles and ensuring that national legislation was harmonized with the broader EU objectives.

In addition, in practice, Bulgaria had to transition from the traditional Absolute Priority Rule to the Relative Priority Rule. This shift necessitated a change in the approach to creditor hierarchies and required a re-evaluation of existing practices to ensure that the new flexible, pragmatic solutions offered by the RPR were effectively implemented. As a result, the effective implementation of the Directive also demanded an increase in judicial capacity and expertise. Courts had to be equipped with the necessary knowledge and resources to handle complex restructuring cases, review stabilization plans, and ensure that all legal requirements were met while maintaining fairness to all creditors.

On the second place another significant challenge was defining and applying the "likelihood of insolvency" criterion, which was clarified earlier in this paper. The amendment of the Commerce Act extended the assessment period from six months to twelve months, aiming to improve the early detection of financial distress. However, implementing this change required educating and training management bodies to timely identify financial distress and take appropriate action.

Another key point is the complexity of the stabilization plan. The requirement for detailed stabilization plans that include comprehensive information about the debtor, financial status, court proceedings, and anticipated improvements added to the administrative burden. Preparing these plans necessitated a high level of expertise and resources, both from the debtors and the legal professionals involved.

And on the last place, implementing the RPR required meticulous planning to ensure that dissenting creditors were not placed in a worse position than they would be under the regular order of claims. Balancing flexibility with fairness, and ensuring that the plans were equitable, added another layer of complexity to the restructuring process.

6.3.3. Conclusion on the Usage of RPR in Bulgaria and Its Connection to the Restructuring Directive

The transposition of the Preventive Restructuring Directive in Bulgaria through the Commerce Act marks a significant step towards modernizing the country's restructuring framework. By adopting the Relative Priority Rule, Bulgaria aims to provide a more flexible and pragmatic approach to dealing with financial distress, promoting early intervention and increasing the likelihood of successful restructurings. This alignment with the directive's goals is expected to enhance the overall efficiency and fairness of the restructuring process in Bulgaria.

Moreover, the adoption and affirmation of the stabilization plan in Bulgaria emphasize the protection of creditors' interests through the application of the RPR. This rule, as explained in details earlier in this work, ensures that dissenting creditors are not placed in a worse position than they would be under the regular order of claims. Furthermore, the court must confirm that dissenting creditor classes are treated at least as favorably as other classes of the same rank and more favorably than any lower-ranking classes.

This approach aligns with the principles set forth in the European Union's Restructuring Directive, which aims to provide a harmonized framework for preventive restructuring across member states. The directive emphasizes the importance of fair treatment for creditors and the need for effective mechanisms to prevent insolvency. By incorporating the RPR, Bulgaria's stabilization plan process ensures compliance with these European standards, promoting consistency and fairness in creditor treatment during restructuring efforts.

In essence, Bulgaria's adherence to the RPR within its stabilization plan framework not only upholds domestic legal principles but also aligns with the broader objectives of the Restructuring Directive, facilitating a more cohesive and equitable approach to insolvency and restructuring within the EU.

7. Summary on the Implementation of the Relative Priority Rule and the EU Restructuring Directive by the three Member States

The adoption of the EU Restructuring Directive (Directive (EU) 2019/1023) represents a significant development in the harmonization of insolvency and restructuring laws across the European Union. The directive introduces the Relative Priority Rule (RPR) as an alternative to the Absolute Priority Rule (APR), aiming to offer more flexibility in restructuring processes. This conclusion evaluates further the implications of adopting the RPR, its impact on different jurisdictions, and the broader connection to the EU's objectives.

7.1. Impact of the RPR in Various Jurisdictions

7.1.1. Austria

Austria's implementation of the Restructuring Directive through the new Restructuring Code (ReO) marks a significant shift towards more flexible and pragmatic restructuring processes. By incorporating the Relative Priority Rule (RPR), Austria aligns its framework with the EU directive, enhancing its preventive restructuring mechanisms. This approach allows for greater negotiation and compromise among creditors, fostering a collaborative environment for restructuring. The flexibility offered by the RPR encourages stakeholders to engage in constructive dialogue and seek mutually beneficial solutions, which can lead to more effective and timely restructurings. Additionally, Austria's integration of the RPR reflects a commitment to modernizing its insolvency framework, making it more adaptable to the complexities of contemporary business challenges.

7.1.2. The Netherlands

The Dutch approach, through the Wet homologatie onderhands akkoord (WHOA), integrates the RPR within a flexible restructuring framework. In other words, the Netherlands primarily uses the Absolute Priority Rule (APR) but incorporates aspects of the RPR to allow some flexibility in restructuring plans. This approach helps preserve the value of businesses and encourages early restructuring efforts. In particular WHOA provides mechanisms for both restructuring and liquidation plans, emphasizing the importance of preserving business value and avoiding bankruptcy. The inclusion of exceptions and modifications to the APR demonstrates a balanced approach, ensuring fair treatment of SMEs and protecting creditor interests while maintaining flexibility. By adopting a hybrid approach, the Netherlands aims to create a more resilient and adaptable restructuring framework that can address the needs of diverse business scenarios, from large corporations to small and medium-sized enterprises.

7.1.3. Bulgaria

Bulgaria's alignment with the EU directive, incorporating the RPR within its Commerce Act, represents a strategic move to enhance the efficiency and accessibility of restructuring processes. The RPR's flexibility supports early intervention, aiming to preserve business operations and maintain employment. By ensuring that dissenting creditors are treated no worse than under the regular order of claims, Bulgaria promotes fairness and consistency in creditor treatment. The country's proactive stance in integrating the RPR reflects a broader commitment to aligning its insolvency laws with EU standards, thereby improving its attractiveness to foreign investors and supporting domestic economic stability. Furthermore, Bulgaria's approach highlights the importance of creating a legal environment that encourages timely restructuring actions, which can prevent businesses from descending into insolvency and protect the broader economic ecosystem.

8. Benefits and Challenges of the RPR

The implementation of the Relative Priority Rule (RPR) within the restructuring frameworks of various jurisdictions brings with it a range of benefits and challenges that significantly impact the efficiency and fairness of insolvency proceedings.

On the benefits side, the RPR allows for tailored restructuring solutions that can better accommodate the specific circumstances of each case, potentially leading to more successful outcomes. This flexibility supports early intervention in financial distress, facilitating restructuring efforts before insolvency becomes inevitable and thereby preserving viable businesses and jobs. Additionally, the RPR fosters a collaborative environment where creditors can negotiate and reach mutually beneficial agreements, reducing the likelihood of holdout behavior and promoting a smoother restructuring process.

However, the RPR also presents several challenges. Its flexibility can lead to unpredictability in restructuring outcomes, which might affect creditors' willingness to extend credit due to the legal uncertainty involved. Ensuring that all creditors are treated equitably remains a complex issue, as the RPR might result in junior creditors receiving more favorable terms at the expense of senior creditors. Furthermore, the practical application of the RPR requires robust judicial oversight to ensure consistent and fair implementation, adding a layer of complexity to the restructuring process.

9. Recommendations for Future Consideration

Considering the comprehensive analysis that was made in the present thesis, some highlights for optimizing the application and more positive effect of the RPR in the restructuring process could be taken into account. Firstly, adopting a hybrid approach that integrates the principles of the RPR with elements of the Absolute Priority Rule (APR) and the best-interest-of-creditors test can provide a more balanced and robust framework. This combination would accommodate diverse stakeholder interests by blending the flexibility of the RPR with the structured hierarchy of the APR, ensuring that the interests of both senior and junior creditors are addressed. This balance helps in gaining broader acceptance and cooperation from various creditor classes. Additionally, incorporating the best-interest-of-creditors test ensures that no creditor is worse off under the restructuring plan than they would be in a liquidation scenario, promoting equity and fairness.

Secondly, ensuring that judges and practitioners involved in restructuring processes are well-trained in the nuances of the RPR and the EU Directive is crucial for consistent and effective application. Specialized training programs focused on the legal and practical aspects of the RPR should be developed, covering the principles of the rule, case studies, and best practices from other jurisdictions. Continuous learning opportunities should be provided to keep judges and practitioners updated on the latest developments and interpretations of the RPR and related EU directives, maintaining a high standard of expertise and application consistency.

In addition, implementing a system of regular monitoring and evaluation of the RPR's application can help identify areas for improvement and ensure the rule's effectiveness over time. Performance metrics should be established to evaluate the success and challenges of the RPR in practice, such as the rate of successful restructurings, stakeholder satisfaction, and timeframes for plan approval and implementation. Creating formal channels for feedback from stakeholders, including creditors, debtors, legal practitioners, and judges, can provide valuable insights into practical challenges and areas for refinement. Using the data and feedback collected, an adaptive framework should be implemented to make informed adjustments to the RPR framework, ensuring it remains relevant and effective in changing economic and legal contexts.

And last but not least, educating creditors, debtors, and other stakeholders about the RPR and its implications is essential for promoting better understanding and smoother implementation. Comprehensive information campaigns should be launched to explain the RPR, its benefits, and how it differs from traditional approaches like the APR. These campaigns should use various media, including online platforms, workshops, and printed materials. Organizing workshops and seminars for creditors, debtors, and legal professionals can facilitate knowledge exchange and build confidence in the new framework.

Optimizing the implementation of the Relative Priority Rule requires a multifaceted approach that includes a hybrid legal framework, enhanced training for judicial and legal professionals, regular monitoring and adaptive improvements, and comprehensive stakeholder education. By addressing these areas, the RPR can provide a more balanced, fair, and effective restructuring process that meets the diverse needs of all parties involved. This holistic approach ensures that the RPR not only aligns with the broader objectives of the EU directive but also fosters a more resilient and efficient restructuring environment.

10. Conclusion

The EU Restructuring Directive aims to harmonize preventive restructuring frameworks across member states, promoting early intervention and the preservation of viable businesses. The directive's emphasis on flexibility, fairness, and efficiency aligns with the broader EU objectives of fostering economic stability and improving the investment climate.

By allowing Member States to choose between the RPR and APR, the directive provides flexibility to adapt to national contexts while maintaining a cohesive framework. This harmonization effort is crucial for reducing legal uncertainties and facilitating cross-border restructuring within the EU.

The adoption of the Relative Priority Rule (RPR) within the framework of the EU Restructuring Directive represents a significant advancement in harmonizing insolvency and restructuring laws across the European Union. While the RPR offers notable benefits in terms of flexibility and early intervention, its implementation must be carefully managed to address potential challenges and ensure fairness.

By balancing the RPR with elements of the Absolute Priority Rule (APR) and ensuring robust judicial oversight, member states can create restructuring frameworks that are both compliant with European standards and responsive to domestic economic environments. This harmonized approach enhances creditor protection, promotes business continuity, and fosters a more stable and predictable investment climate across the EU.

Ultimately, the successful implementation of the RPR and the EU Restructuring Directive depends on continuous evaluation, adaptation, and collaboration among Member States to achieve the Directive's goals of economic stability and efficient restructuring processes.

List of Abbreviations

1. **APR** Absolute Priority Rule
2. **DBA** Dutch Bankruptcy Act
3. **EC** European Commission
4. **EUR** Euro
5. **EU** European Union
6. **EU2019/1023** European Union Restructuring Directive 2019/1023
7. **IV** Implementation Volume
8. **KO** Konkursordnung (Austrian Bankruptcy Act)
9. **MS** Member States
10. **PRD** Preventive Restructuring Directive
11. **RPR** Relative Priority Rule
12. **SME** Small and Medium-sized Enterprises
13. **URG** Unternehmensreorganisationsgesetz (Austrian Company Reorganization Act)
14. **US** United States
15. **USA** United States of America
16. **WHOA** Wet Homologatie Onderhands Akkoord (Dutch Act on the Confirmation of Private Plans)
17. **AO** Administrative Orders
18. **IO** Insolvency Orders

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Abstract (in German)

Flexibilität vs. Sicherheit: Bewertung der Auswirkungen der Relativen Prioritätsregel (RPR) gemäß der Europäischen Richtlinie über präventive Restrukturierung und Insolvenz

Umsetzung und Auswirkungen der Relativen Prioritätsregel (RPR) im Rahmen der Europäischen Restrukturierungsrichtlinie (EU) 2019/1023

Diese Arbeit untersucht die Implementierung und die Auswirkungen der Relativen Prioritätsregel (RPR) innerhalb der Europäischen Richtlinie (EU) 2019/1023 über präventive Restrukturierungsrahmen. Die Analyse konzentriert sich auf die Auswirkungen der RPR auf den Gläubigerschutz und ihr Potenzial, opportunistisches Verhalten zu fördern, und zieht dabei Vergleiche zur Absoluten Prioritätsregel (APR) in den USA.

Die EU-RPR ermöglicht größere Flexibilität in Restrukturierungsprozessen, indem sie eine günstigere Behandlung widersprechender Gläubiger im Vergleich zu nachrangigen Gläubigerklassen, wie etwa zahlungsunfähigen Aktionären, ohne vollständige Befriedigung ihrer Ansprüche zulässt. Diese Flexibilität steht im Gegensatz zur starren Hierarchie der APR, die vorschreibt, dass vorrangige Gläubiger vollständig befriedigt werden müssen, bevor nachrangige Gläubiger Werte erhalten können.

Während die Flexibilität der RPR Verhandlungen und einvernehmliche Restrukturierungslösungen erleichtern kann, führt sie auch zu Herausforderungen in Bezug auf Rechtssicherheit und Vorhersehbarkeit. Die Möglichkeit, von traditionellen Prioritätsregeln abzuweichen, kann zu unvorhersehbaren Ergebnissen führen und die Stabilität verringern, auf die sich Gläubiger in Restrukturierungsszenarien verlassen. Diese Unvorhersehbarkeit kann zu erhöhten Kosten und einer verringerten Bereitschaft führen, Kredite zu gewähren, da Gläubiger Schwierigkeiten haben könnten, ihre Positionen und Erholungsraten in einer Restrukturierung vorherzusehen.

Darüber hinaus diskutiert die Arbeit die praktischen Auswirkungen der RPR, wie die Förderung von Blockadeverhalten unter nachrangigen Gläubigern und zahlungsunfähigen Aktionären, was Restrukturierungsprozesse verzögern und die Kosten erhöhen kann. Es wird auch untersucht, wie die Verhandlungsposition unbesicherter Gläubiger unter der RPR

geschwächt werden würde, was zu unfairen Verteilungen und Komplikationen bei der Erzielung einvernehmlicher Restrukturierungslösungen führen könnte.

Um diese Probleme zu adressieren, plädiert die Arbeit für einen maßgeschneiderten Ansatz bei Prioritätsregeln, der mit den grundlegenden Zielen des Insolvenzrechts übereinstimmt, um die Wertverteilung zu maximieren und systemische Risiken zu minimieren. Es wird empfohlen, dass die Mitgliedstaaten die Nuancen beider Regeln bei der Umsetzung der Richtlinie in ihre gesetzlichen Rahmen berücksichtigen, um unbeabsichtigte Konsequenzen in Insolvenzverfahren zu vermeiden.

Die Arbeit liefert auch eine vergleichende Analyse der Umsetzungsstrategien in drei Ländern: Österreich, die Niederlande und Bulgarien. Es wird untersucht, wie jedes Land die präventiven Restrukturierungsrahmen implementiert hat und welche der beiden Regeln, RPR oder APR, übernommen wurde. Die Vorteile und Herausforderungen jeder Herangehensweise werden hervorgehoben.

Schlüsselwörter: Präventive Restrukturierungsrichtlinie; Relative Prioritätsregel (RPR); Absolute Prioritätsregel (APR); Vor- und Nachteile der EU-RPR; Maßgeschneiderte Version der APR und RPR; Umsetzung durch Mitgliedstaaten.